



**INVENTRONICS LIMITED**

**2017 ANNUAL FINANCIAL REPORT**

**MANAGEMENT'S DISCUSSION & ANALYSIS**

**For the year ended December 31, 2017**

## 2017 Annual and Fourth Quarter Financial Report – December 31, 2017

### Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A") is dated April 26, 2018 and was prepared based on information available to Inventronics Limited (referred to herein as "Inventronics" or the "Corporation") as of this date to help readers interpret Inventronics' financial results for the three and twelve month periods ended December 31, 2017. This MD&A should be read in conjunction with the Corporation's 2017 audited annual financial statements which consist of the Corporation's Statement of Financial Position, Statement of Comprehensive Income, Statement of Cash Flows, Statement of Changes in Equity, Notes to the Financial Statements and the Auditors' Report thereon (collectively referred to as the "financial statements"). The financial statements and other information relating to the Corporation are available under Inventronics' profile on the SEDAR website at [www.sedar.com](http://www.sedar.com). The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and all dollar amounts within this report are expressed in Canadian dollars unless otherwise stated.

**Forward-looking information advisory.** Certain statements contained in this report, including this MD&A, contain forward-looking information that represents the Corporation's internal projections, expectations, estimates or beliefs concerning, among other things, the Corporation's expectations, perceptions and/or beliefs with respect to: economic conditions and the related impact on the Corporation's customers and/or demand for the Corporation's products; its working capital position and its sufficiency to support the Corporation's operations; its future revenue expectations; the manner in which the Corporation will utilize its property, plant and equipment and the useful lives and residual value of that property, plant and equipment; and its forecast financial results for the first quarter of 2018. All statements other than statements of historical fact may be forward-looking statements. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expects", "projects", "plans", "anticipates", and similar expressions. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties, which could cause actual results to differ materially from those anticipated in these forward-looking statements. These risks and uncertainties include, but are not limited to: general economic conditions; foreign currency fluctuations; actions by government authorities; competitor activity; indebtedness of the Corporation; availability of future financing; customer concentration risks; changes in the price of raw materials; interest rates; and changes in the communications, power and cable industries. Although management of the Corporation believes such statements are reasonable, undue reliance should not be placed on forward-looking information as the Corporation can give no assurance that such assumptions will prove to be correct. The forward-looking information has been included herein to provide shareholders with a more complete outlook on the Corporation's future business and operations and this information may not be appropriate for other purposes. The Corporation does not undertake to update the forward-looking information contained herein except as required by applicable laws.

#### **1. Corporation Overview**

Originally founded in 1970 in Brandon, Manitoba, Canada, Inventronics designs and manufactures protective enclosures for use in utility-type infrastructures. The Corporation's products are typically found in telecommunication networks, cable television networks, electric power distribution networks, traffic control systems and oil and gas installations where they are utilized in both outdoor and indoor applications to house and protect passive and/or active electrical and electronic components. Although the Corporation's products have been primarily placed in service throughout North America, it is not uncommon to find Inventronics enclosures in other international infrastructures as well. A significant portion of Inventronics' revenues are generated from the sale of Inventronics-branded standard products which are sold directly to utilities, original equipment manufacturers and/or through distributors. Additionally, for customers with specialty requirements, the Corporation designs and manufactures products that have been custom designed to suit the customer's particular needs. This can range from the modification of an existing Inventronics cabinet to the conceptualization and manufacture of a brand new enclosure.

Inventronics operates from its ISO 9001:2015 certified facility located in Brandon, Manitoba where product design, manufacturing, corporate administration and sales functions are performed. The Corporation's production employees are organized under the United Steelworkers Union ("USW"). The Corporation is incorporated in the Province of Alberta, Canada, has no subsidiaries and its shares are publicly traded on the TSX Venture Exchange under the symbol IVX.

## 2. Selected Annual Financial Information

<b>Selected Annual Financial Information</b>			
<i>(in thousands of dollars, except per share amounts)</i>			
<b>For the years ended December 31</b>			
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Revenue	4,480	3,830	4,187
EBITDA <sup>1</sup>	321	213	82
Net income (loss)	81	(283)	(414)
Total assets	3,228	3,268	3,513
Long-term debt, excluding current portion	2,189	2,234	2,270
Basic and diluted earnings (loss) per share	1.8¢	(6.4)¢	(9.4)¢

Note 1. See "Non-IFRS Measures" below.

## 3. Summary of Financial Results

The Corporation's revenues tend to show a strong correlation to prevailing Canadian economic conditions. It is the Corporation's management's assessment that fiscal 2017 represented a modest but notable improvement in these economic conditions compared to the recessionary conditions that existed through much of fiscal 2016. Staying true to form, for both the three and twelve month periods ended December 31, 2017, the Corporation also experienced modest improvements in product demand, compared to the same periods of 2016, across a number of customers and across multiple industries and geographical locations.

During the third quarter of 2017, the Corporation completed a review of its estimated useful lives and residual values for its property, plant and equipment in light of current and forecast revenues. The result of the review was to extend the useful lives and/or increase the residual values on several of the Corporation's capital assets, thereby, reducing depreciation expense to a level more appropriate to the Corporation's expected revenues (see "Change in Accounting Estimate - Depreciation and Amortization" below). The Corporation accounted for the resulting adjustment to depreciation and amortization prospectively, effective as of the beginning of 2017, and did not issue restated interim reports for previously released periods that were affected. These periods consisted of the first and second quarters of 2017 and the table below identifies the restated amounts, where applicable, along with the previously reported amounts.

### Selected Quarterly Financial Information

*(in thousands of dollars, except percentage and per share amounts)*

	<b>2017</b>				<b>2016</b>			
	<b>Q4</b>	<b>Q3</b>	<b>Q2<sup>2</sup></b>	<b>Q1<sup>2</sup></b>	<b>Q4</b>	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>
Revenue	1,135	1,224	1,113	1,008	1,009	981	1,080	760
Cost of sales as a percentage of Revenue <sup>2</sup>	86%	80%	79%	78%	89%	88%	84%	102%
EBITDA <sup>1</sup>	12	127	94	88	76	90	130	(83)
Net income (loss) <sup>2</sup>	(45)	68	32	26	(46)	(34)	5	(208)
Basic and diluted earnings (loss) per share <sup>2</sup>	(1.0)¢	1.5¢	0.7¢	0.6¢	(1.1)¢	(0.8)¢	0.1¢	(4.7)¢

Note 1. See "Non-IFRS Measures" below.

Note 2. Applicable to 2017 Q2 and 2017 Q1 only, see "Change in Accounting Estimate - Depreciation and Amortization" below. For 2017 Q2 and 2017 Q1: Cost of sales as a percentage of Revenue originally reported as 85% and 84%, respectively; Net income (loss) originally reported as a net loss of \$27,000 and a net loss of \$34,000, respectively; Basic and diluted earnings (loss) per share originally reported as a loss of 0.6 cents and a loss of 0.8 cents, respectively.

## 4. Results of Operations

### Revenue

Revenue for the fourth quarter of 2017 of \$1.135 million was \$126,000, or 12%, greater than the \$1.009 million reported for the comparative quarter of 2016. Revenue for the year ended December 31, 2017 of \$4.480 million was \$650,000, or 17%, greater than the \$3.830 million reported for the comparative period of 2016. For both periods, the improvement was attributed to general and modest increases in demand, compared to fiscal 2016, from many of the Corporation's customers. It is the Corporation's management's belief that the improvement in demand was a result of the generally stronger economic conditions in 2017 compared to 2016.

### Cost of Sales

Cost of sales as a percentage of revenue for the three and twelve month periods ended December 31, 2017 of 86% and 81%, respectively, was an improvement compared to the 89% and 90% reported for the comparative periods of 2016, respectively, due to a reduction in depreciation expense. Excluding the impact of depreciation expense, cost of sales as a percentage of revenue for the three and twelve months ended December 31, 2017 was 84% and 79%, respectively, compared to 81% and 82% reported for the comparative periods of 2016. During fiscal 2017, the Corporation experienced upward pressure on raw material costs, most notably sheet steel, but also realized improved labour utilization from the increased product flow, compared to 2016, through the facility.

Depreciation and amortization expense included in cost of sales for the three and twelve month periods ended December 31, 2017 of \$20,000 and \$81,000, respectively, was lower than the \$80,000 and \$324,000 reported for the comparative periods of 2016, respectively, as a result of the impact to depreciation expense for a change in estimated useful life and/or residual value on some of the Corporation's capital assets that was accounted for prospectively as of the beginning of 2017 (see "Change in Accounting Estimate - Depreciation and Amortization" below). The Corporation did not make any significant net capital additions during fiscal 2017 and 2016.

### Selling and Administration Expense

Selling and administration expense as a percentage of revenue for the three and twelve month periods ended December 31, 2017 of 15% and 14%, respectively, was greater than the 12% and 13%, respectively, reported for the comparative periods of 2016 due to the effect of the variable component of compensation arrangements, higher costs related to typical public company issues and compliance, and increased selling activities.

### Interest

Interest expense for the three and twelve month periods ended December 31, 2017 of \$37,000 and \$159,000, respectively, was lower than the \$42,000 and \$172,000, respectively, reported for the comparative periods of 2016, reflecting lower debt principal balances and interest rates in 2017 compared to the prior year.

### Net Income or Loss

For the fourth quarter of 2017, the Corporation reported a net loss of \$45,000, or 1.0 cents per share, which was consistent with the net loss of \$46,000, or 1.1 cents per share, reported for the comparative quarter of 2016 where an improvement in gross profit from lower depreciation charges in 2017 was offset by an increase in selling and administrative expenses.

For the year ended December 31, 2017, the Corporation reported net income of \$81,000, or 1.8 cents per share, compared to a net loss of \$283,000, or 6.4 cents per share, for the comparative period of 2016 where the improvement compared to 2016 was attributed to higher revenue and lower depreciation and amortization charges in 2017 offset somewhat by higher selling and administrative expenses.

## 5. Income Taxes

At December 31, 2017, the Corporation had Canadian non-capital losses of \$1,452,000 (2016 - \$526,000). There were no Canadian non-capital losses that expired in 2017 (2016 - \$0) and the remaining Canadian non-capital losses are scheduled to expire as follows:

(In thousands of dollars)

2026	\$ 268
2028	91
2034	50
2035	117
2037	926
<u>Total</u>	<u>\$ 1,452</u>

## 6. Liquidity and Capital Resources

### Cash Flow from Operations

The Corporation considers a more useful measure of cash flow from operations to be cash flow from operating activities before changes in non-cash working capital balances. For the three months ended December 31, 2017, the Corporation's operations generated cash flow of \$9,000 compared to cash flow of \$72,000 for the comparative quarter of the prior year. For the year ended December 31, 2017, the Corporation's operations generated cash flow of \$303,000 compared to cash flow of \$193,000 for the comparative period of 2016.

### Cash Flow from Operations

(in thousands of dollars)

For the periods ended December 31	Three months		Twelve months	
	2017	2016	2017	2016
Net income (loss)	(45)	(46)	81	(283)
Add: Interest on long-term debt <sup>1</sup>	34	38	140	151
Add: Depreciation	20	80	81	324
Add: Other items not involving cash	-	-	1	1
<u>Cash flow from Operations</u>	<u>9</u>	<u>72</u>	<u>303</u>	<u>193</u>

Note 1. Interest on long-term debt considered a component of financing and therefore added back to net income (loss) to determine cash flow from operations.

### Working Capital Position

As at December 31, 2017, the Corporation reported a working capital balance of \$349,000, which represented a decrease of \$77,000 during the fourth quarter of 2017 as a result of: payments for long-term debt interest and principal of \$44,000; capital expenditures of \$41,000; less cash flow from operations of \$9,000. Working capital during fiscal 2017 grew by \$46,000 as a result of: cash flow from operations of \$303,000; less: payments for long-term debt interest and principal of \$178,000; capital expenditures of \$72,000; and an increase in the current portion of long-term debt of \$6,000.

### Working Capital Position

(in thousands of dollars, except ratio calculation)

At the end of	2017				2016			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Current assets	1,003	1,193	1,334	1,286	1,034	1,065	1,096	1,086
Current liabilities	654	767	977	959	731	782	844	904
Working capital	349	426	357	327	303	283	252	182
Working capital ratio	1.53 :1	1.56 :1	1.37 :1	1.34 :1	1.41 :1	1.36 :1	1.30 :1	1.20 :1

At December 31, 2017, the Corporation's working capital ratio was 1.53:1. It is management's belief that the Corporation's working capital position at December 31, 2017 was sufficient to support the current operating requirements of the business.

### Working Capital Liquidity

Working capital liquidity for operating purposes has generally been provided through positive cash flow from operations and the Corporation's operating credit facility. The Corporation's operating credit facility limit is \$850,000 and is margined on trade accounts receivable and inventories (see "Borrowing Arrangements and Covenants" below).

## 7. Share Capital

An unlimited number of common shares are authorized for issue. The following table summarizes the authorized, issued and outstanding common shares of the Corporation.

### Share Capital

(dollar amounts in thousands)

As at	December 31, 2017		December 31, 2016	
	Shares	Amount	Shares	Amount
Authorized, issued and outstanding common shares	4,405,145	\$ 2,276	4,405,145	\$ 2,276

There was no change to the Corporation's share capital during the years ended December 31, 2017 and 2016, respectively, and there was no change to the Corporation's share capital since December 31, 2017.

### Stock option plan

Inventronics maintains a stock option plan providing the Corporation the ability to grant options to employees and directors to purchase one common share of the Corporation per option. At December 31, 2017, there were 400,000 options granted, outstanding and exercisable with an exercise price of \$0.10 (December 31, 2016 - 400,000). There was no activity with respect to the Corporation's stock option plan during the years ended December 31, 2017 and 2016, respectively, and there was no activity related to the Corporation's stock option plan since December 31, 2017.

The following table summarizes the issued and outstanding common shares of the Corporation along with stock options convertible into common shares.

### Diluted Common Shares Outstanding

As at December 31

	2017		2016	
	Number of shares	Weighted average number of shares	Number of shares	Weighted average number of shares
Issued and outstanding common shares	4,405,145	4,405,145	4,405,145	4,405,145
Stock options outstanding <sup>(1)</sup>	400,000	114,286	400,000	114,286
Diluted common shares outstanding	4,805,145	4,519,431	4,805,145	4,519,431

Note 1: For the purposes of calculating the diluted weighted average number of shares outstanding, only those options which are considered "in the money" (strike price below the Corporation's annual average common share price) are considered.

## **8. Borrowing Arrangements and Covenants**

### ***Operating credit***

The Corporation maintains a demand operating credit facility with its banker in the form of an overdraft lending account, margined on the Corporation's accounts receivable and inventory balances and secured by a general security agreement constituting a first ranking security interest on all personal property of the Corporation and *Section 427 of the Bank Act (Canada)* security over inventory. Effective August 25, 2016, the Corporation reduced its authorized limit to \$850,000 from \$1.25 million and received a reduction in interest rate to prime plus 2.50% from prime plus 2.75%. There are two financial covenants pertaining to this demand operating credit facility that are tested annually at December 31: (i) working capital ratio; and (ii) debt to tangible net worth ("DTNW") ratio. The Corporation is in compliance with all covenants and obligations pertaining to this arrangement.

### ***Long-term debt***

The Corporation has a long-term lending agreement in the form of a fixed rate mortgage maturing in 2042; bearing interest of 6.0%; repayable monthly in blended principal and interest installments of \$14,571; secured by a mortgage on the Corporation's production facility and land in Brandon, Manitoba, a general security agreement providing a security interest in all of the Corporation's present and after acquired personal property but accepting a subordinate position to all existing registered charges. Effective April 10, 2017, after a five-year period from the initial loan agreement date, the loan was subject to a market-based interest rate adjustment in accordance with the loan agreement. The Corporation selected a 2-year fixed interest rate term with an interest rate and installment amount as described above. Prior to April 10, 2017, the interest rate was 6.6% with a monthly blended principal and interest installment of \$15,409. Although containing general performance conditions, the loan agreement does not contain any financial covenants that must be periodically tested. The Corporation is in compliance with all covenants and obligations pertaining to this arrangement.

## **9. Foreign Currency Exposure**

For the years ended December 31, 2017 and 2016, the Corporation did not have a significant direct exposure to foreign currency risk as a majority of its sales were delivered to the Canadian marketplace and denominated in Canadian dollars ("CAD"), a substantial majority of the Corporation's purchases were denominated in CAD and the Corporation maintained minimal United States dollar ("USD") cash balances. For the 2017 fiscal year, 96% (2016 - 88%) of the Corporation's sales were denominated in CAD with 4% (2016 - 12%) in USD.

## **10. Collective Bargaining Agreement**

The Corporation's production labour force is organized under a collective bargaining agreement ("CBA") with the USW. The most recent CBA expired on May 31, 2017 and the Corporation and its unionized employees have continued to operate under that agreement.

## **11. Related Party Transactions**

The members of Inventronics' senior management team, as a group, wholly own the corporation that holds approximately 69% of the outstanding common shares of the Corporation. Each of the four members of the senior management team are members of Inventronics' Board of Directors ("Board") and receive no compensation for their service as Board members. The Corporation pays salary to its senior management team for their employment services and incurs related employee benefit costs. For the year ended December 31, 2017, the Corporation expensed \$619,000 (2016 - \$483,000) related to salary and employee benefits for its senior management team, including statutorily mandated contributions to the Government of Canada's Employment Insurance and Canada Pension Plan programs.

## **12. Governance**

The Corporation's Board is comprised of the four members of the Corporation's senior management team and two independent members. The Corporation's President and the two independent members sit on the Corporation's Audit Committee. On June 23, 2017, one member of the Corporation's senior management team resigned their position on the Board to facilitate the appointment of the two independent directors. On November 24, 2017, with the Corporation's Annual General Meeting of Shareholders, the number of Board positions was increased from five to six and the existing five Board members were re-elected, along with the member of the Corporation's senior management team who previously resigned their Board position on June 23, 2017.

### 13. Non-IFRS Measures

#### EBITDA

Earnings before interest, tax, depreciation and amortization ("EBITDA") is not a recognized measure under International Financial Reporting Standards ("IFRS"). However, management believes that EBITDA is a useful supplementary measure to net earnings, as it provides investors with an indication of cash earnings prior to debt service, capital expenditure, income tax and non-cash items. Readers should be cautioned, however, that EBITDA should not be construed as an alternative to net earnings determined in accordance with IFRS as an indicator of the Corporation's performance or to cash flows from operating, investing and financing activities as a measure of liquidity or cash flows. The Corporation's method of calculating EBITDA may differ from the methods by which other companies calculate EBITDA and, accordingly, the EBITDA used herein may not be comparable to measures used by other companies.

A reconciliation of EBITDA to net income is:

<b>Reconciliation of EBITDA to Net Income (Loss)</b>				
<i>(in thousands of dollars)</i>				
<b>For the periods ended December 31</b>	<b>Three months</b>		<b>Twelve months</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
EBITDA	12	76	321	213
Less: Depreciation and amortization	20	80	81	324
Less: Interest expense	37	42	159	172
Net income (loss)	(45)	(46)	81	(283)

### 14. Change in Accounting Estimate

#### Depreciation and Amortization

IFRS IAS 16 *Property, Plant and Equipment* recommends that the useful life and residual value of assets be reviewed if expectations differ from previous estimates. During the third quarter of 2017, the Corporation's management completed a review and revised its assumptions as to the level of business the Corporation is likely to experience over the foreseeable future and the manner in which it is likely to utilize its property, plant and equipment based on these assumptions. As the Corporation has lowered its revenue growth expectations, the Corporation is assuming that much of the Corporation's equipment will be useful to the Corporation over a greater period than previously estimated. Further, it is the Corporation's management's view that prior residual values were, in hindsight, conservative as they were established during a time of economic recession and depressed secondary equipment markets. In accordance with IAS 16 and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the Corporation accounted for the results of its review as a change in accounting estimate to be applied prospectively. The Corporation applied this change as of the beginning of the current fiscal year and did not issue restated interim reports for 2017 Q1 and 2017 Q2. For 2017 Q1, the amended depreciation and amortization expense was \$20,000 which was originally reported as \$80,000. For 2017 Q2, the amended depreciation and amortization expense was \$20,000 which was originally \$80,000. The estimated impact for the twelve month period ended December 31, 2017 was to reduce depreciation and amortization expense from \$315,000 to \$81,000.

### 15. Outlook

In addition to other sections of this MD&A, this section contains forward-looking information and actual outcomes may differ materially from those expressed or implied therein. Please see the forward-looking information advisory included in the opening section of this MD&A.

The Corporation's revenues often show a close correlation to Canadian economic conditions. Although general economic conditions in Canada appear to be stable, there are many economic and political factors that are injecting uncertainty and unrest into the Canadian economy. The specific impact to the Corporation's customers is not known, however, product orders during the first quarter of 2018 were unusually low despite earlier indications from some of the Corporation's largest customers that spending plans would be generally consistent with the prior fiscal year. As a result, the Corporation is forecasting revenue for the first quarter of 2018 to be lower than recent quarters, which have been generally consistent, and more in line with the first quarter of 2016.