



INVENTRONICS LIMITED

2018 ANNUAL FINANCIAL REPORT

MANAGEMENT'S DISCUSSION & ANALYSIS

For the year ended December 31, 2018

2018 Annual and Fourth Quarter Financial Report – December 31, 2018

Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A") is dated April 22, 2019 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, 2018. This MD&A should be read in conjunction with the Corporation's 2018 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. 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. 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

Selected Annual Financial Information

(in thousands of dollars, except per share amounts)

For the years ended December 31	2018	2017	2016
Revenue	4,616	4,480	3,830
EBITDA ¹	257	321	213
Net income (loss)	16	81	(283)
Total assets	3,636	3,228	3,268
Long-term debt, excluding current portion	2,266	2,189	2,234
Basic and diluted earnings (loss) per share	0.4¢	1.8¢	(6.4)¢

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

3. Summary of Financial Results

The fourth quarter of 2018 showed a strong revenue recovery after a slow start to the year resulting in sales for the year modestly ahead of the previous year and earnings before a restructuring cost well ahead of 2017. Working capital increased by more than \$150,000 in the year and management's cost cutting measures substantially reduced selling and administration costs. Though modest, the earnings have now been positive for two consecutive years. Net income was negatively impacted by a one-time non-cash reorganization charge in the third quarter of 2018.

Selected Quarterly Financial Information

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

	2018				2017			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	1,708	1,282	874	752	1,135	1,224	1,113	1,008
Cost of sales as a percentage of Revenue	80%	79%	88%	87%	86%	80%	79%	78%
EBITDA ¹ before Restructuring	249	216	14	(34)	12	127	94	87
Net income (loss)	189	(34)	(47)	(93)	(45)	68	33	26
Basic and diluted earnings (loss) per share	4.3¢	(0.8)¢	(1.1)¢	(2.1)¢	(1.0)¢	1.5¢	0.7¢	0.6¢

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

4. Results of Operations

Revenue

Revenue for the fourth quarter of 2018 of \$1,708,000 was \$573,000, or 50%, greater than the \$1,135,000 reported for the same quarter of 2017. Revenue for the year ended December 31, 2018 of \$4,616,000 was \$136,000, or 3%, greater than the \$4,480,000 reported for 2017. The substantial increase in sales in the fourth quarter was the result of new business while the total year improvement was small because of very slow industry activity in the first half of the year.

Cost of Sales

Cost of sales as a percentage of revenue for the three and twelve month periods ended December 31, 2018 of 80% and 83%, respectively, compared to the 86% and 81% reported for the same periods of 2017. During fiscal 2018, the Corporation experienced upward pressure on raw material costs, most notably sheet steel, but also realized improved labour utilization from the increased production volume.

Selling and Administration Expense

Selling and administration expense as a percentage of revenue for the three and twelve month periods ended December 31, 2018 of 6% and 10%, respectively, was less than the 15% and 14%, respectively, reported for the same periods of 2017 due to the effect of the variable component of compensation arrangements, management cost cutting measures, and higher revenue in the fourth quarter.

Interest

Interest expense for the three and twelve month periods ended December 31, 2018 of \$39,000 and \$157,000, respectively, were similar to the \$37,000 and \$159,000 reported for the comparative periods of 2017.

Net Income or Loss

For the fourth quarter of 2018, the Corporation reported net income of \$189,000, or 4.3 cents per share, which was a substantial improvement over the net loss of \$45,000, or 1.0 cents per share, reported for the fourth quarter of 2017. This was a result of increased revenue year over year.

For the year ended December 31, 2018, the Corporation reported net income of \$16,000, or 0.4 cents per share, compared to net earnings of \$81,000, or 1.8 cents per share, for 2017. Net earnings for 2018 includes a one-time non-cash charge of \$187,500 with no such charge in the prior year.

5. Income Taxes

At December 31, 2018, the Corporation had non-capital losses of \$2,279,000 (2017 - \$1,452,000). There were no non-capital losses that expired in 2018 (2017 - \$0) and the remaining non-capital losses are scheduled to expire as follows:

(In thousands of dollars)

2026	\$ 268
2028	91
2034	50
2035	117
2037	926
2038	828
<u>Total</u>	<u>\$ 2,279</u>

6. Liquidity and Capital Resources

Cash Flow from Operations

For the three months ended December 31, 2018, the Corporation's operations generated cash flow before changes in non-cash working capital balances of \$243,000 compared to \$9,000 for the same quarter of the prior year. For the year ended December 31, 2018, the Corporation's operations generated cash flow before changes in non-cash working capital balances of \$420,000 compared to \$303,000 for 2017.

Cash Flow from Operations

(in thousands of dollars)

For the periods ended December 31	Three months		Twelve months	
	2018	2017	2018	2017
Net income before restructuring (loss)	189	(45)	203	81
Add: Interest on long-term debt ¹	33	34	133	140
Add: Depreciation	21	20	83	81
Add: Other items not involving cash		-	1	1
<u>Cash flow from Operations</u>	<u>243</u>	<u>9</u>	<u>420</u>	<u>303</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, 2018, the Corporation reported a working capital balance of \$492,000, which represented an increase of \$180,000 in the fourth quarter of 2018 mainly as a result of strong quarterly sales. Working capital during fiscal 2018 grew by \$143,000 primarily as a result of cash flow from operations.

Working Capital Position

(in thousands of dollars, except ratio calculation)

At the end of	2018				2017			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Current assets	1,460	1,538	1,134	895	1,003	1,193	1,334	1,286
Current liabilities	968	1,226	902	649	654	767	977	959
Working capital	492	312	232	246	349	426	357	327
<u>Working capital ratio</u>	<u>1.51 :1</u>	<u>1.25 :1</u>	<u>1.26 :1</u>	<u>1.38 :1</u>	<u>1.53 :1</u>	<u>1.56 :1</u>	<u>1.37 :1</u>	<u>1.34 :1</u>

At December 31, 2018, the Corporation's working capital ratio was 1.51:1. It is management's belief that the Corporation's working capital position at December 31, 2018 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				
<i>(dollar amounts in thousands)</i>				
As at	December 31, 2018		December 31, 2017	
	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, 2018 and 2017, respectively, and there was no change to the Corporation's share capital since December 31, 2018.

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, 2018, there were 400,000 options granted, outstanding and exercisable with an exercise price of \$0.10 (December 31, 2017 - 400,000). There was no activity with respect to the Corporation's stock option plan during the years ended December 31, 2018 and 2017, respectively, and there was no activity related to the Corporation's stock option plan since December 31, 2018.

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	2018		2017	
	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 ⁽¹⁾	400,000	92,308	400,000	114,286
Diluted common shares outstanding	4,805,145	4,497,453	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. Interest is paid at prime plus 2.50%. 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. As of April 10, 2019 the Corporation selected the option to have the rate float at BDC's Base Rate plus 1%. BDC Base Rate was 6.05% as at April 10, 2019. 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.

Restructuring obligation

In order to reduce the overhead costs of the Corporation, as of August 1, 2018 the Corporation and the Chief Financial Officer ("CFO") reached an agreement whereby the work time and salary of the CFO was reduced. This was done by terminating the existing employment agreement of indefinite term and replacing it with an employment agreement with a 36 month term with a reduced salary, benefits and time commitment. Pursuant to the terminated contract, a payment of \$187,500 was required. The CFO and the Corporation agreed to settle that obligation by 36 equal monthly payments of \$5,208 with no interest.

9. Foreign Currency Exposure

For the years ended December 31, 2018 and 2017, the Corporation did not have a significant direct exposure to foreign currency risk as more than 95% 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

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 as negotiations continue.

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. Three of the four members of the senior management team are current 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, 2018, excluding amounts paid to the CFO related to restructuring, the Corporation expensed \$505,000 (2017 - \$619,000) 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. In addition the Corporation expensed \$187,500 as a restructuring charge associated with the employment contract settlement with the CFO of which \$26,000 was paid.

12. Governance

The Corporation's Board is comprised of the three members of the Corporation's senior management team and three independent members. The Corporation's President and the three independent members sit on the Corporation's Audit Committee.

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:

Reconciliation of EBITDA before restructuring to Net Income (Loss) before restructuring

(in thousands of dollars)

For the periods ended December 31	Three months		Twelve months	
	2018	2017	2018	2017
EBITDA before restructuring	249	12	445	321
Less: Depreciation and amortization	21	20	83	81
Less: Interest expense	39	37	158	159
Net income (loss) before restructuring	189	(45)	204	81

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 had lowered its revenue growth expectations, the Corporation assumed that much of the Corporation's equipment will be useful to the Corporation over a greater period than previously estimated. Further, it was 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 2017. 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.

In the first half of 2018 the Corporation experienced very low revenues, even worse than would normally be expected for this seasonally lower period. This was more than compensated for by an unusually strong second half. Management is still not clear about why this happened across the entire customer base as, even in hindsight, no clear economic factors seem to have been in play. Factors such as economic and political uncertainty and trade negotiations may have been responsible. Revenues for the first quarter of 2019 have returned to seasonal norms. Generally, the first half of 2019 is expected to outperform the first half of 2018.