



WIRE & WIRE PRODUCTS

ESTABLISHED IN 1964



**Quarterly Report
Q3 2019**

Since 1964, Tree Island Steel Ltd. has been making products from steel wire for a diverse range of customers for industrial, construction, agricultural, and specialty applications.

Our products include concrete reinforcing mesh, fencing, galvanized wire, bright wire, a broad array of fasteners, stucco reinforcing products, and other fabricated wire products. We market these products under the Tree Island®, Halsteel®, True Spec®, K-Lath®, TI Wire® and ToughStrand® brand names.

Listed on the Toronto Stock Exchange (“TSX”), our shares trade under the symbol TSL.

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Mixed loads for shipment to distributors.

MANAGEMENT DISCUSSION AND ANALYSIS

September 30, 2019 and 2018

The following is a discussion of the financial condition and results of operations of Tree Island Steel ("Tree Island" or the "Company") and its wholly owned operating subsidiary Tree Island Industries (together with Tree Island Steel, referred to as "Tree Island"). This discussion is current to October 24, 2019 and should be read in conjunction with the unaudited interim condensed consolidated financial statements for the nine months ended September 30, 2019. Tree Island Steel's unaudited interim condensed consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of financial statements and are reported in Canadian dollars. Additional information relating to Tree Island Steel, including the audited consolidated financial statements and Annual Information Form ("AIF") for the year ended December 31, 2018, can be found at www.sedar.com or on Tree Island Steel's website at www.treeisland.com.

1 FORWARD-LOOKING STATEMENTS AND RISK

This management's discussion and analysis ("MD&A") includes forward-looking information with respect to Tree Island Steel, including our business, operations and strategies, as well as financial performance and conditions. The use of forward-looking words such as, "may," "will," "expect" or similar variations generally identify such statements. Any statements that are not statements of historical fact should be considered to be forward-looking statements. Although we believe that the forward-looking statements are reasonable, they involve risks and uncertainties, including the risks and uncertainties discussed under the heading "Risks Relating to Our Business" in the Company's AIF for the year ended December 31, 2018.

The forward-looking statements contained herein reflect management's current beliefs and are based upon certain assumptions that management believes to be reasonable based on the information currently available to management. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and a number of factors could cause actual events or results to differ materially from the results discussed in the forward-looking statements. In evaluating these statements, prospective investors should specifically consider various factors including the risks outlined in the 2018 Annual Information Form under the heading "Risk Factors" which may cause actual results to differ materially from any forward-looking statement. Such risks and uncertainties include, but are not limited to: general economic, market and business conditions, the cyclical nature of our business and demand for our products, financial condition of our customers, competition, volume and price pressure from import competition, deterioration in the Company's liquidity, disruption in the supply of raw materials, volatility in the costs of raw materials, transportation costs, foreign exchange fluctuations, leverage and restrictive covenants, labour relations, trade actions, dependence on key personnel and skilled workers, intellectual property risks, energy costs, un-insured loss, credit risk, operating risk, management of growth, changes in tax, environmental and other legislation, and other risks and uncertainties set forth in our publicly filed materials.

This MD&A has been reviewed by the Board of Directors of Tree Island Steel and its Audit Committee, and contains information that is current as of the date of this MD&A, unless otherwise noted. Events occurring after that date could render the information contained herein inaccurate or misleading in a material respect. Readers are cautioned not to place undue reliance on this forward-looking information and management of Tree Island undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise except as required by applicable securities law.

2 NON-IFRS MEASURES

References in this MD&A to “EBITDA” are to provide an EBITDA that we define as operating income and adding back depreciation and foreign exchange gains or losses. EBITDA is not a measure recognized by IFRS and does not have a standardized meaning prescribed by IFRS. We believe that providing an EBITDA is an important supplemental measure for evaluating our performance. You are cautioned that our EBITDA should not be construed as an alternative to net income or loss determined in accordance with IFRS, nor should it be used as an indicator of performance, cash flows from operating, investing and financing activities, as a measure of liquidity or cash flows. Our method of calculating EBITDA may differ from methods used by other issuers and, accordingly, our EBITDA may not be comparable to similar measures presented by other issuers.

3 TREE ISLAND STEEL

Since 1964, Tree Island has been manufacturing products from steel wire for a diverse range of customers and applications. Tree Island Steel was incorporated under the laws of Canada on August 2, 2012 following a conversion from an income trust to a corporate entity, and the units of the income fund were converted to common shares in Tree Island Steel.

There were 28,831,637 Shares outstanding as of September 30, 2019 and as of October 24, 2019.

3.1 ORGANIZATIONAL STRUCTURE

Our corporate structure has the following primary entities: Tree Island Industries (“TI Canada”), which is our Canadian operating company as well as the ultimate parent company to our operations in the United States, which are managed through our U.S. operating subsidiary, Tree Island Wire (“TI USA”).

3.2 PRODUCTS

Tree Island is a manufacturer and supplier of premium quality wire products for a broad range of applications. Our goal is to match the appropriate wire product with our customers’ needs. We achieve this by manufacturing most of our products at our own manufacturing facilities, while outsourcing others from qualified manufacturers. We market these products to customers in Canada, the United States and internationally.

We market our products under the following brands:



Our manufactured products offer: consistent, high quality that meet or exceed customers' needs, ASTM standards and applicable codes; broad range of applications; short lead times; technical support and excellent customer service.

The products we source from other suppliers are generally limited to commodity items, or items we do not produce. Products within this group meet general industry specifications, but are not customized to individual customer requirements. Outsourced products allow us to enhance our relationship with those customers that require competitively priced commodity products. These products typically create complementary pull through for our manufactured products. As a service to our customers, we also use our network of suppliers to source commodity wire products and direct ship to our customers.

3.3 MARKETS

The following summarizes the markets, key product groups, the specific end-use markets, and regions we serve with our products:

Markets	Brand	Key Product Groups	Specific End-Use Markets	Regions
Industrial	Tree Island®, TI Wire®	Bright/galvanized/annealed low and high carbon wire	Wire fabricating, industrial applications, OEM manufacturing	North America and International
Agricultural	Tree Island®, ToughStrand®	Game fence and farm fence Vineyard wire and barbed wire	Agriculture, farming	North America
Commercial Construction	Tree Island®, TI Wire®	Welded wire reinforcement mesh Concrete reinforcing products	Commercial construction, mining, infrastructure projects	North America and International
Residential Construction	Tree Island®, Halsteel®, K-Lath®, True Spec®	Collated, bulk and packaged nails Stucco reinforcing mesh	Construction and renovation for new and existing homes	North America and International

3.4 SEASONALITY

Our operations are impacted by the seasonal nature of the various industries we serve, primarily the construction and agriculture industries. Accordingly, revenues, sales volumes and operating results for interim quarters are not necessarily indicative of the results that may be expected for the full fiscal year, and fourth quarter results are traditionally lower than other quarters due to the onset of winter and the corresponding reduction in construction and agricultural activities.

4 2019 BUSINESS OVERVIEW AND DEVELOPMENT

4.1 BUSINESS OVERVIEW

On May 19, 2019, Canada and the U.S. reached an agreement that eliminates all tariffs the U.S. imposed under Section 232 on imports of steel from Canada, and eliminates all tariffs Canada imposed in retaliation to the Section 232 action taken by the U.S. Since the announcement of the agreement, demand for our products has increased but not yet to the levels we had experienced in the past. This relates primarily to sales in the U.S. in our Industrial markets and to a lesser degree in our Agricultural markets which were the markets most impacted by these tariffs.

For the three-month period ended September 30, 2019, revenues amounted to \$49.7 million compared to \$55.8 million in the same period last year. In the quarter, the revenues of products impacted by the tariffs have begun to recover. However, this was offset by lower pricing impacted by reduced raw material prices, industry wide competitive pricing pressures, and a lower demand in the Residential and Commercial segments. The lower selling prices and softer demand in the quarter resulted in a gross profit of \$4.6 million for the quarter, compared to \$6.9 million in the same period in 2018. As a result, EBITDA in the third quarter of 2019 amounted to \$2.5 million compared to \$3.4 million during the third quarter of 2018.

For the nine-month period ended September 30, 2019, revenues amounted to \$155.3 million compared to \$190.4 million in the first nine months of last year, attributable to lower sales volumes to U.S. customers in the Industrial and Agricultural markets, impacted by Section 232 steel tariffs affecting the first half of 2019, and softer market demand in Residential and Commercial markets. These impacts resulted in a gross profit of \$14.3 million for the first nine months of 2019, compared to \$22.1 million in the same period in 2018. As a result, EBITDA in the first three quarters of 2019 amounted to \$6.9 million compared to \$12.3 million during the same period of 2018.

4.2 UNSOLICITED NON-BINDING ACQUISITION PROPOSAL

Tree Island Steel announced on June 28, 2019 that it had been advised of the intention of The Futura Corporation and Arbutus Distributors Ltd. (together, the "Offerors"), entities controlled by certain directors of the Company, to make an unsolicited non-binding proposal ("Proposal") by way of a plan of arrangement to acquire all of the common shares of the Company not already owned by the Offerors.

The board of directors of the Company appointed a special committee of the board made up entirely of directors who were independent of both management and the Offerors (the "Special Committee"). The Special Committee engaged PwC to prepare a formal valuation of the Company and advise on an appropriate response to the Proposal.

On August 31, 2019, the Special Committee was advised by the Offerors of the withdrawal of their Proposal. As a result of the withdrawal of the Proposal by the Offerors, the engagement of the financial adviser to prepare a formal valuation was terminated by the Special Committee before completion of the valuation and the Special Committee was dissolved.

5 RESULTS FROM OPERATIONS

(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018 ¹	2019	2018 ¹
Revenue	49,701	55,846	155,261	190,424
Cost of sales	(43,513)	(48,014)	(136,361)	(165,691)
Depreciation ²	(1,565)	(903)	(4,611)	(2,589)
Gross profit	4,623	6,929	14,289	22,144
Selling, general and administrative expenses	(3,762)	(4,379)	(11,790)	(12,714)
Operating income	861	2,550	2,499	9,430
Foreign exchange gain (loss)	70	(77)	(186)	298
Gain (loss) on property, plant and equipment	(3)	(2)	-	2
Restructuring and other expenses	(215)	(39)	(482)	(104)
Changes in financial instruments recognized at fair value	-	(123)	-	(89)
Financing expenses ³	(1,111)	(850)	(3,590)	(2,492)
Income (loss) before income taxes	(398)	1,459	(1,759)	7,045
Current income tax (expense) recovery	-	(311)	(231)	(311)
Deferred income tax (expense) recovery	39	(125)	(1)	(1,814)
Net income (loss)	(359)	1,023	(1,991)	4,920
Operating income	861	2,550	2,499	9,430
Add back depreciation	1,565	903	4,611	2,589
Foreign exchange gain (loss)	70	(77)	(186)	298
EBITDA ⁴	2,496	3,376	6,924	12,317
Net income (loss) per share - basic (\$/share)	(0.01)	0.03	(0.07)	0.17
Dividends per share (\$/share)	0.02	0.02	0.06	0.06
Financial Position as at:	September 30, 2019		December 31, 2018	
Total assets ⁵	174,223		158,449	
Total non-current financial liabilities ⁶	49,395		21,928	

¹ On adoption of IFRS 16 Leases, the comparative information presented for 2018 have not been restated and is presented as previously reported. See Section 12 ACCOUNTING POLICIES AND STATEMENTS.

² Tree Island recognized depreciation from the adoption of IFRS 16 during Q3 2019 of \$0.7 million and \$2.0 million for the year-to-date. See Note 3 of the Q3 2019 Interim Unaudited Condensed Consolidated Financial Statements.

³ Tree Island recognized financing expenses from the adoption of IFRS 16 of \$0.4 million during Q3 2019 and \$1.1 million for the year-to-date. See Notes 3 and 10 of the Q3 2019 Interim Unaudited Condensed Consolidated Financial Statements.

⁴ See definition of EBITDA in Section 2 NON-IFRS MEASURES.

⁵ Tree Island recognized right-of-use assets of \$29.8 million at the end of Q3 2019 from the adoption of IFRS 16. See Note 3 of the Q3 2019 Interim Unaudited Condensed Consolidated Financial Statements.

⁶ Tree Island recognized lease liability of \$33.0 million at the end of Q3 2019 from the adoption of IFRS 16. See Note 3 of the Q3 2019 Interim Unaudited Condensed Consolidated Financial Statements.

6 COMPARISON OF RESULTS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2019 AND 2018

<i>(\$'000 unless otherwise stated)</i>	Q3 2019	Q3 2018	Variance Fav/(Unfav)	
SALES	49,701	55,846	(6,145)	(11.0%)

Revenues decreased by 11.0% when compared to prior year primarily due to lower raw materials prices, aggressive pricing actions from competitors, and lower volumes in our Residential and Commercial market segments.

Revenue by Market Segment

(\$'000 unless otherwise stated)

	Three Months Ended September 30,					
	2019		2018		Variance	
	<u>Revenue</u>	<u>% of Total</u>	<u>Revenue</u>	<u>% of Total</u>	<u>Amount</u>	<u>%</u>
Industrial	18,037	36.3%	18,082	32.4%	(45)	(0.1%)
Commercial	13,252	26.7%	15,338	27.5%	(2,086)	(3.7%)
Agricultural	3,720	7.5%	4,576	8.2%	(856)	(1.5%)
Residential	14,692	29.6%	17,850	32.0%	(3,158)	(5.7%)
Total revenue	49,701	100.0%	55,846	100.0%	(6,145)	(11.0%)

Revenues generated in the US and Canada were both impacted by the factors noted above.

Revenue by Location

(\$'000 unless otherwise stated)

	Three Months Ended September 30,					
	2019		2018		Variance	
	<u>Revenue</u>	<u>% of Total</u>	<u>Revenue</u>	<u>% of Total</u>	<u>Amount</u>	<u>%</u>
United States	32,199	64.8%	36,773	65.8%	(4,574)	(12.4%)
Canada	16,057	32.3%	17,872	32.0%	(1,815)	(10.2%)
International	1,445	2.9%	1,201	2.2%	244	20.3%
Total	49,701	100.0%	55,846	100.0%	(6,145)	(11.0%)

Average C\$/US\$	1.3205	1.3067
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<i>(\$'000 unless otherwise stated)</i>	Q3 2019	Q3 2018	Variance Fav/(Unfav)	
COST OF SALES	43,513	48,014	4,501	9.4%

The cost of goods sold decreased when compared to last year due to lower raw material costs and a rebalance in production to match lower volumes as part of our ongoing commitment to cost management.

<i>(\$'000 unless otherwise stated)</i>	Q3 2019	Q3 2018	Variance Fav/(Unfav)	
GROSS PROFIT	4,623	6,929	(2,306)	(33.3%)

Gross profit for the three months amounted to \$4.6 million versus \$6.9 million during the same period in 2018, mainly the result of the impact of aggressive pricing and lower volumes in the Residential and Commercial construction markets.

<i>(\$'000 unless otherwise stated)</i>	Q3 2019	Q3 2018	Variance Fav/(Unfav)	
SG&A EXPENSES	3,762	4,379	617	14.1%

SG&A expenses are lower when compared to prior year, which was a result of the cost management actions taken.

<i>(\$'000 unless otherwise stated)</i>	Q3 2019	Q3 2018	Variance Fav/(Unfav)	
EBITDA	2,496	3,376	(880)	(26.1%)

EBITDA earned for the quarter is inclusive of \$70 thousand foreign exchange gain in the quarter. The decrease in EBITDA is primarily impacted by the lower gross profit realized in the quarter. In addition, the adoption of IFRS 16 in 2019 resulted in the recognition of depreciation related to the right-of-use assets of \$0.7 million in the quarter whereas prior year comparative results have not been restated to reflect such depreciation.

<i>(\$'000 unless otherwise stated)</i>	Q3 2019	Q3 2018	Variance Fav/(Unfav)	
FINANCING EXPENSES	1,111	850	(261)	(30.7%)

Financing expenses increased mainly from the adoption of IFRS 16 increasing financing costs by \$0.4 million.

Financing Expenses

(\$'000 unless otherwise stated)

	Three Months Ended September 30,			
			Variance Fav / (Unfav)	
	<u>2019</u>	<u>2018</u>	<u>Amount</u>	<u>%</u>
Non-cash financing expenses	178	229	51	22.3%
Interest on senior credit facility	388	412	24	5.8%
Interest on lease liability	354	-	(354)	(100.0%)
Other interest and financing costs	182	152	(30)	(19.7%)
Deferred financing costs	9	57	48	84.2%
Total financing expenses	1,111	850	(261)	(30.7%)

<i>(\$'000 unless otherwise stated)</i>	Q3 2019	Q3 2018	Variance Fav/(Unfav)	
FOREIGN EXCHANGE GAIN (LOSS)	70	(77)	147	190.9%

Our Canadian operation, whose functional currency is Canadian dollar, has a portion of its assets, liabilities, sales and expenses denominated in currencies other than the Canadian dollar, in particular the US dollar. With raw material costs being denominated in US dollar, having a significant portion of our sales also being denominated in US dollar creates a natural partial hedge. Foreign currency forward contracts are used to manage a portion of the remaining currency risk. Foreign exchange gains and losses are unpredictable in nature and therefore can vary significantly over time. As of September 30, 2019, the Company has US \$0.3 million in US dollar currency forward contracts outstanding.

<i>(\$'000 unless otherwise stated)</i>	Q3 2019	Q3 2018	Variance Fav/(Unfav)	
INCOME TAX EXPENSE	39	(436)	475	108.9%

In Q3 2019, income tax recovery is \$39 thousand compared to tax expense of \$0.4 million for Q3 2018. The income tax recovery is based on a statutory rate of 27% for Canadian taxable income and 21% for U.S. based taxable income applied to the income of the respective subsidiaries before taxes, with adjustments for permanent differences between accounting and taxable income.

<i>(\$'000 unless otherwise stated)</i>	Q3 2019	Q3 2018	Variance Fav/(Unfav)	
NET INCOME (LOSS)	(359)	1,023	(1,382)	(135.1%)

The decrease in net income over the prior year is attributable to the lower gross profit margin in the quarter compared to prior year.

7 COMPARISON OF RESULTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2019 AND 2018

<i>(\$'000 unless otherwise stated)</i>	YTD 2019	YTD 2018	Variance Fav/(Unfav)	
SALES	155,261	190,424	(35,163)	(18.5%)

The decrease in year-to-date revenues over the prior year by 18.5% is primarily due to a combination of lower volumes shipped to the U.S. from our Industrial segment on account of U.S. Section 232 import tariffs affecting the first half of the year, aggressive competitive pricing, and softer market demand.

Revenue by Market Segment

(\$'000 unless otherwise stated)

	Nine Months Ended September 30,					
	2019		2018		Variance	
	<u>Revenue</u>	<u>% of Total</u>	<u>Revenue</u>	<u>% of Total</u>	<u>Amount</u>	<u>%</u>
Industrial	49,548	31.9%	64,139	33.7%	(14,591)	(7.7%)
Commercial	40,522	26.1%	40,422	21.2%	100	0.1%
Agricultural	21,831	14.1%	24,657	12.9%	(2,826)	(1.5%)
Residential	43,360	27.9%	61,206	32.1%	(17,846)	(9.4%)
Total revenue	155,261	100.0%	190,424	100.0%	(35,163)	(18.5%)

Revenues generated in the US and Canada decreased over the same period last year as a result of lower Industrial market volumes on the first half of the year, aggressive competitor pricing and reduced market demand.

Revenue by Location

(\$'000 unless otherwise stated)

	Nine Months Ended September 30 ,					
	2019		2018		Variance	
	Revenue	% of Total	Revenue	% of Total	Amount	%
United States	90,922	58.6%	120,003	63.0%	(29,081)	(24.2%)
Canada	58,660	37.7%	65,389	34.4%	(6,729)	(10.3%)
International	5,679	3.7%	5,032	2.6%	647	12.9%
Total	155,261	100.0%	190,424	100.0%	(35,163)	(18.5%)
Average C\$/US\$	1.3289		1.2867			

(\$'000 unless otherwise stated)	YTD 2019	YTD 2018	Variance Fav/(Unfav)	
COST OF SALES	136,361	165,691	29,330	17.7%

The cost of goods sold decreased when compared to last year due to lower raw materials costs and a rebalance in production to match lower volumes as part of our ongoing commitment to cost management.

(\$'000 unless otherwise stated)	YTD 2019	YTD 2018	Variance Fav/(Unfav)	
GROSS PROFIT	14,289	22,144	(7,855)	(35.5%)

Gross profit for the nine months amounted to \$14.3 million versus \$22.1 million during the same period in 2018, mainly the result of lower Industrial market volumes, aggressive competitive pricing actions and softer market demand.

(\$'000 unless otherwise stated)	YTD 2019	YTD 2018	Variance Fav/(Unfav)	
SG&A EXPENSES	11,790	12,714	924	7.3%

SG&A expenses are lower when compared to prior year, which was a result of cost reduction actions taken.

(\$'000 unless otherwise stated)	YTD 2019	YTD 2018	Variance Fav/(Unfav)	
EBITDA	6,924	12,317	(5,393)	(43.8%)

EBITDA earned for the nine months is inclusive of the foreign exchange loss of \$186 thousand in the period. The decrease in EBITDA is primarily a result of the lower gross profit discussed above. Also the adoption of IFRS 16 in 2019 resulted in the recognition of depreciation related to the right-of-use assets of \$2 million in the period whereas prior year comparative results have not been restated to reflect such depreciation.

<i>(\$'000 unless otherwise stated)</i>	YTD 2019	YTD 2018	Variance Fav/(Unfav)	
FINANCING EXPENSES	3,590	2,492	(1,098)	(44.1%)

Financing Expenses

(\$'000 unless otherwise stated)

	Nine Months Ended September 30,			
	<u>2019</u>	<u>2018</u>	Variance Fav / (Unfav)	
			<u>Amount</u>	<u>%</u>
Non-cash financing expenses	603	704	101	14.3%
Interest on senior credit facility	1,272	1,074	(198)	(18.4%)
Interest on lease liability	1,070	-	(1,070)	(100.0%)
Other interest and financing costs	618	634	16	2.5%
Deferred financing costs	27	80	53	66.3%
Total financing expenses	3,590	2,492	(1,098)	(44.1%)

Financing expenses increased mainly from the adoption of IFRS 16 increasing financing costs by \$1.1 million.

<i>(\$'000 unless otherwise stated)</i>	YTD 2019	YTD 2018	Variance Fav/(Unfav)	
FOREIGN EXCHANGE GAIN (LOSS)	(186)	298	(484)	(162.4%)

Our Canadian operation, whose functional currency is Canadian dollar has a portion of its assets, liabilities, sales and expenses denominated in currencies other than the Canadian dollar, in particular the US dollar. With raw material costs being denominated in US dollar, having a significant portion of our sales also being denominated in US dollar creates a natural partial hedge. Foreign currency forward contracts are used to manage a portion of the remaining currency risk. Foreign exchange gains and losses are unpredictable in nature and therefore can vary significantly over time. As at September 30, 2019, the Company has US \$0.3 million in US dollar currency forward contracts outstanding.

<i>(\$'000 unless otherwise stated)</i>	YTD 2019	YTD 2018	Variance Fav/(Unfav)	
INCOME TAX EXPENSE	(232)	(2,125)	1,893	89.1%

For the nine months ended September 30, 2019 an income tax expense of \$0.2 million was booked compared to \$2.1 million for the same period in 2018. The income tax expense/recovery is based on a statutory rate of 27% for Canadian taxable income and 21% for U.S. based taxable income applied to the income of the respective subsidiaries before taxes, with adjustments for permanent differences between accounting and taxable income.

<i>(\$'000 unless otherwise stated)</i>	YTD 2019	YTD 2018	Variance Fav/(Unfav)	
NET INCOME	(1,991)	4,920	(6,911)	(140.5%)

The decrease in net income over the prior year is attributable to the lower gross profit in the first nine months compared to prior year.

8 FINANCIAL CONDITION AND LIQUIDITY

8.1 WORKING CAPITAL

A summary of the composition of our working capital as at September 30, 2019 compared to 2018 is provided below:

Working Capital

(\$'000 unless otherwise stated)

	As at September 30,	
	2019	2018
Cash	1,476	2,456
Accounts receivable	26,242	31,408
Inventories	65,924	80,530
Other current assets	4,730	5,095
Total current assets	98,372	119,489
Senior credit facility	(42,040)	(47,199)
Accounts payable and accrued liabilities	(23,622)	(29,627)
Dividends payable	(577)	(585)
Other current liabilities	(263)	(456)
Current portion of long term debt	(4,274)	(4,038)
Current portion of lease liabilities	(1,644)	-
Total current liabilities	(72,420)	(81,905)
Net working capital	25,952	37,584

Our business requires an ongoing investment in working capital, comprised primarily of accounts receivable and inventories, financed primarily by credit in the form of our Senior Credit Facility and accounts payable and accrued liabilities. Our largest investment in working capital is in our inventories. We have arrangements with our key suppliers to provide us with financing or trade credit for the purchase of the raw materials needed for our operations.

Our investment in working capital fluctuates from quarter-to-quarter based on factors such as seasonal sales demand, strategic purchasing decisions taken by management, and the timing of collections from customers and payments made to our suppliers. The construction and agricultural markets are seasonal in nature. As a result, sales and working capital requirements may be higher in the first three quarters when demand is historically highest.

Accounts receivable as at September 30, 2019 was lower than at the same period last year, reflecting the decrease in sales in the first nine months of 2019 compared to the same period in the prior year.

Our objective for managing the investment in working capital is to maximize the turnover of productive current assets, being accounts receivable and inventories. Our goal is to keep utilization of our Senior Credit Facility as low as practicable to maintain borrowing capacity for when it is needed and to reduce ongoing interest costs. We also work with our key vendors to use vendor credit when available on advantageous terms.

We manage our inventories with an emphasis on a continuous inflow of raw materials to meet our production needs balanced with strategic purchases, barring unforeseen events such as the Section 232 tariffs impacting potential end markets. We have also established processes to regularly adjust the production levels of finished goods stocked in our warehouses so that we can both satisfy customer needs, growth requirements and meet our objective of minimizing inventories on hand.

We manage our accounts receivable and the related credit risk by focusing on well-established customers with favourable credit profiles. The credit worthiness of customers is assessed using credit scores supplied by a third party and through direct monitoring of their financial well-being on a continual basis. We have established guidelines for customer credit limits and when thresholds in these areas are reached, appropriate precautions are taken to improve collectability or limit increasing credit exposure. We maintain provisions for potential credit losses (allowance for doubtful accounts) and such losses to date have been within our expectations.

8.2 CASH FLOW

Cash Flow

(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Cash provided by (used in) operating activities	2,404	2,889	5,869	12,198
Working capital adjustments	7,607	(9,768)	13,820	(16,960)
Net cash provided by (used in) operating activities	10,011	(6,879)	19,689	(4,762)
Net cash provided by (used in) investing activities	(681)	(1,078)	(1,619)	(5,565)
Advance on (repayment of) senior term loans	(492)	3,927	(1,479)	3,055
Repayment of long-term debt	(734)	(468)	(1,776)	(1,392)
Lease liability payment	(433)	-	(1,306)	-
Other financial liabilities	(13)	293	(35)	441
Lease interest paid	(354)	-	(1,069)	-
Other interest paid	(599)	(574)	(1,944)	(1,705)
Deferred financing expenses	-	(183)	(39)	(183)
Advance on (repayment of) senior revolving facility	(5,539)	6,868	(7,756)	13,731
Dividend payment	(577)	(587)	(1,744)	(1,771)
Share buyback	(31)	(287)	(721)	(1,061)
Net cash provided by (used in) financing activities	(8,772)	8,989	(17,869)	11,115
Exchange rate changes on foreign cash balances	2	(14)	(2)	17
Increase (decrease) in cash balances	560	1,018	199	805

For the three and nine months ended September 30, 2019, there was a net increase in cash. The net cash provided in operating activities for the three and nine months ended September 30, 2019 was mainly the result of the reduction of inventory.

On adoption of IFRS 16 Leases, the comparative information presented for 2018 have not been restated and is presented as previously reported. See Section 12 ACCOUNTING POLICIES AND STATEMENTS.

8.3 SENIOR CREDIT FACILITY

On July 1, 2018, the Company renewed its senior secured committed banking facility, now maturing in June of 2023, which enables the Company to borrow up to \$80.0 million in Canadian and/or U.S. funds. Interest payable on funds borrowed in Canadian currency is at variable rates based on the Canadian Dollar Offered Rate ("CDOR") for Canadian dollar banker's acceptance. Interest payable on funds borrowed in U.S. currency is at variable rates based on the London Interbank Offered Rate ("LIBOR") for U.S. dollar deposits. For the revolving facility, up to \$60 million may be borrowed at any time in Canadian and/or U.S. dollars with the amount advanced under the revolving facility

limited to a defined percentage of inventories, accounts receivable, machinery and equipment, and real estate, less certain reserves. In addition, up to \$20 million may be borrowed as term debt, in Canadian and/or U.S. dollars for financing existing machinery and equipment and future capital expenditures.

The existing term debts applied against the Senior Credit Facility was incorporated into a single term loan of \$10 million, denominated in Canadian dollars on July 1, 2018, referred to as "Fixed Asset Term Loan". An additional \$10 million is available to finance future capital expenditures, to be denominated in either Canadian or U.S. dollars and referred to as "Capex Term Loans". On September 24, 2018, \$3.8 million was applied against the "Capex Term Loan" for financing a new welded wire mesh machine in our U.S. Operations.

The Senior Credit Facility is secured by a first charge over Tree Island's assets supported by the appropriate guarantees, pledges and assignments, and requires that certain covenants be met by Tree Island. The Senior Credit Facility has defined covenants, the primary one being based on the remaining funds within the Senior Credit Facility that is available ("Availability Test"). Only if this amount falls below a certain threshold, then other covenants, which include a defined fixed charge coverage ratio, are tested. In addition, there are other restrictive covenants that limit the discretion of management with respect to certain business matters.

As at September 30, 2019, the availability was in excess of the Availability Test and the Company was in compliance with its covenants on the Senior Credit Facility.

8.4 LONG TERM DEBT AGREEMENTS

On June 11, 2012, Tree Island entered into a Second Amendment to the long-term debt agreement ("Agreement"). Under the terms of this Agreement, the total principal debt amount of approximately US\$15.8 million is to be repaid monthly over a ten year amortization period, of which US\$3.4 million is outstanding as at September 30, 2019. Interest, which began accruing in June 2017, is non-compounding. The interest is payable over a four year period beginning June 2024 (see Note 9 in the consolidated financial statements).

9 CAPITAL EXPENDITURES AND CAPACITY

For the three months ended September 30, 2019, we made capital expenditures of \$0.7 million and for the year-to-date, we made capital expenditures of \$1.6 million. These expenditures were for capital maintenance activities and new manufacturing equipment. As noted in Section 10 of this MD&A, there are a further \$1.6 million in capital equipment commitments in 2020. The capital assets we have committed to are expected to be delivered in 2020 with commissioning of the equipment generally taking approximately three months after arrival.

10 CONTRACTUAL OBLIGATIONS AND COMMITMENTS

As of September 30, 2019, we were committed to the contracts, operating leases and debt repayments (including scheduled interest payments on interest bearing debt) set out below, which will be financed through working capital and our senior credit facility.

The production materials include raw materials, such as wire rod and zinc, and finished goods. The raw materials, wire rod and zinc, are used in the day-to-day operations of our manufacturing facilities and are in the normal course of our business activities. Finished goods are purchased for resale without further processing and are also in the normal course of our business activities. All committed production materials are to be delivered in the fourth quarter of 2019 and first quarter of 2020.

From time to time, we make investments to update, replace or make additions to our existing capital assets, which includes, but is not limited to, the buildings we occupy and capital equipment. These investments are in the normal

course of our business activity. For the capital assets we have committed to purchase but have not yet received, amounts remaining to be paid are purchase commitments.

On adoption of IFRS 16 Leases on January 1, 2019, Tree Island recognized all its operating leases as lease liabilities and as such are recorded on the consolidated statement of financial position.

From time to time, the Company enters into U.S. dollar currency forward contracts for periods consistent with a portion of U.S. dollar currency transaction exposures, generally from one to three months. These are not designated as cash flow, fair value or net investment hedges. As of September 30, 2019, the Company has US \$0.3 million in U.S. dollar currency forward contracts outstanding.

Contractual Obligations and Commitments

(\$'000 unless otherwise stated)

	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>Thereafter</u>	<u>Total</u>
Production materials	19,645	5,382	-	-	-	-	25,027
Capital asset purchases	-	1,649	-	-	-	-	1,649
Total commitments	19,645	7,031	-	-	-	-	26,676
Senior revolving facility	42,040	-	-	-	-	-	42,040
AP and accrued liabilities	23,622	-	-	-	-	-	23,622
Other current liabilities	263	-	-	-	-	-	263
Dividends	577	-	-	-	-	-	577
Lease liabilities	792	2,914	2,870	2,920	2,562	37,748	49,806
Senior term loans	493	1,970	1,970	1,970	1,970	3,374	11,747
Long-term debt	735	1,922	1,414	476	-	4,969	9,516
Total financial liabilities	68,522	6,806	6,254	5,366	4,532	46,091	137,571
Total obligations and commitments	88,167	13,837	6,254	5,366	4,532	46,091	164,247

11 SUMMARY OF QUARTERLY FINANCIAL RESULTS

The table below provides selected quarterly financial information for the eight most recent fiscal quarters to September 30, 2019. Sales volume in the fourth quarter of the year has traditionally been the lowest in the year due to the seasonality of our business and the markets we sell to. Quarter-over-quarter results may also be impacted by unusual or infrequently occurring items.

Summary of Quarterly Financial Results

(\$'000 unless otherwise stated)

	<u>Sep 30,</u> <u>2019</u>	<u>Jun 30,</u> <u>2019</u>	<u>Mar 31,</u> <u>2019</u>	<u>Dec 31,</u> <u>2018</u>	<u>Sep 30,</u> <u>2018</u>	<u>Jun 30,</u> <u>2018</u>	<u>Mar 31,</u> <u>2018</u>	<u>Dec 31,</u> <u>2017</u>
Revenue	49,701	52,618	52,942	44,882	55,846	68,087	66,491	54,561
Gross profit	4,623	4,912	4,754	3,686	6,929	8,509	6,706	2,452
Foreign exchange gain (loss)	70	(85)	(171)	408	(77)	256	119	119
EBITDA	2,496	2,598	1,830	1,065	3,376	5,451	3,490	1,932
Net income (loss)	(359)	(536)	(1,096)	(2,334)	1,023	2,792	1,105	(1,974)
Net income (loss) per unit - basic	(0.01)	(0.02)	(0.04)	(0.08)	0.03	0.09	0.04	(0.07)

Commentary:

- The rapid rise in raw material costs had a negative impact on the gross profit and EBITDA for most of 2017.
- The average prices of finished good products increased month-over-month to counter inflationary cost of raw materials during 2018.
- Aggressive pricing impacted revenue and margins in Q2 and Q3 2019.
- Volumes in the Industrial markets were impacted by Section 232 tariffs in the second half of 2018 and the first half of 2019.
- On adoption of IFRS 16 Leases, the comparative information presented for 2018 have not been restated and is presented as previously reported.

These financial results are not necessarily indicative of results for any future period and should not be relied upon to predict future performance.

12 ACCOUNTING POLICIES AND STATEMENTS

Certain of our accounting policies involve critical accounting estimates that require us to make subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under differing conditions or using different assumptions. We evaluate these estimates and assumptions regularly.

Our significant accounting policies are described in Note 3 of the December 31, 2018 audited consolidated financial statements, the Annual Information Form for the year ended December 31, 2018 and Note 3 to the September 30, 2019 unaudited interim condensed consolidated financial statements.

12.1 CRITICAL ACCOUNTING ESTIMATES

The areas that we consider to have critical accounting estimates are: financial instruments valued at fair value through profit and loss, inventory valuation, allowance for doubtful accounts, property, plant and equipment, and income taxes. These critical estimates and the judgments involved are discussed further in the audited consolidated financial statements for December 31, 2018 (Note 3).

12.2 CHANGES IN ACCOUNTING POLICIES

Tree Island has initially adopted IFRS 16 Leases from January 1, 2019. IFRS 16 introduced a single, on-balance sheet accounting model for lessees. As a result, Tree Island, as a lessee, has recognized right-of-use assets representing its right to use the underlying assets and lease liabilities representing its obligation to make lease payments.

Tree Island adopted IFRS 16 using the modified retrospective approach on January 1, 2019. Under this method, the cumulative effect of initially applying the standard is recognized in retained earnings at January 1, 2019. Accordingly, the comparative information presented for 2018 has not been restated and is presented as previously reported under IAS 17 and related interpretations.

On transition, Tree Island elected to apply the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases under IAS 17. Tree Island also elected to use the recognition exemptions for lease contracts that, at the commencement date, have a lease term of 12 months or less and do not contain a purchase option (short-term leases), and lease contracts for which the underlying asset is of low value (low-value assets). The transition and impact are further discussed in Note 3 to the September 30, 2019 unaudited interim condensed consolidated financial statements.

13 RELATED PARTY TRANSACTIONS

13.1 TRANSACTIONS WITH ASSOCIATED COMPANIES

The Futura Corporation (“Futura”) is considered to be a related party to the Company because of its Share ownership interest and the fact that Mr. Doman, the sole shareholder and president of Futura, and Mr. Rosenfeld, the Executive Vice President of Futura, sit on the Board of Directors.

Based on Tree Island Steel’s outstanding Shares as at October 24, 2019, Futura owns 30.6% of the fully diluted Shares of the Company.

In addition, Mr. Doman is Chairman and CEO of CanWel Building Materials Group Ltd. (“CanWel”). For the three and nine months ended September 30, 2019, Tree Island sold, net of rebates, approximately \$0.5 million and \$2.3 million respectively (\$0.7 million and \$3.1 million in 2018) of goods to CanWel and trade accounts receivable owing from CanWel as at September 30, 2019 is approximately \$0.1 million (approximately \$0.2 million in 2018). Outstanding trade accounts receivable from CanWel at period end are unsecured, interest free and settlement occurs in cash.

13.2 TRANSACTIONS WITH KEY MANAGEMENT PERSONNEL

Included in the definition of key management for purposes of disclosure of related party transactions are members of Board of Directors and officers of Tree Island Steel. Amounts for key management personnel for the nine months ended September 30, 2019 was approximately \$0.5 million and \$1.7 million respectively (approximately \$0.5 million and \$1.5 million in 2018) which includes wages, salaries and social security contributions, paid annual and sick leave, vehicle costs and bonuses. It also includes directors’ fees paid to members of the Board.

14 RISKS AND UNCERTAINTIES

Investment in Tree Island Steel is subject to a number of risks. Our income is dependent upon the wire products business, which is susceptible to a number of risks. Risks pertaining to current economic conditions are discussed in the section above under the heading “2019 Business Overview and Development”. A detailed discussion of our significant business risks is provided in the 2018 Annual Information Form under the heading “Risk Factors” which can be found at www.sedar.com.

15 DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for designing disclosure controls and procedures that: (a) provide reasonable assurance that material information required to be disclosed by us is accumulated and communicated to management to allow timely decisions regarding required disclosure; and (b) ensure that information required to be disclosed by us is recorded, processed, summarized, and reported within the time periods specified in applicable securities legislation.

Our management is responsible for designing, establishing, and maintaining an adequate system of internal control over financial reporting. Our internal control system was designed based on the 2013 Internal Control – Integrated Framework (“2013 COSO Framework”) published by the Committee of Sponsoring Organizations of the Treadway Commission to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with IFRS.

Our Chief Executive Officer and Chief Financial Officer certified the appropriateness of the financial disclosures in the interim financial report together with the other financial information included in the interim filings for the period ended September 30, 2019. These executives also certified that they are responsible for the design of disclosure

controls and procedures and internal control over financial reporting. There have been no changes in internal control over financial reporting during the quarter ended September 30, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The Company's Board of Directors and Audit Committee reviewed and approved the September 30, 2019 unaudited interim condensed consolidated financial statements and this MD&A prior to its release.

INTERIM UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2019 and 2018

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102 “Continuous Disclosure Obligations”, Part 4, Subsection 4.3(3a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying interim condensed consolidated financial statements of Tree Island Steel have been prepared by and are the responsibility of Tree Island Steel’s management.

Tree Island Steel’s independent auditor, KPMG LLP, has not performed a review of these financial statements in accordance with standards established by the Chartered Professional Accountants of Canada for a review of interim financial statements by an entity’s auditor.

October 24, 2019

INTERIM UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION*(\$'000 unless otherwise stated)*

	As at September 30, 2019	December 31, 2018
Cash	1,476	1,277
Accounts receivable <i>(Note 5)</i>	26,242	24,128
Inventories <i>(Note 6)</i>	65,924	81,619
Prepaid and other current assets	4,620	4,013
Income taxes recoverable	110	-
Current assets	98,372	111,037
Property, plant and equipment <i>(Note 7)</i>	45,899	47,230
Right-of-use assets <i>(Note 3)</i>	29,835	-
Other non-current assets	117	182
Total assets	174,223	158,449
Senior credit facility <i>(Note 8.1)</i>	42,040	49,797
Accounts payable and accrued liabilities	23,622	22,017
Income taxes payable	-	171
Other current liabilities	263	346
Dividends payable	577	584
Current portion of long-term borrowing <i>(Notes 8.2, 9)</i>	4,274	4,980
Current portion of lease liabilities <i>(Note 3)</i>	1,644	-
Current liabilities	72,420	77,895
Senior term loans <i>(Note 8.2)</i>	9,776	11,349
Long-term debt <i>(Note 9)</i>	4,209	4,922
Long-term lease liabilities <i>(Note 3)</i>	31,395	-
Other non-current liabilities	784	2,426
Deferred income tax liability	3,231	3,231
Total liabilities	121,815	99,823
Shareholders' equity	52,408	58,626
Total liabilities and shareholders' equity	174,223	158,449

See accompanying Notes to the Interim Unaudited Condensed Consolidated Financial Statements

Approved on behalf of Tree Island Steel Ltd.

[Signed]
 "Amar S. Doman"
 Chairman of the Board of Directors

[Signed]
 "Dale R. Maclean"
 Director, President and Chief Executive Officer

INTERIM UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Sales (Note 5)	49,701	55,846	155,261	190,424
Cost of sales (Note 6)	(43,513)	(48,014)	(136,361)	(165,691)
Depreciation	(1,565)	(903)	(4,611)	(2,589)
Gross profit	4,623	6,929	14,289	22,144
Selling, general and administrative expenses	(3,762)	(4,379)	(11,790)	(12,714)
Operating income	861	2,550	2,499	9,430
Foreign exchange gain (loss)	70	(77)	(186)	298
Gain (loss) on property, plant and equipment	(3)	(2)	-	2
Restructuring and other expenses	(215)	(39)	(482)	(104)
Changes in financial liabilities at fair value	-	(123)	-	(89)
Financing expenses (Note 10)	(1,111)	(850)	(3,590)	(2,492)
Income (loss) before income taxes	(398)	1,459	(1,759)	7,045
Current income tax recovery (expense) (Note 13)	-	(311)	(231)	(311)
Deferred income tax recovery (expense) (Note 13)	39	(125)	(1)	(1,814)
Net income (loss)	(359)	1,023	(1,991)	4,920
Net income (loss) per share (Note 17)	(0.01)	0.03	(0.07)	0.17
Dividends per share	0.02	0.02	0.06	0.06
Weighted average number of shares (Note 17)	29,162,348	29,327,529	29,107,774	29,473,611

INTERIM UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Net income (loss) for the year	(359)	1,023	(1,991)	4,920
Unrealized gain (loss) on foreign exchange translation	22	(101)	(77)	104
Comprehensive income (loss)	(337)	922	(2,068)	5,024

See accompanying Notes to the Interim Unaudited Condensed Consolidated Financial Statements

INTERIM UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(\$'000 unless otherwise stated)

	Shareholders' Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance as at December 31, 2018	224,715	(163,354)	(2,735)	58,626
Adjustment on application of IFRS 16	-	(1,708)	-	(1,708)
Adjusted balance at January 1, 2019	224,715	(165,062)	(2,735)	56,918
Repurchase of shares	(96)	-	-	(96)
Net income	-	(1,095)	-	(1,095)
Dividends	-	(583)	-	(583)
Other comprehensive income (loss)	-	-	(51)	(51)
Balance as at March 31, 2019	224,619	(166,740)	(2,786)	55,093
Repurchase of shares	(594)	-	-	(594)
Net income	-	(535)	-	(535)
Dividends	-	(577)	-	(577)
Other comprehensive income (loss)	-	-	(34)	(34)
Balance as at June 30, 2019	224,025	(167,852)	(2,820)	53,353
Repurchase of shares	(31)	-	-	(31)
Net income	-	(359)	-	(359)
Dividends	-	(577)	-	(577)
Other comprehensive income (loss)	-	-	22	22
Balance as at September 30, 2019	223,994	(168,788)	(2,798)	52,408
Balance as at December 31, 2017	225,977	(163,600)	(3,108)	59,269
Repurchase of shares	(279)	-	-	(279)
Net Income	-	1,105	-	1,105
Dividends	-	(591)	-	(591)
Other comprehensive income (loss)	-	-	105	105
Balance as at March 31, 2018	225,698	(163,086)	(3,003)	59,609
Repurchase of shares	(495)	-	-	(495)
Net income	-	2,792	-	2,792
Dividends	-	(587)	-	(587)
Other comprehensive income (loss)	-	-	100	100
Balance as at June 30, 2018	225,203	(160,881)	(2,903)	61,419
Repurchase of shares	(287)	-	-	(287)
Net income	-	1,023	-	1,023
Dividends	-	(585)	-	(585)
Other comprehensive income (loss)	-	-	(101)	(101)
Balance as at September 30, 2018	224,916	(160,443)	(3,004)	61,469

See accompanying Notes to the Interim Unaudited Condensed Consolidated Financial Statements

INTERIM UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income (loss)	(359)	1,023	(1,991)	4,920
Depreciation	1,565	903	4,611	2,589
Changes in financial liabilities recognized at fair value	-	123	-	89
Loss on property, plant and equipment	3	2	-	(3)
Net financing costs (Note 10)	1,111	850	3,590	2,492
Deferred income tax expense	(39)	125	1	1,814
Exchange revaluation of foreign denominated debt (Notes 8.2, 9)	123	(137)	(342)	297
Working capital adjustments				
Accounts receivable	1,998	4,806	(2,115)	(5,260)
Inventories	205	(15,414)	15,696	(20,567)
Accounts payable and accrued liabilities	4,557	882	602	10,308
Prepaid expenses	1,767	(534)	99	(1,655)
Income and other taxes	(333)	311	(235)	311
Other	(587)	181	(227)	(97)
Net cash provided by (used in) operating activities	10,011	(6,879)	19,689	(4,762)
Proceeds on disposal of property, plant and equipment	-	4	-	4
Purchase of property, plant and equipment	(681)	(1,082)	(1,619)	(5,569)
Net cash used in investing activities	(681)	(1,078)	(1,619)	(5,565)
Term loans – advances (repayment), net (Note 8.2)	(492)	3,927	(1,479)	3,055
Repayment of long-term debt (Note 9)	(734)	(468)	(1,776)	(1,392)
Payment of lease liabilities (Note 3)	(433)	-	(1,306)	-
Other financing liabilities	(13)	293	(35)	441
Lease interest paid (Note 3, 10)	(354)	-	(1,069)	-
Other interest paid	(599)	(574)	(1,944)	(1,705)
Deferred financing fees	-	(183)	(39)	(183)
Advance on (repayment of) senior revolving facility	(5,539)	6,868	(7,756)	13,731
Dividend paid	(577)	(587)	(1,744)	(1,771)
Repurchase of common shares	(31)	(287)	(721)	(1,061)
Net cash provided by (used in) financing activities	(8,772)	8,989	(17,869)	11,115
Effect of exchange rate change on cash	2	(14)	(2)	17
Increase (decrease) in cash	560	1,018	199	805
Cash - beginning of period	916	1,438	1,277	1,651
Cash - end of period	1,476	2,456	1,476	2,456

See accompanying Notes to the Interim Unaudited Condensed Consolidated Financial Statements

1 NATURE OF BUSINESS

These consolidated financial statements of Tree Island Steel Ltd. ("Tree Island Steel" or the "Company") for the quarter ended September 30, 2019 were authorized for issue in accordance with a resolution of the Board of Directors on October 24, 2019.

Tree Island Steel is the successor to Tree Island Wire Income Fund and was incorporated under the laws of Canada on August 2, 2012 to affect the conversion from an income trust to a corporate entity. The units of Tree Island Wire Income Fund were converted into common shares of the Company ("Shares") upon conversion. The Company is headquartered at 3933 Boundary Road, Richmond, British Columbia, Canada and the Shares are publicly traded on the Toronto Stock Exchange ("TSX") under the symbol TSL.

Tree Island Steel owns 100% of the Shares of Tree Island Industries Ltd. ("TI Canada") (collectively "Tree Island"). TI Canada supplies a diverse range of steel wire and fabricated steel wire products to customers in Canada, the United States, and internationally.

2 BASIS OF PREPARATION

The interim condensed consolidated financial statements as at and for nine months ended September 30, 2019 have been prepared in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting". They should be read in conjunction with the annual consolidated financial statements and the notes thereto for the year ended December 31, 2018 and do not include all information required for the full annual financial statements. Certain comparative information has been reclassified to conform to the presentation adopted during the period.

3 SIGNIFICANT ACCOUNTING POLICIES, CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The accounting policies, methods of application and critical judgements and estimates used in the preparation of these unaudited condensed consolidated financial statements are consistent with those disclosed in the annual consolidated financial statements as at December 31, 2018, except for the adoption of new standards effective as of January 1, 2019.

3.1 CHANGES IN ACCOUNTING POLICIES

IFRS 16 LEASES

Tree Island has initially adopted IFRS 16 Leases from January 1, 2019. IFRS 16 introduced a single, on-balance sheet accounting model for lessees. As a result, Tree Island, as a lessee, has recognized right-of-use assets representing its right to use the underlying assets and lease liabilities representing its obligation to make lease payments.

Tree Island adopted IFRS 16 using the modified retrospective approach on January 1, 2019. Under this method, the cumulative effect of initially applying the standard is recognized in retained earnings at January 1, 2019. Accordingly, the comparative information presented for 2018 has not been restated and is presented as previously reported under IAS 17 and related interpretations.

On transition, Tree Island elected to apply the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases under IAS 17. Upon adoption of IFRS 16, Tree Island applied a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The standard provides specific transition requirements and practical expedients, which has been applied by Tree Island.

NOTES TO THE INTERIM UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the periods ended September 30, 2019 and 2018

Tree Island and its subsidiaries applied the available practical expedients wherein it:

- Used a single discount rate to a portfolio of leases with reasonably similar characteristics;
- Relied on its assessment of whether leases are onerous immediately before the date of initial application;
- Applied the short-term leases exemptions to leases with lease term that ends within 12 months at the date of initial application;
- Applied the leases of low value exemption to leases that are considered of low value, with a threshold of below \$5 thousand;
- Excluded the initial direct costs from the measurement of the right-of-use asset at the date of initial application; and
- Used hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

3.2 SUMMARY OF NEW ACCOUNTING POLICIES

RIGHT-OF-USE ASSETS

Tree Island recognizes a right-of-use asset and a lease liability at the commencement date of the lease. The right-of-use asset is measured at cost, and subsequently at cost less any accumulated depreciation and impairment losses, and adjusted for any remeasurements of the lease liability. When a right-of-use asset meets the definition of investment property, it is presented in investment property. Tree Island does not have any right-of-use asset that meets the definition of an investment property. The right-of use asset is initially measured at cost, and subsequently measured at fair value, in accordance with Tree Island's accounting policies.

LEASE LIABILITIES

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, Tree Island's incremental borrowing rate. Generally, Tree Island uses its incremental borrowing rate as the discount rate.

The lease liability is subsequently increased by the interest cost on the lease liability and decreased by lease payment made. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, a change in the estimate of the amount expected to be payable under a residual value guarantee, or as appropriate, changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised.

Tree Island has applied judgement to determine the lease term for some lease contracts in which it is a lessee that include renewal options. The assessment of whether Tree Island is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right-of-use assets recognized.

SHORT-TERM LEASES AND LEASES OF LOW-VALUE

Tree Island applied the short-term lease recognition exemption to its short-term leases of machinery and equipment which have a lease term of 12 months or less from the commencement date and do not contain a purchase option. Tree Island also applied the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value, with a threshold of below \$5 thousand. Lease payments on short-term leases and leases of low-value assets are recognized as expense on a straight-line basis over the lease term.

TRANSITION TO IFRS 16

Tree Island entered into lease contracts for real estate, machinery, vehicles and other equipment. Before the adoption of IFRS 16, Tree Island classified each of its leases at the inception date as either a finance lease or an operating lease.

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The lease liabilities as at January 1, 2019 can be reconciled to the operating lease commitments as of December 31, 2018 as follows:

	<i>(\$'000 unless otherwise stated)</i>
Operating lease commitments as at December 31, 2018	31,169
Weighted average incremental borrowing rate as at January 1, 2019	4.2%
Discounted operating lease commitments at January 1, 2019	23,429
Less:	
Recognition exemption for short-term leases	(8)
Recognition exemption for leases of low-value assets	(35)
Add:	
Extension options reasonably certain to be exercised and other transitional adjustments	10,172
Lease liabilities as at January 1, 2019	<u>33,558</u>

As at January 1, 2019, lease liabilities include an adjustment for \$0.9 million, which was previously recorded in other non-current liabilities as at December 31, 2018.

IMPACTS FOR THE PERIOD

As a result of initially applying IFRS 16, in relation to the leases that were previously classified as operating leases, Tree Island recognized \$29.8 million of right-of-use assets and \$33.0 million of lease liabilities as at September 30, 2019.

In relation to those leases under IFRS 16, Tree Island has recognized depreciation and interest costs, instead of operating lease expense. During the nine month period ended September 30, 2019, Tree Island recognized \$2.0 million of depreciation and \$1.1 million of interest costs from these leases.

Below is a table of the carrying amounts of Tree Island's right-of-use assets and lease liabilities and the related movements during the period:

(\$'000 unless otherwise stated)

	Land & buildings	Machinery & equipment	Total right-of-use assets
Cost			
As at January 1, 2019	33,580	1,512	35,092
Additions	435	1,076	1,511
Disposals	-	(23)	(23)
Foreign exchange translation	(727)	(27)	(754)
As at September 30, 2019	<u>33,288</u>	<u>2,538</u>	<u>35,826</u>
Depreciation and impairment			
As at January 1, 2019	(3,460)	(643)	(4,103)
Depreciation for the period	(1,705)	(281)	(1,986)
Disposals	-	23	23
Foreign exchange translation	61	14	75
As at September 30, 2019	<u>(5,104)</u>	<u>(887)</u>	<u>(5,991)</u>
Carrying value as at			
January 1, 2019	30,120	869	30,989
September 30, 2019	28,184	1,651	29,835

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(\$'000 unless otherwise stated)

	Land & buildings	Machinery & equipment	Total lease liability
Lease liability			
As at January 1, 2019	32,670	888	33,558
New contracts and renewals	435	1,174	1,609
Interest expense	1,011	49	1,060
Payment of lease liability	(1,984)	(457)	(2,441)
Foreign exchange translation	(732)	(15)	(747)
Lease liability as at September 30, 2019	31,400	1,639	33,039
Less: current portion	(1,217)	(427)	(1,644)
Total	30,183	1,212	31,395

4 FUTURE IFRS STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

Tree Island prepares its financial statements in accordance with IFRS standards. At this time, new standards, interpretations or amendments to existing accounting standards are either not applicable or not expected to have a significant impact on Tree Island's consolidated financial statements.

5 REVENUE AND ACCOUNTS RECEIVABLE

Revenue is inclusive of the cost of freight associated with those sales to customers where the Company arranges the freight. For the nine months ended September 30, 2019, this amounts to \$9.1 million (\$12.4 million as of September 30, 2018).

Below is the composition and aging of Tree Island's accounts receivable:

(\$'000 unless otherwise stated)

	As at September 30, 2019	As at December 31, 2018
Current	23,281	20,945
30 - 60 days past due	1,280	1,657
61 - 90 days past due	493	784
Over 91 days past due	1,435	1,066
Total accounts receivable	26,489	24,452
Allowance for doubtful accounts	(247)	(324)
Net accounts receivable	26,242	24,128

Accounts receivable are non-interest bearing and are generally due on 30-day to 90-day terms. The maximum credit risk that Tree Island was exposed to by way of its accounts receivable is equal to the net amount of \$26.2 million as at September 30, 2019 (\$24.1 million as at December 31, 2018).

At the end of each reporting period, a review of the allowance for bad and doubtful accounts is performed. It is an assessment of the expected credit loss associated with trade accounts receivable after the consolidated statement of financial position date. The assessment is made by reference to age, status and risk of each receivable, current economic conditions and historical information. The trade accounts receivable balance is reduced through the use of the allowance for doubtful accounts and the amount of the loss is recognized in the consolidated statement of operations. Reversals to the allowance for doubtful accounts occur when previously allowed for trade accounts receivable are collected. Individual trade accounts receivable, together with any associated allowance previously

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recognized, are written off when there is no realistic prospect of future recovery. Accounts receivable with related parties are discussed in Note 12.

The following table represents a summary of the movement of the allowance for doubtful accounts:

(\$'000 unless otherwise stated)

	As at September 30, 2019	As at December 31, 2018
Opening balance – beginning of period	324	338
Additions during the period	21	134
Reversals during the period	(16)	2
Payments	(15)	(19)
Write-offs during the period	(72)	(143)
Foreign exchange revaluation	5	12
Closing balance – end of period	247	324

See Note 15.1 on credit risk of trade receivables to understand how credit quality of accounts receivable that are neither past due nor impaired are managed and measured.

6 INVENTORIES

Tree Island had the following categories of inventory:

(\$'000 unless otherwise stated)

	As at September 30, 2019	As at December 31, 2018
Raw materials	21,687	27,599
Finished and semi-finished products	30,501	38,558
Consumable supplies and spare parts	13,736	15,462
Total inventory	65,924	81,619

For the three and nine month periods ended September 30, 2019 and 2018, Tree Island recognized, in income, inventory costs for the following:

(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Opening inventory	66,129	65,117	81,619	59,992
Raw material purchases	29,595	46,812	78,774	133,778
Finished goods purchased for resale	901	2,190	4,120	6,051
Conversion costs	12,812	14,425	37,772	46,400
Closing inventory	(65,924)	(80,530)	(65,924)	(80,530)
Cost of sales	43,513	48,014	136,361	165,691

At each period end, the ending inventories on hand are reviewed to determine if a write down to net realizable value is required. Based on this review, it was determined that no write downs were necessary in the three and nine

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months period ended September 30, 2019 and 2018. The reserve for slow moving inventory as at September 30, 2019 was \$1.2 million (\$1.8 million at September 30, 2018).

7 PROPERTY, PLANT AND EQUIPMENT

The carrying value of property, plant and equipment is reviewed each reporting period. For the purposes of testing for impairment, or the reversal of impairment, Tree Island Steel's assets are grouped and tested at the CGU level. Tree Island considers both qualitative and quantitative factors when determining whether an asset may be impaired, or when a reversal of impairment is required. Where the carrying value of the assets is not expected to be recoverable from future cash flows, they are written down to their recoverable amount. Tree Island has noted no indicators of impairment for this reporting period.

From time to time, we make investments to update, replace or make additions to our existing capital assets, which includes, but is not limited to, the buildings we occupy and capital equipment. These investments are in our normal course of business activity. For capital assets, we have committed to purchase but have not yet received the amounts remaining to be paid are recognized as purchase commitments (refer to Note 18.2).

The net book value of the Company's property, plant and equipment is detailed below:

(\$'000 unless otherwise stated)

	Land & Improvement	Building & Improvement	Machinery & Equipment	Capital in Progress	Total
Cost					
As at December 31, 2017	9,695	44,326	30,560	3,909	88,490
Additions	-	608	2,818	5,299	8,725
Disposals	-	(80)	(181)	-	(261)
Foreign exchange translation	174	806	651	141	1,772
As at December 31, 2018	9,869	45,660	33,848	9,349	98,726
Additions	-	1,402	6,774	(6,207)	1,969
Disposals	-	-	(279)	-	(279)
Foreign exchange translation	(63)	(298)	(434)	(198)	(993)
As at September 30, 2019	9,806	46,764	39,909	2,944	99,423
Depreciation and impairment					
As at December 31, 2017	31	32,231	14,538	-	46,800
Depreciation for the period	16	1,271	2,206	-	3,493
Disposals	-	(80)	(134)	-	(214)
Foreign exchange translation	(5)	389	1,033	-	1,417
As at December 31, 2018	42	33,811	17,643	-	51,496
Depreciation for the period	12	1,024	1,537	-	2,573
Disposals	-	-	(156)	-	(156)
Foreign exchange translation	(2)	(147)	(240)	-	(389)
As at September 30, 2019	52	34,688	18,784	-	53,524
Net book value as at					
December 31, 2018	9,827	11,849	16,205	9,349	47,230
September 30, 2019	9,754	12,076	21,125	2,944	45,899

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8 SENIOR CREDIT FACILITY

On July 1, 2018, the Company renewed its senior banking facility with Wells Fargo Capital Finance Corporation Canada ("Wells Fargo"). The five-year senior secured committed banking facility (the "Senior Credit Facility") which matures in June of 2023, may be used for Tree Island's financing requirements in Canadian and/or U.S. dollars, and comprises of the following:

- \$60 million of revolving credit facility;
- \$10 million "Fixed Asset Term Loan" applied against existing term loans; and
- \$10 million "Capex Term Loan" to finance future capital expenditures.

8.1 SENIOR CREDIT FACILITY

The amount advanced under the Senior Credit Facility at any time is limited to a defined percentage of inventories, accounts receivable, machinery and equipment, and real estate, less certain reserves. The Senior Credit Facility is secured by a first charge over Tree Island's assets supported by the appropriate guarantees, pledges and assignments, and requires that certain covenants be met by Tree Island.

The Senior Credit Facility includes a \$10.0 million Letter of Credit sub-facility which enables TI Canada and TI USA to open documentary and standby letters of credit for raw material purchases. There was a \$40 thousand Letter of Credit outstanding as at September 30, 2019.

The amount available under the revolving portion of the Senior Credit Facility is limited to the amount of the calculated borrowing base, less issued Letters of Credit. The borrowing base is calculated as 90% of eligible receivables, plus the lesser of (a) 90% of the net orderly liquidation value of inventory and (b) 70% of eligible inventory.

Interest payable on funds borrowed in Canadian currency is at variable rates based on the Canadian Dollar Offered Rate ("CDOR") for Canadian dollar banker's acceptance. Interest payable on funds borrowed in U.S. currency is at variable rates based on the London Interbank Offered Rate ("LIBOR") for U.S. dollar deposits.

The following amounts are outstanding under the revolving portion of the Senior Credit Facility:

(\$'000 unless otherwise stated)

	As at September 30, 2019	As at December 31, 2018
Revolving portion of the Senior Credit Facility	42,040	49,797
Deferred financing costs	(117)	(182)
Total	41,923	49,615

The revolving portion of the Senior Credit Facility denominated in U.S. dollars as at September 30, 2019 is \$12.0 million (\$21.4 million at September 30, 2018).

Deferred financing costs are included in other non-current assets on the statement of consolidated financial position.

The Senior Credit Facility has financial tests and other covenants with which the Company and its subsidiaries must comply, the primary one being based on the remaining funds within the Senior Credit Facility that is available ("Availability Test"). Only if the Availability Test falls below a certain threshold then other covenants, which include a rolling four quarters defined fixed charge coverage ratio of 1:1, are tested. As well, the Senior Credit Facility contains restrictive covenants that limit the discretion of the Company's management with respect to certain business matters. These covenants place restrictions on, among other things, the ability of the Company's operating subsidiaries to incur additional indebtedness, to create liens or other encumbrances, to pay dividends or make

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certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity.

As at September 30, 2019, the availability was in excess of the Availability Test and the Company was in compliance with its financial covenants on the Senior Credit Facility.

8.2 SENIOR TERM LOANS

Under the terms of the Senior Credit Facility, the Company has designated portions up to a total of \$20 million as two term loans denominated in either Canadian or U.S. dollars, and is available for existing machinery and equipment and future capital expenditures. The existing term debts applied against the Senior Credit Facility was incorporated into a single term loan of \$10 million, denominated in Canadian dollars on July 1, 2018, referred to as "Fixed Asset Term Loan". An additional \$10 million is available to finance future capital expenditures, to be denominated in either Canadian or U.S. dollars and referred to as "Capex Term Loans". On September 24, 2018, \$3.8 million was applied against the Capex Term Loan of the Senior Credit Facility for financing a new concrete mesh machine in our U.S. Operations.

The following amounts are outstanding under the Senior Term Loans:

(\$'000 unless otherwise stated)

	As at September 30, 2019	As at December 31, 2018
Senior term loans - beginning of period	13,335	10,546
Advances	-	3,758
Foreign exchange revaluation	(110)	202
Payments	(1,478)	(1,171)
Senior term loans - end of period	11,747	13,335
Less: current portion	(1,970)	(1,986)
Total	9,777	11,349

9 LONG-TERM DEBT

In June of 2012, the Company entered into long-term debt agreements with a trade creditor. The repayment schedule of the long-term debt extends to June 2028 with principal payments over a 10 year amortization period. The interest is non-compounding interest at 4% and commenced accruing June 2017 and will become payable monthly over 4 years commencing June 2024. Principal payments, which started in 2009, are monthly in the amounts of US \$100k in years 1 and 2, US \$110k in years 3 and 4, US \$120k years 5, 6 and 7, and US \$190k in years 8, 9, 10 and \$90k in years 11, 12 and 13 and there are provisions for making additional principal payments. Present value of the debt was determined using discounted cash flows and a credit adjusted discount rate of 9%. The discount rate, together with the stated interest, comprises the debt discount. Using the effective interest rate method, the debt discount is amortized as accretion and charged to interest expense over the term of the amended long-term debt agreements.

The amounts owing under the long-term debts are denominated in U.S. dollars.

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The elements of the long-term debt are listed below:

(\$'000 unless otherwise stated)

	As at September 30, 2019	As at December 31, 2018
Beginning of period	7,916	8,187
Payments	(1,776)	(1,873)
Foreign exchange revaluation	(231)	671
Accretion of debt discount	604	931
End of period	6,513	7,916
Less: current portion	(2,304)	(2,994)
Net long-term debt	4,209	4,922

10 FINANCING EXPENSES

(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Non-cash accretion of debt discount and interest on long term debt	178	229	603	704
Interest on senior credit facility	388	412	1,272	1,074
Interest on lease liability <i>(Note 3)</i>	354	-	1,070	-
Other interest and financing costs	182	152	618	634
Amortization of deferred financing costs	9	57	27	80
Total	1,111	850	3,590	2,492

11 SHAREHOLDERS' CAPITAL

Tree Island is authorized to issue an unlimited number of Shares. The Shares have no par value. There were no Shares issued in the period and 352,013 Shares were repurchased (totaling \$0.7 million at an average price of \$2.05 per Share) and cancelled in the nine months ended September 30, 2019. Shares issued and outstanding are as follows:

(\$'000 except for Shares)

	Shares	Gross	Issuance Cost ⁷	Net
Shareholders' capital - December 31, 2017	29,649,799	237,377	11,400	225,977
Repurchase of common shares	(466,149)	(1,262)	-	(1,262)
Shareholders' capital - December 31, 2018	29,183,650	236,115	11,400	224,715
Repurchase of common shares	(352,013)	(721)	-	(721)
Shareholders' capital - September 30, 2019	28,831,637	235,394	11,400	223,994

⁷ Issuance costs were incurred as a result of the November 2002 Initial Public Offering and October 2004 Secondary Offering.

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11.1 NORMAL COURSE ISSUER BID

The Company had a normal course issuer bid (the "Bid") effective from September 21, 2018 to September 20, 2019 to purchase up to 1,460,000 Shares. For the period January 1, 2019 to September 30, 2019 the Company purchased 352,013 Shares under the Bid at a total cost of \$0.7 million (at an average price of \$2.05 per Share). All 352,013 Shares were cancelled prior to September 30, 2019.

12 RELATED PARTY TRANSACTIONS

12.1 TRANSACTIONS WITH ASSOCIATED COMPANIES

The Futura Corporation ("Futura") is considered to be a related party to the Company because of its Share ownership interest and the fact that Mr. Doman, the sole shareholder and president of Futura, and Mr. Rosenfeld, the Executive Vice President of Futura, sit on the Board of Directors.

Based on Tree Island Steel's outstanding Shares as at October 24, 2019, Futura owns 30.6% of the fully diluted Shares of the Company.

In addition, Mr. Doman is Chairman and CEO of CanWel Building Materials Group Ltd. ("CanWel"). For the three and nine months ended September 30, 2019, Tree Island sold, net of rebates, approximately \$0.5 million and \$2.3 million respectively (\$0.7 million and \$3.1 million in 2018) of goods to CanWel and trade accounts receivable owing from CanWel as at September 30, 2019 is approximately \$0.1 million (approximately \$0.2 million in 2018). Outstanding trade accounts receivable from CanWel at period end are unsecured, interest free and settlement occurs in cash.

12.2 TRANSACTIONS WITH KEY MANAGEMENT PERSONNEL

Included in the definition of key management for purposes of disclosure of related party transactions are members of Board of Directors and officers of Tree Island Steel. Amounts for key management personnel for the three and nine months ended September 30, 2019 were approximately \$0.5 million and \$1.7 million respectively (approximately \$0.5 million and \$1.5 million in 2018) which includes wages, salaries and social security contributions, paid annual and sick leave, vehicle costs, and bonuses. It also includes directors' fees paid to members of the Board.

13 INCOME TAXES

A provision for income taxes is recognized for Tree Island Steel, TII and its wholly owned subsidiaries.

13.1 INCOME TAX EXPENSE

The income tax expense is divided between current and deferred taxes as follows:

(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Current tax expense	-	(311)	(231)	(311)
Deferred tax (expense) recovery	39	(125)	(1)	(1,814)
Total recorded in the Statement of Operations	39	(436)	(232)	(2,125)

14 FINANCIAL INSTRUMENTS

14.1 FAIR VALUE OF FINANCIAL INSTRUMENTS

Tree Island records certain of its financial instruments at fair value using various techniques. These include estimates of fair values based on prevailing market rates (bid and ask prices, as appropriate) for instruments with similar characteristics and risk profiles or internal or external valuation models, such as discounted cash flow analysis and option pricing models, using, to the extent possible, observable market-based inputs.

The fair values of the financial assets and financial liabilities are included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than a forced or liquidation sale. The following methods and assumptions were used to estimate the fair values:

- Cash, accounts receivable, the revolving portion of the Senior Credit Facility and accounts payable and accrued liabilities approximate their carrying amounts largely due to the short-term nature of these instruments and interest rates being variable for the senior credit facility;
- Fair value on the Company's Senior Term Loans and Long-Term Debt are based on estimated market interest rate on similar borrowings. The carrying value of the Senior Term Loans approximates fair value as the interest rates approximate market. A 1% change in the market interest rate would change the fair value of Long-Term Debt by \$0.2 million and Senior Term Loans by \$0.1 million;
- Fair value of the commodity purchase contract embedded derivatives are estimated using observable spot rates for zinc; and
- Fair value of the forward exchange forward contracts is estimated using observable foreign exchange spot and forward rates. The Company does not consider interest rates or the credit quality of counterparties as significant inputs to the valuation.
- Fair value on the Company's lease liabilities are based on estimated market interest rate on similar borrowings. The carrying value of the lease liabilities approximates fair value as the interest rates approximate market.

(\$'000 unless otherwise stated)

	As at September 30, 2019		As at December 31, 2018	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash investments	1,476	1,476	1,277	1,277
Accounts receivable	26,242	26,242	24,128	24,128
Total financial assets	27,718	27,718	25,405	25,405
Senior revolving facility	42,040	42,040	49,797	49,797
Accounts payable and accrued liabilities	23,622	23,622	22,017	22,017
Senior term loans	11,747	11,747	13,335	13,335
Long-term debt	6,513	6,657	7,916	7,041
Lease liabilities (Note 3)	33,039	33,039	-	-
Total financial liabilities	116,961	117,105	93,065	92,190

14.2 FAIR VALUE HIERARCHY

The financial instruments have been categorized on a fair value hierarchy based on whether the inputs to those valuation techniques are observable (inputs reflect market data obtained from independent sources) or unobservable (inputs reflect the Company's market assumptions).

The three levels of fair value estimation are:

Level 1: Quoted (unadjusted) market prices in active markets for identical assets or liabilities;

Level 2: Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable; and

Level 3: Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

The only financial estimates carried at fair value are commodity purchase derivatives, which are level 2 financial instruments.

15 RISK EXPOSURE AND MANAGEMENT

Tree Island is exposed to various risks associated with its financial instruments. These risks are categorized as credit risk, liquidity risk and market risk.

15.1 CREDIT RISK

Credit risk consists of credit losses arising in the event of non-payment of accounts receivable of customer accounts. However, the credit risk is minimized through selling to well-established customers of high-credit quality. The credit worthiness of customers is assessed using credit scores supplied by a third party and through direct monitoring of their financial well-being on a continual basis. Management establishes guidelines for customer credit limits and should thresholds in these areas be reached, appropriate precautions are taken to improve collectability. Provisions for potential credit losses (allowance for doubtful accounts) are maintained and any such losses to date have been within management's expectations.

15.2 LIQUIDITY RISK

Liquidity arises from our financial obligations and in the management of our assets, liabilities and capital structure. This risk is managed by regular evaluation of our liquid financial resources to fund current and long-term obligations and to meet its capital commitments in a cost-effective manner.

The main factors that affect liquidity include realized sales prices, production levels, cash production costs, working capital requirements, future capital expenditure requirements, scheduled payments on financial liabilities and lease obligations, credit capacity and expected future debt and equity capital market conditions.

Liquidity requirements are met through a variety of sources including cash balances on hand, cash generated from operations, existing credit facilities, and debt and equity capital markets. Management monitors and manages liquidity risk by preparing annual budgets, monthly projections to the end of the fiscal year and regular monitoring of financial liabilities against the constraints of the available revolving credit facilities.

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The table below summarizes the future undiscounted contractual cash flow requirements for financial liabilities (including scheduled interest payments on interest bearing liabilities) as at September 30, 2019 and December 31, 2018:

(\$'000 unless otherwise stated)

	Carrying Amount	Contractual Cash Flow	Less Than 1 Year	1 – 2 Years	Greater Than 2 Years
Senior revolving facility	42,040	42,040	42,040	-	-
Accounts payable and accrued liabilities	23,885	23,885	23,885	-	-
Senior term loans	11,747	11,747	1,970	3,940	5,837
Long-term debt	6,513	9,516	2,304	3,336	3,876
Lease Liability	33,039	49,806	2,987	2,861	43,958
As at September 30, 2019	117,224	136,994	73,186	10,137	53,671
Senior revolving facility	49,797	49,797	49,797	-	-
Accounts payable and accrued liabilities	22,017	22,017	22,017	-	-
Senior term loans	13,335	13,335	1,986	3,972	7,377
Long-term debt	7,916	11,616	2,994	3,028	5,594
As at December 31, 2018	93,065	96,765	76,794	7,000	12,971

15.3 FOREIGN CURRENCY RISK

Tree Island's U.S. dollar-denominated cash, accounts receivable, accounts payable and accrued liabilities, Senior Credit Facility and Long-Term Debt are exposed to foreign currency exchange rate risk because the value of these financial instruments will fluctuate with changes in the U.S./Canadian dollar exchange rate. The Company enters into U.S. dollar currency forward contracts for periods consistent with a portion of U.S. dollar currency transaction exposures, generally from one to three months. These are not designated as cash flow, fair value or net investment hedges. As of September 30, 2019, the Company has US \$0.3 million in US dollar currency forward contracts outstanding.

For the period ending September 30, 2019, a \$0.01 increase (decrease) in the Canadian dollar to U.S. dollar exchange rate will increase (decrease) net comprehensive income by \$17 thousand.

15.4 INTEREST RATE RISK

Tree Island is exposed to interest rate risk on its Senior Credit Facility. Interest payable on the funds advanced under the Senior Credit Facility are based on the Canadian interbank bid rates for Canadian dollar banker's acceptance for Canadian dollar denominated borrowings or the London Inter-Market Offered Rate ("LIBOR") for U.S. dollar deposits for U.S. dollar denominated borrowings.

A 1% increase in the interest rates charged on the Senior Credit Facility would increase financing expenses by \$0.4 million annually. Tree Island does not use derivative instruments to manage the interest rate risk.

15.5 RAW MATERIAL PRICE RISK

Tree Island is exposed to changes in the price of the materials used in its production process and, from time to time, enters into contracts to purchase a portion of the zinc to be used. These are not designated as cash flow, fair value or net investment hedges. As at September 30, 2019, the Company had no outstanding zinc forward contracts.

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For the periods ended September 30, 2019 and 2018

16 MANAGEMENT OF CAPITAL

The Company's objectives when managing its capital are:

- To manage capital in a manner that will comply with the financial covenants on the Senior Credit Facility, Senior Term Loan agreements and Long-Term Debt agreements as described further in Notes 8.1, 8.2 and 9.
- To maintain a capital base so as to preserve and enhance investor, creditor, and market confidence and to sustain viability and future development of the business; and

Management manages the capital structure in accordance with these objectives, with considerations given to changes in economic conditions and the risk characteristics of the underlying assets in particular, by closely monitoring cash flows and compliance with external debt covenants. The table below is what management considers capital:

(\$'000 unless otherwise stated)

	<u>As at September 30, 2019</u>	<u>As at December 31, 2018</u>
Total shareholders' equity	52,408	58,626
Senior revolving facility	42,040	49,797
Senior term loans	11,747	13,335
Long-term debt	6,513	7,916
Lease liability (Note 3)	33,039	-
Total capital	<u>145,747</u>	<u>129,674</u>

17 NET INCOME PER SHARE

Basic earnings per Share amounts are calculated by dividing net income for the year by the weighted average number of Shares outstanding during the year.

Diluted earnings per Share amount is calculated by dividing the net income for the year by the weighted average number of Shares outstanding during the year plus the weighted average number of Shares that would be issued on conversion of all the dilutive potential units into Shares. As at September 30, 2019 the Company does not have any instruments issued that could be dilutive.

The company has repurchased and cancelled 352,013 Shares in the nine months ended September 30, 2019 (Note 11).

The following reflects the income and Share data used in the basic and diluted earnings per Share computations:

(\$'000 unless otherwise stated)

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Net income (loss) for the period	(359)	1,023	(1,991)	4,920
Weighted average number of shares outstanding:	29,162,348	29,327,529	29,107,774	29,473,611
Net income (loss) per share (\$/share)	(0.01)	0.03	(0.07)	0.17

18 PROVISIONS AND COMMITMENTS

18.1 LITIGATION AND CLAIMS

From time to time, Tree Island is party to certain legal actions and claims, none of which individually, or in the aggregate, is expected to have a material adverse effect on its financial position, consolidated statement of operations or cash flows.

18.2 PURCHASE COMMITMENTS

As at September 30, 2019, Tree Island's wholly owned subsidiaries have committed to production material purchases (including finished goods) totalling \$28.9 million (\$21.6 million – September 30, 2018) and capital equipment purchase commitments of \$1.6 million (\$0.6 million – September 30, 2018). The committed product material purchases, which are to be delivered in the fourth quarter of 2019 and first quarter of 2020, and capital equipment purchases, which are to be delivered in 2020, are in the normal course of our business activity.

19 SEGMENTED INFORMATION

19.1 MARKET SEGMENTS

Revenues for each group for the three and nine months ended September 30, 2019 and 2018 were as follows:

(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Industrial	18,037	18,082	49,548	64,139
Commercial	13,252	15,338	40,522	40,422
Agricultural	3,720	4,576	21,831	24,657
Residential	14,692	17,850	43,360	61,206
Total revenue	<u>49,701</u>	<u>55,846</u>	<u>155,261</u>	<u>190,424</u>

Tree Island operates primarily within one industry, the steel wire products industry, with no separately reportable operating segments. Tree Island groups its products into the following: Industrial, Agricultural, Commercial Construction, and Residential Construction. No one customer is more than 10% of total revenue.

19.2 GEOGRAPHIC SEGMENTS

The products are sold primarily to customers in the United States and Canada and are attributed to geographic areas based on the location of customers:

(\$'000 unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
United States	32,199	36,773	90,922	120,003
Canada	16,057	17,872	58,660	65,389
International	1,445	1,201	5,679	5,032
Total revenue	<u>49,701</u>	<u>55,846</u>	<u>155,261</u>	<u>190,424</u>

NOTES TO THE INTERIM UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the periods ended September 30, 2019 and 2018

Non-current assets for this purpose consist of property, plant and equipment, right-of-use assets recognized on the adoption of IFRS 16 (Note 3) and other non-current assets. These assets are attributed to geographic areas based on the locations of the subsidiary company owning the assets and right-of-use assets.

(\$'000 unless otherwise stated)

	September 30, 2019	December 31, 2018
United States	37,943	17,110
Canada	37,908	30,302
Total non-current assets	75,851	47,412

With the adoption of IFRS 16 in 2019, right-of-use assets of \$30.9 million were recognized on January 1, 2019 whereas prior year comparatives were not restated to reflect such right-of-use assets (Note 3). As of September 30, 2019, the right-of-use assets are \$29.8 million.

20 UNSOLICITED NON-BINDING ACQUISITION PROPOSAL

Tree Island Steel announced on June 28, 2019 that it had been advised of the intention of The Futura Corporation and Arbutus Distributors Ltd. (together, the "Offerors"), entities controlled by certain directors of the Company, to make an unsolicited non-binding proposal ("Proposal") by way of a plan of arrangement to acquire all of the common shares of the Company not already owned by the Offerors.

The Board of Directors of the Company appointed a special committee of the board made up entirely of directors who were independent of both management and the Offerors (the "Special Committee"). The Special Committee engaged PwC to prepare a formal valuation of the Company and advise on an appropriate response to the Proposal.

On August 31, 2019, the Special Committee was advised by the Offerors of the withdrawal of their Proposal. As a result of the withdrawal of the Proposal by the Offerors, the engagement of the financial adviser to prepare a formal valuation was terminated by the Special Committee before completion of the valuation and the Special Committee was dissolved.

SHAREHOLDER INFORMATION

TREE ISLAND STEEL
LTD.

Board of Directors:

Amar S. Doman –
Chairman of the Board

Dale R. MacLean

Peter Bull

Harry Rosenfeld

Michael Fitch

Sam Fleiser

Theodore A. Leja

Joe Downes

Leadership Team:

Dale R. MacLean
*President and Chief
Executive Officer*

Remy Stachowiak
Chief Operating Officer

Nancy Davies
*Chief Financial Officer and
Vice President, Finance*

Shares:

Market Information

Tree Island Steel Ltd., is
listed on the Toronto Stock
Exchange trading symbol:
TSL.

Registrar and Transfer Agent

Computershare Investor
Services Inc.

Corporate Head Office:

3933 Boundary Road
Richmond, B.C.
Canada, V6V 1T8

Website:

www.treeisland.com

Investor Relations:

Ali Mahdavi
Investor Relations
(416)-962-3300 or
amahdavi@treeisland.com

Auditors:

KPMG LLP
Vancouver, B.C.

