Hammond Power Solutions Inc.

Q2 Report

For the six months ending June 30, 2018

What's Inside...

Our Vision

To be a leading global supplier of transformers and magnetics within our chosen markets.

Our Mission

We are a growing and profitable global supplier of transformers and related magnetic products dedicated to satisfying the collective needs of our shareholders, customers, suppliers, employees and community.

Our Values

We value the **safety and well-being** of all

We expect **honesty, integrity and ethical behaviour**

We embrace **diversity** by nurturing an inclusive environment and treating everyone with dignity and respect

We promote **innovation** and a relentless pursuit of continuous improvement through teamwork

We believe in **a collaborative approach** to social and environmental sustainability

Fellow shareholder:

Hammond Power Solutions Inc. ("HPS") experienced an unexpected setback during the second quarter which hurt our financial performance. Unforeseen elements came together in the quarter and culminated in a significant drop in profitability. The last six months have seen a significant rise in the costs of key raw materials such as copper and aluminum wire, core steel and insulation, as well as a variety of components used in the manufacturing of transformers. We acted as quickly as possible to increase our prices however there is always a lag time for these increases to take effect with new shipments.

Our financial performance in the quarter was also affected by lower sales than anticipated. The biggest drop in sales was in India where our shipments suffered from several internal execution issues and customer delays. Sales were lower in Europe compared to a year ago, but much of this was the result of a refocusing of the business and closure of one of our plants in Italy.

Despite our disappointing and unexpected Quarter 2, 2018 results, we are very positive about a strong finish to the year. Bookings continue to grow in North America the highest levels of sales in both Canada and the U.S. ever seen. A stronger second half is expected in India as we work through the internal issues that affected our shipments. What is most encouraging is that our backlog continues to grow and sits at unprecedented levels.

We are anticipating that marketing margins will improve during the last half of the year as price increases that have been implemented over the last four months are beginning to flow through to the bottom line. The customer and product mix is expected to drive higher margins as markets using more highly customized transformers like mining, drilling, utility and public infrastructure strengthen in this stage of the economic cycle.

This tough quarter was totally unexpected and although these results are not as predicted, we remain confident in our business model in these volatile times. As we have seen, we are not immune to the challenges facing North American manufacturers but our diversity of geography, markets, channels and products puts HPS in a strong position to weather the volatility and recover moving forward.

William G. Hammond
CHAIRMAN OF THE BOARD & CHIEF EXECUTIVE OFFICER

Grandson of founder Oliver Hammond

Management's Discussion and Analysis

HPS has a strong history of strength, perseverance and resilience.

The Company has navigated through difficult and fluctuating economic times and increased globalization. We have adapted to changes in customers and markets and have experienced significant advances in technology. HPS has framed these challenges as opportunities and developed strategies to address these rapid changes.

Hammond Power Solutions Inc. ("HPS" or the "Company") is a North American leader in the design and manufacture of custom electrical engineered magnetics, standard electrical dry-type, cast resin and liquid filled transformers. Advanced engineering capabilities, high quality products, global reach and fast responsive service to customers' needs have established the Company as a technical and innovative leader in the electrical transformer industry. The Company has manufacturing plants in Canada, the United States (U.S.), Mexico, Italy and India.

The following is Management's Discussion and Analysis ("MD&A") of the Company's consolidated operating results for the six months ended June 30, 2018, and should be read in conjunction with the unaudited Condensed Interim Consolidated Financial Statements of the Company for the second quarter of fiscal 2018. This information is based on Management's knowledge as at August 1, 2018. The Company assumes that the reader of this MD&A has access to and has read the audited Annual Consolidated Financial Statements and MD&A of the Company, contained in our 2017 Annual Report and accordingly, the purpose of this document is to provide a second quarter update to the information contained in the fiscal 2017 MD&A. All amounts are reported under International Financial Reporting Standards ("IFRS"). All amounts in this report are expressed in thousands of Canadian dollars unless otherwise noted. Additional information relating to the Company may be found on SEDAR's website at www.sedar.com, or on the Company's website at www.hammondpowersolutions.com.

Caution regarding forward-looking information

This MD&A contains forward-looking statements that involve a number of risks and uncertainties including statements that relate to among other things, HPS' strategies, intentions, plans, beliefs, expectations and estimates, and can generally be identified by the use of words such as "may", "will", "could", "should", "would", "likely", "expect", "intend", "estimate", "anticipate", "believe", "plan", "objective" and "continue" and words and expressions of similar import. Although HPS believes that the expectations reflected in such forward-looking statements are reasonable, such statements involve risks and uncertainties and undue reliance should not be placed on such statements. Certain material factors or assumptions are applied in making forward-looking statements, and actual results may differ materially from those expressed or implied in such statements. Important factors that could cause actual results to differ materially from expectations include but are not limited to: general business and economic conditions (including but not limited to currency rates); changes in laws and regulations; legal and regulatory proceedings; and the ability to execute strategic plans. HPS does not undertake any obligation to update publicly or to revise any of the forward-looking statements contained in this document, whether as a result of new information, future events or otherwise, except as required by law.

Additional GAAP and Non-GAAP measures

This document uses the terms "earnings from operations" which represents earnings before finance and other costs/(income) and income taxes. "EBITDA" is also used and is defined as earnings before interest, taxes, depreciation and amortization. Operating earnings and EBITDA are some of the measures the Company uses to evaluate the operational profitability. The Company presents EBITDA to show its performance before interest, taxes and depreciation and amortization. Management believes that HPS shareholders and potential investors in HPS use additional GAAP and non-GAAP financial measures, such as operating earnings and EBITDA in making investment decisions about the Company and to measure its operational results. A reconciliation of EBITDA to earnings from operations for the quarters ending June 30, 2018 and July 1, 2017 is contained in the MD&A. EBITDA should not be construed as a substitute for net income determined in accordance with IFRS. "Order bookings" represent confirmed purchase orders for goods or services received from our customers. "Backlog" represents all unshipped customer orders. "Book value per share" is the total shareholders' equity divided by the average outstanding shares. The terms "earnings from operations" "EBITDA", "adjusted EBITDA", "order bookings", "backlog" and "book value per share" do not have any standardized meaning prescribed within IFRS and may not be comparable to similar measures presented by other companies.

Sales

Sales for the quarter-ended June 30, 2018 were $77,393, a decrease of $1,481 or 1.9% from Quarter 2, 2017 sales of $78,874. Year-to-date 2018 sales decreased $770 or 0.5% to $150,466 compared to $151,236 in 2017.

Sales in the United States ("U.S.") increased by $3,063 or 6.8%, finishing at $48,143 for Quarter 2, 2018 compared to $45,080 in Quarter 2, 2017. Year-to-date U.S. sales were $92,855 in 2018 and $87,751 in 2017, an increase of $5,104 or 5.8%. The increase in the Quarter 2, 2018 sales is a result of growth in the North American Electrical Distributor ("NAED"), motor control and switchgear markets, partially offset by softness in the power control and petro chemical markets in the quarter.

Second quarter sales were unfavourably affected by a 4.4% weaker U.S. dollar ("USD") $1.00 USD = $1.29 Canadian dollar ("CAD") compared against $1.00 USD = $1.35 CAD in Quarter 2, 2017. Year-to-date sales were negatively impacted by a 4.4% weaker U.S. dollar - $1.00 USD = 1.28 CAD compared against $1.00 USD = 1.33 CAD in 2017. U.S. sales, when stated in U.S. dollars were $37,334 in Quarter 2, 2018, compared to Quarter 2, 2017 of $33,473, an improvement of $3,861 or 11.5%. Year-to-date U.S. sales stated in U.S. dollars were $73,196 in 2018 compared to $65,737 in 2017, an increase of $7,459 or 11.3%.

Canadian sales were $22,592 for the quarter, an increase of $2,866 or 14.5% from Quarter 2, 2017 sales of $19,726. Year-to-date Canadian sales were $43,312 in 2018 compared to $36,665 in 2017, an increase of $6,647 or 18.1%. Canadian sales experienced improvements in a number of markets this quarter compared to the same quarter last year, specifically NAED, technical services and motor control markets.

International sales for Quarter 2, 2018 finished at $6,658 versus $14,068 in Quarter 2, 2017, a decrease of $7,410 or 52.7%. Year-to-date international sales were $14,299 in 2018 compared to $26,820 in 2017, a decrease of $12,521 or 46.7%.

Italian sales were $1,974 in Quarter 2, 2018 as compared to $5,383 in Quarter 2, 2017, a decrease of $3,409 or 63.3%, and $4,650 year-to-date versus $10,167 year-to-date 2017 a decrease of $5,517 or 54.3% as vacuum pressure impregnated ("VPI") product sales have significantly reduced mainly due to the sale of the VPI business in November 2017.

India sales were $4,684 versus $8,685, a reduction of $4,001 or 46.1% due to a delay in delivery to several Original Equipment Manufacturer ("OEM") shipments and year-to-date sales were $9,649 for 2018 versus $16,653 in 2017 a change of $7,004 or 42.1%.

Quarter 2, 2018 sales stated by geographic segment were derived from U.S. sales of 62.2% (Quarter 2, 2017 – 57.2%) of total sales, Canadian sales of 29.2% (Quarter 2, 2017 – 25.0%), and International sales of 8.6% (Quarter 2, 2017 – 17.8%).

The Company continues to realize growth in the North American market through its strong NAED and OEM channels, its expanded product offerings, organic customer diversity, new customer additions, geographically diverse manufacturing capabilities and global market reach. The Company's market diversification strategy is not single-market or industry dependent, resulting in a natural business hedge as some markets grow while others decline.

HPS' commitment to its growth strategy is evidenced by its business development activities, capital investment and vertical integration strategies. HPS' recent restructuring activities will ensure HPS remains competitive and able to respond to customer needs. The Company will continue to focus on providing exceptional value to our customers through product breadth, competitive customer engineered designs, uncompromised quality and new product development.

These factors, combined with multi-national manufacturing capabilities and a strong distribution channel will continue to be a competitive advantage to the Company and key to revenue growth.

Order bookings and backlog

The Company increased bookings 7.3% over Quarter 2, 2017 due to stronger bookings in both the direct and distributor channels in North America.

Booking rates in the distributor channel increased 11.4% over Quarter 2, 2017. On a direct channel basis, bookings were higher than Quarter 2, 2017 by 3.8%. Stronger bookings in both the U.S. and Canadian markets were experienced as the Company continues to grow market share in our traditional markets via both the distribution and direct OEM channels, particularly power conditioning, mining, oil drilling and construction.

On a year-to-date basis overall Company bookings have increased 5.5% over the same period as last fiscal year. The distributor channel bookings increased 14.9% and the direct channel bookings are lower by 2.1%, due to lower bookings in the Italian operation with the sale of the VPI business in 2017.

Backlog increased 20.0% over Quarter 2, 2017. The company has experienced increased order activity from North American distributor and OEM customers in mining, oil drilling and the project/construction markets.

Quotation activity continues to be active – a good indicator of future sales. It is expected the combination of the Company's strategic sales initiatives, expanded distributor footprint and new product development will translate into a rise in booking rates.

HPS is sensitive to the volatility and unpredictability of current global economies and the impact that this will have on booking trends. While several markets are seeing positive quotation and order trends, the Company is cognizant that it may see some volatility and unpredictability in longer term booking rates.

Gross margin

The gross margin rate for Quarter 2, 2018 was 22.5% compared to a Quarter 2, 2017 gross margin rate of 25.0%, a decline of 2.5% of sales. Year-to-date the gross margin rate was 22.9% in 2018 versus 24.7% in 2017, a decrease of 1.8%. The weakening in the year-to-date margin rate can be attributed to the inability to recover material cost increases due to severe selling price pressures, the negative impact a stronger Canadian dollar has on our Canadian produced U.S. sales, rising/volatile commodity costs and sales mix. The Company implemented price increases late in the first quarter to offset material cost increases but the full impact of these price increases have not yet been fully realized. There continues to be downward pricing pressures as a result of ongoing and prolonged industry overcapacity. HPS continues to experience competitor short-sighted pricing strategies but is confident in our value-added engineered solutions that provide the customer with quality products and exceptional customer service.

The quarter quotation activity, backlog growth and consistent sales continue to provide certain indications of financial performance improvement. Fluctuating markets, pricing pressures and product mix can have significant impacts on financial results. Looking forward, the Company remains cautiously optimistic it will realize growth in some markets and a decline in others underscoring the volatility of markets and sales demand. The uncertain economic environment has negatively impacted margin rates from a price realization and manufacturing capacity utilization perspective. To mitigate this effect, the Company has utilized a number of cost reduction activities, continues to actively advance its geographic presence and invest in new product development.

Currently, the Company's diversified geographic approach supports anticipated growth from implemented market strategies and eventual economic improvement. As sales grow, the favourable impact that higher manufacturing throughput will have on the absorption of factory overheads, will favourably impact margin rates. The Company's capacity strategy is fundamental for future increases in sales demand created through growth of market share and sales from newly developed products.

HPS continues to implement productivity enhancements, cost reductions and lead-time improvements across the entire organization. The Company is confident that these actions will enhance margin rates and overall profitability.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

Selling and distribution expenses

Total selling and distribution expenses were $8,641 in Quarter 2, 2018 or 11.2% of sales versus $8,627 in Quarter 2, 2017 or 10.9% of sales, a minimal increase of $14 and an increase 0.3% of sales. Year-to-date selling and distribution expenses were $17,246 or 11.5% of sales in 2018 compared to $16,832 or 11.1% in 2017, an increase of $414 and 0.4% of sales. The year-over-year increase in selling and distribution expenses is a result of higher variable freight and commission expenses attributable to the higher sales volume early in the year.

General and administrative expense

General and administrative expenses for Quarter 2, 2018 totaled $6,677 or 8.6% of sales, compared to Quarter 2, 2017 expenses of $6,128 or 7.8% of sales, an increase of $549 or 0.8% of sales. Year-to-date general and administrative expenses were $13,175 or 8.8% of sales in 2018, compared to $12,366 or 8.2% of sales in 2017, an increase of $809 or 0.6% of sales. The increase in the quarter and year-to-date general and administrative expenses is a result of International strategic investments in people to focus on revenue generation and operation efficiencies.

Earnings from operations

Quarter 2, 2018 earnings from operations were $1,561 a decrease of $3,392 or 68.5% from $4,953 for the same quarter last year. The year-to-date earnings from operations were $3,534 in 2018 compared to $7,358 in 2017, a decrease of $3,824 or 52.0%. The change in the quarter is a result of restructuring charges and non-recurring operating expenses associated with our Italian operation, decreased sales which were negatively impacted by the sales loss attributed to the sale of the Italian VPI portion of the business, lower Indian OEM shipments, a reduced gross margin rate and higher selling and administrative expenses. The year-to-date earnings from operations change was primarily as a result of decreased sales which were negatively impacted by the sales loss attributed to the sale of the Italian VPI portion of the business, lower Indian OEM shipments, lower gross margin rate and higher selling and administrative expenses.

Earnings from operations are calculated as outlined in the following table:

	Quarter 2, 2018	Quarter 2, 2017	YTD 2018	YTD 2017
Net (loss) earnings	$ (370)	$ 2,842	$ 525	$ 3,926
Add:				
Income tax expense	772	1,559	1,404	2,207
Interest expense	338	286	684	602
Foreign exchange loss (gain)	255	(22)	93	45
Share of loss of investment in joint venture	479	255	758	512
Other	37	33	70	66
Earnings from operations	$ 1,561	$ 4,953	$ 3,534	$ 7,358

Interest expense

Interest expense for Quarter 2, 2018 was $388, an increase of $102 or 35.7% compared to the Quarter 2, 2017 expense of $286. Year-to-date interest cost was $684, an increase of $82 or 13.6% when compared to the 2017 year-to-date expense of $602. Interest expense year-to-date in 2018 was generated as a result of lower net earnings and higher operating debt levels due to working capital requirements, particularly created by a rise in accounts receivable and inventory. Interest expense includes all bank fees.

Foreign exchange gain/loss

The foreign exchange loss in Quarter 2, 2018 was $255. This loss relates primarily to the transactional exchange pertaining to the Company's U.S. dollar trade accounts payable in Canada compared to a foreign exchange gain of $22 in Quarter 2, 2017. The year-to-date foreign exchange loss for 2018 was $93, compared to $45 for the same period last year. The earnings impact of the foreign exchange gains and losses are related to the increased volatility in the exchange rates during the past year.

As at June 30, 2018, the Company had outstanding foreign exchange contracts in place for 15,850 Euros ("EUR") and $9,000 USD – both implemented as an economic hedge against translation gains and losses on inter-company loans as well as $40,000 USD to economically hedge the U.S. dollar denominated accounts payable in Canadian HPS operations.

Income taxes

Quarter 2, 2018 income tax expense was $772 as compared to $1,559 in Quarter 2, 2017, a decrease of $787 or 50.5%. Year-to-date income tax expense was $1,404 in 2018 and $2,207 in 2017, a decrease of $803 or 36.4%.

The consolidated effective tax rate for Quarter 2, 2018 was 192.0% versus 35.4% for Quarter 2, 2017, an increase of 156.6%. The year-to-date effective tax rate for the first six months of 2018 was 72.8% compared to 36.0% for the same period in 2017, an increase of 36.8%. The changes in the effective tax rates are greatly impacted by changes in the earnings mix of the Company and the share of the loss of investment in joint venture. The Company income is generated from different tax jurisdictions and is subject to different tax rates and regulations. Although there is a net loss in our Italian operation, the Italian entity is unable to reduce the loss by the amount of taxes recoverable and is subject to a minimum tax expense. The impact on consolidated taxes is approximately $500 for the quarter and $815 year-to-date. Adjusting for this, the overall tax would drop to approximately 68% for the quarter and 30.5% year-to-date.

Deferred tax assets and liabilities consisting mainly of reserves and allowances are related to temporary differences on current assets and liabilities, and are not deductible against current year earnings. Deferred tax assets and liabilities relate to temporary differences resulting from intangible assets and the difference between the net book value and un-depreciated capital cost of property, plant and equipment.

Net loss/earnings

Net loss for Quarter 2, 2018 finished at $370 compared to net earnings of $2,842 in Quarter 2, 2017, a decrease of $3,212 or 113.0%. Year-to-date net earnings were $525 in 2018 compared to $3,926 in 2017, a decrease of $3,401 or 86.6%. The change in the quarter is a result of restructuring charges and non-recurring operational expenses associated with our Italian operation, decreased sales which were negatively impacted by the sales loss attributed to the sale of the Italian VPI portion of the business and lower Indian OEM shipments, a reduced gross margin rate and higher selling and administrative expenses.

The decline in year-to-date earnings is a result of decreased sales which were negatively impacted by the sales loss attributed to the sale of the Italian VPI portion of the business and lower Indian OEM shipments, sales mix, lower gross margin rate, higher selling and administrative expenses, increased losses on investment in the joint venture and a higher effective tax rate.

Excluding the share of loss of investment in joint venture, adjusted net earnings for the quarter would have been $109 and Quarter 2, 2017 earnings would have been $3,097, a decrease of $2,988 or 96.5%. Year-to-date adjusted net earnings would have been $1,283, in 2018 and $4,438 in 2017, a decrease of $3,155 or 71.1%.

Earnings per share

The basic loss per share was $0.03 for Quarter 2, 2018, a decrease of $0.28 from prior year basic earnings per share of $0.25. Adjusting for the share of loss of investment in the joint venture the basic earnings per share would have been $0.01 as compared to $0.27 earnings per share in Quarter 2, 2017. Year-to-date the basic earnings per share was $0.05 in 2018 and $0.34 in 2017. Adjusting for the share of loss of the investment in the joint venture the year-to-date basic earnings per share would have been $0.11 as compared to $0.38 as of Quarter 2, 2017.

EBITDA

EBITDA for Quarter 2, 2018 was $2,184 versus $6,273 in Quarter 2, 2017, a decrease of $4,089 or 65.2%. Adjusted for foreign exchange gains and losses, adjusted EBITDA for Quarter 2, 2018 was $2,439 versus $6,251 in Quarter 2, 2017, a decrease of $3,812 or 61.0%.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

Year-to-date EBITDA was $5,815 in 2018 and $10,175 in 2017, a decrease of $4,360 or 42.9%. Adjusted year-to-date EBITDA was $5,908 in the current year, a decrease of $4,312 and 42.2% from $10,220 in 2017.

EBITDA and adjusted EBITDA is calculated as outlined in the following table:

	Quarter 2, 2018	Quarter 2, 2017	**YTD 2018**	YTD2017
Net (loss) earnings	$ (370)	$ 2,842	$ 525	$ 3,926
Add:				
Interest expense	388	286	684	602
Income tax expense	772	1,559	1,404	2,207
Depreciation and amortization	1,394	1,586	3,202	3,440
EBITDA	$ 2,184	$ 6,273	$ 5,815	$ 10,175
Add (deduct):				
Foreign exchange loss (gain)	255	(22)	93	45
Adjusted EBITDA	$ 2,439	$ 6,251	$ 5,908	$ 10,220

Summary of Quarterly Financial Information (Unaudited)

Fiscal 2018 Quarters	Quarter 1, 2018	Quarter 2, 2018	YTD Total
Sales	$ 73,073	$ 77,393	$ 150,466
Net earnings (loss)	$ 895	$ (370)	$ 525
Net income (loss) per share – basic	$ 0.08	$ (0.03)	$ 0.05
Net income (loss) per share – diluted	$ 0.08	$ (0.03)	$ 0.05
Average U.S. to Canadian exchange rate	$ 1.2618	$ 1.2895	$ 1.2757

Fiscal 2017 Quarters	Q1, 2017	Q2, 2017	Q3, 2017	Q4, 2017	Total
Sales	$ 72,362	$ 78,874	$ 74,685	$ 75,829	$ 301,750
Net earnings	$ 1,084	$ 2,842	$ 1,563	$ 625	$ 6,114
Net income per share – basic	$ 0.09	$ 0.25	$ 0.14	$ 0.05	$ 0.53
Net income per share – diluted	$ 0.09	$ 0.25	$ 0.14	$ 0.04	$ 0.52
Average U.S. to Canadian exchange rate	$ 1.3225	$ 1.3468	$ 1.2531	$ 1.2704	$ 1.2982

Quarter 2, 2018 sales were consistent with previous years' sales levels. There continues to be significant downward pricing pressures, fluctuations in sales volumes in several markets and profitability is extremely sensitive to sales mix. Sales to-date in 2018 experienced a decline in U.S. exchange rates while 2017 was positively impacted by favourable changes in rates. Currency changes resulted in a significant increase in foreign exchange losses for the first six months of 2018 to $93 compared to $45 as of the second quarter of 2017. The loss for Quarter 2, 2018 was $255 compared to a gain of $22 in Quarter 2, 2017.

The Company continues to identify opportunities for savings to control expenses and improve profitability. Quarter 2, 2018 included restructuring expenses of $560 versus $0 for Quarter 2, 2017. Year-to-date restructuring expenses for 2018 are $560 as compared to $816 year-to-date 2017.

Corefficient, our joint venture that manufactures transformer cores, had a loss of $758 year-to-date for 2018 compared to year-to-date losses in 2017 of $512, an increase of $246. The increased loss is compounded as a result of the inability to tax effect the pretax losses. Excluding the share of loss of investment in joint venture, net earnings for the quarter would have been $109, and Quarter 2, 2017 earnings would have been $3,097 a change of $2,988 or 96.5%. Year-to-date net earnings would have been $1,283 in 2018 and $4,438 in 2017, a decrease of $3,155 or 71.1%.

Competitive pricing pressures, challenging market conditions, product mix, and a weakened Canadian dollar all have an impact on the year-to-year quarterly fluctuations for both sales and income.

Capital resources and liquidity

Net cash generated by operating activities for Quarter 2, 2018 was $972 versus $2,315 in Quarter 2, 2017, a decline of $1,343. Year-to-date net cash used in operating activities was $935 compared to $5,307 in 2017, a decrease of $4,372. This change is a result of a decrease in income tax payments and a decrease in the cash used for working capital.

During the quarter, non-cash working capital used cash of $275 compared to $1,746 for the same quarter last year. The year-to-date change in non-cash working capital was a usage of cash of $5,970 in 2018 compared to $13,201 in 2017. The working capital changes are primarily related to an increase in inventory and accounts receivable and foreign exchange impacts on working capital changes.

Cash used in investing activities increased by $733 from $1,639 in the first six months of 2017 to $2,372 in the same period of 2018. One key driver of this change was the current year purchase of the remaining 15% minority interest in the Indian operation in the amount of $1,511. The remainder of the change is a result of the no cash funding requirement of the Corefficient joint venture in 2018 compared to $626 in 2017. Capital expenditures were $358 in Quarter 2, 2018 compared to $348 for Quarter 2, 2017, an increase of $10. Year-to-date capital expenditures were $703 in the current year compared to $868 in 2017, a decrease of $165. The Company continues to invest in the areas of manufacturing processes and capabilities and new product development.

Total cash provided by financing activities for Quarter 2, 2018 was $86 as compared to cash used of $8,342 in Quarter 2, 2017. The source of this change was higher borrowing in Quarter 2, 2018 from the bank operating lines of credit to fund changes in working capital. Year-to-date financing activities generated cash of $3,784 compared to cash used of $12,635 in the first six months of 2017. Bank operating lines of credit have increased from prior year levels finishing Quarter 2, 2018 at $33,285 compared to $25,878 at the end of Quarter 2, 2017, an increase of $7,407. The bank operating lines of credit have increased $5,530 since the year-end balance of $27,755, and increased $972 since the Quarter 1, 2018 balance of $32,313.

The Company's overall operating debt balance net of cash was $21,578 in Quarter 2, 2018 compared to $20,416 in Quarter 2, 2017, an increase in debt position of $1,162 primarily reflective of decreased funding of the joint venture, lower tax payments, offset with higher working capital usage.

All bank covenants continue to be met as at June 30, 2018.

The Company will utilize its cash generated from operations combined with the existing available credit facilities to finance ongoing business operational cash requirements for working capital, capital expenditures and investing activities going forward.

Contractual obligations

	2018	2019	2020	2021	2022	Total
Operating leases	$ 2,094	$ 1,622	$ 571	$ 167	$ 128	$ 4,582
Accounts payable and accrued liabilities	46,110	–	–	–	–	$ 46,110
Capital expenditure purchase commitments	79	–	–	–	–	$79
Bank operating lines	–	–	–	33,285	–	$ 32,285
Total	$ 48,283	$ 1,622	$ 571	$ 33,452	$ 128	$ 84,056

Contingent liabilities

In June 2017, the Corporation received notice of an environmental claim from the owner of a property located nearby to a property that was once partially owned by the Corporation. At this time the Company feels that there is no merit to the claim.

Management is not aware of any contingent liabilities.

Regular quarterly dividend declaration

The Board of Directors of HPS declared a quarterly cash dividend of six cents ($0.06) per Class A Subordinate Voting Share of HPS and a quarterly cash dividend of six cents ($0.06) per Class B Common Share of HPS payable on June 20, 2018 to shareholders of record at the close of business on June 13, 2018. The ex-dividend date was June 19, 2018. The Company has paid a cash dividend of twelve cents ($0.12) per Class A Subordinate Voting Share and twelve cents ($0.12) per Class B Common Share year-to-date.

Controls and procedures

The Chief Executive Officer and the Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures and for establishing and maintaining adequate internal controls over financial reporting. The control framework used in the design of disclosure controls and procedures and internal control over financial reporting is the 2013 Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("2013 COSO Framework"). Our internal control system was designed to provide reasonable assurance to our Management and Board of Directors regarding the preparation and fair presentation of published financial statements in accordance with International Financial Reporting Standards. All internal control systems, no matter how well designed, have inherent limitations. Therefore even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

During Quarter 2, 2018 there were no material changes identified in HPS' internal controls over financial reporting that had materially affected, or was reasonably likely to materially affect HPS' internal control over financial reporting. HPS does carry out ongoing improvements to its internal controls over financial reporting but nothing considered at a material level.

Risks and uncertainties

The Company's goal is to proactively manage risks in a structured approach in conjunction with strategic planning, with the intent to preserve and enhance shareholder value. However, as with most businesses, HPS is subject to a number of market place, industry and economic-related business risks, which could cause our results to vary materially from anticipated future results. The Company is acutely cognizant of these risks and continually assesses the current and potential impacts that they have on the business. HPS continuously strives to curtail the negative impact of these risks through diversification of its core business, market channel expansion, breadth of product offering, geographic diversity of its operations and business hedging strategies. If any of the following risks were to occur they could materially adversely affect the HPS' financial condition, liquidity or results of operations.

These risks include:

We may not realize all of the anticipated benefits of our acquisitions, divestures, joint ventures or strategic initiatives, or these benefits may take longer to realize than expected. In order to be profitable, the Company must successfully execute upon its strategic initiatives and effectively manage the resulting changes in its operations. The Company's assumptions underlying its strategic plans may be subjective, the market may react negatively to these plans and HPS may not be able to successfully execute these plans, and even if successfully executed, its actions may not be effective or may not lead to the anticipated benefits within the expected time frame.

These strategic initiatives can include acquisitions and joint ventures. To be successful, management will conduct due diligence to identify valuation issues and potential loss contingencies, negotiate transaction terms, complete complex transactions and manage post-closing matters such as the integration of acquired startup businesses. Management's due diligence reviews are subject to the completeness and accuracy of disclosures made by third parties. The Company may incur unanticipated costs or expenses following a completed acquisition, including post-closing asset impairment charges, expenses associated with eliminating duplicate facilities, litigation or other liabilities.

Many of the factors that could have an adverse impact will be outside of management's control and could result in increased costs and decreases in the amount of expected revenues and diversion of management's time and attention. Failure to implement an acquisition strategy, including successfully integrating acquired businesses, could have an adverse effect on our business, financial condition and result of operations.

We sell to customers around the world and have global operations and, therefore, are subject to the risks of doing business in many countries.
We do business in a host of countries around the world. Approximately 75% of our sales were to customers outside of Canada. In addition, a number of our manufacturing operations, suppliers and employees are located in many places around the world. The future success of our business depends in large part on growth in our sales in non-Canadian markets. Our global operations are subject to numerous financial, legal and operating risks, such as political and economic instability; prevalence of corruption in certain countries; enforcement of contract and intellectual property rights and compliance with existing and future laws, regulations and policies, including those related to tariffs, investments, taxation, trade controls, product content and performance, employment and repatriation of earnings.

Our global business translates into conducting business in various currencies, all of which are subject to fluctuations.
HPS' global footprint exposes the Company to currency fluctuations and volatility and at times, has had a significant impact on the financial results of the Company. The Company's functional currency is the Canadian dollar with its operating results reported in Canadian dollars. A significant portion of Company's sales and material purchases are denominated in U.S. dollars. There is a natural hedge, as sales denominated in U.S. dollars are partially offset by the cost of raw materials purchased from the U.S. and commodities tied to U.S. dollar pricing. A change in the value of the Canadian dollar against the U.S. dollar will impact earnings significantly at times. Generally a lower value for the Canadian dollar compared to the U.S. dollar will have a beneficial impact on the Company's results while a higher value for the Canadian dollar compared to the U.S. dollar will have a corresponding negative impact on the Company's profitability.

HPS has partially reduced the impact of foreign exchange fluctuations by increasing our U.S. dollar driven manufacturing output, periodically instituting price increases to help offset negative changes and entering into forward foreign exchange contracts.

Worldwide, HPS is subject to and required to comply with multiple income and other taxes, regulations and is exposed to uncertain tax liabilities risk.
The Company operates and is subject to income tax and other forms of taxation in numerous tax jurisdictions. Taxation laws and rates, which determine taxation expense, may vary significantly in different jurisdictions and legislation governing taxation laws and rates is also subject to change. Therefore, the Company's earnings may be impacted by changes in the proportion of earnings taxed in different jurisdictions, changes in taxation rates, changes in estimates of liabilities and changes in the amount of other forms of taxation. Tax structures are subject to review by both domestic and foreign taxation authorities. The determination of the consolidated tax provision and liabilities requires significant judgment. Tax filings are subject to audits, which could materially change the amount of current and deferred income tax assets and liabilities.

We face the potential harms of natural disasters, pandemics, acts of war, terrorism, international conflicts or other disruptions to our operations.
Our business depends on the movement of goods around the world. Natural disasters, pandemics, acts or threats of war or terrorism, international conflicts, political instability and the actions taken by governments could cause damage to or disrupt our business operations, our suppliers or our customers and could create economic instability. Although it is not possible to predict such events or their consequences, these events could decrease demand for our products or make it difficult or impossible to deliver our products.

The U.S. political uncertainty and potential for changes in the business environment can lead to legislative changes that could impact business.
The results of the last U.S. election have created a number of geopolitical risks that could be challenging for the Company. The impact of these political changes can be difficult to predict and can have a pervasive impact on the global business climate. Changes in political leaders can impact trade relations as well as taxes and/or duties. The Company's current structure includes a significant amount of business that crosses borders and any changes in the current trade structure could have a material impact for the Company. The Company's global footprint will be critical to mitigating any impact for political changes that would modify the current trade relationships.

Our industry is highly competitive.
HPS faces competition in all of our market segments. Current

and potential competitors may have greater brand name recognition, more established distribution networks, access to larger customer bases and substantially greater financial, distribution, technical, sales and market, manufacturing and other resources than HPS. As a result, those competitors may have advantages relative to HPS; including stronger bargaining power with suppliers that may result in more favourable pricing, the ability to secure supplies at time of shortages, economies of scale in production, the ability to respond more quickly to changing customer demands and the ability to devote great resources to the development, promotion and sales of their products and services. If the Company is unable to compete effectively, it may experience a loss of market share or reduced profitability. We expect the level of competition to remain high in the future.

Our business is highly sensitive to global and regional economic conditions in the industries we serve.
Current global economic conditions influence the Company's focus, direction, strategic initiatives and financial performance. To address the current uncertainty we are focusing our efforts on projects that will increase our market reach, advance our cost competiveness, expand capacity and improve our manufacturing flexibility.

The Company believes that being an agile organization will hold even greater importance in order to respond quickly to both unexpected opportunities and challenges. HPS' management believes that the key to expanding our market share during this economic slowdown is growing our access to a variety of domestic and global markets. This will be achieved through our current and new OEM and distributor channels.

The disruption to businesses that can come from unpredictable weather can have an impact on sales volume as customer projects can be delayed or cancelled.
Extreme weather conditions such as heavy rains, flooding, snowfall, tornadoes and hurricanes can potentially have a negative impact on the Company's sales trends and booking rates. When these conditions are present the Company may see short-term effects of such occurrences due to their unpredictability. This may impact delivery and capacity requirements.

The business practice of extending credit to customers can lead to a risk of un-collectability.
A substantial portion of the Company's accounts receivable are with customers in manufacturing sectors and are subject to credit risks normal to those industries. The Company's expansion into emerging markets increases credit risk, which is partially mitigated by progress payments. Approvals are based on trade information, payment history, credit rating and financial analysis. Although the Company has historically incurred very low bad debt expense, the current economic environment conditions elevate this exposure.

Market supply and demand impact on commodity prices.
An area that has a definite impact on the Company's costs and earnings is the cyclical effects and unprecedented market cost pressures of both copper commodity and steel pricing in the global markets. This risk is mitigated through strategic supply line agreements and alliances in place with major steel suppliers to ensure adequate supply and competitive market pricing.

Off-balance sheet arrangements

The Company has no off-balance sheet arrangements, other than operating leases disclosed in Notes to the Consolidated Financial Statements contained in our 2017 Annual Report.

Transactions with related parties

The Company had no transactions with related parties in 2018, other than transactions disclosed in Note 12 in the Condensed Notes to the Condensed Consolidated Interim Financial Statements contained in our Quarter 2, 2018 Report.

Proposed transactions

The Company continues to evaluate strategic business development initiatives and has no firm transactions as at June 30, 2018 other than disclosed in subsequent events.

Financial instruments

As at June 30, 2018, the Company had outstanding foreign exchange contracts in place for 15,850 EUR and $9,000 USD with both implemented as a hedge against translation gains and losses on inter-company loans as well as $40,000 USD to hedge the U.S. dollar denominated accounts payable in Canadian operations of HPS.

Critical accounting estimates

The preparation of the Company's condensed consolidated interim financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. These estimates are based upon Management's historical experience and various other assumptions that are believed by Management to be reasonable under the circumstances.

Such assumptions and estimates are evaluated on an ongoing basis and form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates. The Company assesses the carrying value of its property, plant and equipment, intangible assets and goodwill every year - or more often if necessary. If it is determined that we cannot recover the carrying value of an asset or goodwill, the unrecoverable amount is written off against current earnings. The Company bases its assessment of recoverability on assumptions and judgments about future prices, demand and manufacturing costs. A material change in any of these assumptions could have a significant impact on the potential impairment and/or useful lives of these assets.

Outstanding share data

Details of the Company's outstanding share data:

8,971,624	Class A Shares
2,778,300	Class B Common Shares
11,749,924	Total Class A and B Shares

There have been no material changes to the outstanding share data as of the date of this report.

New accounting pronouncements

The International Accounting Standards Board has issued the following Standards, Interpretations and Amendments to Standards that are not yet effective and while considered relevant to the Company, the Company has not yet adopted these Standards.

Leases

On January 13, 2016 the IASB issued IFRS 16 Leases. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities from all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted including the definition of a lease. The Group intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning on January 1, 2019. The Company has identified a complete inventory of contracts impacted by this standard and is in the process of evaluating potential software to manage the upcoming change. The extent of the impact of adoption of this standard is in the process of being determined.

Uncertainty over Income Tax Treatments

On June 7, 2017 the IASB issued IFRIC Interpretation 23, Uncertainty over Income Tax Treatments. The Interpretation provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances, which there is uncertainty over income tax treatments. The Interpretation is applicable for annual periods beginning on or after January 1, 2019. Earlier application is permitted.

The Interpretation requires:

- An entity to contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better prediction of the resolution;
- An entity to determine if it is probable that the tax authorities will accept uncertain tax treatment; and
- If it is not probable that the uncertain tax treatment will be accepted, measure the tax uncertainty based on the most likely amount or expected value depending on whichever method better predicts the resolution of the uncertainty.

The Group intends to adopt the Interpretation in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the Interpretation has not yet been determined.

Transfer of Assets between an Investor and its Associate or Joint Venture

On September 11, 2014 the IASB issued Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28). The amendments were to be applied prospectively for annual periods beginning on or after January 1, 2016, however, on December 17, 2015 the IASB decided to defer the effective date for these amendments indefinitely. Adoption is still permitted.

The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28 (2011), in dealing with the sale or contribution of assets between an investor and its associate or joint venture (JV). Specifically under the existing consolidation standard the parent recognises the full gain on the loss of control, whereas under the existing guidance on associates and JV's the parent recognises the gain only to the extent of unrelated investors' interests in the associate or JV.

The main consequence of the amendments is that a full gain/loss is recognised when the assets transferred meet the definition of a 'business' under IFRS 3 Business Combinations. A partial gain/loss is recognized when the assets transferred do not meet the definition of a business even if these assets are housed in a subsidiary.

The Group does not intend to adopt these amendments in its financial statements for the annual period beginning January 1, 2018, as the effective date for these amendments has been deferred indefinitely.

Strategic direction and outlook

HPS has a long history of strength, perseverance and resilience.

The Company has navigated through difficult and fluctuating economic times, increased globalization, adapted to changes in customers and markets and has experienced significant advances in technology. HPS has framed these challenges as opportunities and developed strategies to address these rapid changes.

The Company is continuously building our strategic advantage by focusing on:

- Investing in capital and its employees;
- Disciplined cost management initiatives;
- Sales development;
- Broadened product offering;
- Bringing quality and value to all stakeholders of the Company;
- Identifying and pursuing additional sales opportunities with both existing as well as new customers;
- Cash flow generation;
- Product development; and
- Capital expansion.

The Company purchased the final minority interest of our Indian operation and now owns 100% of this subsidiary. This purchase allows management to make appropriate strategic decisions from a global perspective.

A significant change for the Company was the implementation of an Enterprise Resource Planning ("ERP") system that has enhanced availability and quality of information accessible as well as streamlining processes. This system has been implemented in the majority of our North American facilities and phase one for the implementation in our Indian operation is scheduled to go live mid Quarter 3, 2018. This newest addition to the ERP platform is an important step towards providing one global, integrated, consistent source of information and data.

HPS continues to focus on customer service and expanding existing relationships while exploring new opportunities. The upcoming Natural Resources Canada (NRCan) efficiency standard change has created opportunities for the Company to deliver to our customers and ensure their needs and regulations are being met. These regulation changes have resulted in new product development and manufacturing techniques.

The Company has state-of-the art facilities throughout the world that continue to be enhanced through capital investment. This is further evidence of HPS' strategic investment in facilities and technology, which also supports the Company's cost competitiveness and manufacturing capabilities.

The Company achieved disappointing results during the first half of 2018. The unpredictable and erratic global economic climate continues to have a pervasive, persistent and inconsistent impact on HPS' profitability. The Company continues to experience the adverse impact of variability of foreign currency exchange rates, rising raw material commodity costs, fluctuating manufacturing throughput and market pricing pressures. Management continues to manage these challenges through the Company's operational plans and strategic initiatives and projects.

HPS continues to have a strong reputation of being an industry leader and is both operationally and financially strong. Historically the Company has navigated through long-term economic uncertainty and management continues to remain confident in the vision of the future. HPS is well positioned to meet the evolving needs of both our traditional markets while becoming a leading player in a growing number of other market sectors. The Company continues to be focused on escalation of market share, improved sales growth from new product development, geographic diversification, productivity gains, cost reduction and capacity flexibility. The combination of our resilience, drive, decades of experience, commitment, engineering expertise, solid supplier relationships and a broad and unique business perspective gained through our diverse products, customers and markets are all key success factors critical to the success of the Company.

The Company's strategic vision and operational initiatives have supported Hammond Power Solutions' industry leadership, operational strength and financial stability.

The Company is focused on delivering escalating improvement in its financial results, revenue and profitability growth, building market share, cost management and cash flow generation.

The Company is committed to provide a sustainable return to our shareholders and to delivering long-term value to all stakeholders of the company.

Selected Annual and Quarterly Information

The information contained in the following table presents the historic audited annual financial information as at December 31 and the unaudited financial information for the previous eight quarters up to, and including the Second Quarter of 2018. The quarterly information has been extracted from our unaudited consolidated financial statements, which in the opinion of Management are prepared in accordance with the IFRS accounting framework as noted.

(tabular amounts in thousands of dollars)

Annual Information	2013	2014	2015	2016	**2017**
Sales	242,941	247,756	274,639	274,793	301,750
Earnings from operations	11,036	6,460	12,644	10,873	14,470
EBITDA	16,924	12,327	18,748	14,356	19,633
Net earnings	6,104	2,520	6,320	1,793	6,114
Total assets	186,878	184,291	222,969	205,177	192,449
Non-current liabilities	10,220	9,527	5,454	4,131	3,442
Total liabilities	77,827	69,854	90,668	84,524	77,438
Total shareholders' equity attributable to equity holders of the Company	107,014	112,271	129,665	120,441	114,848
Total debt	(21,104)	(14,833)	(13,202)	(11,318)	(16,983)
Cash provided by operations	765	18,450	16,065	15,216	1,032
Basic earnings per share	0.52	0.22	0.53	0.16	0.53
Diluted earnings per share	0.52	0.22	0.53	0.16	0.53
Dividends declared and paid	2,328	2,800	2,807	2,808	2,809
Average exchange rate (USD$=CAD$)	1.029	1.1025	1.274	1.325	1.298
Book value per share	9.17	9.61	11.08	10.29	9.80

	2016		2017				**2018**	
Quarterly Information	Q3	Q4	Q1	Q2	Q3	Q4	**Q1**	**Q2**
Sales	62,860	74,073	72,362	78,874	74,685	75,829	73,073	**77,983**
Earnings from operations	1,003	4,633	2,405	4,953	3,338	3,774	1,973	**1,561**
EBITDA	1,858	5,110	3,902	6,273	4,903	4,555	3,631	**2,184**
Net earnings (loss)	99	293	1,084	2,842	1,563	625	895	**(370)**
Total assets	200,896	205,177	204,371	197,887	194,147	192,449	197,187	**202,635**
Non-current liabilities	5,241	4,131	4,549	4,291	4,198	3,442	3,429	**3,383**
Total liabilities	79,364	84,524	81,639	76,252	80,478	77,438	77,829	**83,210**
Total shareholders' equity attributable to equity holders of the Company	121,333	120,441	122,732	121,288	116,491	114,848	119,358	**119,425**
Total debt	(26,640)	(11,318)	(21,475)	(20,416)	(16,407)	(16,983)	(21,483)	**(21,578)**
Cash provided by (used in) operations	6,282	17,255	(7,622)	2,315	5,918	421	(1,907)	**972**
Basic earnings per share	0.01	0.03	0.09	0.25	0.14	0.05	0.08	**(0.03)**
Diluted earnings per share	0.01	0.03	0.09	0.25	0.14	0.04	0.08	**(0.03)**
Dividends declared and paid	702	702	702	702	702	703	704	**704**
Average exchange rate (USD$=CAD$)	1.306	1.332	1.323	1.347	1.253	1.270	1.262	**1.290**
Book value per share	10.37	10.29	10.46	10.37	9.96	9.80	10.18	**10.16**

Condensed Consolidated Statements of Financial Position

(unaudited) (tabular amounts in thousands of dollars)

	As at	
	June 30, 2018	December 31, 2017
Assets		
Current assets		
Cash	$ 11,707	$ 10,772
Accounts receivable	62,557	59,170
Inventories	47,156	38,340
Income taxes receivable	1,442	1,701
Prepaid expenses and other assets	2,883	3,419
Total current assets	125,745	113,402
Non-current assets		
Long-term lease and note receivable	4,573	4,605
Property, plant and equipment (note 4)	31,041	32,276
Investment in properties	1,044	1,044
Investment in joint venture (note 5)	11,942	12,158
Deferred tax assets	870	776
Goodwill	17,118	17,022
Intangible assets (note 6)	10,302	11,166
Total non-current assets	76,890	79,047
Total assets	$ 202,635	$ 192,449
Liabilities		
Current liabilities		
Bank operating lines of credit	$ 33,285	$ 27,755
Accounts payable and accrued liabilities	46,110	45,647
Income tax liabilities	–	137
Provisions	432	457
Total current liabilities	79,827	73,996
Non-current liabilities		
Provisions	100	100
Deferred tax liabilities	3,283	3,342
Total non-current liabilities	3,383	3,442
Total liabilities	$ 83,210	$ 77,438
Shareholders' Equity		
Share capital (note 7)	14,231	13,986
Contributed surplus	2,562	2,600
Accumulated other comprehensive income (note 8)	8,526	1,916
Retained earnings	94,106	96,346
Total shareholders' equity attributable to equity holders of the Company	$ 119,425	$ 114,848
Non-controlling interests	–	163
Total shareholder's equity	119,425	115,011
Total liabilities and shareholders' equity	$ 202,635	$ 192,449

See accompanying notes to condensed consolidated interim financial statements

Condensed Consolidated Statements of Earnings

(unaudited) (tabular amounts in thousands of dollars, except per share amounts)

	Quarter Ending		Six Months Ending	
	June 30, 2018	July 1, 2017	**June 30, 2018**	July 1, 2017
Sales (note 10)	$ 77,393	$ 78,874	$ 150,466	$ 151,236
Cost of sales	59,954	59,166	115,951	113,864
Gross margin	17,439	19,708	34,515	37,372
Selling and distribution	8,641	8,627	17,246	16,832
General and administrative	6,677	6,128	13,175	12,366
Restructuring charges (note 11)	560	–	560	816
Earnings from operations	1,561	4,953	3,534	7,358
Finance and other costs				
Interest expense	388	286	684	602
Foreign exchange loss (gain)	255	(22)	93	45
Share of loss of investment in joint venture (note 5)	479	255	758	512
Other	37	33	70	66
Net finance and other costs	1,159	552	1,605	1,225
Earnings before income taxes	402	4,401	1,929	6,133
Income tax expense	772	1,559	1,404	2,207
Net (loss) earnings	$ (370)	$ 2,842	$ 525	$ 3,926
Net loss attributable to non-controlling interests	$ –	$ (20)	–	(2)
Net (loss) earnings attributable to the equity holders of the Company	(370)	2,862	525	3,928
Net (loss) earnings	$ (370)	$ 2,842	$ 525	$ 3,926
Earnings per share				
Basic (loss) earnings per share (dollars)	$ (0.03)	$ 0.25	$ 0.05	$ 0.34
Diluted earnings per share (dollars)	$ (0.03)	$ 0.25	$ 0.05	$ 0.34

See accompanying notes to condensed consolidated interim financial statements

Condensed Consolidated Statements of Comprehensive Income

(unaudited) (tabular amounts in thousands of dollars)

	Quarter Ending		Six Months Ending	
	June 30, 2018	July 1, 2017	**June 30, 2018**	July 1, 2017
Net (loss) earnings	$ (370)	$ 2,842	$ 525	$ 3,926
Other comprehensive income (loss)				
Foreign currency translation differences for foreign operations	1,004	(3,237)	6,601	(1,554)
Other comprehensive income (loss) for the period, net of income tax (note 8)	1,004	(3,237)	6,601	(1,554)
Total comprehensive (loss) income for the period	$ 634	$ (395)	$ 7,126	$ 2,372
Attributable to:				
Equity holders of the Company	$ 634	$ (337)	$ 7,126	$ 2,237
Non-controlling interest	–	(58)	–	135
Total comprehensive income (loss) for the period	$ 634	$ (395)	$ 7,126	$ 2,372

See accompanying notes to condensed consolidated interim financial statements

Condensed Consolidated Statements of Changes in Equity

(unaudited) For the six months ended June 30, 2018

(tabular amounts in thousands of dollars)	SHARE CAPITAL	CONTRIBUTED SURPLUS	AOCI*	RETAINED EARNINGS	NON-CONTROLLING INTEREST	TOTAL SHAREHOLDERS' EQUITY
Balance as at January 1, 2018	$ 13,986	$ 2,600	$ 1,916	$ 96,346	$ 163	$ 115,011
Total comprehensive income for the year						
Net earnings	–	–	–	525	–	525
Other comprehensive income						
Foreign currency translation differences related to joint venture (note 5)	–	–	542	–	–	542
Foreign currency translation differences (note 10)	–	–	6,059	–	–	6,059
Total other comprehensive income	–	–	6,601	–	–	6,601
Total comprehensive income for the year	–	–	6,601	525	–	7,126
Transactions with owners, recorded directly in equity						
Stock options exercised (note 7)	245	(38)	–	–	–	207
Dividends to equity holders (note 7)	–	–	–	(1,408)	–	(1,408)
Non-controlling interest (note 9)	–	–	9	(1,357)	(163)	(1,511)
Total transactions with shareholders	245	(38)	9	(2,761)	(163)	(2,712)
Balance at June 30, 2018	$ 14,231	$ 2,562	$ 8,526	$ 94,106	$ –	$ 119,425

*AOCI – Accumulated other comprehensive income

See accompanying notes to condensed consolidated interim financial statements

Condensed Consolidated Statements of Changes in Equity

(unaudited) For the six months ended July 1, 2017

(tabular amounts in thousands of dollars)	SHARE CAPITAL	CONTRIBUTED SURPLUS	AOCI*	RETAINED EARNINGS	NON-CONTROLLING INTEREST	TOTAL SHAREHOLDERS' EQUITY
Balance as at January 1, 2017	$ 13,843	$ 2,605	$ 10,992	$ 93,001	$ 212	$ 120,653
Total comprehensive (loss) income for the year						
Net earnings	–	–	–	3,928	(2)	3,926
Other comprehensive (loss) income						
Foreign currency translation differences related to joint venture (note 5)	–	–	427	–	–	427
Foreign currency translation differences (note 10)	–	–	(2,118)	–	137	(1,981)
Total other comprehensive (loss) income	–	–	(1,691)	–	137	(1,554)
Total comprehensive (loss) income for the year	–	–	(1,691)	3,928	135	2,372
Transactions with owners, recorded directly in equity						
Share-based payment transactions	–	14	–	–	–	14
Dividends to equity holders (note 9)	–	–	–	(1,404)	–	(1,404)
Total transactions with shareholders	–	14	–	(1,404)	–	(1,390)
Balance at July 1, 2017	$ 13,843	$ 2,619	$ 9,301	$ 95,525	$ 347	$ 121,635

*AOCI – Accumulated other comprehensive income

See accompanying notes to condensed consolidated interim financial statements

Condensed Consolidated Statements of Cash Flows

(unaudited) tabular amounts in thousands of dollars)	Six Months Ending June 30, 2018	July 1, 2017
Cash flows from operating activities		
Net earnings	$ 525	$ 3,926
Adjustments for:		
Share of loss of investment in joint venture	758	512
Amortization of property, plant and equipment	2,063	2,575
Amortization of intangible assets	1,139	865
Loss on disposal of equipment	(5)	–
Provisions	(25)	(16)
Interest expense	684	602
Income tax expense	1,404	2,207
Change in unrealized (loss) gain on derivatives	(226)	327
Stock-based compensation expense	–	14
	6,317	11,012
Change in non-cash working capital (note 12)	(5,970)	(13,201)
Cash generated (used) in operating activities	347	(2,189)
Income tax paid	(1,282)	(3,118)
Net cash used in operating activities	(935)	(5,307)
Cash flows from investing activities		
Purchase of non-controlling interest (note 9)	(1,511)	–
Investment in joint venture (note 5)	–	(626)
Proceeds on disposal of equipment	117	–
Acquisition of property, plant and equipment	(703)	(868)
Acquisition of intangible assets	(275)	(145)
Cash used in investing activities	(2,372)	(1,639)
Cash flows from financing activities		
Advances (repayments) of borrowings	5,530	(10,629)
Receipt of lease receivable payments	139	–
Issue of common shares	207	–
Cash dividends paid (note 8)	(1,408)	(1,404)
Interest paid	(684)	(602)
Cash generated (used) in financing activities	3,784	(12,635)
Foreign exchange on cash held in a foreign currency	458	(146)
Increase (decrease) in cash	935	(19,727)
Cash and cash equivalents at beginning of period	10,772	25,189
Cash and cash equivalents at end of period	$ 11,707	$ 5,462

See accompanying notes to condensed consolidated interim financial statements

Notes to the Condensed Consolidated Financial Statements

Six months ended June 30, 2018 and July 1, 2017 (amounts in thousands of dollars except share and per share amounts)

The accompanying unaudited interim financial statements of Hammond Power Solutions Inc., ("HPS" or the "Company") have been prepared by and are the responsibility of the Company's Management. The Company's independent auditor has not performed a review of these financial statements in accordance with standards adopted by the Canadian Institute of Charted Accountants ("CICA") for a review of interim financial statements by an entity's auditor.

1. Reporting entity

Hammond Power Solutions Inc. ("HPS" or the "Company") is a company domiciled in Canada. The address of the Company's registered office is 595 Southgate Drive Guelph, Ontario. The Company's Class A subordinate voting shares are listed on the Toronto Stock Exchange and trade under the symbol HPS.A.

The Condensed Consolidated Interim Financial Statements of the Company as at and for the second quarter ended June 30, 2018 comprise the Company and its subsidiaries (together referred to as the "Group" and individually as "Group entities"). The Group is primarily involved in the design and manufacture of custom electrical magnetics, cast resin, custom liquid filled distribution and power transformers and standard electrical transformers, serving the electrical and electronic industries. The Company has manufacturing plants in Canada, United States ("U.S."), Mexico, Italy, and India, the latter being Hammond Power Solutions Private Limited, a subsidiary in which the Company now holds a 100% equity ownership. The Company also holds a 55% economic interest in a joint venture located in Mexico called Corefficient de R.L. de C.V. ("Corefficient").

2. Basis of preparation

(a) Statement of compliance

These condensed consolidated interim financial statements have been prepared in accordance with requirements of IAS 34, Interim Financial Reporting and do not include all of the information required for full annual financial statements.

These condensed consolidated interim financial statements were approved by the Board of Directors on August 1, 2018.

(b) Use of estimates and judgments

The preparation of the condensed consolidated interim financial statements in conformity with IFRS requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In preparing these condensed consolidated interim financial statements, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended December 31, 2017.

3. Summary of significant accounting policies:

These condensed consolidated interim financial statements should be read in conjunction with the Group's 2017 annual audited financial statements, which are available on the System for Electronic Document Analysis and Retrieval ("SEDAR"). The significant accounting policies applied by the Company in these condensed consolidated interim financial statements are the same as those applied by the Company in its Consolidated Financial Statements as at and for the year ended December 31, 2017.

Six months ended June 30, 2018 and July 1, 2017 (amounts in thousands of dollars except share and per share amounts)

Changes to accounting policies

Classification and Measurement of Share-Based Payment Transactions

On June 20, 2016 the IASB issued amendments to IFRS 2 Share-Based Payments clarifying how to account for certain types of share-based payment transactions. The amendments apply for annual periods beginning on or after January 1, 2017. As a practical simplification, the amendments can be applied prospectively. Retrospective, or early, application is permitted if information is available without the use of hindsight.

The amendments provide requirements on the accounting for:

- The effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments;
- Share-based payment transactions with a net settlement feature for withholding tax obligations; and
- A modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity settled.

The Group intends to adopt the amendments to IFRS 2 in its consolidated financial statements for the annual period ending December 31, 2018. The adoption of the amendment did not have a material impact on the consolidated financial statements.

Revenue from contracts with customers

On May 28, 2014 the IASB issued IFRS 15, Revenue from Contracts with Customers. This new standard is effective for annual and interim periods beginning on or after January 1, 2018. IFRS 15 will replace IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programs, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers and SIC 31 Revenue – Barter Transactions Involving Advertising Services. On April 12, 2016, the IASB issued Clarification to IFRS 15, Revenue from Contracts with Customers, which is effective at the same time as IFRS 15.

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue – at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.

Transition considerations

IFRS 15 can be applied using one of the following two methods: retrospectively to each prior reporting period presented in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, or retrospectively with the cumulative effect of initially applying IFRS 15 recognized in opening retained earnings at the date of initial application (the “modified retrospective method”). The Group decided to adopt IFRS 15 using the modified retrospective method, without restatement of comparative figures.

IFRS 15 provides for certain optional practical expedients, including upon the initial adoption of the standard. The Group applied the following practical expedients upon adoption of IFRS 15 on January 1, 2018:

- Completed contract – the Group applied IFRS 15 retrospectively only to contracts that were not completed contracts as at January 1, 2018. There were no uncompleted contracts at January 1, 2018.
- Contract modifications – the Group did not apply IFRS 15 retrospectively to contract modifications that occurred before January 1, 2018.

The adoption of IFRS 15 did not have a material impact on the consolidated financial statements.

Financial instruments

On July 24, 2014 the IASB issued the complete IFRS 9 Financial Instruments (IFRS 9 (2014)). The mandatory effective date of IFRS 9 is for annual and interim periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. The restatement of prior periods is not required and is only permitted if information is available without the use of hindsight. IFRS 9 (2014) introduces new requirements for the classification and measurement of financial assets. Under IFRS 9 (2014), financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The standard introduces additional changes relating to financial liabilities. It also amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment.

Six months ended June 30, 2018 and July 1, 2017 (amounts in thousands of dollars except share and per share amounts)

IFRS 9 (2014) also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship. Special transitional requirements have been set for the application of the new general hedging model. The Group has adopted IFRS 9 (2014) in its consolidated financial statements for the annual and interim periods beginning on January 1, 2018.

The adoption of IFRS 9 did not have a material impact on the consolidated financial statements.

4. Property, plant and equipment

The Group had acquisitions of fixed assets for the six months ended June 30, 2018 in the amount of $703,000 of machinery and equipment (2017 - $868,000).

5. Joint venture

The Company has a 55% economic interest and voting interest in Corefficient. By virtue of the contractual arrangement with National Material LLP ("National"), the other shareholder in Corefficient, decisions about significant, relevant, operating and strategic activities require the unanimous consent of both parties, and therefore the Company jointly controls Corefficient. Distributions of dividends and returns of capital from Corefficient are subject to unanimous Corefficient shareholder approval. Accordingly, the Company has treated its investment in Corefficient as a joint arrangement. Corefficient's principal place of business is in Monterrey, Mexico.

The carrying value of the Company's interest in Corefficient is as follows:

	June 30, 2018	December 31, 2017
Cost of investment in joint venture	$ 19,304	$ 19,304
Cumulative share of loss in investment in joint venture	(4,535)	(3,778)
Foreign currency translation differences related to the joint venture	(2,827)	(3,368)
	$ 11,942	$ 12,158

Selected financial information relating to Corefficient is as follows:

	June 30, 2018	December 31, 2017
Cash	$ **1,233**	$ 2,261
Trade and other receivables	**5,844**	5,546
Inventories	**1,099**	1,050
Other current assets	**123**	162
Total current assets	$ **8,299**	$ 9,019
Non-current assets	**16,174**	16,487
Total assets	$ **24,473**	$ 25,506
Current liabilities	$ **3,883**	$ 3,671
Non-current liabilities	**–**	–
Total liabilities	$ **3,883**	$ 3,671

Six months ended June 30, 2018 and July 1, 2017 (amounts in thousands of dollars except share and per share amounts)

	Six Months Ending			
		June 30, 2018		July 1, 2017
Revenue	$	**14,098**	$	8,618
Loss for the period		**1,378**		1,360

The loss for the six months ended June 30, 2018 includes depreciation and amortization expense of $1,025,000 (2017 - $1,055,000), interest income of $71,000 (2017 - $35,000) and an income tax expense of $7,000 (2017 – recovery of $583,000) related to Corefficient.

6. Intangible assets

The Group had acquisitions of intangible assets for the six months ended June 30, 2018 in the amount of $275,000 (2017 - $145,000), for the addition of software. None of the intangible assets have been developed internally.

7. Share capital

(a) Dividends:

The following dividends were declared and paid by the Company:

	Six Months Ending			
		June 30, 2018		July 1, 2017
12 cents per Class A common share (2017: 12 cents)	$	**1,074**	$	1,070
12 cents per Class B common share (2017: 12 cents)		**334**		334
	$	**1,408**	$	1,404

(b) Stock option plan:

There were no stock options issued during the six months ended June 30, 2018. Stock-based compensation recognized the amount credited to contributed surplus during the period is $nil (2017 – $14,000) and relates to options granted in prior years that vested during the period.

During the six months ended July 1, 2018, there were 30,000 options exercised, 10,000 at an exercise price of $6.20, 5,000 at an exercise price of $6.62 and 15,000 at an exercise price of $7.50.

(c) Deferred Stock Units:

During 2017, the Company enacted a deferred share unit plan (the "DSU Plan") in order to issue deferred share units ("DSUs") to non-employee directors and senior-executives (collectively, "participants") of HPS. The DSU Plan was adopted to allow participants the opportunity to defer compensation and encourage a sense of ownership in HPS. Under the DSU Plan, participants may elect to defer compensation and receive DSUs equal to the value of the deferred compensation. The first DSUs were issued in March 2017. The number of DSUs was determined by dividing the amount of deferred compensation by the Fair Market Value of DSUs, defined under the DSU Plan as the weighted average closing price of HPS shares for the five business days immediately preceding the relevant date. Upon the occurrence of the Redemption Event, which could include ceasing to hold any position in the Company and/or any Subsidiary or upon death of the participant, the affected participant will be entitled to receive a lump sum cash payment, net of applicable withholding taxes, equal to the product of number of DSUs held by that participant and the Fair Market Value on the date of the Redemption Event. The DSUs do not contain any vesting conditions or forfeiture provisions, as they are issued in exchange for past service. Under the DSU Plan, outstanding DSUs as at the record date are increased by the dividend rate whenever dividends are paid to shareholders.

The DSUs issued are not performance based.

Six months ended June 30, 2018 and July 1, 2017 (amounts in thousands of dollars except share and per share amounts)

The movement in DSUs for the six months ended:

	June 30, 2018			July 1, 2017		
	Number of DSUs	Weighted Average Share Price	Carrying Amount	Number of DSUs	Weighted Average Share Price	Carrying Amount
Opening Balance	32,578	$ 9.16	$ 285	–	$ –	$ –
DSUs Issued	17,634	$ 9.44	181	14,801	$ 6.95	103
Balance at June 30, 2018	50,212	$ 9.30	$ 466	14,801	$ 6.95	$ 103

8. Accumulated Other Comprehensive Income

Changes to the accumulated other comprehensive income ("AOCI") balance include foreign currency translation differences relating to the net assets of foreign operations. Total other comprehensive income for the six months ended June 30, 2018 was $6,601,000 (2017 – loss of $1,691,000), resulting in an ending balance of accumulated other comprehensive income of $8,526,000 (July 1, 2017 – $9,301,000).

9. Non-controlling interest

On January 10, 2018, the terms and conditions under an agreement to acquire the remaining 15% economic interest of Hammond Power Solutions Private Limited from a minority shareholder, which included the mutually agreed upon resignation from the Board of the minority shareholder, at a discounted amount of 76,933,000 Indian Rupees ("INR") (approximately $1,511,000 Canadian dollars) were fulfilled, resulting in the Company's equity ownership in Hammond Power Solutions Private Limited becoming 100%. As a result, the Company recorded an elimination of non-controlling interests on the condensed consolidated statement of financial position in the amount of $163,000, a reduction in retained earnings of $1,357,000, and an increase in accumulated other comprehensive income in the amount of $9,000.

10. Sales

	Three Months Ending		Six Months Ending	
	June 30, 2018	July 1, 2017	**June 30, 2018**	July 1, 2017
Canada	$ 22,592	$ 19,726	$ 43,312	$ 36,665
United States and Mexico	48,143	45,080	92,855	87,751
Italy	1,974	5,383	4,650	10,167
India	4,684	8,685	9,649	16,653
	$ 77,393	$ 78,874	$ 150,466	$ 151,236

As at March 31, 2018, the Company has deferred revenue of $nil (2017 - $55).

11. Restructuring charges

During 2017 and the first six months of 2018, the Company incurred restructuring charges. These charges were comprised of severance and benefit costs relating to workforce reductions. The restructuring activities were undertaken to adjust the Company's cost structure, to streamline various support activities in consideration of the current and expected industry market conditions. These charges are reported in the restructuring charge line within the consolidated statement of earnings. The Company incurred restructuring charges of $560 for the six months ended June 30, 2018.

Six months ended June 30, 2018 and July 1, 2017 (amounts in thousands of dollars except share and per share amounts)

The following table highlights the activity and balance of the restructuring charge for the six month period ending June 30, 2018:

	Employee Termination Benefits	
Opening balance January 1, 2018	$	329
Cgarges to expense		560
Cash payments		829
Accrued balance at June 30, 2018	$	60

12. Related party transactions

Related parties

Arathorn Investments Inc. beneficially owns 2,778,300 (2017 – 2,778,300) Class B common shares of the Company, representing 100% of the issued and outstanding Class B common shares of the Company and 1,058,420 (2017 – 1,056,290) Class A subordinate voting shares of the Company, representing approximately 11.8% (2017 – 11.8%) of the issued and outstanding Class A subordinate voting shares of the Company and as a result controls the Company. William G. Hammond, Chief Executive Officer and Chairman of the Company, owns all of the issued and outstanding shares of Arathorn Investments Inc. Total dividends paid during the quarter, directly and indirectly to William G. Hammond were $230,000 (Quarter 2 2017– $230,000).

Transactions with key management personnel

During the six months ended June 30, 2018, the Company purchased $147,000 (2017 – $110,000) of inventory from ILSCO of Canada Limited ("ILSCO"), a company in which HPS director David J. FitzGibbon serves as a Vice Chairman. The Company purchases a component part from ILSCO, which is utilized in the manufacture of transformers. The purchases were measured at the exchange amount. Accounts payable and accrued liabilities include $23,000 (2017 – $24,000), which is owed to this company.

13. Change in non-cash operating working capital

The table below depicts the receipt of (use of) cash for working capital purposes by the Company:

	Six Months Ending			
		June 30, 2018		July 1, 2017
Accounts receivable	$	(3,387)	$	(12,581)
Inventories		(8,816)		241
Prepaid expenses		560		112
Accounts payable and accrued liabilities		689		2,325
Foreign exchange		4,984		(3,298)
	$	(5,970)	$	(13,201)

Canada
Hammond Power Solutions Inc.

Corporate Head Office
595 Southgate Drive
Guelph, Ontario N1G 3W6

15 Industrial Road
Walkerton, Ontario N0G 2V0

10 Tawse Place
Guelph, Ontario N1H 6H9

Delta Transformers Inc.

795 Industriel Boul.
Granby, Quebec J2G 9A1

3850 place de Java
Suite 200
Brossard, Québec J4Y 0C4

India
Hammond Power Solutions Private Limited

2nd Floor
Icon Plaza, H. No. 5-2/222/IP/B
Allwyn X-Roads
Miyapur, Hyderabad – 500049

Italy
Hammond Power Solutions S.p.A.

Via A. Gramsci, 98
21050 Marnate (VA), Italy

Mexico
Hammond Power Solutions S.A. de C.V.

Ave. Avante #810
Parque Industrial Guadalupe
Guadalupe, Nuevo Leon, C.P. 67190
Monterrey, Mexico

Ave. Avante #900
Parque Industrial Guadalupe
Guadalupe, Nuevo Leon, C.P. 67190
Monterrey, Mexico

Mexico
Corefficient, S. de R.L. de C.V.

Ave. Avante #840
Parque Industrial Guadalupe
Guadalupe, Nuevo León, México
C.P. 67190

United States
Hammond Power Solutions, Inc.

1100 Lake Street
Baraboo, Wisconsin 53913

17715 Susana Road
Compton, California 90224

Corporate Officers and Directors

William G. Hammond *
Chairman of the Board and
Chief Executive Officer

Chris R. Huether
Corporate Secretary and
Chief Financial Officer

Donald H. MacAdam *+
Director

Douglas V. Baldwin *+
Director

Grant C. Robinson *+
Director

David J. FitzGibbon *+
Director

Dahra Granovsky *+
Director

Fred M. Jaques *+
Director

Richard S. Waterman *+
Director

* Corporate Governance Committee
+ Audit and Compensation Committee

Stock Exchange Listing

Toronto Stock Exchange (TSX)
Trading Symbol: HPS.A

Registrar and Transfer Agent

Computershare Investor Share
Services Inc.
100 University Avenue
Toronto, Ontario
Canada M5J 2Y1

Auditors

KPMG LLP
115 King Street South
Waterloo, Ontario N2J 5A3

Legal Representation

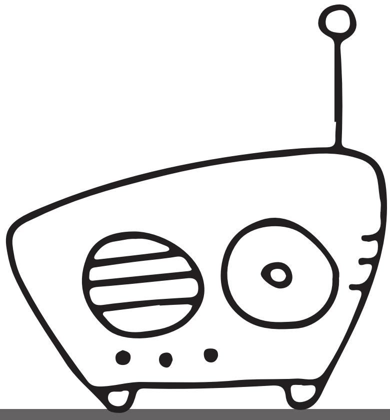
Borden Ladner Gervais LLP
Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, Ontario
Canada M5H 4E3

Banking Institution

JP Morgan Chase
Bank N.A. 66 Wellington Street West,
Suite 4500
Toronto, ON M5K 1E7

Investor Relations

Contact: Dawn Henderson,
Manager Investor Relations
Phone: 519.822.2441
Email: ir@hammondpowersolutions.com



The Hammond Museum of Radio is one of North America's premiere wireless museums. It is home to thousands of receivers and transmitters dating back to the turn of the century. The museum is open regular business hours Monday to Friday; evenings and weekends by special appointment.

Tours can be arranged by calling:
519-822-2441 x590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