



Hammond Power  
Solutions Inc.

2008 Q3

Nine months ended September 27, 2008

## A Productive Company, for a Productive World.

A productive world is a place where market opportunities are abundant. It is a place where generations of people build and support strong business strategies. It is a place where the rising need for alternative energy solutions creates new markets for reliable power generation.

A productive world is our world.

Hammond Power Solutions Inc. is the largest manufacturer of dry-type transformers in North America. We engineer and manufacture a wide range of custom transformers that are exported globally in electrical equipment and systems. We support solid industries such as oil and gas, mining, steel, waste and water treatment, and wind power-generation.

A productive world is a place where we make a difference.

## DEAR FELLOW INVESTOR,

We are pleased to present our Third Quarter financial results for 2008. Considering the current economic, banking and political issues buffeting North America, we are very proud of our accomplishments.

These challenges are certainly unprecedented in my life time, and as a result I question whether anyone can accurately predict what is going to happen in the short term. Given this, here is what Hammond Power Solutions Inc., ("HPS") is doing to position itself to weather the current economic storm.

Over the last five years, HPS has been purposely expanding its penetration of strategic market segments and channels to make us less dependent on any one particular market. We recognize that even in North America certain market segments are still growing while others are decelerating. For example, while commercial construction may be poised to slow, spending on public and utility infrastructure is still expanding due to wear and tear. The North American economy may have stalled, but many of our OEM customers are building equipment and systems that are being exported to China, India, Brazil, Russia and other countries that are still showing positive GDP growth. And although commodity prices may be falling, commodity consumption, especially in Asia, is still growing, causing resource companies to scour the world for ever-shrinking deposits of oil and metals. At the same time we are also aggressively increasing our share of the U.S. and Canadian distributor channels. As mentioned in previous reports, the U.S. distributor channel in particular opens up new regional markets and customers that Hammond Power Solutions can exploit even in a slower economy. Finally, in moving forward we are investigating opportunities to build and sell our products in Asia to make us less dependent on North America.

Internally, we have a number of projects underway to improve our flexibility and cost competitiveness. These include the additional plant in Mexico, which is now up and running, as well as the expansion of our Granby, Quebec plant which should be underway in Quarter 1, 2009; both will give us additional capacity, improve our service and increase our sales. HPS now has six plants operating in three countries which will help to insulate us from wild fluctuations in any one North American currency. Secondly, we have started a lean manufacturing initiative to improve productivity in our Canadian plants, a program which will then be rolled out across the entire Company. In addition, we are expanding our global sourcing of materials and components in order to reduce our costs in a more competitive environment.

HPS has performed extremely well in a difficult North American manufacturing environment over the last five years. We have delivered strong growth in sales and profits as well as a very high rate of return on net assets year after year. All of this is the result of sound strategic planning, hard work, some luck and passion for the transformer business. I believe these same attributes will help us in the future and as always we will continue to manage the business in a conservative manner to maximize cash flow while carefully investing in our future, a future that we believe will be bright after we navigate through these stormy conditions. •



William G. Hammond  
Chairman and Chief Executive Officer

# MANAGEMENT'S DISCUSSION & ANALYSIS

## THIRD QUARTER 2008

### OVERVIEW

Hammond Power Solutions Inc. ("HPS" or the "Company") is the North American leader for the design and manufacture of custom electrical engineered magnetics, as well as a leading manufacturer of standard electrical dry-type transformers. Advanced engineering capabilities, high quality products, and fast responsive service to customers' needs have established the Company, as a technical and innovative leader in the electrical and electronic industries. The Company has manufacturing plants in Canada, the United States and Mexico.

The following is Management's Discussion and Analysis of the Company's consolidated operating results for the quarter-ended September 27, 2008, and should be read in conjunction with the notes to the Consolidated Financial Statements of the Company, contained in our 2007 Annual Report, which have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts in this report are expressed in Canadian dollars unless otherwise noted. Additional information relating to the Company may be found on SEDAR's website at [www.sedar.com](http://www.sedar.com).

### SALES

Sales for the quarter-ended September 27, 2008 were \$57,940,000 up \$16,945,000 or 41.3% from the comparative quarter last year, and are up \$38,833,000 or 31.7% year-to-date, finishing at \$161,232,000 compared to \$122,399,000 last year. Sales in Quarter 3, 2008 include sales of \$8,931,000 by Delta Transformers Inc., ("DTI") a wholly owned subsidiary of HPS that was acquired January 1, 2008. Quarterly sales compared when excluding sales generated by DTI, for the quarter-ended September 27, 2008, were \$49,009,000 up \$ 8,014,000 or 19.5% from the comparative quarter last year. On a year-to-date basis excluding sales of \$26,485,000 generated by DTI, overall sales totaled \$134,747,000, an increase of \$12,348,000 or 10.1% from last year-to-date. Sales in the United States were \$37,146,000, an increase of \$6,442,000 or 21.0% from Quarter 3, 2007 and up \$3,533,000 or 10.5% from Quarter 2, 2008. Year-to-date sales in the United States were \$100,811,000, an increase of \$10,446,000 or 11.6%, compared to \$90,365,000 last year-to-date. U.S. sales, stated in U.S. dollars continue to rise, up \$6,423,000 or 21.9% from Quarter 3, 2007 and were higher by \$2,471,000 or 7.4% from Quarter 2, 2008 and also increased \$17,060,000 or 20.8% year-to-date finishing at \$98,946,000 as compared to \$81,886,000. Canadian sales (including DTI) were \$20,794,000 for Quarter 3, 2008, increasing \$10,501,000 or 102.0%

over Quarter 3, 2007. Canadian sales (excluding DTI) were \$11,863,000 for the quarter showing growth over Quarter 3, 2007, of \$1,570,000 or 15.3%.

Year-to-date Canadian sales (including DTI) were \$60,421,000 an increase of \$28,386,000 or 88.6% as compared to sales of \$32,035,000 last year. Excluding DTI, year-to-date Canadian sales, were \$33,936,000, an increase of \$1,901,000 or 5.9% as compared to sales of \$32,035,000 last year.

By geographic segment, U.S. sales were 64.1% of our total sales, while 35.9% of the sales were derived in Canada in the quarter.

The North American Electrical Distributor channel, capital equipment, motor control, switchgear, mining equipment, and oil and gas pumping markets in both Canada and the United States all showed growth in the quarter as compared to Quarter 3, 2007. This is evidenced by our continued increased booking rates as compared to the same quarter in the previous year, growing sales backlog levels and steady financial performance.

Hammond Power Solutions' market diversification provides a natural business hedge as the Company is not dependent on any one single market.

HPS will continue to direct its efforts toward the production of premium quality transformers, expanding product breadth and competitive custom engineered designs. These strategies will provide existing customer sales growth and new customer opportunities. We expect that this, combined with our distributor channel growth and our multi-national manufacturing capabilities, will continue to generate sales expansion, positive revenue and profitability trends.

### ORDER BOOKINGS AND BACKLOG

Our sales development initiatives combined with the acquisition of Delta Transformers Inc., our engineering and manufacturing strategies and the current electrical industry market conditions produced another quarter-over-quarter increase in bookings rates. This resulted in a 46.6% increase in bookings over the same quarter last year and a 31.4% increase compared on a year-to-date basis. By channel, booking levels grew 51.5% on a direct basis and increased 44.6% through our distributor channel as compared to Quarter 3, 2007. This booking rate appreciation resulted in a backlog rise of 61.1% from the same quarter last year despite the significant sales growth in Quarter 3, 2008.

Excluding the positive impact DTI has on our year-over-year results, bookings increased 20.8% over the same quarter last year. By channel, booking rates increased 31.2% on a direct basis, and increased 11.5% through our distributor channel as compared to Quarter 3, 2007. Despite capacity increases, booking rates once again exceeded our sales rates, resulting in a backlog rise

(excluding DTI backlog) of 28.8% from Quarter 3, 2007.

### GROSS MARGINS

Quarter 3, 2008 gross margin dollars increased by 36.4% compared to Quarter 3, 2007 as a result of our rising sales levels, the acquisition of DTI, selling price increases and a beneficial product mix. Gross margin rates finished at 27.0% versus 27.9% in Quarter 3, 2007, and were 27.6% for the year compared to 29.1% in 2007 down 1.5%.

Compared to Quarter 3, 2007 current quarter gross margin rates were impacted by higher customer rebate costs, Mexican manufacturing plant start up and a stronger Canadian dollar which has an eroding effect on gross margin rates on Canadian manufactured products sold in the United States. The Company continues to see downward selling price pressure and lower manufacturing lead-time from many of our competitors. Margins were positively augmented through material procurement activities, product design cost reduction initiatives, selling price increases, higher manufacturing throughput as well as productivity improvements and competitive lead-times which will positively affect margin rates going forward.

Sustaining gross margin rates is critical to delivering the profit objectives of the Company.

### SELLING GENERAL & ADMINISTRATIVE EXPENSE

Total selling, general and administrative ("SG&A") expenses amounted to \$9,054,000 in Quarter 3, 2008 versus \$7,344,000 in Quarter 3, 2007, an increase of \$1,710,000 or 23.3% and were \$26,660,000 year-to-date versus \$21,175,000 in 2007, an increase of \$5,485,000 or 25.9%.

SG&A expenses attributed to Delta Transformers Inc. were 1,568,000 for the quarter and 5,100,000 year-to-date. As a percentage of sales, SG&A expenses dropped from 17.9% in Quarter 3, 2007 to 15.6% in Quarter 3, 2008, a decrease of 2.3% and on a year-to-date basis decreased 0.8% to finish at 16.5%

SG&A expenses are also reflective of foreign currency exchange gains of \$84,000 in the quarter, as compared to a foreign currency exchange loss of \$768,000 in Quarter 3, 2007 a gain of \$338,000 year-to-date compared to a loss of \$1,522,000 in 2007.

Excluding foreign exchange gains and losses, SG&A expenses reduced 0.3% finishing at 15.8% in Quarter 3, 2008 versus 16.1% last year and was up 0.6% year-to-date finishing at 16.7% compared to 16.1% in 2007.

Although there is a natural rise in freight costs and sales commission expense from the increased sales volumes and foreign exchange losses, the Company still shows reductions in SG&A expenses as a percent of sales on a year-to-date basis, through controlled expense management and the impact

of higher sales volumes.

The Company continues to invest in its people resources, specifically in the areas of information services, sales and engineering.

### EARNINGS FROM OPERATIONS

The Company continues to deliver growth in earnings from operations. This is proven by our Quarter 3, 2008 numbers, which were up \$2,459,000 or 59.9% from the same quarter last year, finishing at \$6,567,000 in the quarter, as compared to \$4,108,000 in Quarter 3, 2007. Earnings from operations were \$17,897,000 on a year-to-date basis, up \$3,426,000 or 23.7% from the \$14,471,000 for the same period last year.

Our strategic focus on sales escalation from market expansion in the United States and Canada, sales mix, market specific selling price increases, cost reduction initiatives, and higher manufacturing throughput, collectively contributed to this rise in earnings from operations.

### INTEREST EXPENSE

The interest expense for the quarter-ended September 27, 2008 amounted to \$49,000 compared to \$38,000 in Quarter 3, 2007, an increase of \$11,000 or 28.9% and was \$228,000 year-to-date versus \$250,000 last year, down 8.8%.

The increase of interest expense for the quarter was as a result of an increase in total bank indebtedness as compared to Quarter 3, 2007 of \$8,839,000. The expense was further offset by interest earned on income taxes of \$60,000.

Interest expense as a percent of sales has not changed, finishing at 0.1% in the quarter as compared to 0.1% in Quarter 3, 2007 and dropped 0.1% year-to-date, finishing at 0.1% compared to 0.2% in 2007.

### CO-TENANCY EXPENSE

The property at 2 Glen Road, Georgetown, Ontario, is owned equally as a co-tenancy agreement with Hammond Manufacturing Company Limited and expenses in respect to the property are shared equally.

There were ongoing legal and consulting fees pertaining to the Glen Road property for Quarter 3, 2008 of \$33,000 compared to \$93,000, in Quarter 3, 2007 and \$98,000 year-to-date versus \$113,000 last year.

The Company has a Balance Sheet provision of \$383,000 for future costs of environmental remediation at this site.

## SALE OF EQUITY INVESTMENT IN MOLONEY ELECTRIC INC

### 1159714 ONTARIO INC PROPERTY

The Company announced on January 8, 2008 that the sale of the Company's 45% interest in the operations (oil filled distribution transformers) of Moloney Electric Inc. ("MEI") to Universal Power Transform Private Limited had been finalized. In addition to the operations, the Company also sold the Sackville, New Brunswick and Spruce Grove, Alberta plants, which had been jointly owned with HMCL in 1159714 Ontario Inc., which were associated with the MEI operations. The Sterling Rd., Toronto, Ontario plant continues to be held by 1159714 Ontario Inc. and is rented by Universal Power Transform Private Limited on a short-term basis.

Gross proceeds for the sale to Universal Power Transform was \$7,727,000 derived from \$6,027,000 for HPS' equity interest in MEI and \$1,700,000 for HPS' share of the related properties held in 1159714 Ontario Ltd. This translates to HPS in a book gain of \$1,033,000 from MEI and a current tax provision of \$346,000 as well as a net book gain of \$1,053,000 from 1159714 Ontario Inc.

### ASSET PURCHASE OF DELTA TRANSFORMERS INC.

The Company announced on February 7, 2008 that the acquisition of Delta Group XFO Inc. and Delta Transformer of Canada (1999) Ltd. was completed and will be operated as Delta Transformers Inc. ("DTI") a wholly owned subsidiary of HPS. With over 20 years of experience, DTI has a manufacturing plant in Granby and a sales office in Boucherville, both located in Quebec. DTI's business involves the design and manufacture of standard and custom dry-type distribution and power transformers with annual sales revenues of approximately \$40,000,000 and has a reputation in the industry for product reliability and quality. DTI has been a technical leader in the industry and holds a number of patents.

Total purchase consideration is comprised of the following:

Cash	\$ 13,062,000
Common Stock - HPS	\$ 2,043,000
Term debt	\$ 1,000,000
Transaction fees	\$ 247,000
<b>Total</b>	<b>\$ 16,352,000</b>

The allocation of the acquisition costs for Delta as at March 29, 2008 is as follows:

Accounts Receivable	\$ 5,232,000
Inventory	\$ 5,150,000
Prepaid Expenses	\$ 105,000
Machinery & Equipment	\$ 3,622,000
Intangible Assets – Customer Relationship	\$ 5,250,000
Goodwill	\$ 2,019,000
Accounts Payable	\$ (5,026,000)
<b>Fair value of assets acquired</b>	<b>\$ 16,352,000</b>

The purchase price allocation of the tangible and intangible assets is still in the process of being finalized and may be adjusted as a result of the final 2007 Audited Financial Statements of Delta Group and from additional information regarding preliminary estimates of fair values.

### INCOME TAXES

As a result in the rise of income before income tax, Quarter 3, 2008 income tax expense was \$2,150,000 as compared to \$1,511,000 in Quarter 3, 2007, and was \$6,588,000 year-to-date, versus \$5,356,000 last year an increase of \$1,232,000. The current future tax assets and liabilities consist mainly of reserves and allowances, and are related to current assets and liabilities which are not deductible against current year earnings. The long-term future tax assets and liabilities relate to temporary differences resulting from losses carried forward, capital leases (the lease payments are expensed for tax purposes), foreign exchange losses (recognized for tax purposes only on the actual debt repayments) and the difference between net book value and un-depreciated capital cost of capital assets.

### NET EARNINGS

Due to the increased sales and higher margin dollars, net earnings for Quarter 3, 2008, grew by \$1,352,000 or 45.3%, concluding at \$4,335,000 compared to \$2,983,000 in Quarter 3, 2007, and was up \$3,390,000 or 35.0%, finishing at \$13,078,000 year-to-date versus \$9,688,000 last year.

EBITDA (earnings before interest, taxes, depreciation and amortization) for Quarter 3, 2008 was \$7,379,000 versus \$5,096,000, in Quarter 3, 2007, an increase of \$2,283,000 or 44.8% and year-to-date was \$22,671,000 versus \$16,974,000, an increase of \$5,697,000 or 33.6%. Although there is not a standard definition of this term, the Company uses EBITDA as a non-GAAP financial measure as one of its indicators of operational profitability.

EBITDA is calculated as outlined in the following table:

	Quarter 3 2008	Quarter 3 2007	YTD 2008	YTD 2007
Net earnings	\$ 4,335,000	\$ 2,983,000	\$13,078,000	\$ 9,688,000
Add:				
Interest expense	\$ 49,000	\$ 38,000	\$ 228,000	\$ 250,000
Income tax expense	\$ 2,150,000	\$ 1,511,000	\$ 6,588,000	\$ 5,356,000
Depreciation and amortization	\$ 845,000	\$ 564,000	\$ 2,777,000	\$ 1,680,000
<b>EBITDA</b>	<b>\$ 7,379,000</b>	<b>\$ 5,096,000</b>	<b>\$22,671,000</b>	<b>\$16,974,000</b>

## CAPITAL RESOURCES AND LIQUIDITY

Cash provided by operations for Quarter 3, 2008 was \$3,735,000, versus \$2,219,000, in Quarter 3, 2007, an increase of \$1,516,000. Cash used by operations year-to-date was \$1,268,000, versus cash provided by operations of \$426,000 in 2007, an increase in cash used by operations of \$1,694,000.

Working capital requirements to support our sales growth resulted in increased accounts receivable (+\$2,505,000) and inventory (+\$1,249,000) which was partially offset by a rise in accounts payable and accruals (+\$1,242,000) from Quarter 2, 2008. The Company continues to focus on its customer accounts receivable collections and inventory turnover velocity.

Capital expenditures were up \$3,375,000, or 445.9% finishing at \$4,132,000, this quarter compared to \$757,000, for Quarter 3, 2007, and increased 301.2% or \$4,918,000, year-to-date, finishing at \$6,551,000 compared to \$1,633,000 in 2007.

The company purchased a new Canadian distribution warehouse in the Quarter for \$2,250,000 as well invested in machinery and equipment relating to the startup of the second Mexican manufacturing facility. Capital expenditures in Quarter 3, 2008 were related to manufacturing capacity expansion initiatives in several of our locations, productivity improvement projects and information technology infrastructure.

Cash used in financing activities resulted from financing costs and repayment of long-term debt of \$159,000, in Quarter 3, 2008, and \$729,000 year-to-date, compared to \$169,000, for the same quarter last year and \$506,000 year-to-date 2007.

Bank operating lines increased by \$82,000 in Quarter 3, 2008, as compared to a decrease in Quarter 3, 2007 of \$209,000.

Overall bank operating lines of credit and long term debt, net of cash balances increased to \$9,884,000 as at September 27, 2008, an increase of \$8,839,000 or 845.8% as compared to a balance of \$1,045,000 as at September 29, 2007. This increase can be attributed to a plant expansion in Mexico and the purchase of a new warehouse in Canada.

All scheduled payments of principal and interest have been made by the Company on the applicable due dates.

All bank covenants continue to be met as at September 27, 2008.

In early October, 2008 the Company completed a new financing arrangement with JP Morgan Chase Bank, N.A. for a \$25,000,000 U.S. revolving credit facility and a \$15,000,000 U.S. delayed draw credit facility. This financing better aligns our Canadian and U.S. banking requirements, supports our hedging strategies, provides financing for our operational requirements and capital for our strategic initiatives

## CONTINGENT LIABILITIES

The Company has two properties for which there are contingent liabilities.

### Moloney Properties (1159714 Ontario Inc.):

The Company and Hammond Manufacturing Company Limited each own 50% of the shares of 1159714 Ontario Inc., which in turn owns the property at 213 Sterling Road, Toronto, occupied by Moloney Electric Inc. ("MEI"). The property has mineral oil contamination as well as some PCB contamination; the source of such contamination (except for a spill in 1993 by MEI) has not been determined. The contamination does not result from the normal operations of the Company. It appears to pre-date the Company's ownership. The source or sources may include adjoining properties. As indirect owner and occupier, the Company and Hammond Manufacturing Company Limited may, without admitting any liability, have some responsibility to participate in the remediation of the property and adjacent properties. In this regard, the Company received a complaint in 1994 from Toronto Hydro, as an adjoining owner, to the effect that mineral oil and possibly PCB contaminants may have migrated to its property, which is an inactive substation. The Company has worked in conjunction with the Ontario Ministry of the Environment and with Toronto Hydro to remediate the properties. The Company continues to review further remediation activities. 1159714 Ontario Inc. will fund current recovery, monitoring, professional fees and reporting, at this site through its rental income received from Moloney Electric Inc. No determination as to the specifics of full remediation has been made, but the recovery period is expected to take several years.

### Glen Ewing Properties:

The property at 2 Glen Road, Georgetown, Ontario is owned equally as a co-tenant with Hammond Manufacturing Company Limited and any expenses or liabilities in respect of the property have been agreed to be shared equally. In January 2002, the two owners were served with a statement of

claim by an adjoining industrial property owner in which the plaintiff has claimed damages in the amount of \$8 million for negligence, breach of warranty and other matters relating to alleged environmental contamination of the property. The Company intends to vigorously defend the action if it proceeds. In 2004, the Company and Hammond Manufacturing Company Limited served a counter-claim against the plaintiff in the amount of \$8 million. Both claims, by agreement between the parties, are in abeyance. The contamination does not result from the normal operations of the Company. The parties, under the direction of the Ontario Ministry of the Environment, are in the process of undertaking a coordinated and shared investigation of the condition of the property and remediation options. In 2006, the exact approach for active remediation was not finalized but there was a determination of remediation alternatives and estimates of related costs to the Company. In 2007, the Company undertook a detailed selection process for the engagement of environmental remediation consultants and finalizing a remediation plan and is now just entering the first phase of the plan. The Company is satisfied that the best estimate available for the Company's portion of the environmental remediation costs for this site remains at \$383,000 (December 31, 2006 - \$383,000). Excluding the provision, HPS will share the ongoing operational legal and consulting costs pertaining to the Glen Road site with Hammond Manufacturing Company Limited.

Other than the above sites, management is not aware of any unusual or significant issues. Expenditures will be recorded as appropriate when environmental remediation is probable and the costs can be reasonably estimated in accordance with generally accepted accounting principles. Management is not aware of any other contingent liabilities.

#### **SECOND MANUFACTURING FACILITY IN MEXICO IS OPERATIONAL**

In January 2008 the Company signed a seven-year lease on a second plant in Monterrey, Mexico. The Company accepted beneficial occupancy of this facility early in Quarter 2, 2008 and completed the commissioning of the plant, equipment installation and training of employees in the second half of Quarter 3, 2008. This plant is now manufacturing and shipping transformers to the U.S and Canadian markets. The second plant in Monterrey is located close to the existing plant, which started production in mid 2001. Both these facilities support the growing, yet very competitive, commercial and industrial markets for general purpose distribution transformers and provide a dependable, high level of quality and workmanship which our worldwide customers have come to expect.

#### **CANADIAN DISTRIBUTION WAREHOUSE FACILITY**

The Company purchased a 45,000 square foot warehouse facility in Aberfoyle, Ontario, on August 29, 2008. This facility will serve as a distribution centre

that will supply standard dry-type transformers to the Canadian and north eastern U.S. customer base. This warehouse consolidates and eliminates the need of two leased facilities and was funded through our operating line of credit. It is expected that the new distribution centre will be fully operational in early Quarter 1, 2009.

#### **RISK FACTORS**

As with most businesses, Hammond Power Solutions Inc., is subject to a number of marketplace, industry and economic related business risks, which could have some material impact on our operating results.

These risks include:

- The cyclical effects, unpredictability and volatility of market costs and supply pressures for commodities such as copper, insulation and electrical grain oriented steel;
- A significant, unexpected change in the global demand for resources;
- The extreme variability of the Canadian dollar versus the U.S. dollar;
- Global economic slowdown / recession;
- Interest rates;
- Competition; and
- Global political unrest.

The company continuously works to minimize the negative impact of these risks and strengthen its position through diversification of its core business, market channel expansion, geographic diversity of its operations and business hedging strategies.

#### **STRATEGIC OUTLOOK**

As demonstrated in our Quarter 3, 2008 report, despite erratic and unpredictable economic and market conditions, the Company continues to grow in both Canada and the United States. Although to this point of the year we continue to perform well in the markets we serve, the Company is very cognizant of the slowdown in the U.S and Canadian economies, the banking crisis particularly in the U.S., the unpredictability of the Canadian dollar and resource based commodity costs and the global economic unrest.

The Company does expect that with its current backlog and bookings outlook, it will finish the year strongly as the Canadian and U.S. resource based markets continue with capital spending on new equipment and infrastructure and has momentum going into 2009.

We remain cautious yet determined that we will sustain profit rates through customer growth, productivity gains, sales development from new and competitive products and further market share penetration.

Management is committed to the achievement of its market growth and profitability goals through the execution of its strategic and operational initiatives, ensuring the Company is well capitalized and is confident that its

## SELECTED ANNUAL AND QUARTERLY FINANCIAL INFORMATION

The information contained in the following table presents the historic audited annual financial information as at December 31, 2007 and the un-audited financial information for the previous eight quarters up to, and including the Third Quarter of 2008.

The quarterly information has been extracted from our un-audited consolidated financial statements which, in the opinion of management, are prepared in accordance with Canadian generally accepted accounting principles.

### ANNUAL INFORMATION

(in thousands of dollars except earnings per share)

	2003	2004	2005	2006	2007
Sales	\$ 73,408	81,349	98,896	131,978	160,606
Earnings from operations	209	4,627	7,231	14,067	19,575
EBITDA	2,152	6,361	9,789	16,190	22,704
Net earnings (loss) for the year	(875)	1,449	3,857	8,674	12,403
Total assets	41,821	40,760	45,260	57,688	70,264
Total liabilities	24,441	21,907	22,242	25,907	25,784
Total cash (debt)	(14,395)	(10,387)	(5,463)	(180)	4,395
Cash provided from operations	3,514	5,042	4,280	7,661	7,611
Basic earnings (loss) per share	\$ (0.08)	0.13	0.34	0.76	1.08
Diluted earnings (loss) per share	\$ (0.08)	0.13	0.34	0.75	1.06

### QUARTERLY INFORMATION

(in thousands of dollars except earnings per share)

	2006	2007				2008		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Sales	36,846	40,226	41,178	40,995	38,207	<b>48,356</b>	<b>54,936</b>	<b>57,940</b>
Earnings from operations	6,165	5,707	4,656	4,108	5,104	<b>5,347</b>	<b>5,983</b>	<b>6,567</b>
EBITDA	6,569	6,316	5,562	5,096	5,730	<b>8,338</b>	<b>6,954</b>	<b>7,379</b>
Net earnings	4,349	3,584	3,121	2,983	2,715	<b>5,120</b>	<b>3,623</b>	<b>4,335</b>
Total assets	57,688	60,705	62,551	65,255	70,264	<b>86,688</b>	<b>93,467</b>	<b>99,669</b>
Total liabilities	25,907	25,297	23,846	23,508	25,784	<b>34,688</b>	<b>37,811</b>	<b>39,645</b>
Total cash (debt)	(180)	(4,622)	(2,607)	(1,045)	4,395	<b>(5,481)</b>	<b>(9,610)</b>	<b>(9,884)</b>
Cash provided								
(used) by operations	5,571	(4,133)	2,340	2,219	7,185	<b>(2,824)</b>	<b>(2,179)</b>	<b>3,735</b>
Basic earnings per share	\$ 0.38	0.31	0.27	0.26	0.24	<b>0.44</b>	<b>0.31</b>	<b>0.37</b>
Diluted earnings per share	\$ 0.38	0.31	0.27	0.26	0.23	<b>0.43</b>	<b>0.30</b>	<b>0.37</b>

## CONSOLIDATED BALANCE SHEET

(unaudited) (dollars in thousands)

	As at <b>September 27</b> 2008	As at December 31 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 327	\$ 8,394
Accounts receivable	40,009	22,708
Note receivable	–	1,574
Inventories	29,138	19,038
Prepaid expenses	307	249
Income taxes recoverable	613	855
Future income taxes	503	488
	<b>70,897</b>	<b>53,306</b>
Property, plant, and equipment	19,227	11,568
Investment in properties	1,044	1,044
Long-term investments	1,305	3,619
Deferred costs	–	138
Future income taxes	94	89
Intangible assets - customer relationships	4,988	–
Goodwill	2,114	–
Other assets	–	500
	<b>\$ 99,669</b>	<b>\$ 70,264</b>
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Bank operating lines of credit	\$ 7,550	\$ 1,609
Accounts payable and accrued liabilities	26,410	19,613
Income taxes payable	431	796
Note payable to related party	1,208	–
Current portion of long-term debt	2,661	2,390
	<b>38,260</b>	<b>24,408</b>
Accrued pension benefit obligation	24	23
Long-term debt	–	–
Future income taxes	1,137	1,129
Environmental reserve, net of current portion	224	224
Shareholders' equity:		
Share capital	13,061	10,850
Contributed surplus	503	248
Retained earnings	46,460	33,382
	<b>60,024</b>	<b>44,480</b>
	<b>\$ 99,669</b>	<b>\$ 70,264</b>

## CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE EARNINGS

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

	Quarter Ending		9 Months Ending	
	Sep 27 2008	Sep 29 2007	Sep 27 2008	Sep 29 2007
Sales	\$ 57,940	\$ 40,995	\$ 161,232	\$ 122,399
Cost of Sales	42,319	29,543	116,675	86,753
Gross Margin	15,621 27.0%	11,452 27.9%	44,557 27.6%	35,646 29.1%
Selling, general, and administrative	9,054	7,344	26,660	21,175
Earnings from operations	6,567	4,108	17,897	14,471
Other (income) and expense:				
Interest expense	49	38	228	250
Gain on sale of investment	—	—	(1,033)	—
Co-tenancy expense	33	93	98	113
Equity earnings - (refer to MD&A - Sale of MEI)	—	(517)	(1,062)	(936)
Income before income taxes	6,485	4,494	19,666	15,044
Income tax expense	2,150	1,511	6,588	5,356
Net earnings and comprehensive earnings	\$ 4,335	\$ 2,983	\$ 13,078	\$ 9,688
Earnings per share for the period				
Basic	\$ 0.37	\$ 0.26	\$ 1.12	\$ 0.84
Diluted	\$ 0.37	\$ 0.26	\$ 1.11	0.83
EBITDA	\$ 7,379	\$ 5,096	\$ 22,671	\$ 16,974

### Disclosure

In the opinion of management, these unaudited financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and use the same accounting policies used in the preparation of the Company's annual financial statements. These interim statements and notes have not been independently reviewed by the external auditors and should be read in conjunction with the December 31, 2007, Notes to the Consolidated Financial Statements.

### Segment Sales

Consistent with the prior year, HPS reflects its results under a single reportable operating segment

## CONSOLIDATED STATEMENT OF CASH FLOWS

(unaudited) (dollars in thousands)

	Quarter Ending		9 Months Ending	
	Sep 27 2008	Sep 29 2007	Sep 27 2008	Sep 29 2007
Cash provided by (used in):				
Operations:				
Net earnings	\$ 4,335	\$ 2,983	\$ 13,078	\$ 9,688
Add (deduct) items not involving cash:				
Amortization of property, plant, and equipment	757	553	2,514	1,574
Amortization of deferred costs	–	11	–	106
Amortization of intangible assets	88	–	263	–
Equity income on long-term investments	–	(517)	(1,062)	(936)
Gain on sale of investment	–	–	(1,033)	–
Accrued pension benefit obligation	–	–	1	–
Future income taxes	2	–	(12)	–
Stock option compensation costs	10	10	307	21
	\$ 5,192	3,040	14,056	10,453
Change in non-cash operating working capital	(1,457)	(821)	(15,324)	(10,027)
Cash (used in) provided by operations	\$ 3,735	\$ 2,219	(\$ 1,268)	426
Financing:				
Advances from bank operating lines	82	(209)	5,941	1,379
Issue of common shares	23	50	116	162
Note payable	–	–	1,208	–
Principal repayment of long-term debt	(159)	(169)	(729)	(506)
Cash provided by (used in) financing activities	(54)	(328)	6,536	1,035
Investments:				
Other assets	100	–	–	–
Repayment of notes receivable	–	50	1,949	180
Proceeds on disposal of investment	–	–	4,134	–
Acquisition of subsidiary company	–	–	(12,867)	–
Purchase of property, plant and equipment	(4,132)	(757)	(6,551)	(1,633)
Cash used in investment activities	(4,032)	(707)	(13,335)	(1,453)
(Decrease) increase in cash	(351)	\$ 1,184	(8,067)	8
Cash and cash equivalents, beginning of period	678	3,173	8,394	4,349
Cash and cash equivalents, end of period	\$ 327	\$ 4,357	\$ 327	\$ 4,357

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(unaudited) (dollars in thousands)

Nine-month periods ended September 27, 2008 and September 29, 2007

	Share Capital	Contributed Surplus	Retained Earnings	Total Shareholders' Equity
Balance as at December 31, 2007	\$ 10,850	248	33,382	44,480
Cash consideration on exercise of stock options	116	—	—	116
Ascribed value credited to share capital from exercise of stock options	52	(52)	—	—
Stock option compensation costs	—	307	—	307
Issue of shares	2,043	—	—	2,043
Net earnings	—	—	13,078	13,078
Balance as at September 27, 2008	\$ 13,061	503	46,460	60,024

(unaudited) (dollars in thousands)

	Share Capital	Contributed Surplus	Retained Earnings	Total Shareholders' Equity
Balance as at December 31, 2006	\$ 10,613	284	20,884	31,781
Adjustment to opening due to the new accounting policies adopted regarding financial instrument	—	—	95	95
Cash consideration on exercise of stock options	161	—	—	161
Ascribed value credited to share capital from exercise of stock options	66	(66)	—	—
Stock option compensation costs	—	22	—	22
Issue of shares	—	—	—	—
Net earnings	—	—	9,688	9,688
Balance as at September 29, 2007	\$ 10,840	240	30,667	41,747

(audited) (dollars in thousands)

	Share Capital	Contributed Surplus	Retained Earnings	Total Shareholders' Equity
Balance as at January 1, 2007	\$ 10,613	284	20,979	31,876
Cash consideration on exercise of stock options	161	—	—	161
Ascribed value credited to share capital from exercise of stock options	76	(76)	—	—
Stock option compensation costs	—	40	—	40
Net earnings	—	—	12,403	12,403
Balance as at December 31, 2007	\$ 10,850	248	33,382	44,480

## CONDENSED NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Hammond Power Solutions Inc. ("HPS" or the "Company") is a public company, traded on the Toronto Stock Exchange ("HPS.A") and is incorporated under the Ontario Business Corporations Act.

The following notes should be read in conjunction with our 2007 Notes to the Consolidated Financial Statements contained in the 2007 Annual Report for the Company.

### 1. Summary of significant accounting policies:

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following policies:

#### (a) Principles of consolidation:

The consolidated financial statements include the accounts of Hammond Power Solutions Inc. and its wholly-owned subsidiaries, Hammond Power Solutions, Inc. and Hammond Power Solutions, S.A. de C.V and Delta Transformers Inc. All significant inter-company transactions and balances have been eliminated.

#### (b) Translation of foreign currencies:

The Company's subsidiary operations, located in the United States and Mexico are deemed to be integrated foreign operations and, therefore, their financial statements are translated using the temporal method. Under this method, all asset, liability, revenue and expense items are translated at the exchange rate in effect at the transaction date. At the balance sheet dates, monetary assets and liabilities are adjusted to reflect the year end exchange rate. The gain or loss resulting from translation is included in the determination of income for the current period.

#### (c) Revenue recognition:

The Company recognizes revenue when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable.

Service revenue is recognized when the service is performed, or, in the case of maintenance contracts, is recognized as costs are incurred to fulfill the contract.

A provision for potential warranty claims is provided for at the same time of sale, based on warranty terms and prior claims experience.

#### (d) Inventories:

Inventories are valued at the lower of cost, determined on a first-in, first-out basis, and market, with market defined as net realizable value for finished goods and work-in-process, and replacement cost for raw materials.

#### (e) Long-term investments:

The investments in the co-tenancy of Glen Ewing Properties (50%) and in 1159714 Ontario Inc. (50%), the rental property investment, are accounted for using the proportionate consolidation method whereby the Company's proportionate share of the assets, liabilities and the related revenues and expenses of the co-tenancy and rental property is included in the consolidated financial statements.

#### (f) Property, plant and equipment:

Property, plant and equipment are stated at cost less accumulated amortization. Property, plant and equipment under capital leases are initially recorded at the present value of the minimum lease payments at the inception of the lease.

#### (g) Derivative financial instruments:

The Company is party to derivative financial instruments in the form of forward foreign exchange contracts used to manage foreign currency exposures on export sales. The Company records all of its forward foreign exchange contracts at fair value, with changes in fair value recognized through earnings as foreign exchange gains or losses. The carrying amount of foreign exchange contracts is included in accounts receivable in the case of contracts in a gain position and in accounts payable and accrued liabilities in the case of contracts in a loss position.

#### (h) Income taxes:

The Company provides for income taxes under the asset and liability method. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying value of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

#### (i) Stock-based compensation:

The Company has a stock-based compensation plan, which is described in note 14(c). The Company accounts for all stock-based payments using the fair value based method, in accordance with CICA Handbook Section 3870 – *Stock based compensation and other stock based payments*.

Under the fair value based method, compensation cost for stock options and direct awards of stock is measured at fair value at the grant date. Compensation cost is recognized in earnings on a straight-line basis over the relevant vesting period. The counterpart is recognized in contributed surplus. Upon exercise of a stock option, share capital is recorded at the sum of the proceeds received and the related amount of contributed surplus.

#### (j) Use of estimates:

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant items subject to such estimates and assumptions include the carrying amount of property, plant and equipment, valuation of receivables, inventories, future income taxes, long-term investments, investment in properties and derivative financial instruments and obligations related to accrued pension benefit obligation and environmental liabilities. Actual results could differ from those estimates.

#### (k) Share capital:

Authorized:

Unlimited number of special shares, discretionary dividends, non-voting, redeemable and retractable.

Unlimited number of Class A subordinate voting shares.

Unlimited number of Class B common shares with four votes per share, convertible into Class A subordinate voting shares on a one-for-one basis. Annual dividends on the Class B common shares may not exceed the annual dividends on the Class A subordinate voting shares.

Issued:	(dollars in thousands)	
	2007	2006
8,726,000 Class A shares (2006 - 8,657,000)	\$ 10,843	\$ 10,606
2,778,300 Class B common shares (2006 - 2,778,300)	7	7
11,504,300 total Class A and B shares	\$ 10,850	\$ 10,613

## 2. Future accounting changes:

The CICA has issued the following new Handbook Sections that will become effective on January 1, 2008 for the Company:

- CICA Handbook Section 3862, "Financial Instruments – Disclosures"
- CICA Handbook Section 3863, "Financial Instruments – Presentation"
- CICA Handbook Section 1535, "Capital Disclosures"
- CICA Handbook Section 3031, "Inventories"

CICA Handbook Section 3862 modifies the disclosure requirements for CICA Handbook Section 3861, "Financial Instruments – Disclosure and Presentation", including required disclosure for the assessment of the significance of financial instruments for an entity's financial position and performance and of the extent of risks arising from financial instruments to which the Company is exposed and how the Company manages those risks. CICA Handbook Section 3863 carries forward the presentation requirements of CICA Handbook Section 3861. The Company is currently evaluating the impact of the adoption of these standards.

CICA Handbook Section 1535 establishes standards for disclosing information about an entity's capital and how it is managed. The entity's disclosure should include information about its objectives, policies and processes for managing capital and disclose whether or not it has complied with any capital requirements to which it is subject and the consequences of non-compliance. The Company is currently evaluating the impact of adoption of this new standard.

CICA Handbook Section 3031 provides additional guidance on the measurement and disclosure requirements for inventories. Specifically, the new pronouncement requires inventories to be measured at the lower of cost and net realizable value, and provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. The Company is currently evaluating the impact of adoption of this new standard.

## 3. Adaptation of New Accounting Standards:

### Capital Risk Management

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future business development. The company includes cash and cash equivalents, debt and equity, comprising of issued common shares, contributed surplus and retained earnings in the definition of capital. The company is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital risk management strategy during the three months ended September 27, 2008.

### Financial Risk Management

The Company is exposed to a variety of financial risks by virtue of its activities: market risk (including currency risk, credit risk and interest rate risk) and liquidity risk. The overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on financial performance.

Risk management is carried out by the finance department under guidance by the Board of Directors. This department identifies and evaluates financial risks in close cooperation with management. The finance department is charged with the responsibility of establishing controls and procedures to ensure that financial risks are mitigated.

### Currency Risk

The Company operates internationally and is exposed to foreign exchange risk from various currencies, primarily U.S. dollars. Foreign exchange risk arises from purchase and Canada / U.S. cross border sales transactions as well as recognized financial assets and liabilities denominated in foreign currencies.

The Company manages its foreign exchange risk by having geographically diverse manufacturing facilities, purchasing U.S. dollar raw materials in Canada, and foreign exchange contracts. The Company also monitors forecasted cash flows in foreign currencies and attempts to mitigate the risk by entering into foreign exchange contracts. Foreign exchange contracts are only entered into for the purposes of managing foreign exchange risk and not for speculative purposes.

Fluctuations in the U.S. dollar exchange rate could have a potentially significant impact on the company's results from operations. However, they would not impair or enhance the ability of the Company to pay its foreign currency-denominated expenses as such items would be similarly affected.

### Sensitivity Analysis

A one cent weakening of the Canadian dollar against the U.S. dollar as at September 27, 2008 would have increased equity by \$179,000 and increased annual net income by \$100,000. This analysis assumes that all other variables, in particular interest rates, remain constant. Inversely, a one cent strengthening of the Canadian dollar against the U.S. dollar as at September 27, 2008 would have had the equal but opposite effect.

### Interest Rate Risk

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's cash and cash equivalents include highly liquid investments that earn interest at market rates.

The Company manages its interest rate risk by maximizing the interest income earned on excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis.

Fluctuations in market rates of interest do not have a significant impact on the Company's results of operations due to the low level of bank indebtedness.

## Credit Risk

An increase in the allowance for doubtful trade accounts receivable of \$107,000 (2007 - \$107,000) was recognized in selling, general and administrative expenses in Quarter 3, 2008.

## Impairment losses

The aging of trade receivables as at:

(In thousands of Canadian dollars)	September 27, 2008		December 31, 2007	
	Gross	Allowance	Gross	Allowance
	2008	2008	2007	2007
Not past due	22,750	–	12,901	–
Past due 0-30 days	12,659	–	7,677	–
Past due 31-120 days	3,585	569	1,633	386
More than one year	173	173	9	9
<b>Total</b>	<b>39,167</b>	<b>742</b>	22,220	395

The movement in the allowance for doubtful accounts receivable in respect of trade accounts receivable during the year was as follows:

	2008	2007
Opening balance	395	–
Impairment loss recognized	347	395
<b>Ending balance</b>	<b>742</b>	<b>395</b>

## Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due. The Company manages its liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities. Senior Management is also actively involved in the review and approval of planned expenditures.

## Inventories

Commencing with the fiscal year beginning January 1, 2008, the Company will be adopting CICA handbook Section 3031, "Inventories", 3863. The inventories section establishes standards for presentation and measurement of inventories. The impact of the adoption of this new standard has not been determined although any impact to the balance sheet and income statement is not expected to be material.

## Corporate Information

### DIRECTORS

William G. Hammond, Chairman and Chief Executive Officer \*  
Chris R. Huether, Corporate Secretary and Chief Financial Officer  
Donald H. MacAdam, Director \* +  
Zoltan D. Simo, Director \* +  
Douglas V. Baldwin, Director \* +  
Grant C. Robinson, Director \* +

\* Corporate Governance Committee

+ Audit and Compensation Committee

### CORPORATE HEAD OFFICE

595 Southgate Drive  
Guelph, Ontario Canada N1G 3W6

### STOCK EXCHANGE LISTING

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

### REGISTRAR AND TRANSFER AGENT

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

### AUDITORS

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

### INVESTOR RELATIONS

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



Hammond Power  
Solutions Inc.

[www.hammondpowersolutions.com](http://www.hammondpowersolutions.com)