



**WIRE & WIRE PRODUCTS**

**ESTABLISHED IN 1964**



**2019  
Annual Report**

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

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

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

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*Mixed load to distributor*

## TO OUR SHAREHOLDERS

### Letter to Shareholders

2019 marked another year of rapid change with an evolving business environment for Tree Island. The U.S. Section 232 tariffs on certain imported steel products along with competitive pricing pressures and soft market demand in certain segments impacted both our sales volume and operating results for the year.

Our business priorities remain the same. We will continue managing our cost structure and improve the productivity of our manufacturing activities, while investing in our people and facilities, as well as capitalizing on the competitive advantages available to us.

Although 2019 was a difficult year, we continued to take steps in improving our focus on higher value-added product offerings. In that regard, during 2019 in our U.S. operations, the new welded wire mesh machine came online. This investment will support our long-term objectives and strengthen our market and cost leadership positions in mesh and concrete reinforcing products, as well as provide our customers with a one-stop shop experience for a more complete product offering. Also in 2019, we committed to the purchase of a new fence machine for our Canadian operations that will be arriving and installed in 2020. This new fence machine broadens our agricultural product offering for both Canadian and U.S. markets.

Looking to 2020, the outlook remains positive for our end markets. With the removal of the Section 232 tariffs we anticipate to return to historical sales levels in the product areas most affected. While this outlook remains positive, we caution that the volatility caused by trade actions and Section 232 may continue. The trade environment continues to be unpredictable and can require us to manage our supply chains and product mix differently. We will continue to adapt our product offering and business strategies to address any future trade impacts or opportunities that could arise.

As in prior years, we would like to thank all our employees, customers and shareholders for their continued support. We would not have been able to address the challenges we experienced in 2019 without the trust and confidence placed on the Tree Island brand. With the retirement of Dale MacLean in November 2019, we thank him for his service and contributions to the Company.

Sincerely,

Amar S. Doman  
Chairman of the Board of Directors

# MANAGEMENT DISCUSSION AND ANALYSIS

December 31, 2019

The following is a discussion of the financial condition and results of operations of Tree Island Steel ("Tree Island" or the "Company") and its wholly owned operating subsidiary Tree Island Industries (together with Tree Island Steel, referred to as "Tree Island"). This discussion is current to March 5, 2020 and should be read in conjunction with the consolidated financial statements for the year ended December 31, 2019. Tree Island Steel's consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") and are reported in Canadian dollars. Additional information relating to Tree Island Steel, including the audited consolidated financial statements and Annual Information Form ("AIF") for the year ended December 31, 2019, can be found at [www.sedar.com](http://www.sedar.com) or on Tree Island Steel's website at [www.treeisland.com](http://www.treeisland.com).

## 1 FORWARD LOOKING STATEMENTS AND RISK

This management's discussion and analysis ("MD&A") includes forward-looking information with respect to Tree Island Steel, including our business, operations and strategies, as well as financial performance and conditions. The use of forward-looking words such as, "may," "will," "expect" or similar variations generally identify such statements. Any statements that are not statements of historical fact should be considered to be forward-looking statements. Although we believe that the forward-looking statements are reasonable, they involve risks and uncertainties, including the risks and uncertainties discussed under the heading "Risks Relating to the Company's Business" in the Company's AIF for the year ended December 31, 2019.

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

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

## 2 NON-IFRS MEASURES

References in this MD&A to EBITDA are to provide an “Adjusted EBITDA” that we define as operating income and adding back total depreciation, foreign exchange gains or losses and deducting the IFRS 16 depreciation impact. Adjusted EBITDA is not a measure recognized by IFRS and does not have a standardized meaning prescribed by IFRS. We believe that providing an Adjusted EBITDA is an important supplemental measure for evaluating our performance. You are cautioned that our definition of Adjusted EBITDA should not be construed as an alternative to net income or loss determined in accordance with IFRS, nor should it be used as an indicator of performance, cash flows from operating, investing and financing activities, as a measure of liquidity or cash flows. Our method of calculating Adjusted EBITDA may differ from methods used by other issuers and, accordingly, our definition of Adjusted EBITDA may not be comparable to similar measures presented by other issuers.

## 3 TREE ISLAND STEEL

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

There were 28,831,637 Shares outstanding as of December 31, 2019 and the same amount of shares outstanding as of March 5, 2020.

### 3.1 ORGANIZATIONAL STRUCTURE

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

### 3.2 PRODUCTS

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

We market our products under the following brands:



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

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

### 3.3 MARKETS

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

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

### 3.4 SEASONALITY

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

## **4 FULL YEAR 2019 BUSINESS OVERVIEW AND DEVELOPMENT**

### **4.1 BUSINESS OVERVIEW**

During the first two quarters of 2019, the continued impact of U.S. Section 232 tariffs on steel imported into the U.S. reduced volumes from the Industrial segment, as several products within this segment were subject to a 25% import tariff. Section 232 also brought about the proliferation of lower priced imported finished and semi-finished products that were not subject to the 25% tariff, which contributed to the compression of margins and reduction in overall shipments.

On May 19, 2019, Canada and the U.S. reached an agreement that eliminates all tariffs the U.S. imposed under Section 232 on imports of steel from Canada, and eliminates all tariffs Canada imposed in retaliation to the Section 232 action taken by the U.S. Since the announcement of the agreement, demand for our products has increased but by the end of 2019 had not yet reached the levels we had experienced in the past. This relates primarily to sales in the U.S. in our Industrial markets, which were the most impacted by these tariffs, and to a lesser degree in our Agricultural markets. We are anticipating customer purchase behaviour to return to normalized levels in 2020.

For the year-ended December 31, 2019, total revenues were \$200.4 million, which represents a 14.8% decrease to 2018. This decrease is attributable to a lower sales volumes to U.S. customers, especially in the Industrial and Residential markets. As noted, these markets were also impacted by Section 232 steel tariffs in the first half of 2019. An additional factor impacting revenue for the year was a softer market demand in the Residential and Commercial markets. These impacts resulted in a gross profit of \$17.8 million for 2019, compared to \$25.8 million in 2018. As a result Adjusted EBITDA in 2019 amounted to \$4.8 million compared to \$13.4 million for 2018.

During 2019 our new welded wire mesh machine has come online in our U.S. Etiwanda facility. This investment will support our long-term objectives and strengthen our market and cost leadership positions in mesh and concrete reinforcing products, as well as provide our customers with a one-stop shop experience for a more complete product offering. Also in 2019, we committed to the purchase of a new fence machine for our Canadian operations that will be arriving and installed in 2020. This new fence machine broadens our agricultural product offering for both Canadian and U.S. markets.

### **4.2 UNSOLICITED NON-BINDING ACQUISITION PROPOSAL**

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

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

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

### 4.3 DEPARTURE OF THE CEO

On November 18, 2019 the Company announced that the President and CEO of the Company retired and departed the company. The Board is in the process of searching for a replacement CEO. In the interim both the Chief Operating Officer and Chief Financial Officer report directly to the Board.

## 5 RESULTS FROM OPERATIONS

(\$'000 unless otherwise stated)

		Year Ended December 31,	
	2019	2018	2017
Revenue	200,405	235,306	234,705
Cost of sales	(176,407)	(205,977)	(213,223)
Depreciation <sup>1</sup>	(6,227)	(3,492)	(3,291)
Gross profit	17,771	25,837	18,191
Selling, general and administrative expenses	(15,757)	(16,646)	(13,899)
Operating income	2,014	9,191	4,292
Foreign exchange gain (loss)	(676)	706	(582)
Gain (loss) on property, plant and equipment	5	(664)	(47)
Restructuring and other expenses	(1,901)	(903)	(635)
Changes in financial liabilities recognized at fair value	(1)	(67)	84
Financing expenses <sup>2</sup>	(4,662)	(3,500)	(2,967)
Income (loss) before income taxes	(5,221)	4,763	145
Current income tax (expense) recovery	(14)	(332)	(2)
Deferred income tax (expense) recovery	45	(1,838)	(1,781)
Net income (loss)	(5,190)	2,593	(1,638)
Net income/ (loss) per share	(0.18)	0.09	(0.05)
Dividends per share	0.08	0.08	0.08
Financial position as at:		December 31,	
	2019	2018	2017
Total assets <sup>3</sup>	159,122	158,449	133,681
Total non-current financial liabilities <sup>3</sup>	85,627	71,725	51,824

<sup>1</sup> Tree Island recognized depreciation from the adoption of IFRS 16 of \$2.7 million for the year. See Note 3 and 8 of the fiscal year (FY) 2019 Audited Consolidated Financial Statements.

<sup>2</sup> Tree Island recognized financing expenses from the adoption of IFRS 16 of \$1.4 million for the year. See Notes 3 and 11 of the FY 2019 Audited Consolidated Financial Statements.

<sup>3</sup> See Note 8 of the 2019 Audited Consolidated Financial Statements.



## 6 ADJUSTED EBITDA

(\$'000 unless otherwise stated)

	Year Ended December 31,		
	2019	2018	2017
Operating income (loss)	2,014	9,191	4,292
Add back depreciation	6,227	3,492	3,291
Foreign exchange gain (loss)	(676)	706	(582)
EBITDA	7,565	13,389	7,001
IFRS 16 depreciation adjustment	(2,722)	-	-
Adjusted EBITDA <sup>4</sup>	4,843	13,389	7,001

## 7 COMPARISON OF RESULTS FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

(\$'000 unless otherwise stated)	2019	2018	Variance Fav/(Unfav)	
<b>SALES</b>	200,405	235,306	(34,901)	(14.8%)

The decrease in revenues over the prior year by 14.8% is primarily due to a combination of lower volumes shipped to the U.S. from our Industrial segment on account of U.S. Section 232 import tariffs affecting the first half of the year along with aggressive competitive pricing, and softer market demand impacting the residential markets.

### Revenue by Market Segment

(\$'000 unless otherwise stated)

	Years Ended December 31,					
	2019		2018		Variance	
	Revenue	% of Total	Revenue	% of Total	Amount	%
Industrial	67,358	33.6%	79,295	33.7%	(11,937)	(5.1%)
Commercial	51,348	25.6%	54,375	23.1%	(3,027)	(1.3%)
Agricultural	27,134	13.5%	28,044	11.9%	(910)	(0.4%)
Residential	54,565	27.3%	73,592	31.3%	(19,027)	(8.1%)
Total revenue	200,405	100.0%	235,306	100.0%	(34,901)	(14.8%)

### Revenue by Location

(\$'000 unless otherwise stated)

	Years Ended December 31 ,					
	2019		2018		Variance	
	Revenue	% of Total	Revenue	% of Total	Amount	%
United States	120,497	60.1%	148,410	63.1%	(27,913)	(18.8%)
Canada	72,528	36.2%	80,381	34.1%	(7,853)	(9.8%)
International	7,380	3.7%	6,515	2.8%	865	13.3%
Total	200,405	100.0%	235,306	100.0%	(34,901)	(14.8%)
Average C\$/U.S.\$	1.3269		1.2925			

<sup>4</sup> See definition of Adjusted EBITDA in Section 2 NON-IFRS MEASURES.

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

<i>(\$'000 unless otherwise stated)</i>	<u>2019</u>	<u>2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>COST OF SALES</b>	176,407	205,977	29,570	14.4%

The cost of goods sold decreased when compared to prior year due to lower raw materials costs and a rebalance in production mix, to match lower volumes.

<i>(\$'000 unless otherwise stated)</i>	<u>2019</u>	<u>2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>GROSS PROFIT</b>	17,771	25,837	(8,066)	(31.2%)

Gross profit for the year amounted to \$17.8 million versus \$25.8 million during the same period in 2018, mainly the result of lower Industrial market volumes, aggressive competitive pricing actions combined with softer residential construction market demand. The gross profit margin for the year was 8.9% compared to 11.0% the prior year.

<i>(\$'000 unless otherwise stated)</i>	<u>2019</u>	<u>2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>SG&amp;A EXPENSES</b>	15,757	16,646	889	5.3%

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

<i>(\$'000 unless otherwise stated)</i>	<u>2019</u>	<u>2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>FINANCING EXPENSES</b>	4,662	3,500	(1,162)	(33.2%)

Financing expenses increased primarily from the adoption of IFRS 16, increasing financing costs by \$1.4 million.

#### Financing Expense

*(\$'000 unless otherwise stated)*

	Years Ended December 31,			
	<u>2019</u>	<u>2018</u>	<u>Variance Fav / (Unfav)</u>	
			<u>Amount</u>	<u>%</u>
Non-cash financing expenses	767	931	164	17.6%
Interest on senior credit facility	1,637	1,533	(104)	(6.8%)
Interest on lease liability	1,417	-	(1,417)	(100.0%)
Other interest and financing costs	805	946	141	14.9%
Deferred financing costs	36	90	54	60.0%
Total financing expenses	4,662	3,500	(1,162)	(33.2%)

<i>(\$'000 unless otherwise stated)</i>	<u>2019</u>	<u>2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>FOREIGN EXCHANGE</b>	(676)	706	(1,382)	(195.8%)

Our Canadian operation, whose functional currency is the Canadian dollar, has a portion of its assets, liabilities, sales and expenses denominated in currencies other than the Canadian dollar, in particular the U.S. dollar. With raw material costs being denominated in U.S. dollars, having a significant portion of our sales also being denominated in U.S. dollars creates a natural partial hedge. Foreign currency forward contracts are used to manage a portion of the remaining currency risk. Foreign exchange gains and losses are unpredictable in nature and therefore can vary significantly over time. As at December 31, 2019, the Company did not have any U.S. dollar currency forward contracts outstanding.

<i>(\$'000 unless otherwise stated)</i>	<u>2019</u>	<u>2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>RESTRUCTURING (EXPENSE)</b>	(1,901)	(903)	(998)	(110.5%)

Restructuring charges for 2019 include \$1.15 million in termination benefits paid to the former CEO in accordance with his employment contract, as well as other severance amounts for restructuring actions taken in the year.

<i>(\$'000 unless otherwise stated)</i>	<u>2019</u>	<u>2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>INCOME TAX RECOVERY (EXPENSE)</b>	31	(2,170)	2,201	101.4%

The income tax expense for 2019 is based on a statutory rate of 27% for Canadian taxable income and 21% for U.S. based taxable income applied to the income of the respective subsidiaries before taxes, with adjustments for permanent differences between accounting and taxable income.

<i>(\$'000 unless otherwise stated)</i>	<u>YTD 2019</u>	<u>YTD 2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>NET INCOME (LOSS)</b>	(5,190)	2,593	(7,783)	(300.2%)

The net loss over the prior year is attributable to the lower gross profit, compared to prior year, and is offset by lower SG&A expenses for the current year.

## 8 FINANCIAL CONDITION AND LIQUIDITY

### 8.1 WORKING CAPITAL

A summary of the composition of our working capital as at December 31, 2019 compared to 2018 is provided below:

#### Working Capital

*(\$'000 unless otherwise stated)*

	As at December 31,	
	<u>2019</u>	<u>2018</u>
Cash	907	1,277
Accounts receivable	24,250	24,128
Inventories	55,034	81,619
Other current assets	3,759	2,758
Total current assets	<u>83,950</u>	<u>109,782</u>
Accounts payable and accrued liabilities	(18,402)	(22,017)
Dividends payable	(577)	(584)
Other current liabilities	(238)	(517)
Current portion of long term debt	(4,057)	(4,980)
Current portion of ROU <sup>5</sup> lease liability	(1,568)	-
Total current liabilities	<u>(24,842)</u>	<u>(28,098)</u>
Net working capital	<u>59,108</u>	<u>81,684</u>

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

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

<sup>5</sup> Please see Note 3 and 8 in the 2019 Audited Consolidated Financial Statements.

Accounts receivable as at December 31, 2019 was slightly higher than the same period last year, reflecting the increase in sales in Q4 2019 compared to the same period in the prior year.

Inventories levels were lower as at December 31, 2019 when compared to the same period in 2018 as a result of planned reduction in levels of raw materials and other inventories on hand.

The decrease in accounts payable and accrued liabilities is reflective of the decrease in raw materials, purchased in Q4 2019 relative to the same period last year, and difference in the timing of payments made and expenses incurred.

Our objective for managing the investment in working capital is to maximize the turnover of productive current assets, being accounts receivable and inventories. We work with our key vendors to use vendor credit when available on advantageous terms.

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

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

## 8.2 CASH FLOW

### Cash Flow

*(\$'000 unless otherwise stated)*

	Years Ended December 31,	
	2019	2018
Cash provided by operating activities	5,127	12,857
Working capital adjustments	21,085	(16,758)
Net cash provided by (used in) operating activities	26,212	(3,901)
Net cash used in investing activities	(1,942)	(8,507)
Advance on (repayment of) senior term loans	(1,970)	2,587
Repayment of long-term debt	(2,224)	(1,873)
Other payables	(47)	1,127
Lease interest paid	(1,417)	-
Interest paid	(2,504)	(2,393)
Deferred financing expenses	(39)	(183)
Advance on (repayment of) senior revolving facility	(11,634)	16,328
Dividend paid	(2,320)	(2,356)
Lease principal paid	(1,714)	-
Share buyback	(721)	(1,262)
Net cash provided by (used in) financing activities	(24,590)	11,975
Exchange rate changes on foreign cash balances	(50)	59
Increase (decrease) in cash balances	(370)	(374)

On adoption of IFRS 16 Leases, the comparative information presented for 2018 have not been restated and is presented as previously reported. See Section 14 ACCOUNTING POLICIES AND STATEMENTS.

For the year, net cash from operating activities has increased compared to prior year as a direct result of the reduction of inventory. The net cash used in investing activities was from capital investments which are further described in Section 9. The net cash used by financing activities was mainly due to repayments on the senior revolving facility, long terms debt and lease obligations.

### **8.3 SENIOR CREDIT FACILITY**

On July 1, 2018, the Company renewed its senior secured committed banking facility, maturing in June of 2023, which enables the Company to borrow up to \$80.0 million in Canadian and/or U.S. funds. Interest payable on funds borrowed in Canadian currency is at variable rates based on the Canadian Dollar Offered Rate (“CDOR”) for Canadian dollar banker’s acceptance. Interest payable on funds borrowed in U.S. currency is at variable rates based on the London Interbank Offered Rate (“LIBOR”) for U.S. dollar deposits. For the revolving facility, up to \$60 million may be borrowed at any time in Canadian and/or U.S. dollars with the amount advanced under the revolving facility limited to a defined percentage of inventories, accounts receivable, machinery and equipment, and real estate, less certain reserves. In addition, up to \$20 million may be borrowed as term debt, in Canadian and/or U.S. dollars for financing existing machinery and equipment and future capital expenditures.

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

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

As at December 31, 2019 the availability was in excess of the Availability Test and the Company was in compliance with its covenants on the Senior Credit Facility.

### **8.4 LONG TERM DEBT AGREEMENT**

On June 11, 2012, Tree Island entered into a Second Amendment to the long-term debt agreement (“Agreement”). Under the terms of this Agreement, the total principal debt amount of approximately U.S.\$15.8 million is to be repaid monthly over a ten year amortization period, of which \$5.2 million is outstanding as at December 31, 2019. Interest, which began accruing in June 2017, is non-compounding. The interest owed is payable over a four year period beginning June 2024 (see Note 10 in the consolidated financial statements). In November 2019, the Company and the Lender agreed to a three month reduction in principal payments.

## **9 CAPITAL EXPENDITURES AND CAPACITY**

For the fourth quarter and full year ended December 31, 2019, we made capital expenditures of \$0.3 million and \$1.9 million, respectively. These expenditures were for capital maintenance activities and new manufacturing equipment. As noted in section 10 of this MD&A there are a further \$1.0 million in capital equipment commitments in 2020, which represent the final balances payable for capital equipment delivered in 2020.

## 10 CONTRACTUAL OBLIGATIONS AND COMMITMENTS

As of December 31, 2019, we were committed to the contracts, operating leases and debt repayments (including scheduled interest payments on interest bearing debt) set out below, which will be financed through working capital and our Senior Credit Facility.

The production materials include raw materials, such as wire rod and zinc, and finished goods. The raw materials, wire rod and zinc, are used in the day-to-day operations of our manufacturing facilities and are in the normal course of our business activities. Finished goods are purchased for resale without further processing and are also in the normal course of our business activities. All committed production materials are to be delivered prior to the end of Q2 2020.

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

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

From time to time, the Company enters into U.S. dollar currency forward contracts for periods consistent with a portion of U.S. dollar currency transaction exposures, generally from one to three months. These are not designated as cash flow, fair value or net investment hedges. As of December 31, 2019, the Company did not have any U.S. dollar currency forward contracts outstanding.

### Contractual Obligations and Commitments

(\$'000 unless otherwise stated)

	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>Thereafter</u>	<u>Total</u>
Production materials	31,601	-	-	-	-	-	31,601
Machinery and equipment	985	-	-	-	-	-	985
Total commitments	<u>32,586</u>	-	-	-	-	-	<u>32,586</u>
AP and accrued liabilities	18,402	-	-	-	-	-	18,402
Other current liabilities	238	-	-	-	-	-	238
Dividends	577	-	-	-	-	-	577
Lease liabilities	784	2,874	2,829	2,880	2,534	37,094	48,995
Senior revolving facility	-	-	-	38,162	-	-	38,162
Senior term loans (principal)	1,960	1,960	1,960	1,960	1,960	1,394	11,194
Senior term loans (interest)	362	292	223	155	86	19	1,137
Long-term debt	2,097	2,097	1,211	709	-	4,893	11,007
Total financial liabilities	<u>24,420</u>	<u>7,223</u>	<u>6,223</u>	<u>43,866</u>	<u>4,580</u>	<u>43,400</u>	<u>129,712</u>
Total obligations and commitments	<u>57,006</u>	<u>7,223</u>	<u>6,223</u>	<u>43,866</u>	<u>4,580</u>	<u>43,400</u>	<u>162,298</u>

## 11 COMPARISON OF RESULTS FOR THE THREE MONTHS ENDED DECEMBER 31, 2019 and 2018

(\$'000 unless otherwise stated)

	Three Months Ended December 31,	
	2019	2018 <sup>6</sup>
Revenue	45,144	44,882
Cost of sales	(40,046)	(40,293)
Depreciation <sup>7</sup>	(1,616)	(903)
Gross profit	3,482	3,686
Selling, general and administrative expenses	(3,967)	(3,932)
Operating income	(485)	(246)
Foreign exchange gain (loss)	(490)	408
Gain (loss) on property, plant and equipment	5	(666)
Restructuring and other expenses	(1,419)	(799)
Changes in financial liabilities recognized at fair value	(1)	22
Financing expenses <sup>8</sup>	(1,072)	(1,008)
Income (loss) before income taxes	(3,462)	(2,289)
Current income tax (expense) recovery	217	(21)
Deferred income tax (expense) recovery	46	(24)
Net income (loss)	(3,199)	(2,334)
Net income per share	(0.11)	(0.08)
Dividends per share	0.02	0.02

## 12 ADJUSTED EBITDA

(\$'000 unless otherwise stated)

	Three Months Ended December 31,	
	2019	2018 <sup>9</sup>
Operating income (loss)	(485)	(246)
Add back depreciation	1,616	903
Foreign exchange gain (loss)	(490)	408
EBITDA	641	1,065
IFRS 16 adjustment	(684)	-
Adjusted EBITDA <sup>10</sup>	(43)	1,065

<sup>6</sup> On adoption of IFRS 16 Leases, the comparative information presented for 2018 have not been restated and is presented as previously reported. See Section 14 ACCOUNTING POLICIES AND STATEMENTS.

<sup>7</sup> Tree Island recognized depreciation from the adoption of IFRS 16 during Q4 2019 of \$0.7 million. See Note 3 and 8 of the FY 2019 Audited Consolidated Financial Statements.

<sup>8</sup> Tree Island recognized financing expenses from the adoption of IFRS 16 of \$0.3 million during Q4 2019. See Notes 3 and 11 of the FY 2019 Audited Consolidated Financial Statements.

<sup>9</sup> On adoption of IFRS 16 Leases, the comparative information presented for 2018 have not been restated and is presented as previously reported. See Section 14 ACCOUNTING POLICIES AND STATEMENTS.

<sup>10</sup> See definition of Adjusted EBITDA in Section 2 NON-IFRS MEASURES.

<i>(\$'000 unless otherwise stated)</i>	<u>Q4 2019</u>	<u>Q4 2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>SALES</b>	45,144	44,882	262	0.6%

Revenue for the quarter increased by 0.6% primarily due to increased volumes compared to the same time in 2018.

<i>(\$'000 unless otherwise stated)</i>	<u>Q4 2019</u>	<u>Q4 2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>COST OF SALES</b>	40,046	40,293	247	0.6%

The cost of goods sold decreased when compared to the same period last year, on lower raw material costs.

<i>(\$'000 unless otherwise stated)</i>	<u>Q4 2019</u>	<u>Q4 2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>GROSS PROFIT</b>	3,482	3,686	(204)	(5.5%)

Gross profit for the three months amounted to \$3.5 million versus \$3.7 million during the same period last year. The decrease in gross profit is primarily a result of a change in product mix during the quarter.

<i>(\$'000 unless otherwise stated)</i>	<u>Q4 2019</u>	<u>Q4 2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>SG&amp;A EXPENSES</b>	3,967	3,932	(35)	(0.9%)

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

<i>(\$'000 unless otherwise stated)</i>	<u>Q4 2019</u>	<u>Q4 2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>FINANCING EXPENSES</b>	1,072	1,008	(64)	(6.3%)

Financing expenses for the quarter include an additional \$347 thousand, when compared to the same period in the prior year, as a result of IFRS 16 implementation in 2019. 2018 comparative numbers have not been adjusted for this implementation. Please see Note 3 of the Audited Consolidated Financial Statements for further details. Additionally, the quarter includes a total \$283 thousand reduction in non cash financing expenses, interest on senior credit facility and other interest and financing costs when compared to the same period in the prior year.

<i>(\$'000 unless otherwise stated)</i>	<u>Q4 2019</u>	<u>Q4 2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>FOREIGN EXCHANGE</b>	(490)	408	(898)	(220.1%)

Our Canadian operation, whose functional currency is the Canadian dollar, has a portion of its assets, liabilities, sales and expenses denominated in currencies other than the Canadian dollar, in particular the U.S. dollar. With raw material costs being denominated in U.S. dollars, having a significant portion of our sales also being denominated in U.S. dollars creates a natural partial hedge. Foreign currency forward contracts are used to manage a portion of the remaining currency risk. Foreign exchange gains and losses are unpredictable in nature and therefore can vary significantly over time. As at December 31, 2019, the Company did not have any U.S. dollar currency forward contracts outstanding.

<i>(\$'000 unless otherwise stated)</i>	<u>Q4 2019</u>	<u>Q4 2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>RESTRUCTURING (EXPENSE)</b>	(1,419)	(799)	(620)	(77.6%)

Restructuring charges for Q4 2019 include \$1.15 million in termination benefits paid to the former CEO in accordance with his employment contract.

<i>(\$'000 unless otherwise stated)</i>	<u>Q4 2019</u>	<u>Q4 2018</u>	<u>Variance Fav/(Unfav)</u>	
<b>INCOME TAX (EXPENSE)</b>	263	(45)	308	684.4%

The income tax expense for Q4 2019 is based on the Canadian statutory rate of 27%, with adjustments for permanent differences between accounting and taxable income.



<i>(\$'000 unless otherwise stated)</i>	<b>Q4 2019</b>	<b>Q4 2018</b>	<b>Variance Fav/(Unfav)</b>	
<b>NET INCOME (LOSS)</b>	(3,199)	(2,334)	(865)	(37.1%)

The net loss before income taxes in Q4 2019 was higher due to restructuring charges.

### 13 SUMMARY OF QUARTERLY FINANCIAL RESULTS

The table below provides selected quarterly financial information for the eight most recent fiscal quarters to December 31, 2019. Sales volumes in the fourth quarter of the year are traditionally lower in the year due to the seasonality of our business. Quarter-over-quarter results may also be impacted by unusual or infrequently occurring items. On adoption of IFRS 16 Leases, the comparative information presented for 2018 have not been restated and is presented as previously reported.

#### Summary of Quarterly Financial Results

*(\$'000 unless otherwise stated)*

	Dec 31, <u>2019</u>	Sep 30, <u>2019</u>	Jun 30, <u>2019</u>	Mar 31, <u>2019</u>	Dec 31, <u>2018</u>	Sep 30, <u>2018</u>	Jun 30, <u>2018</u>	Mar 31, <u>2018</u>
Revenue	45,144	49,701	52,618	52,942	44,882	55,846	68,087	66,491
Gross profit	3,482	4,623	4,912	4,754	3,686	6,936	8,509	6,706
Foreign exchange gain (loss)	(490)	70	(85)	(171)	408	(77)	256	119
Net income (loss)	(3,199)	(359)	(536)	(1,096)	(2,334)	1,030	2,792	1,105
Net income (loss) per unit - basic	(0.11)	(0.01)	(0.02)	(0.04)	(0.08)	0.03	0.09	0.04

Commentary:

- During 2018 the average prices of finished good products increased month-over-month to counter inflationary cost of raw materials.
- In Q2 and Q3 2019, aggressive pricing had a negative impact on revenue and margins.
- During the second half of 2018 and first half of 2019, volumes in the Industrial markets were impacted by Section 232 tariffs.
- Q4 2019 includes restructuring changes of \$1.4 million, of which \$1.15 million relates to termination benefits paid to the former CEO in accordance with his employment contract.

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

## **14 ACCOUNTING POLICIES AND STATEMENTS**

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

Our significant accounting policies are described in Note 3 of the December 31, 2019 Consolidated Financial Statements and in the Annual Information Form for the year ended December 31, 2019.

### **14.1 CRITICAL ACCOUNTING ESTIMATES**

The areas that we consider to have critical accounting estimates are: financial instruments valued at fair value through profit and loss, inventory valuation, allowance for doubtful accounts, property, plant and equipment, leases, and income taxes. These critical estimates and the judgments involved are discussed further in Note 3 to the audited Consolidated Financial Statements for December 31, 2019.

### **14.2 CHANGES IN ACCOUNTING POLICIES**

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

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

On transition, Tree Island elected to apply the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases under IAS 17. Tree Island also elected to use the recognition exemptions for lease contracts that, at the commencement date, have a lease term of 12 months or less and do not contain a purchase option (short-term leases), and lease contracts for which the underlying asset is of low value (low-value assets). The transition and impact are further discussed in Note 3 to the audited Consolidated Financial Statements for December 31, 2019.

## **15 RELATED PARTY TRANSACTIONS**

### **15.1 TRANSACTIONS WITH ASSOCIATED COMPANIES**

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

Based on Tree Island Steel’s outstanding Shares as at March 5, 2020, Futura owns 31.3% of the fully diluted Shares of the Company.

In addition, Mr. Doman is Chairman and CEO of CanWel Building Materials Group Ltd. (“CanWel”). For the twelve months ended December 31, 2019, Tree Island sold, net of rebates, approximately \$3.2 million (\$3.6 million in 2018) of goods to CanWel and trade accounts receivable owing from CanWel as at December 31, 2019 is approximately \$53 thousand (approximately \$0.1 million in 2018). Outstanding trade accounts receivable from CanWel at period end are unsecured, interest free and settlement occurs in cash.

## **15.2 TRANSACTIONS WITH KEY MANAGEMENT PERSONNEL**

Included in the definition of key management for purposes of disclosure of related party transactions are members of Board of Directors and officers of Tree Island Steel. Amounts for key management personnel for the year ended December 31, 2019 was approximately \$3.0 million (\$2.9 million approximately in 2018) which includes wages, salaries and retirement contributions, paid annual and sick leave, vehicle costs and bonuses for retired key management and also includes directors' fees paid to members of the Board. In 2019 this amount also includes termination benefits paid to the former CEO of \$1.15 million in accordance with his employment contract.

## **16 RISKS AND UNCERTAINTIES**

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

## **17 DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING**

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

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

Our management, with the participation of the Chief Financial Officer and Chief Operating Officer, who together perform similar functions to those of a chief executive officer, and the Chief Financial Officer in the capacity of chief financial officer, has conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2019 based on the 2013 COSO Framework. Based on that evaluation, management concluded that our internal control over financial reporting, as defined by National Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings*, is effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS.

Our Chief Financial Officer and Chief Operating Officer, each in their capacities as chief executive officer, and Chief Financial Officer certified the appropriateness of the financial disclosures in the annual financial report together with the other financial information included in the annual filings for the year ended December 31, 2019. These executives also certified that they are responsible for the design of disclosure controls and procedures and internal control over financial reporting.

The Company's Board of Directors and Audit Committee reviewed and approved the December 31, 2019 consolidated financial statements and this MD&A prior to its release.

## **CONSOLIDATED FINANCIAL STATEMENTS**

### **MANAGEMENT'S STATEMENT OF RESPONSIBILITY**

The accompanying consolidated financial statements are the responsibility of management and have been reviewed and approved by the Board of Directors. The consolidated financial statements have been prepared by management, in accordance with the International Financial Reporting Standards and, where appropriate, reflect management's best estimates and judgements. Management has also prepared financial and all other information in the annual report and has ensured that this information is consistent with the consolidated financial statements.

The Company maintains appropriate systems of internal control, policies and procedures, which provide management with reasonable assurance that assets are safeguarded and the financial records are reliable and form a proper basis for preparation of the consolidated financial statements.

The Board of Directors ensures that management fulfills its responsibilities for financial reporting and internal control through an Audit Committee. This committee reviews the consolidated financial statements and reports to the Directors. The auditors have full and direct access to the Audit Committee.

The consolidated financial statements have been independently audited by KPMG LLP, in accordance with Canadian generally accepted auditing standards. Their report below expresses their opinion on the consolidated financial statements of the Company.

Remy Stachowiak  
Chief Operating Officer

Nancy Davies  
Chief Financial Officer



KPMG LLP  
PO Box 10426 777 Dunsmuir Street  
Vancouver BC V7Y 1K3  
Canada  
Telephone (604) 691-3000  
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## INDEPENDENT AUDITORS' REPORT

To the Shareholders of Tree Island Steel Ltd.,

### ***Opinion***

We have audited the accompanying consolidated financial statements of Tree Island Steel Ltd. (the Company), which comprise:

- the consolidated statement of financial position as at December 31, 2019 and December 31, 2018;
- the consolidated statement of operations for the years then ended;
- the consolidated statement of comprehensive income (loss) for the years then ended;
- the consolidated statement of shareholders' equity for the years then ended;
- the consolidated statement of cash flows for the years then ended;
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2019 and December 31, 2018, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

### ***Basis for Opinion***

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.



## ***Other Information***

Management is responsible for the other information. Other information comprises:

- Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.
- Information, other than the financial statements and the auditors' report thereon, included in a document likely to be entitled "Annual Report".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Information, other than the financial statements and the auditors' report thereon, included in a document likely to be entitled "Annual Report" is expected to be made available to us after the date of this auditors' report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance.

## ***Responsibilities of Management and Those Charged with Governance for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.



## ***Auditors' Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgement and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair representation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.



- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

*KPMG LLP*

Chartered Professional Accountants

The engagement partner on the audit resulting in this auditors' report is Andrew James.  
Vancouver, Canada  
March 5, 2020



## CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(\$'000 unless otherwise stated)

	As at December 31, 2019	As at December 31, 2018
Cash	907	1,277
Accounts receivable (Notes 5, 13.1)	24,250	24,128
Inventories (Note 6)	55,034	81,619
Prepaid and other current assets	3,332	2,758
Income taxes recoverable	427	-
<b>Current assets</b>	<b>83,950</b>	<b>109,782</b>
Property, plant and equipment (Notes 7, 20.2)	44,980	47,230
Right of use assets (Note 8)	28,700	-
Other non-current assets	1,492	1,437
<b>Total assets</b>	<b>159,122</b>	<b>158,449</b>
Accounts payable and accrued liabilities	18,402	22,017
Income taxes payable	-	171
Other current liabilities	238	346
Dividends payable	577	584
Current portion of long-term debt and senior term loans (Notes 9.2, 10)	4,057	4,980
Current portion of lease liabilities (Note 8)	1,568	-
<b>Current liabilities</b>	<b>24,842</b>	<b>28,098</b>
Senior revolving facility (Note 9.1)	38,162	49,797
Senior term loans (Note 9.2)	9,234	11,349
Long-term debt (Note 10)	4,010	4,922
Lease Liability (Note 8)	30,517	-
Other non-current liabilities	518	2,426
Deferred income tax liability (Note 15.2)	3,186	3,231
<b>Total liabilities</b>	<b>110,469</b>	<b>99,823</b>
<b>Shareholders' equity</b>	<b>48,653</b>	<b>58,626</b>
<b>Total liabilities and shareholders' equity</b>	<b>159,122</b>	<b>158,449</b>

See accompanying Notes to the Consolidated Financial Statements

Approved on behalf of Tree Island Steel.

[Signed]

"Amar S. Doman"

Chairman of the Board of Directors

## CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### CONSOLIDATED STATEMENTS OF OPERATIONS

(\$'000 unless otherwise stated)

	Years Ended December 31,	
	2019	2018
Sales (Notes 5, 13.1, 21)	200,405	235,306
Cost of sales (Note 6)	(176,407)	(205,977)
Depreciation <sup>11</sup>	(6,227)	(3,492)
Gross profit	17,771	25,837
Selling, general and administrative expenses	(15,757)	(16,646)
Operating income	2,014	9,191
Foreign exchange gain (loss)	(676)	706
Gain (loss) on sale of property, plant and equipment	5	(664)
Restructuring and other expenses (Note 22)	(1,901)	(903)
Changes in financial liabilities at fair value	(1)	(67)
Financing expenses (Note 11)	(4,662)	(3,500)
Income (loss) before income taxes	(5,221)	4,763
Current income tax recovery (expense) (Note 15)	(14)	(332)
Deferred income tax recovery (expense) (Note 15)	45	(1,838)
Net income (loss)	(5,190)	2,593
Net income (loss) per share (Note 19)	(0.18)	0.09
Dividends per share	0.08	0.08
Weighted average number of shares (Note 19)	29,037,981	29,411,890

### CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(\$'000 unless otherwise stated)

	Years Ended December 31,	
	2019	2018
Net income (loss) for the year	(5,190)	2,593
Unrealized gain (loss) on foreign exchange translation	(40)	373
Comprehensive income (loss)	(5,230)	2,966

See accompanying Notes to the Consolidated Financial Statements

<sup>11</sup> Tree Island recognized depreciation from the adoption of IFRS 16 during \$2.7 million for the year. See Note 3, 8 and 9 of the fiscal year (FY) 2019 Audited Consolidated Financial Statements.

## CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(\$'000 unless otherwise stated)

	Shareholders' Capital (Note 12)	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance as at December 31, 2018	224,715	(163,354)	(2,735)	58,626
Accounting policy change (Note 8)	-	(1,708)	-	(1,708)
Repurchase of shares	(721)	-	-	(721)
Net loss	-	(5,190)	-	(5,190)
Dividends	-	(2,314)	-	(2,314)
Other comprehensive income (loss)	-	-	(40)	(40)
Balance as at December 31, 2019	223,994	(172,566)	(2,775)	48,653
Balance as at December 31, 2017	225,977	(163,600)	(3,108)	59,269
Repurchase of shares	(1,262)	-	-	(1,262)
Net income	-	2,593	-	2,593
Dividends	-	(2,347)	-	(2,347)
Other comprehensive income (loss)	-	-	373	373
Balance as at December 31, 2018	224,715	(163,354)	(2,735)	58,626

See accompanying Notes to the Consolidated Financial Statements

## CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$'000 unless otherwise stated)

	Years Ended December 31,	
	2019	2018
Net income (loss)	(5,190)	2,593
Depreciation <sup>12</sup>	6,227	3,492
Changes in financial liabilities recognized at fair value	1	67
Loss (Gain) on sale of property, plant and equipment	(5)	664
Net financing costs	4,662	3,500
Deferred income tax expense (recovery)	(45)	1,838
Exchange revaluation of foreign denominated debt ( <i>Note 9 and 10</i> )	(523)	703
Working capital adjustments		
Accounts receivable	(122)	2,020
Inventories	26,575	(21,674)
Accounts payable and accrued liabilities	(4,616)	3,697
Prepaid expenses	(47)	(573)
Income and other taxes	(980)	332
Other	275	(560)
Net cash provided by (used in) operating activities	26,212	(3,901)
Proceeds on sale of property, plant and equipment	-	33
Purchase of property, plant and equipment	(1,942)	(8,540)
Net cash used in investing activities	(1,942)	(8,507)
Term loans – advances (repayment), net ( <i>Note 9.2</i> )	(1,970)	2,587
Repayment of long-term debt ( <i>Note 10</i> )	(2,224)	(1,873)
Other financing liabilities	(47)	1,127
Lease interest paid	(1,417)	-
Lease principal payments	(1,714)	-
Other interest paid	(2,504)	(2,393)
Deferred financing fees	(39)	(183)
Increase (repayment) of senior revolving facility	(11,634)	16,328
Dividend paid	(2,320)	(2,356)
Repurchase of common shares	(721)	(1,262)
Net cash provided by (used in) financing activities	(24,590)	11,975
Effect of exchange rate change on cash	(50)	59
Increase (decrease) in cash	(370)	(374)
Cash - beginning of year	1,277	1,651
Cash - end of year	907	1,277

See accompanying Notes to the Consolidated Financial Statements

<sup>12</sup> Tree Island recognized depreciation from the adoption of IFRS 16 during \$2.7 million for the year. See Note 3 and 8 of the FY 2019 Audited Consolidated Financial Statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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## 1 NATURE OF BUSINESS

These consolidated financial statements of Tree Island Steel ("Tree Island Steel" or the "Company") for the years ended December 31, 2019 and 2018 were authorized for issue in accordance with a resolution of the Board of Directors on March 5, 2020.

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

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

## 2 BASIS OF PREPARATION

### 2.1 BASIS OF PREPARATION

The consolidated financial statements as at and for the years ended December 31, 2019 and 2018 have been prepared in accordance with International Financial Reporting Standards ("IFRS").

These consolidated financial statements have been prepared on a historical cost basis except for certain financial instruments categorized as fair value through profit or loss. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting.

### 2.2 BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company, TI Canada, and TI Canada's wholly-owned subsidiaries, Tree Island Wire Holdings. ("TIWH") and Tree Island Wire. ("TI USA"). Intercompany accounts and transactions have been eliminated on consolidation.

### 2.3 FUNCTIONAL CURRENCY

The functional and presentation currency of the Company is the Canadian dollar. The functional currency of TI Canada is the Canadian dollar and the functional currency of TI USA and TIWH is the U.S. dollar.

## 3 SIGNIFICANT ACCOUNTING POLICIES, CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The accounting policies applied in the preparation of these consolidated financial statements are set out below:

### 3.1 CHANGES IN ACCOUNTING POLICIES

#### IFRS 16 LEASES

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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

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

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

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

### 3.2 SUMMARY OF NEW ACCOUNTING POLICIES

#### RIGHT-OF-USE ASSETS

Tree Island recognizes a right-of-use (ROU) asset and a lease liability at the commencement date of the lease. The right-of-use asset is initially measured at cost on the lease commencement date which comprises of:

- The initial amount of the lease liability;
- Any lease payments made at or before the commencement date, less an lease incentive received,
- Any initial direct costs incurred by Tree Island, and
- Any estimated costs to dismantle and remove the underlying asset or to restore the underlying asset to the conditions required by the lease contracts.

ROU assets are subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful lives of the ROU assets or the end of the lease term. The estimated useful lives of the ROU assets are determined on the same basis as those of property and equipment. Subsequent to the initial measurement, Tree Island will measure the ROU assets at cost less any accumulated depreciation and impairment losses and adjusted for any remeasurement of the lease liability.

#### LEASE LIABILITIES

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

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

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2019 and 2018**

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

### **SHORT-TERM LEASES AND LEASES OF LOW-VALUE**

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

### **3.3 REVENUE RECOGNITION**

Tree Island recognizes revenue on the sale of goods when control passes to the buyer which is typically when the product is shipped. Revenue related to contract manufacturing (also known as tolling) is recognized at the point at which the items are ready to ship to the customer. For both the sale of goods and contract manufacturing, revenue is stated net of early payment discounts, freight where applicable, and rebates granted.

Early payment discounts are recognized on an invoice-by-invoice basis (not in aggregate) prior to the early payment date, and if the early payment date lapses without payment being made, the early discount amount forfeited will be recognized as revenue.

Volume rebates discounts are recognized separately for each customer by first estimating the rebate payable for the year based on the most likely amount method and allocating the expected rebates proportionately to each performance obligation.

### **3.4 CASH**

Cash is comprised of bank balances, including outstanding items in deposit and net of outstanding disbursement accounts, cash balances in excess of revolving credit outstanding on the Senior Credit Facility (as defined in Note 9) and cash on hand.

### **3.5 INVENTORIES**

Raw materials and consumable supplies and spare parts inventories are stated at the lower of weighted average cost and net realizable value. Finished and semi-finished products are stated at the lower of weighted average cost and net realizable value. Cost for finished and semi-finished products includes direct costs incurred in production including direct labour, materials, freight, depreciation and directly attributable overhead costs and indirect overhead costs based on normal operating capacity. Net realizable value is the estimated selling price in the ordinary course of business less estimated costs to sell. Consumable supplies and spare parts are inventories that are expected to be consumed in operations.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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### 3.6 PROPERTY, PLANT AND EQUIPMENT AND DEPRECIATION

No depreciation is charged on capital projects during the period of construction. Costs are recognized net of government incentives. Regular repair and maintenance costs are recognized in the consolidated statement of operations as incurred. Depreciation is determined using the straight-line method over the estimated useful lives of the depreciable assets. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment. Depreciation methods, asset residual values and useful lives are reviewed annually and adjusted prospectively as required.

Depreciation is calculated over the following rates:

Land	not depreciated
Buildings and improvements	19 to 30 years
Leasehold improvements	based on the term of the respective lease
Machinery and equipment	3 to 20 years

An item of property, plant and equipment and any significant part initially recognized is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of operations when the asset is derecognized.

### 3.7 IMPAIRMENT OF NON-FINANCIAL ASSETS

#### 3.7.1 IMPAIRMENT CHARGES

Tree Island performs impairment tests on property, plant and equipment when events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss, if any, is determined as the excess of the carrying value of the asset over its recoverable amount, and is recognized in the consolidated statement of operations.

Tree Island assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists Tree Island estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's ("CGU") fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

In determining fair value less costs to sell, fair value is based on quoted market prices, prices for similar assets or other valuation techniques. The impairment analysis contains estimates due to the inherently speculative nature of forecasting long-term estimated cash flows and determining the ultimate useful lives of assets. If any of these estimates change, future net cash flows from the assets could be lower, which would result in additional impairment. As well, as much as practicable, third-party valuers are used to provide fair values which also contain assumptions concerning current market information for similar or same assets and if applicable functional and economic obsolescence.

Impairment losses of continuing operations are recognized in the consolidated statement of operations.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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### 3.8 FAIR VALUE MEASUREMENT

The Company measures financial instruments such as derivatives at fair value at each statement of financial position date. Also, fair values of financial instruments measured at amortized cost are disclosed in Note 16.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible by the Company. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All financial assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy (Note 16.2)

For assets and liabilities that are measured at fair value on a recurring basis, the Company determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

### 3.9 FINANCIAL INSTRUMENTS AND RISKS

#### 3.9.1 FINANCIAL ASSETS

Financial assets initially measured at fair value and thereafter at amortized cost include accounts receivables. The financial assets are classified depending on the business model for which the financial assets were acquired.

Financial assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are classified as current assets or non-current assets based on their maturity date.

Tree Island assesses at each reporting date whether there is objective evidence that financial assets are impaired. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in payments, the probability that they will enter bankruptcy or other financial reorganization. Impaired loans and receivables are charged to the consolidated statement of operations as bad debts and allowance for doubtful accounts is recognized. The allowance for doubtful accounts is determined using the expected credit loss model.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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### 3.9.2 FINANCIAL LIABILITIES

Financial liabilities initially measured at fair value and thereafter at amortized cost include the Senior Credit Facility, accounts payable and other accrued liabilities, senior term loans, and long-term debt.

Financial liabilities are classified as current or non-current based on their maturity date and recognized initially at fair value, net of transaction costs incurred and are subsequently stated at amortized cost. Any difference between the amounts originally received, net of transaction costs, and the redemption value is recognized in the consolidated statement of operations over the period to maturity using the effective interest method.

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

### 3.9.3 FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT AND LOSS

Financial instruments at fair value through profit and loss are initially recognized at their fair value on the date the contract or transaction is entered into and are subsequently re-measured at their fair value at each reporting period with changes in the fair value recognized through the consolidated statement of operations. Financial instruments at fair value through profit and loss include the change in purchase agreements for zinc (Note 16) and foreign exchange forward contracts (Note 16).

### 3.10 LEASES

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

Lease liabilities are measured at the present value of the lease payments discounted using the applicable incremental borrowing rate or rate implicit in the lease. Determining the discount rate (incremental borrowing rate) requires significant judgment and may have a significant quantitative impact on lease liability valuations. Many of the lease liabilities contain one or several lease extension clauses, and could reasonably be extended beyond the lease extensions outlined in the contract. Determining the length of the lease to be used in the present value calculation of the lease obligation requires significant judgement and may have significant impact on lease liability valuations.

On transition, Tree Island elected to apply the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases under IAS 17. Tree Island also elected to use the recognition exemptions for lease contracts that, at the commencement date, have a lease term of 12 months or less and do not contain a purchase option (short-term leases), and lease contracts for which the underlying asset is of low value (low-value assets).

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

### 3.11 PROVISIONS

#### 3.11.1 GENERAL

Provisions are recognized when Tree Island has an obligation (legal or constructive) as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made on the amount of the obligation. Where Tree Island expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of operations, net of any reimbursement.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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### 3.11.2 ASSET DECOMMISSIONING AND RETIREMENT OBLIGATIONS

Tree Island recognizes obligations associated with the retirement of property, plant and equipment that result from the acquisition, construction, development or normal operations of the assets. These obligations, if material, are recorded at fair value and capitalized and depreciated as part of the cost of the related asset. Management has determined that Tree Island does not have any material asset decommissioning or retirement obligations.

### 3.12 POST-RETIREMENT BENEFITS

Tree Island contributes to a group registered retirement savings plan for Canadian employees and a 401K plan for U.S. employees. The cost of these plans are expensed as earned by employees.

### 3.13 TAXES

#### 3.13.1 CURRENT INCOME TAX

Current income tax assets and liabilities for the current period are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date in the countries where Tree Island operates and generates taxable income.

Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

#### 3.13.2 DEFERRED TAX

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

Deferred tax assets and liabilities are recognized for all taxable temporary differences, except in respect of taxable temporary differences associated with investments in subsidiaries when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary difference to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax losses can be utilized, except in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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### 3.13.3 SALES TAX

Revenues, expenses and assets are recognized net of the amount of sales tax, except when the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case, the sales tax is recognized as part of the cost of acquisition of the asset or as part of the expense item, as applicable.

Receivables and payables are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the consolidated statement of financial position.

### 3.14 NET INCOME (LOSS) PER SHARE

Basic net income (loss) per Share is calculated by dividing net income (loss) by the weighted-average number of Shares outstanding during the period. Diluted net income (loss) per Share is calculated by factoring in the impact of dilutive instruments, if applicable.

### 3.15 FOREIGN EXCHANGE

Transactions in currencies other than the functional currency are recorded at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities that are denominated in foreign currencies are translated at the rate prevailing at each reporting date. Non-monetary assets and liabilities denominated in foreign currencies are translated to the functional currency at the exchange rate at the date of the transaction. Non-monetary items that are measured at historical cost in a foreign currency are translated at the exchange rate on the date of the transaction.

On consolidation the assets and liabilities of foreign operations are translated into Canadian dollars at the rate of exchange prevailing at the reporting date and their consolidated statement of operations are translated at exchange rates prevailing at the dates of the transactions. The exchange differences arising on translation for consolidation are recognized in other comprehensive income.

### 3.16 CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant areas that involve estimates are listed below:

#### 3.16.1 INVENTORY VALUATION

Inventories are recognized at the lower of cost or their Net Realizable Value ("NRV"), which is the estimated selling price in the ordinary course of business less the estimated costs of completion and estimated costs necessary to make the sale. IFRS requires that the estimated NRV be based on the most reliable evidence available at the time the estimates are made of the amounts that inventories are expected to realize.

The measurement of an inventory write-down to NRV is based on our best estimate of the NRV and of our expected future sale or consumption of our inventories. Due to market driven fluctuations in certain product group sales prices and the commodity nature of our significant raw materials, there is uncertainty as to whether the NRV of the inventories will remain consistent with those used in our assessment of NRV at period end. As a result there is the risk that a write-down of on-hand and unconsumed inventories could occur in future periods. Also, a certain portion of inventory may become damaged or obsolete. A slow moving reserve is recorded, as required, based on an analysis of the length of time product has been in inventory and historical rates of damage and obsolescence. Refer to Note 6 for the inventory provision as at December 31, 2019 and 2018.

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2019 and 2018**

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### **3.16.2 ALLOWANCE FOR DOUBTFUL ACCOUNTS**

It is possible that a certain portion of required customer payments will not be made, and as such an allowance for these doubtful accounts is maintained. The allowance is based on estimation of the potential of recovering the accounts receivable and incorporates current and expected collection trends. The estimates will change, as necessary, to reflect market or specific industry risks, as well as known or expected changes in the customers' financial position. Refer to Note 5 for the carrying amount of allowance for doubtful accounts as at December 31, 2019 and 2018.

### **3.16.3 PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment comprises a large component of the total assets of Tree Island and as such the capitalization of costs, the determination of estimated recoverable amounts and the estimates of useful lives of these assets have a significant effect on Tree Island's financial results.

During the repair and maintenance of an asset, the useful life of the respective asset may be reviewed and revised as appropriate.

The carrying value of plant, property and equipment is reviewed at the end of each reporting period. The impairment analysis contains estimates that can change due to the inherently speculative nature of forecasting long-term estimated cash flows and determining the ultimate useful lives of assets. If any of these estimates change significantly, future net cash flows from the property, plant and equipment could be lower or higher, which would result in additional impairment or reversal of impairments recognized in prior periods. As well, as much as practicable, third-party valuers are used to provide fair values that also contain assumptions concerning current market information for similar or same assets and if applicable functional and economic obsolescence.

### **3.16.4 INCOME TAXES**

As at each consolidated statement of financial position date, a deferred income tax asset would be recognized for all deductible temporary differences, unused tax losses and income tax reductions, but only to the extent that their realization is probable. The determination of this requires significant judgment. This evaluation includes review of: (1) the ability to carry back operating losses to offset taxes paid in prior years; (2) the carry-forward periods of the losses; (3) an assessment of the excess of fair value over the tax basis of Tree Island's net assets, and, (4) appropriate and feasible corporate actions with respect to repatriation of foreign earnings. If, based on this review, it is not probable such assets will be realized, then no deferred income tax asset is recognized. Refer to Note 15.2 for deferred income tax assets and liabilities as at December 31, 2019 and 2018.

### **3.16.5 LEASES**

Lease liabilities are measured at the present value of the lease payments discounted using the applicable incremental borrowing rate or rate implicit in the lease. Determining the discount rate (incremental borrowing rate) requires significant judgment and may have a significant quantitative impact on lease liability valuations. Many of the lease liabilities contain one or several lease extension clauses, and could reasonably be extended beyond the lease extensions outlined in the contract. Determining the length of the lease to be used in the present value calculation of the lease obligation requires significant judgement and may have significant impact on lease liability valuations.

## **4 FUTURE IFRS STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE**

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### 5 REVENUE AND ACCOUNTS RECEIVABLE

Revenue is net of the cost of freight associated with those sales to customers where the Company arranges the freight. In 2019, this amounts to \$11.6 million ( \$15.2 million in 2018).

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

(\$'000 unless otherwise stated)

	As at December 31, 2019	As at December 31, 2018
Current	21,462	20,945
30 - 60 days past due	1,262	1,657
61 - 90 days past due	860	784
Over 91 days past due	1,246	1,066
Total accounts receivable	24,830	24,452
Allowance for doubtful accounts	(580)	(324)
Net accounts receivable	24,250	24,128

Accounts receivable are non-interest bearing and are generally due on 30-day to 90-day terms. The maximum credit risk that Tree Island was exposed to by way of its accounts receivable is equal to the net amount of \$24.3 million as at December 31, 2019 ( \$24.1 million as at December 31, 2018).

At the end of each reporting period a review of the allowance for bad and doubtful accounts is performed. It is an assessment of the expected credit loss associated with trade accounts receivable after the consolidated statement of financial position date. The assessment is made by reference to age, status and risk of each receivable, current economic conditions and historical information. The trade accounts receivable balance is reduced through the use of the allowance for doubtful accounts and the amount of the loss is recognized in the consolidated statement of operations. Reversals to the allowance for doubtful accounts occur when previously allowed for trade accounts receivable are collected. Individual trade accounts receivable, together with any associated allowance previously recognized, are written off when there is no realistic prospect of future recovery. Accounts receivable with related parties are discussed in Note 13.1.

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

(\$'000 unless otherwise stated)

	As at December 31, 2019	As at December 31, 2018
Opening balance – January 1	324	338
Additions during the period	294	134
Reversals during the period	18	2
Collections	(6)	(19)
Write-offs during the period	(72)	(143)
Foreign exchange revaluation	22	12
Closing balance – December 31	580	324

See Note 17 on credit risk of trade receivables to understand how credit quality of accounts receivable that are neither past due nor impaired are managed and measured.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### 6 INVENTORIES

Tree Island had the following categories of inventory:

(\$'000 unless otherwise stated)

	As at December 31, 2019	As at December 31, 2018
Raw materials	13,319	27,599
Finished and semi-finished products	29,708	38,558
Consumable supplies and spare parts	12,007	15,462
Total inventory	<u>55,034</u>	<u>81,619</u>

For the full year ended December 31, 2019 and 2018, Tree Island recognized, in income, inventory costs for the following:

(\$'000 unless otherwise stated)

	Years Ended December 31,	
	2019	2018
Opening inventory	81,619	59,992
Raw material purchases	94,784	161,591
Finished goods purchased for resale	5,010	7,842
Conversion costs	50,028	58,171
Closing inventory	(55,034)	(81,619)
Cost of sales	<u>176,407</u>	<u>205,977</u>

At each year end, the ending inventories on hand are reviewed to determine if a write down to net realizable value is required. Based on this review, it was determined that no write-downs were necessary in 2019 and no write-downs were required in 2018. The reserves for slow moving inventory as at December 31, 2019 were \$1.3 million (\$1.4 million at December 31, 2018).

### 7 PROPERTY, PLANT AND EQUIPMENT

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

From time to time the company makes investments to update, replace or make additions to existing capital assets, which includes, but is not limited to, the buildings occupied and capital equipment. These investments are part of the normal course of business activity. The company has certain capital commitments (refer to section 20.2).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

(\$'000 unless otherwise stated)

	Land & Improvement	Building & Improvement	Machinery & Equipment	Capital in Progress	Total
<b>Cost</b>					
As at December 31, 2017	9,695	44,326	30,560	3,909	88,490
Additions	-	608	2,818	5,299	8,725
Disposals	-	(80)	(181)	-	(261)
Foreign exchange translation	174	806	651	141	1,772
As at December 31, 2018	9,869	45,660	33,848	9,349	98,726
Additions	-	1,531	8,092	(7,532)	2,091
Disposals	-	-	(276)	-	(276)
Foreign exchange translation	(104)	(489)	(397)	(323)	(1,313)
As at December 31, 2019	9,765	46,702	41,267	1,494	99,228
<b>Depreciation and impairment</b>					
As at December 31, 2017	31	32,231	14,538	-	46,800
Depreciation for the period	16	1,271	2,205	-	3,492
Disposals	-	(80)	(133)	-	(213)
Foreign exchange translation	(6)	389	1,034	-	1,417
As at December 31, 2018	41	33,811	17,644	-	51,496
Depreciation for the period	16	1,368	2,121	-	3,505
Disposals	-	-	(239)	-	(239)
Foreign exchange translation	(2)	(249)	(263)	-	(514)
As at December 31, 2019	55	34,930	19,263	-	54,248
<b>Net book value as at</b>					
December 31, 2018	9,828	11,849	16,204	9,349	47,230
December 31, 2019	9,710	11,772	22,004	1,494	44,980

## 8 LEASES

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

	<i>(\$'000 unless otherwise stated)</i>
Operating lease commitments as at December 31, 2018	31,169
Weighted average incremental borrowing rate as at January 1, 2019	4.2%
Discounted operating lease commitments at January 1, 2019	24,322
Less:	
Recognition exemption for short-term leases	(8)
Recognition exemption for leases of low-value assets	(35)
Add:	
Extension options reasonably certain to be exercised and other transitional adjustments	10,172
Lease liabilities as at January 1, 2019	34,451

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### IMPACTS FOR THE PERIOD

As a result of initially applying IFRS 16, in relation to the leases that were previously classified as operating leases, Tree Island recognized \$28.7 million of right-of-use assets and \$32.1 million of lease liabilities as at December 31, 2019.

In relation to those leases under IFRS 16, Tree Island has recognized depreciation and interest costs, instead of operating lease expense. During the fiscal year 2019, Tree Island recognized \$2.7 million of depreciation and \$1.4 million of interest costs from these leases.

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

(\$'000 unless otherwise stated)

	Land & buildings	Machinery & equipment	Total right-of-use assets
<b>Cost</b>			
As at January 1, 2019	33,580	2,405	35,985
Additions	1,217	270	1,487
Disposals	-	(151)	(151)
Change in lease duration	(782)	-	(782)
Foreign exchange translation	(1,190)	(47)	(1,237)
As at December 31, 2019	32,825	2,477	35,302
<b>Depreciation and impairment</b>			
As at January 1, 2019	(3,460)	(643)	(4,103)
Depreciation for the period	(2,230)	(492)	(2,722)
Disposals	-	115	115
Foreign exchange translation	81	27	108
As at December 31, 2019	(5,609)	(993)	(6,602)
<b>Carrying value as at</b>			
January 1, 2019	30,120	1,762	31,882
As at December 31, 2019	27,216	1,484	28,700

(\$'000 unless otherwise stated)

	Land & buildings	Machinery & equipment	Total lease liability
<b>Lease liability</b>			
As at January 1, 2019	32,670	1,781	34,451
New contracts and renewals	1,217	270	1,487
Contract disposal	-	(38)	(38)
Change in lease duration	(856)	-	(856)
Interest expense	1,354	63	1,417
Payment of lease liability	(2,550)	(581)	(3,131)
Foreign exchange translation	(1,221)	(24)	(1,245)
Lease liability as at As at December 31, 2019	30,614	1,471	32,085
Less: current portion	(1,164)	(404)	(1,568)
Total	29,450	1,067	30,517

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### 9 SENIOR CREDIT FACILITY

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

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

#### 9.1 SENIOR CREDIT FACILITY

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

The Senior Credit Facility includes a \$10.0 million Letter of Credit sub-facility which enables TI Canada and TI USA to open documentary and standby letters of credit for raw material purchases. There was a \$39 thousand Letter of Credit outstanding as at December 31, 2019.

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

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

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

*(\$’000 unless otherwise stated)*

	As at December 31, 2019	As at December 31, 2018
Revolving portion of the senior credit facility	38,162	49,797
Deferred financing costs	(59)	(182)
Total	<u>38,103</u>	<u>49,615</u>

The revolving portion of the Senior Credit Facility denominated in U.S. dollars as at December 31, 2019 is \$10.7 million (\$19.4 million in 2018).

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

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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

As at December 31, 2019, the availability was in excess of the Availability Test and the Company was in compliance with its financial covenants on the Senior Credit Facility.

### 9.2 SENIOR TERM LOANS

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

The following amounts are outstanding under the Senior Term Loans:

*(\$'000 unless otherwise stated)*

	As at December 31, 2019	As at December 31, 2018
Senior term loans - beginning of period	13,335	10,546
Advances	-	3,758
Foreign exchange revaluation	(171)	202
Payments	(1,970)	(1,171)
Senior term loans - end of period	11,194	13,335
Less: current portion	(1,960)	(1,986)
Total	9,234	11,349

## 10 LONG-TERM DEBT

In June of 2012, the Company entered into long-term debt agreements with a trade creditor. The repayment schedule of the long-term debt extends to June 2028 with principal payments over a 10 year amortization period. The interest is non-compounding interest at 4% and commenced accruing June 2017 and will become payable monthly over 4 years commencing June 2024. In November 2019, the Company and creditor agreed to a three month reduction in principal payments. Present value of the debt was determined using discounted cash flows and a credit adjusted discount rate of 9%. The discount rate, together with the stated interest, comprises the debt discount. Using the effective interest rate method, the debt discount is amortized as accretion and charged to interest expense over the term of the amended long-term debt agreements.

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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

(\$'000 unless otherwise stated)

	As at December 31, 2019	As at December 31, 2018
Beginning of period	7,916	8,187
Payments	(2,224)	(1,873)
Foreign exchange revaluation	(352)	671
Accretion of debt discount	767	931
End of period	6,107	7,916
Less: current portion	(2,097)	(2,994)
Net long-term debt	4,010	4,922

In addition, under the terms of this long-term debt agreement, Tree Island is required to make an accelerated payment of between \$0.3 million to \$0.5 million on the principal outstanding within 120 days of any fiscal year end in which EBITDA exceeds a specified amount.

## 11 FINANCING EXPENSES

(\$'000 unless otherwise stated)

	Years Ended December 31,	
	2019	2018
Non-cash accretion of debt discount and interest on long term debt	767	931
Interest on senior credit facility (Note 9.1)	1,637	1,533
Interest on lease liability	1,417	-
Other interest and financing costs	805	946
Amortization of deferred financing costs	36	90
Total	4,662	3,500

## 12 SHAREHOLDERS' CAPITAL

Tree Island is authorized to issue an unlimited number of shares. The Shares have no par value. There were no shares issued and 352,013 shares were repurchased (totaling \$721 thousand at an average price of \$2.05 per share) and cancelled in the year ended December 31, 2019. Shares issued and outstanding are as follows:

(\$'000 except for shares)

	Shares	Gross	Issuance Cost <sup>13</sup>	Net
Shareholders' capital - December 31, 2017	29,649,799	237,377	11,400	225,977
Repurchase of common shares	(466,149)	(1,262)	-	(1,262)
Shareholders' capital - December 31, 2018	29,183,650	236,115	11,400	224,715
Repurchase of common shares	(352,013)	(721)	-	(721)
Shareholders' capital - December 31, 2019	28,831,637	235,394	11,400	223,994

<sup>13</sup> Issuance costs were incurred as a result of the November 2002 Initial Public Offering and October 2004 Secondary Offering.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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### 12.1 NORMAL COURSE ISSUER BID

The Company has an ongoing normal course issuer bid (the “Bid”). The previous Bid was effective from September 21, 2018 to September 20, 2019 to purchase up to 1,460,000 Shares. The Company renewed the Bid, effective November 7, 2019 to November 6, 2020. The renewed Bid allows the Company to purchase up to 1,441,000 Shares in the period. Tree Island has no obligation to purchase any Shares under the Bid.

For the period January 1, 2019 to September 20, 2019 the Company purchased 352,013 Shares under the previous Bid at a total cost of \$721 thousand (at an average price of \$2.05 per Share). Under the current Bid from November 7, 2019, the Company has not purchased shares, and no additional Shares were purchased under the Bid for the period January 1, 2020 to March 5, 2020.

## 13 RELATED PARTY TRANSACTIONS

### 13.1 TRANSACTIONS WITH ASSOCIATED COMPANIES

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

Based on Tree Island Steel’s outstanding Shares as at March 5, 2019, Futura owns 31.3% of the fully diluted Shares of the Company.

In addition, Mr. Doman is Chairman and CEO of CanWel Building Materials Group Ltd. (“CanWel”). For the year ended December 31, 2019, Tree Island sold, net of rebates, approximately \$3.2 million (\$3.6 million in 2018) of goods to CanWel and trade accounts receivable owing from CanWel as at December 31, 2019 is approximately \$53 thousand (approximately \$0.1 million in 2018). Outstanding trade accounts receivable from CanWel at period end are unsecured, interest free and settlement occurs in cash (Note 5).

### 13.2 TRANSACTIONS WITH KEY MANAGEMENT PERSONNEL

Included in the definition of key management for purposes of disclosure of related party transactions are members of Board of Directors and officers of Tree Island Steel. Amounts for key management personnel for the year ended December 31, 2019 was approximately \$3.0 million (approximately and \$2.9 million in 2018) which includes wages, salaries and social security contributions, paid annual and sick leave, vehicle costs and bonuses. This amount includes termination benefits paid to the former CEO of \$1.15 million in accordance with his employment contract. It also includes directors’ fees paid to members of the Board.

## 14 POST RETIREMENT BENEFITS

Tree Island contributes to a group registered retirements savings plan for all eligible Canadian employees and a 401K for all eligible U.S. employees. Contributions made by Tree Island’s subsidiaries in 2019 amounted to \$1.4 million (\$1.4 million in 2018). Funding obligations are satisfied upon making contributions.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### 15 INCOME TAXES

#### 15.1 INCOME TAX RECOVERY (EXPENSE)

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

*(\$'000 unless otherwise stated)*

	Years Ended December 31,	
	2019	2018
Current tax expense	(14)	(332)
Deferred tax recovery (expense)	45	(1,838)
Total in the Consolidated Statement of Operations	31	(2,170)

The expense or recovery of income taxes varies from the amount that would be expected if computed by applying the Canadian federal and provincial and U.S. federal and state statutory income tax rates to the income before income taxes as shown in the following table:

*(\$'000 unless otherwise stated)*

	As at December 31,	
	2019	2018
Income (loss) before provision for income taxes	(5,221)	4,763
Tax Rate	27.0%	27.0%
Expected income tax recovery (expense)	1,410	(1,286)
Revisions to prior year estimates	-	(582)
Items not deductible for tax	(60)	(65)
Foreign exchange on intercompany loans	406	(681)
Change in unrecognized deferred tax benefits	(1,677)	538
Other	(48)	(94)
Total in the Consolidated Statement of Operations	31	(2,170)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### 15.2 DEFERRED INCOME TAX ASSETS AND LIABILITIES

The components of deferred income tax assets and liabilities as at December 31 are as follows:

(\$'000 unless otherwise stated)

	As at December 31,	
	2019	2018
Non-capital tax loss-carry forwards	1,237	1,340
Deferred gain and financing costs	8	-
Property, plant and equipment	(4,925)	(4,729)
Long-Term Debt	566	380
Reserves and other liabilities	139	-
Goodwill and intangibles	2	-
Interest and other	(213)	(222)
Deferred tax asset (liability)	<u>(3,186)</u>	<u>(3,231)</u>
Deferred tax (liability) beginning of year	(3,231)	(1,418)
Deferred tax recovery (expense) during the year	45	(1,838)
Deferred tax asset (liability) - Other	-	25
Deferred tax asset (liability) end of year	<u>(3,186)</u>	<u>(3,231)</u>

No deferred tax assets have been recognized on the consolidated statements of financial position where Tree Island has concluded that it is not probable that the benefits of recognized deferred income tax assets will be realized prior to their expiry. As such, Tree Island has not recognized a deferred tax asset on the following items:

(\$'000 unless otherwise stated)

	As at December 31,	
	2019	2018
Non-capital tax loss carry-forwards	432	68
Goodwill and intangibles	116	168
Unrealized foreign exchange losses	1,210	804
Reserves and other liabilities	275	313
Capital losses	2,720	2,715
Interest and other	8,374	7,832
Deferred tax asset	<u>13,127</u>	<u>11,900</u>

### 15.3 INCOME TAX LOSS CARRY-FORWARDS

As at December 31, 2019, Tree Island had income tax loss carry forwards available to offset future taxable income with expiries as shown in the table below:

(\$'000 unless otherwise stated)

Year of Expiration	Canada	U.S. - State
2031	27	5,530
2032	354	480
2033	-	1,281
2034	-	3,540
2035	-	2,544
Total	<u>381</u>	<u>13,375</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

As at December 31, 2019, the Company had capital losses of \$20.5 million in addition to the non-capital loss carry forwards listed above. The capital losses can be carried forward indefinitely to offset against future capital gains in Canada.

### 16 FINANCIAL INSTRUMENTS

#### 16.1 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

(\$'000 unless otherwise stated)

	As at December 31, 2019		As at December 31, 2018	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash investments	907	907	1,277	1,277
Accounts receivable	24,250	24,250	24,128	24,128
Total financial assets	25,157	25,157	25,405	25,405
Senior revolving facility	38,162	38,162	49,797	49,797
Accounts payable, accrued and other current liabilities	18,402	18,402	22,017	22,017
Senior term loans	11,194	11,194	13,335	13,335
Long-term debt	6,107	5,622	7,916	7,041
Lease Liabilities	32,085	32,085	-	-
Total financial liabilities	105,950	105,465	93,065	92,190



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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### 16.2 FAIR VALUE HIERARCHY

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

The three levels of fair value estimation are:

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

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

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

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

## 17 RISK EXPOSURE AND MANAGEMENT

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

### 17.1 CREDIT RISK

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

### 17.2 LIQUIDITY RISK

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

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

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

(\$'000 unless otherwise stated)

	Carrying Amount	Contractual Cash Flow	Less Than 1 Year	1 – 2 Years	Greater Than 2 Years
Senior revolving facility	38,162	38,162	-	-	38,162
Accounts payable, accrued and other liabilities	18,640	18,640	18,640	-	-
Senior term loans (principal)	11,194	11,194	1,960	3,920	5,314
Senior term loans (interest)	-	1,137	362	292	483
Long-term debt	6,107	11,007	2,097	3,308	5,602
Lease liability	32,085	48,995	2,949	2,820	43,226
Lease liability	106,188	129,135	26,008	10,340	92,787

### 17.3 FOREIGN CURRENCY RISK

Tree Island's U.S. dollar-denominated cash, accounts receivable, accounts payable and accrued liabilities, Senior Credit Facility and Long-Term Debt are exposed to foreign currency exchange rate risk because the value of these financial instruments will fluctuate with changes in the U.S./Canadian dollar exchange rate. The Company enters into U.S. dollar currency forward contracts for periods consistent with a portion of U.S. dollar currency transaction exposures, generally from one to three months. These are not designated as cash flow, fair value or net investment hedges. As of December 31, 2019, the Company had no outstanding U.S. dollar currency forward contracts.

For the period ending December 31, 2019, a \$0.01 increase (decrease) in the Canadian dollar to U.S. dollar exchange rate will increase (decrease) net comprehensive income by \$49 thousand.

### 17.4 INTEREST RATE RISK

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

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

### 17.5 RAW MATERIAL PRICE RISK

Tree Island is exposed to changes in the price of the materials used in its production process and, from time to time, enters into forward contracts to purchase a portion of the zinc used. These are not designated as cash flow or fair value hedges. As at December 31, 2019, the Company had no outstanding zinc forward contracts.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 18 MANAGEMENT OF CAPITAL

The Company's objectives when managing its capital are:

- To maintain a capital base so as to preserve and enhance investor, creditor, and market confidence and to sustain viability and future development of the business; and
- To manage capital in a manner that will comply with the financial covenants on the Senior Credit Facility, Senior Term Loan agreements and Long-Term Debt agreements as described further in Notes 9.1, 9.2 and 10.

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

*(\$'000 unless otherwise stated)*

	As at December 31, 2019	As at December 31, 2018
Total shareholders' equity	48,653	58,626
Senior revolving facility	38,162	49,797
Lease liabilities	32,085	-
Senior term loans	11,194	13,335
Long-term debt	6,107	7,916
Total capital	<u>136,201</u>	<u>129,674</u>

### 19 NET INCOME PER SHARE

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

Diluted earnings per Share amount is calculated by dividing the net income for the year by the weighted average number of Shares outstanding during the year plus the weighted average number of Shares that would be issued on conversion of all the dilutive potential units into Shares. As at December 31, 2019 the Company does not have any instruments issued that could be dilutive.

During 2019, 352,013 shares were repurchased and cancelled and no additional Shares were repurchased and cancelled from January 1, 2020 up to March 5, 2020 (Note 12).

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

*(\$'000 unless otherwise stated)*

	Years Ended December 31,	
	2019	2018
Net income (loss) for the year	(5,190)	2,593
Weighted average number of shares outstanding:	29,037,981	29,411,890
Net income per share (\$/share)	(0.18)	0.09

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

### 20 PROVISIONS AND COMMITMENTS

#### 20.1 LITIGATION AND CLAIMS

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

#### 20.2 PURCHASE COMMITMENTS

As at December 31, 2019, Tree Island's wholly owned subsidiaries have committed to raw material purchases (including finished goods) totalling \$31.6 million (\$28.4 million in 2018). As at December 31, 2019, the Company also committed to payments on capital equipment, with the total amount outstanding totalling \$1.0 million (\$0.5 million in 2018).

### 21 SEGMENTED INFORMATION

#### 21.1 MARKET SEGMENTS

Revenues for each group for the twelve months ended December 31, 2019 and 2018 were as follows:

*(\$'000 unless otherwise stated)*

	Years Ended December 31,	
	2019	2018
Industrial	67,358	79,295
Commercial	51,348	54,375
Agricultural	27,134	28,044
Residential	54,565	73,592
Total revenue	200,405	235,306

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

#### 21.2 GEOGRAPHIC SEGMENTS

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

*(\$'000 unless otherwise stated)*

	Years Ended December 31,	
	2019	2018
United States	120,497	148,410
Canada	72,528	80,381
International	7,380	6,515
Total revenue	200,405	235,306

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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

*(\$'000 unless otherwise stated)*

	Years Ended December 31,	
	2019	2018
United States	36,720	17,110
Canada	37,019	30,302
Total non-current assets	<u>73,739</u>	<u>47,412</u>

## 22 RESTRUCTURING AND OTHER EXPENSES

The company incurred \$1.9 million (2018 – \$0.9 million) in restructuring expenses which are primarily comprised of \$1.15 million of termination benefits payable to the former CEO in accordance with his employment contract and the remainder related to severance amounts for staff terminated during the period as part of cost cutting measures.

## SHAREHOLDER INFORMATION

TREE ISLAND STEEL

### Board of Directors:

Amar S. Doman –  
Chairman of the Board

Peter Bull

Harry Rosenfeld

Michael Fitch

Sam Fleiser

Theodore A. Leja

Joe Downes



### Executive Officers:

Remy Stachowiak  
*Chief Operating Officer*

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

### Shares:

#### *Market Information*

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

#### *Registrar and Transfer Agent*

Computershare Investor  
Services Inc.

### Corporate Head Office:

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

### Website:

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

### Investor Relations:

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

### Auditors:

KPMG LLP  
Vancouver, B.C.