



# **Hydrogenics Corporation**

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First Quarter 2014 Consolidated Financial Statements and Results of Operations

## Hydrogenics Corporation


### Consolidated Interim Balance Sheets

(in thousands of US dollars)  
(unaudited)

|  | March 31<br>2014 | December 31<br>2013 |
|--|------------------|---------------------|
| <b>Assets</b>                            |                  |                     |
| <b>Current assets</b>                    |                  |                     |
| Cash and cash equivalents                | \$ 9,343         | \$ 11,823           |
| Restricted cash (note 15)                | 1,154            | 635                 |
| Trade and other receivables              | 8,205            | 5,391               |
| Inventories (note 4)                     | 16,635           | 12,821              |
| Prepaid expenses                         | 1,330            | 979                 |
|  | <b>36,667</b>    | <b>31,649</b>       |
| <b>Non-current assets</b>                |                  |                     |
| Restricted cash (note 15)                | 1,123            | 1,389               |
| Property, plant and equipment            | 1,838            | 1,684               |
| Intangible assets (note 7)               | 171              | 100                 |
| Goodwill (note 8)                        | 5,246            | 5,248               |
|  | <b>8,378</b>     | <b>8,421</b>        |
| <b>Total assets</b>                      | <b>\$ 45,045</b> | <b>\$ 40,070</b>    |
| <b>Liabilities</b>                       |                  |                     |
| <b>Current liabilities</b>               |                  |                     |
| Trade and other payables (note 5)        | \$ 17,261        | \$ 13,193           |
| Operating Borrowings                     | 1,722            | -                   |
| Warranty provisions (note 6)             | 2,268            | 1,912               |
| Deferred revenue                         | 9,148            | 6,348               |
| Warrants (note 8)                        | -                | 1,075               |
|  | <b>30,399</b>    | <b>22,528</b>       |
| <b>Non-current liabilities</b>           |                  |                     |
| Other non-current liabilities (note 7)   | 2,991            | 3,095               |
| Non-current warranty provisions (note 6) | 798              | 981                 |
| Non-current deferred revenue             | 6,988            | 7,305               |
| <b>Total liabilities</b>                 | <b>41,176</b>    | <b>33,909</b>       |
| <b>Equity</b>                            |                  |                     |
| Share capital (note 8)                   | 334,698          | 333,312             |
| Contributed surplus                      | 18,525           | 18,449              |
| Accumulated other comprehensive loss     | (254)            | (249)               |
| Deficit                                  | (349,100)        | (345,351)           |
| <b>Total equity</b>                      | <b>3,869</b>     | <b>6,161</b>        |
| <b>Total equity and liabilities</b>      | <b>\$ 45,045</b> | <b>\$ 40,070</b>    |

Contingencies and guarantees (notes 13 and 15)

  
Douglas Alexander  
Chairman

  
Don Lowry  
Director

The accompanying notes form an integral part of these consolidated interim financial statements.

**Hydrogenics Corporation****Consolidated Interim Statements of Operations and Comprehensive Loss**

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

(unaudited)

|  | <b>Three months ended<br/>March 31</b> |                        |
|--|--|------------------------|
|  | <b>2014</b>                            | <b>2013</b>            |
|  |  | As Revised<br>(Note 2) |
| <b>Revenues</b>  | <b>\$ 8,059</b>                        | \$ 12,391              |
| <b>Cost of sales</b>   | <b>6,142</b>                           | 8,515                  |
| <b>Gross profit</b>  | <b>1,917</b>                           | 3,876                  |
| <b>Operating expenses</b>  |  |                        |
| Selling, general and administrative expenses (note 9)            | 4,567                                  | 3,622                  |
| Research and product development expenses (note 10)              | 916                                    | 860                    |
|  | <b>5,483</b>                           | 4,482                  |
| <b>Loss from operations</b>                                      | <b>(3,566)</b>                         | (606)                  |
| <b>Finance income (expenses)</b>                                 |  |                        |
| Interest income  | 2                                      | 7                      |
| Interest expense   | (134)                                  | (92)                   |
| Foreign currency gains   | 148                                    | 115                    |
| Foreign currency losses  | (59)                                   | (212)                  |
| Other finance gains (losses), net (note 11)                      | (140)                                  | (351)                  |
| <b>Finance income (loss), net</b>                                | <b>(183)</b>                           | (533)                  |
| <b>Loss before income taxes</b>                                  | <b>(3,749)</b>                         | (1,139)                |
| <b>Income tax expense</b>  | -                                      | -                      |
| <b>Net loss for the period</b>                                   | <b>(3,749)</b>                         | (1,139)                |
| <i>Items that will be reclassified subsequently to net loss:</i> |  |                        |
| Exchange differences on translating foreign operations           | (5)                                    | (298)                  |
| <b>Comprehensive loss for the period</b>                         | <b>\$ (3,754)</b>                      | \$ (1,437)             |
| <b>Net loss per share</b>  |  |                        |
| Basic and diluted (note 12)                                      | <b>\$ (0.41)</b>                       | \$ (0.15)              |
| Weighted average number of common shares outstanding (note 12)   | <b>9,073,527</b>                       | 7,843,373              |

The accompanying notes form an integral part of these consolidated interim financial statements.

**Hydrogenics Corporation****Consolidated Interim Statements of Changes in Equity**

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

(unaudited)

|   | Common shares |            | Contributed surplus | Deficit      | Accumulated other comprehensive loss | Total equity |
|---|---------------|------------|---------------------|--------------|--------------------------------------|--------------|
|   | Number        | Amount     |                     |              |                                      |              |
| <b>Balance at December 31, 2012<br/>As Revised (Note 2)</b>     | 7,775,540     | \$ 323,513 | \$ 17,995           | \$ (336,443) | \$ (758)                             | \$ 4,307     |
| Net loss  | -             | -          | -                   | (1,139)      |                                      | (1,139)      |
| Other comprehensive loss  | -             | -          | -                   |              | (298)                                | (298)        |
| Total comprehensive loss  | -             | -          | -                   | (1,139)      | (298)                                | (1,437)      |
| Issuance of common shares (note 8)                              | 115,000       | 999        | -                   | -            | -                                    | 999          |
| Stock-based compensation expense (note 9)                       | -             | -          | 176                 | -            | -                                    | 176          |
| <b>Balance at March 31, 2013<br/>As Revised (Note 2)</b>        | 7,890,540     | \$324,512  | \$18,171            | \$ (337,582) | \$ (1,056)                           | \$4,045      |
| <b>Balance at December 31, 2013</b>                             | 9,017,617     | \$ 333,312 | \$ 18,449           | \$ (345,351) | \$ (249)                             | \$ 6,161     |
| Net loss  | -             | -          | -                   | (3,749)      |                                      | (3,749)      |
| Other comprehensive loss  | -             | -          | -                   |              | (5)                                  | (5)          |
| Total comprehensive loss  | -             | -          | -                   | (3,749)      | (5)                                  | (3,754)      |
| Issuance of common shares (note 8)                              | 57,144        | 1,217      | -                   | -            | -                                    | 1,217        |
| Issuance of common shares on exercise of stock options (note 9) | 13,861        | 169        | (60)                | -            | -                                    | 109          |
| Stock-based compensation expense (note 9)                       | -             | -          | 136                 | -            | -                                    | 136          |
| <b>Balance at March 31, 2014</b>                                | 9,088,622     | \$334,698  | \$18,525            | \$ (349,100) | \$ (254)                             | \$3,869      |

The authorized share capital of the Corporation consists of an unlimited number of common shares, with no par value, and an unlimited number of preferred shares in series, with no par value.

The accompanying notes form an integral part of these consolidated interim financial statements.

## Hydrogenics Corporation

### Consolidated Interim Statements of Cash Flows

(in thousands of US dollars)  
(unaudited)

|   | Three months ended<br>March 31 |                 |
|---|--------------------------------|-----------------|
|   | 2014                           | 2013            |
|   | As Revised<br>(Note 2)         |                 |
| <b>Cash and cash equivalents provided by (used in):</b>                     |                                |                 |
| <b>Operating activities</b>   |                                |                 |
| Net loss for the year   | \$ (3,749)                     | \$ (1,139)      |
| Increase in restricted cash   | (253)                          | (225)           |
| Items not affecting cash:   |                                |                 |
| Amortization and depreciation   | 140                            | 198             |
| Other finance losses (gains), net (note 11)                                 | 140                            | 351             |
| Unrealized foreign exchange (gains) losses                                  | 87                             | 111             |
| Stock-based compensation (note 9)   | 136                            | 176             |
| Accreted non-cash interest (note 7)   | 118                            | 89              |
| Payment of post-retirement benefit liability (note 7)                       | (24)                           | (27)            |
| Liabilities for compensation indexed to share price                         | 1,561                          | 401             |
| Net change in non-cash working capital (note 17)                            | (1,972)                        | (6,093)         |
| <b>Cash used in operating activities</b>                                    | <b>(3,816)</b>                 | <b>(6,158)</b>  |
| <b>Investing activities</b>   |                                |                 |
| Proceeds from disposals   | 9                              | -               |
| Purchase of property, plant and equipment                                   | (306)                          | (189)           |
| Purchase of intangible assets   | (80)                           | -               |
| <b>Cash used in investing activities</b>                                    | <b>(377)</b>                   | <b>(189)</b>    |
| <b>Financing activities</b>   |                                |                 |
| Repayment of repayable government contributions (note 7)                    | (50)                           | -               |
| Proceeds of operating borrowings  | 1,722                          | 1,412           |
| Common shares issued and warrants exercised, net of issuance costs (note 8) | 109                            | 423             |
| <b>Cash provided by financing activities</b>                                | <b>1,781</b>                   | <b>1,835</b>    |
| Effect of exchange rate fluctuations on cash and cash equivalents held      | (68)                           | (325)           |
| Decrease in cash and cash equivalents during the period                     | (2,480)                        | (4,837)         |
| <b>Cash and cash equivalents - Beginning of period</b>                      | <b>11,823</b>                  | <b>13,020</b>   |
| <b>Cash and cash equivalents - End of period</b>                            | <b>\$ 9,343</b>                | <b>\$ 8,183</b> |
| <b>Supplemental disclosure</b>  |                                |                 |
| Income taxes paid   | \$ -                           | \$ -            |
| Interest paid   | -                              | 3               |

The accompanying notes form an integral part of these consolidated interim financial statements.

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Notes to Consolidated Interim Financial Statements  
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**Note 1. Description of Business**

Hydrogenics Corporation and its subsidiaries (“Hydrogenics” or the “Corporation”) design, develop and manufacture hydrogen generation products based on water electrolysis technology, and fuel cell products based on proton exchange membrane (“PEM”) technology. The Corporation has manufacturing plants in Canada and Belgium, a satellite facility in Germany, and a branch office in Russia. Its products are sold throughout the world.

The Corporation is incorporated and domiciled in Canada. The address of the Corporation’s registered head office is 220 Admiral Boulevard, Mississauga, Ontario, Canada. The Corporation is a public corporation and its shares trade under the symbol “HYG” on the Toronto Stock Exchange and under the symbol “HYGS” on the NASDAQ.

**Note 2. Basis of Preparation, Summary of Significant Accounting Policies, Judgments and Estimation Uncertainty**

These consolidated interim financial statements have been prepared in accordance with IFRS as issued by the International Accounting Standards Board (“IASB”) applicable to the preparation of consolidated interim financial statements, including International Accounting Standard (“IAS”) 34.

These consolidated interim financial statements were approved for issue by the Board of Directors of the Corporation on May 6, 2014.

The accounting policies applied in these consolidated interim financial statements are consistent with those disclosed in Note 2 to the annual consolidated financial statements for the year ended December 31, 2013.

There were no standards adopted by the Corporation for the first time for the financial year beginning on or after January 1, 2014 that have a material impact on the Corporation.

The preparation of consolidated interim financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the amounts reported in the consolidated interim financial statements and notes to the consolidated interim financial statements. These estimates are based on management’s experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. Significant areas requiring the Corporation to make estimates include revenue and gross profit recognition, warranty provisions, and the long-term debt.

The significant accounting judgments and estimation uncertainties used in the preparation of these consolidated interim financial statements should be read in conjunction with the consolidated annual financial statements for the year ended December 31, 2013 and the notes thereto.

***Out of period adjustments***

In connection with the preparation of the Corporation’s consolidated financial statements for the year ended December 31, 2013, adjustments were identified relating to prior periods. The out of period errors identified relate to several items that are individually immaterial and the impact on each financial statement line is summarized in the tables below.

The Corporation assessed the errors and concluded that the related amounts were not material to any of its previously issued financial statements, either individually or in the aggregate. However, the Corporation elected to revise its previously issued consolidated financial statements to correct the effect of

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these errors. This non-cash revision does not impact cash flows for any prior period.

The following tables present the effect of this correction on the Corporation's Consolidation Statements of Operations and Comprehensive loss and Consolidated Statements of Cash Flow:

|   | <b>For the three months ended March 31, 2013</b> |                   |                   |
|---|--|-------------------|-------------------|
|   | <b>As previously reported</b>                    | <b>Adjustment</b> | <b>As revised</b> |
| <i>(unaudited)</i>                        |  |                   |                   |
| Revenue                                   | \$ 12,312  | \$ 79             | \$ 12,391         |
| Cost of sales                             | 8,770  | (255)             | 8,515             |
| Research and product development expenses | 938  | (78)              | 860               |
| Net loss                                  | 1,551  | (412)             | 1,139             |
| Net loss per share                        | \$ (0.20)  | \$ (0.05)         | \$ (0.15)         |

### Note 3. Accounting Standards Issued But Not Yet Applied

IFRS 9, *Financial Instruments*, was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model with only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income ("OCI"). Where equity instruments are measured at fair value through OCI, dividends are recognized in profit or loss to the extent they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated OCI indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement*, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in OCI. In January 2012, the effective date was revised to January 1, 2015 with earlier application permitted. The Corporation has not yet assessed the impact of this standard and amendments or determined whether it will early adopt them.

IFRS 9 was amended In November 2013, to (i) include guidance on hedge accounting, (ii) allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk, from financial liabilities designated under the fair value option, in OCI (without having to adopt the remainder of IFRS 9) and (iii) remove the previous mandatory effective date of January 1, 2015, although the standard is available for early adoption.

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There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Corporation.

**Note 4. Inventories**

|                  | <b>March 31<br/>2014</b> | December 31<br>2013 |
|------------------|--------------------------|---------------------|
| Raw materials    | <b>\$ 9,250</b>          | \$ 8,036            |
| Work-in-progress | <b>6,973</b>             | 4,533               |
| Finished goods   | <b>412</b>               | 252                 |
|                  | <b>\$ 16,635</b>         | \$ 12,821           |

During the three months ended March 31, 2014, the Corporation recorded inventory obsolescence provisions as follows:

|  | <b>Three months ended March 31</b> |          |
|--|------------------------------------|----------|
|  | <b>2014</b>                        | 2013     |
| At January 1                                     | <b>\$ 1,011</b>                    | \$ 1,286 |
| Write downs during the period, net of recoveries | <b>32</b>                          | (6)      |
| Foreign exchange revaluation                     | <b>-</b>                           | 26       |
| At March 31                                      | <b>\$ 1,043</b>                    | \$ 1,306 |

Previously recorded inventory obsolescence provisions were reversed as a result of subsequent recoveries in net realizable value.

**Note 5. Trade and Other Payables**

Accounts payable and accrued liabilities are as follows:

|   | <b>March 31<br/>2014</b> | December 31<br>2013 |
|---|--------------------------|---------------------|
| Trade accounts payable                                    | <b>\$ 6,121</b>          | \$ 3,115            |
| Accrued payroll and related compensation                  | <b>4,289</b>             | 3,871               |
| Liabilities for compensation plans indexed to share price | <b>3,271</b>             | 1,402               |
| Supplier accruals   | <b>2,115</b>             | 3,182               |
| Current portion of repayable government contributions     | <b>454</b>               | 465                 |
| Accrued professional fees                                 | <b>244</b>               | 270                 |
| Current portion of post-retirement benefit liability      | <b>90</b>                | 83                  |
| Other   | <b>677</b>               | 805                 |
|   | <b>\$ 17,261</b>         | \$ 13,193           |



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### Note 6. Warranty Provisions

Changes in the Corporation's aggregate warranty provision are as follows:

|                              | <b>Three months ended March 31,</b> |                 |
|------------------------------|-------------------------------------|-----------------|
|                              | <b>2014</b>                         | <b>2013</b>     |
| At January 1                 | \$ 2,893                            | \$ 1,808        |
| Additional provisions        | 648                                 | 416             |
| Utilized during the period   | (434)                               | (66)            |
| Unused amounts reversed      | (41)                                | (136)           |
| Foreign exchange differences | -                                   | (40)            |
| At March 31                  | <b>\$ 3,066</b>                     | <b>\$ 1,982</b> |

|                     | <b>March 31</b> | <b>December 31</b> |
|---------------------|-----------------|--------------------|
|                     | <b>2014</b>     | <b>2013</b>        |
| Current provision   | \$ 2,268        | \$ 1,912           |
| Long term provision | 798             | 981                |
| Total provision     | <b>\$ 3,066</b> | <b>\$ 2,893</b>    |

### Note 7. Other Non-current Liabilities

Other non-current liabilities are as follows:

|  | <b>March 31</b> | <b>December 31</b> |
|--|-----------------|--------------------|
|  | <b>2014</b>     | <b>2013</b>        |
| Long-term debt (i)                                   | \$ 2,261        | \$ 2,260           |
| Non-current post-retirement benefit liability (ii)   | 261             | 309                |
| Non-current repayable government contributions (iii) | 469             | 526                |
|  | <b>\$ 2,991</b> | <b>\$ 3,095</b>    |

(i) *Long-term debt*

In 2011, the Corporation entered into a loan agreement with the Province of Ontario's Ministry of Economic Development and Trade, Strategic Jobs and Investment Fund for funding up to CA\$6,000. Each draw on the loan is calculated based on 50% of eligible costs to a maximum of CA\$1,500 per disbursement. Eligible costs must be incurred between October 1, 2010 and September 30, 2015.

The maturity date of the loan is ten years from the date of the first disbursement. The loan will be interest free for the first five years, commencing on the first day of the month following the date of the first disbursement, if certain criteria are met, such as the retention and creation of a specified number of jobs. After this five-year period, the loan will bear interest at a rate of 3.67%, if all criteria have been met, and will require repayment at a rate of 20% per year of the outstanding

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balance for the next five years. If the criteria are not met, the loan will bear interest at a rate of 5.67% per annum for the entire term of the loan commencing from the first disbursement. At the project completion date of September 30, 2015, the outstanding amount of the loan is subject to accelerated repayment in an amount based on the percentage shortfall of actual expenditures incurred to date compared to the contractual minimum. Such amount will be immediately repayable with interest calculated from the date of the last disbursement at a rate of 5.67%.

The change in carrying value of this liability for the three months ended March 31 was as follows:

|                                      | <b>Three months ended March 31</b> |             |
|--------------------------------------|------------------------------------|-------------|
|                                      | <b>2014</b>                        | <b>2013</b> |
| At January 1                         | <b>\$ 2,260</b>                    | \$ 1,288    |
| Draw downs during the period         | -                                  | -           |
| Interest accretion during the period | <b>85</b>                          | 50          |
| Foreign exchange revaluation         | <b>(84)</b>                        | (26)        |
| At March 31                          | <b>\$ 2,261</b>                    | \$ 1,312    |

(ii) *Post-retirement benefit liability*

The liability, which is unfunded and payable in Canadian dollars, is a defined benefit plan to be paid to a beneficiary.

The present value of the unfunded obligation recognized in the consolidated interim balance sheets at March 31, 2014, including the current portion, is \$352 (December 31, 2013 - \$391).

(iii) *Repayable government contributions*

The Corporation has received government contributions related to certain historical research and development projects. In 1998, Stuart Energy Systems Corporation ("Stuart Energy") entered into an agreement (the "TPC Agreement") with Technologies Partnerships Canada ("TPC"), a program of Industry Canada to develop and demonstrate hydrogen fleet fuel appliances.

In January 2011, with respect to the TPC Agreement, the Corporation entered into an amended agreement (the "Amendment") with Industry Canada. Under the terms of the Amendment, a total of CA\$1,500 will be paid to Industry Canada in quarterly instalments which commenced in January 2011 and will continue until September 2017. An additional payment of 3% of the net proceeds of all equity instrument financing transactions completed by the Corporation on or before September 30, 2017 or the sum of CA\$800, whichever will be the lesser amount, will be paid to Industry Canada ("the Contingent Amount").

The Amendment was not determined to be a significant modification of the TPC Agreement for accounting purposes. Accordingly, as at the date of the Amendment, the carrying value of the liability was adjusted to \$1,158, determined by taking the net present value of the CA\$1,500 due in accordance with the Amendment plus \$285, which represented the Corporation's best estimate of the Contingent Amount, using the effective interest rate inherent in the original TPC Agreement of 14%.

The change in carrying value of this liability for the three months ended March 31 was as follows:

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|                                      | <b>Three months ended March 31</b> |                 |
|--------------------------------------|------------------------------------|-----------------|
|                                      | <b>2014</b>                        | <b>2013</b>     |
| At January 1                         | \$ 990                             | \$ 1,130        |
| Repayments during the period         | (50)                               | -               |
| Interest accretion during the period | 33                                 | 39              |
| Foreign exchange revaluation         | (49)                               | (24)            |
| Fair value (gain) loss               | (1)                                | (28)            |
| At March 31                          | <u>\$ 923</u>                      | <u>\$ 1,117</u> |

Fair value gains and losses have been recorded in other finance gains and losses, net of interest expense.

The values of the liability as at March 31, 2014 and December 31, 2013 were \$923 and \$990, of which the current portions of \$454 and \$465 were included in trade and other payables, respectively. The company has paid CA\$488 to date under the 3% contingent payment provisions described above. Maximum additional contingent payments amount to CA\$312. The company has estimated further contingent payments of CA\$300 as at March 31, 2014.

## Note 8. Share Capital

### Common shares

|                                  | <b>March 31, 2014</b> |                   | <b>March 31, 2013</b> |               |
|----------------------------------|-----------------------|-------------------|-----------------------|---------------|
|                                  | <b>Number</b>         | <b>Amount</b>     | <b>Number</b>         | <b>Amount</b> |
| Balance at January 1             | 9,017,617             | \$ 333,312        | 7,775,540             | \$ 323,513    |
| Warrants exercised               | 57,144                | 1,217             | 115,000               | 999           |
| Stock options exercised (note 9) | 13,861                | 169               | -                     | -             |
| Balance at March 31              | <u>9,088,622</u>      | <u>\$ 334,698</u> | 7,890,540             | \$ 324,512    |

### Common Share Issuance

On April 30, 2013 the Company entered into an underwriting agreement with Roth Capital to issue 775,000 common shares of the Company at an issue price of \$7.75 per share. Roth Capital also retained an over-allotment of 116,250 shares that could be issued at any time on the ensuing 30 days. On May 3, 2013 the Company issued 891,250 shares for gross proceeds of \$6,907 inclusive of the over-allotment. Net proceeds after underwriting fees and expenses were \$6,145.

### Agreement with Enbridge Inc.

On April 20, 2012, the Corporation entered into the Subscription Agreement and a joint development agreement with Enbridge, a North American leader in delivering energy. Under the terms of the joint development agreement, the Corporation and Enbridge will jointly develop utility scale energy storage. Under the terms of the Subscription Agreement, Enbridge purchased from Hydrogenics 1,082,251 common shares at CA\$4.62 per share for an aggregate purchase price of CA\$5,000. Pursuant to the terms of the Subscription Agreement, the Corporation will use a portion of the proceeds to develop utility scale energy storage. The Corporation incurred issuance costs of \$190 in connection with common

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shares issued under the Subscription Agreement.

The Subscription Agreement provides, among other things, that Enbridge will have certain participation rights and, subject to certain ownership requirements, will have the right to appoint one non-voting observer to the Board of Directors of Hydrogenics.

*Strategic Alliance with CommScope Inc.*

On August 9, 2010, the Corporation entered into a strategic alliance with CommScope Inc. (“CommScope”), a global leader in infrastructure solutions for communications networks, for the development and distribution of specialized fuel cell power systems and included an equity investment in the Corporation.

Under the agreement, CommScope purchased from the Corporation 2,186,906 common shares on a private placement basis in four tranches for an aggregate purchase price of \$8,500.

The agreement provides, among other things, that CommScope has certain participation rights in future financings, which expire one year from the date of closing the fourth tranche. These participation rights expired on June 30, 2012. In addition, subject to the maintenance of certain ownership requirements, CommScope has the right to have one non-voting observer on the Board of Directors of the Corporation. The Corporation and CommScope have also entered into an intellectual property licence agreement on the closing of the first tranche, wherein the Corporation granted to CommScope a licence to certain intellectual property resulting from the transaction, which is only exercisable by CommScope on the occurrence of specified events (such as the Corporation becoming insolvent or exiting the fuel cell business).

*Registered direct offering*

On January 14, 2010, as part of a registered direct offering, the Corporation issued 239,356 warrants (the “Series A warrants”), which are exercisable at any time until January 14, 2015, at an exercise price of \$13.00 per common share. On the same day, the Corporation also issued 260,646 warrants (the “Series B warrants”) exercisable for a period of five years beginning on July 15, 2010 at an exercise price of \$13.00 per common share. The terms of the warrants stipulated that the exercise price of the Series A and B warrants is to be reduced if the Corporation completes a share offering, whereby the price per common share of such an offering is lower than \$13.00 per common share. As a result of the above noted investment by CommScope on August 9, 2010, the exercise price of the Series A and B warrants was reduced to \$3.68 per common share.

Key assumptions included the following:

|                               | March 31, 2014 |          | December 31, 2013 |           |
|-------------------------------|----------------|----------|-------------------|-----------|
|                               | Series A       | Series B | Series A          | Series B  |
| Market price of common shares | -              | -        | -                 | \$ 19.15  |
| Risk-free interest rate       | -              | -        | -                 | 1.10%     |
| Term to maturity              | -              | -        | -                 | 1.5 years |
| Volatility                    | -              | -        | -                 | 64%       |

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The Series A warrants were fully exercised in 2013 and the Series B warrants were fully exercised in the three months ended 2014. During the period 69,072 Series B warrants were exercised. Of these, 69,072 Series A warrants were exercised as a cashless exercise, resulting in 57,144 shares being issued.

The Corporation included the warrants within liabilities at the date of issuance because of the cash settlement features associated with the warrants. The Corporation measured these warrants at fair value at the time of issuance as \$2,941.

The outstanding warrants during the three months ended March 31, 2014 was as follows:

|              | March 31, 2014 |          | March 31, 2013 |          |
|--------------|----------------|----------|----------------|----------|
|              | Series A       | Series B | Series A       | Series B |
| At January 1 | -              | 69,072   | 141,856        | 260,646  |
| Exercised    | -              | (69,072) | (87,178)       | (27,822) |
| March 31     | -              | -        | 54,678         | 232,824  |

Cash proceeds on the warrants exercise amounted to \$nil (March 31, 2013 – \$423) during the three months ended March 31, 2014.

The change in fair value of outstanding warrants during the three months ended March 31, 2014 was as follows:

|  | Three months ended March 31 |          |
|--|-----------------------------|----------|
|  | 2014                        | 2013     |
| At January 1                                       | \$ 1,075                    | \$ 1,545 |
| Fair value of warrants exercised during the period | (1,075)                     | (435)    |
| Fair value (gain) loss upon revaluation            | -                           | 240      |
| At March 31  | \$ -                        | \$ 1,350 |

Fair value gains and losses upon revaluation of warrants are included in other finance gains (losses), net of income tax expense.

## Note 9. Stock-based Compensation

### Stock option plan

Under the Hydrogenics Omnibus Incentive Plan adopted in 2012, the Corporation may issue stock options to employees, directors and consultants as part of a long-term incentive plan. Stock options were previously granted under the Corporation's Stock Option Plan.

A summary of the Corporation's employee stock option plan activity of the three months ended March 31 is as follows:

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|                                  | 2014             |  | 2013             |  |
|----------------------------------|------------------|--|------------------|--|
|                                  | Number of shares | Weighted average exercise price (CA\$) | Number of shares | Weighted average exercise price (CA\$) |
| Outstanding, beginning of period | 503,907          | 8.63                                   | 526,519          | 9.71                                   |
| Granted                          | -                | -                                      | 30,000           | 8.10                                   |
| Exercised                        | (13,861)         | 8.74                                   | -                | -                                      |
| Expired                          | (296)            | 89.50                                  | -                | -                                      |
| Outstanding, end of period       | 489,750          | 8.58                                   | 556,519          | 9.62                                   |

All options are for a term of ten years from the date of grant and vest over four years unless otherwise determined by the Board of Directors. The fair value of the stock options granted was determined using the Black-Scholes option pricing model with the following weighted average assumptions:

|                             | March 31<br>2014 | March 31<br>2013 |
|-----------------------------|------------------|------------------|
| Risk-free interest rate (%) | -                | 1.39%            |
| Expected volatility (%)     | -                | 69%              |
| Expected life (in years)    | -                | 5.5              |
| Expected dividends          | -                | \$ nil           |

Expected volatility during the three months ended March 31, 2013 was determined using the stock historical volatility for the 5.5 years prior to the date of grant, as this is the expected life of the stock option.

Stock-based compensation expense related to the stock options and PSUs of \$136 for the three months ended March 31, 2014 is included in selling, general and administrative expenses (March 31, 2013 - \$134). Proceeds on the exercise of options amounted to \$109 for the three months ended March 31, 2014 (March 31, 2013 - \$nil).

#### Deferred Share Units (“DSUs”)

|                          | March 31, 2014 |          | March 31, 2013 |        |
|--------------------------|----------------|----------|----------------|--------|
|                          | Number         | Amount   | Number         | Amount |
| DSU continuity schedule: |                |          |                |        |
| Balance at December 31   | 131,320        | \$ 2,521 | 124,085        | \$ 842 |
| DSU redemptions          | (49,442)       | (1,472)  | -              | -      |
| DSU compensation expense | 964            | 26       | 3,086          | 24     |

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|                            |               |                 |         |                 |
|----------------------------|---------------|-----------------|---------|-----------------|
| DSU fair value adjustments | n/a           | 1,177           | n/a     | 138             |
| Balance at March 31        | <b>82,842</b> | <b>\$ 2,252</b> | 127,171 | <b>\$ 1,004</b> |

The Corporation recognized a compensation expense associated with DSUs issued of \$1,202 for the three months ended March 31, 2014 (March 31, 2013 - \$162). The portion relating to compensation expense for the three months ended March 31, 2014 totaled \$26 (March 31, 2013 - \$24), and the portion related to fair value adjustments totaled \$1,177 (March 31, 2013 - \$138). The liability amount of \$2,252 (December 31, 2013 - \$2,521) is included in trade and other payables. DSUs issued vest immediately on the date of issuance.

### Restricted Share Units (“RSUs”)

|                            | March 31, 2014 |                 | March 31, 2013 |                 |
|----------------------------|----------------|-----------------|----------------|-----------------|
|                            | Number         | Amount          | Number         | Amount          |
| RSU continuity schedule:   |                |                 |                |                 |
| Balance at December 31     | <b>46,885</b>  | <b>\$ 660</b>   | 189,694        | \$ 859          |
| RSU compensation expense   | n/a            | <b>84</b>       | n/a            | 99              |
| RSU fair value adjustments | n/a            | <b>275</b>      | n/a            | 140             |
| Balance at March 31        | <b>46,885</b>  | <b>\$ 1,019</b> | 189,694        | <b>\$ 1,098</b> |

During the three months ended March 31, 2014, the Corporation recognized a compensation expense of \$359 (March 31, 2013 - \$239) associated with RSUs issued under the Hydrogenics Omnibus Incentive Plan and the former RSU plan. The portion relating to compensation expense for the three months ended March 31, 2014 totaled \$84 (March 31, 2013 - \$99), and the portion related to fair value adjustments totaled \$275 (March 31, 2013 - \$140). The liability amount of \$1,019 (December 31, 2013 - \$660) is included in trade and other payables.

### Performance Share Units (“PSUs”)

|                          | March 31       |         |
|--------------------------|----------------|---------|
|                          | 2014           | 2013    |
| PSU continuity schedule: |                |         |
| Balance at December 31   | <b>154,493</b> | 148,320 |
| PSUs issued              | <b>37,827</b>  | 6,173   |
| PSUs forfeited           | -              | -       |
| Balance at March 31      | <b>192,320</b> | 154,493 |

During the three months ended March 31, 2014, the Corporation recognized a stock-based compensation expense associated with PSUs issued under the Hydrogenics Omnibus Incentive Plan of \$42 (March 31, 2013 - \$42), with the offsetting increase to contributed surplus.

### Note 10. Research and Product Development Expenses

Research and product development expenses are recorded net of non-repayable third party program

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funding received or receivable. For the three months ended March 31, 2014 and 2013, research and product development expenses and non-repayable program funding, which have been received, or are to be received, are as follows:

|   | Three months ended March 31, |               |
|---|------------------------------|---------------|
|   | 2014                         | 2013          |
| Research and product development expenses           | \$ 1,569                     | \$ 1,194      |
| Government research and product development funding | (653)                        | (334)         |
|   | <u>\$ 916</u>                | <u>\$ 860</u> |

**Note 11. Other Finance Gains and Losses, Net**

Components of other finance gains and losses, net are as follows:

|  | Three months ended March 31, |                 |
|--|------------------------------|-----------------|
|  | 2014                         | 2013            |
| (Loss) gain from change in fair value of exercised warrants (note 8)                       | \$ (142)                     | \$ (140)        |
| (Loss) gain from change in fair value of outstanding warrants (note 8)                     | -                            | (240)           |
| (Loss) gain from change in net present value of repayable government contribution (note 7) | 2                            | 29              |
|  | <u>\$ (140)</u>              | <u>\$ (351)</u> |

**Note 12. Net Loss Per Share**

For the three months ended March 31, 2014, the weighted average number of common shares outstanding was 9,073,527. No effect has been given to the potential exercise of stock options and warrants in the calculation of diluted net loss per share, as the effect would be anti-dilutive.

**Note 13. Contingencies**

The Corporation has entered into indemnification agreements with its current and former directors and officers to indemnify them, to the extent permitted by law, against any and all charges, costs, expenses, amounts paid in settlement, and damages incurred by the directors and officers as a result of any lawsuit or any other judicial, administrative or investigative proceeding in which the directors and officers are sued as a result of their service.

These indemnification claims will be subject to any statutory or other legal limitation period. The nature of the indemnification agreements prevents the Corporation from making a reasonable estimate of the maximum potential amount it could be required to pay to counterparties. The Corporation has purchased directors' and officers' liability insurance. No amount has been recorded in the consolidated interim financial statements with respect to these indemnification agreements, as the Corporation is not aware of any claims.



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In the normal course of operations, the Corporation may provide indemnification agreements, other than those listed above, to counterparties that would require the Corporation to compensate them for costs incurred as a result of changes in laws and regulations or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnification agreements will vary based on the contract. The nature of the indemnification agreements prevents the Corporation from making a reasonable estimate of the maximum potential amount it could be required to pay to counterparties. No amount has been recorded in the consolidated interim financial statements with respect to these indemnification agreements, as the Corporation is not aware of any claims.

**Note 14. Lines of Credit and Other Loan Facilities**

**Operating lines of credit**

At March 31, 2014, the Corporation had entered into operating lines of credit for up to 5,300 Euro, or the US equivalent of \$7,300 (December 31, 2013 - \$12,019). Subsequent to March 31, 2014 the operating lines of credit increased to 7,000 Euro.

Pursuant to the terms of the credit facility, Hydrogenics Europe NV (the "Borrower"), a wholly owned Belgian based subsidiary, may utilize the facility for the issuance of standby letters of credit and letters of guarantee up to 5,300 Euro. The Borrower may also borrow a maximum of 75% of the value of awarded sales contracts, approved by the Belgian financial institution, to a maximum of 750 Euro, provided that sufficient room exists under the overall facility limit of 5,300 Euro. The Borrower may also borrow up to 1,250 Euro for general business purposes, provided sufficient limit exists under the overall facility limit of 5,300 Euro. At March 31, 2014, 3,319 Euro of standby letters of credit and letters of guarantee are outstanding and 1,250 Euro has been drawn upon the operating line of credit. At March 31, 2014, the Corporation had availability of 731 Euro or the US equivalent of \$1,007 (December 31, 2013 - \$4,405).

The credit facility bears interest at a rate of EURIBOR plus 1.45% per annum and is secured by a 1,000 Euro secured first charge covering all assets of the Borrower. The credit facility contains a negative pledge precluding the Borrower from providing security over its assets. Additionally, the Borrower is required to maintain a solvency covenant, defined as equity plus current account divided by total liabilities of not less than 25%, and ensure that its intercompany accounts with Hydrogenics Corporation ("the parent Corporation") do not fall below a defined level. At March 31, 2014, the Borrower was in compliance with these covenants.

Within the Power Systems business segment, the Corporations have an additional \$2,384 (December 31, 2013 - \$2,374) of available operating lines of credit, for which \$2,384 is outstanding, representing standby letters of credit and letters of guarantee issued by the financial institution. At March 31, 2014, the Corporation had availability of \$nil (December 31, 2013 - \$nil).

**Other loan facilities**

On September 28, 2011, the Canadian operating entity ("Hydrogenics Corporation") entered into a loan agreement with the Province of Ontario's Ministry of Economic Development, Strategic Jobs and Investment Fund for funding up to CA\$6,000. Refer to Note 7 for further details.

The Corporation drew CA \$nil on the loan during the three months ended March 31, 2014. The remaining CA\$988 remains undrawn at March 31, 2014. The loan is collateralized by a general security agreement covering assets of Hydrogenics Corporation. Additionally, the Corporation is required to maintain a minimum balance of cash in CAD dollars in a Canadian financial institution at all times.

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**Note 15. Guarantees**

At March 31, 2014, the Corporation had outstanding standby letters of credit and letters of guarantee issued by several financial institutions that totalled \$6,996 (December 31, 2013 - \$7,614), with expiry dates extending to August 2017. The Corporation has restricted cash totalling \$2,277 as partial security for these standby letters of credit and letters of guarantee, with \$1,828 restricted in Hydrogenics Europe NV, \$391 restricted in Hydrogenics Corporation, and \$58 restricted within the German entity included in the Power Systems business segment. These instruments relate primarily to obligations in connection with the terms and conditions of the Corporation's sales contracts. The standby letters of credit and letters of guarantee may be drawn on by the customer if the Corporation fails to perform its obligations under the sales contracts and the Corporation would be liable to the financial institution for the amount of the standby letter of credit or letter of guarantee in the event the instruments are drawn on.

**Note 16. Related Party Transactions**

In the normal course of operations, the Corporation subcontracts certain manufacturing functions to a corporation owned by a relative of one of the shareholders of the Corporation. Billings by this related corporation for material totalled \$35 in the three months ended March 31, 2014 (March 31, 2013 - \$88). At March 31, 2014, the Corporation has an accounts payable balance due to this related party of \$8 (December 31, 2013 - \$4).

As a result of CommScope's investments in the Corporation, CommScope is also a related party. Revenues from this related party for product were \$16 in the three months ended March 31, 2014 (March 31, 2013 - \$2,346). At March 31, 2014, the Corporation has an accounts receivable balance from this related party of \$16 (December 31, 2013 - \$nil). Billings from this related party for product were \$nil in the three months ended March 31, 2014 (March 31, 2013 - \$nil). At March 31, 2014, the Corporation has an accounts payable balance to this related party of \$nil (December 31, 2013 - \$35).

All related party transactions involve the parent company. There are no related party transactions to disclose for the subsidiaries.

**Note 17. Consolidated Interim Statements of Cash Flows**

Components of the net change in non-cash working capital are as follows:

|  | <b>Three months ended March 31,</b> |                   |
|--|-------------------------------------|-------------------|
|  | <b>2014</b>                         | <b>2013</b>       |
| Decrease (increase) in current assets                  |                                     |                   |
| Trade and other receivables                            | \$ (2,801)                          | \$ (1,143)        |
| Grants receivable                                      | -                                   | (34)              |
| Inventories  | (3,814)                             | (847)             |
| Prepaid expenses                                       | (351)                               | 131               |
| Increase (decrease) in current liabilities             |                                     |                   |
| Trade and other payables, including warranty provision | 2,484                               | (392)             |
| Deferred revenue                                       | 2,483                               | (3,808)           |
| Subtotal   | <b>\$ (1,972)</b>                   | <b>\$ (6,093)</b> |
| Liabilities for compensation indexed to share price    | 1,561                               | 401               |

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|    |     |    |         |
|----|-----|----|---------|
| \$ | 411 | \$ | (5,692) |
|----|-----|----|---------|

**Note 18. Segmented Financial Information**

The Corporation's two reportable segments include OnSite Generation and Power Systems. Segmentation is based on the internal reporting and organizational structure, taking into account the different risk and income structures of the key products and production processes of the Corporation. Where applicable, corporate and other activities are reported separately as Corporate and Other. OnSite Generation includes the design, development, manufacture and sale of hydrogen generation products. Power Systems includes the design, development, manufacture and sale of fuel cell products.

Financial information by reportable segment for the three months ended March 31, 2014 and March 31, 2013 is as follows:

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|   | Three months ended March 31, 2014 |                  |                        |           |
|---|-----------------------------------|------------------|------------------------|-----------|
|   | OnSite<br>Generation              | Power<br>Systems | Corporate<br>and Other | Total     |
| <b>Consolidated Interim Statement of Operations and Comprehensive Loss:</b> |                                   |                  |                        |           |
| Revenues from external customers  | \$ 5,963                          | \$ 2,096         | \$ -                   | \$ 8,059  |
| Intersegment revenue  | -                                 | -                | -                      | -         |
| Gross profit  | 767                               | 1,150            | -                      | 1,917     |
| Selling, general and administrative expenses                                | 841                               | 1,055            | 2,671                  | 4,567     |
| Research and product development expenses                                   | 383                               | 533              | -                      | 916       |
| Other finance losses, net   | -                                 | -                | (51)                   | (51)      |
| Interest income   | -                                 | -                | 2                      | 2         |
| Interest expense  | -                                 | -                | (134)                  | (134)     |
| Segment gain (loss) (i)   | (456)                             | (435)            | (2,858)                | (3,749)   |
| <b>Consolidated Interim Balance Sheet:</b>                                  |                                   |                  |                        |           |
| Total segment assets  | 29,215                            | 13,442           | 2,388                  | 45,045    |
| Total segment liabilities (current and non-current)                         | 18,522                            | 17,999           | 4,655                  | 41,176    |
| <b>Three months ended March 31, 2013</b>                                    |                                   |                  |                        |           |
|   | OnSite<br>Generation              | Power<br>Systems | Corporate<br>and Other | Total     |
| <b>Consolidated Interim Statement of Operations and Comprehensive Loss:</b> |                                   |                  |                        |           |
| Revenues from external customers  | \$ 6,466                          | \$ 5,925         | \$ -                   | \$ 12,391 |
| Intersegment revenue  | 1                                 | 14               | -                      | 15        |
| Gross profit  | 1,471                             | 2,405            | -                      | 3,876     |
| Selling, general and administrative expenses                                | 826                               | 1,195            | 1,601                  | 3,622     |
| Research and product development expenses                                   | 165                               | 688              | 7                      | 860       |
| Other finance losses, net   | -                                 | -                | (351)                  | (351)     |
| Interest income   | -                                 | -                | 7                      | 7         |
| Interest expense  | -                                 | -                | (92)                   | (92)      |
| Segment gain (loss) (i)   | 480                               | 523              | (2,142)                | (1,139)   |
| <b>Consolidated Interim Balance Sheet:</b>                                  |                                   |                  |                        |           |
| Total segment assets  | 24,995                            | 8,466            | 5,571                  | 39,032    |
| Total segment liabilities (current and non-current)                         | 14,964                            | 17,847           | 2,176                  | 34,987    |

(i) Segment loss includes directly attributable selling, general and administrative expenses, research and product development costs, net of associated grants and depreciation of property, plant and equipment and amortization of intangible assets. It is consistent with the Corporation's profit or loss before tax expense (income).

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Goodwill relating to the Corporation's OnSite Generation segment at March 31, 2014 was \$5,246 (December 31, 2013 - \$5,248). OnSite Generation consists of the Corporation's subsidiary primarily located in Belgium with a functional currency of the euro. The changes in goodwill are a result of currency fluctuations between the US dollar and the euro.

**Note 19. Risk Management Arising From Financial Instruments – Fair Value**

*Fair value*

The carrying value of cash and cash equivalents, restricted cash, accounts receivable, and accounts payable and accrued liabilities (excluding the liabilities relating to the RSUs and DSUs) approximate their fair value given their short-term nature. The carrying value of the non-current liabilities approximates their fair value given the difference between the discount rates used to recognize the liabilities in the consolidated balance sheets and the market rates of interest is insignificant.

Fair value measurements recognized in the balance sheets must be categorized in accordance with the following levels:

- (i) Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- (ii) Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- (iii) Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The Corporation has not transferred any financial instruments between Level 1, 2, or 3 of the fair value hierarchy during the three months ended March 31, 2014.