

# MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis ("MD&A") for Enerflex Ltd. ("Enerflex" or "the Company") should be read in conjunction with the audited consolidated financial statements and MD&A for the years ended December 31, 2013 and 2012.

The consolidated financial statements reported herein have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are presented in Canadian dollars unless otherwise stated. IFRS has been adopted in Canada as Generally Accepted Accounting Principles ("GAAP") and, as a result, GAAP and IFRS are used interchangeably within this MD&A.

The MD&A has been prepared taking into consideration information that is available up to February 27, 2014 and focuses on information and key statistics from the audited annual consolidated financial statements, and pertains to known risks and uncertainties relating to the oil and gas service sector. This discussion should not be considered all-inclusive, as it excludes possible future changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur which could affect industry conditions and/or Enerflex in the future. Additional information relating to the Company, including the Annual Information Form and Information Circular, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

## Forward-Looking Statements

This MD&A contains forward-looking statements. Certain statements containing words such as "anticipate", "could", "expect", "seek", "may", "intend", "will", "believe" and similar expressions, statements that are based on current expectations and estimates about the markets in which the Company operates and statements of the Company's belief, intentions and expectations about development, results and events which will or may occur in the future constitute "forward-looking statements" and are based on certain assumptions and analyses made by the Company derived from its experience and perceptions. Any statements, other than statements of historical fact, contained in this MD&A may be forward-looking statements, including, without limitation: statements with respect to anticipated financial performance; future capital expenditures, including the amount and nature thereof; bookings and backlog; oil and gas prices and the impact of such prices on demand for Enerflex products and services; development trends in the oil and gas industry; seasonal variations in the activity levels of certain oil and gas markets; business prospects and strategy; expansion and growth of the business and operations, including market share and position in energy service markets; the ability to raise capital; the ability of existing and expected cash flows and other cash resources to fund investments in working capital and capital assets; the impact of economic conditions on accounts receivable; expectations regarding future dividends; expectations and implications of changes in government regulation, laws and income taxes; uncertainties relating to the sale of the European Service and Combined Heat and Power business; and other such matters.

The forward-looking statements in this MD&A, primarily in the *Enerflex Strategy* and *Outlook for Markets* sections, are subject to important risks, uncertainties, and assumptions, which are difficult to predict and which may affect the Company's operations. The critical risks, uncertainties, and assumptions relating to these sections, include, without limitation: the impact of economic conditions including volatility in the price of oil, gas, and gas liquids, interest rates and foreign exchange rates; industry conditions including supply and demand fundamentals for oil and gas, and the related infrastructure including new environmental, taxation and other laws and regulations; the ability to continue to build and improve on proven manufacturing capabilities and innovate into new product lines and markets; increased competition; insufficient funds to support capital investments required to grow the business; the lack of availability of qualified personnel or management; and political unrest. As such, actual results, performance, or achievements could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits, including the amount of proceeds or dividends the Company and its shareholders will derive therefrom. The forward-looking statements included in this MD&A are made as of the date of this MD&A and other than as required by law, the Company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

## The Company

Enerflex is a single-source supplier of natural gas compression, oil and gas processing, refrigeration systems and electric power equipment – plus in-house engineering and mechanical services expertise. The Company's broad in-house resources provide the capability to engineer, design, manufacture, construct, commission and service hydrocarbon handling systems. Enerflex's expertise encompasses field production facilities, compression and natural gas processing plants, CO<sub>2</sub> processing plants, refrigeration systems and electric power equipment serving the natural gas production industry.

Headquartered in Calgary, Canada, Enerflex has approximately 2,900 employees worldwide. Enerflex, its subsidiaries, interests in associates and joint-ventures, operate in Canada, the United States, Colombia, Australia, the United Kingdom, Russia, the United Arab Emirates ("UAE"), Oman, Bahrain, Indonesia, Malaysia and Singapore.

Enerflex operates three business segments: Canada and Northern U.S., Southern U.S. and Latin America, and International. Each regional business segment has two or more of the three main product lines: Engineered Systems, Service and Rentals. A summary of the business segments and product lines is provided below.

### Canada and Northern U.S.

- Compression and Process provides custom and standard compression packages for reciprocating and screw compressor applications. Retrofit provides re-engineering, reconfiguration and repackaging of compressors for various field applications. Manufacturing facilities are located in Calgary, Alberta, and Retrofit facilities are located in Calgary, Grande Prairie and Red Deer, Alberta and Casper, Wyoming;
- Production and Processing ("P&P") designs, manufactures, constructs and installs modular processing equipment, and waste gas systems, for the natural gas, heavy oil steam assisted gravity drainage ("SAGD") and heavy mining segments of the market. The manufacturing facility is located in Nisku, Alberta;
- Service (Gas Drive) provides mechanical services and parts as the authorized distributor of GE's Waukesha gas engines to the oil and gas industry, focusing in Canada and the Northern U.S., and as the authorized distributor and service provider of Jenbacher engines and parts in Canada. Service branches are located in British Columbia, Alberta, Ontario, Quebec, Alaska, Michigan, North Dakota, Ohio, Wyoming, Colorado and Utah; and
- Rentals provides natural gas compression and electric power equipment rentals, from its locations in Calgary, Alberta and Casper, Wyoming.

### Southern U.S. and Latin America

- Compression and Process provides custom and standard compression packages for reciprocating and screw compressor applications from a facility located in Houston, Texas;
- Gas Processing engineers, designs, manufactures, constructs and installs modular natural gas processing equipment, refrigeration systems and turnkey deep cut cryogenic gas processing facilities packages from the Houston facility; and
- Service provides mechanical services and products to the oil and gas industry in the Southern U.S., Eastern U.S. and Latin America. Service branches are located in Pennsylvania, Missouri, Oklahoma, Texas, Louisiana and Bogota, Colombia.

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## International

### Continuing Operations

- AustralAsia provides process facility construction for gas and power facilities and compression package assembly. This division also provides mechanical service and parts, as the authorized Waukesha distributor for the oil and gas industry in this region. The division has locations in Queensland, New South Wales, Southern Australia and Western Australia;
- Southeast Asia, including Singapore and a recently-launched operation in Malaysia, provides processing and compression solutions to customers in the region. Service capabilities are also provided to Southeast Asia through the Jakarta, Indonesia operations in AustralAsia; and
- Middle East and North Africa ("MENA") provides engineering, procurement and construction services, compression and process package sales, as well as operating and maintenance services for gas compression and processing facilities in the region. The division has locations in Bahrain, UAE and Oman.

Effective January 1, 2013, the reporting for the P&P division was changed from the International business segment to the Canada and Northern U.S. segment. The change in reporting was to focus the division on expansion into Alberta's oil sands, and to better align Enerflex's North American manufacturing facilities. Comparative amounts for 2012 have been reclassified to reflect this change for both the Canada and Northern U.S., and International business segments.

### Discontinued Operations

- Enerflex Europe ("EE") provides Service and Combined Heat and Power ("CHP") products to the region. Enerflex has reported EE as a discontinued operation since the third quarter of 2011. Enerflex completed the sale of this business in the second quarter of 2013.

## Engineered Systems

The Engineered Systems product line includes engineering, fabrication and assembly of standard and custom-designed compression packages; production and processing equipment and facilities, including refrigeration systems and turnkey deep cut cryogenic gas processing packages; and electric power systems.

## Service

The Service product line includes support services, labour and parts sales to the oil and gas industry. Enerflex, directly or through wholly-owned Gas Drive Global LP ("Gas Drive") subsidiaries, is the authorized distributor and service provider, for GE's Waukesha gas engines and parts in Canada, the Northern U.S. including Alaska, Australia, Indonesia and Papua New Guinea, and for Jenbacher gas engines and parts in Canada. The Company is also the exclusive authorized distributor for Altronic, a leading manufacturer of electric ignition and control systems in Canada, Australia, and New Zealand. Outside of Gas Drive's designated distribution/service areas, after-market service continues to be provided by Enerflex.

## Rentals

The Rentals product line includes a variety of rental and leasing alternatives for natural gas compression, electric power and processing equipment. The rental fleet is primarily deployed in Western Canada and the Northern U.S. Expansion in international markets is conducted on a selective basis to minimize the risk of these newer markets.

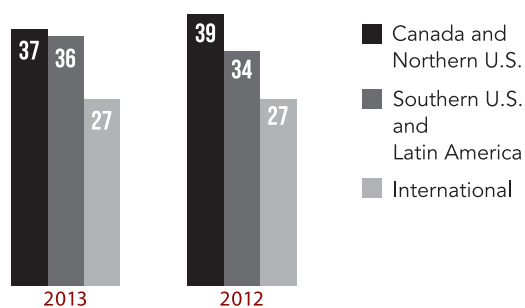
## Enerflex Strategy

Enerflex's vision is to be the leader at delivering innovative natural gas compression, processing and electric power solutions throughout the world. Enerflex's strategy to support this vision centres on being an operationally focused, financially strong, dividend-paying company that delivers profitable growth by serving an expanding industry in six gas producing regions worldwide. Being a global company enables Enerflex to generate more value.

Across the Company, Enerflex looks to leverage its international positioning to provide exposure to projects in growing natural gas markets; to offer all phases of a project life-cycle from engineering and design through to after-market service; and to leverage the synergies from being active in multiple regions to deploy key expertise worldwide and generate repeat business from globally active customers. Enerflex seeks to continue to diversify its revenue streams from multiple markets, to maintain a strong backlog globally and to ensure profitable global margins, with a medium-term goal of achieving a 10 percent earnings before interest and tax ("EBIT") margin. In addition, Enerflex seeks to expand the diversification of its product lines, with a goal to achieve 35-40 percent recurring revenue (revenue from the Service and Rental product lines). The table below demonstrates the progress towards these diversification goals, in terms of revenue sources, and in terms of product lines.

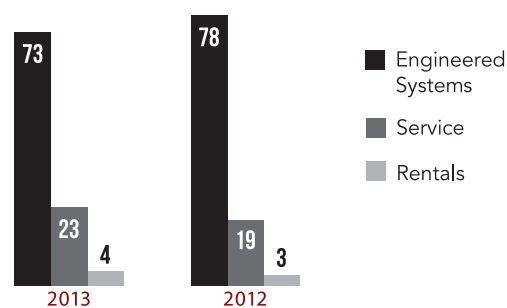
### REVENUE BY SEGMENT (%)

Twelve months ended December 31



### REVENUE BY PRODUCT LINE (%)

Twelve months ended December 31



The Company has identified the key performance drivers required to achieve its company-wide goals and monitors its performance against these company-wide goals through the use of key performance indicators. The key performance drivers include a highly qualified and motivated workforce, integrated systems and processes, world-class design and manufacturing capabilities, excellent safety performance, a strong financial footing, and a global reach across the product life-cycle. Further information and discussion on the key performance indicators used to monitor performance is provided in the *Financial Highlights, Canada and Northern U.S. Segment Results, Southern U.S. and Latin America Segment Results, International Segment Results, and Liquidity* sections.

Enerflex determines strategies for each of its business segments to achieve company-wide goals, focusing on the areas of its operations that best support these goals. A summary of progress against 2013 strategic objectives during the twelve months of 2013 is provided on the following page.

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2013 Strategic Objective	Performance to December 31, 2013
<p>Become increasingly active in the Alberta oil sands through the pursuit of opportunities to supply modules and equipment that build on the Company's proven manufacturing competencies.</p>	<p>The Company's presence in the Alberta oil sands continues to grow with bookings of \$74.5 million during the 2013 year, and with the decision late in 2013 to focus the P&amp;P division on the oil sands.</p>
<p>Enter the Southeast Asia market for gas compression and processing equipment through the new Singapore location.</p>	<p>A sales presence was added in Malaysia, and bookings of \$27.5 million were recorded during the twelve months of 2013, including new projects in Indonesia.</p>
<p>Initiate the sale of cryogenic processing facilities in North American liquids-rich gas plays.</p>	<p>Enerflex has partially pre-built two cryogenic plants, but the market has been slower to develop than originally thought.</p>
<p>Build on the strong sales growth of 2012 by pursuing continued growth in the Southern U.S. and Latin America, and International compression and processing markets.</p>	<p>Domestic bookings for the Southern U.S. and Latin America, and bookings in Canada and Northern U.S. and Southern U.S. and Latin America destined for international markets, were higher for the 2013 year compared with 2012. These increases were partially offset by lower bookings in the International segment.</p>
<p>Continue to improve manufacturing processes, systems and project execution in all regions. This will include progressing the Company-wide implementation of SAP, an enterprise resource planning system, and implementing regional gas processing models.</p>	<p>During 2013, the Company successfully completed the implementation of SAP for the North American manufacturing facilities, and aligned the reporting under one business segment. The remaining phases of the SAP implementation are being undertaken. In addition, the Company closed the Casper, Wyoming facility in June 2013 to align production capabilities with current market dynamics. The Company has made some progress on project execution, but continued to experience challenges in the International region and anticipates improvements going forward.</p>
<p>Continue progress in safety management programs and improve the Company-wide total recordable injury rate ("TRIR") by 13.0 percent in 2013.</p>	<p>Progress has been made, with the TRIR for 2013 at 1.87, which is 41.7 percent below the 2012 rate of 3.21 and therefore representing a significant improvement beyond the 2013 goal of 2.80.</p>
<p>Conduct a capital expenditure program of approximately \$36.0 million that balances growth and risk management objectives. It includes developing the cryogenic engineering and manufacturing capability in the Southern U.S. and Latin America segment, adding to the rental fleet as needed, and expanding facilities to accommodate future growth.</p>	<p>During the 2013 year, the Company incurred \$36.7 million in capital expenditures. These expenditures were primarily for IT systems, expansion of the Houston facility, and rental and shop equipment.</p>
<p>Continue progressing towards the goal of 35-40 percent recurring revenue on a trailing 12 month basis.</p>	<p>Recurring revenue as a percentage of revenue for the year ended December 31, 2013 increased to 26.7 percent compared to 21.5 percent for the year ended December 31, 2012.</p>
<p>Make measurable progress towards the medium-term objective of a 10 percent EBIT margin on a trailing 12 month basis.</p>	<p>EBIT margin decreased to 6.2 percent for the year ended December 31, 2013 compared to 7.8 percent for the year ended December 31, 2012.</p>

## Overview

The oil and natural gas service sector in the Canada and Northern U.S. segment has a distinct seasonal trend in activity levels which results from well site access and drilling pattern adjustments to take advantage of weather conditions. Generally, Enerflex's Engineered Systems product line has experienced higher revenues in the fourth quarter of each year while the Service and Rentals product line revenues are generally more stable throughout the year. Rentals' revenues are also impacted by both the Company's and its customers' capital investment decisions. The Southern U.S. and Latin America and International segments are not significantly impacted by seasonal factors. Variations from these trends in all regional segments generally occur when hydrocarbon energy supply and demand fundamentals are either improving or deteriorating.

During the fourth quarter of 2013, Enerflex recorded bookings of \$386.4 million compared to \$242.6 million during the same period in 2012, an increase of \$143.8 million. During the year ended December 31, 2013, bookings were \$1,140.8 million compared to \$875.5 million during 2012, an increase of \$265.3 million. The increases were due to higher bookings in the Southern U.S. and Latin America, and Canada and Northern U.S. segments, primarily driven by customer orders destined for domestic markets despite continuing weak gas and natural gas liquids ("NGL") prices, partially offset by lower International segment bookings.

Manufacturing activity levels for the Engineered Systems product line, and correspondingly revenue, decreased in the fourth quarter of 2013 primarily due to lower revenue in the Southern U.S. and Latin America and International segments. For the 2013 year, Engineered Systems revenue was lower in all segments. The lower revenues for 2013 were primarily a result of the lower backlog at the start of 2013 of \$683.2 million, compared to \$986.1 million at the start of 2012. Engineered Systems revenue decreased by 26.9 percent from \$334.8 million in the fourth quarter of 2012 to \$244.8 million in the fourth quarter of 2013, and by 12.6 percent from \$1,178.4 million to \$1,030.0 million in 2012 and 2013, respectively. With higher booking levels and the lower Engineered Systems revenue, the backlog has increased by 16.2 percent to \$794.0 million as at December 31, 2013 from \$683.2 million at the start of 2013, and 21.7 percent from \$652.3 million as at September 30, 2013.

During the second quarter of 2013, Enerflex ceased all compression and process new unit packaging out of its Casper, Wyoming location. Sales, Service, Rentals and Retrofit operations in the area will continue as before. The Casper new unit packaging location was started in 2006 for the primary purpose of supplying coal bed methane compression that would be installed in the Wyoming Powder River Basin. This facility had been very successful in serving this market over a number of years. Unfortunately with the emergence of more economical shale gas plays in other parts of the United States, the Powder River Basin is no longer an active area for new compression. In addition, Enerflex experienced ongoing manufacturing quality challenges at the facility, which resulted in warranty expenses of \$9.6 million over the 24 months prior to its closure in June 2013. Equipment scheduled to be packaged in Casper is now being completed at the Calgary facility. Enerflex intends to sell or lease the Casper facility and recorded \$1.1 million in restructuring expenses related to the closure during the second quarter of 2013. This region is currently being served through the Denver and Houston operations.

The Company continued to experience cost increases without corresponding revenue on projects in the International region, which adversely impacted margin performance for both the fourth quarter and for the full year. In 2013, gross margin was negatively impacted by \$20.0 million as a result of these increased project costs, which were substantially customer driven. Variation claims are filed once forecast costs on a fixed price project exceed budgeted costs, as a result of increased scope or design changes to the project, which are common for engineering, procurement and construction ("EPC") contracts. To the extent that these cost increases are subsequently recovered through approved variation claims from customers, revenue will be recognized in the corresponding period. This results in volatility in gross margins for the International segment as additional costs are recognized as incurred on these projects, while revenue resulting from variation claims is recognized in the period that claims are approved.

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During the early part of 2014, two international projects in AustralAsia, which had experienced margin erosion in 2013, were substantially completed. Accordingly, additional material cost increases in respect of these projects are not expected. Effective February 1, 2014, Enerflex made a leadership change with the appointment of Mr. James K. Rodgers as Managing Director for AustralAsia. Mr. Rodgers brings extensive EPC and construction experience through his executive and leadership roles with multi-national oil and gas companies. He is addressing the challenges faced in the region with respect to customer contract and project timing issues, and will take the lead in returning the region to acceptable profitability.

Work on a third international project in Oman continues to experience substantial customer driven scope and schedule challenges, which will result in further cost increases of \$14.0 million to \$17.0 million in 2014 and a corresponding impact on gross margin. The Company intends to vigorously pursue further variation claims for such increases, but does not expect resolution before the second half of 2014.

Service activity levels in 2013 improved over 2012 in all segments, with the Company continuing to benefit from increased activity in the Canada, Southern U.S. and AustralAsia regions. Company-wide, revenues from the Service product line in 2013 have increased 19.6 percent from \$77.0 million to \$92.1 million in the fourth quarter and 14.5 percent from \$284.2 million to \$325.4 million in the 2013 year. Service revenues have increased for both the quarter and year due to higher engine sales and additional branches in the Southern U.S. and Latin America region. During the second quarter of 2013, Enerflex signed a long-term maintenance agreement in the AustralAsia region, valued at more than \$70.0 million over the first eight years.

North American rental utilization levels as a percentage of total horsepower improved to 70 percent during the fourth quarter of 2013, compared to 61 percent during the same period in 2012. The increase in utilization over 2012 was largely the result of sales of idle rental units from the fleet, resulting in a decrease in the total horsepower available, and a corresponding increase in revenues in 2013. Rental revenue for the International segment in the fourth quarter and 2013 year was down from the same periods in 2012.

## **Update on Discontinued Operations**

The European Service and CHP business has been reported as a discontinued operation since the third quarter of 2011. In June 2013, Enerflex completed the sale of the European business to a company specializing in CHP fabrication and service. As part of the arrangement, Enerflex transferred certain maintenance contracts and employees to the purchasing company, as well as all obligations associated with these contracts and employees. The sale was conducted in accordance with Dutch information and consultation rules, and the Company is in the process of closing out the few remaining activities.

## Outlook for Markets

The Canada and Northern U.S. segment experienced a downturn in activity levels during 2012 as a result of weak natural gas prices, which began to recover in the second half of 2012, and continued through to April 2013. After a slight downward trend through to August 2013, gas prices have moved upwards, currently sitting at around USD\$5.00/MCF. North American storage levels are down year-over-year and are trending below the five year average range. The lower storage levels resulting from record high withdrawals have driven natural gas prices to their highest levels in four years in early February 2014. Natural gas fundamentals appear to be improving into early 2014, a trend which Enerflex expects to continue through 2014. Fundamentals will further improve as liquefied natural gas ("LNG") projects in Western Canada progress, and as the development of the Duvernay shale play expands. Enerflex has recently seen increased activity in traditional processing equipment destined for the Alberta oil sands, and in compression and process equipment related to natural gas liquids opportunities such as in the Alberta Deep Basin, Duvernay and Montney reservoirs. Backlog levels in this segment improved during the fourth quarter of 2013, and stood at \$306.5 million at December 31, 2013.

The performance of the Southern U.S. and Latin America segment has been largely dependent on activity in liquids-rich U.S. gas basins, which give rise to new orders for compression and processing equipment for this region. These liquids-rich resource basins can achieve superior returns for producers despite low natural gas prices due to the higher value that can be realized for the NGL. Activity levels remain strong in these basins as long as the frac spread (the differential between NGL prices and natural gas prices) remains high. Activity in these regions has been steady through 2013 despite improving but weak NGL prices. Enerflex continues to be optimistic yet cautious with respect to this region. Enerflex remains well-positioned in this segment given backlog levels, which stood at \$358.9 million at the end of the fourth quarter of 2013.

The International segment continues to hold considerable long-term opportunity despite lower bookings activity for the fourth quarter of 2013, compared to the same period in 2012. For the 2013 year, bookings were \$131.2 million, compared to \$161.8 million recorded during 2012. Generally, bookings are reflected within the contracting entity. Therefore in assessing international prospects, consideration should also be given to bookings recorded in the Canada and Northern U.S., and Southern U.S. and Latin America segments, which are destined for international markets but are not presented in the International segment. Bookings for compression and processing equipment, destined for international markets, which were recorded and will be fabricated in the Canada and Northern U.S., and Southern U.S. and Latin America segments, totalled \$113.5 million in the fourth quarter of 2013 and \$231.2 million for the 2013 year, compared to \$46.6 million and \$138.0 million for the same periods in 2012.

International activity is generally driven by the natural gas industry in Australia, Southeast Asia and the MENA region. In Australia, there are numerous LNG projects in various stages of progression with the potential for additional phases to be developed in the future. In addition, there are improving after-market service opportunities resulting from deliveries of LNG related equipment, as evidenced by a recent long-term maintenance agreement for over \$70.0 million signed with Enerflex. In the MENA region, Enerflex has adopted a targeted approach to mitigate exposure to political uncertainties. Enerflex commenced commercial activities on some key projects in the region during 2012 including the gas processing plant currently being constructed in Oman. Domestic demand for gas in this region remains strong and the Company is well-positioned to compete for future projects in the UAE, Oman and Bahrain for compression, processing equipment and after-market service support. Enerflex has recorded bookings in Southeast Asia and continues to see significant growth opportunities in this market. Project tendering, bid evaluation and contract awards have longer lead times in the International region due to projects being larger in scale and scope. Enerflex remains well-positioned in this segment given backlog levels, which stood at \$128.6 million at the end of the fourth quarter of 2013.



# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Financial Highlights

(\$ Canadian thousands)	Three months ended		Twelve months ended	
	2013	December 31, 2012	2013	December 31, 2012
Revenue				
Canada and Northern U.S.	<b>\$ 147,572</b>	\$ 134,710	<b>\$ 524,892</b>	\$ 592,110
Southern U.S. and Latin America	<b>125,192</b>	154,453	<b>503,758</b>	512,145
International	<b>77,302</b>	132,427	<b>376,372</b>	397,429
Total revenue	<b>350,066</b>	421,590	<b>1,405,022</b>	1,501,684
Cost of goods sold	<b>290,925</b>	344,019	<b>1,159,117</b>	1,228,529
Gross margin	<b>59,141</b>	77,571	<b>245,905</b>	273,155
Selling and administrative expenses	<b>44,908</b>	41,117	<b>163,875</b>	158,598
Operating income	<b>14,233</b>	36,454	<b>82,030</b>	114,557
(Gain) loss on disposal of property, plant and equipment	<b>(122)</b>	61	<b>(79)</b>	(951)
Equity earnings from associates and joint ventures	<b>(2,141)</b>	(367)	<b>(5,232)</b>	(1,833)
Earnings before finance costs and taxes	<b>16,496</b>	36,760	<b>87,341</b>	117,341
Finance costs and income	<b>1,249</b>	1,368	<b>5,518</b>	5,661
Earnings before taxes	<b>15,247</b>	35,392	<b>81,823</b>	111,680
Income tax expense	<b>4,487</b>	8,388	<b>24,105</b>	29,427
Loss from discontinued operations	<b>92</b>	639	<b>1,852</b>	10,479
Net earnings	<b>\$ 10,668</b>	\$ 26,365	<b>\$ 55,866</b>	\$ 71,774

### Key Financial Performance Indicators<sup>1</sup>

Bookings	<b>\$ 386,409</b>	\$ 242,558	<b>\$ 1,140,801</b>	\$ 875,477
Backlog	<b>\$ 793,977</b>	\$ 683,206	<b>\$ 793,977</b>	\$ 683,206
Recurring revenue as a percentage of revenue <sup>2</sup>	<b>26.7%</b>	21.5%	<b>26.7%</b>	21.5%
Gross margin as a percentage of revenue	<b>16.9%</b>	18.4%	<b>17.5%</b>	18.2%
Selling and administrative expenses as a percentage of revenue	<b>12.8%</b>	9.8%	<b>11.7%</b>	10.6%
EBIT as a percentage of revenue <sup>2</sup>	<b>6.2%</b>	7.8%	<b>6.2%</b>	7.8%
Earnings before interest, tax, depreciation and amortization ("EBITDA")	<b>\$ 26,217</b>	\$ 47,073	<b>\$ 126,936</b>	\$ 156,828
Return on capital employed ("ROCE") <sup>2</sup>	<b>9.7%</b>	13.3%	<b>9.7%</b>	13.3%
Net (cash) debt to EBITDA ratio	<b>(0.85):1</b>	(0.26):1	<b>(0.70):1</b>	(0.31):1

<sup>1</sup> Key financial performance indicators used by Enerflex to measure its performance include revenue and EBIT.

<sup>2</sup> Determined by taking the trailing 12-month period.

## Definitions

The success of the Company and its business unit strategies is measured using a number of key financial performance indicators, some of which are outlined below. A number of these indicators do not have a standardized meaning as prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other companies. These non-GAAP measures are bookings and backlog, recurring revenue as a percentage of revenue, EBITDA, net (cash) debt to EBITDA ratio, and return on capital employed ("ROCE"). Further information on these non-GAAP measures is provided in the section, *Non-GAAP Measures*. Operating income and EBIT are both considered additional GAAP measures, and are presented in the Statement of Earnings, but may not be comparable with similar additional GAAP measures used by other entities.

## Operating Income

Operating income assists the reader in understanding the net contributions made from the Company's core businesses after considering all selling, general and administrative ("SG&A") expenses. Each operating segment assumes responsibility for its operating results as measured by, amongst other factors, operating income, which is defined as income before income taxes, interest (or finance) costs (net of interest income), equity earnings or loss and gain or loss on sale of assets. Financing and related charges cannot be attributed to business segments on a meaningful basis that is comparable to other companies. Business segments and income tax jurisdictions are not synonymous, and it is believed that the allocation of income taxes distorts the historical comparability of the performance of business segments.

## Bookings and Backlog

Bookings and backlog are monitored by Enerflex as an indicator of future revenue and business activity levels for the Engineered Systems product line. Bookings are recorded in the period when a firm commitment or order is received from customers. Bookings increase backlog in the period that they are received. Revenue recognized on Engineered Systems products decreases backlog in the period that this revenue is recognized. As a result, backlog is an indication of revenue to be recognized in future periods using percentage of completion accounting.

## Recurring Revenue

Recurring revenue is defined as revenue from the Service and Rental product lines, and provides a measure of the Company's revenue that is probable to recur into the future.

## EBIT

EBIT provides the results generated by the Company's primary business activities prior to consideration of how those activities are financed or taxed in the various jurisdictions that the Company operates in.

## EBITDA

EBITDA provides the results generated by the Company's primary business activities prior to consideration of how those activities are financed, assets are amortized or how the results are taxed in various jurisdictions.

## ROCE

ROCE is a measure to analyze operating performance and efficiency of the Company's capital allocation process. The ratio is calculated by taking EBIT for the 12-month trailing period divided by capital employed. Capital employed is the average of four previous quarters plus current month balance (short-term debt + long-term debt + equity – cash).

## Net (Cash) Debt to EBITDA

Net (cash) debt is defined as short and long-term debt less cash and cash equivalents at the end of the period divided by the annualized EBITDA.

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## Consolidated Results for the Three and Twelve Months Ended December 31, 2013

During the fourth quarter of 2013, the Company generated \$350.1 million in revenue compared to \$421.6 million in the fourth quarter of 2012. During the year ended December 31, 2013, revenue was \$1,405.0 million compared to \$1,501.7 million in the same period of 2012. The decrease of \$71.5 million in the fourth quarter of 2013 was due to lower revenue in the Southern U.S. and Latin America and International segments, partially offset by higher revenue from the Canada and Northern U.S. segment. The decrease of \$96.7 million in the 2013 year was due to lower revenue in all segments. As compared to the three and twelve months ended December 31, 2012:

- Canada and Northern U.S. segment revenue increased by \$12.9 million during the fourth quarter of 2013 as a result of an increase in Service and Rental revenue. Segment revenue decreased by \$67.2 million for the year ended December 31, 2013, as a result of lower Engineered Systems revenue, partially offset by higher Service and Rental revenue;
- Southern U.S. and Latin America segment revenue decreased by \$29.3 million in the fourth quarter of 2013, and by \$8.4 million for the year ended December 31, 2013, due to lower Engineered Systems revenue, partially offset by higher Service revenue; and
- International segment revenue decreased by \$55.1 million in the fourth quarter of 2013 on account of lower Engineered Systems revenue. Segment revenue decreased by \$21.1 million for the year ended December 31, 2013 due to lower Engineered Systems revenue, partially offset by higher Service revenue.

**Gross Margin** for the three months ended December 31, 2013 was \$59.1 million or 16.9 percent of revenue compared to \$77.6 million or 18.4 percent of revenue for the three months ended December 31, 2012. Gross margin for the twelve months ended December 31, 2013 was \$245.9 million or 17.5 percent of revenue compared to \$273.2 million or 18.2 percent of revenue for the twelve months ended December 31, 2012.

The decrease in gross margin during the fourth quarter of 2013 was a result of lower margin in the Southern U.S. and Latin America and International segments. For the 2013 year, the gross margin decrease was driven by lower margins in the Canada and Northern U.S. and International segments, partially offset by higher margin in the Southern U.S. and Latin America segment. The decrease in gross margin in Canada and the Northern U.S. for the 2013 year was primarily due to lower revenues, weaker manufacturing utilization, and warranty costs incurred on Engineered Systems jobs in Casper, Wyoming, partially offset by improved project margin in backlog and more favourable project pick ups as a result of improved project execution. The lower gross margin in the Southern U.S. and Latin America segment in the fourth quarter of 2013 was attributable to lower revenue and less favourable job pick ups, partially offset by improved project margin in backlog. For the year ended 2013, gross margin in the Southern U.S. and Latin America segment was higher as a result of improved project margin in backlog, partially offset by weaker manufacturing utilization, less favourable but still strong project pick ups as a result of good project execution and the impact of lower revenue. In the International segment, gross margin decreased due to significant cost increases on three international projects due to scope and design variations, and to a lesser degree due to project execution challenges, and due to lower revenues. Volatility in gross margins arises when cost increases are recognized as incurred on projects, while revenue resulting from any variation claims is recognized in the period that these claims are approved, typically at the completion of the project.

**SG&A** expenses were \$44.9 million or 12.8 percent of revenue during the three months ended December 31, 2013, compared to \$41.1 million or 9.8 percent of revenue in the same period of 2012. SG&A expenses were \$163.9 million or 11.7 percent of revenue during the year ended December 31, 2013, compared to \$158.6 million or 10.6 percent of revenue in the same period of 2012. The increase in SG&A expenses was a result of higher compensation and stock-based compensation costs, higher third party services, higher depreciation and amortization expense, and higher office and occupancy costs largely due to the expansion of the Houston facility.

**Operating Income** during the fourth quarter of 2013 was \$14.2 million or 4.1 percent of revenue compared to \$36.5 million or 8.6 percent of revenue in the same period of 2012. Operating income during the 2013 year was \$82.0 million or 5.8 percent compared to \$114.6 million or 7.6 percent of revenue in the same period of 2012. The decreases in operating income were attributable to the lower gross margin and higher SG&A expenses in the 2013 periods.

**EBIT** for the fourth quarter of 2013 was \$16.5 million or 4.7 percent of revenue compared to \$36.8 million or 8.7 percent of revenue in the same period of 2012. EBIT for the 2013 year was \$87.3 million or 6.2 percent compared to \$117.3 million or 7.8 percent of revenue in the same period of 2012. The decreases in EBIT were attributable to the lower gross margin and higher SG&A expenses, partially offset by higher earnings from associates and joint ventures.

**Income Tax Expense** totalled \$4.5 million or 29.4 percent of earnings before tax for the three months ended December 31, 2013 compared to \$8.4 million or 23.7 percent of earnings before tax in the same period of 2012. Income tax expense totalled \$24.1 million or 29.5 percent of earnings before tax for the year ended December 31, 2013 compared to \$29.4 million or 26.3 percent of earnings before tax in the same period of 2012. The decreases in income tax expense were primarily due to lower pre-tax earnings when compared to the prior periods. The increases in the effective tax rate were primarily due to higher earnings in foreign operations subjected to higher statutory tax rates.

**Net Earnings** from continuing operations for the fourth quarter of 2013 were \$10.8 million or \$0.14 per share, compared to \$27.0 million or \$0.35 per share in the same period of 2012. Net earnings from continuing operations for the 2013 year were \$57.7 million or \$0.74 per share, compared to \$82.3 million or \$1.06 per share in 2012. The decreases in net earnings were a result of lower gross margin and higher SG&A expenses, partially offset by higher earnings from associates and joint ventures and lower income tax expense.

Loss from discontinued operations reflects the results of EE during 2012 and 2013. This business recorded a nominal net loss in the fourth quarter of 2013 compared to a net loss of \$0.6 million (\$0.01 per share) in the fourth quarter of 2012. The business unit recorded a net loss of \$1.9 million (\$0.02 per share) and \$10.5 million (\$0.14 per share) in 2013 and 2012, respectively.

**EBITDA** from continuing operations for the fourth quarter of 2013 was \$26.2 million, compared to \$47.1 million in the same period of 2012. EBITDA from continuing operations for the 2013 year was \$126.9 million, compared to \$156.8 million in the same period of 2012.

**ROCE** from continuing operations for the fourth quarter and twelve months of 2013 was 9.7 percent, compared to 13.3 percent in the same periods of 2012.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Canada and Northern U.S. Segment Results

(\$ Canadian thousands)	Three months ended December 31,		Twelve months ended December 31,	
	2013	2012	2013	2012
Segment revenue	<b>\$ 153,934</b>	\$ 172,851	<b>\$ 594,510</b>	\$ 674,860
Intersegment revenue	<b>(6,362)</b>	(38,141)	<b>(69,618)</b>	(82,750)
Revenue	<b>\$ 147,572</b>	\$ 134,710	<b>\$ 524,892</b>	\$ 592,110
Revenue – Engineered Systems	<b>\$ 80,775</b>	\$ 80,597	<b>\$ 287,086</b>	\$ 385,283
Revenue – Service	<b>\$ 54,301</b>	\$ 45,254	<b>\$ 191,263</b>	\$ 171,452
Revenue – Rental	<b>\$ 12,496</b>	\$ 8,859	<b>\$ 46,543</b>	\$ 35,375
Operating income	<b>\$ 5,438</b>	\$ 10,113	<b>\$ 21,937</b>	\$ 39,964
EBIT	<b>\$ 7,737</b>	\$ 10,711	<b>\$ 27,268</b>	\$ 43,205
Segment revenue as a % of total revenue	<b>42.1%</b>	32.0%	<b>37.4%</b>	39.4%
Recurring revenue as a % of segment revenue	<b>45.3%</b>	40.2%	<b>45.3%</b>	34.9%
Operating income as a % of segment revenue	<b>3.7%</b>	7.5%	<b>4.2%</b>	6.7%
EBIT as a % of segment revenue	<b>5.2%</b>	8.0%	<b>5.2%</b>	7.3%

Canada and Northern U.S. revenue totalled \$147.6 million and \$524.9 million in the fourth quarter of 2013 and the 2013 year, respectively, compared to \$134.7 million and \$592.1 million for the same periods of 2012. The increase in revenue of \$12.9 million during the fourth quarter was a result of higher Service revenue due to increased parts and engine sales, and higher Rental revenue as a result of an increase in rental unit sales.

The decrease in revenue of \$67.2 million for the 2013 year was a result of lower Engineered Systems revenue caused by lower backlog to start 2013, and the impact of the closure of the Casper, Wyoming facility. The lower Engineered Systems revenue was partially offset by higher Service revenue due to increased parts and engine sales, and higher Rental revenue as a result of an increase in rental unit sales, compared to the 2012 year.

(\$ Canadian thousands)	Three months ended December 31,		Twelve months ended December 31,	
	2013	2012	2013	2012
<b>Revenue</b>				
Canada and United States	<b>\$ 136,259</b>	\$ 120,756	<b>\$ 498,505</b>	\$ 527,908
International <sup>1</sup>	<b>11,313</b>	13,954	<b>26,387</b>	64,202
	<b>\$ 147,572</b>	\$ 134,710	<b>\$ 524,892</b>	\$ 592,110

<sup>1</sup> International revenue represents revenue from equipment manufactured in this segment and delivered to international markets that Enerflex services.

Operating income decreased by \$4.7 million to \$5.4 million in the fourth quarter of 2013 compared to the fourth quarter of 2012 as a result of higher SG&A expenses attributable to higher compensation and stock-based compensation costs, and third party services. For the 2013 year, operating income decreased by \$18.0 million to \$21.9 million compared to the same period in 2012 due to lower gross margin, and higher SG&A expenses. The decrease in gross margin was a result of lower revenues and the corresponding impact on gross margin, weaker manufacturing utilization and warranty costs incurred on Engineered Systems jobs in Casper, Wyoming, partially offset by improved project margin in backlog and more favourable project pick ups as a result of improved project execution. SG&A expenses increased due to higher compensation and stock-based compensation costs, severance costs associated with a reduction in the workforce in the P&P business, and the costs associated with the closure of the Casper, Wyoming facility, partially offset by lower office and occupancy costs.

(\$ Canadian thousands)	Three months ended December 31,		Twelve months ended December 31,	
	2013	2012	2013	2012
<b>Bookings</b>				
Canada and United States	\$ 136,523	\$ 59,006	\$ 360,642	\$ 242,380
International <sup>1</sup>	30,507	26,369	74,190	59,287
	<b>\$ 167,030</b>	<b>\$ 85,375</b>	<b>\$ 434,832</b>	<b>\$ 301,667</b>

<sup>1</sup> International bookings represent orders for equipment that will be manufactured in this segment and delivered to international markets that Enerflex services.

Backlog in the Canada and Northern U.S. segment was \$306.5 million at December 31, 2013 compared to \$220.3 million at September 30, 2013 and \$158.8 million at December 31, 2012, an increase of \$86.2 million and \$147.7 million, respectively. The increases in backlog were a result of higher bookings and lower Engineered System revenue in the 2013 year. The increases in bookings during the quarter and year ended December 31, 2013 were driven by an increase in domestic activity levels despite continued weakness in natural gas prices, and to a lesser extent, increased activity in international markets.

## Southern U.S. and Latin America Segment Results

(\$ Canadian thousands)	Three months ended December 31,		Twelve months ended December 31,	
	2013	2012	2013	2012
Segment revenue	\$ 128,947	\$ 159,465	\$ 522,008	\$ 517,574
Intersegment revenue	(3,755)	(5,012)	(18,250)	(5,429)
Revenue	<b>\$ 125,192</b>	\$ 154,453	<b>\$ 503,758</b>	\$ 512,145
Revenue – Engineered Systems	\$ 106,744	\$ 142,072	\$ 443,527	\$ 468,960
Revenue – Service	\$ 18,448	\$ 12,381	\$ 60,231	\$ 43,185
Operating income	\$ 16,965	\$ 20,174	\$ 59,765	\$ 55,937
EBIT	\$ 16,964	\$ 20,009	\$ 59,762	\$ 55,619
Segment revenue as a % of total revenue	35.8%	36.6%	35.8%	34.1%
Recurring revenue as a % of segment revenue	14.7%	8.0%	12.0%	8.4%
Operating income as a % of segment revenue	13.6%	13.1%	11.9%	10.9%
EBIT as a % of segment revenue	13.6%	13.0%	11.9%	10.9%

Southern U.S. and Latin America revenue totalled \$125.2 million and \$503.8 million in the fourth quarter of 2013 and the 2013 year, respectively, compared to \$154.5 million and \$512.1 million, respectively, in the same periods of 2012. The decreases in revenue of \$29.3 million and \$8.4 million, respectively, were attributable to lower Engineered Systems revenue, partially offset by higher Service revenue on increased service calls and parts sales, compared to the same periods in 2012. Engineered Systems revenue was lower due to the impact of lower opening backlog to start 2013.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

(\$ Canadian thousands)	Three months ended December 31,		Twelve months ended December 31,	
	2013	2012	2013	2012
<b>Revenue</b>				
United States and Latin America	<b>\$ 109,944</b>	\$ 129,544	<b>\$ 423,612</b>	\$ 426,959
International <sup>1</sup>	<b>15,248</b>	24,909	<b>80,146</b>	85,186
	<b>\$ 125,192</b>	\$ 154,453	<b>\$ 503,758</b>	\$ 512,145

<sup>1</sup> International revenue represents revenue from equipment manufactured in this segment and delivered to international markets that Enerflex services.

Operating income decreased by \$3.2 million in the fourth quarter of 2013, compared to the same period of 2012, to \$17.0 million due to lower gross margin. For the 2013 year, operating income increased by \$3.8 million to \$59.8 million, due to higher gross margin. The decrease in gross margin in the fourth quarter of 2013 was attributable to the lower revenue and the corresponding impact on gross margin and less favourable job pick ups, partially offset by improved project margin in backlog. For the year ended December 31, 2013, the increase in gross margin resulted from improved gross margin in backlog on Engineered Systems jobs, partially offset by lower manufacturing utilization rates at the expanded Houston facility, less favourable but still strong project pick ups as a result of good project execution and the impact of lower revenue.

(\$ Canadian thousands)	Three months ended December 31,		Twelve months ended December 31,	
	2013	2012	2013	2012
<b>Bookings</b>				
United States and Latin America	<b>\$ 102,807</b>	\$ 97,717	<b>\$ 417,786</b>	\$ 333,307
International <sup>2</sup>	<b>82,993</b>	20,271	<b>156,967</b>	78,674
	<b>\$ 185,800</b>	\$ 117,988	<b>\$ 574,753</b>	\$ 411,981

<sup>2</sup> International bookings represent orders for equipment that will be manufactured in this segment and delivered to international markets that Enerflex services.

Southern U.S. and Latin America backlog was \$358.9 million at the end of the fourth quarter of 2013 compared to \$279.8 million at September 30, 2013, and \$227.6 million at the end of 2012, increases of \$79.1 million and \$131.3 million, respectively. The increases in backlog were a result of higher bookings, and lower Engineered Systems revenue in 2013. Bookings for the quarter and twelve months ended December 31, 2013 increased as a result of higher domestic bookings despite the continued weakness in NGL and gas prices, and higher bookings destined for international markets.

## International Segment Results

(\$ Canadian thousands)	Three months ended		Twelve months ended	
	2013	December 31, 2012	2013	December 31, 2012
Segment revenue	\$ 77,408	\$ 132,428	\$ 376,763	\$ 398,279
Intersegment revenue	(106)	(1)	(391)	(850)
Revenue	\$ 77,302	\$ 132,427	\$ 376,372	\$ 397,429
Revenue – Engineered Systems	\$ 57,249	\$ 112,098	\$ 299,417	\$ 324,134
Revenue – Service	\$ 19,329	\$ 19,379	\$ 73,934	\$ 69,521
Revenue – Rental	\$ 724	\$ 950	\$ 3,021	\$ 3,774
Operating (loss) income	\$ (8,170)	\$ 6,167	\$ 328	\$ 18,656
EBIT	\$ (8,205)	\$ 6,040	\$ 311	\$ 18,517
Segment revenue as a % of total revenue	22.1%	31.4%	26.8%	26.5%
Recurring revenue as a % of segment revenue	25.9%	15.4%	20.4%	18.4%
Operating (loss) income as a % of segment revenue	(10.6)%	4.7%	0.1%	4.7%
EBIT as a % of segment revenue	(10.6)%	4.6%	0.1%	4.7%

### Continuing Operations

International revenue totalled \$77.3 million and \$376.4 million in the fourth quarter of 2013 and the 2013 year, respectively, compared to \$132.4 million and \$397.4 million in the same periods of 2012. The decrease of \$55.1 million in the fourth quarter of 2013 was on account of lower Engineered Systems revenue due to lower opening backlog. For the year ended December 31, 2013, International segment revenue decreased by \$21.1 million due to lower Engineered Systems revenue resulting from lower opening backlog, partially offset by higher Service revenue due to increased activity in AustralAsia.

Operating loss was \$8.2 million and operating income was \$0.3 million for the fourth quarter of 2013 and the 2013 year, respectively, compared to operating income of \$6.2 million and \$18.7 million in the same periods of 2012. Operating income decreased by \$14.3 million, moving to a loss for the fourth quarter of 2013 due to lower gross margin, partially offset by lower SG&A expenses as a result of lower compensation and stock-based compensation costs. For the 2013 year, operating income decreased by \$18.3 million due to lower gross margin and higher SG&A expenses resulting from higher compensation costs, and higher office and occupancy costs.

The lower gross margin for the fourth quarter of 2013 and for the 2013 year, was driven primarily by continuing significant cost increases on three international projects due to scope and design variations, and to a lesser degree due to project execution challenges. For the 2013 year, the cost increases have been the primary driver for the \$20.0 million deterioration in gross margin on international projects. Variation claims, where appropriate, have either been submitted, or are in the process of being submitted. Some of these variation claims have been approved by the customer.

To the extent these cost increases are subsequently recovered through variation claims from customers, revenue will be recognized in the corresponding period. Volatility in gross margins arises when cost increases are recognized as incurred on projects, while revenue resulting from any variation claims is recognized in the period that these claims are approved, which is typically at the completion of the project. For the fourth quarter, and for the 2013 year, gross margin also decreased due to the impact of lower revenue on gross margin.



# MANAGEMENT'S DISCUSSION AND ANALYSIS

(\$ Canadian thousands)	Three months ended December 31,		Twelve months ended December 31,	
	2013	2012	2013	2012
<b>Bookings</b>				
International <sup>1</sup>	<b>\$ 33,579</b>	\$ 39,195	<b>\$ 131,216</b>	\$ 161,829

<sup>1</sup> International bookings for the three and twelve months ended December 31, 2013 do not include orders of \$113.5 million and \$231.2 million, respectively, for equipment that will be manufactured in the Canada and Northern U.S., and Southern U.S. and Latin America segments, and to be delivered to international markets that Enerflex services (December 31, 2012: \$46.6 million and \$138.0 million, respectively).

International backlog was \$128.6 million at December 31, 2013 compared to \$152.2 million at September 30, 2013 and \$296.8 million at December 31, 2012, decreases of \$23.6 million and \$168.2 million, respectively. The decreases are primarily related to lower booking levels relating to opportunities in the MENA region, and in Australia related to coal seam gas exploration and gas storage projects when compared to 2012, and due to backlog conversion exceeding new bookings in 2013.

## Discontinued Operations

Loss from discontinued operations reflects the results of EE during 2012 and 2013, which recorded a nominal net loss during the fourth quarter of 2013 compared to a loss of \$0.6 million in the fourth quarter of 2012. These discontinued operations recorded a net loss of \$1.9 million for the twelve months of 2013, compared to a net loss of \$10.5 million in the twelve months of 2012.

## Quarterly and Annual Summary

(\$ Canadian thousands, except per share amounts)	Revenue <sup>2</sup>	Net earnings <sup>2</sup>	Earnings per share – basic <sup>2</sup>	Earnings per share – diluted <sup>2</sup>
<b>December 31, 2013</b>	<b>\$ 350,066</b>	<b>\$ 10,760</b>	<b>\$ 0.14</b>	<b>\$ 0.13</b>
September 30, 2013	390,657	13,174	0.16	0.16
June 30, 2013	311,037	18,405	0.24	0.24
March 31, 2013	353,262	15,379	0.20	0.20
December 31, 2012	421,590	27,004	0.35	0.35
September 30, 2012	369,727	20,950	0.27	0.27
June 30, 2012	354,636	19,401	0.25	0.25
March 31, 2012	355,731	14,898	0.19	0.19
December 31, 2011	383,802	17,720	0.22	0.22
September 30, 2011	282,335	16,979	0.22	0.22
June 30, 2011	246,491	12,210	0.16	0.16
March 31, 2011	314,509	9,832	0.13	0.13

<sup>2</sup> Amounts presented are from continuing operations.

(\$ Canadian thousands, except per share amounts)	Total assets	Total non-current financial liabilities	Cash dividends declared per share
<b>December 31, 2013</b>	<b>\$ 1,416,079</b>	<b>\$ 92,935</b>	<b>\$ 0.285</b>
December 31, 2012	1,389,264	96,469	0.25
December 31, 2011	1,351,618	118,963	0.18

## Non-GAAP Measures

The success of the Company and its business units' strategies is measured using a number of key performance indicators, some of which do not have a standardized meaning as prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other companies. These non-GAAP measures are also used by management in its assessment of relative investments in operations and include bookings and backlog, recurring revenue as a percentage of revenue, EBITDA, net (cash) debt to EBITDA ratio, and ROCE. They should not be considered as an alternative to net earnings or any other measure of performance under GAAP. The reconciliation of these non-GAAP measures to the most directly comparable measure calculated in accordance with GAAP is provided below where appropriate. Bookings and backlog do not have a directly comparable GAAP measure. Definitions of the non-GAAP measures are provided in the *Definitions* section.

(\$ Canadian thousands)	Three months ended December 31,		Twelve months ended December 31,	
	<b>2013</b>	2012	<b>2013</b>	2012
<b>EBITDA</b>				
Earnings before finance costs and taxes	\$ 16,496	\$ 36,760	\$ 87,341	\$ 117,341
Depreciation and amortization	9,721	10,313	39,595	39,487
<b>EBITDA</b>	<b>\$ 26,217</b>	<b>\$ 47,073</b>	<b>\$ 126,936</b>	<b>\$ 156,828</b>
<b>Net (Cash) Debt</b>				
Short and long-term debt, net of deferred transaction costs	\$ 92,935	\$ 96,469	\$ 92,935	\$ 96,469
Less: cash and cash equivalents	181,973	(144,988)	181,973	(144,988)
<b>Net (Cash) Debt</b>	<b>\$ (89,038)</b>	<b>\$ (48,519)</b>	<b>\$ (89,038)</b>	<b>\$ (48,519)</b>
<b>Net (Cash) Debt to EBITDA</b>				
Net debt	\$ (89,038)	\$ (48,519)	\$ (89,038)	\$ (48,519)
Annualized EBITDA	104,868	188,292	126,936	156,828
<b>Net (Cash) Debt to EBITDA ratio</b>	<b>(0.85):1</b>	<b>(0.26):1</b>	<b>(0.70):1</b>	<b>(0.31):1</b>
<b>Recurring Revenue</b>				
Service	\$ 92,078	\$ 77,014	\$ 325,428	\$ 284,158
Rental	13,220	9,809	49,564	39,149
<b>Total Recurring Revenue</b>	<b>\$ 105,298</b>	<b>\$ 86,823</b>	<b>\$ 374,992</b>	<b>\$ 323,307</b>
Trailing 12-month Recurring Revenue	\$ 374,992	\$ 323,307	\$ 374,992	\$ 323,307
<b>ROCE</b>				
Trailing 12-month EBIT	\$ 87,341	\$ 117,341	\$ 87,341	\$ 117,341
Capital employed – beginning of period				
Net (Cash) Debt	\$ (13,333)	\$ (4,122)	\$ (48,519)	\$ 37,763
Shareholders' equity	915,891	860,619	886,679	836,262
	<b>\$ 902,558</b>	<b>\$ 856,497</b>	<b>\$ 838,160</b>	<b>\$ 874,025</b>
Capital employed – end of period				
Net (Cash) Debt	\$ (89,038)	\$ (48,519)	\$ (89,038)	\$ (48,519)
Shareholders' equity	931,662	886,679	931,662	886,679
	<b>\$ 842,624</b>	<b>\$ 838,160</b>	<b>\$ 842,624</b>	<b>\$ 838,160</b>
Average Capital Employed	\$ 897,042	\$ 880,524	\$ 897,042	\$ 880,524
<b>ROCE</b>	<b>9.7%</b>	<b>13.3%</b>	<b>9.7%</b>	<b>13.3%</b>

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Financial Position

The following table outlines significant changes in the consolidated statements of financial position as at December 31, 2013 as compared to December 31, 2012:

(\$ Canadian millions)	Increase (Decrease)	Explanation
<b>Assets:</b>		
Cash	\$ 37.0	Cash is higher compared to the prior year end as cash from operations exceeded expenditures on capital assets and funds used to repay long-term debt obligations.
Accounts receivable	\$ 43.8	The increase in total accounts receivable is due to the timing of revenue recognition, as revenue earned from the Engineered Systems product line exceeded progress billings issued to customers.
Inventories	\$ (26.7)	The decrease in inventories from the prior year end is due to lower work-in-process ("WIP") balances in Southern U.S. and Latin America in line with production and shipping, and the closure of the Wyoming plant. The decrease in WIP was partially offset by an increase in parts for the Service product line.
Rental equipment	\$ (15.8)	The decrease in net book value of rental equipment is due to the sale of units out of the fleet coupled with the annual depreciation charge, which was partially offset by the purchase of new rental units.
Intangible assets	\$ (5.2)	The decrease in intangible assets is due to amortization of finite life intangible assets, partially offset by additions of software intangibles during the year.
Goodwill	\$ (6.0)	The decrease is a result of foreign exchange translation of goodwill allocated to U.S. and International subsidiaries.
<b>Liabilities:</b>		
Accounts payable and accrued liabilities	\$ (12.8)	Accounts payable and accrued liabilities were lower at the end of 2013 as a result of a reduced profit share accrual and lower trade payables outstanding compared to the end of 2012. This was slightly offset by a higher share unit liability as a result of new awards and the year-end mark-to-market adjustment.
Deferred revenue	\$ 15.9	The increase in deferred revenue compared to the end of 2012 is due to an excess of progress billings issued when compared to revenue recognized on Engineered Systems jobs. This more than offset the reduction in deferred revenue associated with the completion of jobs being built in the Casper, Wyoming facility.

## Liquidity

The Company's primary sources of liquidity and capital resources are:

- Cash generated from continuing operations;
- Bank financing and operating lines of credit; and
- Issuance and sale of debt and equity instruments.

## Statements of Cash Flow

(\$ Canadian thousands)	Three months ended		Twelve months ended	
	2013	December 31, 2012	2013	December 31, 2012
Cash, beginning of period	\$ 101,990	\$ 125,620	\$ 144,988	\$ 81,200
Cash provided by (used in):				
Operating activities	79,419	56,136	69,024	126,101
Investing activities	(304)	(7,136)	(12,559)	(23,402)
Financing activities	(110)	(29,756)	(20,899)	(38,484)
Exchange rate changes on foreign currency cash	978	124	1,419	(427)
Cash, end of period	\$ 181,973	\$ 144,988	\$ 181,973	\$ 144,988

## Operating Activities

In the fourth quarter of 2013 and the 2013 year, cash provided by operating activities totalled \$79.4 million and \$69.0 million respectively. This compared to \$56.1 million and \$126.1 million of cash provided by operating activities for the same periods of 2012. For the quarter, the increase in cash from operations was due to improved working capital management, which more than offset the decrease in net earnings of \$15.7 million. For the 2013 year, the decrease in cash provided by operating activities when compared to 2012 was due to lower net earnings and higher working capital requirements.

## Investing Activities

Cash used in investing activities totalled \$0.3 million and \$12.6 million in the fourth quarter of 2013 and the 2013 year, respectively, compared to \$7.1 million cash used and \$23.4 million used in investing activities for the same periods of 2012. Net capital spending for the fourth quarter of 2013 was \$3.4 million compared to \$8.4 million in the same period of 2012. On a year-to-date basis, net capital spending was \$17.4 million in 2013 compared to \$32.7 million for the year 2012.

## Financing Activities

Cash used in financing activities totalled \$0.1 million and \$20.9 million in the fourth quarter of 2013 and the 2013 year, respectively, compared to \$29.8 million and \$38.5 million in cash used for the same periods of 2012. Proceeds from long-term debt totalled \$4.1 million for the fourth quarter of 2013, compared to repayments totalling \$25.2 million in the same period of 2012. Long-term debt repayment was \$4.3 million for the 2013 year, compared to \$23.3 million for 2012. Cash used to finance dividends increased on both a quarter and year-to-date basis as dividends paid in 2013 were at \$0.07 per share compared to \$0.06 per share in 2012.

At December 31, 2013, the net (cash) debt to EBITDA ratio was (0.70):1 compared to (0.31):1 for 2012. The improvement was driven primarily by higher cash balances, lower long-term debt levels, partially offset by the impact of lower EBITDA compared to the same period of 2012. The Company expects that cash flows from operations in 2014, together with cash and cash equivalents on hand and currently available credit facilities, will be more than sufficient to fund its requirements for investments in working capital and capital assets.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Risk Management

In the normal course of business, the Company is exposed to financial and operating risks that may potentially impact its operating results. The Company employs risk management strategies with a view to mitigating these risks on a cost-effective basis. The Company enters into derivative financial agreements to manage exposure to fluctuations in exchange rates and interest rates, but not for speculative purpose.

## Project Execution Risk

The Company's broad in-house resources provide the capability to engineer, design, manufacture, construct, commission and service hydrocarbon handling systems. Enerflex's expertise encompasses field production facilities, compression and natural gas processing plants, CO<sub>2</sub> processing plants, refrigeration systems, and electric power equipment serving the natural gas production industry. The Company's ability to profitably execute on these solutions for customers is dependent on numerous factors which include, but are not limited to, changes in project scope, the availability and timeliness of external approvals and other required permits, skilled labour availability and productivity, availability and cost of material and services, design, engineering and construction errors, and the availability of contractors to deliver on commitments. A number of these risks are discussed in more detail below.

The Company is making significant progress on a multi-year initiative to integrate its systems and processes, while bringing its facilities to world-class standards. In addition, continuous improvement initiatives are in place to achieve accurate, complete and timely provision of deliverables. Nonetheless, project risks can translate into performance issues and project delays, as well as project costs being in excess of cost estimates, as evidenced in the International segment. While the Company will assess the recoverability of these cost overruns where based on customer requested change orders, there can be no assurance that these costs will be reimbursed.

## Personnel

Enerflex's Engineered Systems product line requires skilled engineering and design professionals in order to maintain customer satisfaction and engage in product innovation. Enerflex competes for these professionals, not only with other companies in the same industry, but with oil and gas producers and other industries. In periods of high energy activity, demand for the skills and expertise of these professionals increases, making the hiring and retention of these individuals more difficult.

Enerflex's Service product line relies on the skills and availability of trained and experienced tradesmen and technicians to provide efficient and appropriate services to Enerflex and its customers. Hiring and retaining such individuals is critical to the success of Enerflex's businesses. Demographic trends are reducing the number of individuals entering the trades, making Enerflex's access to skilled individuals more difficult. There are few barriers to entry in a number of Enerflex's businesses, so retention of staff is essential in order to differentiate Enerflex's businesses and compete in its various markets.

Additionally, in increasing measures, Enerflex is dependent upon the skills and availability of various professional and administrative personnel to meet the increasing demands of the requirements and regulations of various professional and governmental bodies.

In order to retain skilled professionals, reward high performing employees, and create alignment between employee performance and business objectives, Enerflex's global compensation philosophy is to provide competitive pay for competitive performance.

Compensation is designed to reinforce Enerflex's values and culture and reflect market practices, as well as best practices. Enerflex strives to provide a compensation program that is externally competitive and internally equitable. Elements include base salary, a bonus for certain employees that is tied to corporate and business segment performance, share options and share units that vest over future periods, and an employee share purchase plan. In addition, as part of its total rewards strategy, Enerflex offers a comprehensive benefits program, which allows employees to tailor their retirement, wellness, health and dental, and work-life balance benefits to their needs.

### **Energy Prices and Industry Conditions**

The oil and gas service industry is highly reliant on the levels of capital expenditures made by oil and gas producers and explorers. The majority of Enerflex's customers generate cash flow from crude oil and natural gas production. They, in turn, base their capital expenditure decisions on various factors, including but not limited to hydrocarbon prices, exploration and development prospects in various jurisdictions, production levels of their reserves and access to capital – none of which can be accurately predicted. Periods of prolonged or substantial reductions in commodity prices may lead to reduced levels of exploration and production activities, which may negatively impact the demand for the products and services that Enerflex offers.

In addition, changing political, economic or military circumstances throughout the energy producing regions of the world can impact the market price of oil for extended periods of time, which in turn impacts the price of natural gas, as industrial users often have the ability to choose to use the lower priced energy source.

While the Company attempts to diversify its exposure to energy price and industry conditions, and changing political, economic or military circumstances, any such changes could have a significant effect on its results of operations and financial condition.

### **Inflationary Pressures**

Strong economic conditions and competition for available personnel, materials and major components may result in significant increases in the cost of obtaining such resources. To the greatest extent possible, Enerflex passes such cost increases on to its customers and it attempts to reduce these pressures through proactive procurement and human resource practices.

### **Climatic Factors and Seasonal Demand**

Demand for natural gas fluctuates largely with the heating and electric power requirements caused by the changing seasons in North America. Cold winters typically increase demand for, and the price of, natural gas. This increases customers' cash flow which can have a positive impact on Enerflex. At the same time, access to many western Canadian oil and gas properties is limited to the period when the ground is frozen so that heavy equipment can be transported. As a result, the first quarter of the year is generally accompanied by increased winter deliveries of equipment. Warm winters in western Canada, however, can both reduce demand for natural gas and make it difficult for producers to reach well locations. This restricts drilling and development operations, reduces the ability to supply gas production in the short-term and can negatively impact the demand for Enerflex's products and services.

### **Foreign Operations**

Enerflex sells products and services throughout the world. This diversification exposes Enerflex to risks related to cultural, political and economic factors of foreign jurisdictions which are beyond the control of Enerflex. Other issues, such as the quality of receivables, may also arise.

Enerflex exercises caution with respect to the countries in which it chooses to operate, and expand into, through a thorough assessment of the operational and political risks, but recognizes that conditions can change quickly.

### **Distribution Agreements**

One of Enerflex's strategic assets is its distribution and original equipment manufacturer agreements with leading manufacturers, notably for GE's Waukesha gas engines and parts, and for Jenbacher gas engines and parts. Enerflex is also the authorized distributor for Altronic, a leading manufacturer of electric ignition and control systems in Australia, New Zealand, and Canada. Enerflex also has relationships and agreements with other key equipment manufacturers including Finning (Caterpillar) and Ariel Corporation.

In the event that one or more of these agreements were to be terminated, Enerflex may lose a competitive advantage. Enerflex and its people make it a priority to maintain and enhance these strategic relationships.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Competition

Enerflex has a number of competitors in all aspects of its business, both domestically and abroad. Some of these competitors, particularly in the Engineered Systems product line, are large, multi-national companies with potentially greater access to resources and more experience in international operations than Enerflex. Within Canada, particularly in the Service product line, Enerflex has a number of small to medium-sized competitors, who may not have access to the capital and resources that Enerflex has, but may also incur lower overhead costs than Enerflex.

## Availability of Raw Materials, Component Parts or Finished Products

Enerflex purchases a broad range of materials and components in connection with its manufacturing and service activities. Enerflex purchases most of its natural gas engines and parts either through a distributor or an original equipment manufacturer agreement with GE's Gas Engines, or through an original equipment manufacturer agreement with Finning (Caterpillar). Enerflex purchases most of its compressors and related parts through a distributor agreement with Ariel Corporation. Enerflex has had longstanding relationships with these companies. Additionally, Enerflex has relationships with a number of other suppliers including Howden Compressors Ltd., Kobelco Compressors (America) Inc. and Mycom Group Inc. The availability of the component parts and the delivery schedules provided by these suppliers affect the assembly schedules of Enerflex's production and services.

Enerflex purchases coolers for its compression packages from a limited number of suppliers. The production schedules and delivery timetables from these suppliers affect the assembly schedule of Enerflex's products.

Though Enerflex is generally not dependent on any single source of supply, the ability of suppliers to meet performance, quality specifications and delivery schedules is important to the maintenance of customer satisfaction.

A challenge to achieving improved profitability will be the timely availability of certain original equipment manufacturer components and repair parts, which will generally be in steady demand.

## Information Technology

As Enerflex continues to expand internationally, access engineering and other technical skills in foreign locations, develop web-based applications and monitoring products, and improve its business software applications, information technology assets and protocols become increasingly important to Enerflex. Enerflex has attempted to reduce this exposure by improving its information technology general controls, updating or implementing new business applications and hiring or training specific employees with respect to the protection and use of information technology assets.

## Environmental Considerations

Demand for the Company's products and services could be adversely affected by changes to Canadian, U.S. or other countries' laws or regulations pertaining to the emission of CO<sub>2</sub> and other green house gases ("GHGs") into the atmosphere. Although the Company is not a large producer of GHGs, the products and services of the Company are primarily related to the production of hydrocarbons including crude oil and natural gas, whose ultimate consumption are generally considered a major source of GHG emissions. Changes in the regulations concerning the release of GHG into the atmosphere, including the introduction of so-called "carbon taxes" or limitations over the emissions of GHGs, may adversely impact the demand for hydrocarbons and ultimately the demand for the Company's products and services.

## **Insurance**

The Company could be subject to substantial liability claims, which could adversely affect its projections, business, results of operations and financial condition. Some of the Company's products are used in hazardous applications where an accident or a failure of a product could cause personal injury, loss of life, damage to property, equipment, or the environment, as well as the suspension of the end-user's operations. If the Company's products were to be involved in any of these difficulties, the Company could face litigation and may be held liable for those losses.

Enerflex carries insurance to protect the Company in the event of destruction or damage to its property and equipment, subject to appropriate deductibles and the availability of coverage. Liability and executive insurance coverage is also maintained at prudent levels to limit exposure to unforeseen incidents. An annual review of insurance coverage is completed to assess the risk of loss and risk mitigation alternatives. Extreme weather conditions, natural occurrences and terrorist activity have strained insurance markets, leading to substantial increases in insurance costs and limitations on coverage.

## **Bank Facilities and Senior Notes**

Enerflex relies on its Bank Facilities and Senior Notes to meet its funding and liquidity requirements. The Senior Notes are due on two separate dates with \$50.5 million, at a coupon of 4.8 percent, due on June 22, 2016 and \$40.0 million, at a coupon of 6.0 percent, due on June 22, 2021. The Bank Facilities are subject to floating rates of interest, are due on June 1, 2017 and may be renewed annually with the consent of the lenders. If the Company cannot successfully renegotiate all or part of the Bank Facilities prior to their due date, the cash available for dividends to shareholders and to fund ongoing operations could be adversely affected.

The Bank Facilities and Note Agreement also contain a number of covenants. Failure to meet any of these covenants, financial ratios or financial tests could result in events of default under each agreement. While Enerflex is currently in compliance with all covenants, financial ratios and financial tests, there can be no assurance that it will be able to comply with these covenants, financial ratios and financial tests in future periods. These events could restrict the Company's and other guarantors' ability to fund its operations, meet its obligations associated with financial liabilities or declare and pay dividends.

## **Government Regulation**

The Company is subject to health, safety and environmental laws and regulations that expose it to potential financial liability. The Company's operations are regulated under a number of federal, provincial, state, local, and foreign environmental laws and regulations, which govern, among other things, the discharge of hazardous materials into the air and water as well as the handling, storage, and disposal of hazardous materials. Compliance with these environmental laws is a major consideration in the manufacturing of the Company's products, as the Company uses, generates, stores and disposes of hazardous substances and wastes in its operations. The Company may be subject to material financial liability for any investigation and clean-up of such hazardous materials. In addition, many of the Company's current and former properties are or have been used for industrial purposes. Accordingly, the Company also may be subject to financial liabilities relating to the investigation and remediation of hazardous materials resulting from the actions of previous owners or operators of industrial facilities on those sites. Liability in certain instances may be imposed on the Company regardless of the legality of the original actions relating to the hazardous or toxic substances or whether or not the Company knew of, or was responsible for, the presence of those substances. The Company is also subject to various Canadian and U.S. federal, provincial, state and local laws and regulations, as well as foreign laws and regulations relating to safety and health conditions in its manufacturing facilities. Those laws and regulations may also subject the Company to material financial penalties or liabilities for any non-compliance, as well as potential business disruption if any of its facilities or a portion of any facility is required to be temporarily closed as a result of any violation of those laws and regulations. Any such financial liability or business disruption could have a material adverse effect on the Company's projections, business, results of operations and financial condition.



# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Tax Indemnity Agreement

The Company could be exposed to substantial tax liabilities if certain requirements of the “butterfly” rules in section 55 of the Income Tax Act are not complied with. Failure to comply with these requirements could give rise to tax liabilities resulting from the 2011 Plan of Arrangement with Toromont Industries Limited (“Toromont”) which would require the company to indemnify Toromont for the resulting tax.

## Foreign Exchange Risk

Enerflex reports its financial results to the public in Canadian dollars; however, a significant percentage of its revenues and expenses is denominated in currencies other than Canadian dollars. The Company identifies and hedges all significant transactional currency risks and its hedging policy is unchanged in the current year. Further information on Enerflex's hedging activities is provided in Note 26 to the consolidated financial statements.

## Transaction Exposure

The Canadian operations of the Company source the majority of its products and major components from the United States. Consequently, reported costs of inventory and the transaction prices charged to customers for equipment and parts are affected by the relative strength of the Canadian dollar. The Company also sells compression and processing packages in foreign currencies, primarily the U.S. dollar and the Australian dollar. Most of Enerflex's international orders are manufactured in the United States if the contract is denominated in U.S. dollars. This minimizes the Company's foreign currency exposure on these contracts.

The Company identifies and hedges all significant transactional currency risks. The Company has implemented a hedging policy, applicable primarily to the Canadian domiciled business units, with the objective of securing the margins earned on awarded contracts denominated in currencies other than Canadian dollars. In addition, the Company may hedge input costs that are paid in a currency other than the home currency of the subsidiary executing the contract. The Company utilizes a combination of foreign denominated debt and currency forward contracts to meet its hedging objectives.

Under IFRS, derivative instruments that do not qualify for hedge accounting are subject to mark-to-market at the end of each period with the changes in fair value recognized in current period net earnings. The Company applies hedge accounting to the majority of its forward contracts. As such, the gains or losses on the forward contracts are deferred to accumulated other comprehensive income and reclassified to the statement of earnings when the hedged transaction affects the statement of earnings. Any hedge ineffectiveness is recognized immediately in net earnings. However, there can be no assurance that the Company will apply or qualify for hedge accounting in the future. As such, the use of currency forwards may introduce significant volatility to the Company's reported earnings.

Enerflex mitigates the impact of exchange rate fluctuations by matching expected future U.S. dollar denominated cash inflows with U.S. dollar liabilities, including foreign exchange contracts, bank debt, and accounts payable, and by manufacturing U.S. dollar denominated contracts at plants located in the United States.

## Translation Exposure

The Company's earnings from and net investment in foreign subsidiaries are exposed to fluctuations in exchange rates. The currencies with the most significant impact are the U.S. dollar, Australian dollar and the British Pound.

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars using the exchange rates in effect at the balance sheet dates. Non-monetary assets and liabilities measured at historical cost are translated using the rates of exchange at the date of the transaction. Unrealized translation gains and losses are deferred and included in accumulated other comprehensive income. The cumulative currency translation adjustments are recognized in earnings when there has been a reduction in the net investment in the foreign operations.

Earnings from foreign operations are translated into Canadian dollars each period at average exchange rates for the period. As a result, fluctuations in the value of the Canadian dollar relative to these other currencies will impact reported net earnings. Such exchange rate fluctuations have historically not been material year-over-year relative to the overall earnings or financial position of the Company. As such, the Company does not hedge its exposure to net investments in foreign subsidiaries.

For the twelve months ended December 31, 2013, a 5 percent depreciation in the Canadian dollar against the U.S. dollar, Australian dollar and British Pound would increase other comprehensive income by \$12.1 million. A 5 percent depreciation of the Canadian dollar against the U.S. dollar, Australian dollar and British Pound would increase net earnings before tax by \$4.3 million.

Enerflex does not hedge its exposure to investments in foreign subsidiaries. Exchange gains and losses on net investments in foreign subsidiaries are included in accumulated other comprehensive income ("AOCI"). The AOCI at December 31, 2012 was \$1.1 million, which increased to \$5.7 million at December 31, 2013 as a result of changes in the value of the Canadian dollar against the U.S. dollar, Australian dollar and British Pound.

### **Interest Rate Risk**

The Company's Notes outstanding at December 31, 2013 are at fixed interest rates and therefore the related interest expense will not be impacted by fluctuations in interest rates. The Company's Bank Facilities, however, are subject to changes in market interest rates. For each 1 percent change in the rate of interest on the Bank Facilities, the change in interest expense for the twelve months ended December 31, 2013 would be \$0.1 million. All interest charges are recorded in finance costs on the consolidated statements of earnings.

### **Credit Risk**

The Company has accounts receivable from clients engaged in various industries including natural gas production, natural gas transport, agriculture, chemical and petrochemical processing, and the generation and sale of electricity. These specific industries may be affected by economic factors that may impact collectability of accounts receivable. Enerflex has entered into a number of significant projects into 2014 and beyond. For the twelve months ended December 31, 2013, the Company had no individual customer which accounted for more than 10 percent of its revenue.

### **Liquidity Risk**

Liquidity risk is the risk that the Company may encounter difficulties in meeting obligations associated with financial liabilities. Accounts payable are primarily due within 45 days and will be satisfied from current working capital.

### **Capital Resources**

On January 31, 2014, Enerflex had 78,185,559 shares outstanding. Enerflex has not established a formal dividend policy and the Board of Directors anticipates setting the quarterly dividends based on the availability of cash flow and anticipated market conditions, taking into consideration business opportunities and the need for growth capital. During the fourth quarter of 2013, the Company announced an increase to its annual dividend to \$0.30 per year, or \$0.075 per quarter, effective for the fourth quarter dividend. This is the second annual increase in the Company's dividend to shareholders since it re-emerged as a publicly-traded entity in June 2011.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

At December 31, 2013, the Company had \$5.0 million cash drawings against the syndicated revolving credit facilities ("Bank Facilities") (December 31, 2012 – \$8.8 million). The weighted average interest rate on the Bank Facilities at December 31, 2013 was 3.06 percent (December 31, 2012 – 2.99 percent).

The composition of the borrowings on the Bank Facilities and the Notes was as follows:

	<b>December 31, 2013</b>	December 31, 2012
Drawings on Bank Facilities	<b>\$ 5,000</b>	\$ 8,835
Notes due June 22, 2016	<b>50,500</b>	50,500
Notes due June 22, 2021	<b>40,000</b>	40,000
Deferred transaction costs	<b>(2,565)</b>	(2,866)
	<b>\$ 92,935</b>	\$ 96,469

At December 31, 2013, without considering renewal at similar terms, the Canadian dollar equivalent principal payments due over the next five years are \$55.5 million, and \$40.0 million thereafter.

## Contractual Obligations, Committed Capital Investment and Off-Balance Sheet Arrangements

The Company's contractual obligations are contained in the following table.

<b>Contractual Obligations</b> (\$ Canadian thousands)	Payments due by period				Total
	2014	2015-2016	2017-2018	Thereafter	
Leases	\$ 5,181	\$ 7,847	\$ 6,185	\$ 3,375	\$ 22,588
Purchase obligations	37,401	1,410	–	–	38,811
Total	<b>\$ 42,582</b>	<b>\$ 9,257</b>	<b>\$ 6,185</b>	<b>\$ 3,375</b>	<b>\$ 61,399</b>

The majority of the Company's lease commitments are operating leases for Service vehicles.

The majority of the Company's purchase commitments relate to major components for the Engineered Systems product line and to long-term information technology and communications contracts entered into in order to reduce the overall cost of services received.

The Company does not have off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on the Company's financial condition, results of operations, liquidity or capital expenditures.

## Related Parties

Related parties include Total Production Services Inc. ("Total"), the Company's 45 percent equity investment and the Company's 51 percent joint venture interest in Enerflex-ES, established in the fourth quarter of 2011.

All transactions occurring with related parties were in the normal course of business operations under the same terms and conditions as transactions with unrelated companies. All related party transactions are settled in cash. A summary of the financial statement impacts of all transactions with all related parties is as follows:

December 31,	2013		2012	
<b>Associate – Total</b>				
Revenue	\$	7,107	\$	286
Purchases		14		347
Accounts Receivable		157		73
<b>Joint Venture – Enerflex-ES</b>				
Revenue	\$	102	\$	–
Purchases		–		36
Accounts Receivable		–		–

## Significant Accounting Estimates

The Company's significant accounting policies are described in Note 3 of the audited consolidated financial statements for the year ended December 31, 2013. The preparation of financial statements in conformity with GAAP requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the end of the reporting period. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods. In the process of applying the Company's accounting policies, management has made the following judgments, estimates and assumptions which have the most significant effect on the amounts recognized in the consolidated financial statements:

### Revenue Recognition – Long-Term Contracts and Service Contracts

The Company reflects revenues generated from the assembly and manufacture of projects and long-term service contracts using the percentage-of-completion approach of accounting. This approach to revenue recognition requires management to make a number of estimates and assumptions surrounding the expected profitability of the contract, the estimated degree of completion based on cost progression and other detailed factors. Although these factors are routinely reviewed as part of the project management process, changes in these estimates or assumptions could lead to changes in the revenues recognized in a given period.

### Provisions for Warranty

Provisions set aside for warranty exposures either relate to amounts provided systematically based on historical experience under contractual warranty obligations or specific provisions created in respect of individual customer issues undergoing commercial resolution and negotiation. Amounts set aside represent management's best estimate of the likely settlement and the timing of any resolution with the relevant customer.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## **Property, Plant and Equipment**

Property, plant and equipment is stated at cost less accumulated depreciation, including any asset impairment losses. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of items of property, plant and equipment are reviewed on an annual basis. Assessing the reasonableness of the estimated useful lives of property, plant and equipment items requires judgment and is based on currently available information. Property, plant and equipment is also reviewed for potential impairment on a regular basis or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Changes in circumstances, such as technological advances and changes to business strategy, can result in actual useful lives and future cash flows differing significantly from estimates. The assumptions used, including rates and methodologies, are reviewed on an ongoing basis to ensure they continue to be appropriate. Revisions to the estimated useful lives of items of property, plant and equipment or future cash flows constitute a change in accounting estimate and are applied prospectively.

## **Allowance for Doubtful Accounts**

An estimate for doubtful accounts is made when there is objective evidence that the collection of the full amount is no longer probable under the terms of the original invoice. Impaired receivables are derecognized when they are assessed as uncollectible. Amounts estimated represent management's best estimate of the probability of collection of amounts from customers.

## **Impairment of Inventories**

The Company regularly reviews the nature and quantities of inventories on hand and evaluates the net realizable value of inventories based on historical usage patterns, known changes to equipment or processes and customer demand for specific products. Significant or unanticipated changes in business conditions could impact the magnitude and timing of impairment recognized.

## **Impairment of Non-Financial Assets**

Impairment exists when the carrying value of an asset or cash generating unit ("CGU") exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value-in-use. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. The value-in-use calculation is based on a discounted cash flow model. Estimating the value-in-use requires the Company to make an estimate of the expected future cash flows from each asset or CGU and also to determine a suitable discount rate in order to calculate the present value of those cash flows.

## **Impairment of Goodwill**

The Company tests whether goodwill is impaired at least on an annual basis. This requires an estimation of the value-in-use of the groups of CGUs to which the goodwill is allocated. Estimating the value-in-use requires the Company to make an estimate of the expected future cash flows from each group of CGUs and also to determine a suitable discount rate in order to calculate the present value of those cash flows.

## Income Taxes

Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Given the wide range of international business relationships and the long-term nature and complexity of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to tax income and expense already recorded. The Company establishes provisions, based on reasonable estimates, for possible consequences of audits by the tax authorities of the respective countries in which it operates. The amount of such provisions is based on various factors, such as experience of previous tax audits and differing interpretations of tax regulations by the taxable entity and the responsible tax authority. Such differences of interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective company's domicile.

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

## Share-Based Compensation

The Company employs the fair value method of accounting for stock options and phantom share appreciation rights. The determination of the share-based compensation expense for stock options and phantom shares requires the use of estimates and assumptions based on exercise prices, market conditions, vesting criteria, length of employment and past experiences of the Company. Changes in these estimates and future events could alter the determination of the provision for such compensation. Details concerning the assumptions used are shown in Note 22 to the annual consolidated financial statements.

## Assets Held for Sale and Discontinued Operations

The Company's accounting policy related to assets held for sale is described in Note 3(c). In applying this policy, judgment is used in determining whether certain assets should be reclassified to assets held for sale on the consolidated statements of financial position. Judgment is applied in determining the carrying value of assets and related liabilities held for sale, and whether the results of operations associated with the assets should be recorded in discontinued operations on the consolidated statements of earnings.

## Changes in Accounting Policies

Effective January 1, 2013, the Company applied the following new IFRS standards for the first time: IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IFRS 13 *Fair Value Measurement* and amendments to IAS 1 *Presentation of Financial Statements*. The new standards did not have a significant impact.

In addition, the Company will be required to adopt IAS 32 *Offsetting Financial Assets and Financial Liabilities* effective January 1, 2014. IFRS 9 *Financial Instruments* is being published in phases and its implementation date has been deferred. The Company is in the process of conducting a detailed review of the potential impacts of these new standards as they are issued.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## **Responsibility of Management and the Board Of Directors**

Management is responsible for the information disclosed in this MD&A and the accompanying annual audited consolidated financial statements, and has in place appropriate information systems, procedures and controls to ensure that information used internally by management and disclosed externally is materially complete and reliable. In addition, the Company's Audit Committee, on behalf of the Board of Directors, provides an oversight role with respect to all public financial disclosures made by the Company, and has reviewed and approved this MD&A and the audited annual consolidated financial statements. The Audit Committee is also responsible for determining that management fulfills its responsibilities in the financial control of operations, including disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR").

## **Disclosure Controls and Procedures and Internal Control Over Financial Reporting**

The Chief Executive Officer and the Chief Financial Officer, together with other members of management, have evaluated the effectiveness of the Company's disclosure controls and procedures and internal controls over financial reporting as at December 31, 2013, using the internal control integrated framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 1992. Based on that evaluation, management has concluded that the design and operation of the Company's disclosure controls and procedures were adequate and effective as at December 31, 2013, to provide reasonable assurance that a) material information relating to the Company and its consolidated subsidiaries would have been known to them and by others within those entities, and b) information required to be disclosed is recorded, processed, summarized and reported within required time periods. They have also concluded that the design and operation of internal controls over financial reporting were adequate and effective as at December 31, 2013, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial reporting in accordance with GAAP.

There have been no significant changes in the design of the Company's ICFR during the year ended December 31, 2013 that would materially affect, or are reasonably likely to materially affect the Company's ICFR.

While the Officers of the Company have designed the Company's disclosure controls and procedures and internal controls over financial reporting, they expect that these controls and procedures may not prevent all errors and fraud. A control system, no matter how well conceived or operated, can only provide reasonable, not absolute, assurance that the objectives of the control system are met.

## **Subsequent Event**

Subsequent to December 31, 2013, the Company declared a quarterly dividend of \$0.075 per share, payable on April 3, 2014, to shareholders of record on March 13, 2014.

# MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL POSITION

## **To the Shareholders of Enerflex Ltd.**

The accompanying consolidated financial statements and all information in the Annual Report have been prepared by management and approved by the Board of Directors of the Company. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and; where appropriate, reflect management's best estimates and judgments. Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements within reasonable limits of materiality and for the consistency of finance data included in the text of the Annual Report with that in the consolidated financial statements.

To assist management in the discharge of these responsibilities, the Company maintains a system of internal controls designed to provide reasonable assurance that accounting records are reliable and assets are safeguarded.

The Audit Committee is appointed by the Board of Directors. The Audit Committee meets with management, as well as with the external auditors, to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the auditors' report. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for presentation to the shareholders. The external auditors have direct access to the Audit Committee of the Board of Directors.

The consolidated financial statements have been audited independently by Ernst & Young LLP on behalf of the shareholders in accordance with generally accepted auditing standards. Their report outlines the nature of their audits and expresses their opinion on the consolidated financial statements.

[signed] "J. Blair Goertzen"

**J. Blair Goertzen**

*President, Chief Executive Officer and Director*

[signed] "D. James Harbilas"

**D. James Harbilas**

*Vice President and Chief Financial Officer*

February 27, 2014



# INDEPENDENT AUDITORS' REPORT

## To the Shareholders of Enerflex Ltd.

We have audited the accompanying consolidated financial statements of Enerflex Ltd., which comprise the consolidated statements of financial position as at December 31, 2013 and 2012 and the consolidated statements of earnings, comprehensive income, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

## Management's Responsibility for the Consolidated Financial Statements

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

## Auditors' Responsibility

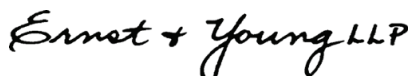
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

## Opinion

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Enerflex Ltd. as at December 31, 2013 and 2012 and its financial performance and cash flows for the years then ended in accordance with International Financial Reporting Standards.

The logo for Ernst & Young LLP, featuring the company name in a stylized, cursive script.

**Ernst & Young LLP**

*Chartered Accountants*

Calgary, Canada

February 27, 2014

# CONSOLIDATED FINANCIAL STATEMENTS

## Consolidated Statements of Financial Position

<i>(\$ Canadian thousands)</i>	December 31, 2013	December 31, 2012
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 181,973	\$ 144,988
Accounts receivable (Note 8)	331,170	287,387
Inventories (Note 9)	166,023	192,704
Income taxes receivable	320	–
Derivative financial instruments (Note 26)	358	1,737
Other current assets	9,368	9,839
Total current assets	689,212	636,655
Property, plant and equipment (Note 10)	133,933	129,383
Rental equipment (Note 10)	75,336	91,117
Deferred tax assets (Note 18)	31,999	32,786
Other assets (Note 11)	10,463	8,803
Intangible assets (Note 12)	23,922	29,137
Goodwill (Note 13)	451,214	457,208
	1,416,079	1,385,089
Assets held for sale (Note 7)	–	4,175
Total assets	\$ 1,416,079	\$ 1,389,264
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Accounts payable and accrued liabilities (Note 14)	\$ 156,484	\$ 169,275
Provisions (Note 15)	15,148	17,169
Income taxes payable	2,241	5,410
Deferred revenues	209,268	193,401
Derivative financial instruments (Note 26)	1,518	596
Total current liabilities	384,659	385,851
Long-term debt (Note 16)	92,935	96,469
Deferred tax liability (Note 18)	–	410
Other liabilities	6,823	3,478
	484,417	486,208
Liabilities related to assets held for sale (Note 7)	–	16,377
Total liabilities	\$ 484,417	\$ 502,585
Shareholders' equity		
Share capital (Note 19)	220,901	212,875
Contributed surplus (Note 20)	654,538	655,879
Retained earnings	50,476	16,826
Accumulated other comprehensive income	5,747	1,099
Total shareholders' equity	931,662	886,679
Total liabilities and shareholders' equity	\$ 1,416,079	\$ 1,389,264

See accompanying Notes to the Consolidated Financial Statements, including guarantees, commitments and contingencies (Note 17).

# CONSOLIDATED FINANCIAL STATEMENTS

## Consolidated Statements of Earnings

(\$ Canadian thousands, except per share amounts)	Years ended December 31,	
	2013	2012
Revenue (Note 21)	<b>\$ 1,405,022</b>	\$ 1,501,684
Cost of goods sold	<b>1,159,117</b>	1,228,529
Gross margin	<b>245,905</b>	273,155
Selling and administrative expenses	<b>163,875</b>	158,598
Operating income	<b>82,030</b>	114,557
Gain on disposal of property, plant and equipment	<b>(79)</b>	(951)
Equity earnings from associates and joint ventures	<b>(5,232)</b>	(1,833)
Earnings before finance costs and income taxes	<b>87,341</b>	117,341
Finance costs (Note 24)	<b>6,076</b>	6,761
Finance income (Note 24)	<b>(558)</b>	(1,100)
Earnings before income taxes	<b>81,823</b>	111,680
Income taxes (Note 18)	<b>24,105</b>	29,427
Net earnings from continuing operations	<b>\$ 57,718</b>	\$ 82,253
Loss from discontinued operations (Note 7)	<b>(1,852)</b>	(10,479)
Net earnings	<b>\$ 55,866</b>	\$ 71,774
Earnings (loss) per share – basic (Note 25)		
Continuing operations	<b>\$ 0.74</b>	\$ 1.06
Discontinued operations	<b>\$ (0.02)</b>	\$ (0.14)
Earnings (loss) per share – diluted (Note 25)		
Continuing operations	<b>\$ 0.73</b>	\$ 1.06
Discontinued operations	<b>\$ (0.02)</b>	\$ (0.14)
Weighted average number of shares – basic	<b>77,923,314</b>	77,590,203
Weighted average number of shares – diluted	<b>78,243,929</b>	77,685,770

See accompanying Notes to the Consolidated Financial Statements.

## Consolidated Statements of Comprehensive Income

(\$ Canadian thousands)	Years ended December 31,	
	2013	2012
Net earnings	\$ 55,866	\$ 71,774
Other comprehensive income (loss):		
Other comprehensive income (loss) that may be reclassified to profit or loss in subsequent periods:		
Change in fair value of derivatives designated as cash flow hedges net of income tax (recovery) expense (2013: \$(649); 2012: \$116)	(2,949)	523
Gain (loss) on derivatives designated as cash flow hedges transferred to net earnings in the current year, net of income tax expense (recovery) (2013: \$63; 2012: \$(130))	283	(389)
Unrealized gain (loss) on translation of financial statements of foreign operations	7,314	(6,892)
Other comprehensive income (loss)	\$ 4,648	\$ (6,758)
Total comprehensive income	\$ 60,514	\$ 65,016

See accompanying Notes to the Consolidated Financial Statements.

# CONSOLIDATED FINANCIAL STATEMENTS

## Consolidated Statements of Cash Flows

(\$ Canadian thousands)	Years ended December 31,	
	2013	2012
<b>Operating Activities</b>		
Net earnings	\$ 55,866	\$ 71,774
Items not requiring cash and cash equivalents:		
Depreciation and amortization	39,595	39,487
Equity earnings from associates and joint ventures	(5,232)	(1,833)
Deferred income taxes (Note 18)	849	6,992
Share-based compensation expense (Note 22)	6,954	3,167
Gain on sale of property, plant and equipment	(79)	(910)
	<b>97,953</b>	118,677
Net change in non-cash working capital and other (Note 28)	<b>(28,929)</b>	7,424
Cash provided by operating activities	<b>\$ 69,024</b>	\$ 126,101
<b>Investing Activities</b>		
Additions to:		
Property, plant and equipment (Note 10)	\$ (22,771)	\$ (31,524)
Rental equipment (Note 10)	(13,888)	(11,385)
Proceeds on disposal of:		
Property, plant and equipment	619	2,655
Rental equipment	18,675	7,548
Change in other assets	4,806	9,304
Cash used in investing activities	<b>\$ (12,559)</b>	\$ (23,402)
<b>Financing Activities</b>		
Repayment of long-term debt	\$ (4,287)	\$ (23,275)
Dividends	(21,798)	(18,606)
Stock option exercises	5,186	3,397
Cash used in financing activities	<b>\$ (20,899)</b>	\$ (38,484)
Effect of exchange rate changes on cash and cash equivalents denominated in foreign currencies	<b>\$ 1,419</b>	\$ (427)
Increase in cash and cash equivalents	<b>36,985</b>	63,788
Cash and cash equivalents, beginning of period	<b>144,988</b>	81,200
Cash and cash equivalents, end of period	<b>\$ 181,973</b>	\$ 144,988

See accompanying Notes to the Consolidated Financial Statements.

## Consolidated Statements of Changes in Equity

(\$ Canadian thousands)	Share capital	Contributed surplus	Retained earnings (deficit)	Foreign currency translation adjustments	Hedging reserve	Total accumulated other comprehensive income	Total
At January 1, 2012	\$ 207,409	\$ 656,536	\$ (35,540)	\$ 6,881	\$ 976	\$ 7,857	\$ 836,262
Net earnings	–	–	71,774	–	–	–	71,774
Other comprehensive income (loss)	–	–	–	(6,892)	134	(6,758)	(6,758)
Effect of stock option plans	5,466	(657)	–	–	–	–	4,809
Dividends	–	–	(19,408)	–	–	–	(19,408)
<b>At December 31, 2012</b>	<b>\$ 212,875</b>	<b>\$ 655,879</b>	<b>\$ 16,826</b>	<b>\$ (11)</b>	<b>\$ 1,110</b>	<b>\$ 1,099</b>	<b>\$ 886,679</b>
Net earnings	–	–	55,866	–	–	–	55,866
Other comprehensive income (loss)	–	–	–	7,314	(2,666)	4,648	4,648
Effect of stock option plans	8,026	(1,341)	–	–	–	–	6,685
Dividends	–	–	(22,216)	–	–	–	(22,216)
<b>At December 31, 2013</b>	<b>\$ 220,901</b>	<b>\$ 654,538</b>	<b>\$ 50,476</b>	<b>\$ 7,303</b>	<b>\$ (1,556)</b>	<b>\$ 5,747</b>	<b>\$ 931,662</b>

See accompanying Notes to the Consolidated Financial Statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of Canadian dollars, except per share amounts or as otherwise noted)

## Note 1. Nature and Description of the Company

Enerflex Ltd. ("Enerflex" or "the Company") is a single-source supplier of natural gas compression, oil and gas processing, refrigeration systems and electric power equipment – plus in-house engineering and mechanical services expertise. The Company's broad in-house resources provide the capability to engineer, design, manufacture, construct, commission and service hydrocarbon handling systems. Enerflex's expertise encompasses field production facilities, compression and natural gas processing plants, CO<sub>2</sub> processing plants, refrigeration systems and electric power systems serving the natural gas production industry.

Headquartered in Calgary, the registered office is located at 904, 1331 Macleod Trail SE, Calgary, Canada. Enerflex has approximately 2,900 employees worldwide. Enerflex, its subsidiaries, interests in associates and joint-ventures, operate in Canada, the United States, Colombia, Australia, the United Kingdom, Russia, the United Arab Emirates ("UAE"), Oman, Bahrain, Indonesia, Malaysia and Singapore. Enerflex operates three business segments: Canada and Northern U.S., Southern U.S. and Latin America and International.

The following table represents material subsidiaries of the Company:

Name	Jurisdiction of Incorporation	% Ownership	Business Segment
Enerflex Ltd.	Canada	Public Shareholders	Canada and Northern U.S.
Enerflex Inc.	Delaware, U.S.	100.0%	Southern U.S. and Latin America
Gas Drive Global LP	Alberta, Canada	100.0%	Canada and Northern U.S.
Enerflex Energy Systems PTY Ltd.	Melbourne, Australia	100.0%	International

## Note 2. Basis of Presentation

### (a) Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), and were approved and authorized for issue by the Board of Directors on February 27, 2014. Certain prior year amounts have been reclassified to conform with the current period's presentation.

### (b) Basis of Measurement

The consolidated financial statements are prepared on a historical cost basis except as detailed in the accounting policies disclosed in Note 3. The accounting policies described in Note 3 and Note 4 have been applied consistently to all periods presented in these financial statements. Standards and guidelines not effective for the current accounting period are described in Note 6.

### (c) Functional Currency and Presentation Currency

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

### (d) Use of Estimates and Judgment

The timely preparation of financial statements requires that management make estimates and assumptions and use judgment. Accordingly, actual results may differ from estimated amounts as future confirming events occur. Significant estimates and judgment used in the preparation of the financial statements are described in Note 5.

#### **(e) Basis of Consolidation**

These consolidated financial statements include the accounts of the Company and its subsidiaries. Subsidiaries are fully consolidated from the date of acquisition, and continue to be consolidated until the date that control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent Company, using consistent accounting policies. All intra-group balances, income and expenses, and unrealized gains and losses resulting from intra-group transactions are eliminated in full.

### **Note 3. Summary of Significant Accounting Policies**

#### **(a) Investments in Associates and Joint Ventures**

The Company uses the equity method to account for its 45 percent investment in Total Production Services Inc. and its 51 percent interest in the Enerflex-ES joint venture.

Under the equity method, the investments are carried on the consolidated statement of financial position at cost plus post acquisition changes in the Company's share of net assets of the associate or joint venture.

The consolidated statement of earnings reflects the Company's share of the results of operations of the associate and joint venture. Unrealized gains and losses resulting from transactions between the Company and the associate are eliminated to the extent of the interest in the associate or joint venture.

The Company's share of profits from associates and joint ventures is shown on the face of the consolidated statement of earnings. This is the profit attributable to equity holders of the associate and joint venture partners and, therefore, is profit after tax and non-controlling interests in the subsidiaries of the associate and joint venture.

#### **(b) Foreign Currency Translation**

In the accounts of individual subsidiaries, transactions in currencies other than the Company's functional currency are recorded at the prevailing rate of exchange at the date of the transaction. At year end, monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange prevailing at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated using the rates of exchange at the date the fair value was determined. All foreign exchange gains and losses are taken to the consolidated statement of earnings with the exception of exchange differences arising on monetary assets and liabilities that form part of the Company's net investment in subsidiaries. These are taken directly to other comprehensive income until the disposal of the foreign subsidiary at which time the unrealized gain or loss is recognized in the consolidated statement of earnings.

The assets and liabilities on the statements of financial position of foreign subsidiaries are translated into Canadian dollars at the rates of exchange prevailing at the reporting date. The consolidated statements of earnings of foreign subsidiaries are translated at average exchange rates for the reporting period. Exchange differences arising on the translation of net assets are taken to accumulated other comprehensive income.

On the disposal of a foreign subsidiary, accumulated exchange differences are recognized in the consolidated statement of earnings as a component of the gain or loss on disposal.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## (c) Assets Held for Sale

Non-current assets and disposal groups are classified as assets held for sale where the asset or disposal group is available for sale in its present condition, and the sale is highly probable. For this purpose, a sale is highly probable if management is committed to a plan to achieve the sale; there is an active program to find a buyer; the non-current asset or disposal group is being actively marketed at a reasonable price; the sale is anticipated to be completed within one year from the date of classification; and it is unlikely there will be changes to the plan.

Non-current assets and disposal groups held for sale are carried at the lesser of carrying amount and fair value less costs to sell. The profit or loss arising on reclassification or sale of a disposal group is recognized in discontinued operations on the consolidated statement of earnings.

## (d) Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses. Cost comprises the purchase price or construction cost and any costs directly attributable to making the asset capable of operating as intended. Depreciation is provided using the straight-line method over the estimated useful lives of the various classes of assets and commences when the assets are ready for intended use.

Asset class	Estimated useful life range
Buildings	5 to 20 years
Equipment	3 to 20 years

Major renewals and improvements are capitalized when they are expected to provide future economic benefit. When significant components of property, plant and equipment are required to be replaced at intervals, the Company derecognizes the replaced part, and recognizes the new part with its own associated useful life and depreciation. No depreciation is charged on land or assets under construction. Repairs and maintenance costs are charged to operations as incurred.

The carrying amount of an item of property, plant and equipment is derecognized on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from derecognition of property, plant and equipment is included in the consolidated statement of earnings when the item is derecognized.

Each asset's estimated useful life, residual value and method of depreciation are reviewed and adjusted, if appropriate, at each year end.

## (e) Rental Equipment

Rental equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which are generally between 5 and 15 years.

When, under the terms of a rental contract, the Company is responsible for major maintenance and overhauls, the actual overhaul cost is capitalized and depreciated over the estimated useful life of the overhaul, generally between 2 and 5 years. Repairs and maintenance costs are charged to operations as incurred.

Each asset's estimated useful life, residual value and method of depreciation are reviewed and adjusted, if appropriate, at each year end.

**(f) Goodwill**

Goodwill arising on an acquisition of a business is initially measured at cost, being the excess of the aggregate of the consideration transferred over the net identifiable assets acquired and liabilities assumed. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill allocated to a group of cash generating units ("CGUs") is reviewed for impairment annually, or when there is an indication that a related group of CGUs may be impaired. Impairment is determined by assessing the recoverable amount of the group of CGUs to which the goodwill relates. Where the recoverable amount of the group of CGUs is less than the carrying amount of the CGUs and related goodwill, an impairment loss is recognized in the consolidated statement of earnings. Impairment losses on goodwill are not reversed.

**(g) Intangible Assets**

Intangible assets are carried at cost less accumulated amortization and any accumulated impairment losses. Intangible assets with a finite life are amortized on a straight-line basis over management's best estimate of their expected useful lives. The amortization charge in respect of intangible assets is included in the selling, general and administrative expense line in the consolidated statement of earnings. The expected useful lives and amortization method are reviewed on an annual basis with any change in the useful life or pattern of consumption adjusted at year end. Intangible assets are tested for impairment whenever there is an indication that the asset may be impaired.

Acquired identifiable intangible assets with finite lives are amortized on a straight-line basis over the estimated useful lives. Customer relationships, software and other intangible assets have an estimated useful life range of 3 to 5 years.

**(h) Impairment of Non-Financial Assets (Excluding Goodwill)**

At least annually, the Company reviews the carrying amounts of its tangible and intangible assets with finite lives to assess whether there is an indication that those assets may be impaired. If any such indication exists, the Company makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value-in-use. In assessing its value-in-use, the estimated future cash flows attributable to the asset 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.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. A corresponding impairment loss is recognized in the consolidated statement of earnings.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the original carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Any impairment reversal is recognized in the consolidated statement of earnings.

**(i) Inventories**

Inventories are valued at the lower of cost and net realizable value.

Cost of equipment, repair and distribution parts and direct materials includes purchase cost and costs incurred in bringing each product to its present location and condition. Serialized inventory is determined on a first-in first-out basis. Non-serialized inventory is determined based on a weighted average cost.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Cost of work-in-process includes cost of direct materials, labour and an allocation of manufacturing overheads, based on normal operating capacity.

Cost of inventories includes the transfer from accumulated other comprehensive income of gains and losses on qualifying cash flow hedges in respect of the purchase of inventory.

Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

Inventories are written down to net realizable value when the cost of inventories is estimated to be unrecoverable due to obsolescence, damage or declining selling prices. Inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. When circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in selling prices, the amount of the write down previously recorded is reversed.

## **(j) Trade Receivables**

Trade receivables are recognized and carried at original invoice amount less an allowance for any amounts estimated to be uncollectible. An allowance for doubtful accounts is recorded when there is objective evidence that the collection of the full amount is no longer probable under the terms of the original invoice. Trade receivables are derecognized when they are assessed as uncollectible.

## **(k) Cash**

Cash includes cash and cash equivalents, which are defined as highly liquid investments with original maturities of three months or less.

## **(l) Provisions**

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

## **(m) Onerous Contracts**

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Company recognizes any impairment loss on the assets associated with that contract.

## **(n) Employee Future Benefits**

The Company sponsors various defined contribution pension plans, which cover substantially all employees and are funded in accordance with applicable plan and regulatory requirements. Regular contributions are made by the Company to the employees' individual accounts, which are administered by a plan trustee, in accordance with the plan document. The actual cost of providing benefits through defined contribution pension plans is charged to earnings in the period in respect of which contributions become payable.

## **(o) Share-Based Payments**

### **Equity-Settled Share-Based Payments**

The Company offers a Stock Option Plan to certain directors and key employees, measured at the fair value of the equity instrument at the grant date. In 2012, the Board of Directors of Enerflex ceased granting Options to non-employee directors. Details regarding the determination of the fair value of equity-settled share-based transactions are set out in Note 22 under Stock Options.

The fair value of equity-settled share-based payments is expensed over a five-year vesting period with a corresponding increase in equity. Stock options have a seven-year expiry and are exercisable at the designated common share price, which is determined by the average of the market price of the Company's shares on the five days preceding the date of the grant. The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest.

### **Cash-Settled Share-Based Payments**

The Company offers a Deferred Share Unit ("DSU"), Performance Share Unit ("PSU"), and Restricted Share Unit ("RSU") plan to certain employees and non-employee directors (in the case of DSUs only). For each cash-settled share-based payment plan, a liability is recognized at the fair value of the liability. At the end of each reporting period until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with changes in fair value recognized in the consolidated statement of earnings.

The Company also offers a Phantom Share Appreciation Rights Plan ("SAR") to certain employees of affiliates located in Australia, the UAE and Singapore. SARs are measured at the fair value of the equity instrument at the grant date and expensed over a five-year vesting period and expire on the fifth anniversary. The exercise price of each SAR equals the average of the market price of the Company's shares on the five days preceding the date of the grant. At the end of each reporting period until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with changes in fair value recognized in the consolidated statement of earnings. The award entitlements for increases in the share trading value of the Company are to be paid to the recipient in cash upon exercise.

## **(p) Leases**

Leases which transfer substantially all of the benefits and risk of ownership of the asset to the lessee are classified as finance leases; all other leases are classified as operating leases.

### **Company as a Lessor**

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized on a straight-line basis over the lease term.

The Company recognizes selling profit or loss in the period for outright sales relating to manufacture type leases. Amounts due from finance leases are recorded as receivables at the amount of the Company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Company's net investment outstanding in respect of leases.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## Company as a Lessee

The Company does not hold any assets under finance lease. Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

## (q) Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, and is reduced for discounts, rebates, sales taxes and duties. The following describes the specific revenue recognition policies for each major category of revenue:

- Product support services include sales of parts and servicing of equipment. For the sale of parts, revenue is recognized when the part is shipped to the customer. For servicing of equipment, revenue is recognized on a straight-line basis determined based on performance of the contracted upon service;
- Revenue from long-term service contracts is recognized on a stage of completion basis proportionate to the service work that has been performed based on parts and labour service provided. At the completion of the contract, any remaining profit on the contract is recognized as revenue. Any expected losses on such projects are charged to operations when determined; and
- Revenue from equipment rentals is recognized in accordance with the terms of the relevant agreement with the customer on a straight-line basis over the term of the agreement. Certain rental contracts contain an option for the customer to purchase the equipment at the end of the rental period. Should the customer exercise this option to purchase, revenue from the sale of the equipment is recognized directly in the consolidated statement of earnings.

## (r) Construction Contracts

Revenue from the supply of equipment systems involving design, manufacture, installation and start-up is accounted for as a construction contract. When the outcome of a construction contract can be estimated reliably, revenue and costs pertaining to the contract are recognized at the end of the reporting period, measured based on the proportion of costs incurred to date relative to estimated total contract costs. Variations in contract work are included to the extent that the amount can be measured reliably and its receipt is considered probable.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized as an expense immediately.

When contract costs incurred to date plus recognized profits less recognized losses exceed progress billings, the excess is shown on the consolidated statement of financial position as other receivables. For contracts where progress billings exceed contract costs incurred to date plus recognized profits less recognized losses, the excess is shown on the consolidated statement of financial position as deferred revenue.

### **(s) Financial Instruments**

Financial instruments are measured at fair value on initial recognition of the instrument, and classified into one of the five following categories: held-for-trading, loans and receivables, held-to-maturity investments, available-for-sale investments or other financial liabilities.

The Company primarily applies the market approach for recurring fair value measurements. Three levels of inputs may be used to measure fair value:

- Level 1: Fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis;
- Level 2: Fair value measurements are those derived from 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); and
- Level 3: Fair value measurements are those derived from inputs for the asset or liability that are not based on observable market data (unobservable inputs). In these instances, internally developed methodologies are used to determine fair value.

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability and may affect placement within.

The Company has made the following classifications:

- Cash and cash equivalents are classified as assets-held-for-trading and are measured at fair value. Gains and losses resulting from the periodic revaluation are recorded in the consolidated statement of earnings;
- Accounts receivable are classified as loans and receivables and are recorded at amortized cost using the effective interest rate method; and
- Accounts payable, accrued liabilities and long-term debt are classified as other financial liabilities. Subsequent measurements are recorded at amortized cost using the effective interest rate method.

Transaction costs are expensed as incurred for financial instruments classified or designated as fair value through profit or loss. Transaction costs related to other financial liabilities are added to the value of the instrument at acquisition and taken into the consolidated statement of earnings using the effective interest rate method.

### **(t) Derivative Financial Instruments and Hedge Accounting**

The Company formally documents its risk management objectives and strategies to manage exposures to fluctuations in foreign currency exchange rates. The risk management policy permits the use of certain derivative financial instruments, including forward foreign exchange contracts, to manage these fluctuations. The Company does not enter into derivative financial agreements for speculative purposes.

Derivative financial instruments are measured at their fair value upon initial recognition and are remeasured to their fair value at the end of each reporting period. The fair value of quoted derivatives is equal to their positive or negative market value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The Company elected to apply hedge accounting for foreign exchange forward contracts for anticipated transactions. These are designated as cash flow hedges. For cash flow hedges, fair value changes of the effective portion of the hedging instrument are recognized in accumulated other comprehensive income, net of taxes. The ineffective portion of the fair value changes is recognized in the consolidated statement of earnings. Amounts charged to accumulated other comprehensive income are reclassified to the consolidated statement of earnings when the hedged transaction affects the consolidated statement of earnings.

On an ongoing basis, an assessment is made as to whether the designated derivative financial instruments continue to be effective in offsetting changes in cash flows of the hedged transactions.

## **(u) Income Taxes**

Income tax expense represents the sum of current income tax and deferred tax.

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from, or paid to the taxation authorities. Taxable earnings differs from earnings as reported in the consolidated statement of earnings because it excludes temporary and permanent differences. The Company's liability for current tax is calculated by using tax rates that have been enacted or substantively enacted at the reporting date.

Deferred income tax is recognized on all temporary differences at the reporting date based on the difference between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, with the following exceptions:

- Where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss;
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future; and
- Deferred income tax assets are recognized only to the extent that it is probable that a taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilized.

The carrying amount of deferred income 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 income tax assets to be utilized. Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the asset is realized or the liability is settled, based on tax rates and tax laws enacted or substantively enacted at the reporting date.

Current and deferred income tax is charged or credited directly to equity if it relates to items that are credited or charged to equity in the same period. Otherwise, income tax is recognized in the consolidated statement of earnings.

**(v) Discontinued Operations**

The results of discontinued operations are presented net of tax on a one-line basis in the consolidated statement of earnings. Direct corporate overheads and income taxes are allocated to discontinued operations. Finance costs (income) and general corporate overheads are not allocated to discontinued operations.

**(w) Earnings Per Share**

Basic earnings per share is calculated by dividing the net earnings for the period by the weighted average number of common shares outstanding during the period.

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding for dilutive common shares related to the Company's equity share-based compensation plan.

**(x) Finance Costs and Income**

Finance income comprises interest income on funds invested and finance income from leases. Finance income is recognized as it accrues in profit or loss, using the effective interest rate method.

Finance costs comprise interest expense on borrowings.

## **Note 4. Changes in Accounting Policies**

**(a) IFRS 10 Consolidated Financial Statements ("IFRS 10")**

IFRS 10 sets a single basis for consolidation, that being control of an entity. IFRS 10 replaces portions of IAS 27, "Consolidated and Separate Financial Statements" and Standing Interpretations Committee 12, "Special Purpose Entities", providing a single model on how entities should prepare consolidated financial statements. This standard was adopted on January 1, 2013, and there were no changes to the consolidated financial statements as a result of the adoption of this standard.

**(b) IFRS 11 Joint Arrangements ("IFRS 11")**

IFRS 11 establishes principles for financial reporting by entities involved in a joint arrangement and distinguishes between joint operations and joint ventures. IFRS 11 supersedes the current IAS 31, "Interests in Joint Ventures" and Standing Interpretations Committee 13, "Jointly Controlled Entities – Non Monetary Contributions by Venturers". This standard was adopted on January 1, 2013, and there were no changes to the consolidated financial statements as a result of the adoption of this standard.

Under IFRS 11, both the Company's investments are accounted for under the equity method with the Company's proportionate share of profit or loss included in the consolidated statement of earnings under "Equity Earnings" and presented on the consolidated statement of financial position as "Other Long-Term Assets".

**(c) IFRS 12 Disclosure of Interests in Other Entities ("IFRS 12")**

IFRS 12 establishes new classification rules for interests in subsidiaries, joint arrangements, associates or unconsolidated structured entities. IFRS 12 is intended to combine the disclosure requirements for interests in other entities currently located among accounting frameworks. This standard was adopted on January 1, 2013.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## (d) IFRS 13 Fair Value Measurements ("IFRS 13")

IFRS 13 defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies to IFRS that require or permit fair value measurements or related disclosures, except in specified circumstances. This standard was adopted on January 1, 2013. There were no changes to the consolidated financial statements as a result of the adoption of this standard.

## (e) IAS 1 Presentation of Items of Other Comprehensive Income ("IAS 1")

The amendments to IAS 1 introduce new terminology to the statement of earnings and statement of comprehensive income, and require additional disclosures in other comprehensive income. Under the revised requirements of IAS 1, items of other comprehensive income are grouped into two categories: (a) items that will not be subsequently reclassified to profit or loss; and (b) items that may be subsequently reclassified to profit or loss when specific conditions are met. The Company has updated the presentation of the consolidated statement of other comprehensive income as required.

## Note 5. Significant Accounting Estimates and Judgment

The timely preparation of financial statements requires that management make estimates and assumptions and use judgment. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Uncertainty about these assumptions and estimates could, however, result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods. In the process of applying the Company's accounting policies, management has made the following judgments, estimates and assumptions which have the most significant effect on the amounts recognized in the consolidated financial statements:

### → *Revenue Recognition – Construction and Long-Term Service Contracts*

The Company reflects revenues generated from the assembly and manufacture of projects and long-term service contracts using the percentage-of-completion approach of accounting. This approach to revenue recognition requires management to make a number of estimates and assumptions surrounding the expected profitability of the contract, the estimated degree of completion based on cost progression and other detailed factors. Although these factors are routinely reviewed as part of the project management process, changes in these estimates or assumptions could lead to changes in the revenues recognized in a given period.

### → *Provisions for Warranty*

Provisions set aside for warranty exposures either relate to amounts provided systematically based on historical experience under contractual warranty obligations or specific provisions created in respect of individual customer issues undergoing commercial resolution and negotiation. Amounts set aside represent management's best estimate of the likely settlement and the timing of any resolution with the relevant customer.

### → *Property, Plant and Equipment*

Property, plant and equipment are stated at cost less accumulated impairment losses, including any asset impairment losses. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of property, plant and equipment are reviewed on an annual basis. Assessing the reasonableness of the estimated useful lives of property, plant and equipment requires judgment and is based on currently available information. Property, plant and equipment are also reviewed for potential impairment on an annual basis or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Changes in circumstances, such as technological advances and changes to business strategy can result in actual useful lives differing significantly from estimates. The assumptions used, including rates and methodologies, are reviewed on an ongoing basis to ensure they continue to be appropriate. Revisions to the estimated useful lives of property, plant and equipment constitute a change in accounting estimate and are applied prospectively.

→ *Allowance for Doubtful Accounts*

An allowance for doubtful accounts is recorded when there is objective evidence that the collection of the full amount is no longer probable under the terms of the original invoice. Impaired receivables are derecognized when they are assessed as uncollectible. Amounts estimated represent management's best estimate of probability of collection of amounts from customers.

→ *Impairment of Inventories*

The Company regularly reviews the nature and quantities of inventory on hand and evaluates the net realizable value of items based on historical usage patterns, known changes to equipment or processes and customer demand for specific products. Significant or unanticipated changes in business conditions could impact the magnitude and timing of impairment recognized.

→ *Impairment of Non-Financial Assets*

Impairment exists when the carrying value of an asset or group of assets exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value-in-use. The fair value less costs to sell calculation is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. The value-in-use calculation is based on a discounted cash flow model, which requires the Company to estimate future cash flows and use judgment to determine a suitable discount rate to calculate the present value of those cash flows.

→ *Impairment of Goodwill*

The Company tests goodwill for impairment at least on an annual basis. This requires an estimation of the value-in-use of the groups of CGUs to which the goodwill is allocated. Estimating the value-in-use requires the Company to make an estimate of the expected future cash flows from each group of CGUs and use judgment to determine a suitable discount rate in order to calculate the present value of those cash flows.

→ *Income Taxes*

Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Given the wide range of international business relationships and the long-term nature and complexity of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to taxable income. The Company establishes provisions, based on reasonable estimates, for possible consequences of audits by the tax authorities of the respective countries in which it operates. The amount of such provisions is based on various factors, such as experience of previous tax audits and differing interpretations of tax regulations by the taxable entity and the responsible tax authority. Such differences of interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective company's domicile.

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## → *Share-Based Compensation*

The Company employs the fair value method of accounting for stock options and phantom share appreciation rights. The determination of the share-based compensation expense for stock options and phantom shares requires the use of estimates and assumptions based on exercise prices, market conditions, vesting criteria, length of employment and past experiences of the Company. Changes in these estimates and future events could alter the determination of the provision for such compensation. Details concerning the assumptions used are described in Note 22.

## → *Assets Held for Sale and Discontinued Operations*

The Company's accounting policy related to assets held for sale is described in Note 3(c). In applying this policy, judgment is used in determining whether certain assets should be reclassified to assets held for sale on the consolidated statements of financial position. Judgment is also applied in determining whether the results of operations associated with the assets should be recorded in discontinued operations on the consolidated statements of earnings.

## **Note 6. Future Accounting Changes**

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Company:

### **IFRS 9 Financial Instruments ("IFRS 9")**

IFRS 9 introduces new requirements for the classification and measurement of financial assets and financial liabilities, including derecognition. IFRS 9 requires all recognized financial assets under the scope of the current IAS 39 Financial Instruments: Recognition and Measurement to be subsequently measured at amortized cost or fair value. In addition, IFRS 9 requires that changes in fair value attributable to a financial liability's credit risk must be presented in other comprehensive income, rather than in profit or loss. The effective date of IFRS 9 has not yet been determined.

The Company will conduct a detailed review of the potential impacts on amounts reported in financial assets and liabilities; however, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed.

### **Amendments to IFRS 7 and IAS 32 Offsetting Financial Assets and Financial Liabilities and Related Disclosures**

The amendments to IAS 32 clarify existing application issues relating to the offset of financial assets and financial liabilities requirements. Specifically, the amendments clarify the meaning of "currently has a legally enforceable right of set-off" and "simultaneous realization and settlement". The amendments to IFRS 7 require entities to disclose information about rights of offset and related arrangements for financial instruments under an enforceable master netting agreement or similar arrangement.

The amendments to IAS 32 are effective for annual periods beginning on or after January 1, 2014, with retrospective application required. The Company anticipates that the application of these amendments to IFRS 7 may result in more disclosure being made with regard to offsetting financial assets and financial liabilities in the future.

## Note 7. Disposal of Assets Held for Sale and Discontinued Operations

The European Service and Combined Heat and Power business has been reported as a discontinued operation since the third quarter of 2011, with the assets and related liabilities presented as held for sale. In the second quarter of 2013, Enerflex completed the sale of the European business. As part of the arrangement, Enerflex transferred specified maintenance contracts, and certain obligations associated with the contracts and employees. The resolution of uncertainties that arise from the terms of the disposal transaction, or from performance obligations existing prior to the sale, could impact net earnings in 2014.

The following table summarizes the revenue and loss from discontinued operations:

Years ended December 31,	2013	2012
Revenue	\$ 10,229	\$ 27,564
Loss from operations	\$ (1,852)	\$ (10,479)

The following table summarizes cash from discontinued operations:

Years ended December 31,	2013	2012
Cash provided by (used in) operating activities	\$ 268	\$ (338)
Cash provided by (used in) investing activities	\$ 590	\$ (355)

## Note 8. Accounts Receivable

Accounts receivable consisted of the following:

Years ended December 31,	2013	2012
Trade receivables	\$ 232,992	\$ 227,717
Less: allowance for doubtful accounts	(1,093)	(1,369)
Trade receivables, net	231,899	226,348
Other receivables <sup>1</sup>	99,271	61,039
Total accounts receivable	\$ 331,170	\$ 287,387

Aging of trade receivables:

December 31,	2013	2012
Current to 90 days	\$ 214,256	\$ 196,318
Over 90 days	18,736	31,399
	\$ 232,992	\$ 227,717

<sup>1</sup> Included in Other receivables at December 31, 2013 is \$87.8 million relating to amounts due from customers under construction contracts (December 31, 2012 – \$56.4 million).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Movement in allowance for doubtful accounts:

December 31,	2013	2012
Balance, beginning of year	\$ 1,369	\$ 3,761
Impairment provision reversed on receivables	(402)	(1,901)
Amounts written off during the year as uncollectible	–	(482)
Currency translation effects	126	(9)
Balance, end of year	\$ 1,093	\$ 1,369

## Note 9. Inventories

Inventories consisted of the following:

December 31,	2013	2012
Equipment	\$ 10,536	\$ 8,671
Repair and distribution parts	48,893	41,411
Direct materials	26,358	30,108
Work-in-process	80,235	112,514
Total inventories	\$ 166,023	\$ 192,704

The amount of inventory and overhead costs recognized as an expense and included in cost of goods sold during 2013 was \$1,159.1 million (December 31, 2012 – \$1,228.5 million). Cost of goods sold includes inventory write-downs pertaining to obsolescence and aging together with recoveries of past write-downs upon disposition. The net amount charged to the consolidated statement of earnings and included in cost of goods sold in 2013 was \$1.6 million (December 31, 2012 – \$2.3 million).

## Note 10. Property, Plant and Equipment and Rental Equipment

	Land	Building	Equipment	Assets under construction	Total property, plant and equipment	Rental equipment
<b>Cost</b>						
<b>January 1, 2013</b>	\$ 26,002	\$ 104,744	\$ 56,409	\$ 3,123	\$ 190,278	\$ 130,883
Additions	5,536	56	2,101	15,078	22,771	13,888
Reclassification <sup>1</sup>	–	2,104	2,843	(12,279)	(7,332)	–
Disposals	–	(312)	(6,654)	–	(6,966)	(27,114)
Currency translation effects	614	3,686	822	45	5,167	2,318
<b>December 31, 2013</b>	<b>\$ 32,152</b>	<b>\$ 110,278</b>	<b>\$ 55,521</b>	<b>\$ 5,967</b>	<b>\$ 203,918</b>	<b>\$ 119,975</b>
<b>Accumulated depreciation</b>						
<b>January 1, 2013</b>	\$ –	\$ (26,047)	\$ (34,848)	\$ –	\$ (60,895)	\$ (39,766)
Depreciation charge	–	(6,284)	(7,896)	–	(14,180)	(12,586)
Reclassification <sup>1</sup>	–	556	169	–	725	–
Disposals	–	181	5,763	–	5,944	8,440
Currency translation effects	–	(865)	(714)	–	(1,579)	(727)
<b>December 31, 2013</b>	<b>\$ –</b>	<b>\$ (32,459)</b>	<b>\$ (37,526)</b>	<b>\$ –</b>	<b>\$ (69,985)</b>	<b>\$ (44,639)</b>
<b>Net book value –</b>						
<b>December 31, 2013</b>	<b>\$ 32,152</b>	<b>\$ 77,819</b>	<b>\$ 17,995</b>	<b>\$ 5,967</b>	<b>\$ 133,933</b>	<b>\$ 75,336</b>

<sup>1</sup> Total reclassifications relate to balance transferred to Intangibles at December 31, 2013; refer to Note 12.

	Land	Building	Equipment	Assets under construction	Total property, plant and equipment	Rental equipment
<b>Cost</b>						
January 1, 2012	\$ 26,499	\$ 87,894	\$ 47,239	\$ 12,968	\$ 174,600	\$ 132,753
Additions	–	902	4,655	25,967	31,524	11,385
Reclassification <sup>1</sup>	–	18,374	7,915	(35,615)	(9,326)	–
Disposals	(346)	(1,482)	(2,894)	–	(4,722)	(12,492)
Currency translation effects	(151)	(944)	(506)	(197)	(1,798)	(763)
December 31, 2012	<u>\$ 26,002</u>	<u>\$ 104,744</u>	<u>\$ 56,409</u>	<u>\$ 3,123</u>	<u>\$ 190,278</u>	<u>\$ 130,883</u>
<b>Accumulated depreciation</b>						
January 1, 2012	\$ –	\$ (21,247)	\$ (30,223)	\$ –	\$ (51,470)	\$ (30,845)
Depreciation charge	–	(5,742)	(7,227)	–	(12,969)	(14,050)
Disposals	–	698	2,279	–	2,977	4,943
Currency translation effects	–	244	323	–	567	186
December 31, 2012	<u>\$ –</u>	<u>\$ (26,047)</u>	<u>\$ (34,848)</u>	<u>\$ –</u>	<u>\$ (60,895)</u>	<u>\$ (39,766)</u>
<b>Net book value –</b>						
December 31, 2012	<u>\$ 26,002</u>	<u>\$ 78,697</u>	<u>\$ 21,561</u>	<u>\$ 3,123</u>	<u>\$ 129,383</u>	<u>\$ 91,117</u>

<sup>1</sup> Total reclassifications relate to balance transferred to Intangibles at December 31, 2012; refer to Note 12.

Depreciation of property, plant and equipment and rental equipment included in net earnings for the year ended December 31, 2013 was \$26.8 million (December 31, 2012 – \$27.0 million) of which \$18.4 million was included in cost of goods sold and \$8.4 million was included in selling and administrative expenses (December 31, 2012 – \$19.8 million and \$7.2 million, respectively).

## Note 11. Other Assets

December 31,	2013	2012
Investment in associates and joint ventures	<b>\$ 8,388</b>	\$ 6,347
Net investment in finance leases	<b>2,075</b>	2,456
	<b><u>\$ 10,463</u></b>	<u>\$ 8,803</u>

### (a) Net Investment in Finance Leases

The Company entered into finance lease arrangements for certain of its rental assets. Leases are denominated in Canadian or U.S. dollars. The terms of the leases entered into range from 1.5 to 5 years.

The value of the net investment is comprised of the following:

December 31,	Minimum lease payments		Present value of minimum lease payments	
	2013	2012	2013	2012
Less than one year	<b>\$ 1,338</b>	\$ 2,609	<b>\$ 1,284</b>	\$ 2,559
Between one and five years	<b>2,075</b>	2,456	<b>1,826</b>	2,021
	<b>\$ 3,413</b>	\$ 5,065	<b>\$ 3,110</b>	\$ 4,580
Less: unearned finance income	<b>(303)</b>	(485)	–	–
	<b><u>\$ 3,110</u></b>	<u>\$ 4,580</u>	<b><u>\$ 3,110</u></b>	<u>\$ 4,580</u>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The average interest rates inherent in the leases are fixed at the contract date for the entire lease term and are approximately 7.8 percent per annum (December 31, 2012 – 9.0 percent). The finance lease receivables at the end of the reporting period are neither past due nor impaired.

## Note 12. Intangible Assets

	Customer relationships and other	Software	Total intangible assets
<b>Acquired value</b>			
<b>January 1, 2013</b>	\$ 35,769	\$ 25,189	\$ 60,958
Additions	–	51	51
Reclassification	–	6,607	6,607
Disposals	(3,700)	–	(3,700)
Currency translation effects	–	22	22
<b>December 31, 2013</b>	<b>\$ 32,069</b>	<b>\$ 31,869</b>	<b>\$ 63,938</b>
<b>Accumulated amortization</b>			
<b>January 1, 2013</b>	\$ (21,548)	\$ (10,273)	\$ (31,821)
Amortization charge	(7,023)	(5,052)	(12,075)
Disposals	3,700	–	3,700
Currency translation effects	–	180	180
<b>December 31, 2013</b>	<b>\$ (24,871)</b>	<b>\$ (15,145)</b>	<b>\$ (40,016)</b>
<b>Net book value – December 31, 2013</b>	<b>\$ 7,198</b>	<b>\$ 16,724</b>	<b>\$ 23,922</b>
<b>Total intangible assets</b>			
<b>Acquired value</b>			
January 1, 2012	\$ 38,300	\$ 15,875	\$ 54,175
Reclassification	–	9,326	9,326
Disposals	(2,531)	–	(2,531)
Currency translation effects	–	(12)	(12)
December 31, 2012	\$ 35,769	\$ 25,189	\$ 60,958
<b>Accumulated amortization</b>			
January 1, 2012	\$ (15,926)	\$ (6,721)	\$ (22,647)
Amortization charge	(8,153)	(3,534)	(11,687)
Disposals	2,531	–	2,531
Currency translation effects	–	(18)	(18)
December 31, 2012	\$ (21,548)	\$ (10,273)	\$ (31,821)
<b>Net book value – December 31, 2012</b>	<b>\$ 14,221</b>	<b>\$ 14,916</b>	<b>\$ 29,137</b>

## Note 13. Goodwill and Impairment Review of Goodwill

	2013	2012
Balance, January 1	\$ 457,208	\$ 459,935
Currency translation effects	(5,994)	(2,727)
Balance, December 31	<u>\$ 451,214</u>	<u>\$ 457,208</u>

Goodwill acquired through business combinations has been allocated to the Canada and Northern U.S., Southern U.S. and Latin America and International business segments, and represents the lowest level within the entity at which the goodwill is monitored for internal management purposes. For the year ended December 31, 2013 goodwill was not impaired.

In assessing whether goodwill has been impaired, the carrying amount of the segment (including goodwill) is compared with its recoverable amount. The recoverable amount is the higher of the fair value less costs to sell and value-in-use.

The recoverable amounts for the segments have been determined based on value-in-use calculations, using discounted cash flow projections. Management has adopted a four-year projection period to assess each segment's value-in-use. The cash flow projections are based on financial budgets approved by the Board of Directors, extrapolated over a four-year period at a growth rate of 2.1 percent per annum. Management considers this a conservative long-term growth rate relative to both the economic outlook for the units in their respective markets within the oil and gas industry and the long-term growth rates experienced in the recent past by each segment.

### Key Assumptions Used in Value-In-Use Calculations:

The calculation of value-in-use for the Company's segments is most sensitive to the following assumptions:

- Earnings Before Finance Costs and Taxes: Management has made estimates relating to the amount and timing of revenue recognition for projects included in backlog, and the assessment of the likelihood of maintaining and growing market share. For each 1 percent change in earnings before finance costs and taxes, the average impact on the value-in-use of the Company's three segments would be \$7.3 million; and
- Discount Rate: Management has used an average pre-tax discount rate of 12.0 percent per annum which is derived from the estimated weighted average cost of capital of the Company. This discount rate has been calculated using an estimated risk-free rate of return adjusted for the Company's estimated equity market risk premium, the Company's cost of debt, and the tax rate in the local jurisdiction. For each 1 percent change in the discount rate, the average impact on the value-in-use of the Company's three segments would be \$57.3 million.

The 1 percent change in earnings before finance costs and taxes, as well as the 1 percent change in discount rate would not trigger an impairment.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## Note 14. Accounts Payable and Accrued Liabilities

December 31,	2013	2012
Accounts payable and accrued liabilities	<b>\$ 149,214</b>	\$ 163,672
Accrued dividend payable	<b>5,854</b>	5,436
Cash-settled share-based payments	<b>1,416</b>	167
	<b>\$ 156,484</b>	\$ 169,275

## Note 15. Provisions

December 31,	2013	2012
Warranty provision	<b>\$ 14,645</b>	\$ 14,669
Legal provision	<b>503</b>	2,500
	<b>\$ 15,148</b>	\$ 17,169

2013	Warranty provision	Legal provision	Total
Balance, January 1	<b>\$ 14,669</b>	<b>\$ 2,500</b>	<b>\$ 17,169</b>
Net additions during the year	<b>12,784</b>	–	<b>12,784</b>
Net amounts settled and released in the year	<b>(13,642)</b>	<b>(2,000)</b>	<b>(15,642)</b>
Currency translation effects	<b>834</b>	<b>3</b>	<b>837</b>
Balance, December 31	<b>\$ 14,645</b>	<b>\$ 503</b>	<b>\$ 15,148</b>

2012	Warranty provision	Legal provision	Total
Balance, January 1	\$ 12,345	\$ 608	\$ 12,953
Additions (reversals) during the year	15,876	(15)	15,861
Reclassification from accrued liabilities	–	2,000	2,000
Net amounts settled and released in the year	(13,359)	(91)	(13,450)
Currency translation effects	(193)	(2)	(195)
Balance, December 31	<b>\$ 14,669</b>	<b>\$ 2,500</b>	<b>\$ 17,169</b>

## Note 16. Long-Term Debt

Through private placement, the Company has \$90.5 million of unsecured notes (“Notes”) issued and outstanding. These Notes consist of \$50.5 million, with a coupon of 4.8 percent, maturing on June 22, 2016 and \$40.0 million, with a coupon of 6.0 percent, maturing on June 22, 2021.

The Company has syndicated revolving credit facilities (“Bank Facilities”) with an amount available of \$345.0 million. The Bank Facilities consist of a committed 4-year \$270.0 million revolving credit facility (the “Revolver”), a committed 4-year \$10.0 million operating facility (the “Operator”), a committed 4-year \$40.0 million Australian operating facility (the “Australian Operator”) and two committed 4-year \$12.5 million bi-lateral letter of credit facilities (collectively known as the “LC Bi-Lateral”). The Revolver, Operator, Australian Operator and LC Bi-Lateral are collectively referred to as the Bank Facilities. The weighted average interest rate on the Bank Facilities for the year ended December 31, 2013 was 3.1 percent (December 31, 2012 – 3.0 percent).

The Bank Facilities have a maturity date of June 1, 2017 ("Maturity Date"), but may be extended annually on or before the anniversary date with the consent of the lenders. In addition, the Bank Facilities may be increased by \$50.0 million at the request of the Company, subject to the lenders' consent. There is no required or scheduled repayment of principal until the Maturity Date of the Bank Facilities.

Drawings on the Bank Facilities are available by way of Prime Rate loans ("Prime"), U.S. Base Rate loans, London Interbank Offered Rate ("LIBOR") loans, and Bankers' Acceptance ("BA") notes. The Company may also draw on the Bank Facilities through bank overdrafts in either Canadian or U.S. dollars and issue letters of credit under the Bank Facilities.

Pursuant to the terms and conditions of the Bank Facilities, a margin is applied to drawings on the Bank Facilities in addition to the quoted interest rate. The margin is established in basis points and is based on a consolidated net debt to earnings before finance costs, income taxes, depreciation and amortization ("EBITDA") ratio. The margin is adjusted effective the first day of the third month following the end of each fiscal quarter based on the above ratio.

In addition to the Bank Facilities, the Company also has a committed facility with one of the lenders in the Bank Facilities for the issuance of letters of credit (the "Bi-Lateral"). The amount available under the Bi-Lateral is \$50.0 million and has a maturity date of June 1, 2015, which may be extended annually with the consent of the lender. Drawings on the Bi-Lateral are by way of letters of credit.

Also in addition to the Bank Facilities, the Company has a committed facility with a U.S. lender ("U.S. Facility") in the amount of USD\$20.0 million. Drawings on the U.S. Facility are by way of LIBOR loans, U.S. Base Rate loans and letters of credit. The maturity date of the U.S. Facility is July 1, 2015, and may be extended annually at the request of the Company, subject to the U.S. Lenders consent. There are no required or scheduled repayments of principal until the maturity date of the U.S. Facility.

The Company has a \$10.0 million on-demand revolving letter of credit facility (the "LC Facility") with one of the lenders in its Bank Facilities syndicate for purposes of issuing letters of credit. The maturity date on the LC Facility is June 1, 2017.

The Bank Facilities, the Bi-Lateral, the U.S. Facility and the LC Facility are unsecured and rank pari passu with the Notes. The Company is required to maintain certain covenants on the Bank Facilities, the Bi-Lateral, the U.S. Facility and the Notes. As at December 31, 2013, the Company was in compliance with these covenants.

The composition of the borrowings on the Bank Facilities and the Notes was as follows:

December 31,	<b>2013</b>	2012
Drawings on Bank Facilities	<b>\$ 5,000</b>	\$ 8,835
Notes due June 22, 2016	<b>50,500</b>	50,500
Notes due June 22, 2021	<b>40,000</b>	40,000
Deferred transaction costs	<b>(2,565)</b>	(2,866)
	<b>\$ 92,935</b>	\$ 96,469

At December 31, 2013, without considering renewal of similar terms, the Canadian dollar equivalent principal payments due over the next five years are \$55.5 million, and \$40.0 million thereafter.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## Note 17. Guarantees, Commitments and Contingencies

At December 31, 2013, the Company had outstanding letters of credit of \$87.9 million (December 31, 2012 – \$74.5 million).

The Company is involved in litigation and claims associated with normal operations against which certain provisions have been made in the financial statements. Management is of the opinion that any resulting settlement arising from the litigation would not materially affect the financial position, results of operations or liquidity of the Company.

Operating leases relate to leases of equipment, automobiles and premises with lease terms between one and ten years. The material lease arrangements generally include renewal and escalation clauses.

The aggregate minimum future required lease payments over the next five years and thereafter is as follows:

2014	\$	5,181
2015		4,091
2016		3,756
2017		3,175
2018		3,010
Thereafter		3,375
Total	\$	<u>22,588</u>

In addition, the Company has purchase obligations over the next three years as follows:

2014	\$	37,401
2015		781
2016		629

## Note 18. Income Taxes

### (a) Income Tax Recognized in Net Earnings

The components of income tax expense were as follows:

Years ended December 31,	2013	2012
Current tax	\$ 23,256	\$ 22,435
Deferred income tax	849	6,992
	<u>\$ 24,105</u>	<u>\$ 29,427</u>

## Reconciliation of Tax Expense

The provision for income taxes attributable to continuing operations differs from that which would be expected by applying Canadian statutory rates. A reconciliation of the difference is as follows:

Years ended December 31,	2013	2012
Earnings before income taxes from continuing operations	\$ 81,823	\$ 111,680
Canadian statutory rate	25.0%	25.0%
Expected income tax provision	\$ 20,456	\$ 27,920
Add (deduct)		
Earnings taxed in foreign jurisdictions	4,507	1,546
Expenses not deductible for tax purposes	504	427
Impact of equity-accounted earnings	(1,308)	(458)
Other	(54)	(8)
Income tax expense	\$ 24,105	\$ 29,427

The applicable tax rate is the aggregate of the Canadian federal income tax rate of 15.0 percent (2012 – 15.0 percent) and the provincial income tax rate of 10.0 percent (2012 – 10.0 percent).

## (b) Income Tax Recognized in Other Comprehensive Income

Years ended December 31,	2013	2012
<b>Deferred Tax</b>		
Arising on income and expenses recognized in other comprehensive income:		
Fair value remeasurement of hedging instruments entered into for cash flow hedges	\$ (649)	\$ 116
Arising on income and expenses reclassified from other comprehensive income to net earnings:		
Relating to cash flow hedges	63	(130)
Total income tax recognized in other comprehensive income	\$ (586)	\$ (14)

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## (c) Net Deferred Tax Assets (Liability)

Deferred tax assets and liabilities arise from the following:

	Accounting provisions and accruals	Tax losses	Property, Plant and Equipment	Other	Cash flow hedges	Total
January 1, 2013	\$ 22,752	\$ 16,542	\$ (8,858)	\$ 2,097	\$ (157)	\$ 32,376
Charged to net earnings	(664)	(3,641)	3,900	(444)	–	(849)
Charged to other comprehensive income	–	–	–	–	586	586
Exchange differences	563	(371)	(301)	–	(5)	(114)
December 31, 2013	\$ 22,651	\$ 12,530	\$ (5,259)	\$ 1,653	\$ 424	\$ 31,999

	Accounting provisions and accruals	Tax losses	Property, Plant and Equipment	Other	Cash flow hedges	Total <sup>1</sup>
January 1, 2012	\$ 20,132	\$ 26,652	\$ (9,847)	\$ 2,745	\$ (101)	\$ 39,581
Charged to net earnings	2,534	(9,772)	894	(648)	–	(6,992)
Charged to other comprehensive income	–	–	–	–	14	14
Exchange differences	86	(338)	95	–	(70)	(227)
December 31, 2012	\$ 22,752	\$ 16,542	\$ (8,858)	\$ 2,097	\$ (157)	\$ 32,376

<sup>1</sup> Net deferred tax assets at December 31, 2012 of \$32.4 million consist of assets of \$32.8 million net of liabilities of \$0.4 million.

## (d) Unrecognized Deferred Tax Assets

The Company has unused tax losses of \$56.7 million which arose in European discontinued operations for the year ended December 31, 2013 (December 31, 2012 – \$45.4 million). These unrecognized tax losses are subject to expiration in the years 2017 through 2022. Deferred tax assets totalling \$14.2 million on these tax losses have not been recognized in the consolidated statements of financial position at December 31, 2013 (December 31, 2012 – \$11.4 million).

## Note 19. Share Capital

### Authorized

The Company is authorized to issue an unlimited number of common shares. Share capital comprises only one class of ordinary shares. The ordinary shares carry a voting right and a right to a dividend.

### Issued and Outstanding

	2013		2012	
	Number of common shares	Common share capital	Number of common shares	Common share capital
Balance, January 1	77,670,981	\$ 212,875	77,339,781	\$ 207,409
Exercise of stock options	461,980	8,026	331,200	5,466
Cancelled shares	(6,132)	–	–	–
Balance, December 31	78,126,829	\$ 220,901	77,670,981	\$ 212,875

Total dividends declared in the year were \$22.2 million, or \$0.07 per share for the first three quarters and \$0.075 per share for the last quarter of 2013 (December 31, 2012 – \$19.4 million, or \$0.06 per share for the first three quarters and \$0.07 per share for the last quarter of 2012).

### Normal Course Issuer Bid ("NCIB")

On December 19, 2012, Enerflex received acceptance from the Toronto Stock Exchange ("TSX") of the Company's intention to make an NCIB to purchase up to 6.3 million of the public float of its common shares, representing approximately 10 percent of common shares then outstanding. Purchases made under the bid can be executed on the TSX in the 12 months following commencement of the bid on December 21, 2012. During the year ended December 31, 2013, Enerflex did not purchase any of its common shares.

### Note 20. Contributed Surplus

Contributed surplus consists of accumulated stock option expense less the fair value of the options at the grant date that have been exercised and reclassified to share capital. Changes in contributed surplus were as follows:

	2013	2012
Balance, January 1	<b>\$ 655,879</b>	\$ 656,536
Share-based compensation	<b>1,500</b>	1,412
Exercise of stock options	<b>(2,841)</b>	(2,069)
Balance, December 31	<b>\$ 654,538</b>	\$ 655,879

### Note 21. Revenue

Years ended December 31,	2013	2012
Engineered Systems	<b>\$ 1,030,030</b>	\$ 1,178,377
Service	<b>325,428</b>	284,158
Rentals	<b>49,564</b>	39,149
	<b>\$ 1,405,022</b>	\$ 1,501,684

Proceeds received and receivable from the sale of rental equipment included in revenue for the year ended December 31, 2013 was \$21.7 million (2012 – \$8.2 million).

Revenue by geographic location, which is attributed by destination of sale, was as follows:

Years ended December 31,	2013	2012
Australia	<b>\$ 241,347</b>	\$ 314,102
Canada	<b>408,386</b>	438,478
Nigeria	<b>21,986</b>	35,828
Oman	<b>101,162</b>	99,862
United States	<b>501,935</b>	478,189
Other	<b>130,206</b>	135,225
Total Revenue	<b>\$ 1,405,022</b>	\$ 1,501,684

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## Note 22. Share-Based Compensation

### (a) Stock Options

The Company maintains a stock option program for non-employee and directors. Under the plan, up to 7.7 million options may be granted for subsequent exercise in exchange for common shares.

The stock option plan entitles the holder to acquire shares of the Company at the strike price, established at the time of the grant, after vesting and before expiry. The strike price of each option equals the weighted average of the market price of the Company's shares on the five days preceding the effective date of the grant. The options have a seven-year term and vest at a rate of one-fifth on each of the five anniversaries of the date of the grant.

	2013		2012	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Options outstanding, January 1	2,655,575	\$ 11.71	2,563,985	\$ 11.53
Granted	507,557	14.33	486,915	11.78
Exercised <sup>1</sup>	(461,980)	11.22	(331,200)	10.26
Forfeited	(17,600)	11.71	(62,700)	12.67
Expired	(4,350)	10.72	(1,425)	9.57
<b>Options outstanding, December 31</b>	<b>2,679,202</b>	<b>\$ 12.30</b>	2,655,575	\$ 11.71
<b>Options exercisable, December 31</b>	<b>1,109,253</b>	<b>\$ 11.82</b>	1,100,800	\$ 11.60

<sup>1</sup> The weighted average share price at the date of the exercise for the year ended December 31, 2013 was \$13.48 (December 31, 2012 – \$12.51).

The Company granted 507,557 stock options during 2013 (2012 – 486,915). Using the Black-Scholes option pricing model, the weighted average fair value of stock options granted during the year ended December 31, 2013 was \$3.81 per option (December 31, 2012 – \$3.62).

The weighted average assumptions used in the determination of fair value are noted below:

	2013	2012
Expected life (years)	5.0	5.0
Expected volatility <sup>2</sup>	30.8%	47.3%
Dividend yield	2.1%	2.0%
Risk-free rate	2.6%	1.2%
Estimated forfeiture rate	0.4%	0.4%

<sup>2</sup> Expected volatility is based on Enerflex and its peers over a five-year period, consistent with the expected life of the option.

The following table summarizes options outstanding and exercisable at December 31, 2013:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Number outstanding	Weighted average remaining life (years)	Weighted average exercise price	Number outstanding	Weighted average exercise price
\$9.61 – \$11.96	1,461,945	4.43	\$ 11.33	606,953	\$ 11.03
\$11.97 – \$14.33	1,217,257	4.19	13.46	502,300	12.78
<b>Total</b>	<b>2,679,202</b>	<b>4.32</b>	<b>\$ 12.30</b>	<b>1,109,253</b>	<b>\$ 11.82</b>

### (b) Deferred Share Units

The Company offers a DSU plan for executives and non-employee directors, whereby they may elect on an annual basis to receive all or a portion of their annual bonus, or retainer and fees, respectively, in deferred share units. In addition, the Board may grant discretionary DSUs to executives. A specified component of non-employee directors' compensation must be received in DSUs. A DSU is a notional unit that entitles the holder to receive payment, as described below, from the Company equal to the implied market value calculated as the number of DSUs multiplied by the weighted average price per share at which Enerflex's shares on the TSX for the five trading days immediately preceding the grant.

Additional Enerflex DSUs will be credited on the regular dividend payment dates as all dividends are assumed to be reinvested.

DSUs may be granted to eligible participants on an annual basis and will vest upon being credited to the executive or non-employee director's account. Participants are not able to cash in their DSUs until they are no longer employed by or cease to be directors of Enerflex. The Company satisfies its payment obligation through cash payments to the participant.

DSUs represent an indexed liability of the Company relative to the Company's share price. In 2013, the Board of Directors granted 5,096 DSUs (December 31, 2012 – 6,213) to executives of the Company. For the year ended December 31, 2013, the value of directors' compensation and executive bonuses elected to be received in DSUs totalled \$1.4 million (December 31, 2012 – \$0.8 million).

	Number of DSUs	Weighted average grant date fair value per unit
DSUs outstanding, January 1, 2013	109,818	\$ 11.46
Granted or elected	109,334	13.53
In lieu of dividends	3,006	11.92
Redeemed	(23,808)	14.28
<b>DSUs outstanding, December 31, 2013</b>	<b>198,350</b>	<b>\$ 12.27</b>

The carrying amount of the liability relating to DSUs included in Other Long-Term Liabilities at December 31, 2013 was \$3.0 million (December 31, 2012 – \$1.3 million).



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## (c) Phantom Share Rights

The Company utilizes a SAR plan for key employees of affiliates located in Australia, the UAE and Singapore, for whom the Company's stock option plan would have negative personal taxation consequences.

The exercise price of each SAR equals the average of the market price of the Company's shares on the five days preceding the date of the grant. The SARs vest at a rate of one-fifth on each of the first five anniversaries of the date of the grant and expire on the fifth anniversary. The award entitlements for increases in the share trading value of the Company are to be paid to the recipient in cash upon exercise.

In 2013, the Board of Directors granted 110,349 SARs (December 31, 2012 – 99,567). The intrinsic value of the vested awards at December 31, 2013 was \$0.7 million (December 31, 2012 – \$0.1 million).

	Number of SARs	Weighted average grant date fair value per unit
SARs outstanding, January 1, 2013	158,567	\$ 11.29
Granted	110,349	14.33
<b>SARs outstanding, December 31, 2013</b>	<b>268,916</b>	<b>\$ 12.54</b>

The carrying amount of the liability relating to the SARs included in Other Long-Term Liabilities at December 31, 2013 was \$0.7 million (December 31, 2012 – \$0.1 million).

## (d) Performance Share Units

The Company offers a PSU plan for officers of the Company or its related entities. The PSU is a notional unit that entitles the holder to receive payment, as described below, from the Company equal to the number of vested PSUs multiplied by the weighted average price per share at which the shares of the Company have traded on the TSX during the last 5 trading days immediately preceding the grant. Vesting is based on the achievement of performance measures and objectives specified by the Board of Directors. The Board of Directors assesses performance of the officer to determine the vesting percentage, which can range from 0 percent – 200 percent. On the 14th day after the determination of the vesting percentage, the holder will be paid for the vested PSUs either in cash or in shares of the Company acquired by the Company on the open market on behalf of the holder, at the discretion of the Company.

Additional Enerflex PSUs will be credited on the regular dividend payment dates as all dividends are assumed to be reinvested.

	Number of PSUs	Weighted average grant date fair value per unit
PSUs outstanding, January 1, 2013	137,954	\$ 11.83
Granted	117,368	14.33
In lieu of dividends	2,945	11.83
<b>PSUs outstanding, December 31, 2013</b>	<b>258,267</b>	<b>\$ 12.97</b>

The carrying amount of the liability relating to PSUs included in Other Long-Term Liabilities at December 31, 2013 was \$1.7 million (December 31, 2012 – \$0.6 million). No PSUs had vested at December 31, 2013 and 2012.

### (e) Restricted Share Units

The Company offers an RSU plan to officers and other key employees of the Company or its related entities. RSUs may be granted at the discretion of the Board of Directors. An RSU is a notional unit that entitles the holder to receive payment, as described below, from the Company equal to the number of vested RSUs multiplied by the weighted average price per share at which the shares of the Company have traded on the TSX during the last 5 trading days immediately preceding the vesting date. RSUs vest at a rate of one-third on the first, second and third anniversaries of the award date. Within 30 days of the vesting date, the holder will be paid for the vested RSUs either in cash or in shares of the Company acquired by the Company on the open market on behalf of the holder, at the discretion of the Company.

Additional Enerflex RSUs will be credited on the regular dividend payment dates as all dividends are assumed to be reinvested.

During 2013, the Board of Directors granted 223,713 RSUs to officers or key employees of the Company (December 31, 2012 – 226,447). The company paid \$1.1 million for the period ended December 31, 2013 representing units vested in the year (December 31, 2012 – nil).

	Number of RSUs	Weighted average grant date fair value per unit
RSUs outstanding, January 1, 2013	226,447	\$ 11.04
Granted	223,713	14.33
In lieu of dividends	3,112	11.04
Vested	(76,233)	14.65
<b>RSUs outstanding, December 31, 2013</b>	<b>377,039</b>	<b>\$ 12.26</b>

The carrying amount of the liability relating to RSUs at December 31, 2013 was \$1.0 million (December 31, 2012 – \$0.1 million).

### (f) Employee Share Ownership Plan

The Company offers an employee share ownership plan whereby employees who meet the eligibility criteria can purchase shares by way of payroll deductions. There is a Company match of up to \$1,000 per employee per annum based on contributions by the Company of \$1 for every \$3 contributed by the employee. Company contributions vest to the employee immediately. Company contributions are charged to selling and administrative expense when paid. This plan is administered by a third party.

### (g) Share-Based Compensation Expense

The share-based compensation expense included in the determination of net earnings was:

Years ended December 31,	2013	2012
Stock options	\$ 1,500	\$ 1,412
Deferred share units	1,422	996
Phantom share units	534	128
Performance share units	1,477	556
Restricted share units	2,021	75
Total share-based compensation expense	\$ 6,954	\$ 3,167

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## Note 23. Retirement Benefit Plans

The Company sponsors arrangements for substantially all of its employees through defined contribution plans in Canada, the Middle East and Australia, and a 401(k) matched savings plan in the United States. In the case of the defined contribution plans, regular contributions are made to the employees' individual accounts, which are administered by a plan trustee, in accordance with the plan document. Both in the case of the defined contribution plans and the 401(k) matched savings plan, the pension expenses recorded in earnings are the amounts of actual contributions the Company is required to make in accordance with the terms of the plans.

Years ended December 31,	2013		2012	
Defined contribution plans	\$	9,374	\$	10,324
401(k) matched savings plan		1,124		899
Net pension expense	\$	10,498	\$	11,223

## Note 24. Finance Costs and Income

Years ended December 31,	2013		2012	
<b>Finance Costs</b>				
Long-term borrowings	\$	5,942	\$	6,406
Short-term borrowings		134		355
Total finance costs	\$	6,076	\$	6,761
<b>Finance Income</b>				
Bank interest income	\$	316	\$	554
Income from finance leases		242		546
Total finance income	\$	558	\$	1,100

## Note 25. Reconciliation of Earnings Per Share Calculations

Years ended December 31,	2013			2012		
	Net earnings	Weighted average shares outstanding	Per share	Net earnings	Weighted average shares outstanding	Per share
Basic	\$ 55,866	77,923,314	\$ 0.72	\$ 71,774	77,590,203	\$ 0.92
Dilutive effect of stock option conversion	–	320,615	(0.01)	–	95,567	–
Diluted	\$ 55,866	78,243,929	\$ 0.71	\$ 71,774	77,685,770	\$ 0.92

## Note 26. Financial Instruments

### Designation and Valuation of Financial Instruments

The Company has designated its financial instruments as follows:

December 31, 2013	Carrying value	Estimated fair value
<b>Financial Assets</b>		
Cash and cash equivalents	\$ 181,973	\$ 181,973
Derivative instruments in designated hedge accounting relationships	358	358
Loans and receivables:		
Accounts receivable	331,170	331,170
<b>Financial Liabilities</b>		
Derivative instruments in designated hedge accounting relationships	1,518	1,518
Other financial liabilities:		
Accounts payable and accrued liabilities	156,484	156,484
Long-term debt – Bank Facilities	5,000	5,000
Long-term debt – Notes	90,500	95,021
Other long-term liabilities	6,823	6,823
<hr/>		
December 31, 2012	Carrying value	Estimated fair value
<b>Financial Assets</b>		
Cash and cash equivalents	\$ 144,988	\$ 144,988
Derivative instruments in designated hedge accounting relationships	1,737	1,737
Loans and receivables:		
Accounts receivable	287,387	287,387
<b>Financial Liabilities</b>		
Derivative instruments in designated hedge accounting relationships	596	596
Other financial liabilities:		
Accounts payable and accrued liabilities	169,275	169,275
Long-term debt – Bank Facilities	8,835	8,835
Long-term debt – Notes	90,500	97,808
Other long-term liabilities	3,478	3,478

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## Fair Values of Financial Assets and Liabilities

The following table presents information about the Company's financial assets and financial liabilities measured at fair value on a recurring basis as at December 31, 2013 and indicates the fair value hierarchy of the valuation techniques used to determine such fair value. During the year ended December 31, 2013, there were no transfers between Level 1 and Level 2 fair value measurements.

Fair values are determined using inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. Fair values determined using inputs including forward market rates and credit spreads that are readily observable and reliable, or for which unobservable inputs are determined not to be significant to the fair value, are categorized as Level 2. If there is no active market, fair value is established using valuation techniques, including discounted cash flow models. The inputs to these models are taken from observable market data where possible, including recent arm's-length market transactions, and comparisons to the current fair value of similar instruments; but where this is not feasible, inputs such as liquidity risk, credit risk and volatility are used.

	Carrying value	Level 1	Fair value Level 2	Level 3
<b>Financial Assets</b>				
Derivative financial instruments	\$ 358	\$ –	\$ 358	\$ –
<b>Financial Liabilities</b>				
Derivative financial instruments	\$ 1,518	\$ –	\$ 1,518	\$ –

Cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities are reported at amounts approximating their fair values on the statement of financial position. The fair values approximate the carrying values for these instruments due to their short-term nature.

The fair value of derivative financial instruments is measured using the discounted value of the difference between the contract's value at maturity based on the contracted foreign exchange rate and the contract's value at maturity based on prevailing exchange rates. The financial institution's credit risk is also taken into consideration in determining fair value.

Long-term debt associated with the Company's Notes is recorded at amortized cost using the effective interest rate method. The amortized cost of the Notes is equal to the face value as there were no premiums or discounts on the issuance of the debt. Transaction costs associated with the debt were deducted from the debt and are being recognized using the effective interest rate method over the life of the related debt. The fair value of these Notes determined on a discounted cash flow basis, using a weighted average discount rate of 4.1 percent, was \$95.0 million at December 31, 2013.

## Derivative Financial Instruments and Hedge Accounting

Foreign exchange contracts are transacted with financial institutions to hedge foreign currency denominated obligations and cash receipts related to purchases of inventory and sales of products.

The following table summarizes the Company's commitments to buy and sell foreign currencies as at December 31, 2013:

		Notional amount	Maturity
<b>Canadian Dollar Denominated Contracts</b>			
Purchase contracts	USD	<b>18,419</b>	January 2014 – January 2015
	EUR	<b>103</b>	March 2014
Sales contracts	USD	<b>56,181</b>	January 2014 – January 2015
	AUD	<b>12,000</b>	January 2014
<b>U.S. Dollar Denominated Contracts</b>			
Purchase contracts	AUD	<b>6,760</b>	January 2014 – May 2014
<b>British Pound Denominated Contracts</b>			
Purchase contracts	EUR	<b>450</b>	January 2014 – April 2014

Management estimates that a loss of \$1.2 million would be realized if the contracts were terminated on December 31, 2013. Certain of these forward contracts are designated as cash flow hedges and, accordingly, a loss of \$2.9 million has been included in other comprehensive income for the year 2013. These gains or losses are not expected to affect net earnings as the gains will be reclassified to net earnings and will offset losses recorded on the underlying hedged items, namely foreign currency denominated accounts payable and accounts receivable. The amount removed from other comprehensive income during the year and included in the carrying amount of the hedged items for the year 2013 was a gain of \$0.3 million (December 31, 2012 – loss of \$0.4 million).

All hedging relationships are formally documented, including the risk management objective and strategy. On an ongoing basis, an assessment is made as to whether the designated derivative financial instruments continue to be effective in offsetting changes in cash flows of the hedged transactions.

### Risks Arising from Financial Instruments and Risk Management

In the normal course of business, the Company is exposed to financial risks that may potentially impact its operating results in any or all of its business segments. The Company employs risk management strategies with a view to mitigating these risks on a cost-effective basis. Derivative financial agreements are used to manage exposure to fluctuations in exchange rates and interest rates. The Company does not enter into derivative financial agreements for speculative purposes.

### Foreign Currency Translation Exposure

In the normal course of operations, the Company is exposed to movements in the U.S. dollar, the Australian dollar and the British Pound. In addition, Enerflex has significant international exposure through export from its Canadian operations as well as a number of foreign subsidiaries, the most significant of which are located in the United States, Australia, the United Kingdom and the United Arab Emirates. The Company does not hedge its net investment exposure in foreign subsidiaries.

The types of foreign exchange risk and the Company's related risk management strategies are as follows:

### Transaction Exposure

The Canadian operations of the Company source the majority of its products and major components from the United States. Consequently, reported costs of inventory and the transaction prices charged to customers for equipment and parts are affected by the relative strength of the Canadian dollar. The Company also sells compression and processing packages in foreign currencies, primarily the U.S. dollar and the Australian dollar. Most of Enerflex's international orders are manufactured in the United States if the contract is denominated in U.S. dollars. This minimizes the Company's foreign currency exposure on these contracts.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The Company identifies and hedges all significant transactional currency risks. The Company has implemented a hedging policy, applicable primarily to the Canadian domiciled business units, with the objective of securing the margins earned on awarded contracts denominated in currencies other than Canadian dollars. In addition, the Company may hedge input costs that are paid in a currency other than the home currency of the subsidiary executing the contract. The Company utilizes a combination of foreign denominated debt and currency forward contracts to meet its hedging objectives.

## Translation Exposure

The Company's earnings from and net investment in foreign subsidiaries are exposed to fluctuations in exchange rates. The currencies with the most significant impact are the U.S. dollar, Australian dollar and British pound.

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars using the exchange rates in effect at the reporting dates. Non-monetary assets and liabilities measured at historical cost are translated using the rates of exchange at the date of the transaction. Unrealized translation gains and losses are deferred and included in accumulated other comprehensive income. The cumulative currency translation adjustments are recognized in earnings when there has been a reduction in the net investment in the foreign operations.

Earnings from foreign operations are translated into Canadian dollars each period at average exchange rates for the period. As a result, fluctuations in the value of the Canadian dollar relative to these other currencies will impact reported net earnings. Such exchange rate fluctuations have historically not been material year-over-year relative to the overall earnings or financial position of the Company. The following table shows the effect on net earnings before tax for year 2013 of a 5 percent weakening of the Canadian dollar against the U.S. dollar, Australian dollar and British Pound, everything else being equal. A 5 percent strengthening of the Canadian dollar would have an equal and opposite effect. This sensitivity analysis is provided as an indicative range in a volatile currency environment.

<b>Canadian dollar weakens by 5 percent</b>	<b>USD</b>	<b>AUD</b>	<b>GBP</b>
Net earnings before tax	\$ 2,863	\$ 664	\$ 152

The movement in net earnings before tax in Canadian operations is a result of a change in the fair values of financial instruments. The majority of these financial instruments are hedged.

## Sensitivity Analysis

The following sensitivity analysis is intended to illustrate the sensitivity to changes in foreign exchange rates on the Company's financial instruments and show the impact on net earnings and other comprehensive income. Financial instruments affected by currency risk include cash and cash equivalents, accounts receivable, accounts payable and derivative financial instruments. The following table shows the Company's sensitivity to a 5 percent weakening of the Canadian dollar against the U.S. dollar, Australian dollar, and British pound. A 5 percent strengthening of the Canadian dollar would have an equal and opposite effect. This sensitivity analysis relates to the position as at December 31, 2013 and for the year then ended.

<b>Canadian dollar weakens by 5 percent</b>	<b>USD</b>	<b>AUD</b>	<b>GBP</b>
Financial instruments held in foreign operations			
Other comprehensive income	\$ 9,648	\$ 2,014	\$ 436
Financial instruments held in Canadian operations			
Net earnings before tax	\$ 622	\$ -	\$ -

### **Interest Rate Risk**

The Company's liabilities include long-term debt that is subject to fluctuations in interest rates. The Company's Notes outstanding at December 31, 2013 include interest rates that are fixed and therefore the related interest expense will not be impacted by fluctuations in interest rates. The Company's Bank Facilities, however, are subject to changes in market interest rates. For each 1 percent change in the rate of interest on the Bank Facilities, the change in interest expense would be approximately \$0.1 million. All interest charges are recorded on the consolidated statement of earnings as a separate line item called finance costs.

### **Credit Risk**

Financial instruments that potentially subject the Company to credit risk consist of cash equivalents, accounts receivable, net investment in finance lease, and derivative financial instruments.

The Company has accounts receivable from clients engaged in various industries. These specific industries may be affected by economic factors that may impact accounts receivable. Credit quality of the customer is assessed based on an extensive credit rating scorecard and individual credit limits are defined in accordance with this assessment. Credit is extended based on an evaluation of the customer's financial condition and, generally, advance payment is not required. For the years ended December 31, 2013 and 2012, the Company had no individual customers which accounted for more than 10 percent of its revenues. Outstanding customer receivables are regularly monitored and an allowance for doubtful accounts is established based upon specific situations.

The Company evaluates the concentration of risk at December 31, 2013 with respect to trade receivables as low, as its customers are located in several jurisdictions and industries and operate in largely independent markets. The maximum exposure to credit risk at the reporting date is the carrying value of each class of financial assets disclosed in this note. The Company does not hold collateral as security.

The credit risk associated with the net investment in finance leases arises from the possibility that the counterparties may default on their obligations. In order to minimize this risk, the Company enters into finance lease transactions only in select circumstances. Close contact is maintained with the customer over the duration of the lease to ensure visibility to issues as and if they arise.

The credit risk associated with derivative financial instruments arises from the possibility that the counterparties may default on their obligations. In order to minimize this risk, the Company enters into derivative transactions only with highly-rated financial institutions.

### **Liquidity Risk**

Liquidity risk is the risk that the Company may encounter difficulties in meeting obligations associated with financial liabilities. In managing liquidity risk, the Company has access to a significant portion of its U.S. Facilities and Bank Facilities for future drawings to meet the Company's future growth targets. As at December 31, 2013, the Company held cash and cash equivalents of \$182.0 million and had drawn \$5.0 million against the Bank Facilities, leaving it with access to \$297.5 million for future drawings.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

A liquidity analysis of the Company's financial instruments has been completed on a maturity basis. The following table outlines the cash flows, including interest associated with the maturity of the Company's financial liabilities, as at December 31, 2013:

	Less than 3 months	3 months to 1 year	Greater than 1 year	Total
Derivative financial instruments				
Foreign currency forward contracts	\$ 848	\$ 609	\$ 61	\$ 1,518
Accounts payable and accrued liabilities	156,484	–	–	156,484
Long-term debt – Bank Facilities	–	–	5,000	5,000
Long-term debt – Notes	–	–	90,500	90,500
Other long-term liabilities	–	–	6,823	6,823

The Company expects that cash flows from operations in 2014, together with cash and cash equivalents on hand and credit facilities, will be more than sufficient to fund its requirements for investments in working capital, and capital assets.

## Note 27. Capital Disclosures

The capital structure of the Company consists of shareholders' equity plus net (cash) debt. The Company manages its capital to ensure that entities in the Company will be able to continue to grow while maximizing the return to shareholders through the optimization of the debt and equity balances. The Company makes adjustments to its capital structure in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, issue new Company shares, or access debt markets.

The Company formally reviews the capital structure on an annual basis and monitors it on an ongoing basis. As part of this review, the cost of capital and the risks associated with each class of capital are considered. In order to position itself to execute its long-term plan to maintain its status as a leading supplier of products and services to the global energy sector, the Company is maintaining a conservative statement of financial position. The Company uses the following measure to monitor its capital structure:

### Net (Cash) Debt to EBITDA Ratio

Net (cash) debt is defined as short and long-term debt less cash and cash equivalents as the end of the period divided by annualized EBITDA. The Company targets a net debt to EBITDA ratio of less than 2.50:1. At December 31, 2013, the net (cash) debt to EBITDA ratio was:

December 31,	2013	2012
Long-term debt	\$ 92,935	\$ 96,469
Cash	(181,973)	(144,988)
Net (cash) debt	\$ (89,038)	\$ (48,519)
Earnings before finance costs and income taxes	\$ 87,341	\$ 117,341
Depreciation and amortization	39,595	39,487
EBITDA	\$ 126,936	\$ 156,828
Net (cash) debt to EBITDA ratio	(0.70):1	(0.31):1

## Note 28. Supplemental Cash Flow Information

Years ended December 31,	2013	2012
<b>Cash (used in) provided by changes in non-cash working capital</b>		
Accounts receivable	\$ (39,848)	\$ (31,368)
Inventories	26,681	32,394
Accounts and taxes payable, accrued liabilities and deferred revenue	(18,491)	8,786
Foreign currency and other	2,729	(2,388)
	<b>\$ (28,929)</b>	<b>\$ 7,424</b>

Cash paid and received during the period:

Years ended December 31,	2013	2012
Interest paid	\$ 5,960	\$ 6,520
Interest received	552	164
Taxes paid	27,106	16,951
Taxes received	305	228

## Note 29. Related Parties

Enerflex transacts with certain related parties as a normal course of business. Related parties include Total Production Services Inc. ("Total"), the Company's 45 percent equity investment, and the Company's 51 percent joint venture interest in Enerflex-ES.

All transactions occurring with related parties were in the normal course of business operations under the same terms and conditions as transactions with unrelated companies. A summary of the financial statement impacts of all transactions with all related parties is as follows:

December 31,	2013	2012
<b>Associate – Total</b>		
Revenue	\$ 7,107	\$ 286
Purchases	14	347
Accounts Receivable	157	73
<b>Joint Venture – Enerflex-ES</b>		
Revenue	\$ 102	\$ –
Purchases	–	36
Accounts Receivable	–	–

All related party transactions are settled in cash.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The remuneration of directors and other key management personnel was as follows:

Years ended December 31,	2013	2012
Short-term compensation	\$ 4,677	\$ 4,617
Post-employment compensation	453	357
Share-based payments	4,340	3,758

The remuneration of directors and key executives is determined by the Board of Directors having regard to the performance of individuals and market trends.

## Note 30. Seasonality

The oil and natural gas service sector in Canada and the Northern U.S. has a distinct seasonal trend in activity levels which results from well-site access and drilling pattern adjustments to take advantage of weather conditions. Generally, Enerflex's Engineered Systems product line has experienced higher revenues in the fourth quarter of each year while the Service and Rentals product line revenues are stable throughout the year. Rentals revenues are also impacted by both the Company's and its customers' capital investment decisions. The international markets are not significantly impacted by seasonal variations. Variations from these trends usually occur when hydrocarbon energy fundamentals are either improving or deteriorating.

## Note 31. Segmented Information

The Company has three reportable operating segments as outlined below, each supported by the Corporate office. Corporate overheads are allocated to the operating segments based on revenue. For each of the operating segments, the Company's Chief Operating Decision Maker reviews internal management reports on at least a quarterly basis.

Effective January 1, 2013, the reporting for Enerflex's Production and Processing division was changed from the International reportable segment to the Canada and Northern U.S. segment. Prior period segmented information has been reclassified to conform with the current period's presentation.

The following summary describes the operations of each of the Company's reportable segments:

- Canada and Northern U.S. generates revenue from manufacturing (primarily compression equipment), service and rentals;
- Southern U.S. and Latin America generates revenue from the manufacture of natural gas compression equipment and process equipment in addition to generating revenue from product support services; and
- International generates revenue from manufacturing primarily process equipment, service and rentals.

The accounting policies of the reportable operating segments are the same as those described in the summary of significant accounting policies.

	Canada and Northern U.S.		Southern U.S. and Latin America		International		Total	
Years ended December 31,	2013	2012	2013	2012	2013	2012	2013	2012
Segment revenue	\$ 594,510	\$ 674,860	\$ 522,008	\$ 517,574	\$ 376,763	\$ 398,279	\$ 1,493,281	\$ 1,590,713
Intersegment revenue	(69,618)	(82,750)	(18,250)	(5,429)	(391)	(850)	(88,259)	(89,029)
External revenue	\$ 524,892	\$ 592,110	\$ 503,758	\$ 512,145	\$ 376,372	\$ 397,429	\$ 1,405,022	\$ 1,501,684
Operating income	\$ 21,937	\$ 39,964	\$ 59,765	\$ 55,937	\$ 328	\$ 18,656	\$ 82,030	\$ 114,557

	Canada and Northern U.S.		Southern U.S. and Latin America		International		Total	
December 31,	2013	2012	2013	2012	2013	2012	2013	2012
Segment assets	\$ 461,205	\$ 450,487	\$ 300,162	\$ 273,458	\$ 226,166	\$ 273,099	\$ 987,533	\$ 997,044
Goodwill	249,261	268,836	77,821	53,220	124,132	135,152	451,214	457,208
Corporate	–	–	–	–	–	–	(22,668)	(69,163)
	\$ 710,466	\$ 719,323	\$ 377,983	\$ 326,678	\$ 350,298	\$ 408,251	\$ 1,416,079	\$ 1,385,089
AHFS	–	–	–	–	–	4,175	–	4,175
Total segment assets	\$ 710,466	\$ 719,323	\$ 377,983	\$ 326,678	\$ 350,298	\$ 412,426	\$ 1,416,079	\$ 1,389,264

## Note 32. Subsequent Events

Commencing in 2013, the Company began to experience customer driven cost increases on its international project in Oman, which adversely impacted gross margin performance for both the fourth quarter and for the full year. Variation claims are being vigorously pursued. Revenue will be recognized on variation claims in the period in which they are approved. During the early part of 2014, work on this project continued to experience customer driven scope and schedule challenges, which is expected to result in further cost increases of approximately \$14.0 million to \$17.0 million in 2014 and a corresponding impact on gross margin.

Subsequent to December 31, 2013, the Company declared a dividend of \$0.075 per share, payable on April 3, 2014, to shareholders of record on March 13, 2014.