

TSX VENTURE EXCHANGE "CSA"

# Commercial

Solutions Inc



**THIRD QUARTER REPORT**  
For the Nine Months Ended June 30, 2004

To Our Shareholders:

Commercial Solutions Inc. (the "Company") (TSX-V: CSA) is pleased to announce its operating results for the third quarter and nine-month period ended June 30, 2004. This quarter represents the seventh consecutive quarter of revenue growth and sixth consecutive quarter of increased pre-tax profitability. During the third quarter, the Company generated net earnings of \$0.5 million or \$0.05 per share on consolidated revenues of \$19.6 million, up from last year's third quarter revenue figure of \$18.2 million and earnings of \$0.7 million or \$0.09 per share. For the nine-month period ended June 30, 2004 revenues were \$58.8 million as compared to \$48.9 million from the prior year with current earnings of \$1.3 million or \$0.15 per share compared to earnings of \$0.4 million or \$0.06 per share in 2003 representing a 192% increase.

Financial highlights from the third quarter are as follows:

	Three Months Ended June 30			Nine Months Ended June 30		
	2004	2003	Increase (%)	2004	2003	Increase (%)
Revenue	\$ 19,550,851	\$ 18,163,466	7.6%	\$ 58,770,548	\$ 48,923,645	20.1%
Gross profit margin (\$)	5,518,853	5,227,868	5.6%	16,621,495	13,237,027	25.6%
Gross profit margin (%)	28.2%	28.8%		28.3%	27.1%	
EBITDA	1,144,265	996,027	14.9%	3,277,972	1,373,031	138.7%
Pre-tax earnings	734,035	657,123	11.7%	2,085,142	449,160	364.2%
Net earnings	462,442	657,123	-29.6%	1,313,639	449,160	192.5%
Basic earnings per share pre-tax	\$ 0.08	\$ 0.09		\$ 0.24	\$ 0.06	
Basic earnings per share	\$ 0.05	\$ 0.09		\$ 0.15	\$ 0.06	
Diluted earnings per share	\$ 0.04	\$ 0.08		\$ 0.13	\$ 0.05	
Weighted average Issued and outstanding shares	8,836,071	7,055,628		8,834,775	7,055,628	

The overall increase in revenue and profitability is attributable to the acquisition of the Cando group of companies and the results of synergies and restructurings performed overall by the Company. In addition to its contribution towards increased revenue, the Cando group continued to strengthen the gross profit margin by 1.2% for the nine months ended June 30, 2004. Operating expenses were reduced as a percentage of sales by 1.6%, due to increased volume of sales, acquisition synergies and restructuring. The Company experiences seasonality in its business cycle, with the first quarter generally the slowest.

The Company currently has approximately \$5.0 million in tax losses available to carry forward to offset against taxable income in the future. In accordance with generally accepted accounting principles (GAAP), the Company must report income tax at its effective rate; however no income tax will actually be paid until such time as after all the tax losses carry forwards have been applied. Accordingly, management considers the income tax figure of \$771,503 (\$0.09 per share) reported for the nine months ended June 30, 2004 to be a non-cash expense.

The increase in sales and earnings reflects our successful growth through acquisitions and national customer partnerships. The expected continued strength in the energy sector bodes well for the upcoming quarters as energy generates 37% of the revenues for the Company. We are also actively pursuing additional strategic acquisitions to diversify our overall product offering and geographic market penetration.

**ON BEHALF OF THE BOARD OF DIRECTORS**

(signed) "James Barker"

James Barker, Chairman, CEO and President  
August 30, 2004

# Commercial Solutions Inc.

## Consolidated Balance Sheets

	June 30 2004 (unaudited)	June 30 2003 (unaudited)	September 30 2003 (audited)
<b>Assets</b>			
Receivables	\$ 11,207,404	\$ 9,149,384	\$ 12,356,440
Inventory	14,244,452	11,229,618	12,671,682
Prepays	500,678	514,414	428,925
	<u>25,952,534</u>	<u>20,893,416</u>	<u>25,457,047</u>
<b>Due from related parties</b>	-	-	7,184
<b>Future income tax asset</b>	1,468,940	449,000	2,233,101
<b>Capital assets</b>	2,327,534	2,210,773	2,058,935
<b>Goodwill and other assets</b>	<u>7,847,531</u>	<u>1,449,771</u>	<u>7,565,393</u>
	<u>\$ 37,596,539</u>	<u>\$ 25,002,960</u>	<u>\$ 37,321,660</u>
<b>Liabilities</b>			
Bank indebtedness	\$ 8,583,106	\$ 7,694,501	\$ 10,384,011
Payables and accruals	9,822,327	7,913,184	9,762,228
Due to related party	-	200,000	-
Current portion of notes payable	213,000	250,000	1,432,570
Current portion of long-term debt	876,456	449,400	403,516
	<u>19,494,889</u>	<u>16,507,085</u>	<u>21,982,325</u>
<b>Notes payable</b>	2,115,166	-	2,274,917
<b>Long-term debt</b>	<u>5,904,629</u>	<u>4,368,745</u>	<u>4,307,993</u>
	<u>27,514,684</u>	<u>20,875,830</u>	<u>28,565,235</u>
<b>Shareholders' Equity</b>			
Common shares	4,926,696	1,126,350	4,914,905
Preferred shares	1,968,178	1,968,178	1,968,178
Retained earnings	3,186,981	1,032,602	1,873,342
	<u>10,081,855</u>	<u>4,127,130</u>	<u>8,756,425</u>
	<u>\$ 37,596,539</u>	<u>\$ 25,002,960</u>	<u>\$ 37,321,660</u>

Approved by the Board of Directors

(signed) "James Barker"

James Barker, Director

(signed) "Don Caron"

Don Caron, Director

**Commercial**  
Solutions Inc  
**Q3-2004**

# Commercial Solutions Inc.

## Consolidated Statement of Income and Retained Earnings (unaudited)

	Three Months Ended June 30		Nine Months Ended June 30	
	2004	2003	2004	2003
Revenue	\$ 19,550,851	\$ 18,163,466	\$ 58,770,548	\$ 48,923,645
Cost of goods sold	14,031,998	12,935,598	42,149,053	35,686,618
Gross profit margin (\$)	5,518,853	5,227,868	16,621,495	13,237,027
Gross profit margin (%)	28.2%	28.8%	28.3%	27.1%
<b>Expenses</b>				
Selling, general & administrative	1,359,280	1,356,438	4,113,138	3,962,504
Salaries and benefits	3,015,308	2,875,403	9,230,385	7,901,492
	4,374,588	4,231,841	13,343,523	11,863,996
Operating income	1,144,265	996,027	3,277,972	1,373,031
<b>Other expenses</b>				
Amortization	105,778	133,509	296,908	322,053
Interest	304,452	205,395	895,922	601,818
	410,230	338,904	1,192,830	923,871
Net income before tax	734,035	657,123	2,085,142	449,160
Income taxes	271,593	-	771,503	-
Net income for the period	462,442	657,123	1,313,639	449,160
Retained earnings, beginning of period	2,724,539	375,479	1,873,342	583,442
Retained earnings, end of period	\$ 3,186,981	\$ 1,032,602	\$ 3,186,981	\$ 1,032,602
Basic earnings per share	\$ 0.05	\$ 0.09	\$ 0.15	\$ 0.06
Diluted earnings per share	\$ 0.04	\$ 0.08	\$ 0.13	\$ 0.05
Weighted average common shares outstanding	8,836,071	7,055,628	8,834,775	7,055,628

# Commercial Solutions Inc.

## Consolidated Statement of Cash Flow

(unaudited)

	Three Months		Nine Months	
	Ended June 30		Ended June 30	
	2004	2003	2004	2003
<b>Operating</b>				
Net Income (loss)	\$ 462,442	\$ 657,123	\$ 1,313,639	\$ 449,160
Items not involving cash				
Amortization	105,778	133,509	296,908	322,053
Income tax expense	271,593	-	771,503	-
	<u>839,813</u>	<u>790,632</u>	<u>2,382,050</u>	<u>771,213</u>
<b>Changes in non-cash working capital</b>	<b>1,664,817</b>	<b>(81,514)</b>	<b>(442,730)</b>	<b>(897,043)</b>
	<u>2,504,630</u>	<u>709,118</u>	<u>1,939,320</u>	<u>(125,830)</u>
<b>Investing</b>				
Purchase of capital assets	(266,101)	(120,982)	(565,507)	(225,715)
Goodwill	(282,138)	-	(282,138)	-
Cash surrender value of life ins.	-	-	-	112,198
	<u>(548,239)</u>	<u>(120,982)</u>	<u>(847,645)</u>	<u>(113,517)</u>
<b>Financing</b>				
Subordinated debenture, net	(174,450)	(71,261)	2,225,650	(149,850)
Common shares issued	11,791	-	11,791	-
Long-term debt, net	(50,457)	(32,233)	(156,074)	(350,322)
Notes payable	(303,250)	-	(1,379,321)	-
Related party advances, net	-	200,000	7,184	(124,454)
	<u>(516,366)</u>	<u>96,506</u>	<u>709,230</u>	<u>(624,626)</u>
<b>Increase (decrease) in cash and cash equivalents during the period</b>	<b>1,440,025</b>	<b>684,642</b>	<b>1,800,905</b>	<b>(863,973)</b>
<b>Bank indebtedness</b>				
Beginning of period	<u>10,023,131</u>	<u>8,379,143</u>	<u>10,384,011</u>	<u>6,830,528</u>
End of period	\$ 8,583,106	\$ 7,694,501	\$ 8,583,106	\$ 7,694,501

# **Commercial Solutions Inc.**

## **Notes to the interim Consolidated Financial Statements** (unaudited)

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### **Summary of significant accounting policies**

The unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP) and include the accounts of the Company and its wholly owned subsidiaries. These financial statements do not contain all disclosures required by Canadian GAAP for annual audited financial statements, and accordingly, the financial statements should be read in conjunction with the most recent annual financial statements.

These financial statements, in all material respects, follow the same accounting policies and method of application as the annual audited financial statements of the preceding fiscal year.

### **Reverse takeover – October 1, 2002**

Effective October 1, 2002, the Company completed a reverse takeover ("RTO") of Commercial bearing service (1966) ltd. ("CBS") and a financing for gross proceeds of \$6,390,800. Following the RTO, the Company changed its name to Commercial Solutions Inc. and consolidated its common shares on the basis of five pre-consolidation common shares for one new post consolidation common share.

### **Seasonality of sales**

The Company experiences seasonality in sales for each segment, with the industrial supply segment having the greatest exposure to the seasonality effect. The first quarter is traditionally its weakest. The oilfield parts & supplies segment experiences relatively less seasonality, but peaks in the first quarter. From a consolidation perspective, the second and fourth quarters are the strongest for the Company.

### **Subordinated debenture financing**

On December 10, 2003, the Company issued a five year, 15% coupon, \$2,500,000 subordinated debenture issued to Roynat Capital, Inc. The Company has the option to retire the debenture after three years with minimal penalty.

### **Personnel Matters**

On March 22, 2004, the Company terminated the employment of its President and CEO, Ron Gibbon. The Company offered Mr. Gibbon as a severance package to continue his current salary and benefit payments each month until March 22, 2006. The monthly payments amount to approximately \$17,000 per month. This proposed severance arrangement was in lieu of notice of termination and/or severance pay under applicable employment standards or other legislation or at common law, and is intended to be in full satisfaction of any and all claims which Mr. Gibbon may have arising out of his employment or its termination.

Mr. Gibbon rejected the offer by the Company and on June 24, 2004 filed a statement of claim for \$750,000 citing wrongful dismissal. Since the March 22, 2004 termination, the Company has paid Mr. Gibbon salary continuance of \$51,000 and accrued for an additional \$200,000. These two amounts represent more than 60% of the total \$400,000 severance and termination package offered. Management believes that its offer to Mr. Gibbon is at the high end of severance and termination settlements traditionally awarded given the circumstances with Mr. Gibbon.

On May 3, 2004, Mr. Jim Gibbon, Logistics and Purchasing Manager, left the employment of the Company. On July 6, 2004, Mr. J. Gibbon filed a statement of claim against the Company for \$250,000 citing Mr. J. Gibbon had been constructively dismissed. Management believes the claim is unfounded and the Company is disputing Mr. J. Gibbon's allegations.

# Commercial Solutions Inc.

## Notes to the interim Consolidated Financial Statements (unaudited)

### Segmented information

The Company operates two business segments in Canada: (i) the distribution of industrial supplies; and (ii) the distribution of oilfield parts and supplies.

The following table presents information about reportable segment profit and loss

				Three months ended June 30, 2004 Consolidated
	Industrial Supplies	Oilfield Parts & Supplies	Intersegment Transactions	
Revenue	\$ 17,696,737	\$ 1,901,179	\$ (47,065)	\$ 19,550,851
Segment profit (loss)	1,177,819	231,575	(9,413)	1,399,981
General corporate expenses				255,716
Amortization				105,778
Interest expense				304,452
Income before income taxes				<u>\$ 734,035</u>
Identifiable assets	\$ 24,697,280	\$ 5,911,223	\$ (29,208)	\$ 30,579,295
Corporate assets				<u>7,017,244</u>
Total assets				<u>\$ 37,596,539</u>
Capital expenditures	\$ 254,489	\$ 11,612		\$ 266,101

				Nine months ended June 30, 2004 Consolidated
	Industrial Supplies	Oilfield Parts & Supplies	Intersegment Transactions	
Revenue	\$ 49,459,786	\$ 9,486,424	\$ (175,662)	\$ 58,770,548
Segment profit (loss)	2,364,132	1,893,197	(35,132)	4,222,197
General corporate expenses				944,225
Amortization				296,908
Interest expense				895,922
Income before income taxes				<u>\$ 2,085,142</u>
Identifiable assets	\$ 24,697,280	\$ 5,911,223	\$ (29,208)	\$ 30,579,295
Corporate assets				<u>7,017,244</u>
Total assets				<u>\$ 37,596,539</u>
Capital expenditures	\$ 553,895	\$ 11,612		\$ 565,507

# Commercial Solutions Inc.

## Notes to the interim Consolidated Financial Statements (unaudited)

### Segmented information (con't)

Comparative segment information has not been disclosed as the Company was operating within one segment in the comparative quarter.

### Stock based compensation

As required per the CICA's new standard for stock-based payments for options granted after the adoption date, disclosure of the impact on earnings and earnings per share, as if the fair value based method of accounting for the share-based compensation had been applied, is shown in the chart below. Such impact, using a weighted average fair value of \$0.14 per option for the 1,253,401 options granted for the quarter ended June 30, 2004, would approximate the following pro forma amounts.

	Three months ended		Nine months ended	
	June 30, 2004		June 30, 2004	
Pro forma net Income (loss)	\$	390,789	\$	1,098,681
Proforma earnings (loss) per share - basic		0.04		0.12
Proforma earnings (loss) per share - diluted		0.04		0.11

  

	Three months ended		Nine months ended	
	June 30, 2003		June 30, 2003	
Pro forma net Income (loss)	\$	159,387	\$	(284,812)
Proforma earnings (loss) per share - basic		0.02		(0.04)
Proforma earnings (loss) per share - diluted		0.02		(0.04)

### Subsequent Events

On August 18, 2004, the Company announced that it had entered into an agreement with Paradigm Capital Inc. ("Paradigm") and Canaccord Capital Corporation ("Canaccord") providing for the sale, by Paradigm and Canaccord (collectively, the "Agents"), of an offering of common shares of the Company for gross proceeds of up to \$10,000,000 (the "Offering"). The Offering will be conducted pursuant to a prospectus that was filed in Alberta, British Columbia, Manitoba, Ontario and Quebec. The price per common share under the Offering will be determined by negotiation between the Company and the Agents prior to filing the final prospectus.

In consideration for the Agents' services in connection with the Offering of the common shares, the Company has agreed to pay the Agents a commission of 6% of the proceeds of the common shares sold. The Agents will also be granted Agents' Options, a non-transferable option to acquire a number of common shares corresponding to 10% of the common shares sold, exercisable for a period ending 18 months from the date of closing of the Offering. This prospectus will qualify the distribution of the Agents' Option.

# **Commercial Solutions Inc.**

## **Notes to the interim Consolidated Financial Statements** (unaudited)



### **Subsequent Events (con't)**

The Company has also granted to the Agents the Over-allotment Option, which grants to the Agents the right, for a period of 30 days following the closing, to be issued up to an additional 15% of the common shares sold as part of the Offering, to cover over-allotments. The Prospectus qualifies both the grant of the Over-allotment Option and the distribution and resale of the securities that will be issued in the event the Over-allotment Option is exercised.

The sale of the common shares is subject to a number of conditions, including due diligence and the approval of the TSX Venture Exchange. The net proceeds from the Offering will be used to pursue potential future growth opportunities via acquisition, working capital and general corporate purposes, which may include capital expenditures, and repayment of debt.

## Corporate Information

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### **Officers and Directors**

Jim Barker  
Chairman, President, CEO and Director  
Edmonton, Alberta

Eric Sauze, CA CFA  
Chief Financial Officer  
Edmonton, Alberta

Ken Harrison  
Director  
Edmonton, Alberta

Mary Ellen Neilson  
Director  
Calgary, Alberta

Ron Gibbon  
Director  
Edmonton, Alberta

Don Caron  
Secretary and Director  
Edmonton, Alberta

James Taylor  
Director  
Regina, Saskatchewan

Bill Rosser  
Director  
Edmonton, Alberta

### **Corporate Office**

4203 - 95 Street  
Edmonton, Alberta T6E 5R6  
Ph.: (780) 432-1611  
Fax: (780) 462-0807

### **Auditors**

Grant Thornton LLP  
2400 Scotia Place 1  
10060 Jasper Avenue  
Edmonton, Alberta T5J 3R8

### **Shares Listed**

TSX Venture Exchange  
Trading Symbol – “CSA”

### **Bankers**

Bank of Montreal  
10199 – 101 Street  
Edmonton, Alberta T5J 3Y4

### **Transfer Agent**

Computershare Trust Company of Canada  
600, 530 - 8th Avenue SW  
Calgary, AB  
T2P 3S8

### **Share Capital**

Issued: 8,836,071 common shares  
Issued: 983,760 preferred shares

### **Web Site**

[www.commercialsolutions.ca](http://www.commercialsolutions.ca)