VELAN

REPORT TO SHAREHOLDERS

First quarter

Three-month period ended May 31, 2021

MANAGEMENT’S DISCUSSION AND ANALYSIS

First quarter ended May 31, 2021

HIGHLIGHTS[1]

- Order backlog[2] of $607.2 million at the end of the quarter representing the highest backlog[2] for the Company since August 2012. The portion of the current backlog[2] deliverable in the next nine months is expected to be $323.1 million.
- Net new orders ("bookings")[2] of $116.4 million for the quarter, an increase of $39.6 million or 51.7%, which translated in a strong book-to-bill ratio[2] of 1.56 obtained primarily by the recording of significant orders in the marine, mining, and downstream oil and gas sectors.
- Sales for the quarter amounted to $74.5 million, a decrease of $2.1 million or 2.8% compared to the same quarter of the previous fiscal year. The Company's sales are not subject to seasonality, but quarterly sales can vary greatly based on the timing of the delivery of large project orders which are expected to be greater in the latter part of fiscal 2022; in particular, the shipment of some important large project orders by the Company's Italian operations, originally planned for this quarter, have shifted into the second quarter.
- Gross profit for the quarter of $20.0 million, an increase of $1.6 million or 280 basis points from the same quarter of the previous year driven by the margin improvement activities performed over the past fiscal years in the scope of the V20 restructuring and transformation plan.
- Net loss[3] of $5.1 million and negative EBITDA[2] of 0.9$ million for the quarter primarily attributable to an increase in administration costs and lower Canada Emergency Wage Subsidies («CEWS»); these are the main two factors that drive lower results in the quarter compared to the previous year despite notably improved margins at similar sales level.
- The Company's net cash amounted to $71.2 million at the end of the quarter, an increase of $8.3 million since the beginning of the fiscal year, highlighting the Company's healthy financial position.
- Based on average exchange rates, the Euro strengthened 9.7% and the Canadian dollar 12.7% against the U.S. dollar when compared to the same period last year. This resulted in the Company's net profits and bookings from its European subsidiaries being reported as higher U.S. dollar amounts and Canadian dollar expenses being reported as higher U.S dollar amounts in the current quarter. The net impact of these currency swings was generally unfavorable on the Company's results.

[1] *All dollar amounts are denominated in U.S. dollars.*
[2] *Non-IFRS and supplementary financial measures – additional specifications at the end of this report*
[3] *Net earnings or loss refer to net income or loss attributable to Subordinate and Multiple Voting Shares*

The following discussion provides an analysis of the consolidated operating results and financial position of Velan Inc. ("the Company") for the quarter ended May 31, 2021 is current as of July 13, 2021, the date of approval of this Management Discussion and Analysis ("MD&A") by the Board of Directors. This MD&A should be read in conjunction with the Company's audited consolidated financial statements for the years ended February 28, 2021 and February 29, 2020. The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS"). The significant accounting policies upon which these consolidated financial statements have been prepared are detailed in Note 2 of the Company's audited consolidated financial statements. All foreign currency transactions, balances and overseas operations have been converted to U.S. dollars, the Company's reporting currency. Additional information relating to the Company, including the Annual Information Form and Proxy Information Circular, can be found on SEDAR at **www.sedar.com**.

NON-IFRS AND SUPPLEMENTARY FINANCIAL MEASURES

In this MD&A, the Company has presented measures of performance or financial condition which are not defined under IFRS ("non-IFRS measures") and are, therefore, unlikely to be comparable to similar measures presented by other companies. These measures are used by management in assessing the operating results and financial condition of the Company and are reconciled with the performance measures defined under IFRS. Reconciliations of these amounts can be found at the end of this report. The Company has also presented supplementary financial measures which are defined at the end of this report.

FORWARD-LOOKING INFORMATION

This MD&A may include forward-looking statements, which generally contain words like "should", "believe", "anticipate", "plan", "may", "will", "expect", "intend", "continue" or "estimate" or the negatives of these terms or variations of them or similar expressions, all of which are subject to risks and uncertainties. These risks and uncertainties are disclosed in the Company's filings with the appropriate securities commissions. While these statements are based on management's assumptions regarding historical trends, current conditions and expected future developments, as well as other factors that it believes are reasonable and appropriate in the circumstances, no forward-looking statement can be guaranteed and actual future results may differ materially from those expressed herein. The Company disclaims any intention or obligation to update or revise any forward-looking statements contained herein whether as a result of new information, future events or otherwise, except as required by the applicable securities laws. The forward-looking statements contained in this report are expressly qualified by this cautionary statement.

ABOUT VELAN

The Company designs, manufactures and markets on a worldwide basis a broad range of industrial valves for use in most industry applications including power generation, oil and gas, refining and petrochemicals, chemicals, LNG and cryogenics, pulp and paper, geothermal processes and shipbuilding. The Company is a world leader in steel industrial valves operating 12 manufacturing plants worldwide with 1,688 employees. The Company's head office is located in Montreal, Canada. The Company's business strategy is to design, manufacture, and market new and innovative valves with emphasis on quality, safety, ease of operation, and long service life. The Company's strategic goals include, but are not limited to, customer-driven operational excellence and margin improvements, accelerated growth through increased focus on key target markets where the Company has distinct competitive advantages and continuously improving and modernizing its systems and processes.

The consolidated financial statements of the Company include the North American operations comprising two manufacturing plants in Canada, as well as one manufacturing plant and one distribution facility in the U.S. Significant overseas operations include manufacturing plants in France, Italy, Portugal, Korea, Taiwan, India, and China. The Company's operations also include a sales operation in Germany and a 50%-owned Korean foundry.

RESULTS OF OPERATIONS

(unless otherwise noted, all amounts are in U.S. dollars and all comparisons are to the first quarter of the last fiscal year)

	As at and for the three-month periods ended		
(thousands)	May 31, 2021	May 31, 2020	Variance
Sales	$74,529	$76,653	(2,124)
Gross profit	19,994	18,392	1,602
Administration costs	23,779	17,667	6,112
Income taxes	631	1,113	(482)
Net loss[1]	(5,073)	(1,886)	(3,187)
EBITDA[2]	(941)	2,638	(1,697)
Bookings[2]	116,374	76,736	39,638
Period ending backlog[2] of orders	607,162	410,288	196,874
(as a percentage of sales)			
Gross profit	26.8%	24.0%	280 bpts
(in dollars per share)			
Net loss[1] per share – basic and diluted	(0.24)	(0.09)	(0.15)
EBITDA[2] per share – basic and diluted	(0.04)	0.12	(0.16)

Backlog[2]

	As at		
(thousands)	May 31, 2021	February 28, 2021	May 31, 2020
Backlog[2]	607,162	562,458	410,288
For delivery within the next twelve months	360,414	338,458	260,981
For delivery beyond the next twelve months	246,748	224,035	149,307
Percentage – beyond the next twelve months	40.6%	39.8%	36.4%

As a result of bookings outpacing sales in the current quarter, the Company's book-to-bill ratio[2] was a strong 1.56 for the period. Furthermore, the total backlog[2] increased by $44.7 million or 7.9% since the beginning of the fiscal year, amounting to $607.2 million as at May 31, 2021.

[1] *Net earnings or loss refer to net income or loss attributable to Subordinate and Multiple Voting Shares*
[2] *Non-IFRS and supplementary financial measures – more information at the end of this report*

Bookings[1]

Bookings[1] amounted to $116.4 million, an increase of $39.6 million or 51.7% compared to the same quarter last year. This increase is primarily attributable to large project orders recorded by the Company's North American and Italian operations, notably in the marine, mining, and downstream oil and gas markets.

Sales

Sales decreased by $2.1 million or 2.8% for the quarter. Sales were negatively impacted by temporary shipment delays in the Company's Italian operations due to various customer-related and global logistics factors. As a result, the shipment of some large orders by the Company's Italian operations, whose backlog is currently at a record high, is expected to shift into the second quarter of the current fiscal year. The shift had a negative impact on comparative sales given last year's very high first quarter sales by the Company's Italian operations. On the other hand, the increase in shipments from the Company's French operations partly offset the negative impact of the sales shift in Italy. Additionally, the Company's non-project sales for the quarter were negatively affected by the persistent unfavorable market conditions triggered by the novel coronavirus ("COVID-19") global pandemic which has significantly affected the Company's distribution channels' bookings in the previous fiscal year. The lower distribution channels' bookings in the latter part of the prior year translated in lower shipments of such orders in the current quarter.

Gross profit

Gross profit increased by $1.6 million or 8.7% compared to the same quarter last year, while the gross profit percentage of 26.8% was an increase of 280 basis points from last year's 24.0%. The increase in gross profit percentage was such that it could more than offset the impact of a $1.3 million lower amount of CEWS compared to last year. The subsidies were allocated between cost of sales and administration costs. The improvement in gross profit percentage was mainly attributable to a product mix with a greater proportion of higher margin product sales as well as improved margins stemming from the margin improvement activities implemented by the Company over the course of the past fiscal years in the scope of the V20 restructuring and transformation plan.

EBITDA[1]

EBITDA[1] amounted to negative $0.9 million or $0.04 per share compared to a positive $2.6 million or $0.12 per share last year. The unfavorable movement in EBITDA[1] overshadows the improved profitability and margins of the Company's global operations whereby, with sales essentially flat versus last year:

- Gross profit increased by $1.6 million, from 24.0% to 26.8%, reflecting the notably improved product mix and margins resulting from the Company's targeted efforts under V20, described earlier;
- Restructuring and transformation costs decreased by $1.2 million, also reflecting the progress made last year in the deployment of the Company's V20 program;

On the other hand, these improvements could only partially offset the negative impact of the aforementioned shift in shipments in the Company's Italian operations and an increase in administration costs of $6.1 million or 34.6%, primarily attributable to:

- An increase of $2.1 million in the costs recognized in connection with the Company's ongoing asbestos litigation (see *Contingencies* section). The fluctuation in asbestos costs for the quarter is due to the timing of settlements in these two periods rather than to changes in long-term trends.

[1] *Non-IFRS and supplementary financial measures – more information at the end of this report*

- A decrease of $1.1 million in CEWS received by the Company compared to last year's first quarter. The subsidies were allocated between cost of sales and administration costs; and
- A general increase in administration expenses that had been significantly lowered when the global pandemic broke out last year.

Income taxes

	Three-month periods ended			
(thousands, excluding percentages)		**May 31, 2021**		**May 31, 2020**
	$	%	$	%
Income tax at statutory rate	(1,175)	26.5	(210)	26.6
Tax effects of:				
Difference in statutory tax rates in foreign jurisdictions	114	(2.5)	85	(10.7)
Non-deductible (taxable) foreign exchange losses (gains)	(77)	1.7	131	(16.6)
Unrecognized tax losses	1,939	(43.7)	1,222	(154.4)
Benefit attributable to a financing structure	(66)	1.5	(61)	7.7
Other differences	(104)	2.3	(54)	6.8
Income tax expense	**641**	**(14.2)**	**1,113**	**(140.7)**

Net loss[1]

Net loss[1] amounted to $5.1 million or $0.24 per share compared to $1.9 million or $0.09 per share last year. The movement in net loss[1] was primarily attributable to the same factors as exposed in the EBITDA[2] section.

LIQUIDITY AND CAPITAL RESOURCES – a discussion of liquidity risk, credit facilities, cash flows and proposed transactions *(unless otherwise noted, all dollar amounts are denominated in U.S. dollars)*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages its liquidity risk by continually monitoring its future cash requirements. Cash flow forecasting is performed in the operating entities and aggregated by the Company's corporate finance team. The Company's policy is to maintain sufficient cash and cash equivalents and available credit facilities in order to meet its present and future operational needs.

On May 31, 2021, the Company's order backlog[2] was $607.2 million and its net cash plus unused credit facilities amounted to $150.3 million, which it believes, along with future cash flows generated from operations, is sufficient to meet its financial obligations, increase its capacity, satisfy its working capital requirements, and execute on its business strategy. The Company also believes that its unused credit facilities are sufficient to overcome the remaining lingering effects of the COVID-19 pandemic on the world's economy. However, there can be no assurance that the risk of another sharp downturn in the economy will not materially adversely affect the Company's results of operations or financial condition. As at May 31, 2021, the Company is in compliance with all covenants related to its debt and credit facilities.

As part of managing its liquidity risk, the Company also monitors the financial health of its key suppliers.

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[2] *Non-IFRS and supplementary financial measures – more information at the end of this report*

Cash flows - quarter ended May 31, 2021 compared to the quarter ended May 31, 2020

(unless otherwise noted, all amounts are in U.S. dollars and all comparisons are to same period in the prior fiscal year)

The Company's changes in net cash were as follows:

	Three-month periods ended	
(thousands)	**May 31, 2021**	**May 31, 2020**
Net Cash – Beginning of period	62,953	31,010
Cash provided by operating activities	895	19,243
Cash provided (used) by investing activities	907	(3,907)
Cash provided (used) by financing activities	6,046	(2,654)
Effect of exchange rate differences on cash	436	948
Net Cash – End of period	**71,237**	**44,640**

Operating activities

The decrease in cash provided by operating activities for the quarter is primarily attributable to the less favorable changes in non-cash working capital items as well as the negative EBITDA incurred in the period.

The positive non-cash working capital movements for the quarter ended May 31, 2021 consisted primarily of:

- A decrease in accounts receivable primarily due to increased collections of prior year accounts;
- A higher amount of customer deposits collected on certain large project orders by the Company's Italian, North American and French operations;
- An increase in accounts payable and accrued liabilities primarily due to the timing of payments.

The negative non-cash working capital movements for the quarter ended May 31, 2021 were primarily due to an increase in inventories required for the increase in bookings and backlog in the quarter.

Investing activities

Cash provided by investing activities for the quarter was primarily due to proceeds on disposal of property, plant and equipment related to the sale of a vacant land that used to host a production plant of the Company. The plant's operations were fully transferred in fiscal 2017 to other plants, and the building was demolished.

The fluctuation in additions to property, plant and equipment for the current quarter is primarily attributable to the timing of the receipts of certain equipment. Additions in the prior year were higher due to the Company's restructuring and transformation initiative, V20.

Financing activities

During the current quarter, the Company continued to pay down its outstanding long-term debt, including a $3.0 million lump sum voluntary reimbursement, while withdrawing $9.6 million on its revolving credit facility.

FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, cash flow interest rate risk and fair value interest rate risk), credit risk and liquidity risk. The Company's overall financial risk management program focuses on mitigating unpredictable financial market risks and their potential adverse effects on the Company's financial performance.

The Company's financial risk management is generally carried out by the corporate finance team, based on policies approved by the Board of Directors. The identification, evaluation and hedging of the financial risks are the responsibility of the corporate finance team in conjunction with the finance teams of the Company's subsidiaries. The Company uses derivative financial instruments to hedge certain risk exposures. Use of derivative financial instruments is subject to a policy which requires that no derivative transaction be entered into for the purpose of establishing a speculative or leveraged position (the corollary being that all derivative transactions are to be entered into for risk management purposes only).

Market risk

Currency risk

Currency risk on financial instruments is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Company operates internationally and is exposed to foreign exchange risk arising from various currency exposures. Currency risk arises when future commercial transactions and recognized assets and liabilities are denominated in a currency other than a company's functional currency. The Company has operations with different functional currencies, each of which will be exposed to currency risk based on its specific functional currency.

When possible, the Company matches cash receipts in a foreign currency with cash disbursements in that same currency. The remaining anticipated net exposure to foreign currencies is hedged. To hedge this exposure, the Company uses foreign currency derivatives, primarily foreign exchange forward contracts. These derivatives are not designated as hedges for accounting purposes.

The amounts outstanding as at May 31, 2021 and February 28, 2021 are as follows:

	Range of exchange rates		Gain (loss) (in thousands of U.S. dollars)		Notional amount (in thousands of indicated currency)	
	May 31, 2021	February 28, 2021	May 31, 2021 $	February 28, 2021 $	May 31, 2021	February 28, 2021
Foreign exchange forward contracts						
Sell US$ for CA$ - 0 to 12 months	1.28-1.30	1.30	(6)	(135)	US$33,000	US$22,000
Buy US$ for CA$ - 0 to 12 months	1.20-1.22	1.22	170	48	US$33,000	US$22,000
Sell € for US$ – 0 to 12 months	1.22-1.24	1.22-1.24	(64)	(168)	€16,343	€18,363
Buy € for US$ – 0 to 12 months	1.16-1.20	1.16-1.20	23	148	€16,343	€18,363

Foreign exchange forward contracts are contracts whereby the Company has the obligation to sell or buy the currencies at the strike price. The fair value of the foreign currency instruments is recorded in the consolidated statement of income and reflects the estimated amounts the Company would have paid or received to settle these contracts as at the financial position date. Unrealized gains are recorded as derivative assets and unrealized losses as derivative liabilities on the consolidated statement of financial position.

Interest rate risk

The Company's exposure to interest rate risk is related primarily to its credit facilities, long-term debt and cash and cash equivalents. Items at variable rates expose the Company to cash flow interest rate risk, and items at fixed rates expose the Company to fair value interest rate risk. The Company's long-term debt and credit facilities predominantly bear interest, and its cash and cash equivalents earn interest at variable rates. An assumed 0.5% change in interest rates would have no significant impact on the Company's net income or cash flows.

Credit risk

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises primarily from the Company's trade accounts receivable.

The Company's credit risk related to its trade accounts receivable is concentrated. As at May 31, 2021, four (February 28, 2021 – five) customers accounted for more than 5% each of its trade accounts receivable, of which one customer accounted for 15.3% (February 28, 2021 – 15.6%), and the Company's ten largest customers accounted for 59.1% (February 28, 2021 – 63.5%) of trade accounts receivable. In addition, there was no customer (May 31, 2021 – one) that accounted for more than 10% of the Company's sales.

In order to mitigate its credit risk, the Company performs a continual evaluation of its customers' credit and performs specific evaluation procedures on all its new customers. In performing its evaluation, the Company analyzes the ageing of accounts receivable, historical payment patterns, customer creditworthiness and current economic trends. A specific credit limit is established for each customer and reviewed periodically. For some trade accounts receivable, the Company may obtain security in the form of credit insurance which can be called upon if the counterparty is in default under the terms of the agreement.

The Company applies the IFRS 9 simplified approach to measure expected credit losses using a lifetime expected credit loss allowance for trade receivables. The expected credit loss rates are based on the Company's historical credit losses experienced over the last fiscal year prior to period end. The historical rates are then adjusted for current and forward-looking information on macro-economic factors affecting the Company's customers.

The Company is also exposed to credit risk relating to derivative financial instruments, cash and cash equivalents and short-term investments, which it manages by dealing with highly rated financial institutions. The Company's primary credit risk is limited to the carrying value of the trade accounts receivable and gains on derivative assets.

The table below summarizes the ageing of the trade accounts receivable as at:

	As at	
(thousands)	**May 31, 2021 $**	**February 28, 2021 $**
Current	58,523	76,407
Past due 0 to 30 days	15,817	19,630
Past due 31 to 90 days	13,973	9,672
Past due more than 90 days	21,584	17,653
	109,897	123,362
Less: Loss allowance	(1,081)	(1,146)
	108,816	122,216
Other receivables	12,090	13,157
Total accounts receivable	**120,906**	**135,373**

The table below summarizes the movement in the allowance for doubtful accounts:

	Three-month periods ended	
(thousands)	**May 31, 2021 $**	**May 31, 2020 $**
Balance – Beginning of the year	1,146	2,002
Loss allowance expenses	-	3
Recoveries of trade accounts receivables	(22)	-
Write-off of trade accounts receivable	(55)	(212)
Foreign exchange	12	(6)
Balance – End of the period	**(1,081)**	**(1,787)**

Liquidity risk – see discussion in *liquidity and capital resources* section

CONTINGENCIES (in thousands of U.S. dollars, excluding number of cases)

Two of the Company's U.S. subsidiaries have been named as one of the defendants in a number of pending lawsuits that seek to recover damages for personal injury allegedly caused by exposure to asbestos-containing products manufactured and sold in the past. Management believes it has a strong defence related to certain products that may have contained an internal asbestos containing component. 1,837 claims were outstanding at the end of the reporting period (February 28, 2021 – 1,696). During the reporting period, the Company resolved 63 claims (May 31, 2020 – 73) and received 204 claims (May 31, 2020 – 95). Settlement costs and legal fees related to these asbestos claims amounted to $4,193 (May 31, 2020 - $2,046) in the quarter.

INTERNAL CONTROLS AND PROCEDURES

In accordance with National Instrument 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings, disclosure controls and procedures have been designed to provide reasonable assurance that the information presented in the Company's interim and annual reports to shareholders is accumulated and communicated to management on a timely basis, including the Chief Executive Officer and the Chief Financial Officer, in order for appropriate decisions to be made in regards to disclosures. Internal controls over financial reporting have also been designed to provide reasonable assurance regarding the reliability of the financial reporting and the preparation of financial statements in accordance with IFRS.

The Company did not make any changes to the design of internal controls over financial reporting during the three-month period ended May 31, 2021 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

CRITICAL ACCOUNTING ESTIMATES & JUDGEMENTS

The Company's financial statements are prepared in accordance with IFRS as issued by the IASB. The Company's significant accounting policies as described in notes 2 and 3 of the Company's audited consolidated financial statements are essential to understanding the Company's financial positions, results of operations and cash flows. Certain of these accounting policies require critical accounting estimates that involve complex and subjective judgments and the use of assumptions, some of which may be for matters that are inherently uncertain and susceptible to change. The assumptions and estimates used are based on parameters which are derived from the knowledge at the time of preparing the financial statements and believed to be reasonable under the circumstances. In particular, the circumstances prevailing at this time and assumptions as to the expected future development of the global and industry-specific environment were used to estimate the Company's future business performance. Where these conditions develop differently than assumed and beyond the control of the Company, the actual results may differ from those anticipated (see *Forward-looking information* section above). These estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is changed. There were no significant changes made to critical accounting estimates during the past two fiscal years.

There have been no material changes from those identified in the annual MD&A.

ACCOUNTING STANDARDS AND AMENDMENTS ADOPTED IN THE PERIOD

In August 2020, the International Accounting Standards Board ("IASB") issued *Interest Rate Benchmark Reform (Phase 2)*, which amends *IFRS 9 Financial instruments*, *IAS 39 Financial instruments: Recognition and measurement*, *IFRS 7 Financial instruments: Disclosures* and *IFRS 16 Leases*. The Phase 2 amendments address issues that might affect financial reporting after the reform of an interest rate benchmark, including its replacement with alternative benchmark rates. These amendments complement those issued in 2019 and focus on issues that might affect financial reporting during the reform of an interest rate benchmark, including the effects of changes to contractual cash flows arising from the replacement of an interest rate benchmark with an alternative benchmark rate. This amendment was adopted effective March 1, 2021 and resulted in no material adjustments.

ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

In January 2020, the International Accounting Standards Board ("IASB") issued *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)* providing a more general approach to the classification of liabilities under IAS 1 based on the contractual arrangements in place at the reporting date. The amendments in *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)* affect only the presentation of liabilities in the statement of financial position, not the amount or timing of recognition of any asset, liability income or expenses, or the information that entities disclose about those items. In July 2020, the IASB published *Classification of Liabilities as Current or Non-current – Deferral of Effective Date (Amendment to IAS 1)* deferring the effective date of the January 2020 amendments to IAS 1 by one year. The amendments to IAS 1 are effective for annual reporting periods beginning on or after January 1, 2023 with earlier adoption permitted. The Company is currently evaluating the impact of these amendments on its financial statements.

SUMMARY OF QUARTERLY RESULTS

Summary financial data derived from the Company's unaudited financial statements from each of the eight most recently completed quarters are as follows:

For the quarters in months ending May, August, November and February
(in thousands of U.S. dollars, excluding per share amounts)

	QUARTERS ENDED							
	May 2021	**February 2021**	**November 2020**	**August 2020**	**May 2020**	**February 2020**	**November 2019**	**August 2019**
Sales	$74,529	$85,510	$71,560	$68,340	$76,653	$113,641	$88,701	$85,467
Net earnings (loss)[1]	(5,073)	338	9,527	(5,112)	(1,886)	(11,116)	(819)	1,369
Net earnings (loss) [1] per share								
- Basic and diluted	(0.24)	0.02	0.44	(0.24)	(0.09)	(0.51)	(0.04)	0.06

[1] *Net earnings or loss refer to net income or loss attributable to Subordinate and Multiple Voting Shares*

NON-IFRS AND SUPPLEMENTARY FINANCIAL MEASURES

In this MD&A, the Company has presented measures of performance or financial condition which are not defined under IFRS ("non-IFRS measures") and are, therefore, unlikely to be comparable to similar measures presented by other companies. These measures are used by management in assessing the operating results and financial condition of the Company and are reconciled with the performance measures defined under IFRS. Company has also presented supplementary financial measures which are defined at the end of this report. Reconciliation and definition can be found below.

Net earnings (loss) before interest, taxes, depreciation and amortization ("EBITDA")

	Three-month periods ended	
(thousands, except amount per shares)	May 31, 2021 $	May 31, 2020 $
Net loss[1]	(5,073)	(1,886)
Adjustments for:		
Depreciation of property, plant and equipment	2,414	2,525
Amortization of intangible assets	558	568
Finance costs – net	529	318
Income taxes	631	1,113
EBITDA	**(941)**	**2,638**
EBITDA per share		
- Basic and diluted	(0.04)	0.12

The term "EBITDA" is defined as net income or loss attributable to Subordinate and Multiple Voting Shares plus depreciation of property, plant & equipment, plus amortization of intangible assets, plus net finance costs plus income tax provision. The terms "EBITDA per share" is obtained by dividing EBITDA by the total amount of subordinate and multiple voting shares. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

Definitions of supplementary financial measures

The term "Net new orders" or "bookings" is defined as firm orders, net of cancellations, recorded by the Company during a period. Bookings are impacted by the fluctuation of foreign exchange rates for a given period. The measure provides an indication of the Company's sales operation performance for a given period as well as well as an expectation of future sales and cash flows to be achieved on these orders.

The term "backlog" is defined as the buildup of all outstanding bookings to be delivered by the Company. The Company's backlog is impacted by the fluctuation of foreign exchange rates for a given period. The measure provides an indication of the future operational challenges of the Company as well as an expectation of future sales and cash flows to be achieved on these orders.

The term "book-to-bill" is obtained by dividing bookings by sales. The measure provides an indication of the Company's performance and outlook for a given period.

The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

[1] *Net earnings or loss refer to net income or loss attributable to Subordinate and Multiple Voting Shares*

UNAUDITED CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three-month period ended May 31, 2021

NOTICE OF NO AUDITOR REVIEW OF CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors PricewaterhouseCoopers LLP have not reviewed the unaudited condensed interim consolidated financial statements for the three-month period ended May 31, 2021.

VELAN

Consolidated Statements of Financial Position

(Unaudited)
(in thousands of U.S. dollars)

	As at	
	May 31, 2021 $	**February 28, 2021** $
Assets		
Current assets		
Cash and cash equivalents	80,356	74,688
Short-term investments	471	285
Accounts receivable	120,906	135,373
Income taxes recoverable	4,738	3,798
Inventories (note 7)	236,585	204,161
Deposits and prepaid expenses	11,231	8,670
Derivative assets (note 10)	194	196
	454,481	427,171
Non-current assets		
Property, plant and equipment	93,628	96,327
Intangible assets and goodwill	17,206	17,319
Income taxes recoverable	5,927	5,927
Deferred income taxes	33,366	33,140
Other assets	906	949
	151,033	153,662
Total assets	605,514	580,833
Liabilities		
Current liabilities		
Bank indebtedness	9,119	11,735
Accounts payable and accrued liabilities	106,290	90,840
Income taxes payable	1,474	1,609
Customer deposits	71,177	62,083
Provisions	29,382	29,515
Derivative liabilities (note 10)	71	303
Current portion of long-term lease liabilities	1,635	1,578
Current portion of long-term debt (note 8)	9,303	9,902
	228,451	207,565
Non-current liabilities		
Long-term lease liabilities	12,669	12,649
Long-term debt (note 8)	55,562	48,189
Income taxes payable	1,410	1,410
Deferred income taxes	2,479	2,545
Other liabilities	8,393	8,254
	80,513	73,047
Total liabilities	308,964	280,612
Total equity	296,550	300,221
Total liabilities and equity	605,514	580,833

Contingencies (note 9)

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

VELAN

Consolidated Statements of Loss

(Unaudited)
(in thousands of U.S. dollars, excluding number of shares and per share amounts)

	Three-month periods ended	
	May 31, 2021 $	**May 31, 2020 $**
Sales (note 11)	74,529	76,653
Cost of sales (notes 7)	54,535	58,261
Gross profit	19,994	18,392
Administration costs	23,779	17,667
Restructuring and transformation costs	-	1,176
Other expense	121	24
Operating loss	(3,906)	(475)
Finance income	172	116
Finance costs	(701)	(434)
Finance costs – net	(529)	(318)
Loss before income taxes	(4,435)	(793)
Income Taxes	631	1,113
Net loss for the period	(5,066)	(1,906)
Net loss attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	**(5,073)**	**(1,886)**
Non-controlling interest	7	(20)
Net loss for the period	(5,066)	(1,906)
Net loss per Subordinate and Multiple Voting Share		
Basic and diluted	(0.24)	(0.09)
Total weighted average number of Subordinate and Multiple Voting Shares		
Basic and diluted	21,585,635	21,585,635

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

Consolidated Statements of Comprehensive Loss

(Unaudited)
(in thousands of U.S. dollars)

	Three-month periods ended	
	May 31, 2021 $	**May 31, 2020 $**
Comprehensive loss		
Net loss for the period	(5,066)	(1,906)
Other comprehensive income		
Foreign currency translation adjustment on foreign operations whose functional currency is other than the reporting currency (U.S. dollar)	1,395	906
Comprehensive loss	(3,671)	(1,000)
Comprehensive loss attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	(3,702)	(930)
Non-controlling interest	31	(70)
Comprehensive loss	(3,671)	(1,000)

Other comprehensive loss is composed solely of items that may be reclassified subsequently to the consolidated statement of loss.

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

VELAN

Consolidated Statements of Changes in Equity

(Unaudited)

(in thousands of U.S. dollars, excluding number of shares)

	Equity attributable to the Subordinate and Multiple Voting shareholders						
	Share capital	Contributed surplus	Accumulated other comprehensive loss	Retained earnings	Total	Non-controlling interest	**Total equity**
Balance - February 29, 2020	72,695	6,260	(34,047)	236,269	281,177	3,684	284,861
Net loss for the year	-	-	-	(1,886)	(1,886)	(20)	(1,906)
Other comprehensive income (loss)	-	-	956	-	956	(50)	906
Balance - May 31, 2020	72,695	6,260	(33,091)	234,383	280,247	3,614	283,861
Balance - February 28, 2021	72,695	6,260	(21,007)	239,136	297,084	3,137	300,221
Net loss for the year	-	-	-	(5,073)	(5,073)	7	(5,066)
Other comprehensive income	-	-	1,371	-	1,371	24	1,395
Balance - May 31, 2021	72,695	6,260	(19,636)	234,063	293,382	3,168	296,550

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

VELAN

Consolidated Statements of Cash Flow

(Unaudited)
(in thousands of U.S. dollars)

	Three-month periods ended	
	May 31, 2021 $	May 31, 2020 $
Cash flows from		
Operating activities		
Net loss for the period	(5,066)	(1,906)
Adjustments to reconcile net loss to cash provided by operating activities (note 12)	2,412	4,626
Changes in non-cash working capital items (note 13)	3,549	16,523
Cash provided by operating activities	895	19,243
Investing activities		
Short-term investments	(186)	(1,137)
Additions to property, plant and equipment	(1,739)	(2,531)
Additions to intangible assets	(288)	(257)
Proceeds on disposal of property, plant and equipment, and intangible assets	3,132	40
Net change in other assets	(12)	(22)
Cash provided (used) by investing activities	907	(3,907)
Financing activities		
Dividends paid to Subordinate and Multiple Voting shareholders	-	(482)
Short-term bank loans	-	(982)
Net change in revolving credit facility	9,626	-
Repayment of long-term debt	(3,167)	(759)
Repayment of long-term lease liabilities	(413)	(431)
Cash provided (used) by financing activities	6,046	(2,654)
Effect of exchange rate differences on cash	436	948
Net change in cash during the period	8,284	13,630
Net cash – Beginning of the period	62,953	31,010
Net cash – End of the period	71,237	44,640
Net cash is composed of:		
Cash and cash equivalents	80,356	84,426
Bank indebtedness	(9,119)	(39,786)
Net cash – End of the period	71,237	44,640
Supplementary information		
Interest received (paid)	(350)	(348)
Income taxes received (paid)	(1,121)	(555)

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

NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three-month period ended May 31, 2021

1 General information

These unaudited condensed interim financial statements represent the consolidation of the accounts of Velan Inc. (the “Company”) and its subsidiaries. The Company is an international manufacturer of industrial valves and is a public company listed on the Toronto Stock Exchange under the symbol “VLN”. It was incorporated under the name Velan Engineering Ltd. on December 12, 1952 and continued under the *Canada Business Corporations Act* on February 11, 1977. It changed its name to Velan Inc. on February 20, 1981. Velan Inc. maintains its registered head office at 7007 Cote de Liesse, Montreal, Quebec, Canada, H4T 1G2. The Company’s ultimate parent company is Velan Holdings Co. Ltd.

These unaudited condensed interim consolidated financial statements were approved for issue by the Company’s Board of Directors on July 13, 2021. The Company’s auditors have not performed a review of these unaudited condensed interim consolidated financial statements.

2 Basis of preparation

These unaudited condensed interim consolidated financial statements for the three-month period ended May 31, 2021 have been prepared in accordance with International Financial Reporting Standards (“IFRS”) in accordance with International Accounting Standard (“IAS”) 34, *Interim Financial Reporting*. These unaudited condensed interim consolidated financial statements have been prepared using the same basis of presentation, accounting policies, and methods of computation as outlined in Note 2, *Summary of significant accounting policies*, in the Company’s annual consolidated financial statements for the year ended February 28, 2021, which have also been prepared in accordance with IFRS. Accordingly, these unaudited condensed interim consolidated financial statements should be read in conjunction with the Company’s annual consolidated financial statements for the year ended February 28, 2021.

3 Changes in accounting policies

In August 2020, the International Accounting Standards Board (“IASB”) issued *Interest Rate Benchmark Reform (Phase 2)*, which amends *IFRS 9 Financial instruments*, *IAS 39 Financial instruments: Recognition and measurement*, *IFRS 7 Financial instruments: Disclosures* and *IFRS 16 Leases*. The Phase 2 amendments address issues that might affect financial reporting after the reform of an interest rate benchmark, including its replacement with alternative benchmark rates. These amendments complement those issued in 2019 and focus on issues that might affect financial reporting during the reform of an interest rate benchmark, including the effects of changes to contractual cash flows arising from the replacement of an interest rate benchmark with an alternative benchmark rate. This amendment was adopted effective March 1, 2021 and resulted in no material adjustments.

4 New accounting standards and amendments issued but not yet adopted

In January 2020, the International Accounting Standards Board (“IASB”) issued *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)* providing a more general approach to the classification of liabilities under IAS 1 based on the contractual arrangements in place at the reporting date. The amendments in *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)* affect only the presentation of liabilities in the statement of financial position, not the amount or timing of recognition of any asset, liability income or expenses, or the information that entities disclose about those items. In July 2020, the IASB published *Classification of Liabilities as Current or Non-current – Deferral of Effective*

Date (Amendment to IAS 1) deferring the effective date of the January 2020 amendments to IAS 1 by one year. The amendments to IAS 1 are effective for annual reporting periods beginning on or after January 1, 2023 with earlier adoption permitted. The Company is currently evaluating the impact of these amendments on its financial statements.

5 Estimates

The preparation of interim financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

In preparing these unaudited condensed interim consolidated financial statements, the significant judgements made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the annual consolidated financial statements for the year ended February 28, 2021.

However, the occurrence of the novel coronavirus ("COVID-19") pandemic has caused disruptions in the Company's global operations which have materially adversely affected its business and financial results. The economic slowdown triggered by the global pandemic has translated in a lower sales volume and subsequently depressed results for the Company while net order bookings have showed positive trends for the three-month period ended May 31, 2021. The Company has implemented proactive measures to protect its global workforce and mitigate the numerous effects of the pandemic, but given the ongoing dynamic nature of circumstances surrounding COVID-19, it is not possible to reliably estimate the length, severity and long term impact the global pandemic may have on the Company's results, conditions and cash-flows.

During the three-month period ended May 31, 2021, the company has applied for wage subsidies which provided a reduction of salaries of $579 (May 31, 2020 – $1,895) in Cost of sales and $439 (May 31, 2020 – $1,536) in Administration costs.

6 Seasonality

The Company's sales are not subject to seasonality. Quarterly sales can vary based on the timing of revenue recognition on large project orders.

7 Inventories

		As at
(thousands)	**May 31, 2021 $**	**February 28, 2021 $**
Raw materials	41,939	40,404
Work in process and finished parts	146,210	118,553
Finished goods	48,436	45,204
	236,585	**204,161**

As a result of variations in the ageing of its inventories, the Company recognized a net additional inventory provision for the three-month period ended May 31, 2021 of $1,661 (May 31, 2020 – $523), including reversals of $1,140 (May 31, 2020 - $1,378).

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8 Long-term debt

(thousands)	As at May 31, 2021 $	February 28, 2021 $
Revolving credit facility	31,758	22,132
Canadian subsidiary		
Secured bank loan ($CAD 15,000; February 28, 2021 - $CAD 15,000)	12,178	11,581
French subsidiaries		
Unsecured bank loan (€2,671; February 28, 2021 - €5,547)	3,259	6,723
Italian subsidiary		
Unsecured bank loan (€3,000; February 28, 2021 - €3,000)	3,660	3,636
Unsecured state bank loan (€920; February 28, 2021 - €920)	1,123	1,115
Korean structured entity		
Secured bank loan (KW 6,710,990; February 28, 2021 – KW 7,064,400)	6,053	6,266
Other	6,834	6,638
	64,865	58,091
Less: current portion	9,303	9,902
	55,562	**48,189**

As at May 31, 2021, the Company had drawn down $31,758 (February 28, 2021 – 22,132) on the revolving credit facility and had $4,538 (February 28, 2021 – 5,436) in the form of outstanding letters of credit and letters of guarantee on a total $52,128 (February 28, 2021 – 55,518) borrowing availability. Furthermore, as at May 31, 2021, the Company was in compliance with its covenant.

9 Contingent liabilities

Two of the Company's U.S. subsidiaries have been named as defendants in a number of asbestos-related legal proceedings pertaining to products they formerly sold. Management believes it has a strong defence, and the subsidiaries have previously been dismissed from a number of similar cases. During the three-month period ended May 31, 2021, legal and related costs for these matters amounted to $4,193 (May 31, 2020 – $2,046).

10 Fair value of financial instruments

The fair value hierarchy has the following levels:

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

The fair value of financial assets and financial liabilities on the condensed interim consolidated statements of financial position are as follows:

				As at May 31, 2021
(thousands)	Total $	Level 1 $	Level 2 $	Level 3 $
Financial position classification and nature				
Assets				
Derivative assets	194	-	194	-
Liabilities				
Derivative liabilities	71	-	71	-

				As at February 28, 2021
(thousands)	Total $	Level 1 $	Level 2 $	Level 3 $
Financial position classification and nature				
Assets				
Derivative assets	196	-	196	-
Liabilities				
Derivative liabilities	303	-	303	-

Fair value measurements of the Company's derivative assets and liabilities are classified under Level 2 because such measurements are determined using published market prices or estimates based on observable inputs such as interest rates, yield curves, and spot and future exchange rates. The carrying value of the Company's financial instruments is considered to approximate fair value, unless otherwise indicated.

11 Segment reporting

The Company reflects its results under a single reportable operating segment. The geographic distribution of its sales is as follows:

						Three-month period ended May 31, 2021	
(thousands)	Canada $	United States $	France $	Italy $	Other $	Consolidation adjustment $	Consolidated $
Sales							
Customers -							
Domestic	4,906	21,351	10,965	4	4,503	-	41,729
Export	12,229	-	10,223	8,357	1,991	-	32,800
Intercompany (export)	8,391	2,182	6	74	12,102	(22,755)	-
Total	25,526	23,533	21,194	8,435	18,596	(22,755)	74,529

						Three-month period ended May 31, 2020	
(thousands)	Canada $	United States $	France $	Italy $	Other $	Consolidation adjustment $	Consolidated $
Sales							
Customers -							
Domestic	5,187	24,346	6,750	250	3,070	-	39,603
Export	9,294	-	5,736	18,123	3,897	-	37,050
Intercompany (export)	6,926	3,796	62	-	14,799	(25,583)	-
Total	21,407	28,142	12,548	18,373	21,766	(25,583)	76,653

12 Adjustments to reconcile net loss to cash provided from operating activities

	Three-month periods ended	
(thousands)	**May 31, 2021 $**	**May 31, 2020 $**
Depreciation of property, plant and equipment	2,414	2,525
Amortization of intangible assets	558	568
Deferred income taxes	(246)	636
Gain on disposal of property, plant and equipment	(186)	(20)
Net change in derivative assets and liabilities	(229)	1,262
Net change in other liabilities	101	(345)
	2,412	**4,626**

13 Changes in non-cash working capital items

(thousands)	Three-month periods ended May 31, 2021 $	May 31, 2020 $
Accounts receivable	14,985	18,580
Inventories	(31,207)	5,004
Income taxes recoverable	(910)	757
Deposits and prepaid expenses	(2,455)	(979)
Accounts payable and accrued liabilities	14,830	(10,326)
Income taxes payable	(152)	457
Customer deposits	8,747	3,280
Provisions	(289)	(250)
	3,549	**16,523**

A world leader in industrial valve manufacturing supplying to:

- Fossil, nuclear, and cogeneration power
- Oil and gas
- Refining and petrochemicals
- Chemicals
- Pulp and paper
- Subsea
- LNG and cryogenics
- Marine
- Mining
- HVAC
- Water and wastewater

Velan Inc. is listed on the Toronto stock exchange under the symbol VLN

Visit us on the Web: http://www.velan.com

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