





## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

Second quarter ended August 31, 2021







































## Consolidated Statements of Income (Loss)

(Unaudited)

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

	Three-month periods ended		Six-month periods ended	
	August 31, 2021 \$	August 31, 2020 \$	August 31, 2021 \$	August 31, 2020 \$
<b>Sales</b> (note 11)	101,893	68,340	176,422	144,993
<b>Cost of sales</b> (notes 7)	70,502	51,287	125,037	109,548
<b>Gross profit</b>	31,391	17,053	51,385	35,445
Administration costs	23,977	19,687	47,756	37,354
Restructuring and transformation costs	-	1,723	-	2,899
Other expense (income)	(79)	1,369	42	1,393
<b>Operating profit (loss)</b>	7,493	(5,726)	3,587	(6,201)
Finance income	118	298	290	414
Finance costs	(644)	(342)	(1,345)	(776)
Finance costs – net	(526)	(44)	(1,055)	(362)
<b>Income (loss) before income taxes</b>	6,967	(5,770)	2,532	(6,563)
Income tax expense (recovery)	2,271	(505)	2,902	608
<b>Net income (loss) for the period</b>	4,696	(5,265)	(370)	(7,171)
<b>Net income (loss) attributable to:</b>				
<b>Subordinate Voting Shares and Multiple Voting Shares</b>	<b>5,015</b>	<b>(5,112)</b>	<b>(58)</b>	<b>(6,998)</b>
Non-controlling interest	(319)	(153)	(312)	(173)
<b>Net income (loss) for the period</b>	4,696	(5,265)	(370)	(7,171)
<b>Net income (loss) per Subordinate and Multiple Voting Share</b>				
Basic and diluted	0.23	(0.24)	(0.00)	(0.32)
<b>Total weighted average number of Subordinate and Multiple Voting Shares</b>				
Basic and diluted	21,585,635	21,585,635	21,585,635	21,585,635

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



## Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

(in thousands of U.S. dollars)

	Three-month periods ended		Six-month periods ended	
	August 31, 2021 \$	August 31, 2020 \$	August 31, 2021 \$	August 31, 2020 \$
<b>Comprehensive income (loss)</b>				
<b>Net income (loss) for the period</b>	4,696	(5,265)	(370)	(7,171)
<b>Other comprehensive income (loss)</b>				
Foreign currency translation adjustment on foreign operations whose functional currency is other than the reporting currency (U.S. dollar)	(4,817)	9,903	(3,422)	10,809
<b>Comprehensive income (loss)</b>	(121)	4,638	(3,792)	3,638
<b>Comprehensive income (loss) attributable to:</b>				
Subordinate Voting Shares and Multiple Voting Shares	254	4,707	(3,448)	3,777
Non-controlling interest	(375)	(69)	(344)	(139)
<b>Comprehensive income (loss)</b>	(121)	4,638	(3,792)	3,638

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

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



## 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						Total equity
	Share capital	Contributed surplus	Accumulated other comprehensive loss	Retained earnings	Total	Non-controlling interest	
<b>Balance - February 29, 2020</b>	72,695	6,260	(34,047)	236,269	281,177	3,684	284,861
Net loss for the period	-	-	-	(6,998)	(6,998)	(173)	(7,171)
Other comprehensive income	-	-	10,775	-	10,775	34	10,809
<b>Balance - August 31, 2020</b>	72,695	6,260	(23,272)	229,271	284,954	3,545	288,499
<b>Balance - February 28, 2021</b>	72,695	6,260	(21,007)	239,136	297,084	3,137	300,221
Net loss for the period	-	-	-	(58)	(58)	(312)	(370)
Other comprehensive loss	-	-	(3,390)	-	(3,390)	(32)	(3,422)
<b>Balance - August 31, 2021</b>	72,695	6,260	(24,397)	239,078	293,636	2,793	296,429

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



## Consolidated Statements of Cash Flow

(Unaudited)

(in thousands of U.S. dollars)

	Three-month periods ended		Six-month periods ended	
	August 31, 2021 \$	August 31, 2020 \$	August 31, 2021 \$	August 31, 2020 \$
<b>Cash flows from</b>				
<b>Operating activities</b>				
Net income (loss) for the period	4,696	(5,265)	(370)	(7,171)
Adjustments to reconcile net income (loss) to cash provided (used) by operating activities (note 12)	3,645	633	6,057	5,259
Changes in non-cash working capital items (note 13)	(6,808)	4,492	(3,259)	21,015
<b>Cash provided (used) by operating activities</b>	<b>1,533</b>	<b>(140)</b>	<b>2,428</b>	<b>19,103</b>
<b>Investing activities</b>				
Short-term investments	(1,232)	610	(1,418)	(527)
Additions to property, plant and equipment	(1,830)	(1,405)	(3,569)	(3,936)
Additions to intangible assets	(522)	(266)	(810)	(523)
Proceeds on disposal of property, plant and equipment, and intangible assets	-	989	3,132	1,029
Net change in other assets	(15)	(467)	(27)	(489)
<b>Cash used by investing activities</b>	<b>(3,599)</b>	<b>(539)</b>	<b>(2,692)</b>	<b>(4,446)</b>
<b>Financing activities</b>				
Dividends paid to Subordinate and Multiple Voting shareholders	-	-	-	(482)
Short-term bank loans	-	(395)	-	(1,377)
Net change in revolving credit facility	(3,378)	-	6,248	-
Increase in long-term debt	5,889	14,305	5,889	14,305
Repayment of long-term debt	(1,379)	(1,299)	(4,546)	(2,058)
Repayment of long-term lease liabilities	(444)	(425)	(857)	(856)
<b>Cash provided by financing activities</b>	<b>688</b>	<b>12,186</b>	<b>6,734</b>	<b>9,532</b>
<b>Effect of exchange rate differences on cash</b>	<b>(1,728)</b>	<b>4,218</b>	<b>(1,292)</b>	<b>5,166</b>
<b>Net change in cash during the period</b>	<b>(3,106)</b>	<b>15,725</b>	<b>5,178</b>	<b>29,355</b>
<b>Net cash – Beginning of the period</b>	<b>71,237</b>	<b>44,640</b>	<b>62,953</b>	<b>31,010</b>
<b>Net cash – End of the period</b>	<b>68,131</b>	<b>60,365</b>	<b>68,131</b>	<b>60,365</b>
Net cash is composed of:				
Cash and cash equivalents	76,448	86,894	76,448	86,894
Bank indebtedness	(8,317)	(26,529)	(8,317)	(26,529)
<b>Net cash – End of the period</b>	<b>68,131</b>	<b>60,365</b>	<b>68,131</b>	<b>60,365</b>
<b>Supplementary information</b>				
Interest received (paid)	(484)	(115)	(834)	(463)
Income taxes received (paid)	(463)	(1,954)	(1,584)	(2,509)

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 and six-month periods ended August 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 October 7, 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 and six-month periods ended August 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 statements 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 fiscal year ended February 28, 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 August 31, 2021, the company has applied for wage subsidies which provided a reduction of salaries of \$543 (August 31, 2020 – \$2,278) in Cost of sales and \$450 (August 31, 2020 – \$1,869) in Administration costs. During the six-month period ended August 31, 2021, the company has applied for wage subsidies which provided a reduction of salaries of \$1,121 (August 31, 2020 – \$4,173) in Cost of sales and \$889 (August 31, 2020 – \$3,434) 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	
<i>(thousands)</i>	August 31, 2021 \$	February 28, 2021 \$
Raw materials	41,134	40,404
Work in process and finished parts	144,883	118,553
Finished goods	54,208	45,204
	<b>240,225</b>	<b>204,161</b>

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 August 31, 2021 of \$1,975 (August 31, 2020 - \$ 2,266), including





reversals of \$718 (August 31, 2020 - \$1,152). The Company recognized a net additional inventory provision for the six-month period ended August 31, 2021 of \$3,992 (August 31, 2020 - \$2,798), including reversals of \$1,420 (August 31, 2020 - \$2,539).

## 8 Long-term debt

	As at	
	August 31, 2021	February 28, 2021
<i>(thousands)</i>	\$	\$
Revolving credit facility	28,380	22,132
Canadian subsidiary		
Secured bank loan (\$CAD 22,500; February 28, 2021 - \$CAD 15,000)	17,605	11,581
French subsidiaries		
Unsecured bank loan (€2,295; February 28, 2021 - €5,547)	2,710	6,723
Italian subsidiary		
Unsecured bank loan (€2,968; February 28, 2021 - €3,000)	3,504	3,636
Unsecured state bank loan (€805; February 28, 2021 - €920)	950	1,115
Korean structured entity		
Secured bank loan (KW 6,357,780; February 28, 2021 - KW 7,064,400)	5,485	6,266
Other	6,599	6,638
	65,233	58,091
Less: current portion	8,711	9,902
	<b>56,522</b>	<b>48,189</b>

As at August 31, 2021, the Company had drawn down \$28,380 (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 \$57,364 (February 28, 2021 - \$55,518) borrowing availability. Furthermore, as at August 31, 2021, the Company was in compliance with its covenant.

During the three-month period ended August 31, 2021, the Company's Canadian subsidiary borrowed \$5,889 in the form of a secured mortgage loan bearing monthly interest payments of 3.80%, with principal payments beginning in October 2021 and repayable over 20 years.

## 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 August 31, 2021, legal and related costs for these matters amounted to \$2,454 (August 31, 2020 - \$3,171). During the six-month period ended August 31, 2021, legal and related costs for these matters amounted to \$6,647 (August 31, 2020 - \$5,217).



## 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 August 31, 2021				
<i>(thousands)</i>	Total \$	Level 1 \$	Level 2 \$	Level 3 \$
<b>Financial position classification and nature</b>				
Assets				
<b>Derivative assets</b>	74	-	74	-
Liabilities				
<b>Derivative liabilities</b>	9	-	9	-

As at February 28, 2021				
<i>(thousands)</i>	Total \$	Level 1 \$	Level 2 \$	Level 3 \$
<b>Financial position classification and nature</b>				
Assets				
<b>Derivative assets</b>	196	-	196	-
Liabilities				
<b>Derivative liabilities</b>	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:

Six-month period ended August 31, 2021							
(thousands)	Canada \$	United States \$	France \$	Italy \$	Other \$	Consolidation adjustment \$	Consolidated \$
Sales							
Customers -							
Domestic	9,020	41,767	19,914	130	11,369	-	82,200
Export	26,920	3,960	21,156	30,513	11,673	-	94,222
Intercompany (export)	22,338	4,374	12	7,032	21,362	(55,118)	-
	<b>58,278</b>	<b>50,101</b>	<b>41,082</b>	<b>37,675</b>	<b>44,404</b>	<b>(55,118)</b>	<b>176,422</b>

Six-month period ended August 31, 2020							
(thousands)	Canada \$	United States \$	France \$	Italy \$	Other \$	Consolidation adjustment \$	Consolidated \$
Sales							
Customers -							
Domestic	5,716	45,784	14,861	981	5,736	-	73,078
Export	21,380	-	17,028	26,106	7,401	-	71,915
Intercompany (export)	11,368	6,585	64	1	29,509	(47,527)	-
	<b>38,464</b>	<b>52,369</b>	<b>31,953</b>	<b>27,088</b>	<b>42,646</b>	<b>(47,527)</b>	<b>144,993</b>

## 12 Adjustments to reconcile net income (loss) to cash provided (used) from operating activities

(thousands)	Three-months period ended		Six-month periods ended	
	August 31, 2021 \$	August 31, 2020 \$	August 31, 2021 \$	August 31, 2020 \$
Depreciation of property, plant and equipment	2,394	2,450	4,808	4,975
Amortization of intangible assets	451	626	1,009	1,194
Deferred income taxes	756	(1,492)	510	(856)
Loss (gain) on disposal of property, plant and equipment	10	22	(176)	2
Net change in derivative assets and liabilities	57	(1,185)	(172)	77
Net change in other liabilities	(23)	212	78	(133)
	<b>3,645</b>	<b>633</b>	<b>6,057</b>	<b>5,259</b>



### 13 Changes in non-cash working capital items

	Three-months period ended		Six-month periods ended	
	August 31, 2021 \$	August 31, 2020 \$	August 31, 2021 \$	August 31, 2020 \$
<i>(thousands)</i>				
Accounts receivable	(7,797)	6,286	7,188	24,866
Inventories	(7,281)	(9,809)	(38,488)	(4,805)
Income taxes recoverable	1,099	(575)	189	182
Deposits and prepaid expenses	981	(437)	(1,474)	(1,416)
Accounts payable and accrued liabilities	(2,489)	8,365	12,341	(1,961)
Income taxes payable	(144)	(1,062)	(296)	(605)
Customer deposits	10,206	3,225	18,953	6,505
Provisions	(1,383)	(1,501)	(1,672)	(1,751)
	<b>(6,808)</b>	<b>4,492</b>	<b>(3,259)</b>	<b>21,015</b>

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

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