VELAN

UNAUDITED CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three-month period ended May 31, 2023

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, 2023.

VELAN

Consolidated Statements of Financial Position

(in thousands of U.S. dollars)

	As at	
	May 31, 2023	February 28, 2023
	$	$
Assets		
Current assets		
Cash and cash equivalents	58,842	50,513
Short-term investments	17	37
Accounts receivable	90,755	121,053
Income taxes recoverable	6,700	6,195
Inventories (note 6)	216,903	202,649
Deposits and prepaid expenses	7,912	7,559
Derivative assets (note 8)	192	107
	381,321	388,113
Non-current assets		
Property, plant and equipment	67,553	68,205
Intangible assets and goodwill	16,159	16,153
Deferred income taxes	4,754	4,663
Other assets	654	723
	89,120	89,744
Total assets	470,441	477,857
Liabilities		
Current liabilities		
Bank indebtedness	212	260
Accounts payable and accrued liabilities	79,154	79,408
Income taxes payable	2,375	2,832
Customer deposits	30,459	28,201
Provisions	17,403	16,485
Derivative liabilities (note 8)	93	299
Current portion of long-term lease liabilities	1,367	1,298
Current portion of long-term debt (note 7)	8,312	8,177
	139,375	136,960
Non-current liabilities		
Long-term lease liabilities	9,191	9,458
Long-term debt (note 7)	20,715	21,719
Income taxes payable	933	933
Deferred income taxes	4,052	3,966
Customer deposits	28,770	27,937
Provisions	69,165	70,924
Other liabilities	4,767	5,125
	137,593	140,062
Total liabilities	276,968	277,022
Total equity	193,473	200,835
Total liabilities and equity	470,441	477,857

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

Consolidated Statements of Loss

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

	Three-month periods ended	
	May 31, 2023 $	**May 31, 2022 $**
Sales (note 9)	67,659	75,005
Cost of sales (notes 6)	52,607	54,932
Gross profit	15,052	20,073
Administration costs	21,499	25,812
Other income	(13)	(141)
Operating loss	(6,434)	(5,598)
Finance income	135	90
Finance costs	(1,340)	(326)
Finance costs – net	(1,205)	(236)
Loss before income taxes	(7,639)	(5,834)
Income tax expense	651	1,509
Net loss for the period	(8,290)	(7,343)
Net income (loss) attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	**(8,284)**	**(7,352)**
Non-controlling interest	(6)	9
Net loss for the period	(8,290)	(7,343)
Net loss per Subordinate and Multiple Voting Share		
Basic and diluted	(0.38)	(0.34)
Dividends declared per Subordinate and Multiple Voting Share	0.02 (CA$0.03)	- (CA$-)
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 unaudited condensed interim consolidated financial statements.

VELAN

Consolidated Statements of Comprehensive Loss

(in thousands of U.S. dollars)

	Three-month periods ended	
	May 31, 2023	**May 31, 2022**
	$	**$**
Comprehensive loss		
Net loss for the period	(8,290)	(7,343)
Other comprehensive income (loss)		
Foreign currency translation	1,408	(5,831)
Comprehensive loss	(6,882)	(13,174)
Comprehensive income (loss) attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	(6,876)	(13,182)
Non-controlling interest	(6)	8
Comprehensive loss	(6,882)	(13,174)

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 unaudited condensed interim consolidated financial statements.

Consolidated Statements of Changes in Equity

(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 28, 2022	72,695	6,260	(32,126)	217,995	264,824	686	265,510
Net income (loss) for the period	-	-	-	(7,352)	(7,352)	9	(7,343)
Other comprehensive loss	-	-	(5,830)	-	(5,830)	(1)	(5,831)
Comprehensive income (loss)	-	-	(5,830)	(7,352)	(13,182)	8	(13,174)
Other	-	-	(97)	97	-	-	-
Balance - May 31, 2022	72,695	6,260	(38,053)	210,740	251,642	694	252,336
Balance - Ferbuary 28, 2023	72,695	6,260	(41,208)	162,142	199,889	946	200,835
Net loss for the period	-	-	-	(8,284)	(8,284)	(6)	(8,290)
Other comprehensive income	-	-	1,408	-	1,408	-	1,408
Comprehensive income (loss)	-	-	1,408	(8,284)	(6,876)	(6)	(6,882)
Dividends							
Multiple Voting Shares	-	-	-	(346)	(346)	-	(346)
Subordinate Voting Shares	-	-	-	(134)	(134)	-	(134)
Balance - May 31, 2023	72,695	6,260	(39,800)	153,378	192,533	940	193,473

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

VELAN

Consolidated Statements of Cash Flow

(in thousands of U.S. dollars)

	Three-month periods ended	
	May 31, 2023 $	**May 31, 2022 $**
Cash flows from		
Operating activities		
Net loss for the period	(8,290)	(7,343)
Adjustments to reconcile net loss to cash provided (used) by operating activities (note 10)	834	(1,755)
Changes in non-cash working capital items (note 11)	18,150	6,033
Cash provided (used) by operating activities	10,694	(3,065)
Investing activities		
Short-term investments	19	(1,288)
Additions to property, plant and equipment	(1,109)	(920)
Additions to intangible assets	(384)	(9)
Proceeds on disposal of property, plant and equipment, and intangible assets	14	16
Net change in other assets	28	14
Cash used by investing activities	(1,432)	(2,187)
Financing activities		
Increase in long-term debt	-	2,160
Repayment of long-term debt	(926)	(569)
Repayment of long-term lease liabilities	(362)	(370)
Cash provided (used) by financing activities	(1,288)	1,221
Effect of exchange rate differences on cash	403	(1,782)
Net change in cash during the period	8,377	(5,813)
Net cash – Beginning of the period	50,253	53,465
Net cash – End of the period	58,630	47,652
Net cash is composed of:		
Cash and cash equivalents	58,842	49,621
Bank indebtedness	(212)	(1,969)
Net cash – End of the period	58,630	47,652
Supplementary information		
Interest paid	(49)	(223)
Income taxes paid	(2,610)	(1,817)

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

NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three-month period ended May 31, 2023

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 6, 2023.

2 Basis of preparation

These unaudited condensed interim consolidated financial statements for the three-month period ended May 31, 2023 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, 2023, 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, 2023.

3 New accounting standards and amendments issued but not yet adopted

IAS 1 Presentation of financial statements requires that, for an entity to classify a liability as non-current, the entity must have the right at the reporting date to defer settlement of the liability for at least twelve months after that date.

In January 2020, the Board issued the amendments *Classification of liabilities as current or non-current to IAS 1* (2020 amendments). The 2020 amendments originally had an effective date for reporting periods beginning on or after 1 January 2023. Applying the 2020 amendments, an entity does not have the right to defer settlement of a liability—and thus classifies the liability as current—when the entity would not have complied with covenants based on its circumstances at the reporting date, even if compliance with such covenants were tested only within twelve months after that date.

The amendments issued in October 2022 clarify that covenants of loan arrangements which an entity must comply with only after the reporting date would not affect classification of a liability as current or non-current at the reporting date. However, those covenants that an entity is required to comply with on or before the reporting date would affect classification as current or non-current, even if the covenant is only assessed after the entity's reporting date.

The 2022 amendments introduce additional disclosure requirements. When an entity classifies a liability arising from a loan arrangement as non-current and that liability is subject to the covenants which an entity is required to comply with within twelve months of the reporting date, the entity shall disclose information in the notes that enables users of financial statements to understand the risk that the liability could become repayable within twelve months of the reporting period, including:

a) the carrying amount of the liability;
b) information about the covenants;
c) facts and circumstances, if any, that indicate the entity may have difficulty complying with the covenants. Such facts and circumstances could also include the fact that the entity would not have complied with the covenants based on its circumstances at the end of the reporting period.

The *amendments to IAS 1* are effective for annual reporting periods beginning on or after January 1, 2024 with earlier adoption permitted and should be applied retrospectively. The Company does not expect the amendment to have a significant impact on its consolidated financial statements.

4 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, 2023.

5 Seasonality

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

6 Inventories

		As at
(thousands)	**May 31, 2023 $**	**February 28, 2023 $**
Raw materials	35,717	36,223
Work in process and finished parts	139,080	128,670
Finished goods	42,106	37,756
	216,903	**202,649**

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, 2023 of $1,254 (May 31, 2022 – $753), including reversals of $2,478 (May 31, 2022 - $1,631).

7 Long-term debt

(thousands)	As at May 31, 2023 $	February 28, 2023 $
Canadian subsidiary		
Secured bank loan ($CAD 20,385; February 28, 2023 - $CAD 20,906)	14,986	15,181
French subsidiaries		
Unsecured bank loan (€2,830; February 28, 2023 - €3,183)	3,024	3,366
Italian subsidiary		
Unsecured bank loan (€3,869; February 28, 2023 - €4,186)	4,135	4,427
Unsecured state bank loan (€460; February 28, 2023 - €460)	492	487
Other (note 12)	6,390	6,435
	29,027	29,896
Less: current portion	8,312	8,177
	20,715	**21,719**

As at May 31, 2023, the Company had drawn down nil (February 28, 2023 – nil) on the revolving credit facility and had $5,236 (February 28, 2023 – 5,148) in the form of outstanding letters of credit and letters of guarantee on a total of $42,556 (February 28, 2023 – 49,511) borrowing availability. Furthermore, as at May 31, 2023, the Company was in compliance with all of its covenants.

8 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, 2023
(thousands)	Total $	Level 1 $	Level 2 $	Level 3 $
Financial position classification and nature				
Assets				
Derivative assets	192	-	192	-
Liabilities				
Derivative liabilities	93	-	93	-

				As at February 28, 2023
(thousands)	Total $	Level 1 $	Level 2 $	Level 3 $
Financial position classification and nature				
Assets				
Derivative assets	107	-	107	-
Liabilities				
Derivative liabilities	299	-	299	-

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.

9 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, 2023
(thousands)	Canada $	United States $	France $	Italy $	Other $	Consolidation adjustment $	Consolidated $
Sales							
Customers -							
Domestic	5,184	24,696	8,890	51	2,313	-	41,134
Export	5,102	163	7,002	9,541	4,717	-	26,525
Intercompany (export)	10,626	1,847	85	-	11,446	(24,004)	-
	20,912	**26,706**	**15,977**	**9,592**	**18,476**	**(24,004)**	**67,659**

							Three-month period ended May 31, 2022
(thousands)	Canada $	United States $	France $	Italy $	Other $	Consolidation adjustment $	Consolidated $
Sales							
Customers -							
Domestic	5,350	21,298	9,450	35	4,272	-	40,405
Export	3,785	968	8,062	17,561	4,224	-	34,600
Intercompany (export)	6,325	2,498	29	376	13,948	(23,176)	-
	15,460	**24,764**	**17,541**	**17,972**	**22,444**	**(23,176)**	**75,005**

10 Adjustments to reconcile net loss to cash provided (used) by operating activities

	Three-month periods ended	
(thousands)	**May 31, 2023 $**	**May 31, 2022 $**
Depreciation of property, plant and equipment	2,066	2,161
Amortization of intangible assets	501	504
Amortization of financing costs	62	64
Deferred income taxes	(31)	317
Loss (gain) on disposal of property, plant and equipment	(14)	54
Net change in long-term provisions and customer deposits	(1,088)	(4,133)
Net change in derivative assets and liabilities	(292)	(504)
Net change in other liabilities	(370)	(218)
	834	**(1,755)**

11 Changes in non-cash working capital items

	Three-month periods ended	
(thousands)	**May 31, 2023 $**	**May 31, 2022 $**
Accounts receivable	31,220	14,062
Inventories	(13,492)	(10,173)
Income taxes recoverable	(489)	(561)
Deposits and prepaid expenses	(314)	(302)
Accounts payable and accrued liabilities	(1,192)	413
Income taxes payable	(466)	(1,098)
Customer deposits	2,037	3,790
Provisions	846	(98)
	18,150	**6,033**

12 Subsequent event

On June 1, 2023, the minority shareholders of one of the subsidiaries of the Company exercised the right to their unconditional put option, whereby the Company is obligated to effect the repurchase of their minority stake in the subsidiary. The amount of the repurchase is €4,591 ($4,907) as at May 31, 2023. The repurchase amount is payable within 4 months of notice issuance, thereby requiring a settlement by September 30, 2023. The resulting change to the legal structure of the Company would be that as of the date of the payment, the subsidiary will become a 100% owned subsidiary of the Company.