Report to shareholders
First quarter

Three month period ended May 31, 2019

Velan. Quality that lasts.

VELAN

VELAN

Management's Discussion and Analysis

1st QUARTER ENDED MAY 31, 2019

July 11, 2019

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, 2019. This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the Company's audited consolidated financial statements for the years ended February 28, 2019 and 2018. The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The significant accounting policies upon which these consolidated financial statements have been prepared are detailed in Notes 2 and 3 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. Selected annual information for the three most recently completed reporting periods and a summary of quarterly results for each of the eight most recently completed quarters are included further in this report. Additional information relating to the Company, including the Annual Information Form and Proxy Information Circular, can be found on SEDAR at **www.sedar.com**.

BASIS OF PRESENTATION AND ANALYSIS

The basis of presentation of the Company's first quarter unaudited condensed consolidated financial statements is detailed in Note 1 of the Company's audited consolidated financial statements for the years ended February 28, 2019 and 2018. The Company has adopted IFRS 16 as of March 1, 2019 (see *Accounting standards and amendments adopted in the period* section).

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.

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.

OVERVIEW

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 13 manufacturing plants worldwide with 1,827 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.

Management's Discussion and Analysis

The consolidated financial statements of the Company include the North American operations comprising three manufacturing plants and one distribution facility 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 distribution facility in Germany and a 50%-owned Korean foundry.

CONSOLIDATED HIGHLIGHTS[1]

(millions, excluding per share amounts)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018	Increase (decrease)	% Increase (decrease)
Consolidated statements of earnings				
Sales	$83.8	$77.9	$5.9	7.6%
Gross profit	16.1	17.7	(1.6)	(9.0)%
Gross profit %	19.2%	22.7%		
EBITDA[2]	(4.3)	(1.5)	(2.8)	(186.7)%
EBITDA[2] %	(5.1)%	(1.9)%		
EBITDA[2] per share – basic and diluted	(0.20)	(0.07)	(0.13)	(185.7)%
Net loss[3]	(5.8)	(3.7)	(2.1)	(56.8)%
Net loss[3] %	(6.9)%	(4.7)%		
Net loss[3] per share – basic and diluted	(0.27)	(0.17)	(0.10)	(58.8)%
Weighted average shares outstanding	21.6	21.6		
Consolidated statements of cash flows				
Cash provided by (used in) operating activities	1.7	(6.3)	8.0	127.0%
Cash used in investing activities	(0.7)	(1.5)	0.8	53.3%
Cash used in financing activities	(2.0)	(2.7)	0.7	25.9%
Demand data				
Net new orders received	64.2	86.2	(22.0)	(25.5)%
Period ending backlog of orders	423.3	459.9	(36.6)	(8.0)%

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

Management's Discussion and Analysis

Highlights for the three-month period ended May 31, 2019

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

- Sales amounted to $83.8 million, an increase of $5.9 million or 7.6% from the prior year. Sales were positively impacted by an increase in shipments from the Company's Korean, Italian and North American operations, which was partially offset by a decrease in shipments from the Company's French operations. The increased sales volume for the quarter is primarily attributable to the higher number of orders booked in the prior fiscal year in the shorter lead time MRO business, which was partially offset by lower sales from the Company's French operations due to the timing of the deliveries of certain of its large project orders which are scheduled for the later part of the fiscal year.
- Gross profit percentage decreased by 350 basis points from 22.7% to 19.2%. The decrease in the gross profit percentage is mainly attributable to a combination of temporary or non-recurring factors as well as to more structural business-related factors. Temporary or non-recurring factors include a product mix with a lower proportion of higher margin product sales caused by delays in shipments, such as nuclear valves from the Company's French operations, spare parts, cost items and highly engineered severe service valves in the Company's North American operations, all of which are expected to pick up later this fiscal year. The more structural factors causing the decline in gross margin include the shipment of technically complex orders with lower margins entered prior to this fiscal year. Overall, the Company is still delivering the backlog built since the end of fiscal year 2018, which carries the significantly reduced margins experienced in the Company's North American project manufacturing business, a heavy trend observed and reported in the last three years. Carrying over this legacy backlog means that the first quarter margins do not yet reflect the impact of the number of measures launched in the last months under the Company's V20 transformation plan. The combined effect of these measures is expected to gradually take effect in the course of this fiscal year and next year but the greater impact of the Company's transformative V20 initiatives is only expected late in fiscal year 2021, when the task of reorganizing and reducing the Company's North American footprint will be completed.
- Net loss[1] amounted to $5.8 million or $0.27 per share compared to $3.7 million or $0.17 per share last year. The increase in net loss[1] is primarily attributable to the Company's lower margins despite a higher sales volume.
- EBITDA[2] amounted to a negative $4.3 million or a negative $0.20 per share compared to a negative $1.5 million or a negative $0.07 per share last year. The $2.8 million decrease in EBITDA[2] is primarily attributable to a lower gross profit percentage caused by the shipment of large lower margin orders combined with an unfavorable product mix.
- Administration costs amounted to $23.5 million, an increase of $1.3 million or 5.9% compared to last year. The increase is primarily attributable to a $0.9 million provision regarding the settlement of a product claim that was filed against the Company in a prior fiscal year (see *Contingencies* section). The increase was also attributable to a $0.5 million investment in the Company's transformation and reorganization initiative, V20, which was announced during the prior fiscal year. Excluding these expenses, the Company's administration costs slightly decreased compared to the prior year.
- Net new orders received ("bookings") amounted to $64.2 million, a decrease of $22.0 million or 25.5% compared to last year. This decrease is due primarily to lower orders booked by the Company's North American operations which had seen an unusually high surge of non-project valve re-stocking orders from its distributors in the first quarter of the prior fiscal year. MRO distributor orders this fiscal year are expected to reflect a more normalized stock replenishment cycle. The decrease in bookings is also due to lower project orders booked by the Company's French operations.
- The Company ended the period with a backlog of $423.3 million, a decrease of $26.4 million or 5.9% since the beginning of the current fiscal year. The decrease in backlog is primarily attributable to the weak book-to-bill ratio of 0.77 in the quarter and the weakening of the euro spot rate against the U.S. dollar over the course of the current quarter.

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

[2] *Non-IFRS measures – see reconciliations at the end of this report.*

Management's Discussion and Analysis

- The Company ended the quarter with net cash of $39.4 million, a decrease of $1.5 million or 3.7% since the beginning of the current fiscal year. This decrease is primarily attributable to investments in property, plant and equipment, dividend payments to shareholders and repayments of long-term debt and long-term lease liabilities, partially offset by cash provided by operating activities. Net cash was also negatively impacted by the weakening of the euro spot rate against the U.S. dollar over the course of the current quarter.
- Foreign currency impacts:
  - Based on average exchange rates, the Euro weakened 7.4% 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 lower U.S. dollar amounts in the current quarter.
  - Based on average exchange rates, the Canadian dollar weakened 4.2% against the U.S. dollar when compared to the same period last year. This resulted in the Company's Canadian dollar expenses being reported as lower U.S. dollar amounts in the current quarter.
  - The net impact of the above currency swings was not significant on the Company's net loss[1].

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 2019	**February 2019**	**November 2018**	**August 2018**	**May 2018**	**February 2018**	**November 2017**	**August 2017**
Sales	$83,816	$105,345	$92,271	$91,375	$77,874	$102,607	$87,738	$76,531
Net earnings (loss)[1]	(5,824)	1,519	(236)	(2,438)	(3,727)	(8,221)	305	(5,591)
Net earnings (loss)[1] per share								
- Basic	(0.27)	0.07	(0.01)	(0.11)	(0.17)	(0.38)	0.02	(0.26)
- Diluted	(0.27)	0.07	(0.01)	(0.11)	(0.17)	(0.38)	0.02	(0.26)

Sales can vary from one quarter to the next due to the timing of the shipment of large project orders. Sales were higher in the quarters ended in February 2018 and August 2018 due to increased shipments of such orders, while the lower sales amounts for the quarters ended in August 2017, November 2017 and May 2018 were due to delayed execution on the shipments of such orders. Sales were lower for the quarter ended in May 2019 due to the timing of the deliveries of certain large project orders scheduled for the later part of the fiscal year. Sales were higher in the quarters ended in February 2019 and November 2018 due to increased shipments of large project orders but also an improvement in the MRO business. Net earnings[1] for the quarter ended in February 2019 was higher due to a higher sales volume and a more profitable product mix. A net loss[1] was recorded in the quarter ended in August 2017 due to lower sales volume and a less profitable product mix. The net loss[1] for the quarter ended in May 2019 was due to a less profitable product mix partly caused by the shipment of technically complex orders with lower margins. Net earnings[1] for the quarter ended November 2017 was lower due to a less profitable product mix. The net loss[1] for the quarters ended in August 2018 and November 2018 are largely due to the fact that the North American operations were still below break even and additional costs were incurred in the quarter to meet delivery commitments. The net loss[1] for the quarters ended in February 2018 and May 2018 was due to a less profitable product mix and shipping delays caused by internal operational issues. The quarter ended in February 2018 also had a $4.3 million one-time income tax charge resulting from the U.S. tax reform legislation passed in December 2017.

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

Management's Discussion and Analysis

RESULTS OF OPERATIONS – quarter ended May 31, 2019 compared to the quarter ended May 31, 2018 *(unless otherwise noted, all amounts are in U.S. dollars and all comparisons are to the first quarter of the last fiscal year)*

Sales

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Sales	$83.8	$77.9

Sales increased by $5.9 million or 7.6% for the quarter. Sales were positively impacted by an increase in shipments from the Company's Korean, Italian and North American operations, which was partially offset by the decrease in shipments from the Company's French operations. The increased sales volume for the quarter is primarily attributable to the higher number of orders booked in the prior fiscal year in the shorter lead time MRO business. The increase in sales was partially offset by lower sales by the Company's French operations due to the timing of the deliveries of certain of its large project orders scheduled for the later part of the fiscal year. As competition remains fierce, the Company is continuing to shift its focus and target discrete market segments where its products enjoy a competitive advantage based upon its good reputation for quality.

Bookings and backlog

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Bookings	$64.2	$86.2

Bookings decreased by $22.0 million or 25.5% compared to the same quarter last year. This decrease is due primarily to lower orders booked by the Company's North American operations which had seen an unusually high surge of non-project valve re-stocking orders from our distributors in the first quarter of the prior fiscal year. MRO distributor orders this fiscal year are expected to reflect a more normalized stock replenishment cycle. The decrease in bookings is also due to lower project orders recorded by the Company's French operations.

(millions)	**May 2019**	**February 2019**	**May 2018**
Backlog	$423.3	$449.7	$459.9
For delivery within the next twelve months	$282.4	$299.6	$295.1
For delivery beyond the next twelve months	$140.9	$150.1	$164.8
Percentage – beyond the next twelve months	33.3%	33.4%	35.8%

As a result of sales outpacing bookings in the current quarter, the Company's book-to-bill ratio was 0.77 for the period. Furthermore, the total backlog decreased by $26.4 million or 5.9% since the beginning of the fiscal year, settling at $423.3 million. The backlog was negatively impacted by the weak book-to-bill ratio and the weakening of the euro spot rate against the U.S. dollar over the course of the current quarter.

Gross profit

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Gross profit	$16.1	$17.7
Gross profit percentage	19.2%	22.7%

Gross profit decreased by $1.6 million or 9.0% compared to the same quarter last year, while the gross profit percentage decreased by 350 basis points from 22.7% to 19.2%. The decrease in the gross profit percentage is mainly attributable to a combination of temporary or non-recurring factors as well as to more structural business-related factors. Temporary or non-recurring factors include a product mix with a lower proportion of higher margin product sales mainly caused by delays in shipments, such as nuclear valves from the Company's French operations, spare parts, cost items and highly engineered severe service valves in the Company's North American operations, all of which are expected to pick up later this fiscal year. The more structural factors causing the decline in gross margin include the shipment of technically complex orders with lower margins entered prior to this fiscal year. Overall, the Company is still delivering the backlog built since the end of fiscal year 2018, which carries the significantly reduced margins experienced in the Company's North American project manufacturing business, a heavy trend observed and reported in the last three years. Carrying over this legacy backlog means that the first quarter margins do not yet reflect the impact of the number of measures launched in the last months under the Company's V20 transformation plan. These measures include the establishment of dedicated business units, greater rigour in project selection and pricing, a procurement strategy favoring lower-cost suppliers from India and South-East Asia and a reduction of manufacturing overhead. The combined effect of these measures is expected to gradually take effect in the course of this fiscal year and next year but the greater impact of the Company's transformative V20 initiatives is only expected late in fiscal year 2021, when the task of reorganizing and reducing the Company's North American footprint will be completed.

Administration Costs

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Administration Costs*	$23.5	$22.2
As a percentage of sales	28.0%	28.6%
*Includes asbestos-related costs of:	$2.0	$2.3

Administration costs increased by $1.3 million or 5.9%. The increase is primarily attributable to a $0.9 million provision regarding the settlement of a product claim that was filed against the Company in a prior fiscal year (see *Contingencies* section). The increase is also attributable to a $0.5 million investment in the Company's transformation and reorganization initiative, V20, which was announced over the course of the prior fiscal year. Excluding this investment, the Company's administration costs slightly decreased compared to the prior fiscal year. The costs recognized in connection with the Company's ongoing asbestos litigation (see *Contingencies* section) decreased by $0.3 million compared to the prior year. The fluctuation in asbestos costs for the quarter is due more to the timing of settlements in these two periods rather than to changes in long-term trends.

Like many other U.S. valve manufacturers, two of the Company's U.S. subsidiaries have been named as defendants in a number of pending lawsuits brought on behalf of individuals seeking to recover damages for their alleged asbestos exposure. These lawsuits are related to products manufactured and sold in the past. Management believes that any asbestos was incorporated entirely within the product in such a way that it would not allow for any ambient asbestos during normal operation, inspection or repairs. Management strongly believes its products, which were supplied in accordance with valve industry practice and customer mandated specifications, did not contribute to any asbestos-related illness. The Company will continue to vigorously defend against these claims but given the ongoing course of asbestos litigation in the U.S. and the unpredictability of jury trials, it is not possible to make an estimate of any settlement costs and legal fees.

Finance costs

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Net finance costs	$0.3	$-

Net finance costs increased by $0.3 million for the quarter. While long-term debt slightly decreased when compared to the beginning of the quarter, the Company's overall debt load increased, particularly its bank indebtedness in its North American operations, resulting in an increase in its finance costs (see *Liquidity and Capital Resources* section). The Company's adoption of IFRS 16 caused a $0.1 million increase for the quarter since the Company elected the modified retrospective transition method whereby comparative balances have not been restated.

Income taxes

(in thousands, excluding percentages)	Three-month period ended May 31, 2019 $	%	Three-month period ended May 31, 2018 $	%
Income tax at statutory rate of 26.7%	(2,038)	26.7	(1,201)	26.7
Tax effects of:				
Difference in statutory tax rates in foreign jurisdictions	(38)	0.5	291	(6.5)
Non-deductible (taxable) foreign exchange loss (gain)	329	(4.3)	(68)	1.5
Losses not tax effected	221	(2.9)	525	(11.6)
Losses utilized not previously tax effected	(170)	2.2	-	-
Benefit attributable to a financing structure	(222)	2.9	(227)	5.0
Other differences	99	(1.3)	(149)	3.3
Provision for (Recovery of) income taxes	(1,819)	23.8	(829)	18.4

A separate estimated average annual tax rate is determined for each taxing jurisdiction and applied to their respective interim pre-tax income.

Net loss[1]

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Net earnings (loss)[1]	$(5.8)	$(3.7)
As a percentage of sales	(6.9)%	(4.7)%
EBITDA[2]	$(4.3)	$(1.5)
As a percentage of sales	(5.1)%	(1.9)%

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

[2] *Non-IFRS measures – see reconciliations at the end of this report.*

Net loss[1] amounted to $5.8 million or $0.27 per share compared to $3.7 million or $0.17 per share last year. The increase in net loss[1] is primarily attributable to the Company's lowered margins despite a higher sales volume. EBITDA[2] amounted to a negative $4.3 million or a negative $0.20 per share compared to a negative $1.5 million or a negative $0.12 per share last year. The $2.8 million decrease in EBITDA[2] is primarily attributable to a lower gross profit percentage attributable to the shipment of technically complex orders with lower margins combined with an unfavorable product mix.

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.

The following table presents the Company's financial obligations identified by type and future contractual dates of payment:

(In thousands)					May 31, 2019
	Total $	Less than 1 year $	1 to 3 Years $	4 to 5 Years $	After 5 years $
Long-term debt	20,384	8,120	5,486	3,434	3,344
Long-term lease Liabilities	14,561	1,266	2,076	1,569	9,650
Accounts payable and accrued liabilities	76,474	76,474	-	-	-
Customer deposits	39,176	39,176	-	-	-
Bank indebtedness and short-term bank loans	34,933	34,933	-	-	-
Derivative liabilities	246	246	-	-	-

On May 31, 2019, the Company's order backlog was $423.3 million and its net cash plus unused credit facilities amounted to $115.9 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. 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. The Company continues to closely monitor the continued weakness of the price of oil and the euro currency, as well as recent trade protectionist measures and economic sanctions.

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

Proposed transactions

The Company has not committed to any material asset or business acquisitions or dispositions, other than those already discussed in this MD&A.

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

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Cash flows - quarter ended May 31, 2019 compared to the quarter ended May 31, 2018

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

Net cash

(millions)	May 31, 2019	February 28, 2019	May 31, 2018
Net cash	$39.4	$40.9	$51.6

The Company's net cash decreased by $1.5 million or 3.7% during the quarter. This decrease is primarily attributable to investments in property, plant and equipment, dividend payments to shareholders and repayments of long-term debt and long-term lease liabilities, partially offset by cash provided by operating activities. Net cash was also negatively impacted by the weakening of the euro spot rate against the U.S. dollar over the course of the current quarter.

Cash provided by (used in) operating activities

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Cash provided by (used in) operating activities	$1.7	$(6.3)

Cash provided by operating activities amounted to $1.7 million for the current quarter compared to cash used in operating activities of $6.3 million in the prior year. The current quarter's positive cash flow consisted of negative cash net losses[1] of $3.1 million and positive non-cash working capital movements of $4.8 million, which consisted primarily of a decrease in accounts receivable, partially offset by an increase in inventory and income taxes recoverable.

Accounts receivable

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Accounts receivable decrease	$14.7	$4.6

Accounts receivable balances are a function of the timing of sales and cash collections. The accounts receivable balance decreased in the current quarter due primarily to the increased collection of prior year sales.

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

Inventories

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Inventories increase	$5.9	$1.5
Customer deposits decrease	$(1.1)	$(2.9)

The increase in the quarter is due to the replenishment of stock following large shipments that occurred at the end of the prior fiscal year. In order to help finance its investment in inventories, the Company, where possible, obtains customer deposits for large orders. Customer deposits decreased due to the shipment of certain large project orders in the quarter.

Accounts payable and accrued liabilities

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Accounts payable and accrued liabilities (decrease) increase	$1.5	$(0.3)

The increase in accounts payable and accrued liabilities in the current quarter was primarily related to the timing of payments.

Additions to property, plant and equipment

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Additions to property, plant and equipment	$0.7	$2.0

The decrease in additions to property, plant and equipment for the current quarter when compared to the prior year is due to the timing of the receipts of certain equipment.

Dividends

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Dividends paid	$0.5	$1.6

The Company changed its dividend policy two fiscal years ago, reducing the dividend from CA$0.10 per share per quarter to CA$0.03 per share per quarter. The new policy took effect, starting with the dividend payment of June 29, 2018. The dividend paid in the prior quarter was under the prior dividend policy.

Long-term debt

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Additions of long-term debt	$-	$0.6
Repayment of long-term debt	$0.7	$0.7

During the current quarter, the Company continued to pay down its outstanding long-term debt without undertaking any new debt issuances. In the prior quarter, one of the Company's French subsidiaries undertook a new debt issuance to finance certain building renovations. Specifically, the Company borrowed $0.6 million (€0.5 million) in the form of an unsecured bank loan, bearing interest at 0.53% and repayable in 60 monthly instalments, expiring in 2023.

Long-term lease liabilities

(millions)	Three-month period ended May 31, 2019	Three-month period ended May 31, 2018
Repayment of long-term lease liabilities	$0.4	$-

The Company has adopted IFRS 16 at the beginning of the current fiscal year using the modified retrospective transition method whereby the comparative was not restated. As per the new standard, repayments of the capital portion of lease liabilities are considered as financing activities in the statement of cash flow. During the current quarter, the Company has not signed any new lease agreements and has continued to repay its current lease obligations.

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).

Risk overview

The Company's financial instruments and the nature of risks which they may be subject to are set out in the following table:

	Risks			
	Market			
Financial instrument	**Currency**	**Interest rate**	**Credit**	**Liquidity**
Cash and cash equivalents	x	x	x	
Short-term investments	x	x	x	
Accounts receivable	x		x	
Derivative assets	x		x	
Bank indebtedness	x	x		x
Short-term bank loans	x	x		x
Accounts payable and accrued liabilities	x			x
Customer deposits	x			x
Dividend payable	x			x
Derivative liabilities	x			x
Long-term debt	x	x		x

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, 2019 and February 28, 2019 are as follows:

	Range of exchange rates		Gain (loss) (In thousands of U.S. dollars)		Notional amount (In thousands of indicated currency)	
	May 31, 2019	February 28, 2019	May 31, 2019 $	February 28, 2019 $	May 31, 2019	February 28, 2019
Foreign exchange forward contracts						
Sell US$ for CA$ – 0 to 12 months	1.35-1.36	1.36	(191)	(61)	US$60,750	US$26,000
Buy US$ for CA$ – 0 to 12 months	1.28-1.30	1.30	4	183	US$60,750	US$26,000
Sell US$ for € – 0 to 12 months	1.18	1.15-1.18	(44)	(15)	US$2,000	US$2,010
Sell € for US$ – 0 to 12 months	1.15	1.14	(11)	(2)	€4,710	€907
Buy € for US$ – 0 to 12 months	1.10	-	9	-	€4,710	-

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.

Cash flow and fair value 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, 2019, three (February 28, 2019 – four) customers accounted for more than 5% each of its trade accounts receivable, of which one customer accounted for 12.1% (February 28, 2019 – 10.5%), and the Company's ten largest customers accounted for 47.1% (February 28, 2019 – 58.9%) of trade accounts receivable. In addition, there was one (February 28, 2019 – one) customer 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. An allowance for doubtful accounts is recorded when, based on management's evaluation, the collection of an account receivable is not reasonably certain.

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.

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 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.

Management's Discussion and Analysis

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:

(In thousands of U.S. dollars)	May 31, 2019 $	February 28, 2019 $
Current	51,941	75,888
Past due 0 to 30 days	15,874	13,329
Past due 31 to 90 days	20,812	15,860
Past due more than 90 days	26,532	26,845
	115,159	131,922
Less: Allowance for doubtful accounts	1,808	1,662
Trade accounts receivable	113,351	130,260
Other receivables	8,880	7,260
Total accounts receivable	122,231	137,520

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

(In thousands of U.S. dollars)	May 31, 2019 $	May 31, 2018 $
Balance – Beginning of year	1,662	1,088
Bad debt expenses	10	17
Recoveries of trade accounts receivable	-	-
Write-off of trade accounts receivable	(28)	(1)
Foreign exchange	164	(28)
Balance – End of year	1,808	1,076

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

Management's Discussion and Analysis

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. 1,417 claims were outstanding at the end of the reporting period (February 28, 2019 – 1,349). These claims were filed in the states of Arkansas, California, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, New Jersey, New York, North Carolina, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Texas, Virginia, Washington, Wisconsin and West Virginia. During the reporting period, the Company resolved 88 claims (May 31, 2018 – 137) and was the subject of 156 new claims (May 31, 2018 – 158). Because of the many uncertainties inherent in predicting the outcome of these proceedings, as well as the course of asbestos litigation in the United States, management believes that it is not possible to make an estimate of the Company's asbestos liability. Accordingly, no provision has been set up in the accounts. Settlement costs and legal fees related to these asbestos claims amounted to $2,028 (May 31, 2018 - $2,282) in the quarter.

On December 3, 2014, San Diego Gas & Electric Company ("SDG") filed a claim against Velan Valve Corp., a wholly-owned subsidiary of the Company, in the Superior Court of the State of California, concerning high pressure valves supplied to SDG and installed at its Palomar Energy Center ("Facility"). This lawsuit alleged damages to the Facility in excess of $9,000 related to allegedly defective valves supplied by Velan Valve Corp. The claim was for alleged strict product liability and alleged negligence. The Company vigorously defended its position and undertook all actions necessary to protect its reputation. During the three-month period ended May 31, 2019, the Company has recorded a net settlement of $850 in regard to this claim.

OFF-BALANCE SHEET ARRANGEMENTS

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

RELATED PARTY TRANSACTIONS (in thousands of U.S. dollars)

The Company has entered into the following transactions with related parties, which are measured at their exchange value.

a) PDK Machine Shop Ltd. ("PDK") is a company owned by certain relatives of the controlling shareholder. PDK is a supplier of machined material components for use in the Company's plants.

	Three months ended May 31	
	2019	2018
Purchases of material components	$217	$458

The Company entered into an agreement with PDK pursuant to which it has the right to purchase the shares of PDK for a consideration equal to the book value thereof in the event that they propose to sell their shares to a third party. In the event that PDK proposes to sell all or substantially all of its assets to a third party, the Company has the right to purchase inventory at cost and other assets at book value. In the event of a proposed liquidation or sale of sufficient assets such that PDK cannot fulfill its obligations to the Company under any outstanding purchase orders, the Company also has the right and the obligation to purchase PDK's inventory at an amount equal to the cost thereof. The maximum obligation of the Company pursuant to such put right is $200.

CONTROLS AND PROCEDURES

The Company did not make any changes to the design of internal controls over financial reporting during the three-month period ended May 31, 2019 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 note 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 thousands of U.S. dollars)

(i) In January 2016, the IASB issued IFRS 16, *Leases*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract. It eliminates the classification of leases as either operating leases or finance leases and introduces a single lessee accounting model for lessees. It substantially carries forward the lessor accounting requirements. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. IFRS 16 replaces IAS 17, *Leases*, IFRIC 4, *Determining whether an Arrangement contains a Lease*, SIC-15, *Operating Leases – Incentives*, and SIC-27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

The new standard was adopted effective March 1, 2019 and the Company elected the modified retrospective transition method on the effective date, without restatement of the comparative figures. As such, comparative information continues to be reported under previous accounting standards.

At inception of a contract, the Company assesses whether a contract is, or contains, a lease based on whether the contract includes the right to control the use of an identified asset for a period of time in exchange for consideration.

In situations where the Company is a lessee, the result is the recording, at the lease commencement date, of a right-of-use asset and a lease liability for the present value of the future lease payments on the statement of financial position for most of its contracts that were considered operating leases under IAS 17. In order to determine the present value of the future lease payments, the Company uses the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company uses the incremental borrowing rate of each of its subsidiaries. The Company depreciates its right-of-use asset on the lesser of the lease term or the useful life of the asset using the straight-line method since it closely reflects the expected pattern of consumption of the future economic benefits.

The right-of-use asset may be periodically reduced by impairment losses, if any, and adjusted for certain remeasurement of the lease liability. The lease liability is measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index, rate or estimate. The lease liability is remeasured with a corresponding adjustment to the carrying value of the right-of use asset. If the carrying value of the right-of-use asset has been reduced to zero, the remaining adjustment is recorded in the statement of income (loss).

Cash payments for the principal portion of the lease liability are presented within the financial activities and the interest portion of the lease liability is presented within the operating activities of the statement of cash flows. Payments associated with short-term leases and leases of low-value assets are not included in the measurement of the lease liability and are presented in operating activities in the statement of cash flows.

At the date of initial application, the Company elected to measure the right-of-use asset in an amount equal to the lease liability. The Company also applied the following practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

(i) The Company elected to apply the standard to contracts that were previously identified as leases under IAS 17 and IFRIC 4 and elected to not apply the standard to contracts that were not previously identified as leases under IAS 17 and IFRC 4.
(ii) The Company has elected to exclude intangible assets from the scope of this standard.
(iii) The Company used the exemptions proposed by the standard on lease contracts for which the lease terms end within 12 months as the date of initial application, and lease contracts for which the underlying asset is of low value.
(iv) The Company used hindsight to determine the lease terms if the contract contained options to extend or terminate the lease term.

The following table reconciles the Company's operating lease obligations at February 28, 2019 to the lease liabilities recognized on initial application of IFRS 16 at March 1, 2019.

Operating Lease Commitments disclosed as at February 28, 2019	**15,763**
Discounted using the lessee's weighted average incremental borrowing rate of 2.49% at the date of initial application	(4,249)
(Less): Short-term leases and low-value leases recognized on a straight-line basis as an expense	(331)
Add/(less): Adjustments as a result of a different treatment of extension and termination options	3,980
Lease liability recognized as at March 1, 2019	**15,163**
Of which are:	
Current lease liabilities	1,290
Non-current lease liabilities	13,873

The recognized right-of-use assets relate to the following types of assets:

	As at May 31, 2019 $	**As at March 1, 2019 $**
Land	6,350	6,528
Buildings	6,861	7,150
Furniture & Fixtures	43	48
Data Processing Equipment	210	241
Rolling Stock	1,034	1,196
Total Right of use asset	14,498	15,163

The following table summarizes the impact of adopting IFRS 16 on the Company's consolidated statement of financial position as at March 1, 2019. Prior amounts have not been restated. The Company's transition to IFRS 16 did not impact the Company's retained earnings.

	February 28, 2019 $	Adjustment due to IFRS 16 $	March 1, 2019 $
Non-current assets			
Property, Plant and Equipment	83,537	15,163	98,700
Current liabilities			
Current portion of long-term lease liabilities	-	1,290	1,290
Non-current liabilities			
Long-term lease liabilities	-	13,873	13,873

(ii) In June 2017, IFRIC issued IFRIC 23, *Uncertainty over Income Tax Treatments*. This interpretation clarifies how the recognition and measurement requirements of IAS 12, *Income Taxes*, are applied where there is uncertainty over income tax treatments that have yet to be accepted by tax authorities.

The Company has adopted the interpretation of IFRIC 23 on March 1, 2019 and concluded that it has no impact on previously reported results.

CERTAIN RISKS THAT COULD AFFECT OUR BUSINESS

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

Management's Discussion and Analysis

SUMMARY OF RESULTS

Summary financial data derived from the Company's financial statements prepared in accordance with IFRS for the three most recently completed reporting periods are as follows:

For the reporting periods ended on the following dates
(in thousands of U.S. dollars, excluding number of shares and per share amounts)

	Fiscal year ended February 28, 2019	Fiscal year ended February 28, 2018	Fiscal year ended February 28, 2017
Operating Data			
Sales	$366,865	$337,963	$331,777
Net Earnings (loss)[1]	(4,882)	(17,811)	7,737
Earnings (loss) per Share			
- Basic	(0.23)	(0.82)	0.36
- Diluted	(0.23)	(0.82)	0.36
Balance Sheet Data			
Total Assets	524,357	540,193	519,297
Total Long-Term Financial Liabilities	21,723	22,200	22,532
Shareholder Data			
Cash dividends per share			
- Multiple Voting Shares[2]	0.09	0.31	0.31
- Subordinate Voting Shares	0.09	0.31	0.31
Outstanding Shares at report date			
- Multiple Voting Shares[2]	15,566,567		
- Subordinate Voting Shares	6,055,368		

Sales for fiscal year 2019 increased by 8.6% compared to fiscal year 2018. This increase was primarily attributable to an increase in shipments from the Company's North American, Korean and Indian subsidiaries, which were partially offset by decreased shipments from the Company's German operations. The Company was able to notably improve its MRO business as well as increasing its shipments related to large project orders. Sales for fiscal year 2018 increased by 1.9% compared to fiscal year 2017. This increase was primarily attributable to an increase in shipments from the Company's Italian subsidiary, which were offset by decreased shipments from the Company's North American operations. Delays in shipments of certain large project orders caused by various customer-related, supply chain and internal operational issues, and lower shipments of non-project commodity valves negatively impacted the Company's North American operations in fiscal year 2018.

Gross profit for fiscal year 2019 amounted to $85.6 million, an increase of $14.7 million from fiscal year 2018, while the gross profit percentage increased from the 21.0% reported in fiscal year 2018 to 23.3% in fiscal year 2019. This increase was due primarily to the higher sales volume achieved by the Company's North American, Korea and Indian operations combined with the shipment of a more efficient product mix by the Company's French operations, which was partially offset by the lower sales volume shipped by the Company's German operations. Gross profit for fiscal year 2018 amounted to $70.9 million, a decrease of $17.6 million from fiscal year 2017, while the gross profit percentage decreased from the 26.7% reported in fiscal year 2017 to 21.0% in fiscal year 2018. This decrease was due primarily to the Company's North American operations, which shipped a product mix with a greater proportion of projects with lower margins, coupled with pricing pressures brought on by fierce competition and continued weakness in certain markets, which was only partially offset by material cost savings.

Administration costs for fiscal year 2019 increased by $5.6 million when compared to fiscal year 2018. This fluctuation was attributable to an increase in bad debt expense, selling expenses, retirement expenses and freight charges for certain overseas project customers resulting from the higher sales volume as well as the need to incur air freight costs on a large delayed order. The Company had also invested $1.0 million in its current transformation initiative, Velocity 2020. The Company also experienced an increase in costs recognized in connection with the Company's ongoing asbestos litigation (see *Contingencies* section). Administration costs for fiscal year 2018 increased by $11.8 million when compared to fiscal year 2017. This increase was primarily attributable to an increase in sales commissions and freight charges due to the increased sales volume, an increase in technology license fees paid on the sale of certain highly-engineered cryogenic valves, and an increase in costs recognized in connection with the Company's ongoing asbestos litigation (see *Contingencies* section).

The fiscal year 2018 net loss[1] was also negatively impacted by a $4.3 million one-time income tax charge due to the U.S. tax reform legislation passed in December 2017.

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[1] *Net earnings or loss refers to net income or loss attributable to Subordinate and Multiple Voting Shares.*
[2] *Multiple Voting Shares (five votes per share) are convertible into Subordinate Voting Shares on a 1 to 1 basis.*

RECONCILIATIONS OF NON-IFRS MEASURES

In this MD&A, the Company 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 below.

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

For the quarter ended:	May 31, 2019	May 31, 2018
Net income (loss) attributable to Subordinate Voting Shares and Multiple Voting Shares	(5.8)	(3.7)
Adjustments for:		
Depreciation of property, plant and equipment	2.6	2.6
Amortization of intangible assets	0.4	0.4
Finance costs (income) - net	0.3	0.0
Income taxes	(1.8)	(0.8)
EBITDA	(4.3)	(1.5)

Velan Inc.

Unaudited Condensed Interim Consolidated Financial Statements
For the three-month period ended May 31, 2019

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, 2019

Velan Inc.

Condensed Interim Consolidated Statements of Financial Position

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

As At	May 31, 2019 $	February 28, 2019 $
Assets		
Current assets		
Cash and cash equivalents	72,597	70,673
Short-term investments	662	658
Accounts receivable	122,231	137,520
Income taxes recoverable	20,694	16,863
Inventories (note 7)	171,257	165,583
Deposits and prepaid expenses	3,606	4,612
Derivative assets	13	189
	391,060	396,098
Non-current assets		
Property, plant and equipment (note 3)	95,622	83,537
Intangible assets and goodwill	17,304	18,146
Deferred income taxes	25,135	25,947
Other assets	615	629
	138,676	128,259
Total assets	529,736	524,357
Liabilities		
Current liabilities		
Bank indebtedness	33,200	29,807
Short-term bank loans	1,733	2,172
Accounts payable and accrued liabilities	76,474	74,910
Income taxes payable	481	495
Dividend payable	501	497
Customer deposits	39,176	40,240
Provisions	7,657	8,494
Accrual for performance guarantees	22,375	23,014
Derivative liabilities	246	83
Current portion of long-term debt	8,120	8,609
Current portion of long-term lease liabilities (note 3)	1,266	-
	191,229	188,321
Non-current liabilities		
Long-term debt	12,264	13,242
Long-term lease liabilities (note 3)	13,295	-
Income taxes payable	2,033	1,742
Deferred income taxes	3,551	3,738
Other liabilities	7,682	8,481
	38,825	27,203
Total liabilities	230,054	215,524
Equity		
Equity attributable to the Subordinate and Multiple Voting shareholders		
Share capital (note 8)	73,090	73,090
Contributed surplus	6,075	6,074
Retained earnings	248,301	254,606
Accumulated other comprehensive loss	(31,703)	(28,990)
	295,763	304,780
Non-controlling interests	3,919	4,053
Total equity	299,682	308,833
Total liabilities and equity	529,736	524,357

Commitments and contingencies (note 9)

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

Velan Inc.

Condensed Interim Consolidated Statements of Income (Loss)

(Unaudited)

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

	Three-month periods ended May 31	
	2019	**2018**
	$	**$**
Sales	83,816	77,874
Cost of sales (note 7)	67,722	60,137
Gross profit	16,094	17,737
Administration costs	23,463	22,224
Other income	(57)	(16)
Operating loss	(7,312)	(4,471)
Finance income	140	142
Finance costs	467	174
Finance costs – net	(327)	(32)
Loss before income taxes	(7,639)	(4,503)
Income taxes	(1,819)	(829)
Net loss for the period	(5,820)	(3,674)
Net loss attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	**(5,824)**	**(3,727)**
Non-controlling interest	4	53
	(5,820)	(3,674)
Net loss per Subordinate and Multiple Voting Share		
Basic	(0.27)	(0.17)
Diluted	(0.27)	(0.17)
Dividends declared per Subordinate and Multiple Voting Share	0.02 (CA$0.03)	0.02 (CA$0.03)
Total weighted average number of Subordinate and Multiple Voting Shares		
Basic	21,621,935	21,621,935
Diluted	21,621,935	21,621,935

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

Velan Inc.

Condensed Interim Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)
(in thousands of U.S. dollars)

	Three-month periods ended May 31	
	2019 **$**	**2018** **$**
Comprehensive loss		
Net loss for the period	(5,820)	(3,674)
Other comprehensive loss		
Foreign currency translation adjustment on foreign operations whose functional currency is other than the reporting currency (U.S. dollar)	(2,851)	(5,432)
Comprehensive loss	(8,671)	(9,106)
Comprehensive income (loss) attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	(8,537)	(9,168)
Non-controlling interest	(134)	62
	(8,671)	(9,106)

Other comprehensive income (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 Inc.

Condensed Interim 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							
	Number of shares	Share capital	Contributed surplus	Accumulated other comprehensive income (loss)	Retained earnings	Total	Non-controlling interest	Total equity
Balance - February 28, 2019	21,621,935	73,090	6,074	(28,990)	254,606	304,780	4,053	308,833
Net income (loss) for the period	-	-	-	-	(5,824)	(5,824)	4	(5,820)
Other comprehensive loss	-	-	-	(2,713)	-	(2,713)	(138)	(2,851)
	21,621,935	73,090	6,074	(31,703)	248,782	296,243	3,919	300,162
Effect of share-based compensation (note 8 (c))	-	-	1	-	-	1	-	1
Dividends								
Multiple Voting Shares	-	-	-	-	(346)	(346)	-	(346)
Subordinate Voting Shares	-	-	-	-	(135)	(135)	-	(135)
Balance - May 31, 2019	21,621,935	73,090	6,075	(31,703)	248,301	295,763	3,919	299,682
Balance - February 28, 2018	21,621,935	73,090	6,057	(19,790)	256,668	316,025	5,592	321,617
Adjustment related to the transition to IFRS 15	-	-	-	-	4,741	4,741	-	4,741
Adjusted balance - March 1, 2018	21,621,935	73,090	6,057	(19,790)	261,409	320,766	5,592	326,358
Net income (loss) for the period	-	-	-	-	(3,727)	(3,727)	53	(3,674)
Other comprehensive income (loss)	-	-	-	(5,441)	-	(5,441)	9	(5,432)
	21,621,935	73,090	6,057	(25,231)	257,682	311,598	5,654	317,252
Effect of share-based compensation (note 8 (c))	-	-	4	-	-	4	-	4
Dividends								
Multiple Voting Shares	-	-	-	-	(335)	(335)	-	(335)
Subordinate Voting Shares	-	-	-	-	(130)	(130)	-	(130)
Non-controlling interest	-	-	-	-	-	-	(927)	(927)
Balance - May 31, 2018	21,621,935	73,090	6,061	(25,231)	257,217	311,137	4,727	315,864

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

Velan Inc.

Condensed Interim Consolidated Statements of Cash Flow

(Unaudited)

(in thousands of U.S. dollars)

	Three-month periods ended May 31	
	2019	2018
	$	$
Cash flows from		
Operating activities		
Net loss for the period	(5,820)	(3,674)
Adjustments to reconcile net loss to cash provided by (used in) operating activities (note 10)	2,683	3,550
Changes in non-cash working capital items (note 11)	4,859	(6,205)
Cash provided by (used in) operating activities	1,722	(6,329)
Investing activities		
Short-term investments	(4)	51
Additions to property, plant and equipment	(748)	(2,012)
Additions to intangible assets	(22)	(96)
Proceeds on disposal of property, plant and equipment, and intangible assets	32	10
Net change in other assets	13	527
Cash used in investing activities	(729)	(1,520)
Financing activities		
Dividends paid to Subordinate and Multiple Voting shareholders	(476)	(1,642)
Dividends paid to non-controlling interest	-	(927)
Short-term bank loans	(439)	(35)
Increase in long-term debt	-	607
Repayment of long-term debt	(716)	(662)
Repayment of long-term lease liabilities (note 3)	(396)	-
Cash used in financing activities	(2,027)	(2,659)
Effect of exchange rate differences on cash	(435)	(2,408)
Net change in cash during the period	(1,469)	(12,916)
Net cash – Beginning of the period	40,866	64,543
Net cash – End of the period	39,397	51,627
Net cash is composed of:		
Cash and cash equivalents	72,597	77,969
Bank indebtedness	(33,200)	(26,342)
	39,397	51,627
Supplementary information		
Interest paid	279	36
Income taxes paid	1,831	1,933

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

For the three-month period ended May 31, 2019

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 11, 2019. 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, 2019 have been prepared in accordance with International Financial Reporting Standards ("IFRS") in accordance with International Accounting Standard ("IAS") 34, *Interim Financial Reporting*. Except as disclosed in note 3 below, 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, 2019, 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, 2019.

3 Changes in accounting policies

(i) In January 2016, the IASB issued IFRS 16, *Leases*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract. It eliminates the classification of leases as either operating leases or finance leases and introduces a single lessee accounting model for lessees. It substantially carries forward the lessor accounting requirements. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. IFRS 16 replaces IAS 17, *Leases*, IFRIC 4, *Determining whether an Arrangement contains a Lease*, SIC-15, *Operating Leases – Incentives*, and SIC-27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

The new standard was adopted effective March 1, 2019 and the Company elected the modified retrospective transition method on the effective date, without restatement of the comparative figures. As such, comparative information continues to be reported under previous accounting standards.

At inception of a contract, the Company assesses whether a contract is, or contains, a lease based on whether the contract includes the right to control the use of an identified asset for a period of time in exchange for consideration.

In situations where the Company is a lessee, the result is the recording, at the lease commencement date, of a right-of-use asset and a lease liability for the present value of the future lease payments on the statement of financial position for most of its contracts that were considered operating leases under IAS 17. In order to determine the present value of the future lease payments, the Company uses the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company uses the incremental borrowing rate of each of its subsidiaries. The Company depreciates its right-of-use asset on the lesser of the lease term or the useful life of the asset using the straight-line method since it closely reflects the expected pattern of consumption of the future economic benefits.

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

The right-of-use asset may be periodically reduced by impairment losses, if any, and adjusted for certain remeasurement of the lease liability. The lease liability is measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index, rate or estimate. The lease liability is remeasured with a corresponding adjustment to the carrying value of the right-of use asset. If the carrying value of the right-of-use asset has been reduced to zero, the remaining adjustment is recorded in the statement of income (loss).

Cash payments for the principal portion of the lease liability are presented within the financial activities and the interest portion of the lease liability is presented within the operating activities of the statement of cash flows. Payments associated with short-term leases and leases of low value assets are not included in the measurement of the lease liability and are presented in operating activities in the statement of cash flows.

At the date of initial application, the Company elected to measure the right-of-use asset in an amount equal to the lease liability. The Company also applied the following practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

(i) The Company elected to apply the standard to contracts that were previously identified as leases under IAS 17 and IFRIC 4 and elected to not apply the standard to contracts that were not previously identified as leases under IAS 17 and IFRC 4.
(ii) The Company has elected to exclude intangible assets from the scope of this standard.
(iii) The Company used the exemptions proposed by the standard on lease contracts for which the lease terms end within 12 months as the date of initial application, and lease contracts for which the underlying asset is of low value.
(iv) The Company used hindsight to determine the lease terms if the contract contained options to extend or terminate the lease term.

The following table reconciles the Company's operating lease obligations at February 28, 2019 to the lease liabilities recognized on initial application of IFRS 16 at March 1, 2019.

Operating Lease Commitments disclosed as at February 28, 2019	**15,763**
Discounted using the lessee's weighted average incremental borrowing rate of 2.49% at the date of initial application	(4,249)
(Less): Short-term leases and low-value leases recognized on straight-line basis as expense	(331)
Add/(less): Adjustments as a result of a different treatment of extension and termination options	3,980
Lease liability recognized as at March 1, 2019	**15,163**
Of which are:	
Current lease liabilities	1,290
Non-current lease liabilities	13,873

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

The recognized right-of-use assets relate to the following types of assets:

	As at May 31, 2019 $	As at March 1, 2019 $
Land	6,350	6,528
Buildings	6,861	7,150
Furniture & Fixtures	43	48
Data Processing Equipment	210	241
Rolling Stock	1,034	1,196
Total Right of use asset	14,498	15,163

The following table summarizes the impact of adopting IFRS 16 on the Company's consolidated statement of financial position as at March 1, 2019. Prior amounts have not been restated. The Company's transition to IFRS 16 did not impact the Company's retained earnings.

	February 28, 2019 $	Adjustment due to IFRS 16 $	March 1, 2019 $
Non-current assets			
Property, Plant and Equipment	83,537	15,163	98,700
Current liabilities			
Current portion of long-term lease liabilities	-	1,290	1,290
Non-current liabilities			
Long-term lease liabilities	-	13,873	13,873

(ii) In June 2017, IFRIC issued IFRIC 23, Uncertainty over Income Tax Treatments. This interpretation clarifies how the recognition and measurement requirements of IAS 12, Income Taxes, are applied where there is uncertainty over income tax treatments that have yet to be accepted by tax authorities.

The Company has adopted the interpretation of IFRIC 23 on March 1, 2019 and concluded that it has no impact on previously reported results.

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, 2019.

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

5 Seasonality

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

6 Operating segment information

Consistent with the prior fiscal year, the Company reflects its results under a single reportable operating segment.

7 Inventories

	May 31, 2019 $	February 28, 2019 $
Raw materials	34,197	35,858
Work in process and finished parts	106,945	96,863
Finished goods	30,115	32,862
	171,257	165,583

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, 2019 of $1,246 (May 31, 2018 - $1,186), including reversals of $1,075 (May 31, 2018 - $1,250).

8 Capital stock

a) Authorized – in unlimited number
   Preferred Shares, issuable in series
   Subordinate Voting Shares
   Multiple Voting Shares (five votes per share), convertible into Subordinate Voting Shares

b) Issued

	May 31, 2019 $	February 28, 2019 $
6,055,368 Subordinate Voting Shares	65,964	65,964
15,566,567 Multiple Voting Shares	7,126	7,126
	73,090	73,090

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

c) The Company established a fixed share option plan (the "Share Option Plan") in 1996, amended in fiscal 2007, to allow for the purchase of Subordinate Voting Shares by certain of its full-time employees, directors, officers and consultants.

The subscription price for Subordinate Voting Shares granted under options is the greater of (i) the weighted average trading price for such Subordinate Voting Shares for the five days preceding the date of grant during which the Subordinate Voting Shares were traded on the Toronto Stock Exchange ("TSX") or (ii) the trading price for the Subordinate Voting Shares on the last day the Subordinate Voting Shares were traded on the TSX immediately preceding the date of grant.

Under the Share Option Plan, the maximum number of Subordinate Voting Shares issuable from time to time is a fixed maximum percentage of 5% of the aggregate of the Multiple Voting Shares and the Subordinate Voting Shares issued and outstanding from time to time.

The granting of options is at the discretion of the Board of Directors which, at the date of grant, establishes the term and vesting period. Vesting of options generally commences 12 months after the date of grant and accrues annually over the vesting period provided there is continuous employment. The maximum term permissible is 10 years.

For the three-month period ended May 31, 2019, a compensation cost of $1 (May 31, 2018 – $4) was recorded in the consolidated statement of income and credited to contributed surplus.

The table below summarizes the status of the Share Option Plan.

	Number of shares	**Weighted average exercise price**	**Weighted average contractual life in months**
Outstanding – February 28, 2019	140,000	$14.63 (CA$19.26)	14.4
Outstanding – May 31, 2019	140,000	$14.24 (CA$19.26)	11.4
Exercisable – May 31, 2019	130,000	$14.47 (CA$19.57)	

d) On July 13, 2017, the Company adopted a PSU plan allowing the Board of Directors, through its Corporate Governance and Human Resources ("CGHR") Committee, to grant performance share units ("PSUs") to certain of its full-time employees. A PSU is a notional unit whose value is based on the volume weighted average price of the Company's Subordinate Voting Shares on the Toronto Stock Exchange for the 20 trading days immediately preceding the grant date. The PSU plan is non-dilutive since vested PSUs shall be settled solely in cash. Each PSU grant shall vest at the end of a three-year performance cycle, which will normally start on March 1 of the year in which such PSU is granted and end on the last day of February of the third year following such grant, subject to the achievement of certain performance objectives over such cycle, as determined by the Company's CGHR Committee.

As at May 31, 2019, the Company had a total of 24,691 (February 28, 2019 – 24,611) PSUs outstanding, representing a total liability of $41 (February 28, 2019 – $71) which is included in accounts payable and accrued liabilities. A compensation cost recovery of $28 (May 31, 2018 – cost of $14) was recorded in the consolidated statement of income (loss) and debited (May 31, 2018 – credited) to accounts payable and accrued liabilities. No payments have been made in relation to PSUs since the inception of the plan. No PSUs were forfeited, and no PSUs have vested during the three-month period ended May 31, 2019.

e) On July 13, 2017, the Company adopted a DSU plan allowing the Board of Directors, through its CGHR Committee, to grant deferred share units ("DSUs") to certain of its independent directors and full-time employees. A DSU is a notional unit whose value is based on the volume weighted average price of the Company's Subordinate Voting Shares on the Toronto Stock Exchange for the 20 trading days immediately preceding the grant date. The DSU plan is non-dilutive since vested DSUs shall be settled solely in cash. Each DSU grant shall vest at the earlier of:

- the sixth anniversary of its grant date; or
- the day the holder of the DSU attains the retirement age, which, unless otherwise determined by the CGHR Committee, is the earliest of age 65, or the age at which the combination of years of service at the Company plus his or her age is equal to 75, being understood that the retirement age shall not be less than 55 years old.

For more certainty, a grant made to an independent director or full-time employee who has reached the retirement age will be deemed immediately vested, unless otherwise determined by the CGHR Committee at or after the time of grant. Notwithstanding the foregoing, grants of DSUs made to non-employee directors of the Company shall vest on their grant date.

As at May 31, 2019, the Company had a total of 27,835 (February 28, 2019 – 28,768) DSUs outstanding, representing a total liability of $103 (February 28, 2019 – $98) which is included in accounts payable and accrued liabilities. A compensation cost of $8 (May 31, 2018 – cost recovery of $9) was recorded in the consolidated statement of income (loss) and credited (May 31, 2018 – debited) to accounts payable and accrued liabilities. No payments have been made in relation to DSUs during the three-month period ended May 31, 2019. No DSUs were forfeited, and no DSUs have vested during the three-month period ended May 31, 2019.

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

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. Because of the many uncertainties inherent in predicting the outcome of these proceedings, as well as the course of asbestos litigation in the United States, management believes that it is not possible to make an estimate of the subsidiaries' asbestos liability. Accordingly, no provision has been set up in the accounts.

During the three-month period ended May 31, 2019, legal and related costs for these matters amounted to $2,028 (May 31, 2018 – $2,282).

Lawsuits and proceedings or claims arising from the normal course of operations are pending or threatened against the Company.

On December 3, 2014, San Diego Gas & Electric Company ("SDG") filed a claim against Velan Valve Corp., a wholly-owned subsidiary of the Company, in the Superior Court of the State of California, concerning high pressure valves supplied to SDG and installed at its Palomar Energy Center ("Facility").

This lawsuit alleged damages to the Facility in excess of $9,000 related to allegedly defective valves supplied by Velan Valve Corp. The claim was for alleged strict product liability and alleged negligence. During the three-month period ended May 31, 2019, the Company has recorded a net settlement of $850 in regard to the claim.

10 Adjustments to reconcile net income to cash provided from operating activities

	Three-month periods ended May 31,	
	2019	**2018**
	$	**$**
Depreciation of property, plant and equipment	2,567	2,577
Amortization of intangible assets	452	458
Deferred income taxes	151	23
Share-based compensation expense (note 8 (c))	1	4
Loss (Gain) on disposal of property, plant and equipment	19	(10)
Net change in derivative assets and liabilities	325	417
Net change in other liabilities	(832)	81
	2,683	3,550

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

11 Changes in non-cash working capital items

	Three-month periods ended May 31, 2019 $	2018 $
Accounts receivable	14,664	4,644
Inventories	(5,906)	(1,548)
Income taxes recoverable	(3,987)	(1,935)
Deposits and prepaid expenses	965	(366)
Accounts payable and accrued liabilities	1,500	(252)
Income taxes payable	266	(1,171)
Customer deposits	(1,107)	(2,858)
Provisions	(871)	(1,067)
Accrual for performance guarantees	(665)	(1,652)
	4,859	(6,205)

12 Related party transactions and balances

Transactions and balances with related parties are in the ordinary course of business. Related party transactions and balances not otherwise disclosed separately in these consolidated financial statements are as follows:

	Three-month periods ended May 31, 2019 $	2018 $
Affiliated company owned by certain relatives of the controlling shareholder		
Purchases – Material components	217	458
Key management[1] compensation		
Salaries and other short-term benefits	1,029	993
Share-based compensation – Options	1	4
Share-based compensation – PSUs and DSUs	(28)	5

	May 31, 2019 $	February 28, 2019 $
Accounts payable and accrued liabilities		
Affiliated companies	132	98

[1] Key management includes directors (executive and non-executive) and certain senior management.

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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