



## **REPORT TO SHAREHOLDERS**

Second quarter

Six-month period ended August 31, 2021



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

Second quarter ended August 31, 2021

## HIGHLIGHTS<sup>1</sup>

- Sales for the quarter amounted to \$101.9 million, an increase of 33.6 million or 49.1% compared to the same quarter of the previous fiscal year. This quarter's sales level represents the highest volume in the last six quarters.
- Gross profit for the quarter of \$31.4 million, or 30.8%, an increase of \$14.3 million or 580 basis points from the same quarter of the previous year. The gross profit percentage of 29.1% for the first six-month of the fiscal year is the highest in recent history, a performance essentially driven by the improved sales volume, a more profitable product mix delivered, as well as the margin improvement activities undertaken over the past fiscal years within the scope of the V20 restructuring and transformation plan.
- Net income<sup>2</sup> of \$5.0 million and EBITDA<sup>3</sup> of \$10.7 million for the quarter represent a significant improvement compared to last year's results. The better results are explained primarily by an increased gross profit, driven by an improved sales volume and product mix, despite notably lower Canada Emergency Wage Subsidies («CEWS»).
- Strong order backlog<sup>3</sup> of \$575.8 million at the end of the quarter.
- Net new orders ("bookings")<sup>3</sup> of \$81.6 million for the quarter, a decrease of \$19.7 million or 19.5% compared to the same quarter of the previous fiscal year. The Company's book-to-bill ratio of 0.80 for the quarter has a stronger relation to the improved sales volume rather than the softer quarter in terms of bookings. Nonetheless, the book-to-bill ratio for the six-month period stands at a positive 1.12.
- The Company's net cash amounted to \$68.1 million at the end of the quarter, an increase of \$5.2 million since the beginning of the fiscal year.

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<sup>1</sup> All dollar amounts are denominated in U.S. dollars.

<sup>2</sup> Net earnings or loss refer to net income or loss attributable to Subordinate and Multiple Voting Shares

<sup>3</sup> Non-IFRS and supplementary financial measures – additional specifications at the end of this report

The following discussion provides an analysis of the consolidated operating results and financial position of Velan Inc. ("the Company") for the quarter ended August 31, 2021, current as of October 7, 2021, the date of approval of this Management Discussion and Analysis ("MD&A") by the Board of Directors. This MD&A should be read in conjunction with the Company's audited consolidated financial statements for the years ended February 28, 2021 and February 29, 2020. The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS"). The significant accounting policies upon which these consolidated financial statements have been prepared are detailed in Note 2 of the Company's audited consolidated financial statements. All foreign currency transactions, balances and overseas operations have been converted to U.S. dollars, the Company's reporting currency. Additional information relating to the Company, including the Annual Information Form and Proxy Information Circular, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

## **NON-IFRS AND SUPPLEMENTARY FINANCIAL MEASURES**

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

## **FORWARD-LOOKING INFORMATION**

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

## **ABOUT VELAN**

The Company designs, manufactures and markets on a worldwide basis a broad range of industrial valves for use in most industry applications including power generation, oil and gas, refining and petrochemicals, chemicals, LNG and cryogenics, pulp and paper, geothermal processes and shipbuilding. The Company is a world leader in steel industrial valves operating 12 manufacturing plants worldwide with 1,699 employees. The Company's head office is located in Montreal, Canada. The Company's business strategy is to design, manufacture, and market new and innovative valves with emphasis on quality, safety, ease of operation, and long service life. The Company's strategic goals include, but are not limited to, customer-driven operational excellence and margin improvements, accelerated growth through increased focus on key target markets where the Company has distinct competitive advantages and continuously improving and modernizing its systems and processes.

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

## RESULTS OF OPERATIONS

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

| (thousands)                                                  | Three-month periods ended |                 |          | Six-month periods ended |                 |          |
|--------------------------------------------------------------|---------------------------|-----------------|----------|-------------------------|-----------------|----------|
|                                                              | August 31, 2021           | August 31, 2020 | Variance | August 31, 2021         | August 31, 2020 | Variance |
| Sales                                                        | \$101,893                 | \$68,340        | 33,553   | \$176,422               | \$144,993       | 31,429   |
| Gross profit                                                 | 31,391                    | 17,053          | 14,338   | 51,385                  | 35,445          | 15,940   |
| Administration costs                                         | 23,977                    | 19,687          | 4,290    | 47,756                  | 37,354          | 10,402   |
| Income taxes                                                 | 2,271                     | (505)           | 2,776    | 2,902                   | 608             | 2,294    |
| Net income (loss) <sup>1</sup>                               | 5,015                     | (5,112)         | 10,127   | (58)                    | (6,998)         | 6,940    |
| EBITDA <sup>2</sup>                                          | 10,657                    | (2,497)         | 13,154   | 9,716                   | 141             | 9,575    |
| Bookings <sup>2</sup>                                        | 81,550                    | 101,287         | (19,737) | 197,924                 | 178,023         | 19,901   |
| Period ending backlog <sup>2</sup> of orders                 |                           |                 |          | 575,826                 | 462,695         | 113,131  |
| (as a percentage of sales)                                   |                           |                 |          |                         |                 |          |
| Gross profit                                                 | 30.8%                     | 25.0%           | 580 bpts | 29.1%                   | 24.4%           | 470 bpts |
| (in dollars per share)                                       |                           |                 |          |                         |                 |          |
| Net income (loss) <sup>1</sup> per share – basic and diluted | 0.23                      | (0.24)          | 0.47     | (0.00)                  | (0.32)          | 0.32     |
| EBITDA <sup>2</sup> per share – basic and diluted            | 0.49                      | (0.12)          | 0.61     | 0.45                    | 0.01            | 0.44     |

## Backlog<sup>2</sup>

| (thousands)                                | As at           |                   |                 |
|--------------------------------------------|-----------------|-------------------|-----------------|
|                                            | August 31, 2021 | February 28, 2021 | August 31, 2020 |
| Backlog <sup>2</sup>                       | 575,826         | 562,458           | 462,696         |
| For delivery within the next twelve months | 346,586         | 338,458           | 289,389         |
| For delivery beyond the next twelve months | 229,240         | 224,035           | 173,307         |
| Percentage – beyond the next twelve months | 39.8%           | 39.8%             | 37.5%           |

As a result of bookings<sup>2</sup> outpacing sales in the current six-month period, the Company's book-to-bill ratio<sup>2</sup> was 1.12 for the period. Furthermore, the total backlog<sup>2</sup> increased by \$13.3 million or 2.4% since the beginning of the fiscal year, amounting to \$575.8 million as at August 31, 2021.

<sup>1</sup> Net earnings or loss refer to net income or loss attributable to Subordinate and Multiple Voting Shares

<sup>2</sup> Non-IFRS and supplementary financial measures – more information at the end of this report

**Bookings<sup>1</sup>**

Bookings<sup>1</sup> amounted to \$81.6 million, a decrease of \$19.7 million or 19.5% for the quarter. This decrease is primarily attributable to lower large project orders recorded by the Company's French and North American operations. Bookings<sup>1</sup> amounted to \$197.9 million, an increase of \$19.9 million or 11.2% for the six-month period. The increase is primarily attributable to large project orders recorded by the Company's Italian and North American operations, notably in the marine and oil and gas markets. The increase is also attributable to higher MRO orders recorded by the Company's North American operations. The Company is encouraged by the recovery of its MRO order bookings, which were severely impacted by the global pandemic at the end of the prior fiscal year, and ultimately adversely affected the sales of its current fiscal year as explained in the next paragraph. The increase in bookings for the six-month period was partially offset by a reduction in large project orders recorded by the Company's French operations.

**Sales**

Sales amounted to \$101.9 million, an increase of \$33.6 million or 49.1% for the quarter. Sales amounted to \$176.4 million, an increase of \$31.4 million or 21.7% for the six-month period. Sales for both periods were positively impacted by the Company's North American operations increased large project orders shipments primarily destined for the petrochemical and power markets. For the quarter, sales were positively impacted by the shipment of previously delayed orders by the Company's Italian operations. The delays were due to various customer-related and global logistics factors. In terms of the six-month period, the Company's French operations were able to show an improved sales volume due to their strong performance in the first quarter of the current fiscal year. Finally, the Company's MRO sales for the six-month period were negatively affected by the persistent unfavorable market conditions triggered by the novel coronavirus ("COVID-19") global pandemic which has significantly affected the Company's distribution channels' bookings in the previous fiscal year. The lower distribution channels' bookings in the latter part of the prior year translated in lower shipments of such orders in the first quarter of the current year.

**Gross profit**

Gross profit amounted to \$31.4 million, an increase of \$14.3 million or 84.1% for the quarter. Gross profit amounted to \$51.4 million, an increase of \$15.9 million or 45.0% for the six-month period. The gross profit percentage for the quarter of 30.8% was an increase of 580 basis points compared to last year's second quarter, while the gross profit percentage for the first six-month period of 29.1% represented an increase of 470 basis points compared to the same period last year, and is also the highest in recent history. The improvement in gross profit percentage for both periods is primarily attributable to the higher sales volume, which helped to cover the Company's fixed production overhead costs more efficiently. The Company's improved margins are also stemming from the margin improvement activities implemented over the course of the past fiscal years within the scope of the V20 restructuring and transformation plan. Additionally, the Company's gross profit also benefited from favorable movements in unrealized foreign exchange translation primarily attributable to the fluctuation of the U.S. dollar against the euro and the Canadian dollar for the quarter and the six-month period when compared to the prior year. Finally, the increase in gross profit percentage was such that it could more than offset the impact of a lower amount of CEWS of \$1.7 million for the quarter and \$3.1 million for the six-month period compared to last year. The subsidies are allocated between cost of sales and administration costs.

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<sup>1</sup> Non-IFRS and supplementary financial measures – more information at the end of this report

## EBITDA<sup>1</sup>

EBITDA<sup>1</sup> for the quarter amounted to \$10.7 million or \$0.49 per share compared to a negative \$2.5 million or \$0.12 per share last year. EBITDA<sup>1</sup> for the six-month period amounted to \$9.7 million or \$0.45 per share compared to \$0.1 million or \$0.01 per share in the prior period. The improvements in EBITDA<sup>1</sup> for both periods are primarily attributable to:

- An increase in gross profit by \$14.3 million, from 25.0% to 30.8% for the quarter and \$15.9 million, from 24.4% to 29.1% for the six-month period, primarily due to a higher sales volume, while reflecting the notably improved product mix and margins resulting from the Company's targeted efforts under V20, described earlier. The Company's gross profit also benefited from favorable movements in unrealized foreign exchange translation for the quarter and six-month period when compared to the prior year.
- The absence of restructuring and transformation costs in the current fiscal year which totaled \$1.7 million in the previous quarter and \$2.9 million in the previous six-month period; and
- A reduction in other expenses of \$1.4 million for the quarter and six-month period primarily due to land clean-up costs of a former factory incurred in the second quarter of the prior year.

On the other hand, these improvements were partially offset by an increase in administration costs of \$4.3 million or 21.8% for the quarter and \$10.4 million or 27.8% for the six-month period, primarily attributable to:

- A decrease of \$1.4 million for the quarter and \$2.5 million for the six-month period in CEWS received by the Company compared to last year. The subsidies are allocated between cost of sales and administration costs.
- An increase in sales commissions for both periods due to the higher sales volume.
- A general increase in administration expenses that had been significantly lowered when the global pandemic broke out last year; and
- An increase of \$1.4 million for the six-month period in the costs recognized in connection with the Company's ongoing asbestos litigation (see *Contingencies* section).

## Income taxes

| (thousands, excluding percentages)                         | Three-month periods ended |             |                 |            |
|------------------------------------------------------------|---------------------------|-------------|-----------------|------------|
|                                                            | August 31, 2021           |             | August 31, 2020 |            |
|                                                            | \$                        | %           | \$              | %          |
| Income tax at statutory rate                               | 1,846                     | 26.5        | (1,536)         | 26.6       |
| Tax effects of:                                            |                           |             |                 |            |
| Difference in statutory tax rates in foreign jurisdictions | 65                        | 0.9         | 51              | (0.9)      |
| Non-deductible (taxable) foreign exchange losses (gains)   | 148                       | 2.1         | (143)           | 2.5        |
| Unrecognized tax losses                                    | 158                       | 2.3         | 1,079           | (18.7)     |
| Benefit attributable to a financing structure              | (66)                      | (0.9)       | (64)            | 1.1        |
| Other differences                                          | 120                       | 1.7         | 108             | (1.8)      |
| <b>Income tax expense (recovery)</b>                       | <b>2,271</b>              | <b>32.6</b> | <b>(505)</b>    | <b>8.8</b> |

<sup>1</sup> Non-IFRS and supplementary financial measures – more information at the end of this report

| (thousands, excluding percentages)                         | Six-month periods ended |              |                 |              |
|------------------------------------------------------------|-------------------------|--------------|-----------------|--------------|
|                                                            | August 31, 2021         |              | August 31, 2020 |              |
|                                                            | \$                      | %            | \$              | %            |
| Income tax at statutory rate                               | 671                     | 26.5         | (1,746)         | 26.6         |
| Tax effects of:                                            |                         |              |                 |              |
| Difference in statutory tax rates in foreign jurisdictions | 179                     | 7.1          | 136             | (2.1)        |
| Non-deductible (taxable) foreign exchange losses (gains)   | 71                      | 2.8          | (12)            | 0.2          |
| Unrecognized tax losses                                    | 2,097                   | 82.8         | 2,301           | (35.1)       |
| Benefit attributable to a financing structure              | (132)                   | (5.2)        | (125)           | 1.9          |
| Other differences                                          | 16                      | 0.6          | 54              | (0.8)        |
| <b>Income tax expense</b>                                  | <b>2,902</b>            | <b>114.6</b> | <b>608</b>      | <b>(9.3)</b> |

### Net income (loss)<sup>1</sup>

Net income<sup>1</sup> for the quarter amounted to \$5.0 million or \$0.23 per share compared to a net loss<sup>1</sup> of \$5.1 million or \$0.24 per share last year. Net loss<sup>1</sup> for the six-month period amounted to \$0.1 million or \$0.00 per share compared to a net loss<sup>1</sup> of \$7.0 million or \$0.32 per share in the prior period. The favorable movements in the Company's results were primarily attributable to the same factors as explained in the EBITDA<sup>2</sup> section coupled with an unfavorable movement in income taxes.

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

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

On August 31, 2021, the Company's order backlog<sup>2</sup> was \$575.8 million and its net cash, subject to certain local exchange control restrictions, plus unused credit facilities amounted to \$145.9 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. The Company also believes that its unused credit facilities are sufficient to overcome the remaining lingering effects of the COVID-19 pandemic on the world's economy. However, there can be no assurance that the risk of another sharp downturn in the economy will not materially adversely affect the Company's results of operations or financial condition. As at August 31, 2021, the Company is in compliance with all covenants related to its debt and credit facilities.

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

<sup>1</sup> Net earnings or loss refer to net income or loss attributable to Subordinate and Multiple Voting Shares

<sup>2</sup> Non-IFRS and supplementary financial measures – more information at the end of this report

## **Cash flows - quarter and six-month period ended August 31, 2021**

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

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

|                                              | Three-month periods ended |                 | Six-month periods ended |                 |
|----------------------------------------------|---------------------------|-----------------|-------------------------|-----------------|
|                                              | August 31, 2021           | August 31, 2020 | August 31, 2021         | August 31, 2020 |
| <i>(thousands)</i>                           |                           |                 |                         |                 |
| Net Cash – Beginning of period               | 71,237                    | 44,640          | 62,953                  | 31,010          |
| Cash provided (used) by operating activities | 1,533                     | (140)           | 2,428                   | 19,103          |
| Cash used by investing activities            | (3,599)                   | (539)           | (2,692)                 | (4,446)         |
| Cash provided by financing activities        | 688                       | 12,186          | 6,734                   | 9,532           |
| Effect of exchange rate differences on cash  | (1,728)                   | 4,218           | (1,292)                 | 5,166           |
| <b>Net Cash – End of period</b>              | <b>68,131</b>             | <b>60,365</b>   | <b>68,131</b>           | <b>60,365</b>   |

## **Operating activities**

The favorable movement in cash provided by operating activities for the quarter is primarily attributable to an improved EBITDA<sup>1</sup> partially offset by unfavorable changes in non-cash working capital items. The decrease in cash provided by operating activities for the six-month period is primarily attributable to unfavorable changes in non-cash working capital items partially offset by an improved EBITDA<sup>1</sup>.

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

- An increase in inventories principally in reaction to the delivery schedule of certain large project orders.
- An increase in accounts receivable mainly due to the higher sales output for the quarter which occurred predominantly at the tail end of the quarter.
- An increase in accounts payable and accrued liabilities due to the timing of payments, especially related to inventory purchases.

The positive non-cash working capital movements for the quarter ended August 31, 2021 were primarily due to an increase in customer deposits collected on certain large project orders by the Company's Italian and French operations.

The negative non-cash working capital movements for the six-month period ended August 31, 2021 were mainly due to an increase in inventories required for the increase in bookings and backlog since the beginning of the fiscal year.

The positive non-cash working capital movements for the six-month period ended August 31, 2021 consisted principally of:

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

<sup>1</sup> Non-IFRS and supplementary financial measures – more information at the end of this report

### **Investing activities**

Cash used by investing activities for the quarter was primarily due to additions in property, plant and equipment and an increase in short-term investments.

Cash used by investing activities for the six-month period was primarily due to additions in property, plant and equipment and an increase in short-term investments, partially offset by proceeds on disposal of property, plant and equipment related to the sale of a vacant land that used to host a production plant of the Company. The plant's operations were fully transferred in fiscal 2017 to other plants, and the building was demolished.

The fluctuations in additions to property, plant and equipment for any period when compared to the prior year comparable period is due to the timing of the receipts of certain equipment.

### **Financing activities**

During the course of the current quarter, while the Company continued to pay down its outstanding long-term debt, its North American operations borrowed \$5.9 million in the form of a secured mortgage loan bearing monthly interest payments of 3.80%, with principal payments beginning in October 2021 and repayable over 20 years.

During the second quarter of the previous year, the Company's North American operations borrowed \$10.9 million in the form of a secured mortgage loan bearing monthly interest payments of 3.80%, with principal payments beginning in October 2021 and repayable over 20 years. Additionally, its Italian subsidiary secured three new long-term debt issuances with two financial institutions as part of the measures and initiatives put in place by the Italian government to support companies during the pandemic. Specifically, the subsidiary borrowed \$3.4 million in the form of unsecured bank loans, bearing interest between 1.00% and 1.25%, with principal repayments beginning in 2021 and 2022 and repayable in monthly and quarterly installments, expiring in 2025 and 2026.

During the current quarter, the company reimbursed \$3.4 million of amounts previously drawn on its revolving credit facility, bringing the net withdrawn amount for the six-month period down to \$6.3 million.

## **FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT**

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

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

### **Market risk**

#### *Currency risk*

Currency risk on financial instruments is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Company operates internationally and is exposed to foreign exchange risk arising from various currency exposures. Currency risk arises when future commercial

transactions and recognized assets and liabilities are denominated in a currency other than a company's functional currency. The Company has operations with different functional currencies, each of which will be exposed to currency risk based on its specific functional currency.

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

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

|                                           | Range of exchange rates |                      | Gain (loss)<br>(in thousands of U.S. dollars) |                            | Notional amount<br>(in thousands of indicated currency) |                      |
|-------------------------------------------|-------------------------|----------------------|-----------------------------------------------|----------------------------|---------------------------------------------------------|----------------------|
|                                           | August 31,<br>2021      | February 28,<br>2021 | August 31,<br>2021<br>\$                      | February 28,<br>2021<br>\$ | August 31,<br>2021                                      | February 28,<br>2021 |
| <b>Foreign exchange forward contracts</b> |                         |                      |                                               |                            |                                                         |                      |
| Sell US\$ for CA\$ - 0 to 12 months       | 1.28-1.30               | 1.30                 | (7)                                           | (135)                      | US\$22,000                                              | US\$22,000           |
| Buy US\$ for CA\$ - 0 to 12 months        | 1.20-1.22               | 1.22                 | -                                             | 48                         | US\$22,000                                              | US\$22,000           |
| Sell € for US\$ - 0 to 12 months          | 1.22-1.24               | 1.22-1.24            | -                                             | (168)                      | €11,167                                                 | €18,363              |
| Buy € for US\$ - 0 to 12 months           | 1.16-1.20               | 1.16-1.20            | 73                                            | 148                        | €11,167                                                 | €18,363              |
| Buy US\$ for € - 0 to 12 months           | 1.18-1.21               | -                    | -                                             | -                          | US\$323                                                 | US\$-                |

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

#### *Interest rate risk*

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

#### **Credit risk**

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

The Company's credit risk related to its trade accounts receivable is concentrated. As at August 31, 2021, five (February 28, 2021 – five) customers accounted for more than 5% each of its trade accounts receivable, of which one customer accounted for 11.1% (February 28, 2021 – 15.6%), and the Company's ten largest customers accounted for 55.2% (February 28, 2021 – 63.5%) of trade accounts receivable. In addition, there was no customer (August 31, 2021 – one) that accounted for more than 10% of the Company's sales.

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

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

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

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

|                                  | <b>As at</b>               |                              |
|----------------------------------|----------------------------|------------------------------|
|                                  | <b>August 31,<br/>2021</b> | <b>February 28,<br/>2021</b> |
| <i>(thousands)</i>               | <b>\$</b>                  | <b>\$</b>                    |
| Current                          | 67,387                     | 76,407                       |
| Past due 0 to 30 days            | 14,329                     | 19,630                       |
| Past due 31 to 90 days           | 13,538                     | 9,672                        |
| Past due more than 90 days       | 20,987                     | 17,653                       |
|                                  | 116,241                    | 123,362                      |
| Less: Loss allowance             | (843)                      | (1,146)                      |
|                                  | 115,398                    | 122,216                      |
| Other receivables                | 10,677                     | 13,157                       |
| <b>Total accounts receivable</b> | <b>126,075</b>             | <b>135,373</b>               |

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

|                                          | <b>Six-month periods ended</b> |                            |
|------------------------------------------|--------------------------------|----------------------------|
|                                          | <b>August 31,<br/>2021</b>     | <b>August 31,<br/>2020</b> |
| <i>(thousands)</i>                       | <b>\$</b>                      | <b>\$</b>                  |
| Balance – Beginning of the year          | 1,146                          | 2,002                      |
| Loss allowance expenses                  | 58                             | 2                          |
| Recoveries of trade accounts receivables | (275)                          | (122)                      |
| Write-off of trade accounts receivable   | (8)                            | (212)                      |
| Foreign exchange                         | (78)                           | 100                        |
| <b>Balance – End of the period</b>       | <b>843</b>                     | <b>1,770</b>               |

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

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

Two of the Company's U.S. subsidiaries have been named as one of the defendants in a number of pending lawsuits that seek to recover damages for personal injury allegedly caused by exposure to asbestos-containing products manufactured and sold in the past. Management believes it has a strong defence related to certain products that may have contained an internal asbestos containing component. 1,973 claims were outstanding at the end of the reporting period (February 28, 2021 – 1,696). During the reporting period, the Company resolved 116 claims (August 31, 2020 – 175) and received 393 claims (August 31, 2020 – 253). Settlement costs and legal fees related to these asbestos claims amounted to \$2,454 (August 31, 2020 – \$3,171) for the quarter and \$6,647 (August 31, 2020 – \$5,217) for the six-month period.

## **INTERNAL CONTROLS AND PROCEDURES**

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

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

## **CRITICAL ACCOUNTING ESTIMATES & JUDGEMENTS**

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

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

## ACCOUNTING STANDARDS AND AMENDMENTS ADOPTED IN THE PERIOD

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

## ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

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

## SUMMARY OF QUARTERLY RESULTS

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

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

|                                            | QUARTERS ENDED |          |               |               |             |          |               |               |
|--------------------------------------------|----------------|----------|---------------|---------------|-------------|----------|---------------|---------------|
|                                            | August 2021    | May 2021 | February 2021 | November 2020 | August 2020 | May 2020 | February 2020 | November 2019 |
| Sales                                      | \$101,893      | \$74,529 | \$85,510      | \$71,560      | \$68,340    | \$76,653 | \$113,641     | \$88,701      |
| Net earnings (loss) <sup>1</sup>           | 5,015          | (5,073)  | 338           | 9,527         | (5,112)     | (1,886)  | (11,116)      | (819)         |
| Net earnings (loss) <sup>1</sup> per share |                |          |               |               |             |          |               |               |
| - Basic and diluted                        | 0.23           | (0.24)   | 0.02          | 0.44          | (0.24)      | (0.09)   | (0.51)        | (0.04)        |

<sup>1</sup> Net earnings or loss refer to net income or loss attributable to Subordinate and Multiple Voting Shares

## NON-IFRS AND SUPPLEMENTARY FINANCIAL MEASURES

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

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

|                                               | Three-month periods ended |                    | Six-month periods ended |                    |
|-----------------------------------------------|---------------------------|--------------------|-------------------------|--------------------|
|                                               | August 31,<br>2021        | August 31,<br>2020 | August 31,<br>2021      | August 31,<br>2020 |
| <i>(thousands, except amount per shares)</i>  | \$                        | \$                 | \$                      | \$                 |
| Net income (loss) <sup>1</sup>                | 5,015                     | (5,112)            | (58)                    | (6,998)            |
| <i>Adjustments for:</i>                       |                           |                    |                         |                    |
| Depreciation of property, plant and equipment | 2,394                     | 2,450              | 4,808                   | 4,975              |
| Amortization of intangible assets             | 451                       | 626                | 1,009                   | 1,194              |
| Finance costs – net                           | 526                       | 44                 | 1,055                   | 362                |
| Income taxes                                  | 2,271                     | (505)              | 2,902                   | 608                |
| <b>EBITDA</b>                                 | <b>10,657</b>             | <b>(2,497)</b>     | <b>9,716</b>            | <b>141</b>         |
| EBITDA per share                              |                           |                    |                         |                    |
| - Basic and diluted                           | 0.49                      | (0.12)             | 0.45                    | 0.01               |

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

### Definitions of supplementary financial measures

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

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

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

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

<sup>1</sup> Net earnings or loss refer to net income or loss attributable to Subordinate and Multiple Voting Shares



**UNAUDITED CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS**

For the three-month and six-month periods ended August 31, 2021



## **NOTICE OF NO AUDITOR REVIEW OF CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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



## Consolidated Statements of Financial Position

(Unaudited)

(in thousands of U.S. dollars)

|                                                | As at           |                   |
|------------------------------------------------|-----------------|-------------------|
|                                                | August 31, 2021 | February 28, 2021 |
|                                                | \$              | \$                |
| <b>Assets</b>                                  |                 |                   |
| <b>Current assets</b>                          |                 |                   |
| Cash and cash equivalents                      | 76,448          | 74,688            |
| Short-term investments                         | 1,703           | 285               |
| Accounts receivable                            | 126,075         | 135,373           |
| Income taxes recoverable                       | 3,590           | 3,798             |
| Inventories (note 7)                           | 240,225         | 204,161           |
| Deposits and prepaid expenses                  | 9,969           | 8,670             |
| Derivative assets (note 10)                    | 74              | 196               |
|                                                | 458,084         | 427,171           |
| <b>Non-current assets</b>                      |                 |                   |
| Property, plant and equipment                  | 91,826          | 96,327            |
| Intangible assets and goodwill                 | 16,890          | 17,319            |
| Income taxes recoverable                       | 5,927           | 5,927             |
| Deferred income taxes                          | 32,397          | 33,140            |
| Other assets                                   | 854             | 949               |
|                                                | 147,894         | 153,662           |
| <b>Total assets</b>                            | <b>605,978</b>  | <b>580,833</b>    |
| <b>Liabilities</b>                             |                 |                   |
| <b>Current liabilities</b>                     |                 |                   |
| Bank indebtedness                              | 8,317           | 11,735            |
| Accounts payable and accrued liabilities       | 101,856         | 90,840            |
| Income taxes payable                           | 1,479           | 1,609             |
| Customer deposits                              | 79,738          | 62,083            |
| Provisions                                     | 27,241          | 29,515            |
| Derivative liabilities (note 10)               | 9               | 303               |
| Current portion of long-term lease liabilities | 1,595           | 1,578             |
| Current portion of long-term debt (note 8)     | 8,711           | 9,902             |
|                                                | 228,946         | 207,565           |
| <b>Non-current liabilities</b>                 |                 |                   |
| Long-term lease liabilities                    | 12,197          | 12,649            |
| Long-term debt (note 8)                        | 56,522          | 48,189            |
| Income taxes payable                           | 1,244           | 1,410             |
| Deferred income taxes                          | 2,405           | 2,545             |
| Other liabilities                              | 8,235           | 8,254             |
|                                                | 80,603          | 73,047            |
| <b>Total liabilities</b>                       | <b>309,549</b>  | <b>280,612</b>    |
| <b>Total equity</b>                            | <b>296,429</b>  | <b>300,221</b>    |
| <b>Total liabilities and equity</b>            | <b>605,978</b>  | <b>580,833</b>    |

### Contingencies (note 9)

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



## Consolidated Statements of Income (Loss)

(Unaudited)

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

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

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



## Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

(in thousands of U.S. dollars)

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

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

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



## Consolidated Statements of Changes in Equity

(Unaudited)

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

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

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



## Consolidated Statements of Cash Flow

(Unaudited)

(in thousands of U.S. dollars)

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

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



## NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three-month and six-month periods ended August 31, 2021

### 1 General information

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

These unaudited condensed interim consolidated financial statements were approved for issue by the Company's Board of Directors on October 7, 2021. The Company's auditors have not performed a review of these unaudited condensed interim consolidated financial statements.

### 2 Basis of preparation

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

### 3 Changes in accounting policies

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

### 4 New accounting standards and amendments issued but not yet adopted

In January 2020, the International Accounting Standards Board ("IASB") issued *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)* providing a more general approach to the classification of liabilities under IAS 1 based on the contractual arrangements in place at the reporting date. The amendments in *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)* affect only the presentation of liabilities in the statements of financial position, not the amount or timing of recognition of



any asset, liability income or expenses, or the information that entities disclose about those items. In July 2020, the IASB published *Classification of Liabilities as Current or Non-current – Deferral of Effective Date (Amendment to IAS 1)* deferring the effective date of the January 2020 amendments to IAS 1 by one year. The amendments to IAS 1 are effective for annual reporting periods beginning on or after January 1, 2023 with earlier adoption permitted. The Company is currently evaluating the impact of these amendments on its financial statements.

## 5 Estimates

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

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

However, the occurrence of the novel coronavirus ("COVID-19") pandemic has caused disruptions in the Company's global operations which have materially adversely affected its business and financial results. The economic slowdown triggered by the global pandemic has translated in a lower sales volume and subsequently depressed results for the Company while net order bookings have showed positive trends for the fiscal year ended February 28, 2021. The Company has implemented proactive measures to protect its global workforce and mitigate the numerous effects of the pandemic, but given the ongoing dynamic nature of circumstances surrounding COVID-19, it is not possible to reliably estimate the length, severity and long term impact the global pandemic may have on the Company's results, conditions and cash-flows.

During the three-month period ended August 31, 2021, the company has applied for wage subsidies which provided a reduction of salaries of \$543 (August 31, 2020 – \$2,278) in Cost of sales and \$450 (August 31, 2020 – \$1,869) in Administration costs. During the six-month period ended August 31, 2021, the company has applied for wage subsidies which provided a reduction of salaries of \$1,121 (August 31, 2020 – \$4,173) in Cost of sales and \$889 (August 31, 2020 – \$3,434) in Administration costs.

## 6 Seasonality

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

## 7 Inventories

|                                    | As at              |                      |
|------------------------------------|--------------------|----------------------|
|                                    | August 31,<br>2021 | February 28,<br>2021 |
| (thousands)                        | \$                 | \$                   |
| Raw materials                      | 41,134             | 40,404               |
| Work in process and finished parts | 144,883            | 118,553              |
| Finished goods                     | 54,208             | 45,204               |
|                                    | <b>240,225</b>     | <b>204,161</b>       |

As a result of variations in the ageing of its inventories, the Company recognized a net additional inventory provision for the three-month period ended August 31, 2021 of \$1,975 (August 31, 2020 - \$ 2,266), including



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

## 8 Long-term debt

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

As at August 31, 2021, the Company had drawn down \$28,380 (February 28, 2021 - \$22,132) on the revolving credit facility and had \$4,538 (February 28, 2021 - \$5,436) in the form of outstanding letters of credit and letters of guarantee on a total \$57,364 (February 28, 2021 - \$55,518) borrowing availability. Furthermore, as at August 31, 2021, the Company was in compliance with its covenant.

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

## 9 Contingent liabilities

Two of the Company's U.S. subsidiaries have been named as defendants in a number of asbestos-related legal proceedings pertaining to products they formerly sold. Management believes it has a strong defence, and the subsidiaries have previously been dismissed from a number of similar cases. During the three-month period ended August 31, 2021, legal and related costs for these matters amounted to \$2,454 (August 31, 2020 - \$3,171). During the six-month period ended August 31, 2021, legal and related costs for these matters amounted to \$6,647 (August 31, 2020 - \$5,217).



## 10 Fair value of financial instruments

The fair value hierarchy has the following levels:

- Level 1 – quoted market prices in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and
- Level 3 – unobservable inputs such as inputs for the asset or liability that are not based on observable market data. The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

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

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

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

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



## 11 Segment reporting

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

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

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

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

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



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

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

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