VELAN
Annual report 2014

Velan worldwide

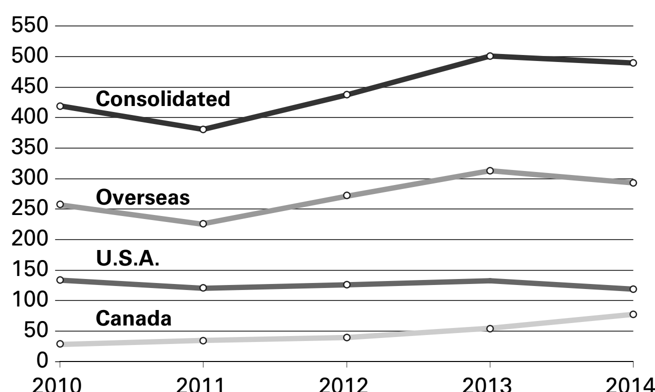
Above: VelTEX, the newest addition to the Velan distribution center network located in Houston, Texas, officially opened its doors in November 2013.

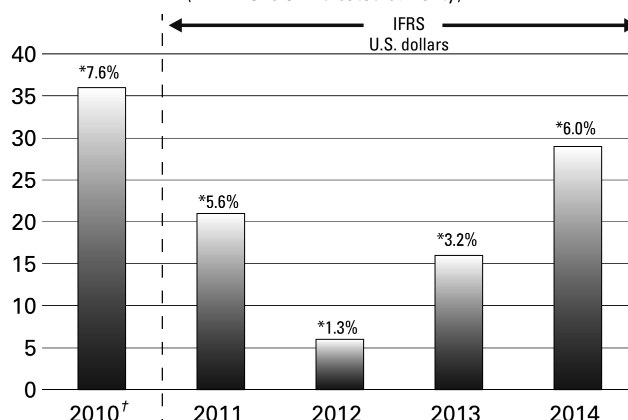
Front Cover:
Two Velan 18" Class 300 air-operated gate valves installed in the naphtha cracker plant.

Right: Wolfgang Maar, Executive VP International Sales and Overseas Operations and Chairman of the Board of Velan ABV S.p.A., with Paolo Ranieri, the new Managing Director/ Chief Executive Officer of Velan ABV S.p.A., located in Lucca, Italy.

Above: A refinery in India before Velan coker valves were installed to replace the existing competitor's valves. Right: the same refinery after Velan valves were installed.

2014 Highlights





(in thousands of indicated currency, except per share amounts and number of employees)	IFRS In U.S.dollars				Prior Canadian GAAP In Canadian dollars
Years Ended	**Feb 2014**	**Feb 2013**	**Feb 2012**	**Feb 2011**	**Feb 2010**
Income statement data					
Sales	$ 489,257	$ 500,574	$ 437,135	$ 380,706	$465,945
Gross profit	131,146	113,899	87,262	101,426	149,012
Gross profit %	26.8%	22.8%	20.0%	26.6%	32.0%
Administration costs	87,143	90,985	83,620	73,597	74,635
Income before income taxes	42,762	12,018	6,097	28,424	56,304
Adjusted net operating results (2)	29,400	15,769	5,630	21,224	35,523
Adjusted net operating results (2) %	6.0%	3.2%	1.3%	5.6%	7.6%
Adjusted net operating results (2) per share	1.34	0.72	0.25	0.96	1.60
Net earnings (3)	29,400	6,169	7,892	21,224	35,523
Net earnings (3) %	6.0%	1.2%	1.8%	5.6%	7.6%
Net earnings (3) per share (4)	1.34	0.28	0.36	0.96	1.60
Statement of financial position data					
Net cash (5)	$ 67,761	$ 19,787	$ 35,376	$ 113,024	$103,741
Working capital	235,318	213,814	217,522	264,930	275,928
Property, plant, and equipment	96,605	90,630	72,961	64,622	73,418
Total assets	624,154	619,774	601,970	516,037	512,697
Total debt	22,087	26,850	9,587	5,011	4,002
Equity	359,119	328,173	335,577	337,723	346,184
Number of employees					
Canada	917	923	926	923	911
United States	188	182	178	178	189
Europe	526	535	519	372	351
Asia	429	390	358	295	289
Total	2,060	2,030	1,981	1,768	1,740

(1) Prior Canadian GAAP sales figures converted at average CAD-USD foreign exchange rate for the applicable fiscal year.

(2) This measure is not a measure of performance defined under Prior Canadian GAAP and IFRS. Therefore, it is unlikely to be comparable to similar measures shown by other companies. However, it is used by management to assess the operating performance of the company.This measure is defined as net income attributable to Subordinate and Multiple Voting Shares excluding goodwill impairment losses, interest accretion adjustments on on the Velan ABV S.p.A. ("ABV") purchase price proceeds payable, positive fair value adjustments to the ABV purchase price proceeds payable, and any unrealized foreign exchange gains or losses on the ABV purchase price proceeds payable.

(3) Net earnings refers to net income attributable to Subordinate and Multiple Voting Shares.

(4) See note 21 in the Notes to the Consolidated Financial Statements.

(5) This is not a measure of financial condition defined under Prior Canadian GAAP and IFRS. Therefore, it is unlikely to be comparable to similar measures shown by other companies. However, it is used by management to assess the financial condition of the company. This mesure is defined as cash & cash equivalents plus short-term investments less bank indebtedness, short-term bank loans and the current portion of long-term bank borrowings.

Message to our shareholders and employees

(In U.S. dollars.)

Highlights

- **Sales of $489.3 million**
- **Net earnings[1] of $29.4 million**
- **Order Backlog of $471.7 million**
- **Order bookings of $430.2 million**
- **Net cash[2] of $67.7 million at year end**
- **Increase dividend payout by 25% effective June 2014**

Tom Velan, President and Chief Executive Officer (left), with A.K. Velan, Founder and Executive Chairman of the Board (right).

We are pleased to report improved results. Our net earnings[1] increased to $29.4 million which is 6% of sales compared to our adjusted net operating results[3] of $15.8 million or 3.2% of sales last year.

Sales, order bookings and backlog

Our sales of $489.3 million were 2.3% lower than last year's record sales. This year, we had record sales in Canada of $77.3 million which represents 15.8% of global sales. The increase in sales in Canada reflects growing shipments of our valves to the Alberta oil and gas industry during the year.

Our sales were diversified by customer, market, and geography as about 60% of our sales were made outside of North America to more than 65 countries. China continued to be our largest overseas export market even though sales declined from $100 million last year to $66 million this year mainly due to decreased nuclear sales following the Fukushima crisis.

Order bookings were $430.2 million which is an increase of 16.3% from last year. Bookings were still lower than sales and our continuing high backlog of orders for some products has necessitated quoting longer lead-times than some of our customers require. In our fourth quarter, we booked $40.5 million in India from two Indian energy companies. The large orders to be manufactured in our North American, Italian and Indian production plants include our Securaseal metal seated ball valves, our forged high pressure pressure seal valves, cast steel gate valves, and coker ball valves for switch and isolation service. We continue to be the world leader in supply of coker ball valves.

Despite the 16.3% increase in bookings, our sales exceeded our bookings by $59.1 million so our backlog of orders declined 11.2% to $471.1 million of which $386.7 million is scheduled for delivery during our current fiscal year. Every year, our sales revenues are made of longer term project orders, made-to-order sales, and book and bill business of commodity valves stocked in our distribution centers. The percentage of longer term orders scheduled to ship in more than one year declined from 25% to 18% reflecting a lower nuclear backlog. The portion of the backlog that is scheduled for shipment within 12 months is 2.9% lower than last year.

Net earnings[1]

Our net earnings[1] of $29.4 million which is 6% of sales was much higher than last year's reported net earnings[1] of $6.2 million or the adjusted net operating results[3] of $15.8 million.

1) *Net earnings refer to net income attributable to Subordinate and Multiple Voting Shares.*

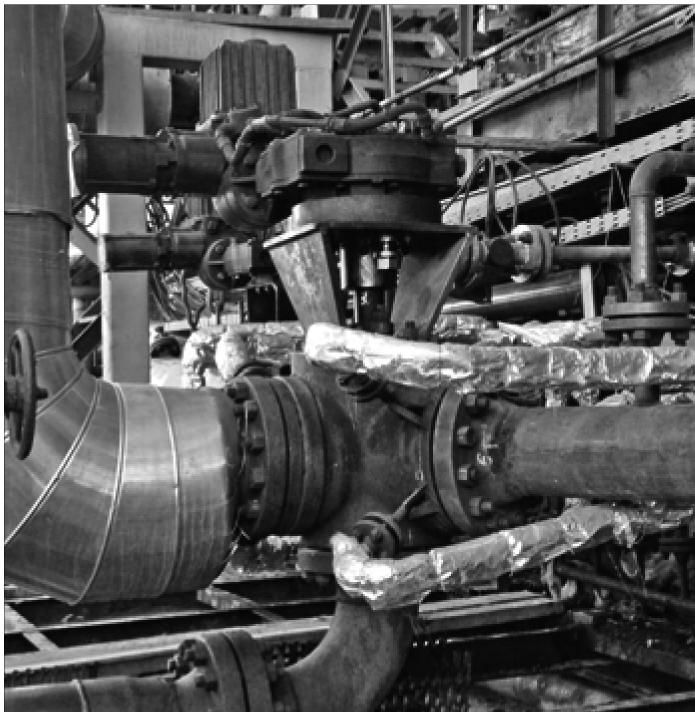
2) *The term "net cash" is defined as cash and cash equivalents plus short-term investments less bank indebtedness, short-term bank loans, and current portion of long-term bank borrowings. This is not a term of financial condition defined under International Financial Reporting Standards ("IFRS") and, therefore, it is unlikely to be comparable to similar measures shown by other companies. However, it is used by management to assess the financial condition of the company.*

3) *The term "adjusted net operating results" is defined as net income attributable to Subordinate and Multiple Voting Shares excluding the goodwill impairment loss, the interest accretion adjustments, the positive fair value adjustments to the ABV purchase price proceeds payable, and the unrealized foreign exchange gain on the ABV purchase price proceeds payable. This is not a term of performance defined under IFRS and, therefore, it is unlikely to be comparable to similar measures shown by other companies. However, it is used by management to assess the operating performance of the company.*

Message to our shareholders and employees

We had improved margins in our North American operations as well as most of our foreign operations including Velan ABV S.p.A. (“ABV”), which was profitable for the first time since the acquisition in 2011.

Our results benefitted from favourable currency changes as the U.S. dollar increased on average by 4.8% against the Canadian dollar and fell 3.3% against the Euro. The changes mean that all the costs denominated in Canadian dollars were a lower percentage of our U.S. dollar selling prices and we consolidated higher net earnings[(1)] from our European operations which report in Euro. Another positive factor in the improved earnings was that our costs related to asbestos lawsuits were $5.5 million, compared to $8.8 million last year. Our gross profit improved four percentage points to 26.8%.



A coker switch valve installed in an oil refinery in Russia.

Investments in our global manufacturing infrastructure

During the last two years, we invested $46.5 million in our global manufacturing infrastructure with an aim to improve efficiency, increase our global presence, and improve our cost competitiveness. This included investments in our North American production plants, a new Greenfield plant in India as well as expanded production ranges in our Chinese and Korean operations.

Pressure seal valve assembly in Velan’s Chinese operations.

The Indian plant completed its first year of production and during the year booked $15.6 million dollars of orders including $8.9 million for supply to the Indian market. In our China plant, we started production of cast pressure seal valves for the China market.

Performance testing of a 24" cast steel valve in Velan’s Indian operations.

Message to our shareholders and employees

Financial Strength

This year we strengthened our balance sheet as net cash[(2)] increased by $47.9 million to reach $67.7 million or $3.08 per share and equity increased by $30.9 million to reach $359.1 million or $16.35 per share. Cash provided by operating activities for the current fiscal year was $75.5 million compared to $14.4 million last year. The $61.1 million increase was principally related to improved net earnings[(1)] and a decrease in inventory.

Outlook

We are pleased to report improved earnings despite slightly lower sales than last year. We start the new fiscal year with an order backlog of $471.1 million. Our global reach, market diversity, and broad range of valves provide us with many sales opportunities around the world that our sales teams are pursuing. We have expanded and strengthened our local manufacturing presence in Asia with an objective to improve our cost competitiveness and increase local sales in Korea, China and India.

We are now 2,060 people working together in 14 countries to design, manufacture and sell superior quality valves to the global market. Our mission is "To be the world's leading valve brand" and we would like to thank all our devoted employees who have contributed their energy and expertise to advance our mission and improve our operating results. We look to the future with a good understanding of the challenges involved in competing on the world market and with confidence that we can continue to successfully build the value of our company for the benefit of all stakeholders.

Members of the Velan team from Plant 4 in Granby, Quebec, who helped supply valves to a naphtha cracker plant project in the Philippines. For this project, Velan designed and manufactured the largest pneumatic-actuated Class 300 gate valves it has ever produced—up to 24".

A.K. Velan
Founder and Executive Chairman of the Board

T. C. Velan
President and Chief Executive Officer

May 20, 2014

The following discussion provides an analysis of the consolidated operating results and financial position of Velan Inc. ("the Company") for the year ended February 28, 2014. This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the Company's audited consolidated financial statements for the years ended February 28, 2014 and 2013. The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The significant accounting policies upon which these consolidated financial statements have been prepared are detailed in 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. Selected annual information for the three most recently completed reporting periods and a summary of quarterly results for each of the eight most recently completed quarters is included further in this report. Additional information relating to the Company, including the Annual Information Form and Proxy Information Circular, can be found on SEDAR at **www.sedar.com**.

BASIS OF PRESENTATION AND ANALYSIS

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

FORWARD-LOOKING INFORMATION

This MD&A may include forward-looking statements, 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 and include among other matters, risks related to foreign exchange, raw material pricing, tax matters, foreign investment and operations as well as contingent liabilities. No forward-looking statement can be guaranteed and actual future results may differ materially from those expressed herein. The Company disclaims any responsibility to update or revise these forward-looking statements except as required by the applicable securities laws.

OVERVIEW

The Company designs, manufactures and markets on a worldwide basis a broad range of industrial valves for use in most industry applications including power generation, oil and gas, refining and petrochemicals, chemical, LNG and cryogenics, pulp and paper, geothermal processes and shipbuilding. The Company is a world leader in steel industrial valves operating 17 manufacturing plants worldwide with 2,060 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, increasing market share in power markets, investing in talent development of high-potential employees, adding talent where necessary, providing high customer service, enhancing manufacturing and/or sales capabilities in emerging markets such as Brazil, Russia, India and China, and continually improving operational excellence.

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

CONSOLIDATED HIGHLIGHTS[1]

(millions, excluding per share amounts)	Fiscal year ended February 28, 2014	Fiscal year ended February 28, 2013	Increase (decrease)	% Increase (decrease)
Consolidated statements of earnings				
Sales	$489.3	$500.6	$(11.3)	(2.3)%
Gross profit	131.1	113.9	17.2	15.1%
Gross profit %	26.8%	22.8%		
Net earnings[2]	29.4	6.2	23.2	374.2%
Net earnings[2] %	6.0%	1.2%		
Earnings per share – basic	1.34	0.28	1.06	378.6%
– diluted	1.34	0.28	1.06	378.6%
Weighted average shares outstanding	22.0	22.0		
Consolidated statements of cash flows				
Cash provided by operating activities	75.5	14.4	61.1	424.3%
Cash provided (used) by investing activities	(17.8)	(23.9)	6.1	25.5%
Cash provided (used) by financing activities	(15.6)	4.8	(20.4)	(425.0)%
Demand data				
Net new orders received	430.2	370.1	60.1	16.2%
Period ending backlog of orders	471.7	531.0	(59.3)	(11.2)%

[1] *All dollar amounts in this schedule are denominated in U.S. dollars.*
[2] *Net earnings refers to net income attributable to Subordinate and Multiple Voting Shares.*

Highlights of fiscal 2014 as well as factors that may impact fiscal 2015

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

- Net earnings[1] amounted to $29.4 million or $1.34 per share compared to $6.2 million or $0.28 per share last year. The $23.2 million increase in net earnings[1] is primarily attributable to improved gross profit margins and lower administration costs. Furthermore, net earnings[1] for the prior year were significantly impacted by an $11.7 million non-cash goodwill impairment charge related to the Company's then 70%-owned Italian subsidiary, Velan ABV S.p.A. ("ABV"). Excluding this charge, as well as other non-recurring items related to the ABV acquisition, the Company's adjusted net operating results[2] would have been $29.4 million or $1.34 per share this year compared to $15.8 million or $0.72 per share last year.
- Sales amounted to $489.3 million, a decrease of $11.3 million or 2.3% from the record total achieved in the prior year. This decrease is primarily attributable to a decrease in nuclear sales following the Fukushima crisis which was partially offset by an increase in sales in Canada to the Alberta oil and gas industry.
- Net new orders received ("bookings") amounted to $430.2 million, an increase of $60.1 million or 16.2% compared to last year. This increase is primarily attributable to significant new orders booked with large Indian energy customers. Since sales outpaced bookings, the Company ended the current year with a backlog of $471.7 million, a decrease of $59.3 million or 11.2% from the end of the prior year.
- Gross profit percentage increased by 4.0 percentage points from 22.8% to 26.8%. This increase is mainly attributable to a higher margin product mix, particularly spare part sales, and improved efficiencies.
- The Company generated net cash[2] from operations of $75.5 million. This source of net cash[2] is primarily attributable to improved net earnings[1] and a decrease in inventory. The Company ended the year with net cash[2] of $67.7 million, an increase of $47.9 million or 241.9% since the beginning of the current fiscal year.
- On May 20, 2014, the Board of Directors approved an increase of its annual dividend payout from CDN$0.32 per share to CDN$0.40 per share. This increase will be effective with the next quarterly dividend payment of CDN$0.10 payable on June 30, 2014, to all shareholders of record as at June 16, 2014.
- Foreign currency impacts:
    - Based on average exchange rates, the Euro strengthened 3.4% against the U.S. dollar when compared to the same period last year. This strengthening resulted in the Company's net profits from its European subsidiaries being reported as higher U.S. dollar amounts in the current fiscal year.
    - Based on average exchange rates, the Canadian dollar weakened 4.6% against the U.S. dollar when compared to the same period last year. This weakening resulted in the Company's Canadian dollar expenses being reported as lower U.S. dollar amounts in the current fiscal year.
    - The impact of these currency swings was favourable to the Company's results for the current fiscal year.

The Company's margins and operational profitability improved over the course of the current year. This was due to a combination of factors including improved gross profit margins and lower administration costs. The improvement in gross profit was mainly attributable to a higher margin product mix and improved efficiencies. Despite a drop from the record sales level achieved in the prior year, the Company realized a higher proportion of spare part sales which generate higher margins than manufactured valves. The decrease in administration costs is mainly attributable to decreases in sales commissions and costs associated with the Company's ongoing asbestos litigation (see *Contingencies* section). Like many other U.S. valve manufacturers, two of the Company's U.S. subsidiaries have been named as defendants in a number of pending lawsuits brought on behalf of individuals seeking to recover damages for their alleged asbestos exposure. These lawsuits are related to products manufactured and sold in the past. Management believes that any asbestos was incorporated entirely within the product in such a way that it would not allow for any ambient asbestos during normal operation, inspection or repairs. Management strongly believes its products, which were supplied in accordance with valve industry practice and customer mandated specifications, did not contribute to any asbestos-related illness. The Company will continue to vigorously defend against these claims but, given the ongoing course of asbestos litigation in the U.S. and the unpredictability of jury trials, it is not possible to make an estimate of any legal or related costs. Settlement costs and legal fees decreased from $8.8 million in fiscal year 2013 to $5.5 million in fiscal year 2014. The fluctuation in asbestos costs is

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

due more to the timing of settlement payments than to changes in long-term trends. All of the above factors as well as favourable currency swings contributed to an 86.1% increase in the Company's adjusted net operating results[1].

Goodwill impairment analysis and acquisition of non-controlling interest

On an annual basis, the Company is required to perform an impairment test on goodwill acquired in a business combination. At the end of the prior fiscal year, the Company determined that the carrying amount of the goodwill associated with ABV exceeded its recoverable amount and, accordingly, the Company recorded a non-cash goodwill impairment loss of $11.7 million. This impairment charge was the result of actual results of ABV coming in below the expectations at the time of the acquisition. The reasons for these lower achieved results were due to a variety of factors, including a business process integration that proved to be more difficult than planned, as well as profitability issues related to the complexity of the manufactured products. In addition, the increasingly competitive landscape of the last two years, particularly amongst upstream oil and gas flow control manufacturers in Italy, negatively impacted margins.

In the second quarter of the current fiscal year, ABV was required to recapitalize its share structure as a result of losses sustained in prior periods. Through the recapitalization, the existing share capital of ABV was cancelled. New shares were issued solely to the Company through the conversion of existing shareholder loans from the Company to ABV. In addition, the existing shareholder loans payable to the non-controlling interest of ABV amounting to $1.4 million (€1.1 million) were repaid through the recapitalization process. As a result of the recapitalization, the Company acquired the remaining 30% of ABV to become its 100% shareholder as of July 16, 2013. Management considered this recapitalization to be a triggering event to test the carrying value of the ABV assets for impairment. The recoverable amount was determined based on the fair value less costs to sell approach using a discounted cash flow model. Although the business process integration was still underway, the Company did not believe that the long-term outlook for the business had changed. As a result, no goodwill impairment loss was recognized following the impairment test performed in the second quarter of the current fiscal year.

In addition to the above impairment test triggered on July 16, 2013, the Company continued to carry out its annual impairment testing at its year-end date. In the context of its annual impairment testing at year-end, the Company completed its impairment analysis and assessed the recoverability of the assets allocated to ABV. The Company calculated the recoverable amounts of ABV using valuation methods which were consistent with those used in prior years. As a result of the impairment analysis, the Company determined that the recoverable amount exceeded the carrying amount of the goodwill associated with ABV and, accordingly, no goodwill impairment loss was recorded at February 28, 2014.

The Company continues to view the acquisition of ABV as a great opportunity to grow its sales and earnings over the coming years and is working with the local management of ABV to help improve operations, as well as increase output and profitability. ABV reported positive net earnings[2] for the first time since its acquisition in the current fiscal year.

Factors that may impact fiscal year 2015

The challenge facing the Company for fiscal year 2015 will be to capitalize on the significant investments it has made over the last two years to improve its productive efficiency as well as its global manufacturing capacity and presence. The Company continues to work to improve its operational excellence through lean, global sourcing, working capital management and cost controls. These initiatives have had a positive impact on current year results.

Despite the increase in bookings for the current fiscal year, the Company's backlog declined by 11.2% over the course of the year as sales outpaced bookings for the second consecutive year. During the prior fiscal year, the Company instituted a policy of quoting longer lead times in order to reduce its very large order backlog to ease pressure on production. Since this strategy accomplished its purpose of reducing the order backlog to more normalized levels over the course of the prior year, the Company began quoting standard lead times in the current year, resulting in higher net bookings, especially in the latter half of the year. The Company believes that the global demand for its products is strong and is working to increase bookings in future years. However, there can be no assurance that outside economic and geopolitical factors will not materially adversely affect the Company's results of operations or financial condition.

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

[2] *Net earnings refers to net income attributable to Subordinate and Multiple Voting Shares.*

SUMMARY OF RESULTS

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

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

	Fiscal year ended February 28, 2014	Fiscal year ended February 28, 2013	Fiscal year ended February 29, 2012
Operating Data			
Sales	$489,257	$500,574	$437,135
Net Earnings[1]	29,400	6,169	7,892
Earnings per Share			
- Basic	1.34	0.28	0.36
- Diluted	1.34	0.28	0.36
Balance Sheet Data			
Total Assets	624,154	619,774	601,970
Total Long-term financial liabilities	19,992	24,393	17,109
Shareholder Data			
Cash dividends per share			
- Multiple Voting Shares[2]	0.31	0.32	0.32
- Subordinate Voting Shares	0.31	0.32	0.32
Outstanding Shares at report date			
- Multiple Voting Shares[2]	15,566,567		
- Subordinate Voting Shares	6,392,201		

Sales for fiscal year 2014 decreased by $11.3 million or 2.3%, compared to fiscal year 2013. This decrease is primarily attributable to a decrease in nuclear sales following the Fukushima crisis which was partially offset by an increase in sales in Canada to the Alberta oil and gas industry. Sales reached a record level for fiscal year 2013, increasing by $63.5 million or 14.5% compared to fiscal year 2012. The increase was due to the Company increasing its sales volume due to improved production execution on large export project orders.

Gross profit for fiscal year 2014 amounted to $131.1 million, an increase of $17.2 million from fiscal year 2013. Gross profit percentage for fiscal year 2014 also increased from the 22.8% reported in fiscal year 2013 to 26.8%. The increase in gross profit percentage reported for fiscal year 2014 is mainly attributable to a higher margin product mix, particularly spare part sales, and improved efficiencies. Gross profit for fiscal year 2013 amounted to $113.9 million, an increase of $26.6 million from fiscal year 2012. Gross profit percentage for fiscal year 2013 also increased from the 20.0% reported in fiscal year 2012 to 22.8%. The increase in gross profit percentage reported for fiscal year 2013 is attributable to a combination of sales mix, as well as the fixed cost component of cost of sales as compared to the increased sales in the year.

Administration costs for fiscal year 2014 decreased by $3.9 million when compared to fiscal year 2013. This decrease was mainly attributable to decreases in sales commissions and costs associated with the Company's ongoing asbestos litigation (see *Contingencies* section). The fluctuation in asbestos costs is due more to the timing of settlement payments than to changes in long-term trends. Administration costs for fiscal year 2013 increased by $7.4 million when compared to fiscal year 2012. Such increase was principally due to an increase in sales commissions on international export orders, an increase in freight costs for the increased customer shipments and an increase in costs associated with the Company's ongoing asbestos litigation (see *Contingencies* section).

The fiscal year 2013 net earnings[1] were also negatively impacted by an $11.7 million non-cash goodwill impairment loss related to the ABV cash-generating unit.

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

RESULTS OF OPERATIONS – for the year ended February 28, 2014 compared to the year ended February 28, 2013

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

Sales

(millions)	Year ended February 28, 2014	Year ended February 28, 2013
Sales	$489.3	$500.6

Sales decreased by $11.3 million or 2.3% from the record total achieved in the prior year. The decrease in sales is primarily attributable to a decrease in sales in the Company's French operations which was partially offset by an increase in sales in its North American operations. For the French operations, the decrease in sales is primarily attributable to a decrease in nuclear sales following the Fukushima nuclear disaster in Japan. For the North American operations, the increase in sales is due primarily to an increase in sales in Canada to the Alberta oil and gas industry.

Net bookings and backlog

(millions)	Year ended February 28, 2014	Year ended February 28, 2013
Net bookings	$430.2	$370.1

Net bookings increased by $60.1 million or 16.2% for the fiscal year. During the prior fiscal year, the Company instituted a policy of quoting longer lead times in order to reduce its very large order backlog to ease pressure on production. Since this strategy accomplished its purpose of reducing the order backlog to more normalized levels over the course of the prior year, the Company began quoting standard lead times in the current year, resulting in higher net bookings. The increase in net bookings was realized primarily in the latter half of the year when the Company booked over $40 million worth of orders with two large Indian energy customers.

(millions)	**February 2014**	**February 2013**	**February 2012**
Backlog	$471.7	$531.0	$661.8
For delivery within the subsequent fiscal year	$386.7	$398.2	$460.5
For delivery beyond the subsequent fiscal year	$85.0	$132.8	$201.3
Percentage – beyond the subsequent fiscal year	18.0%	25.0%	30.4%

The Company's book-to-bill ratio was 0.88 which resulted in a $59.3 million or 11.2% decrease in backlog since the beginning of the fiscal year. The Company ended the year with a backlog of $471.7 million.

Gross profit

(millions)	Year ended February 28, 2014	Year ended February 28, 2013
Gross profit	$131.1	$113.9
Gross profit percentage	26.8%	22.8%

Gross profit increased by $17.2 million for the fiscal year, an increase of 4.0 percentage points in the gross profit percentage from the prior year. This increase is primarily attributable to a higher margin product mix, particularly as a result of a higher proportion of spare parts sales which generally generate higher gross profit as a percentage of sales when compared to manufactured valves.

Administration costs

(millions)	Year ended February 28, 2014	Year ended February 28, 2013
Administration costs	$87.1	$91.0
As a percentage of sales	17.8%	18.2%

Administration costs decreased by $3.9 million or 4.3% for the fiscal year. The decrease is mainly a result of decreases in sales commissions and costs associated with the Company's ongoing asbestos litigation (see *Contingencies* section). The fluctuation in asbestos costs for the fiscal year is due more to the timing of settlement payments in these two periods rather than to changes in long-term trends. Like many other U.S. valve manufacturers, two of the Company's U.S. subsidiaries have been named as defendants in a number of pending lawsuits brought on behalf of individuals seeking to recover damages for their alleged asbestos exposure. These lawsuits are related to products manufactured and sold in the past. Management believes that any asbestos was incorporated entirely within the product in such a way that it would not allow for any ambient asbestos during normal operation, inspection or repairs. Management strongly believes its products, which were supplied in accordance with valve industry practice and customer mandated specifications, did not contribute to any asbestos-related illness. The Company will continue to vigorously defend against these claims but given the ongoing course of asbestos litigation in the U.S. and the unpredictability of jury trials, it is not possible to make an estimate of any settlement costs and legal fees.

Goodwill impairment loss and other income

(millions)	Year ended February 28, 2014	Year ended February 28, 2013
Goodwill impairment loss	$ -	$11.7
Other income	$0.3	$3.4

As a result of the annual goodwill impairment test required under IFRS, the Company recorded an impairment charge of $11.7 million in the prior fiscal year related to its ABV cash-generating unit. For the current fiscal year, the Company performed two goodwill impairment tests with respect to ABV, one in the second quarter of the year when a triggering event occurred following the acquisition of the 30% non-controlling interest in ABV by the Company, and one at year-end as part of the annual goodwill impairment test required under IFRS. As a result of these tests, no goodwill impairment loss was recorded in the current fiscal year. See *Highlights* section above for more details.

The other income of $3.4 million for the prior year consists primarily of a $2.4 million fair value adjustment on the contingent payments related to the ABV acquisition and a $0.4 million unrealized foreign exchange gain on the remaining proceeds payable on the ABV acquisition. During the first quarter of the prior year, the Company signed an agreement with the previous owners of ABV extending the required disbursement date of the €1.5 million contingent payment to be paid in the event that ABV had satisfied certain non-financial criteria from July 29, 2012 to March 15, 2013. In addition, the requirement that ABV satisfy the non-financial criteria was removed. As a result, the Company recorded a $0.2 million fair value adjustment on the contingent payment to other income. In the fourth quarter of the prior year, the Company evaluated the likelihood that the financial criteria related to the second of two €2 million contingent payments to be paid upon ABV satisfying certain earnings before interest, taxes, depreciation and amortization ("EBITDA") targets would be met. Based on this evaluation, the Company determined that it would be more likely than not that such financial criteria would not be satisfied. As a result, the Company recorded an additional fair value adjustment with respect to the applicable contingent payment of $2.2 million to other income in the prior year.

Net finance costs

(millions)	Year ended February 28, 2014	Year ended February 28, 2013
Net finance costs	$1.5	$2.6

The decrease in net finance costs relates primarily to the decrease in long-term debt and short-term borrowings discussed in the *Liquidity and Capital Resources* section below.

Income taxes

(in thousands, excluding percentages)	Year ended February 28, 2014		Year ended February 28, 2013	
	$	%	$	%
Income before income taxes	42,762	100.0	12,018	100.0
Tax calculated at domestic tax rates applicable to earnings in the respective countries	12,528	29.3	4,277	35.6
Tax effects of:				
Non-deductible (taxable) foreign exchange loss (gain)	(4)	0.0	(314)	(2.6)
Non-deductible goodwill impairment loss	-	-	3,147	26.2
Non-taxable income on fair value adjustment of proceeds payable	-	-	(657)	(5.5)
Benefit attributable to a financing structure	(1,308)	(3.1)	(1,178)	(9.8)
Other	544	1.3	9	0.1
Provision for income taxes	11,759	27.5	5,284	44.0

Net earnings[1]

(millions)	Year ended February 28, 2014	Year ended February 28, 2013
Net earnings[1]	$29.4	$6.2
As a percentage of sales	6.0%	1.2%
Adjusted net operating results[2]	$29.4	$15.8
As a percentage of sales	6.0%	3.2%

In order to adequately compare the operations with the prior year, the Company normalized its net earnings[1] by calculating the adjusted net operating results[2] for the two years in question. Adjusted net operating results[2] amounted to $29.4 million or $1.34 per share for the current fiscal year compared to $15.8 million or $0.72 per share achieved in the prior fiscal year. As a percentage of sales, the adjusted net operating results[2] margin was 6.0% for the current year, compared to 3.2% for the prior year. As discussed in the sections above, this increase is due primarily to improved gross profit margins and lower administration costs.

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

SUMMARY OF QUARTERLY RESULTS

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

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

	QUARTERS ENDED							
	February 2014	**November 2013**	**August 2013**	**May 2013**	**February 2013**	**November 2012**	**August 2012**	**May 2012**
Sales	$120,716	$115,611	$120,762	$132,168	$142,070	$134,203	$108,449	$115,852
Net Earnings (loss) [1]	10,392	8,319	4,889	5,800	(3,555)	5,712	3,318	694
Earnings (Loss) per share								
- Basic	0.47	0.38	0.23	0.26	(0.16)	0.26	0.15	0.03
- Diluted	0.47	0.38	0.23	0.26	(0.16)	0.26	0.15	0.03

In the quarters ended August 2012 and May 2012, sales remained fairly constant with prior years. Sales can vary from one quarter to the next due to the timing of the shipment of project orders. Sales were higher in August 2013, May 2013, February 2013 and November 2012 as the Company improved its production execution on large export project orders. As a result, sales for the quarters ended November 2013 and February 2014 returned to historical levels. A net loss[1] was recorded in the quarter ended February 2013 due to a goodwill impairment loss. Net earnings[1] for the quarters ended November 2013 and February 2014 were higher due to a more efficient product mix and lower administration costs.

RESULTS OF OPERATIONS – quarter ended February 28, 2014 compared to the quarter ended February 28, 2013

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

Sales

(millions)	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Sales	$120.7	$142.1

Sales decreased by $21.4 million or 15.1% for the quarter. This decrease is primarily attributable to the Company's French operations which realized lower nuclear sales following the Fukushima nuclear disaster in Japan. This reduction in nuclear sales was partially offset by an increase in sales of spare parts. Furthermore, as the Company's production cycle has normalized over the last fiscal year following the shipment of large export project orders in the prior year quarter, the sales for the current quarter returned to historical levels, which further explains the quarterly drop in sales.

Net bookings and backlog

(millions)	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Net bookings	$142.4	$96.7

Bookings increased by $45.7 million or 47.3% for the quarter. The increase in net bookings is primarily attributable to over $40 million worth of orders that were booked in the quarter with two large Indian energy customers. The large orders, which will be manufactured in the Company's North American, Italian and Indian production plants, include the Company's Securaseal metal seated ball valves, its forged pressure seal valves, its cast steel gate valves, and its coker ball valves for switch and isolation service. The Company continues to be the world leader in the supply of coker ball valves.

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

Gross profit

(millions)	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Gross profit	$36.6	$30.4
Gross profit percentage	30.3%	21.4%

Gross profit increased by $6.2 million for the quarter, an increase of 8.9 percentage points in the gross profit percentage from the prior year. This increase is primarily attributable to a higher margin product mix, particularly as a result of a higher proportion of spare parts sales which generally generate higher gross profit as a percentage of sales when compared to manufactured valves.

Administration costs

(millions)	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Administration costs	$22.1	$22.4
As a percentage of sales	18.3%	15.8%

Administration costs for the quarter remained relatively stable when compared to the prior year quarter.

Goodwill impairment loss and other income

(millions)	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Goodwill impairment loss	$ -	$11.7
Other income	$1.3	$2.6

As a result of the annual goodwill impairment test required under IFRS, the Company recorded an impairment charge of $11.7 million in the prior fiscal year's fourth quarter related to its ABV cash-generating unit. No goodwill impairment loss was recorded in the current fiscal year's quarter as a result of the current year's impairment test. See *Highlights* section above for more details.

In the prior year's fourth quarter, a $2.2 million fair value adjustment on the contingent payments related to the ABV acquisition was recorded. At that time, the Company evaluated the likelihood that the financial criteria related to the second of two €2 million contingent payments to be paid upon ABV satisfying certain EBITDA targets would be met. Based on this evaluation, the Company determined that it would be more likely than not that such financial criteria would not be satisfied. As a result, the Company recorded a fair value adjustment with respect to the applicable contingent payment of $2.2 million to other income in the prior year. There remains no amount of proceeds payable with respect to the ABV acquisition at the end of the current fiscal year.

Finance costs

(millions)	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Net finance costs	$0.4	$0.5

Net finance costs for the quarter remained relatively stable when compared to the prior year quarter.

Income taxes

(in thousands, excluding percentages)	Three-month period ended February 28, 2014		Three-month period ended February 28, 2013	
	$	%	$	%
Income (Loss) before income taxes	15,387	100.0	(1,552)	100.0
Tax calculated at domestic tax rates applicable to earnings in the respective countries	4,918	32.0	(151)	9.7
Tax effects of:				
Non-deductible (taxable) foreign exchange loss (gain)	(83)	(0.5)	-	-
Non-deductible goodwill impairment loss	-	-	3,147	(202.8)
Non-taxable income on fair value adjustment of proceeds payable	-	-	(604)	38.9
Benefit attributable to a financing structure	(329)	(2.1)	(308)	19.9
Other	227	1.4	(117)	7.6
Provision for income taxes	4,733	30.8	1,967	(126.7)

Net earnings[1]

(millions)	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Net earnings (loss)[1]	$10.4	$(3.6)
As a percentage of sales	8.6%	(2.5)%
Adjusted net operating results[2]	$10.4	$6.1
As a percentage of sales	8.6%	4.3%

In order to adequately compare the operations with the prior year quarter, the Company normalized its net earnings[1] by calculating the adjusted net operating results[2] for the two quarters in question. Adjusted net operating results[2] amounted to $10.4 million or $0.47 per share for the current quarter compared to $6.1 million or $0.28 per share achieved in the prior year period. As a percentage of sales, the adjusted net operating results[2] margin was 8.6% for the current quarter, compared to 4.3% for the prior year period. As discussed in the sections above, this increase is due primarily to improved gross profit margins.

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

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

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

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

	As at February 28, 2014				
(In thousands)	Total $	Less than 1 year $	1 to 3 Years $	4 to 5 Years $	After 5 years $
Long-term debt	22,087	10,402	8,987	739	1,959
Accounts payable and accrued liabilities	76,590	76,590	-	-	-
Customer deposits	66,842	66,842	-	-	-
Accrual for performance guarantees	33,842	33,842	-	-	-
Bank indebtedness and short-term bank loans	32,792	32,792	-	-	-
Derivative liabilities	1,501	1,501	-	-	-

On February 28, 2014, the Company's order backlog was $471.7 million and its net cash[1] plus unused credit facilities amounted to $173.1 million, which it believes, along with future cash flows generated from operations, is sufficient to meet its financial obligations, increase its capacity, satisfy its working capital requirements, and execute on its business strategy. However, there can be no assurance that the risk of another sharp downturn in the economy will not materially adversely affect the Company's results of operations or financial condition. The Company continues to closely monitor the continued weakness of the euro currency. The Company is in compliance with all covenants related to its debt and credit facilities.

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

Proposed transactions

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

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

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

Net cash[1]

(millions)	February 2014	November 2013	February 2013	November 2012	February 2012
Net cash[1]	$67.7	$59.2	$19.8	$5.5	$35.4

The Company's net cash[1] increased by $8.5 million during the quarter and $47.9 million since the beginning of the year. For both periods, net cash[1] was positively impacted by improved net earnings[2] and positive non-cash working capital movements.

Cash provided by operating activities

(millions)	Fiscal Year ended February 28, 2014	Fiscal Year ended February 28, 2013	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Cash provided by operating activities	$75.5	$14.4	$13.4	$23.1

Cash provided by operating activities for the current fiscal year increased by $61.1 million when compared to last year. This increase was principally related to improved net earnings[2] and a decrease in inventory. Cash provided by operating activities for the quarter decreased by $9.7 million when compared to the prior year period. This decrease was principally related to non-cash working capital movements, specifically a decrease in customer deposits.

Accounts receivable

(millions)	Fiscal Year ended February 28, 2014	Fiscal Year ended February 28, 2013	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Accounts receivable decrease (increase)	$5.4	$(23.3)	$(2.0)	$(2.2)

Accounts receivable balances are a function of the timing of sales and cash collections. For both the current quarter and fiscal year, the fluctuation in the accounts receivable balance is a function of the timing of payments received on large overseas project accounts, particularly related to the collection period for the Company's nuclear orders in China, as well as a decrease in sales over the current quarter.

Inventory

(millions)	Fiscal Year ended February 28, 2014	Fiscal Year ended February 28, 2013	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Inventory decrease	$23.0	$11.3	$0.5	$17.7
Customer deposits decrease	$9.8	$10.2	$7.0	$8.4

Inventory typically increases in times of rising backlog and order bookings and decreases when the opposite occurs. Inventory is also a function of timing between receipts and shipments. For the current quarter, inventory remained relatively flat while, for the fiscal year, it decreased as a result of the decrease in backlog during the corresponding period. In order to help finance its investment in inventory, the Company, where possible, obtains customer deposits for large orders. The decrease in customer deposits for the fiscal year is in line with the lower backlog and decreased inventory.

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

[2] *Net earnings refers to net income attributable to Subordinate and Multiple Voting Shares.*

Accounts payable and accrued liabilities

(millions)	Fiscal Year ended February 28, 2014	Fiscal Year ended February 28, 2013	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Accounts payable and accrued liabilities (decrease) increase	$(1.8)	$(3.8)	$4.1	$0.1

For all of the indicated periods, the fluctuations in accounts payable and accrued liabilities were primarily related to timing, particularly related to inventory.

Additions to property, plant and equipment

(millions)	Fiscal Year ended February 28, 2014	Fiscal Year ended February 28, 2013	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Additions to property, plant and equipment	$18.0	$28.5	$3.3	$5.8

The additions to property, plant and equipment relate mainly to the Company's North American and Asian operations where it continues to invest in machinery and equipment in order to improve its manufacturing infrastructure and operational efficiency.

Dividends

(millions)	Fiscal Year ended February 28, 2014	Fiscal Year ended February 28, 2013	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Dividends paid	$6.8	$7.1	$1.7	$1.8

During the current fiscal year, the Company maintained its dividend policy of CDN$0.32 per share, payable quarterly. In the next fiscal year, the Company will raise its annual dividend payout to CDN$0.40 per share. This change will apply beginning with the next quarterly dividend payment payable on June 30, 2014, to all shareholders of record as at June 16, 2014.

Long-term debt

(millions)	Fiscal Year ended February 28, 2014	Fiscal Year ended February 28, 2013	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Increase in long-term debt	$2.7	$21.1	$ -	$0.3
Repayment of long-term debt	$8.4	$4.5	$1.8	$1.8

During the current fiscal year, the Company reached an agreement with the minority shareholders of ABV to convert short-term loans of €1.1 million which were set to expire in May 2013, to long-term loans in the same amount, bearing interest at 5% and repayable in February 2016. During the second quarter of the current fiscal year, these loans were repaid as part of the acquisition of the remaining 30% interest of the minority shareholders of ABV (see *Highlights* section). Over the course of the current fiscal year, the Company's Korean special purpose entity converted certain short-term loans totalling KW 1.4 billion into long-term debt with interest rates ranging from 3.1% to 3.4%. These loans are repayable at maturity in 2015.

Other Liabilities

(millions)	Fiscal Year ended February 28, 2014	Fiscal Year ended February 28, 2013	Three-month period ended February 28, 2014	Three-month period ended February 28, 2013
Payment of proceeds payable	$2.0	$3.5	$ -	$0.6

In accordance with the provisions of the purchase and sale agreement for ABV, the Company paid $2.0 million to the former majority shareholders of ABV over the course of the current fiscal year, which represented the final payment of the proceeds payable at the time of the acquisition.

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 subsidiary companies and SPEs. The Company uses derivative financial instruments to hedge certain risk exposures. Use of derivative financial instruments is subject to a policy which requires that no derivative transaction be entered into for the purpose of establishing a speculative or leveraged position (the corollary being that all derivative transactions are to be entered into for risk management purposes only).

Risk overview

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

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

Market risk

Currency risk

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

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

The amounts outstanding as at February 28, 2014 and 2013 are as follows:

	Range of exchange rates		Gain (loss) (In thousands of U.S. dollars)		Notional amount (In thousands of indicated currency)	
	February 28, 2014	February 28, 2013	February 28, 2014 $	February 28, 2013 $	February 28, 2014	February 28, 2013
Foreign exchange forward contracts						
Sell US$ for CA$ – 0 to 12 months	1.04-1.12	0.97-1.04	(1,275)	(951)	US$43,057	US$43,245
Sell US$ for € – 0 to 12 months	1.29-1.36	1.28-1.43	192	(192)	US$8,498	US$8,664
Buy US$ for € – 0 to 12 months	1.34-1.36	1.28-1.41	(14)	1	US$483	US$33
Sell US$ for £ – 0 to 21 months	1.52	1.52	130	(6)	US$1,315	US$1,485
Sell US$ for KW – 0 to 12 months	1,070-1,075	-	94	-	US$1,348	-
Sell € for US$ – 0 to 12 months	1.31-1.37	1.25-1.35	(133)	103	€9,026	€30,693
Buy € for US$ – 0 to 12 months	-	1.26	-	67	-	€1,420
Buy £ for US$ – 0 to 12 months	1.61-1.68	1.51-1.61	3	(62)	£2,746	£889

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. Gains are recorded as derivative assets and losses as derivative liabilities on the consolidated statement of financial position.

Cash flow and fair value interest rate risk

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

Credit risk

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

The Company's credit risk related to its trade accounts receivable is concentrated. As at February 28, 2014, two (February 28, 2013 – three) customers accounted for more than 5% each of its trade accounts receivable, of which one customer accounted for 5.4% (February 28, 2013 – 6.2%), and the Company's ten largest customers accounted for 36.5% (February 28, 2013 – 43.1%).

In order to mitigate its credit risk, the Company performs a continual evaluation of its customers' credit and performs specific evaluation procedures on all its new customers. In performing its evaluation, the Company analyzes the ageing of accounts receivable, historical payment patterns, customer creditworthiness and current economic trends. A specific credit limit is established for each customer and reviewed periodically. An allowance for doubtful accounts is recorded when, based on management's evaluation, the collection of an account receivable is not reasonably certain.

The Company is also exposed to credit risk relating to derivative financial instruments, cash and cash equivalents and short-term investments, which it manages by dealing with highly rated financial institutions.

The Company's primary credit risk is limited to the carrying value of the trade accounts receivable and gains on derivative assets.

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

(In thousands of U.S. dollars)	February 28, 2014 $	February 28, 2013 $
Current	93,053	97,741
Past due 0 to 30 days	13,251	10,351
Past due 31 to 90 days	9,375	8,702
Past due more than 90 days	9,039	10,793
	124,718	127,587
Less: Allowance for doubtful accounts	917	1,525
Trade accounts receivable	123,801	126,062
Other receivables	5,177	8,312
Total accounts receivable	128,978	134,374

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

(In thousands of U.S. dollars)	February 28, 2014 $	February 28, 2013 $
Balance – Beginning of year	1,525	1,144
Bad debt expenses	767	916
Recoveries of trade accounts receivable	(1,237)	(472)
Write-off of trade accounts receivable	(168)	(50)
Foreign exchange	30	(13)
Balance – End of year	917	1,525

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 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. 856 claims were outstanding at the end of the reporting period (February 28, 2013 – 764). These claims were filed in the states of Arizona, Arkansas, California, Connecticut, Delaware, Florida, Hawaii, Illinois, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Missouri, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, South Carolina, Texas, Virginia, Washington and West Virginia. During the current fiscal year, the Company resolved 368 claims (February 28, 2013 – 330) and was the subject of 460 new claims (February 28, 2013 – 423). Because of the many uncertainties inherent in predicting the outcome of these proceedings, as well as the course of asbestos litigation in the United States, management believes that it is not possible to make an estimate of the Company's asbestos liability. Accordingly, no provision has been set up in the accounts. Settlement costs and legal fees related to these asbestos claims amounted to $1,813 for the quarter (February 28, 2013 - $3,173) and $5,472 for the year (February 28, 2013 - $8,763).

OFF-BALANCE SHEET ARRANGEMENTS

The Company has entered into certain off-balance sheet arrangements. They are fully described in notes 22 and 25 of the Company's audited consolidated financial statements. The types of transactions entered into, all of which are in the normal course of business, are as follows:

- Performance bond guarantees related to product warranty and on-time delivery
- Letters of credit issued to overseas suppliers
- Operating leases

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

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

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

	Three months ended		Twelve months ended	
	Feb. 28, 2014	Feb. 28, 2013	Feb. 28, 2014	Feb. 28, 2013
Purchases of material components	$434	$385	$1,889	$1,909
Sales of raw material	32	9	104	168

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

b) SteamTree Systems, Inc. ("SteamTree") is a company, which is 50%-owned by a different relative of the controlling shareholder. SteamTree provides consulting and custom design services related to computer software and software applications. SteamTree developed and implemented a computerized quotations system presently used by Velan's Marketing department.

	Three months ended		Twelve months ended	
	Feb. 28, 2014	Feb. 28, 2013	Feb. 28, 2014	Feb. 28, 2013
Software development and consulting services	$1	$3	$4	$17

c) One of the Company`s subsidiaries and certain of its executives lease, on a weekly basis, a property from Velan Holdings Co. Ltd., the controlling shareholder. Velan Holdings Co. Ltd. charges weekly rates based on usage.

	Three months ended		Twelve months ended	
	Feb. 28, 2014	Feb. 28, 2013	Feb. 28, 2014	Feb. 28, 2013
Rent	$8	$6	$25	$25

CONTROLS AND PROCEDURES

Disclosure controls and procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer ("CEO"), and the Chief Financial Officer ("CFO"), in a timely manner so that appropriate decisions can be made regarding public disclosure.

The CEO and the CFO of the Company have evaluated, or caused the evaluation of, under their direct supervision, the effectiveness of the Company's disclosure controls and procedures (as defined in National Instrument 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings) as at February 28, 2014 and have concluded that such disclosure controls and procedures were designed and operating effectively.

Internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Management has evaluated the design and effectiveness of its internal controls and procedures over financial reporting (as defined in National Instrument 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings). The evaluation was based on the *"Internal Control-Integrated Framework"* issued by the *Committee of Sponsoring Organizations of the Treadway Commission ("COSO").* This evaluation was performed by the CEO and the CFO of the Company with the assistance of other Company Management and staff to the extent deemed necessary. Based on this evaluation, the CEO and the CFO concluded that the internal controls and procedures over financial reporting were appropriately designed and operating effectively as at February 28, 2014.

In spite of its evaluation, Management does recognize that any controls and procedures no matter how well designed and operated, can only provide reasonable assurance and not absolute assurance of achieving the desired control objectives. In the unforeseen event that lapses in the disclosure of internal controls and procedures occur and/or mistakes happen of a material nature, the Company intends to take the steps necessary to minimize the consequences thereof.

Changes in internal control over financial reporting

The Company did not make any material changes to the design of internal control over financial reporting during the year and three-month period ended February 28, 2014 that have materially affected, or are reasonably likely to have materially affected, the Company's internal control over financial reporting.

CRITICAL ACCOUNTING ESTIMATES & JUDGEMENTS

The Company's financial statements are prepared in accordance with IFRS as issued by the IASB. The Company's significant accounting policies as described in note 2 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 financial years.

The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below:

Accounts receivable

The Company must report its accounts receivable at their net realizable value. This involves management judgment and requires the Company to perform continuous evaluations of their collectability and to record an allowance for doubtful accounts when required. In performing its evaluation, the Company analyzes the ageing of accounts receivable, concentration of receivables by customer, customer creditworthiness and current economic trends. Any change in the assumptions used could impact the carrying value of the

accounts receivable on the consolidated statement of financial position with a corresponding impact made to administration costs on the consolidated statement of income.

Inventory

Inventories must be valued at the lower of cost and net realizable value. A writedown of inventory will occur when its estimated market value less applicable variable selling expenses is below its carrying amount. This involves significant management judgment and is based on the Company's assessment of market conditions for its products determined by historical usage, estimated future demand and, in some cases, the specific risk of loss on specifically identified inventory. Any change in the assumptions used in assessing this valuation or selling costs could impact the carrying amount of the inventory on the consolidated statement of financial position with a corresponding impact made to cost of sales on the consolidated statement of income.

Provisions

Provisions must be established for possible product warranty expenses. The Company estimates its warranty exposure by taking into account past experience as well as any known technical problems and estimates of costs to resolve these issues. The Company estimates its exposure under these obligations based on an analysis of all identified or expected claims. Any change in the assumptions used could impact the value of the provision on the consolidated statement of financial position with a corresponding impact made to cost of sales on the consolidated statement of income.

Accrual for performance guarantees

Accruals for performance guarantees must be established for possible late delivery and other contractual non-compliance penalties or liquidated damages. The Company estimates its exposure by taking into account past experience, as well as any known non-compliance with its contractual obligations, and estimates of costs to resolve these issues. The Company estimates its exposure under these obligations based on an analysis of all identified or expected claims. Any change in the assumptions used could impact the value of the accrual on the consolidated statement of financial position with a corresponding impact made to cost of sales on the consolidated statement of income.

Asset impairment test

Assets that have an indefinite life, such as goodwill, are tested annually by the Company for impairment, or more frequently if events or circumstances indicate there may be impairment. All other assets must be reviewed by the Company at the end of each reporting period in order to determine whether there is an indication of possible impairment. For the purposes of impairment testing, assets are grouped at the lowest levels for which there are separately identifiable cash flows. A cash-generating unit ("CGU") is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. If an indication of impairment exists, the Company estimates the recoverable amount of the CGU in order to determine the extent of the impairment loss, if any. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the greater of an asset's fair value less costs to sell and its value in use. In assessing value in use, the Company estimates future cash flows which are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Any change in the assumptions used could impact the carrying amount first of any goodwill allocated to the CGU and then to the other assets of the CGU on a pro rata basis of the carrying amount of each asset in the CGU on the consolidated statement of financial position with a corresponding impact made to the consolidated statement of income.

Income taxes

The Company must estimate its income taxes in each jurisdiction in which it operates. This involves assessing the probability of using net operating losses against future taxable income as well as evaluating positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. In the event these assessments are changed, there would be an adjustment to income tax expense with a corresponding adjustment to income tax balances on the consolidated statement of financial position.

ACCOUNTING STANDARDS AND AMENDMENTS ADOPTED IN THE YEAR

The following standards and amendments to existing standards were adopted by the Company on March 1, 2013. The adoption of these standards and amendments did not have a significant impact on the Company's financial statements.

(i) IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under previous IFRS, consolidation was required when an entity had the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaced SIC-12, *Consolidation -Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*.

(ii) IFRS 11, *Joint Arrangements*, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures are accounted for using the equity method of accounting whereas for a joint operation the venturer recognizes its share of the assets, liabilities, revenue and expenses of the joint operation. Under previous IFRS, entities had the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 superseded IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers*.

(iii) IFRS 12, *Disclosure of Interests in Other Entities*, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carried forward existing disclosures and also introduced significant additional disclosure that addressed the nature of, and risks associated with, an entity's interests in other entities. See note 6 for additional disclosures presented.

(iv) IFRS 13, *Fair Value Measurement*, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under previous IFRS, guidance on measuring and disclosing fair value was dispersed among the specific standards requiring fair value measurements and did not always reflect a clear measurement basis or consistent disclosures.

(v) There have been amendments to existing standards, including IAS 27, *Separate Financial Statements* ("IAS 27"), and IAS 28, *Investments in Associates and Joint Ventures* ("IAS 28"). IAS 27 addressed accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 had been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

(vi) IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in other comprehensive income into two groups, based on whether or not items may be recycled in the future. Entities that choose to present other comprehensive income items before tax are required to show the amount of tax related to the two groups separately.

ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

The following revised standard is effective for annual periods beginning on or after January 1, 2015 with earlier application permitted. The Company has not yet assessed the impact of the standard or determined whether it will early adopt it.

(i) IFRS 9, *Financial Instruments*, was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit or loss are generally recorded in other comprehensive income.

CERTAIN RISKS THAT COULD AFFECT OUR BUSINESS

Cyclical nature of end user markets
The demand for the Company's products in any particular industry or market can vary significantly according to the level of economic activity in that industry or market. These potential variations may be mitigated by the fact that the Company's sales are diversified geographically as well as by end user market. There can be no assurance that an economic recession or downturns in certain industries or geographic locations will not have a significant adverse effect on the Company's sales.

Competition
Competitive pressures in the Company's markets could lead to a loss of market share, which could negatively impact revenues, margins and net income. The Company also competes with manufacturers based in low wage countries that offer valves at substantially lower prices. There can be no assurance that the Company will be able to compete successfully against its current or future competitors or that competition will not have a material adverse effect on the Company's results of operations and financial condition.

Backlog
The Company's order backlog consists of sales orders that are considered firm. It is also an indication of future sales revenues. However, there can be no assurance that subsequent cancellations or scope adjustments will not occur, that the order backlog will ultimately result in earnings, or when the related revenues and earnings from such order backlog will be recognized.

Dependence upon key personnel
The Company is dependent upon the abilities and experience of its executive officers and other key employees. There can be no assurance that the Company can retain the services of such executive officers and key employees. If several executive officers or other key employees were to leave the employ of the Company, its operations could be adversely affected.

Foreign currency exchange risks
Due to the geographic mix of the Company's customers and its operations, the Company is exposed to foreign currency exchange risk. The Company enters into simple foreign currency forward contracts in order to manage a portion of its net exposure to foreign currencies. Such forward contracts contain an inherent credit risk related to default on obligations by the counterparty, which the company mitigates by entering into contracts with sound financial institutions that it anticipates will satisfy their obligations. Risk related to currency fluctuations could have a material adverse effect on the Company's results of operations and its financial position.

Interest rate risk
A portion of the Company's liabilities consist of debt instruments that bear interest at variable rates. As such, the Company is exposed to the risk of interest rate fluctuations. This risk could have an adverse effect on the Company's results of operations.

Availability and prices of raw materials
The price of raw materials, principally steel, represents a substantial portion of the cost of manufacturing the Company's products. Historically, there have been fluctuations in these raw material prices and, in some instances, price movements have been volatile. There can be no certainty that the Company will be able to pass on increases resulting from higher costs of raw materials to its customers through increases in selling prices, or otherwise absorb such cost increases without significantly affecting its margins.

In addition, certain raw materials are in short supply for a period of time. Typically, these shortages do not last long and the Company is usually able to ensure that its needs are met. However, there can be no assurances that its sources of supply will be adequate to supply all of its needs on a timely basis.

Labour relations
A substantial portion of the Company's workforce is covered by union agreements. Although the Company has been successful in the past in negotiating renewals, there can be no assurance that this will continue. Failure to renegotiate these agreements could lead to work disruptions or higher labour costs, which could negatively impact results.

Reliance on key suppliers
The Company has several key suppliers with whom it has invested in forging dies and casting patterns. While the Company has alternate sources for most material purchases, the loss of a key supplier could impact negatively on the Company.

Reliance on distributors and sales agents
The Company is directly affected by the ability of independent third party distributors and sales agents retained by the Company to sell its products in their respective markets. The Company's continued success is thus dependent on its ability to attract and retain the distributors and sales agents it requires to support its existing business and to continue to grow.

Project undertakings
In competing for the sales of valves, the Company may enter into contracts that provide for the production of valves at specified prices and in accordance with time schedules. These contracts may involve greater risks as a result of unforeseen increases in the prices of raw materials and other costs due to more stringent terms and conditions. Although contract terms may vary from customer to customer, production delays and other performance issues may call for liquidated damages or other penalties in case of non-performance or warranty issues due to the more stringent terms and conditions of such contracts.

Political and economic risks associated with international sales and operations
Since the Company sells and manufactures its products worldwide, the business is subject to risks associated with doing business internationally. The Company's business and operating results could be impacted by trade protection measures, changes in tax laws, possibility of expropriation and embargo, foreign exchange restrictions and political, military and/or terrorist disruptions or changes in regulatory environments.

Force majeure events
Force majeure events are unforeseeable events or circumstances that occur beyond the control of the Company. Such events include but are not limited to political unrest, war, terrorism, strikes, riots, and crime, as well as seismic or severe weather related events such as earthquakes, hurricanes, tsunamis, tornadoes, ice storms, flooding and volcanic eruptions. The risk of occurrence of a force majeure event is unpredictable and may result in delays or cancellations of orders and deliveries to customers, delays in the receipt of materials from suppliers, damage to facilities or equipment, personal injury or fatality, and possible legal liability.

Asbestos litigation
Two of the Company's U.S. subsidiaries have been named as 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 defense related to certain products that may have contained an internal component containing asbestos. Although it is defending these allegations vigorously, there can be no assurance that the Company will prevail. Unfavorable rulings, judgments or settlement terms could have a material adverse impact on the Company's business, financial condition, results of operations and cash flows.

Product liability and other lawsuits
The Company, like other worldwide manufacturing companies, has been, and will continue to be, subject to a variety of potential liability claims or other lawsuits connected with its business operations, including potential liabilities and expenses associated with possible product defects or failures. While the Company maintains comprehensive general liability insurance coverage which it considers to generally be in accordance with industry practice, such insurance does not cover certain categories of claims (such as ongoing asbestos claims) to which the Company is subject. Comprehensive general liability premiums have also increased significantly during the last several years. Accordingly, the Company cannot be certain that comprehensive general liability insurance coverage will continue to be available to it at a reasonable cost, or, if available, would be adequate to cover its liabilities.

Health and safety risk
The Company is committed to providing all employees, contractors, and visitors to its premises with a healthy and safe work environment. The Company has implemented a program throughout its operations with policies and procedures that must be followed to ensure that it meets all applicable health and safety laws, regulations, and standards. The Company recognizes that a lack of a strong health and safety program may expose it to lost production time, penalties and lawsuits, and may impact future orders as customers may take into account the Company's health and safety record when awarding sales contracts.

Environmental compliance matters
The Company's operations and properties are subject to increasingly stringent laws and regulations relating to environmental protection, including air and water discharges, waste management and disposal and employee safety. Such laws and regulations both impose substantial fines for violations and mandate cessation of operations in certain circumstances, the installation of costly pollution control equipment, or the undertaking of costly site remediation activities. Furthermore, new laws and regulations, or stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination or the imposition of new clean up requirements could require the Company to incur additional costs which could be significant.

Controls over disclosures and financial reporting
In accordance with National Instrument 52-109, the CEO and the CFO of the Company are responsible for designing, maintaining, and evaluating the effectiveness of disclosure controls and procedures. The CEO and the CFO are also responsible for the effective design of internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS. A system of controls is subject to certain inherent limitations and is partially based on the possibility or probability of future events. Accordingly, a system of internal controls can provide only reasonable, and not absolute, assurance of reaching the desired objectives.

Control of the company
Velan Holding Co. Ltd. (the "Controlling Shareholder") owns 15,566,567 Multiple Voting Shares representing, in the aggregate, approximately 92.4% of the voting interests in the Company. Voting control enables the Controlling Shareholder to determine all matters requiring shareholder approval. The Controlling Shareholder has advised the Company that the disposition of the shares requires the consent of certain Velan family members and controlled entities.

The Controlling Shareholder effectively has sufficient voting power to prevent a change in control of the Company. The sale of a significant number of Subordinate Voting Shares by the Controlling Shareholder pursuant to the exercise of the conversion right attached to the Multiple Voting Shares may impact upon the market price and liquidity thereof.

Income and other tax risks
The Company operates in a number of different tax jurisdictions and has a significant amount of cross-border purchase and sale transactions. The tax rules and regulations in various countries are becoming more complex. There is a risk that one or more tax authorities could disagree with the tax treatment adopted by the Company, resulting in defense costs and possible tax assessments.

Compliance with international laws
Due to the international nature of its operations, the Company is subject to differing systems of laws and regulations which are often complex and differ from one country to the next. Such laws and regulations include but are not limited to anti-bribery legislation, export and customs controls, foreign currency exchange controls, transfer pricing regulations and economic sanctions imposed by governmental authorities. Failure to comply with such laws could negatively impact earnings and may result in criminal, civil and administrative legal sanctions. The Company has implemented policies and procedures to effect compliance with these laws by its employees and representatives.

Special purpose entities and non-controlling interest
The Company's operations in China and Taiwan, and certain of its operations in France and Korea are undertaken with partners that are classified as special purpose entities or non-controlling interest. The success of these operations depends on the satisfactory performance of such partners in their obligations. The failure of such partners to perform their obligations could impose additional financial and performance obligations on the Company that could negatively impact its earnings and financial condition.

Business acquisitions
The success of a business acquisition depends in part upon the integration of the acquired business through such tasks as the realization of synergies, elimination of cost duplication, information systems integration, and establishment of controls and procedures. The inability to adequately integrate an acquired business in a timely manner might result in lost business opportunities, higher than expected integration costs and departures of key personnel, all of which could have a negative impact on earnings.

RECONCILIATIONS AND NON-IFRS MEASURES

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

Net cash

(millions)	Fiscal year ended Feb. 28, 2014	Fiscal year ended Feb. 28, 2013
Cash and cash equivalents	106.7	77.2
Short-term investments	0.2	0.4
Bank indebtedness	(31.9)	(48.6)
Short-term bank loans	(0.9)	(2.3)
Current portion of long-term bank borrowings	(6.4)	(6.9)
	67.7	19.8

Adjusted net operating results

(millions)	Fiscal year ended Feb. 28, 2014	Fiscal year ended Feb. 28, 2013	Three-month period ended Feb. 28, 2014	Three-month period ended Feb. 28, 2013
Net income (loss) attributable to Subordinate Voting Shares and Multiple Voting Shares	29.4	6.2	10.4	(3.6)
Adjustments for:				
Goodwill impairment loss	-	11.7	-	11.7
Interest accretion on ABV proceeds payable	-	0.7	-	0.2
Fair value adjustment for ABV proceeds payable	-	(2.4)	-	(2.2)
Unrealized foreign exchange gain on ABV proceeds payable	-	(0.4)	-	-
Adjusted net operating results	29.4	15.8	10.4	6.1

Velan Inc.

Consolidated Financial Statements
For the years ended February 28, 2014 and 2013

May 20, 2014

Independent Auditor's Report

To the Shareholders of
Velan Inc.

We have audited the accompanying consolidated financial statements of Velan Inc. and its subsidiaries, which comprise the consolidated statements of financial position as of February 28, 2014 and February 28, 2013 and the consolidated statements of income, of comprehensive income, of changes in equity and of cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

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"PwC" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Velan Inc. and its subsidiaries as at February 28, 2014 and February 28, 2013 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP[1]

[1] CPA auditor, CA, public accountancy permit No. A123642

Velan Inc.

Consolidated Statements of Financial Position

(in thousands of U.S. dollars)

	As at February 28, 2014 $	As at February 28, 2013 $
Assets		
Current assets		
Cash and cash equivalents	106,716	77,172
Short-term investments	239	398
Accounts receivable	128,978	134,374
Income taxes recoverable	5,465	7,672
Inventories (note 5)	224,149	246,983
Deposits and prepaid expenses	5,046	6,048
Derivative assets	498	340
	471,091	472,987
Non-current assets		
Property, plant and equipment (notes 7 and 12)	96,605	90,630
Intangible assets and goodwill (note 8)	43,359	43,194
Deferred income taxes (note 20)	11,406	11,226
Other assets	1,693	1,737
	153,063	146,787
Total assets	624,154	619,774
Liabilities		
Current liabilities		
Bank indebtedness (note 10)	31,876	48,580
Short-term bank loans	916	2,284
Accounts payable and accrued liabilities (note 9)	76,590	78,431
Income tax payable	4,158	2,831
Dividend payable	1,586	1,701
Customer deposits	66,842	76,682
Provisions (note 11)	8,060	6,345
Accrual for performance guarantees	33,842	28,525
Derivative liabilities	1,501	1,380
Current portion of long-term debt (note 12)	10,402	10,463
Current portion of other liabilities (note 3)	-	1,951
	235,773	259,173
Non-current liabilities		
Long-term debt (note 12)	11,685	16,387
Deferred income taxes (note 20)	9,270	8,035
Other liabilities	8,307	8,006
	29,262	32,428
Total liabilities	265,035	291,601
Equity		
Equity attributable to Subordinate and Multiple Voting shareholders		
Share capital (note 13)	76,688	76,314
Contributed surplus	6,099	1,746
Retained earnings	272,867	250,129
Accumulated other comprehensive loss	(3,589)	(8,676)
	352,065	319,513
Non-controlling interest (note 6)	7,054	8,660
Total equity	359,119	328,173
Total liabilities and equity	624,154	619,774

Commitments and contingencies (note 22)

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

Approved by the Board of Directors

A. K. Velan, Director

T.C. Velan, Director

Velan Inc.

Consolidated Statements of Income

For the years ended February 28, 2014 and 2013
(in thousands of U.S. dollars, excluding per share amounts)

	2014 $	2013 $
Sales (notes 14 and 24)	489,257	500,574
Cost of sales (notes 5, 14, 15 and 19)	358,111	386,675
Gross profit	131,146	113,899
Administration costs (notes 16 and 19)	87,143	90,985
Goodwill impairment loss (notes 4 and 8)	-	11,700
Other income (note 3)	(269)	(3,364)
Operating profit	44,272	14,578
Finance income	859	631
Finance costs	2,369	3,191
Finance costs – net	(1,510)	(2,560)
Income before income taxes	42,762	12,018
Income taxes (note 20)	11,759	5,284
Net income for the year	31,003	6,734
Net income attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	**29,400**	**6,169**
Non-controlling interest	1,603	565
	31,003	6,734
Earnings per share (note 21)		
Basic	1.34	0.28
Diluted	1.34	0.28
Dividends declared per Subordinate and Multiple Voting Share	0.31 (CA$0.32)	0.32 (CA$0.32)

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

Velan Inc.

Consolidated Statements of Comprehensive Income (Loss)

For the years ended February 28, 2014 and 2013
(in thousands of U.S. dollars)

	2014 $	2013 $
Comprehensive income		
Net income for the year	31,003	6,734
Other comprehensive income (loss)		
Foreign currency translation adjustment on foreign operations whose functional currency is other than the reporting currency (U.S. dollar)	6,311	(4,531)
Comprehensive income	37,314	2,203
Comprehensive income attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	35,624	1,710
Non-controlling interest	1,690	493
	37,314	2,203

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

Velan Inc.

Consolidated Statements of Changes in Equity

For the years ended February 28, 2014 and 2013

(in thousands of U.S. dollars)

	Equity attributable to Subordinate and Multiple Voting shareholders						
	Share capital	Contributed surplus	Accumulated other comprehensive income (loss)	Retained earnings	Total	Non-controlling interest	Total equity
Balance - February 29, 2012	78,764	1,871	(4,217)	250,951	327,369	8,208	335,577
Net income for the year	-	-	-	6,169	6,169	565	6,734
Other comprehensive loss	-	-	(4,459)	-	(4,459)	(72)	(4,531)
	78,764	1,871	(8,676)	257,120	329,079	8,701	337,780
Effect of share-based compensation (note 13(d))	-	58	-	-	58	-	58
Dividends							
Multiple Voting Shares	-	-	-	(4,988)	(4,988)	-	(4,988)
Subordinate Voting Shares	-	-	-	(2,003)	(2,003)	-	(2,003)
Non-controlling interest	-	-	-	-	-	(41)	(41)
Share repurchase (note 13(c))	(2,450)	(183)	-	-	(2,633)	-	(2,633)
Balance - February 28, 2013	76,314	1,746	(8,676)	250,129	319,513	8,660	328,173
Net income for the year	-	-	-	29,400	29,400	1,603	31,003
Other comprehensive income	-	-	6,224	-	6,224	87	6,311
	76,314	1,746	(2,452)	279,529	355,137	10,350	365,487
Effect of share-based compensation (note 13(d))	-	23	-	-	23	-	23
Shares issued under Share Option Plan (note 13(d))	374	-	-	-	374	-	374
Dividends							
Multiple Voting Shares	-	-	-	(4,760)	(4,760)	-	(4,760)
Subordinate Voting Shares	-	-	-	(1,902)	(1,902)	-	(1,902)
Non-controlling interest	-	-	-	-	-	(103)	(103)
Acquisition of non-controlling interest (note 6(d))	-	4,330	(1,137)	-	3,193	(3,193)	-
Balance - February 28, 2014	76,688	6,099	(3,589)	272,867	352,065	7,054	359,119

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

Velan Inc.

Consolidated Statements of Cash Flow

For the years ended February 28, 2014 and 2013
(in thousands of dollars)

Cash flows from	2014 $	2013 $
Operating activities		
Net income for the year	31,003	6,734
Adjustments to reconcile net income to cash provided by operating activities (note 27)	15,890	23,389
Changes in non-cash working capital items (note 28)	28,566	(15,711)
Cash provided by operating activities	75,459	14,412
Investing activities		
Short-term investments	159	4,556
Additions to property, plant and equipment	(17,953)	(28,452)
Additions to intangible assets	(397)	(684)
Proceeds on disposal of property, plant and equipment, and intangible assets	396	905
Net change in other assets	44	(270)
Cash used by investing activities	(17,751)	(23,945)
Financing activities		
Dividends paid to Subordinate and Multiple Voting shareholders	(6,777)	(7,081)
Dividends paid to non-controlling interest	(103)	(41)
Shares issued under Share Option Plan (note 13(d))	374	-
Repurchase of shares (note 13(c))	-	(2,633)
Payment of proceeds payable (note 3)	(1,960)	(3,465)
Short-term bank loans	(1,368)	1,426
Increase in long-term debt	2,654	21,057
Repayment of long-term debt	(8,430)	(4,478)
Cash provided (used) by financing activities	(15,610)	4,785
Effect of exchange rate differences on cash	4,150	364
Net change in cash during the year	46,248	(4,384)
Net cash – Beginning of the year	28,592	32,976
Net cash – End of the year	74,840	28,592
Net cash is composed of:		
Cash and cash equivalents	106,716	77,172
Bank indebtedness	(31,876)	(48,580)
	74,840	28,592
Supplementary information		
Interest paid	(1,062)	(1,895)
Income taxes paid	(1,697)	(2,042)

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

1 General information and basis of preparation

These consolidated financial statements represent the consolidation of the accounts of Velan Inc. (the "Company") and the entities over which it has control, its subsidiary companies and special-purpose entities ("SPEs"). The Company is an international manufacturer of industrial valves.

The Company 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 Côte de Liesse, Montréal, Quebec, Canada, H4T 1G2. The Company's ultimate parent company is Velan Holdings Co. Ltd.

The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These consolidated financial statements were approved by the Company's Board of Directors on May 20, 2014.

2 Summary of significant accounting policies

Functional and presentation currency

Functional currency is defined as the currency of the primary economic environment in which an entity operates. Indicators for determining an entity's functional currency are broken down into primary and secondary indicators.

Primary indicators include:
- the currency of sales and cash inflows;
- the currency of the country having primary influence over sales prices; and
- the currency of expenses and cash outflows.

Primary indicators receive more weight than secondary indicators. If a functional currency can be determined based on the primary indicators, the secondary indicators are not considered.

The functional and presentation currency of the Company is the U.S. dollar.

Consolidation

These financial statements represent the consolidation of the accounts of the Company and the entities over which it has control, its subsidiary companies and SPEs. Control exists when the Company is exposed to, or has rights to, variable returns from its involvement with an entity and has the ability to affect those returns through its power to direct the activities of an entity. Subsidiary companies and SPEs are fully consolidated from the date control has been transferred to the Company and deconsolidated from the date control ceases.

All subsidiary companies and SPEs prepare their financial statements at the same reporting date as the Company except for Velan Valvac Manufacturing Co. Ltd., which has a December 31 fiscal year-end. Consolidated earnings include the Company's share of the results of its operations to that date. Intercompany transactions, balances and unrealized gains or losses on transactions between companies are eliminated.

Foreign currency transactions and balances

The Company and its subsidiary companies and SPEs translate foreign currency transactions and balances into their functional currency. Foreign currency is defined as any currency that is different from an individual entity's functional currency.

Monetary assets and liabilities in foreign currencies are translated at year-end exchange rates. Non-monetary assets are translated at rates prevailing at the transaction dates. Revenue and expenses in foreign currencies are translated at weekly average rates throughout the year. Gains and losses arising on translation are included in the consolidated statement of income for the year.

Translation of accounts of foreign subsidiary companies and SPEs

The financial statements of the Company's foreign subsidiary companies and SPEs whose functional currency is not the U.S. dollar are translated into U.S. dollars for reporting purposes. All assets and liabilities are translated at year-end rates, and revenue and expenses at the average rate for the period. Resulting gains and losses are included in other comprehensive income (loss) for the period.

Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. The Company's financial assets comprise mainly cash and cash equivalents, short-term investments, accounts receivable and derivative assets. The Company's financial liabilities comprise mainly bank indebtedness, short-term bank loans, accounts payable and accrued liabilities, customer deposits, dividend payable, accrual for performance guarantees, long-term debt and derivative liabilities.

The Company recognizes a financial instrument on its consolidated statement of financial position when the Company becomes party to the contractual provisions of the financial instrument or non-financial derivative contract (see *Embedded derivatives*). Financial assets are derecognized when the rights to receive cash flows from the assets have expired or been transferred and the Company has transferred substantially all risks and rewards of ownership. All financial instruments are initially recognized at fair value and are classified into one of these five categories: held for trading, available-for-sale assets, held-to-maturity investments, loans and receivables and other financial liabilities. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

Held for trading

Financial instruments classified as held for trading are carried at fair value at each statement of financial position date with the changes in fair value recorded in the consolidated statement of income in the period in which these changes arise. The Company has classified its derivative financial instruments as held for trading.

Loans and receivables, held-to-maturity investments and other financial liabilities

Financial instruments classified as loans and receivables, held-to-maturity investments and other financial liabilities are carried at amortized cost using the effective interest rate method. The interest income or expense is included in the consolidated statement of income over the expected life of the instrument. Cash and cash

equivalents, short-term investments and accounts receivable are classified as loans and receivables. Bank indebtedness, short-term bank loans, accounts payable and accrued liabilities, customer deposits, dividend payable, accrual for performance guarantees and long-term debt, including interest payable, are classified as other financial liabilities, all of which are measured at amortized cost.

Embedded derivatives

Derivatives may be embedded in other financial instruments (the "host instrument"). Embedded derivatives are treated as separate derivatives if their economic characteristics and risks are not closely related to those of the host instrument, the terms of the embedded derivative are the same as those of a stand-alone derivative, and the combined contract is not held for trading or designated at fair value through profit or loss. These embedded derivatives are classified as held for trading.

The Company and its subsidiary companies and SPEs enter into certain contracts for the purchase and sale of non-financial items that are denominated in currencies other than their respective functional currencies. In cases where the foreign exchange component is not leveraged and does not contain an option feature, the contract is denominated in the functional currency of the counterparty or the non-financial item is routinely denominated in the currency of the contract or the currency of the contract is commonly used in the economic environment in which the transaction takes place, the embedded derivative is considered to be closely related and is not accounted for separately.

The fair value of the embedded derivatives related to sales contracts is recorded in sales; purchase contracts are recorded in cost of sales. On the consolidated statement of financial position, gains are recorded as derivative assets and losses are recorded as derivative liabilities.

Transaction costs are expensed when incurred.

Fair value

Estimated fair values for financial instruments are designed to approximate amounts at which the instruments could be exchanged in a current arm's-length transaction between knowledgeable willing parties. The fair value of derivative instruments is determined using valuation techniques.

The Company has evaluated the fair values of its financial instruments based on the current interest rate environment, related market values and current pricing of financial instruments with comparable terms.

Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Company's activities. Revenue is shown net of sales and value-added taxes, returns, rebates and discounts.

Revenue is recognized when the amount of revenue and associated costs can be reliably measured, it is probable that future economic benefits will flow to the Company and when specific criteria have been met for each of the Company's activities as described below.

Sales of goods

Sales of goods are recognized when the Company has delivered products to the customer and there is no unfulfilled obligation that could affect the customer's acceptance of the products. Delivery of the products does not occur until the products have been shipped to a specified location in accordance with the agreed-upon shipping terms, the risk of obsolescence and loss have been transferred to the customer, and either the customer has accepted the products in accordance with the sales contract, the acceptance provisions have lapsed, or the Company has objective evidence that all criteria for acceptance have been satisfied. Customers have a right to return faulty products, and some products are sold with volume discounts. Sales are recorded based on the price specified in the sales contract, net of the estimated volume discounts and returns at the time of sale. Accumulated experience is used to estimate and provide for the discounts and returns. The volume discounts are assessed based on anticipated annual purchases.

Sales of services

Sales of services are recognized when the Company renders services.

Interest income

Interest income is recognized using the effective interest rate method.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, cash in banks, other short-term highly liquid investments with original maturities of three months or less, and bank indebtedness. Bank indebtedness is shown in current liabilities on the consolidated statement of financial position. Interest is earned on cash and cash equivalents at rates ranging from 0% to 3.5%. Interest is paid on bank indebtedness at rates ranging from 0.4% to 5.0%.

Short-term investments

Short-term investments include all highly liquid investments with original maturities greater than three months but less than one year. Interest is earned on short-term investments at rates ranging from 2.0% to 8.0%.

Inventories

Inventories are valued at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Cost of inventories is determined as follows:

a) raw materials principally using the weighted average method except for items that are not ordinarily interchangeable, in which case specific identification of their individual costs is used; and

b) work in process, finished parts and finished goods using the raw material cost described in (a) plus applicable direct labour and manufacturing overhead.

The value of obsolete or unmarketable inventory is based on the Company's assessment of market conditions for its products determined by historical usage, estimated future demand and, in some cases, the specific risk of

loss on specifically identified inventory. The writedown may be reversed if the circumstances which caused it no longer exist.

Property, plant and equipment

Property, plant and equipment are valued at acquisition or manufacturing costs less any related government assistance, accumulated depreciation and any accumulated impairment losses. Acquisition costs include any expenditure that is directly related to the acquisition of the item. Manufacturing costs include direct material and labour costs plus applicable manufacturing overheads. Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial period of time to be ready for their intended use are added to the cost of those assets, until such time as those assets are ready for their intended use.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be reliably measured. The carrying amount of a replaced part is expensed as the parts are used. All other repairs and maintenance are charged to the consolidated statement of income during the period in which they are incurred.

Depreciation of assets commences when the assets are ready for their intended use. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Changes in expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the depreciation period or method, as appropriate, and treated on a prospective basis as a change in estimate.

Depreciation on the property, plant and equipment is determined principally using the following methods and annual rates or terms:

	Method	**Rate/Term**
Buildings	Declining balance	4% to 5%
Machinery and equipment and furniture and fixtures	Declining balance	10% to 31%
Data processing equipment	Straight-line	3 years
Rolling stock	Declining balance	30%
Leasehold improvements	Straight-line	Over lease terms

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is carried at cost less accumulated impairment losses.

Intangible assets

Purchased intangible assets relate primarily to patents, products, designs, customer lists, non-compete agreements and computer software. Internally generated intangible assets relate to development costs. Research

and development costs are expensed as incurred unless the development costs meet the criteria for deferral. As at February 28, 2014 and February 28, 2013, the Company had not capitalized any development costs.

Amortization expense is recognized in the consolidated statement of income in the expense category consistent with the function of the intangible asset. The assets' useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period or more frequently if events or circumstances occur that would indicate a change in useful life. Changes in expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and treated on a prospective basis as a change in estimate. Amortization is determined principally using the following methods and terms:

	Method	**Term**
Patents, products and designs	Straight-line	15 years
Customer lists	Straight-line	10 years
Non-compete agreements	Straight-line	5 years
Computer software	Straight-line	1 to 3 years

Government assistance

The Company receives assistance in the form of investment tax credits ("ITCs"). ITCs are accounted for using the cost reduction method. Under this method, assistance relating to eligible expenditures is deducted from the cost of the related assets or related expenses in the period in which the expenditures are incurred, provided there is reasonable assurance of realization.

Asset impairment

Assets that have an indefinite life (e.g. goodwill or indefinite life intangible assets) are not subject to amortization and are tested annually for impairment, or more frequently if events or circumstances indicate there may be impairment.

All other long-lived assets must be reviewed at the end of each reporting period in order to determine whether there is an indication of possible impairment.

For the purposes of impairment testing, assets are grouped at the lowest levels for which there are separately identifiable cash flows. A cash-generating unit ("CGU") is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. If an indication of impairment exists, the recoverable amount of the CGU is estimated in order to determine the extent of the impairment loss, if any. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. If the recoverable amount of the CGU is less than the carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to the other assets of the CGU on a pro rata basis of the carrying amount of each asset in the CGU. The recoverable amount is the greater of an asset's fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Goodwill is allocated to CGUs for the purpose of impairment testing based on the level at which it is monitored by management. The allocation is made to those CGUs that are expected to benefit from the business combination in which the goodwill arose.
Non-current and non-financial assets, other than goodwill, that have previously suffered an impairment loss are reviewed for possible reversal of the impairment at each reporting date.

Income taxes

The provision for income taxes for the year comprises current and deferred taxes. Tax is recognized in the consolidated statement of income, except to the extent that it relates to items recognized in other comprehensive income or directly in equity, in which case the tax is recognized in other comprehensive income or equity, respectively.

Current income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date in the countries where the Company generates taxable income. When an asset is transferred between entities within the consolidated group, the difference between the tax rates of the two entities is recognized as a tax expense in the period in which the transfer occurs. Current tax payable is recognized for any taxes payable in the current period. Current tax liabilities are recognized for current tax to the extent that it remains unpaid for current and prior periods.

Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate. Uncertain income tax provisions are recorded when probable and are recorded at the Company’s best estimate of the amount.

Deferred income tax

Deferred income tax is recognized using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amount in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled. Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be used. Deferred income tax assets are reviewed at each statement of financial position date and amended to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred income tax is provided on temporary differences arising on investments in subsidiary companies and SPEs, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Current income tax assets and liabilities are offset when the Company has a legally enforceable right to offset the recognized amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. Normally, the Company would only have a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and

the taxation authority permits the Company to make or receive a single net payment. Deferred income tax assets and liabilities are offset when the Company has a legally enforceable right to set off current income tax assets against current income tax liabilities and deferred tax assets and liabilities related to income taxes levied by the same taxation authority on either: (1) the same taxable entity; or (2) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realize assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated. Provisions are not recognized for costs that need to be incurred to operate in the future or expected future operating losses.

Provisions are measured at the present value of the expenditures required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

Accrual for performance guarantees

Accrual for performance guarantees arise for possible late delivery and other contractual non-compliance penalties or liquidated damages. It is recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated. Accrual for performance guarantees is not recognized for costs that need to be incurred to operate in the future or expected future operating losses.

Accrual for performance guarantees is measured at the present value of the expenditures required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

Leases

Leases are classified as either finance or operating leases. Leases that transfer substantially all of the risks and rewards of ownership of the asset to the Company are accounted for as finance leases. Finance leases are capitalized at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Assets acquired under a finance lease are depreciated over the shorter of the period of expected use on the same basis as other similar assets and the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Rental payments under operating leases are expensed in the consolidated statement of income on a straight-line basis over the term of the lease.

Share-based compensation plans

Grants under the Company’s share-based compensation plans are accounted for in accordance with the fair value based method of accounting. The Company operates a share-based compensation plan under which it

receives services from employees as consideration for share options. The fair value of the employee services received in exchange for the grant of the options is amortized over the vesting period as compensation expense, with a corresponding increase to contributed surplus. The total amount to be expensed is determined by multiplying the number of options expected to vest with the fair value of one option as of the grant date as determined by the Black-Scholes option pricing model. Remaining an employee of the Company for a specified period of time is the only condition for vesting. Vesting typically occurs one-third per year over three years from the grant date. This non-market performance condition is factored into the estimate of the number of options expected to vest. If it becomes obvious that the number of options expected to vest differs from that originally expected, the expense is adjusted accordingly.

When options are exercised, the Company issues new shares. The proceeds received, together with the amount recorded in contributed surplus, net of any directly attributable transaction costs, are recorded in share capital.

Critical accounting estimates and judgments

The Company's significant accounting policies as described above are essential to understanding the Company's results of operations, financial positions 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. 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.

The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next fiscal year are addressed below.

Accounts receivable

The Company must report its accounts receivable at their net realizable value. This involves management judgment and requires the Company to perform continuous evaluations of their collectability and to record an allowance for doubtful accounts when required. In performing its evaluation, the Company analyzes the ageing of accounts receivable, concentration of receivables by customer, customer creditworthiness and current economic trends. Any change in the assumptions used could impact the carrying value of the accounts receivable on the consolidated statement of financial position with a corresponding impact made to administration costs on the consolidated statement of income.

Inventory

Inventories must be valued at the lower of cost and net realizable value. A writedown of inventory will occur when its estimated market value less applicable variable selling expenses is below its carrying amount. This involves significant management judgment and is based on the Company's assessment of market conditions for its products determined by historical usage, estimated future demand and, in some cases, the specific risk of loss

on specifically identified inventory. Any change in the assumptions used in assessing this valuation or selling costs could impact the carrying amount of the inventory on the consolidated statement of financial position with a corresponding impact made to cost of sales on the consolidated statement of income.

Provisions

Provisions must be established for possible product warranty expenses. The Company estimates its warranty exposure by taking into account past experience as well as any known technical problems and estimates of costs to resolve these issues. The Company estimates its exposure under these obligations based on an analysis of all identified or expected claims. Any change in the assumptions used could impact the value of the provision on the consolidated statement of financial position with a corresponding impact made to cost of sales on the consolidated statement of income.

Asset impairment test

Assets that have an indefinite life, such as goodwill, are tested annually by the Company for impairment, or more frequently if events or circumstances indicate there may be impairment. All other assets must be reviewed by the Company at the end of each reporting period in order to determine whether there is an indication of possible impairment. For the purposes of impairment testing, assets are grouped at the lowest levels for which there are separately identifiable cash flows. A cash-generating unit ("CGU") is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. If an indication of impairment exists, the Company estimates the recoverable amount of the CGU in order to determine the extent of the impairment loss, if any. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the greater of an asset's fair value less costs to sell and its value in use. In assessing value in use, the Company estimates future cash flows which are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Any change in the assumptions used could impact the carrying amount first of any goodwill allocated to the CGU and then to the other assets of the CGU on a pro rata basis of the carrying amount of each asset in the CGU on the consolidated statement of financial position with a corresponding impact made to the consolidated statement of income.

Income taxes

The Company must estimate its income taxes in each jurisdiction in which it operates. This involves assessing the probability of using net operating losses against future taxable income as well as evaluating positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. In the event these assessments are changed, there would be an adjustment to income tax expense with a corresponding adjustment to income tax balances on the consolidated statement of financial position.

Accounting standards and amendments adopted in the year

The following standards and amendments to existing standards were adopted by the Company on March 1, 2013. The adoption of these standards and amendments did not have a significant impact on the Company's financial statements.

(i) IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the

investee and has the ability to affect those returns through its power over the investee. Under previous IFRS, consolidation was required when an entity had the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaced SIC-12, *Consolidation - Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*.

(ii) IFRS 11, *Joint Arrangements*, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures are accounted for using the equity method of accounting whereas for a joint operation the venturer recognizes its share of the assets, liabilities, revenue and expenses of the joint operation. Under previous IFRS, entities had the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 superseded IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers*.

(iii) IFRS 12, *Disclosure of Interests in Other Entities*, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carried forward existing disclosures and also introduced significant additional disclosure that addressed the nature of, and risks associated with, an entity's interests in other entities. See note 6 for additional disclosures presented.

(iv) IFRS 13, *Fair Value Measurement*, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under previous IFRS, guidance on measuring and disclosing fair value was dispersed among the specific standards requiring fair value measurements and did not always reflect a clear measurement basis or consistent disclosures.

(v) There have been amendments to existing standards, including IAS 27, *Separate Financial Statements* ("IAS 27"), and IAS 28, *Investments in Associates and Joint Ventures* ("IAS 28"). IAS 27 addressed accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 had been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

(vi) IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in other comprehensive income into two groups, based on whether or not items may be recycled in the future. Entities that choose to present other comprehensive income items before tax are required to show the amount of tax related to the two groups separately.

Accounting standards and amendments issued but not yet adopted

The following revised standard is effective for annual periods beginning on or after January 1, 2015 with earlier application permitted. The Company has not yet assessed the impact of the standard or determined whether it will early adopt it.

(i) IFRS 9, *Financial Instruments*, was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair

value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

3 Business acquisition

On April 29, 2011, the Company acquired a 70% voting interest in ABV Energy S.p.A., now Velan ABV S.p.A. ("ABV"), an Italian manufacturer of engineered valves, actuators and control systems supplied to energy markets. ABV was acquired for a maximum consideration of $50,833 (€34,300). The Company, using its own cash resources, paid $38,384 (€25,900) on closing. Another $4,298 (€2,900) was required ("Holdback") to be paid on July 29, 2012. The $8,151 (€5,500) balance was to be paid to the extent of $2,223 (€1,500) on July 29, 2012 in the event that ABV had satisfied certain non-financial criteria, and the remaining $5,928 (€4,000) was to be payable in two tranches based on ABV meeting certain earnings before interest, taxes, depreciation and amortization ("EBITDA") targets for the period from May 1, 2011 through February 28, 2014. The future Holdback payment was discounted to its net present value using a discount rate of 2%. The future contingent payments were recorded at their fair value, which was determined by discounting the amounts to their net present value using a discount rate of 18%.

	$
Purchase consideration	
Cash paid on closing	38,384
Net present value of Holdback	4,191
Net present value of contingent payment – non-financial criteria	1,807
Net present value of contingent payment – financial criteria	3,772
Total net present value of purchase consideration	48,154

In April 2012, the required disbursement date of the contingent payment to be paid in the event that ABV had satisfied certain non-financial criteria of $2,223 (€1,500) was extended to March 15, 2013. In addition, the requirement that ABV satisfy the non-financial criteria was removed. As a result of these changes, the Company recorded a fair value adjustment with respect to the applicable contingent payment of $196 to other income during the fiscal year ended February 28, 2013.

On an annual basis at each statement of financial position date, the Company evaluated the likelihood that the financial and non-financial criteria related to the contingent payments would be satisfied, based on current projections prepared by local management which factor in the delays in the return to profitability of the operation after the acquisition. Based on these annual evaluations, the Company determined that it would be more likely than not that the financial criteria for the two tranches of the contingent payment based on ABV meeting certain EBITDA targets would not be satisfied. As a result, the Company recorded a fair value

adjustment with respect to the applicable contingent payment of $2,248 to other income during the fiscal year ended February 28, 2013.

The net present value of the Holdback and the fair value of the contingent payments have been recorded in other liabilities. A foreign exchange gain of $407 was recognized in other income during the fiscal year ended February 28, 2013.

For the fiscal year ended February 28, 2014, no fair value adjustments nor foreign exchange gains or losses were recognized in other income on the outstanding Holdback and contingent payments. Furthermore, no such amounts remained outstanding at the end of the current fiscal year.

4 Goodwill impairment analysis

Impairment test at February 28, 2013

In the context of its annual impairment testing at year-end, the Company completed its impairment analysis and assessed the recoverability of the assets allocated to its various CGUs. The Company calculated the recoverable amounts of its CGUs using valuation methods which were consistent with those used in prior years.

As a result of the impairment analysis, the Company determined that the carrying amount of the goodwill associated with the CGU related to its subsidiary in Italy, ABV, exceeded its recoverable amount and, accordingly, the Company recorded a goodwill impairment loss of $11,700 at February 28, 2013.

The recoverable amount was determined based on the fair value less costs to sell approach using a discounted cash flow model. The significant key assumptions included forecasted cash flows based on updated financial plans prepared by management covering a five-year period taking into consideration the following assumptions and trends:

- Expected EBITDA as a percentage of sales for the CGU of 7.3% in 2014, 11.8% in 2015, 14.4% in 2016, 16% in 2017 and 19% in 2018.
- Expected working capital cash absorption ratio for the CGU of 19% of annual incremental sales increases.
- Expected annual capital expenditure needs for the CGU of $500 in 2014, 2015 and 2016, and $1,000 thereafter.

The discounted cash flow model was established using a discount rate of 18.5% and a terminal growth rate of 2%.

This impairment charge was the result of actual results of the CGU coming in below the expectations at the time of the acquisition. The reasons for these lower achieved results were due to a variety of factors, including a business process integration that proved to be more difficult than planned, as well as profitability issues related to the complexity of the manufactured products. In addition, the increasingly competitive landscape of the last two years, particularly amongst upstream oil and gas flow control manufacturers in Italy, negatively impacted margins.

Management based its selection of assumptions upon its assessment of the ability of the restructured CGU to return to is pre-acquisition levels of growth and profitability, as well as its evaluation of the longer term

potential of its key end-user markets, particularly upstream oil and gas flow control. The margin assumptions used were also generally comparable to those obtained in its other similar European project manufacturing operations.

The following table provides a sensitivity analysis of the Company's goodwill impairment loss for the period assuming a one percentage point increase of the selected variables below. Note that this sensitivity analysis assumes that all other assumptions and trends remain constant for each independent variable.

	Increase (Decrease) in impairment loss $
Increase in expected EBITDA as a percentage of sales	(2,866)
Increase in discount rate	2,722
Increase in terminal growth rate	(1,951)

A one percentage point decrease of the selected variables below, assuming all other assumptions and trends remain constant for each independent variable, would have the following impact on the goodwill impairment loss:

	Increase (Decrease) in impairment loss $
Decrease in expected EBITDA as a percentage of sales	2,934
Decrease in discount rate	(3,132)
Decrease in terminal growth rate	1,690

Impairment test at July 16, 2013

On July 16, 2013, the Company acquired the remaining 30% of ABV (see note 6(d)), which management considered to be a triggering event to test the carrying value of the ABV assets for impairment.

The recoverable amount was determined based on the fair value less costs to sell approach using a discounted cash flow model. The significant key assumptions included forecasted cash flows based on updated financial plans prepared by management covering a five-year period taking into consideration the following assumptions and trends:

- Expected earnings before interest, taxes, depreciation and amortization as a percentage of sales for the CGU of 8.3% in 2014, 11.8% in 2015, 14.4% in 2016, 16% in 2017 and 19% in 2018.
- Expected working capital cash absorption ratio for the CGU of 19% of annual incremental sales increases.
- Expected annual capital expenditure needs for the CGU of $500 in 2014, 2015 and 2016, and $1,000 thereafter.

The discounted cash flow model was established using a discount rate of 19% and a terminal growth rate of 2%.

Although the business process integration was still underway, management did not believe that the long-term outlook for the business had changed at the time of this impairment test. As a result, and following the impairment test performed at that date where the recoverable amount exceeded the carrying amount of $13,991 by $1,313, no impairment losses have been recorded at July 16, 2013 with respect to the carrying amount of the goodwill associated with the CGU related to the Company's ABV subsidiary.

The following table provides a sensitivity analysis of the Company's recoverable amount of the goodwill associated with the CGU related to its ABV subsidiary for the period assuming a one percentage point increase of the selected variables below. Note that this sensitivity analysis assumes that all other assumptions and trends remain constant for each independent variable.

	Decrease (Increase) in recoverable amount $
Increase in expected EBITDA as a percentage of sales	(4,519)
Increase in discount rate	2,755
Increase in terminal growth rate	(1,594)

A one percentage point decrease of the selected variables below, assuming all other assumptions and trends remain constant for each independent variable, would have the following impact on the recoverable amount of the goodwill associated with the CGU related to its ABV subsidiary:

	Decrease (Increase) in recoverable amount $
Decrease in expected EBITDA as a percentage of sales	4,833
Decrease in discount rate	(3,114)
Decrease in terminal growth rate	1,417

Impairment test at February 28, 2014

Despite the above impairment test triggered on July 16, 2013, the Company continued to carry out its annual impairment testing at its year-end date. In the context of its annual impairment testing at year-end, the Company completed its impairment analysis and assessed the recoverability of the assets allocated to its various CGUs. The Company calculated the recoverable amounts of its CGUs using valuation methods which were consistent with those used in prior years.

As a result of the impairment analysis, the Company determined that the recoverable amount exceeded the carrying amount of the goodwill associated with the CGU related to its ABV subsidiary of $14,602 by $1,274 and, accordingly, no goodwill impairment loss was recorded at February 28, 2014.

The recoverable amount was determined based on the fair value less costs to sell approach using a discounted cash flow model. The significant key assumptions included forecasted cash flows based on updated financial plans prepared by management covering a five-year period taking into consideration the following assumptions and trends:

- Expected EBITDA as a percentage of sales for the CGU of 7% in 2015, 11.8% in 2016, 19.6% in 2017, 19.3% in 2018 and 19.2% in 2019.
- Expected working capital cash absorption ratio for the CGU of 19% of annual incremental sales increases.
- Expected annual capital expenditure needs for the CGU of $500 in 2015, 2016 and 2017, and $1,000 thereafter.

The discounted cash flow model was established using a discount rate of 18.5% and a terminal growth rate of 2%.

Management based its selection of assumptions upon its assessment of the ability of the restructured CGU to return to is pre-acquisition levels of growth and profitability, as well as its evaluation of the longer term potential of its key end-user markets, particularly upstream oil and gas flow control. The acquisition of the non-controlling interest and the hiring of key senior management personnel were also factored into its assessments of the ABV subsidiary. The margin assumptions used were also generally comparable to those obtained in its other similar European project manufacturing operations.

The following table provides a sensitivity analysis of the Company's recoverable amount of the goodwill associated with the CGU related to its ABV subsidiary for the period assuming a one percentage point increase of the selected variables below. Note that this sensitivity analysis assumes that all other assumptions and trends remain constant for each independent variable.

	Decrease (Increase) in recoverable amount $
Increase in expected EBITDA as a percentage of sales	(4,224)
Increase in discount rate	2,678
Increase in terminal growth rate	(1,864)

A one percentage point decrease of the selected variables below, assuming all other assumptions and trends remain constant for each independent variable, would have the following impact on the recoverable amount of the goodwill associated with the CGU related to its ABV subsidiary:

	Decrease (Increase) in recoverable amount $
Decrease in expected EBITDA as a percentage of sales	4,339
Decrease in discount rate	(3,036)
Decrease in terminal growth rate	1,651

The Company also tested for impairment the carrying amount of the goodwill associated with the CGU related to its French subsidiary, Velan S.A.S., and determined that the recoverable amount exceeded the carrying amount of $10,736 by $39,408. Accordingly, no goodwill impairment loss was recorded for this CGU at February 28, 2014.

5 Inventories

	As at February 28, 2014 $	As at February 28, 2013 $
Raw materials	45,130	54,093
Work in process and finished parts	123,848	141,027
Finished goods	55,171	51,862
	224,149	246,982

As a result of variations in the ageing of its inventories, the Company recognized an inventory provision for the year of $3,245 (2013 – $2,382), net of reversals of $5,892 (2013 – $5,963).

The net book value of inventories pledged as security under the Company's credit facilities amounted to $5,382 (2013 – $3,514).

6 Subsidiaries and transactions with non-controlling interests

a) Interest in subsidiary companies and SPEs

Set out below are the Company's principal subsidiaries and SPEs at February 28, 2014. Unless otherwise stated, the subsidiaries and SPEs have share capital consisting solely of ordinary shares, which are held directly by the Company, and the proportion of ownership interests held equals the voting rights held by the Company. The country of incorporation or registration is also their principal place of business.

Name of entity	Country of incorporation	% of ownership interest held by the Company		% of ownership interest held by the non-controlling interests		Principal Activities
		2014	2013	2014	2013	
Velan Valve Corp.	U.S.A.	100	100	-	-	Valve Manufacture
Velan Ltd.	Korea	100	100	-	-	Valve Manufacture
Juwon Special Steel Co. Ltd.	Korea	50	50	50	50	Foundry
Velan Valvulas Industrias, Lda.	Portugal	100	100	-	-	Valve Manufacture
Velan Valves Limited	U.K.	100	100	-	-	Valve Manufacture
Velan S.A.S.	France	100	100	-	-	Valve Manufacture
Segault S.A.S.	France	75	75	25	25	Valve Manufacture
Velan GmbH	Germany	100	100	-	-	Valve Distribution
Velan ABV S.p.A.	Italy	100	70	-	30	Valve Manufacture
Velan Valvac Manufacturing Co. Ltd.	Taiwan	75	75	25	25	Valve Manufacture
Velan Valve (Suzhou) Co. Ltd.	China	85	85	15	15	Valve Manufacture
Velan Valves India Private Limited	India	100	100	-	-	Valve Manufacture

b) Significant restrictions

Cash and short-term investments held in certain Asian countries are subject to local exchange control regulations. These regulations provide for restrictions on exporting capital from those countries, other than through normal dividends. However, such restrictions do not have a significant impact on the Company's operations and treasury management.

c) Non-controlling interests

Set out below is summarized financial information for each subsidiary company and SPE that has non-controlling interests that are material to the Company and for which the non-controlling interest is recognized as equity rather than as a liability (see note 12(k)). The amounts disclosed for each subsidiary are before intercompany eliminations.

Summarized statement of financial position	**Juwon Special Steel Co. Ltd.**		**Velan Valvac Manufacturing Co. Ltd.**		**Velan ABV S.p.A.**	
As at February 28,	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
	$	**$**	**$**	**$**	**$**	**$**
Current assets	10,745	10,295	4,796	4,992	-	24,084
Current liabilities	2,810	5,634	1,481	1,831	-	23,873
Current net assets	7,935	4,661	3,315	3,161	-	211
Non-current assets	4,693	5,214	1,923	1,972	-	40,711
Non-current liabilities	2,511	1,162	173	205	-	15,511
Non-current net assets	2,182	4,052	1,750	1,767	-	25,200
Net assets	10,117	8,713	5,065	4,928	-	25,411
Accumulated non-controlling interest	5,531	3,972	1,523	1,529	-	3,160

Summarized statement of comprehensive income	**Juwon Special Steel Co. Ltd.**		**Velan Valvac Manufacturing Co. Ltd.**		**Velan ABV S.p.A.**	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	$	**$**	**$**	**$**	**$**	**$**
Sales	20,079	32,315	10,008	9,199	16,247	24,084
Net income (loss) for the year	1,234	3,672	552	520	108	(14,759)
Other comprehensive income (loss)	172	255	-	-	-	(1,122)
Total comprehensive income (loss) for the year	1,406	3,927	552	520	108	(15,881)
Net income (loss) allocated to non-controlling interest	617	1,836	138	130	33	(977)
Dividends paid to non-controlling interest	-	-	103	41	-	-

Summarized statement of cash flows	**Juwon Special Steel Co. Ltd.**		**Velan Valvac Manufacturing Co. Ltd.**		**Velan ABV S.p.A.**	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
	$	**$**	**$**	**$**	**$**	**$**
Cash flows from operating activities	1,615	3,950	485	112	2,810	(8,703)
Cash flows from investing activities	(224)	(1,253)	(37)	(14)	(438)	(1,452)
Cash flows from financing activities	973	(78)	(409)	(167)	(57)	8,947
Net increase (decrease) in cash and cash equivalents	2,364	2,619	39	(69)	2,315	(1,208)

The summarized statements of comprehensive income and cash flows above include the results of Velan ABV S.p.A. for the 2014 fiscal year only for the period beginning March 1, 2013 and ending July 16, 2013, the date at which the Company acquired this subsidiary company's non-controlling interest (see note 6(d)). It is for this reason that the summarized statement of financial position above excludes the financial information for Velan ABV S.p.A. for the 2014 fiscal year.

d) Transactions with non-controlling interests

As a result of losses sustained in prior periods, the Company's Italian subsidiary, ABV, was required to recapitalize its share structure. Through the recapitalization, the existing share capital of ABV was cancelled. New shares were issued solely to the Company through the conversion of existing shareholder loans from the Company to ABV. In addition, the existing shareholder loans payable to the non-controlling interest of ABV amounting to $1,403 (€1,071) were repaid through the recapitalization process. As a result of the recapitalization, the Company acquired the remaining 30% of ABV to become its 100% shareholder as of July 16, 2013.

7 Property, plant and equipment

	Land	Buildings	Machinery & equipment	Furniture & fixtures	Data processing equipment	Rolling stock	Leasehold improvements	Total
	$	$	$	$	$	$	$	$
At February 29, 2012								
Cost	11,480	44,468	123,735	6,827	4,234	2,021	2,438	195,203
Accumulated depreciation	-	(20,234)	(91,534)	(5,304)	(3,075)	(1,144)	(951)	(122,242)
	11,480	24,234	32,201	1,523	1,159	877	1,487	72,961
Year ended February 28, 2013								
Beginning balance	11,480	24,234	32,201	1,523	1,159	877	1,487	72,961
Additions	171	4,211	21,771	837	761	360	341	28,452
Disposals	(28)	-	(567)	-	-	(5)	-	(600)
Depreciation	-	(1,472)	(6,268)	(344)	(688)	(518)	(282)	(9,572)
Internal transfers	-	3,164	(3,773)	580	-	29	-	-
Exchange differences	284	(330)	(916)	(25)	(15)	248	143	(611)
	11,907	29,807	42,448	2,571	1,217	991	1,689	90,630
At February 28, 2013								
Cost	11,907	50,964	136,462	7,960	4,875	2,584	2,897	217,649
Accumulated depreciation	-	(21,157)	(94,014)	(5,389)	(3,658)	(1,593)	(1,208)	(127,019)
	11,907	29,807	42,448	2,571	1,217	991	1,689	90,630
Year ended February 28, 2014								
Beginning balance	11,907	29,807	42,448	2,571	1,217	991	1,689	90,630
Additions	271	1,878	12,855	903	1,043	389	614	17,953
Disposals	-	(2)	153	(116)	(3)	(52)	(52)	(72)
Depreciation	-	(1,720)	(8,416)	(665)	(750)	(400)	(290)	(12,241)
Internal transfers	-	-	-	-	-	-	-	-
Exchange differences	(17)	(453)	(263)	594	5	18	451	335
	12,161	29,510	46,777	3,287	1,512	946	2,412	96,605
At February 28, 2014								
Cost	12,161	52,486	145,907	10,622	5,879	2,922	4,356	234,333
Accumulated depreciation	-	(22,976)	(99,130)	(7,334)	(4,367)	(1,976)	(1,945)	(137,728)
	12,161	29,510	46,777	3,288	1,512	946	2,411	96,605

Depreciation expense of $12,241 (2013 – $9,572) is included in the consolidated statement of income: $10,865 (2013– $8,345) in ‘cost of sales’ and $1,376 (2013 – $1,227) in ‘administration costs’.

8 Intangible assets and goodwill

	Goodwill	Computer software	Patents, products & designs	Customer lists	Non-compete agreements	Other	Total
At March 1, 2012							
Cost	36,732	6,664	14,085	7,254	806	2,379	67,920
Accumulated amortization	-	(5,134)	(1,402)	(606)	(135)	(1,798)	(9,075)
	36,732	1,530	12,683	6,648	671	581	58,845
Year ended February 28, 2013							
Beginning balance	36,732	1,530	12,683	6,648	671	581	58,845
Additions	-	659	-	-	-	25	684
Disposals and transfers	-	(6)	-	-	-	(165)	(171)
Amortization	-	(859)	(860)	(696)	(155)	(345)	(2,915)
Impairment loss	(11,700)	-	-	-	-	-	(11,700)
Exchange differences	(952)	(32)	(341)	(182)	(20)	(22)	(1,549)
	24,080	1,292	11,482	5,770	496	74	43,194
At February 28, 2013							
Cost	24,080	6,953	13,720	7,067	784	2,175	54,779
Accumulated amortization	-	(5,661)	(2,238)	(1,297)	(288)	(2,101)	(11,585)
	24,080	1,292	11,482	5,770	496	74	43,194
Year ended February 28, 2014							
Beginning balance	24,080	1,292	11,482	5,770	496	74	43,194
Additions	-	390	-	-	-	7	397
Disposals and transfers	-	44	3	-	-	(73)	(26)
Amortization	-	(753)	(889)	(720)	(160)	(3)	(2,525)
Impairment loss	-	-	-	-	-	-	-
Exchange differences	1,342	52	606	296	23	-	2,319
	25,422	1,025	11,202	5,346	359	5	43,359
At February 28, 2014							
Cost	25,422	7,611	14,485	7,461	829	1,091	56,899
Accumulated amortization	-	(6,586)	(3,283)	(2,115)	(470)	(1,086)	(13,540)
	25,422	1,025	11,202	5,346	359	5	43,359

Amortization expense of $2,525 (2013 – $2,915) is included in the consolidated statement of income: $1,992 (2013 – $2,220) in 'cost of sales' and $533 (2013 – $695) in 'administration costs'.

9 Accounts payable and accrued liabilities

	As at February 28, 2014 $	As at February 28, 2013 $
Trade accounts payable	31,410	35,530
Accrued liabilities	41,712	39,094
Other	3,468	3,807
	76,590	78,431

10 Credit facilities

a) The Company and its U.S. subsidiary company, Velan Valve Corp., have the following credit facilities available as at February 28, 2014:

Unsecured

Credit facilities available	Borrowing rates
$96,756 (CA$85,000 and US$20,000) (2013 – $105,412 (CA$85,000 and US$23,000)) (note 25)	Prime to prime + 0.75%

The above unsecured facilities are available by way of demand operating lines of credit, bank loans, letters of credit, bankers' acceptances, LIBOR loans, letters of guarantee and bank overdrafts. These facilities are subject to annual renewal.

As at February 28, 2014, an amount of $21,699 (2013 – $31,567) was drawn against these unsecured credit facilities in the form of demand operating lines of credit and bank overdrafts. An additional $7,881 (2013 – $29,225) was drawn against these unsecured credit facilities in the form of letters of credit and letters of guarantee.

In addition to the unsecured credit facilities above, the Company maintains a facility with Export Development Canada of $40,000 for letters of credit and letters of guarantee. As at February 28, 2014, $8,862 was drawn against this facility.

b) Foreign subsidiaries and SPEs have the following credit facilities available as at February 28, 2014:

Secured by corporate guarantees

Credit facilities available	Borrowing rates
Foreign subsidiaries $66,489 (€40,822; £2,000; KW4,691,250; CNY 5,633; INR90,000) (2013 – $70,846 (€44,550; £4,875; KW4,725,500; CNY5,127)) (note 25)	0.75% to 7.65% (2013 – 0.57% to 6.25%)
Foreign SPEs $6,184 (KW6,600,000) (2013 – $7,837 (KW8,500,000)) (note 25)	3.11% to 5.00% (2013 – 3.59% to 4.21%)

The above credit facilities are available by way of demand operating lines of credit, bank loans, guarantees, letters of credit and foreign exchange forward contracts. The majority of these credit facilities have variable borrowing rates based on LIBOR, EURIBOR, KORIBOR, EONIA or prime rate. The borrowing rates listed above are the rates in effect as at February 28, 2014 and February 28, 2013. The terms of the above facilities range from annual renewal to an indefinite term. The aggregate net book value of the assets pledged under the above credit facilities amounted to $21,602 (2013 – $21,689).

As at February 28, 2014, an amount of $11,092 (2013 – $17,837) was drawn against these secured credit facilities in the form of demand operating lines of credit and bank overdrafts. An additional $1,473 (2013 – nil) was drawn against these secured credit facilities in the form of letters of credit and letters of guarantee.

11 Provisions

	As at February 28, 2014 $	As at February 28, 2013 $
Balance – Beginning of year	6,345	5,149
Additional provisions	2,969	2,845
Used during the year	(1,628)	(1,546)
Exchange differences	374	(103)
Balance – End of year	8,060	6,345

The Company's provisions consist entirely of warranties. The Company offers various warranties to the purchasers of its valves. Management estimates the related provision for future warranty claims based on historical warranty claim information, as well as recent trends that might suggest that past cost information may differ from future claims. Factors that could impact the estimated claim information include the success of the Company's productivity and quality initiatives, as well as parts and labour costs.

12 Long-term debt

	As at February 28, 2014 $	As at February 28, 2013 $
The Company		
Unsecured bank loan (note 12(a))	12,000	17,333
French subsidiary		
Unsecured bank loan (€166; 2013 – €246) (note 12(b))	230	322
Secured bank loan (€134; 2013 – €199) (note 12(c))	185	260
Secured bank loan (€342; 2013 – €1,018) (note 12(d))	472	1,332
Italian subsidiary		
Unsecured bank loan (€757; 2013 – €850) (note 12(e))	1,046	1,112
Unsecured bank loan (€707; 2013 – €782) (note 12(f))	977	1,023
Unsecured state bank loan (€439; 2013 – €472) (note 12(g))	605	618
Korean SPE		
Secured bank loan (KW24,000; 2013 – KW336,500) (note 12(h))	22	338
Secured bank loan (KW900,000; 2013 – nil) (note 12(i))	843	-
Unsecured bank loan (KW500,000; 2013 – nil) (note 12(j))	469	-
Other (note 12(k))	5,241	4,512
	22,087	26,850
Less: Current portion	10,402	10,463
	11,685	16,387

a) Unsecured bank loan

The unsecured bank loan of $12,000 bears interest at 2.74% and is repayable in monthly instalments of $444, expiring in 2016.

b) Unsecured bank loan

The unsecured bank loan of $230 (€166) bears interest at 2.6% and is repayable in quarterly instalments of $29, expiring in 2016

c) Secured bank loan

The secured bank loan of $185 (€134) bears interest at 2.7% and is repayable in monthly instalments of $8, expiring in 2016. Certain machinery and equipment are pledged as collateral for this loan.

d) Unsecured bank loan

The unsecured bank loan of $472 (€342) bears interest at EURIBOR plus 1.35% and is repayable in quarterly instalments of $253, expiring in 2014.

e) Unsecured bank loan

The unsecured bank loan of $1,046 (€757) bears interest at 2.91% and is repayable in monthly instalments, expiring in 2021.

f) Unsecured bank loan

The unsecured bank loan of $977 (€707) bears interest at 4.90% and is repayable in monthly instalments, expiring in 2021.

g) Unsecured state bank loan

The unsecured state bank loan of $605 (€439) is non-interest bearing and is repayable in semi-annual instalments, expiring in 2020.

h) Secured Bank Loan

The secured bank loan of $22 (KW24,000) bears interest at 1.50% and is repayable in 2020. Certain land, a building, and certain machinery and equipment are pledged as collateral for this loan.

i) Secured Bank Loan

The secured bank loan of $843 (KW900,000) bears interest at 3.10% and is repayable in 2015. Certain land, a building, and certain machinery and equipment are pledged as collateral for this loan.

j) Unsecured Bank Loan

The unsecured bank loan of $469 (KW500,000) bears interest at 3.39% and is repayable in 2015.

k) Included in Other is an amount of $4,049 (€2,931) (2013 – $3,608 (€2,758)) related to an unconditional put option held by a minority shareholder in one of the Company's subsidiary companies. This is recognized as a liability instead of non-controlling interest. The liability is initially recognized as the non-controlling interest's share of the net identifiable assets of the subsidiary or SPE. Subsequently, the liability is carried at the amount of the present value of estimated future cash flows discounted at the original effective rate. Adjustments to the carrying value are recorded as interest expense in the consolidated statement of income.

l) The following is a schedule of future debt payments:

	$
February 28, 2015	10,402
February 29, 2016	7,201
February 28, 2017	1,786
February 28, 2018	363
February 28, 2019	376
Subsequent years	1,959
	22,087

The aggregate net book value of the assets pledged as collateral under long-term debt agreements amounted to $3,217 (2013 – $6,911).

m) The carrying value of long-term debt approximates its fair value.

13 Capital stock

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

b) Issued

	As at February 28, 2014 $	As at February 28, 2013 $
6,392,201 Subordinate Voting Shares (February 28, 2013 – 6,357,201) (notes 13(c) and (d))	69,562	69,188
15,566,567 Multiple Voting Shares	7,126	7,126
	76,688	76,314

c) Pursuant to its Normal Course Issuer Bid, the Company is entitled to repurchase for cancellation a maximum of 100,000 of the issued Subordinate Voting Shares of the Company, representing approximately 1.57% of the issued shares of such class as at October 10, 2013, during the ensuing 12-month period ending October 21, 2014. During the year ended February 28, 2014, no Subordinate Voting Shares were repurchased. During the year ended February 28, 2013, 225,200 Subordinate Voting Shares were purchased for a cash consideration of $2,633 and cancelled. The amount by which the repurchase amount is above the stated capital of the shares has been debited to contributed surplus.

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

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

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

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

A compensation cost of $23 (2013 – $58) was recorded in the consolidated statement of income and credited to contributed surplus.

During the fiscal year ended February 28, 2014, 35,000 options were exercised resulting in the issuance of 35,000 Subordinate Voting Shares of the Company for proceeds of $374 which were credited to share capital. No options were exercised in the prior fiscal year.

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

	Number of shares	Weighted average exercise price	Weighted average contractual life in months
Outstanding – February 29, 2012	195,000	$11.94 (CA$11.81)	28.1
Expired/forfeited	(15,000)	$10.67 (CA$11.00)	-
Outstanding – February 28, 2013	180,000	$11.51 (CA$11.88)	16.8
Exercisable – February 28, 2013	146,667	$11.01 (CA$11.36)	
Outstanding – February 28, 2013	180,000	$11.51 (CA$11.88)	16.8
Exercised	(35,000)	$10.70 (CA$11.00)	-
Expired/forfeited	(95,000)	$10.70 (CA$11.00)	-
Outstanding – February 28, 2014	50,000	$12,78 (CA$14.15)	29.0
Exercisable – February 28, 2014	33,334	$12.78 (CA$14.15)	

14 Foreign exchange

Foreign exchange gains (losses) realized on the translation of foreign currency balances, transactions and the fair value of foreign currency financial derivatives and embedded derivatives during the period are included in sales and cost of sales and amounted to:

	2014 $	2013 $
Sales	(250)	1,219
Cost of sales	(907)	(1,566)

15 Cost of sales

	2014 $	2013 $
Change in inventories of finished goods and work in progress	15,364	9,304
Raw materials and consumables used	190,382	216,897
Employee expense (note 17)	96,608	99,864
Depreciation and amortization (note 20)	12,857	10,565
Movement in inventory provision – net (note 5)	3,245	2,382
Foreign exchange (note 14)	907	1,566
Other production overhead costs	38,748	46,097
	358,111	386,675

16 Administration costs

	2014 $	2013 $
Employee expense (note 17)	43,310	44,288
Scientific research investment tax credit (note 17)	(4,028)	(3,684)
Commissions	7,095	10,821
Freight to customers	6,411	7,109
Professional fees	11,929	14,186
Movement in bad debt provision (note 25)	(638)	393
Depreciation and amortization (note 19)	1,909	1,922
Other	21,155	15,950
	87,143	90,985

17 Employee expense

	2014 $	2013 $
Wages and salaries	99,518	103,049
Social security costs	33,936	34,652
Scientific research investment tax credit (note 18)	(4,028)	(3,684)
Share-based compensation (note 13(d))	23	58
Other	6,441	6,393
	135,890	140,468

18 Research and development expenses

Research and development expenses are included in cost of sales and administration costs and consist of the following:

	2014 $	2013 $
Research and development expenditures	8,844	9,238
Less: Scientific research and development investment tax credit	4,028	3,684
	4,816	5,554

19 Depreciation and amortization costs

Depreciation and amortization costs are included in cost of sales and administration costs and consist of the following:

	2014 $	2013 $
Depreciation of property, plant and equipment	12,241	9,572
Amortization of intangible assets	2,525	2,915
	14,766	12,487

20 Income taxes

	2014 $	2013 $
Current taxes:		
Current tax on profits for the year	10,289	6,960
Adjustments in respect of prior years	349	(351)
	10,638	6,609
Deferred taxes:		
Origination and reversal of timing differences	1,121	(1,325)
Income tax expense	11,759	5,284

The taxes on the Company’s income before taxes differ from the amount that would arise using the statutory tax rate applicable to income of the consolidated entities as follows:

	2014 $	2013 $
Income before tax at statutory rate of 26.90% (2013 – 26.90%)	11,503	3,233
Tax effects of:		
Difference in statutory tax rates in foreign jurisdictions	1,025	1,044
Non-deductible (taxable) foreign exchange loss (gain)	(4)	(314)
Non-deductible goodwill impairment loss	-	3,147
Non-taxable income on fair value adjustment of proceeds payable	-	(657)
Benefit attributable to a financing structure	(1,309)	(1,178)
Other	544	9
Income tax expense	11,759	5,284

The analysis of deferred tax assets and deferred tax liabilities is as follows:

	2014 $	2013 $
Deferred income tax assets:		
To be realized after more than 12 months	6,465	6,100
To be realized within 12 months	4,941	5,126
Deferred income tax liabilities:		
To be realized after more than 12 months	(7,772)	(7,742)
To be realized within 12 months	(1,498)	(293)
Net deferred income tax asset	2,136	3,191

The movement of the net deferred income tax asset account is as follows:

	2014 $	2013 $
Balance – Beginning of year	3,191	1,882
Recovery (Provision) to consolidated statement of income	(1,121)	1,325
Exchange differences	66	(16)
Balance – End of year	2,136	3,191

The significant components of the net deferred income tax asset are as follows:

	2014 $	2013 $
Property, plant and equipment	(3,832)	(3,830)
Intangible assets	(5,254)	(5,512)
Non-deductible provisions and reserves	3,491	5,202
Investment tax credits	(909)	(394)
Inventories	4,324	5,672
Non-capital loss carryforwards	2,399	2,283
Other	1,917	(230)
	2,136	3,191

The Company did not recognize deferred income tax assets of $606 (2013 – $294) in respect of non-capital losses amounting to $1,782 (2013 – $989) that can be carried forward to reduce taxable income in future years. These losses expire between 2020 and 2022.

The Company did not recognize deferred income tax assets of $276 (2013 – $276) in respect of capital losses amounting to $2,051 (2013 – $2,051) that can be carried forward indefinitely against future taxable capital gains.

Deferred tax liabilities of $7,009 (2013 – $6,412) have not been recognized for the withholding tax and other taxes that would be payable on the unremitted earnings of certain subsidiaries. Such amounts are not expected to reverse in the foreseeable future. Unremitted earnings as at February 28, 2014 totalled $292,798 (2013 – $268,515)

21 Earnings per share

a) Basic

Basic earnings per share is calculated by dividing the net income attributable to the Subordinate and Multiple Voting shareholders by the weighted average number of Subordinate and Multiple Voting Shares outstanding during the year.

	2014	**2013**
Net income attributable to Subordinate and Multiple Voting shareholders	$29,400	$6,169
Weighted average number of Subordinate and Multiple Voting Shares outstanding	21,936,714	22,019,568
Basic earnings per share	$1.34	$0.28

b) Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of Subordinate and Multiple Voting Shares outstanding to assume conversion of all dilutive potential Subordinate and Multiple Voting Shares. The Company has one category of dilutive potential Subordinate and Multiple Voting Shares: stock options. For the stock options, a calculation is done to determine the number of Subordinate and Multiple Voting Shares that could have been acquired at fair value (determined as the average market share price of the Company's outstanding Subordinate and Multiple Voting Shares for the period), based on the exercise prices attached to the stock options. The number of Subordinate and Multiple Voting Shares calculated above is compared with the number of Subordinate and Multiple Voting Shares that would have been issued assuming exercise of the stock options.

	2014	**2013**
Net income attributable to Subordinate and Multiple Voting shareholders	$29,400	$6,169
Weighted average number of Subordinate and Multiple Voting Shares outstanding	21,936,714	22,019,568
Adjustments for stock options	-	11,995
Weighted average number of Subordinate and Multiple Voting Shares for diluted earnings per share	21,936,714	22,031,563
Diluted earnings per share	$1.34	$0.28

22 Commitments and contingencies

a) In the normal course of business, the Company issues performance bond guarantees related to product warranty and on-time delivery as well as advance payment guarantees and bid bonds. As at February 28, 2014, the aggregate maximum value of these guarantees, if exercised, amounted to $73,934 (2013 – $84,762). The guarantees expire as follows:

	$
February 28, 2015	34,443
February 29, 2016	10,037
February 28, 2017	16,220
February 28, 2018	6,477
February 28, 2019	6,234
Subsequent years	523
	73,934

b) The Company has outstanding purchase commitments with foreign suppliers, due within one year, amounting to $4,452 (2013 – $7,899), which are covered by letters of credit.

c) Future minimum payments under operating leases (related mainly to premises and machinery) are as follows:

	$
February 28, 2015	1,282
February 29, 2016	1,118
February 28, 2017	963
February 28, 2018	924
February 28, 2019	898
Subsequent years	837
	6,022

d) Two of the Company's U.S. subsidiaries have been named as defendants in a number of asbestos-related legal proceedings pertaining to products they formerly sold. Management believes it has a strong defence, and the subsidiaries have previously been dismissed from a number of similar cases. Because of the many uncertainties inherent in predicting the outcome of these proceedings, as well as the course of asbestos litigation in the United States, management believes that it is not possible to make an estimate of the subsidiaries' asbestos liability. Accordingly, no provision has been set up in the accounts.

During the year ended February 28, 2014, legal and related costs for these matters amounted to $5,472 (2013 – $8,763).

e) Lawsuits and proceedings or claims arising from the normal course of operations are pending or threatened against the Company. Although at this time it is not possible to determine the outcome based on the facts currently known, the Company does not believe that the ultimate outcome will have a material adverse effect on its financial position, results of operations or liquidity. No provision has been set up in the accounts.

23 Related party transactions

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

	2014 $	2013 $
Affiliated company owned by certain relatives of controlling shareholder		
Purchases – Material components	1,889	1,909
Sales – Material components	104	168
Amounts charged by an affiliated company in which a relative of the controlling shareholder owns a 50% interest		
Computer consulting	4	17
Amount charged by the controlling shareholder to one of the Company's subsidiaries and certain of its executives		
Rent based on weekly usage	25	25
Accounts receivable		
Affiliated companies	32	9
Amount charged by minority shareholders of the Company's Italian subsidiary (up to the acquisition of the remaining 30% - note 6d))		
Rent for manufacturing facilities	271	680
Accounts payable and accrued liabilities		
Affiliated companies	174	296
Controlling shareholder	21	4
Key management[1] compensation		
Salaries and other short-term benefits	3,841	3,581
Share-based compensation	23	58
Short-term loans payable to minority shareholders of the Company's Italian subsidiary		
€1,071 Short term loans, bearing interest at 5%, repayable in May 2013. These loans were repaid in July 2013 in conjunction with the acquisition of non-controlling interest (note 6(d))	-	1,401
Interest expense on short-term loans	33	65

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

24 Segment reporting

Geographic distribution of sales and assets:

February 28, 2014

	Canada	United States	France	Italy	Other	Consolidation Adjustment	Consolidated
	$	$	$	$	$	$	$
Sales							
Customers -							
Domestic	71,899	116,343	58,630	1,011	12,779		260,662
Export	108,673	-	48,538	36,834	34,550		228,595
Intercompany (export)	91,160	33,383	895	839	55,764	(182,041)	-
Total	271,732	149,726	108,063	38,684	103,093	(182,041)	489,257
Property, plant and equipment	42,365	8,693	13,612	5,279	26,663	(7)	96,605
Intangible assets and goodwill	169	-	11,522	31,597	71	-	43,359
Other identifiable assets	261,928	34,886	165,934	30,499	108,026	(117,083)	484,190
Total identifiable assets	304,462	43,579	191,068	67,375	134,760	(117,090)	624,154

February 28, 2013

	Canada	United States	France	Italy	Other	Consolidation Adjustment	Consolidated
	$	$	$	$	$	$	$
Sales							
Customers -							
Domestic	54,284	124,631	49,013	48	13,979		241,955
Export	96,099	-	71,597	42,557	48,366		258,619
Intercompany (export)	103,085	31,492	143	1,239	61,591	(197,550)	-
Total	253,468	156,123	120,753	43,844	123,936	(197,550)	500,574
Property, plant and equipment	41,628	6,514	11,841	5,270	25,397	(20)	90,630
Intangible assets and goodwill	116	-	11,307	31,720	51	-	43,194
Other identifiable assets	263,309	34,638	161,205	35,571	107,401	(116,174)	485,950
Total identifiable assets	305,053	41,152	184,353	72,561	132,849	(116,194)	619,774

25 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 subsidiary companies and SPEs. 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).

Overview

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

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

Market risk

Currency risk

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

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

The amounts outstanding as at February 28, 2014 and February 28, 2013 are as follows:

	Range of exchange rates		Gain (loss) (In thousands of U.S. dollars)		Notional amount (In thousands of indicated currency)	
	February 28, 2014	February 28, 2013	February 28, 2014 $	February 28, 2013 $	February 28, 2014	February 28, 2013
Foreign exchange forward contracts						
Sell US$ for CA$ – 0 to 12 months	1.04-1.12	0.97-1.04	(1,275)	(951)	US$43,057	US$43,245
Sell US$ for € – 0 to 12 months	1.29-1.36	1.28-1.43	192	(192)	US$8,498	US$8,664
Buy US$ for € – 0 to 12 months	1.34-1.36	1.28-1.41	(14)	1	US$483	US$33
Sell US$ for £ – 0 to 21 months	1.52	1.52	130	(6)	US$1,315	US$1,485
Sell US$ for KW – 0 to 12 months	1,070-1,075	-	94	-	US$1,348	-
Sell € for US$ – 0 to 12 months	1.31-1.37	1.25-1.35	(133)	103	€9,026	€30,693
Buy € for US$ – 0 to 12 months	-	1.26	-	67	-	€1,420
Buy £ for US$ – 0 to 12 months	1.61-1.68	1.51-1.61	3	(62)	£2,746	£889

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. Gains are recorded as derivative assets and losses as derivative liabilities on the consolidated statement of financial position.

Cash flow and fair value interest rate risk

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

Credit risk

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

The Company's credit risk related to its trade accounts receivable is concentrated. As at February 28, 2014, two (2013 – three) customers accounted for more than 5% each of its trade accounts receivable, of which one customer accounted for 5.4% (2013 – 6.2%), and the Company's ten largest customers accounted for 36.5% (2013 – 43.1%).

In order to mitigate its credit risk, the Company performs a continual evaluation of its customers' credit and performs specific evaluation procedures on all its new customers. In performing its evaluation, the Company analyzes the ageing of accounts receivable, historical payment patterns, customer creditworthiness and current economic trends. A specific credit limit is established for each customer and reviewed periodically. An allowance for doubtful accounts is recorded when, based on management's evaluation, the collection of an account receivable is not reasonably certain.

The Company 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 trade accounts receivable as at:

	As at February 28, 2014 $	As at February 28, 2013 $
Current	93,053	97,741
Past due 0 to 30 days	13,251	10,351
Past due 31 to 90 days	9,375	8,702
Past due more than 90 days	9,039	10,793
	124,718	127,587
Less: Allowance for doubtful accounts	917	1,525
Trade accounts receivable	123,801	126,062
Other receivables	5,177	8,312
Total accounts receivable	128,978	134,374

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

	As at February 28, 2014 $	As at February 28, 2013 $
Balance – Beginning of year	1,525	1,144
Bad debt expenses	767	916
Recoveries of trade accounts receivable	(1,237)	(472)
Write-off of trade accounts receivable	(168)	(50)
Foreign exchange	30	(13)
Balance – End of year	917	1,525

Liquidity risk

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

The following tables present the Company's financial liabilities identified by type and future contractual dates of payment as at:

	As at February 28, 2014				
	Total $	Less than 1 year $	1 to 3 Years $	4 to 5 Years $	After 5 years $
Long-term debt	22,087	10,402	8,987	739	1,959
Accounts payable and accrued liabilities	76,590	76,590	-	-	-
Customer deposits	66,842	66,842	-	-	-
Accrual for performance guarantees	33,842	33,842	-	-	-
Bank indebtedness and short-term bank loans	32,792	32,792	-	-	-
Derivative liabilities	1,501	1,501	-	-	-

	As at February 28, 2013				
	Total $	Less than 1 year $	1 to 3 Years $	4 to 5 Years $	After 5 years $
Long-term debt	26,850	10,463	12,216	2,013	2,158
Accounts payable and accrued liabilities	78,431	78,431	-	-	-
Customer deposits	76,682	76,682	-	-	-
Accrual for performance guarantees	28,525	28,525	-	-	-
Bank indebtedness and short-term bank loans	50,864	50,864	-	-	-
Derivative liabilities	1,380	1,380	-	-	-

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 measured on the consolidated statements of financial position are as follows:

	As at February 28, 2014			
Financial position classification and nature	**Total $**	**Level 1 $**	**Level 2 $**	**Level 3 $**
Assets				
Derivative assets	498	-	498	-
Liabilities				
Derivative liabilities	1,501	-	1,501	-

	As at February 28, 2013			
Financial position classification and nature	**Total $**	**Level 1 $**	**Level 2 $**	**Level 3 $**
Assets				
Derivative assets	340	-	340	-
Liabilities				
Derivative liabilities	1,380	-	1,380	-

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.

26 Capital management

The Company's capital management strategy is designed to maintain strong liquidity in order to pursue its organic growth strategy, undertake selective acquisitions and provide an appropriate investment return to its shareholders while taking a conservative approach to financial leveraging.

The Company's financial strategy is designed to meet the objectives stated above and to respond to changes in economic conditions and the risk characteristics of underlying assets. In order to maintain or adjust its capital structure, the Company may issue or repurchase shares, raise or repay debt, vary the amount of dividends paid to shareholders or undertake any other activities it considers appropriate under the circumstances.

The Company monitors capital on the basis of its total debt-to-equity ratio. Total debt consists of all interest-bearing debt, and equity is defined as total equity.

The total debt-to-equity ratio was as follows:

	As at February 28, 2014 $	As at February 28, 2013 $
Bank indebtedness	31,545	48,580
Short-term bank loans	1,247	2,284
Current portion of long-term debt	10,402	10,463
Long-term debt	11,685	16,387
Total debt	54,879	77,714
Equity	359,119	328,173
Total debt-to-equity ratio	15.3%	23.7%

The Company's objective is to conservatively manage the total debt-to-equity ratio and to maintain funding capacity for potential opportunities.

The Company's financial objectives and strategy as described above have remained unchanged since the last reporting period. These objectives and strategies are reviewed annually or more frequently if the need arises.

The Company is in compliance with all covenants related to its debt and credit facilities, and is not subject to any capital requirements imposed by a regulator.

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

	2014 $	2013 $
Depreciation of property, plant and equipment	12,241	9,572
Amortization of intangible assets	2,525	2,915
Deferred income taxes	1,121	(1,325)
Goodwill impairment loss (note 4)	-	11,700
Share-based compensation expense	23	58
Gain on disposal of property, plant and equipment	(296)	(134)
Interest accretion on proceeds payable (note 3)	9	663
Income from fair value adjustment of proceeds payable (note 3)	-	(2,444)
Unrealized foreign exchange gain on proceeds payable (note 3)	-	(407)
Net change in derivative assets and liabilities	(37)	2,169
Net change in other liabilities	304	622
	15,890	23,389

28 Changes in non-cash working capital items

	2014 $	2013 $
Accounts receivable	5,443	(23,266)
Inventories	23,033	11,313
Income taxes recoverable	2,226	1,943
Deposits and prepaid expenses	1,011	156
Accounts payable and accrued liabilities	(1,825)	(3,778)
Income tax payable	1,339	335
Customer deposits	(9,754)	(10,189)
Provisions	1,730	1,156
Accrual for performance guarantees	5,363	6,619
	28,566	(15,711)

Directors and officers

Corporate directors

A. K. Velan	Founder and Executive Chairman of the Board
P. Velan	Director
R. Velan	Director
T. Velan	Director
C. Hooper	Director
J. Latendresse	Director
K. MacKinnon	Director
W. Sheffield	Director

Corporate officers

A. K. Velan	Founder and Executive Chairman of the Board
T. Velan	President and Chief Executive Officer
I. Velan	Executive Vice-President
W. Maar	Executive Vice-President, International Sales and Overseas Operations
J. Ball	Chief Financial Officer
S. Cherlet	Chief Operations Officer
V. Apostolescu	Vice-President, Quality Assurance
S. Bruckert	Vice-President, Human Resources and General Counsel, Corporate Secretary
J. Del Buey	Vice-President, Severe Service Applications
P. Dion	Vice-President, Canadian Sales
P. Lee	Vice-President, Sales - United States (Eastern Division)
G. Perez	Vice-President, Engineering
C. Pogue	Vice-President, Sales - United States (Western Division)
G. Sabourin	Vice-President, Treasurer and Financial Systems
A. Smith	Vice-President, Procurement and Overseas Manufacturing
R. Sossoyan	Vice-President, Global Financial Reporting
N. Tarfa	Vice-President, Materials and Process Technologies
R. Velan	Vice-President, Distribution
G. Zarifah	Vice-President, Global Capital Investments and Production Technology

Shareholder Information

Head office

7007 Cote de Liesse
Montreal, Quebec, Canada H4T 1G2

Website

www.velan.com

Investor relations

John D. Ball
Chief Financial Officer
7007 Cote de Liesse, Montreal, Quebec, Canada H4T 1G2
Tel.: (514) 748-7743, Ext. 5537
Fax: (514) 908-0180

Auditors

PricewaterhouseCoopers LLP

Transfer agent

CST Trust Company

Shares outstanding as at February 28, 2014

6,392,201 Subordinate Voting Shares
15,566,567 Multiple Voting Shares

Listing

Symbol: VLN

Price range

High $16.51
Low $10.90

Closing on February 28, 2014: $16.22

Annual meeting

The Annual Meeting of Shareholders will be held July 10, 2014, at 3:00 p.m. at the company's head office:
Velan Inc.
7007 Cote de Liesse,
Montreal, Quebec, Canada H4T 1G2

Velan worldwide

Head Office

Montreal, Canada
Velan Inc.

An extensive global network

- 17 production facilities
  - 5 plants in North America
  - 6 plants in Europe
  - 6 plants in Asia
- 5 stocking and distribution centers
- Hundreds of distributors worldwide
- Over 60 service shops worldwide

Manufacturing - North America

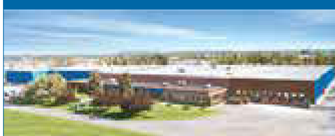
Plant 1

Montreal, Canada
Velan Inc.

Plant 2 and 7

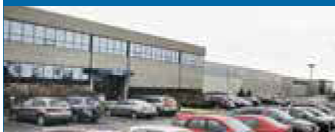
Montreal, Canada
Velan Inc.

Plant 4 and 6



Granby, Canada
Velan Inc.

Plant 5



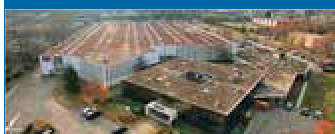
Montreal, Canada
Velan Inc.

Plant 3

Williston, VT, USA
Velan Valve Corp.

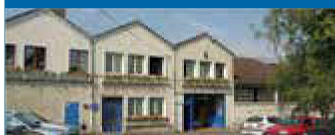
Manufacturing - Europe

Plant



Lyon, France
Velan SAS

Plant



Mennecy, France
Segault SA

Plant

Leicester, UK
Velan Valves Ltd.

Plant

Lisbon, Portugal
Velan Valvulas Industriais, Lda.

Plant 1

Lucca, Italy
Velan ABV S.p.A

Plant 2

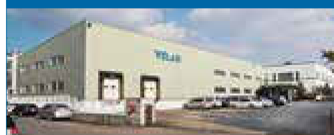
Lucca, Italy
Velan ABV S.p.A

Manufacturing - Asia

Plant 1

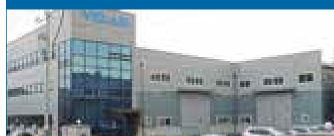
Ansan City, South Korea
Velan Ltd.

Plant 2



Ansan City, South Korea
Velan Ltd.

Plant 3



Ansan City, South Korea
Velan Ltd.

Plant

Taichung, Taiwan
Velan-Valvac

Plant

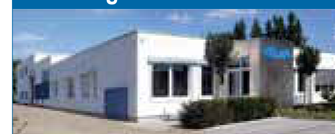
Suzhou, China
Velan Valve (Suzhou) Co., Ltd.

Plant

Coimbatore, India
Velan Valves India Private Ltd.

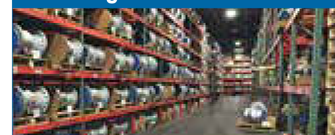
Distribution centers

Stocking and distribution



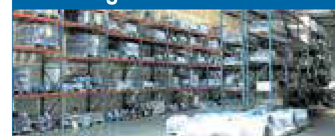
Willich, Germany
Velan GmbH

Stocking and distribution



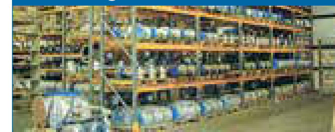
Granby, Canada
Vel*CAN*

Stocking and distribution



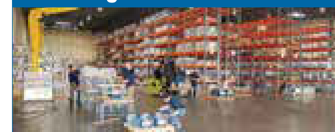
Benicia, CA, USA
Vel*CAL*

Stocking and distribution



Marietta, GA, U.S.A.
Vel*EAST*

Stocking and distribution



Houston, TX, U.S.A.
Vel*TEX*

A world leader in industrial valve design and manufacturing supplying to:

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

Pour une version française de ce rapport annuel adressez-vous à:

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7007, chemin de la Côte-de-Liesse,
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