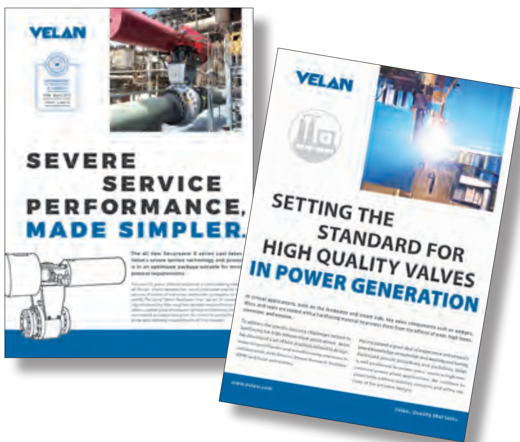
VELAN

Annual report 2018

Highlights

Velan SAS manufactured these cryogenic bellows seal globe control valves for liquid helium application installed in a nuclear fusion reactor in Japan. Photo credit: P.AvavianCEA.

Developed and manufactured by Velan ABV in Italy, these new generation Key-C rotary control ball valves–when combined with our unique, patent protected cable drive actuator–represent a major step forward in control valve technology.



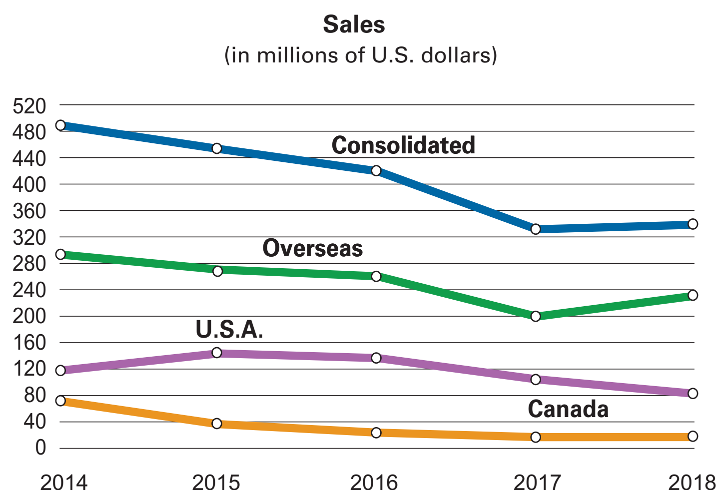
Velan's marketing strategy focused on two main product campaigns this year–the R-series cast metal-seated ball valve and pressure seal valve. The initiative showcased successful teamwork across all departments involved.

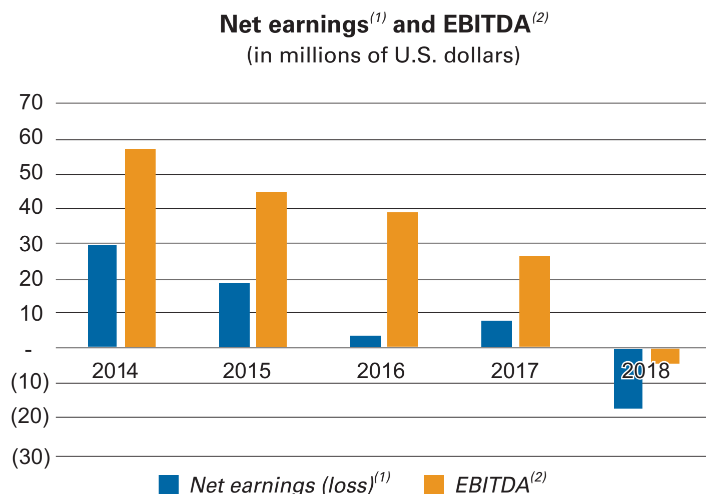
Cover photo:

30" Velan Securaseal isolation ball valve installed in a refinery in South America.

Velan Securaseal C-series valves installed at one of the most severe slurry pipelines in Chile. Velan valves are exceeding the performance requirements in one of the toughest slurry pipelines in the world.

2018 Financial highlights





(in thousands of U.S. dollars, except per share amounts and number of employees)

Years Ended	Feb 2018	Feb 2017	Feb 2016	Feb 2015	Feb 2014
Income statement data					
Sales	$ 337,963	$ 331,777	$ 426,895	$ 455,750	$ 489,257
Gross profit	68,585	88,528	104,283	118,283	131,146
Gross profit %	20.3%	26.7%	24.4%	26.0%	26.8%
Administration costs	85,437	75,868	77,974	88,391	87,143
Income (loss) before income taxes	(18,512)	12,994	12,587	28,965	42,762
EBITDA (2)	(4,376)	26,201	38,563	45,066	57,435
EBITDA (2) %	(1.3)%	7.9%	9.1%	9.9%	11.7%
EBITDA (2) per share	(0.20)	1.21	1.76	2.05	2.62
Net earnings (loss) (1)	(17,811)	7,737	3,641	18,580	29,400
Net earnings (loss) (1) %	(5.3)%	2.3%	0.8%	4.1%	6.0%
Net earnings (loss) (1) per share (3)	(0.82)	0.36	0.17	0.85	1.34
Statement of financial position data					
Net cash (2)	$ 61,048	$ 72,481	$ 82,049	$ 75,612	$ 67,761
Working capital	215,639	233,262	229,959	227,793	235,318
Property, plant and equipment	89,864	91,535	95,257	91,285	96,605
Total assets	540,193	519,297	515,627	558,628	624,154
Total debt	22,129	22,433	22,449	14,827	22,087
Equity	321,617	331,911	333,119	345,093	359,119
Number of employees					
Canada	732	763	787	917	917
United States	146	157	165	181	188
Europe	489	482	520	528	526
Asia	463	474	430	441	429
Total	1,830	1,876	1,902	2,067	2,060

(1) Net earnings or loss refers to net income or loss attributable to Subordinate and Multiple Voting Shares.

(2) This term is a measure of performance and/or financial condition that is not defined under International Financial Reporting Standards and is therefore unlikely to be comparable to similar measures presented by other companies. Such measures are used by management in assessing the operating results and financial condition of the Company. In addition, they provide readers of the Company's consolidated financial statements with enhanced understanding of its results and financial condition, and increase transparency and clarity into the operating results of its core business. Refer to the "Reconciliations of Non-IFRS Measures" section in the Company's Management Discussion and Analysis included in this Annual Report for a detailed calculation of this measure.

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

VELAN

Dear Fellow Shareholders,

As Chairman of the Board and member of the majority shareholder family, I share all our shareholders' disappointment with the poor results in fiscal 2018. This has been a very tough and challenging year for our company as our sales declined and we made a loss, our first operating loss since 2004. The company's Equity declined to US$321.6 million which is C$19.05 per share.

This was a year of transition for both the company and the Velan family. In September 2017, AK Velan, my father who was the founder and the longtime leader of the company, passed away less than 6 months from his 100th birthday. Although he was no longer involved in the company, everyone who knew him was affected by the loss. Many of our employees felt that he was like a second father to them. He was a legend in the valve industry, a philanthropist, and a loving family man. He will be greatly missed.

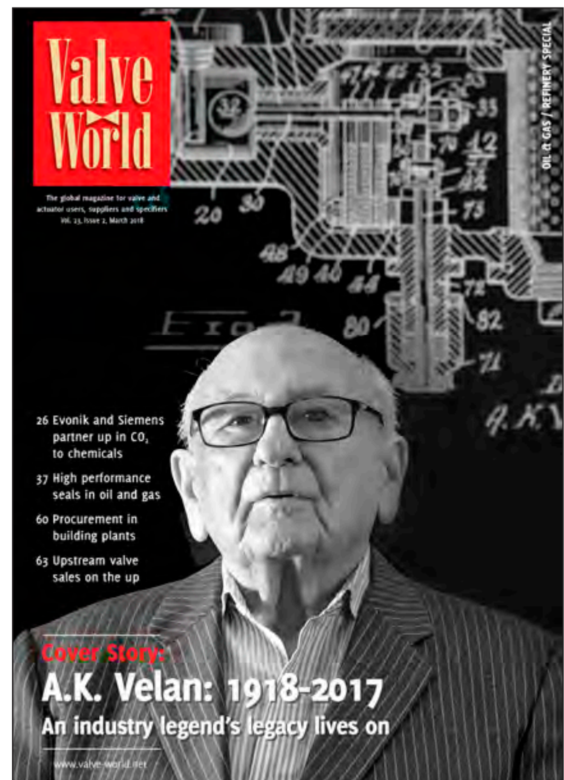
On March 1st, 2017, I retired from my role as CEO and Yves Leduc became the first non-Velan family CEO of the company after serving two years as President. Yves and his executive team are devoting all their efforts to reverse the downward trend and improve the results.

From a corporate governance standpoint, we have established a board renewal succession plan and implemented the first step with the nomination of James Mannebach to replace Ken MacKinnon who is retiring after 13 years of service. James Mannebach is the first independent director who has extensive experience in the valve industry. We are planning to make another director succession next year. We need to balance the need for continuing board renewal with the need to have experienced directors with knowledge about our complex global business.

On behalf of the Board of Directors, I want to thank all shareholders for your continuing support and the confidence you have placed in our company.

Tom Velan

Chairman of the Board



Valve World magazine paid tribute to A.K. Velan in a cover story published in the March issue.

A.K. and Tom Velan standing in front of a large valve in 2006 when A.K. was 88 years old.

Message to our shareholders and employees

(In U.S. dollars, unless otherwise stated.)

Highlights

- **Sales of $338.0 million**
- **Net loss[1] of $17.8 million**
- **Order Backlog of $464.5 million**
- **Order Bookings of $320.9 million**
- **Net Cash[2] of $61.0 million**

Yves Leduc, Velan Inc's President and Chief Executive Officer.

Fiscal year 2018 was my first year as CEO of Velan Inc. (the "Company") and it was by far the most challenging since I joined the Company three years ago. Our results are deeply disappointing as we suffered a loss on slightly increasing revenues.

So what is happening? The poor bookings experienced by North American operations in fiscal year 2017 was not followed with the expected recovery this year. The usual strong performance of our French operations, coupled with Italy's impressive sales recovery, could not offset our performance in North America. Meanwhile, the complexity of our project manufacturing business keeps increasing at a pace faster than our improvements. This, combined with sharply contracting margins in project valves, contributed to a notable margin decline, again mostly in our North American operations.

Let's have a closer look at our results.

Sales, order bookings, and backlog

Sales increased by $6.2 million or 1.9% from the prior year. Sales were positively impacted by an increase in shipments from the Company's Italian subsidiary, which was offset by decreased shipments from the Company's North American operations due to various customer-related, supply chain and internal operational issues. Sales were also negatively impacted by lower shipments of non-project commodity valves, particularly in North America. At first, the weakness in this segment, which mainly sells into the oil and gas sector, was perceived to be temporary and largely related to market conditions. However, as competition has intensified and competitors have gained market share, it is now apparent that the decline is more permanent. As such, it has become imperative for the Company to shift its focus and target discrete market segments where its engineering know-how and agile design capabilities can be a leverage for future growth.

Bookings decreased by $127.3 million or 28.4% from the prior year. The decrease for the year is due primarily to lower project orders booked by the Company's French, German and Italian subsidiaries, all of which had recorded significant large project orders in the prior year comparative period. While the Company's North American operations recorded higher bookings for the year, such amount remains low when compared to previous fiscal years. The current highly competitive environment in its various markets continues to put downward pressure on pricing and lead times.

As a result of sales outpacing bookings in the current fiscal year, the Company's book-to-bill ratio was 0.95 for the year. Despite this low ratio, the total backlog increased by $26.3 million or 6.0% since the beginning of the fiscal year. This improvement in the backlog was achieved as a result of the positive impact of the strengthening of the euro spot rate against the U.S. dollar at the end of the current year when compared to the spot rate at the beginning of the year.

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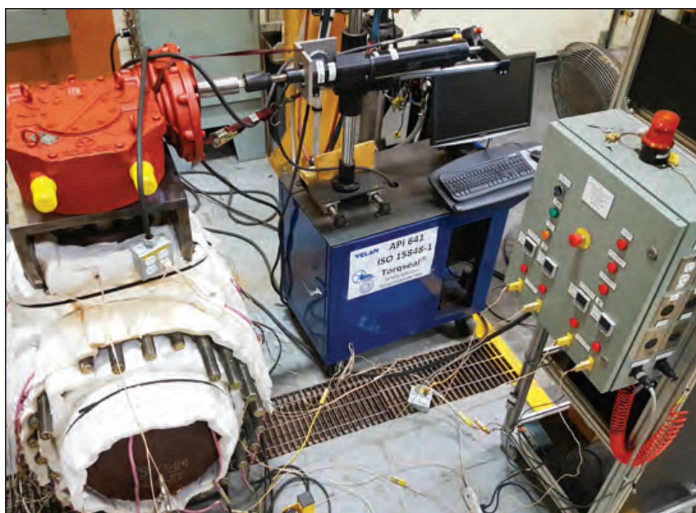
Message to our shareholders and employees



A 20" Class 600 Torqseal triple-offset valve qualification setup for API 641 and ISO-18848-1. Velan is an industry leader in developing better technologies for low fugitive emissions valves that are also operator friendly in the field.

Net earnings (loss)[1] and EBITDA[2]

Net loss[1] amounted to $17.8 million or $0.82 per share compared to net earnings[1] of $7.7 million or $0.36 per share last year. EBITDA[2] amounted to a negative balance of $4.4 million or $0.20 per share compared to a positive balance of $26.2 million or $1.21 per share last year. Despite an increase in sales, the $25.5 million decrease in net earnings[1] is primarily attributable to significantly weaker margins, increased administration costs and the negative effects of the U.S. tax reform legislation passed during the fourth quarter of the current fiscal year, which resulted in a one-time tax expense inclusion of $4.3 million.

Gross profit decreased by $19.9 million for the fiscal year, while the gross profit percentage decreased by 640 basis points from 26.7% to 20.3%. The decrease for the year is due primarily to the Company's North American operations, which shipped a product mix with a greater proportion of projects with lower margins, coupled with pricing pressure brought on by fierce competition and continued weakness in certain markets. This loss of margin was only partially offset by the material cost savings achieved by the Company's supply chain improvement initiatives. Furthermore, the Company's North American operations were impacted by a backlog of project valves which it had difficulty delivering due to various customer-related issues. In addition, the upgrade of the Company's enterprise resource planning ("ERP") system, which was completed successfully and on time at the beginning of the current year, created normally expected learning pains and compounded those delivery challenges, resulting in the disruption of the critical path of several projects within the Company's North American operations. This turbulence reached a peak in the third quarter, at a time where a significant order from Asia was received. The issues created by the deployment of the new ERP system were addressed by the end of the current year, but these shipping delays resulted in increased provisions for late-delivery penalties as well as increased inventory ageing provisions which were a further drag on the Company's gross profit percentage.

Progress overshadowed by business performance…

Our strategic plan, Velocity 2020, launched last fiscal year, rests on a few key building blocks and aims at delivering the consistent returns that would be expected of a high performing company. We are far from that goal, but our business results overshadowed the fact that we are making progress on many fronts in transforming our Company:

- We are on track to deliver the commitment that I made last July to reduce our cost base by a cumulative $20 million over three years. To date, we have identified $5.2 million of cost savings under this initiative. We have achieved material savings through shifting sourcing to low cost countries and tightening up our procurement practices. We are only at the beginning of reaping the benefits of a new corporate function established at the end of fiscal year 2017 and expect material efficiencies to ramp up this year. The fact is however, as noted above, these savings are in large part being transferred to our customers because of the severe price competition currently affecting our current project business.
- The deployment of a new Velan Project Management process ("VPM"), kicked off in fiscal year 2017, is gaining traction, but as project manufacturing becomes increasingly complex and promised lead times increasingly shorter, we are not yet at point where victory can be claimed.
- The number of successfully closed breakthrough initiatives in our manufacturing operations has increased steadily, signaling a step forward in building a culture of continuous improvement.

Cast steel valves for NTPC Telangana supercritical power plant manufactured and ready for shipment from our Velan Valves India location.

Message to our shareholders and employees

- We have successfully restructured our global sales force along vertical, rather than geographic market lines in order to focus resources on higher-margin segments where fewer competitors can match our product capabilities and potential to meet the toughest application requirements.
- This move is accompanied by a greater emphasis on a disciplined commercialization of our innovations and, as such, last year saw a number of new designs and product platforms introduced to the market.
- Our greater focus on the installed base is paying off as spare parts billings in percentage of sales reached a record level a second year in a row in our North American operations In France, we have seen service revenues grow also to record levels, a reflection of the exceptional after-market organization built up to service the installed base and delivering customer satisfaction. This is a business model we intend to expand to our North American operations, as we increase synergies and cooperation across our global organization.
- Most of our subs are doing well, with our French operations performing extremely well in the nuclear business and our Italian operations having turned their business around after a very difficult fiscal year 2017.

Unfortunately, the combined effect of these successes is not showing in the bottom line. Why? I must admit we underestimated the impact of a shifting business environment on our ability to drive quickly enough the business transformation foreseen under our strategic plan.

Yves Leduc, President and CEO, Velan Inc., with Frédéric Segault, President, Segault SAS and Velan SAS, during their visit to CERN. Velan has 2,500 bellows seal valves controlling the flow of 700,000 liters of liquid helium to cool down and optimize the performance of 1,700 magnets to -271°C installed in the LHC (Large Hadron Collider), the world's most powerful particle accelerator.

Velan's first Global Engineering Team Meeting was held in Montreal March 5 – 9, 2018 which included employees from Canada, India, France, and Italy.

For example, our North American plants have had a very difficult time adapting to both the upgrade of our ERP, which created normally expected turbulence, and to the low backlog, which creates turbulence and hinders their ability to level production planning. We expect to see significant improvements in operations this year, thanks to the new systems and the deployment of modernized practices in capacity planning.

Also, we recognized last year the aggressive pricing behavior from our competitors, fighting for share in a slow-recovering global project manufacturing business. In fact, we have witnessed a surge of new competitors seeking to expand their reach in some of the Company's traditional markets. This year, these price wars affected our margins to a degree not seen before. Our response to this challenge is two-fold: an aggressive materials management strategy, mentioned earlier, and a much more focused sales organization, aiming to inject momentum into our product portfolio by doubling down on higher margin growth segments. However, the benefits of this sales approach, because it depends on new capabilities in front-loaded business development, are not immediate and will materialize over time, as we are planting the seeds in promising segments where we have not traditionally been focused before.

…but laying the base for decisive action

Last year I stated that, "because the Company is financially healthy, we are careful not to rush", recognizing the multi-fronted change challenge we are facing. This year I am saying, in reaction to the business performance, but with our financial health still strong, we have become far less patient. The good news is that the progresses made in fiscal year 2018 on the many fronts described above prepare us to move faster. The other good news is that employees tell me they are not accepting the results and are eager to contribute to the Company's return to financial success.

Message to our shareholders and employees

Part of Velan's product strategy included launching product campaigns such as the Securaseal R Series cast valve and the latest in pressure seal valve hardfacing technology which were introduced to our customer's at the Distributor conference held in Quebec City in September.

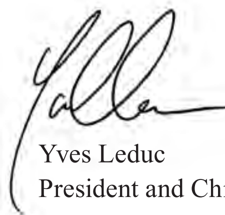
As an example of this winning attitude, the unions and management quickly agreed in March 2018, to postpone the renewal of the collective agreement by one year, to avoid the distraction of the negotiations and keep everybody focused on one common goal: fixing our results. I am grateful to our unionized employees who accepted this exceptional arrangement, as well as to all of our employees, worldwide, who are working tirelessly with great engagement at pulling our Company through these difficult times.

Velan 16" Class 2500 forged gate valves for high pressure and high temperature Hydrogen service installed on an AXENS-HYVAHL process at IRPC Rayong facility in Thailand.

In short, the rapidly changing business environment and the slow recovery in bookings for our North American operations require that we accelerate our transformation. Given the disappointing results, we are currently re-assessing our Velocity 2020 strategic plan to determine how it can be adapted to include ways to simplify our business and rapidly broaden our cost reduction initiatives. Simply put, we will need to make important changes to improve our operating results.

Other companies have undergone tough tests. I told Tom Velan that I believe, even more than when I joined, that the Company has what it takes to grow profitably in the valve world: one of the most reputed brand names in the industry, customers who root for us, incredibly knowledgeable and passionate employees, a global supply chain that is well established in western, as well as low-cost economies, and a strong balance sheet.

This is all we need to have strong confidence in our ability to rebound. Today we realize that more is needed to haul the Company out of its current position and we will respond. As far as our long-term perspective goes, the goal line may have moved away from us, but we are not losing sight of it. Stay tuned.



Yves Leduc
President and Chief Executive Officer

Management's discussion and analysis

May 24, 2018

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, 2018. 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, 2018 and 2017. 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 are included further in this report. Additional information relating to the Company, including the Annual Information Form and Proxy Information Circular, can be found on SEDAR at **www.sedar.com**.

BASIS OF PRESENTATION AND ANALYSIS

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

FORWARD-LOOKING INFORMATION

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

OVERVIEW

The Company designs, manufactures and markets on a worldwide basis a broad range of industrial valves for use in most industry applications including power generation, oil and gas, refining and petrochemicals, chemical, LNG and cryogenics, pulp and paper, geothermal processes and shipbuilding. The Company is a world leader in steel industrial valves operating 14 manufacturing plants worldwide with 1,830 employees. The Company's head office is located in Montreal, Canada. The Company's business strategy is to design, manufacture, and market new and innovative valves with emphasis on quality, safety, ease of operation, and long service life. The Company's strategic goals include, but are not limited to, customer-driven operational excellence and margin improvements, accelerated growth through increased focus on key target markets where the Company has distinctive competitive advantages and continuously improving and modernizing its systems and processes.

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

CONSOLIDATED HIGHLIGHTS[1]

(millions, excluding per share amounts)	Fiscal year ended February 28, 2018	Fiscal year ended February 28, 2017	Increase (decrease)	% Increase (decrease)
Consolidated statements of earnings				
Sales	$338.0	$331.8	$6.2	1.9%
Gross profit	68.6	88.5	(19.9)	(22.5)%
Gross profit %	20.3%	26.7%		
EBITDA[2]	(4.4)	26.2	(30.6)	(116.8)%
EBITDA[2] %	(1.3)%	7.9%		
EBITDA[2] per share – basic and diluted	(0.20)	1.21	(1.41)	(116.5)%
Net earnings (loss)[3]	(17.8)	7.7	(25.5)	(331.2)%
Net earnings (loss)[3] %	(5.3)%	2.3%		
Net earnings (loss)[3] per share – basic and diluted	(0.82)	0.36	(1.18)	(327.8)%
Weighted average shares outstanding	21.6	21.7		
Consolidated statements of cash flows				
Cash provided by (used in) operating activities	(1.9)	7.1	(9.0)	(126.8)%
Cash used in investing activities	(6.7)	(5.5)	(1.2)	(21.8)%
Cash used by financing activities	(11.1)	(8.1)	(3.0)	(37.0)%
Demand data				
Net new orders received	320.9	448.2	(127.3)	(28.4)%
Period ending backlog of orders	464.5	438.2	26.3	6.0%

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

Highlights of fiscal 2018 as well as factors that may impact fiscal 2019

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

- EBITDA[1] amounted to a negative balance of $4.4 million or $0.20 per share compared to a positive balance of $26.2 million or $1.21 per share last year. Despite an increase in sales, the $30.6 million decrease in EBITDA[1] is primarily attributable to significantly weaker margins and increased administration costs.
- Net loss[2] amounted to $17.8 million or $0.82 per share compared to net earnings[2] of $7.7 million or $0.36 per share last year. The $25.5 million decrease in net earnings[2] is primarily attributable to a lower EBITDA[1] and the negative effects of the U.S. tax reform legislation passed during the fourth quarter of the current fiscal year, which resulted in a one-time tax expense inclusion of $4.3 million.
- Sales amounted to $338.0 million, an increase of $6.2 million or 1.9% compared to last year. Sales were positively impacted by an increase in shipments from the Company's Italian subsidiary, which were offset by decreased shipments from the Company's North American operations. Delays in shipments of certain large project orders caused by various customer-related, supply chain and internal operational issues, and lower shipments of non-project commodity valves negatively impacted the Company's North American operations.
- Net new orders received ("bookings") amounted to $320.9 million, a decrease of $127.3 million or 28.4% compared to last year. This decrease is due primarily to lower project orders booked by the Company's French, German and Italian subsidiaries, all of which had recorded significant large project orders in the prior year period. This decrease was partially offset by improved bookings in the Company's North American operations.
- Despite the fact that sales outpaced bookings in the year, the Company ended the year with a backlog of $464.5 million, an increase of $26.3 million or 6.0% since the beginning of the current fiscal year. This increase in backlog was substantially due to the positive impact of the strengthening of the euro spot rate against the U.S. dollar over the course of the year.
- Gross profit percentage decreased by 640 basis points from 26.7% to 20.3%. This decrease is due primarily to the Company's North American operations, which shipped a product mix with a greater proportion of projects with lower margins, coupled with pricing pressure brought on by fierce competition and continued weakness in certain markets; this loss of margin was only partially offset by the material cost savings achieved by the Company's supply chain improvement initiatives. Furthermore, the Company's North American operations were impacted by a significant backlog of project valves which it was not able to deliver due to various customer-related issues and internal operational issues.
- Administration costs amounted to $85.4 million, an increase of $9.5 million or 12.5%. This increase is primarily attributable to an increase in sales commissions and freight charges resulting from the higher sales volume, an increase in technology license fees paid on the sale of certain highly-engineered cryogenic valves by the Company's French operations, and an increase in costs recognized in connection with the Company's ongoing asbestos litigation (see *Contingencies* section). The fluctuation in asbestos costs for the year is due more to the timing of settlement payments in these two years rather than to changes in long-term trends.
- The Company ended the year with net cash[1] of $61.0 million, a decrease of $11.5 million or 15.9% since the beginning of the year. This decrease is primarily attributable to cash used in operations, investments in property, plant and equipment, long-term debt repayments as well as distributions to shareholders via dividends and share repurchases.
- Foreign currency impacts:
  - Based on average exchange rates, the euro strengthened 4.9% against the U.S. dollar when compared to the same period last year. This strengthening resulted in the Company's net profits and bookings from its European subsidiaries being reported as higher U.S. dollar amounts in the current year.
  - Based on average exchange rates, the Canadian dollar strengthened 1.8% against the U.S. dollar when compared to the same period last year. This strengthening resulted in the Company's Canadian dollar expenses being reported as higher U.S. dollar amounts in the current year.
  - Based on spot exchange rates, the euro strengthened 15.3% against the U.S. dollar when compared to the rate at the end of the last fiscal year. This strengthening resulted in losses of $1.8 million incurred on foreign exchange forward contracts used by the Company to hedge the net monetary position of its European subsidiaries. This strengthening

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

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

also resulted in a positive cumulative translation adjustment of $15.9 million which was recorded directly in equity through other comprehensive income (loss).

- The net impact of the above currency swings was generally unfavourable on the Company's net loss[1], although it was generally favourable on the Company's equity.

Fiscal year 2018 was another challenging year for the Company. The year's disappointing financial results were largely driven by the Company's North American operations, which, over the last two years, have been struggling to increase their low order backlog as they continue to face intense competition in their key target markets, leading to increased pressure on pricing and lead times. This trend is now starting to show in the Company's results as its gross profit percentage was adversely impacted by these pricing pressures despite a slight increase in sales. While the Company has been implementing several improvement initiatives at its North American operations under its strategic plan entitled "Velocity 2020", it is clear that the pace of its transformation from a largely commodity valve operation to a more project manufacturing-based business will have to be accelerated. The Company is currently conducting a detailed review of its strategic plan and will be rolling out an accelerated version over the next fiscal year. In the meantime, the Company implemented several improvement initiatives this year, namely the continued rollout of its Valve Project Management process ("VPM"), the successful completion of a number of continuous improvement breakthrough initiatives in the Company's manufacturing operations, the restructuring of the Company's global sales force along vertical market lines rather than geographic lines, the disciplined commercialization of new designs and product platforms introduced to the market, and an increase of spare parts billings as percentage of sales for a second year in a row in the Company's North American operations.

While the Company's North American operations continued to struggle, its wholly-owned French operations continued to outperform the rest of the Company as they maintained their strong sales and margins of the previous year. The Company also realized a turnaround at its Italian subsidiary which saw a return to profitability on significantly improved sales.

Other factors that may impact fiscal year 2019

Due to its diversification in both geography and type of industry, the Company is well positioned to meet the many challenges it currently faces. While its financial position is healthy with a debt-to-equity ratio of only 13.7%, the Company will not be able to sustain results similar to those of the current year for consecutive years into the future. As such, the Company will accelerate its transformation plan, while continuing to pursue its global cost reduction and efficiency initiative, which was announced in the first quarter of the current fiscal year. The goal of this plan is to reduce annual supply chain, production and overhead costs by approximately $20 million by the end of the fiscal year ending February 29, 2020. Approximately $5.2 million in annual cost savings have been identified under this initiative to date. Through its various strategic initiatives, the Company is working to be a more agile player in the global valve market in order to better take advantage of market swings and changes in customer demands and preferences. 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. Such factors include, but are not limited to foreign currency fluctuations, in particular the Canadian dollar and the euro against the U.S. dollar, commodity price fluctuations from both a procurement (price of steel) and sales (price of oil) perspective, and the potential imposition of protectionist trade measures and sanctions. See *Certain Risks That Could Affect Our Business* section below for more details.

[1] *Net earnings or loss refers to net income or loss 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, 2018	Fiscal year ended February 28, 2017	Fiscal year ended February 29, 2016
Operating Data			
Sales	$337,963	$331,777	$426,895
Net Earnings (loss)[1]	(17,811)	7,737	3,641
Earnings (loss) per Share			
- Basic	(0.82)	0.36	0.17
- Diluted	(0.82)	0.36	0.17
Balance Sheet Data			
Total Assets	540,193	519,297	515,627
Total Long-Term Financial Liabilities	22,200	22,532	23,516
Shareholder Data			
Cash dividends per share			
- Multiple Voting Shares[2]	0.31	0.31	0.31
- Subordinate Voting Shares	0.31	0.31	0.31
Outstanding Shares at report date			
- Multiple Voting Shares[2]	15,566,567		
- Subordinate Voting Shares	6,055,368		

Sales for fiscal year 2018 increased by 1.9% compared to fiscal year 2017. This increase was primarily attributable to an increase in shipments from the Company's Italian subsidiary, which were offset by decreased shipments from the Company's North American operations. Delays in shipments of certain large project orders caused by various customer-related, supply chain and internal operational issues, and lower shipments of non-project commodity valves negatively impacted the Company's North American operations. Sales for fiscal year 2017 decreased by 22.3% compared to fiscal year 2016. This decrease was primarily attributable to the lower level of bookings recorded over the course of fiscal year 2016 due in turn to softer demand in our core markets, which negatively impacted the sales volume in fiscal year 2017.

Gross profit for fiscal year 2018 amounted to $68.6 million, a decrease of $19.9 million from fiscal year 2017, while the gross profit percentage decreased from the 26.7% reported in fiscal year 2017 to 20.3% in fiscal year 2018. This decrease was due primarily to the Company's North American operations, which shipped a product mix with a greater proportion of projects with lower margins, coupled with pricing pressure brought on by fierce competition and continued weakness in certain markets, which was only partially offset by the material cost savings. Gross profit for fiscal year 2017 amounted to $88.5 million, a decrease of $15.8 million from fiscal year 2016. However, gross profit percentage for fiscal year 2017 increased from the 24.4% reported in fiscal year 2016 to 26.7%. While the lower sales volume negatively impacted total gross profit in the year, the increase in the gross profit percentage was mainly attributable to a product mix with a greater proportion of higher margin product sales, material cost savings, as well as labour and overhead savings stemming from the restructuring initiatives implemented in the prior fiscal year.

Administration costs for fiscal year 2018 increased by $9.5 million when compared to fiscal year 2017. This increase was primarily attributable to an increase in sales commissions and freight charges due to the increased sales volume, an increase in technology license fees paid on the sale of certain highly-engineered cryogenic valves, and an increase in costs recognized in connection with the Company's ongoing asbestos litigation (see *Contingencies* section). Administration costs for fiscal year 2017 decreased by $2.1 million when compared to fiscal year 2016. This decrease was achieved despite a $1.2 million increase in costs recognized in connection with the Company's ongoing asbestos litigation (see *Contingencies* section).

The fiscal year 2018 net loss[1] was also negatively impacted by a $4.3 million one-time income tax charge due to the U.S. tax reform legislation passed in December 2017. The fiscal year 2016 net earnings[1] were negatively impacted by an $11.5 million non-cash goodwill impairment loss related to the Velan ABV S.r.l. ("ABV") cash-generating unit and restructuring costs of $2.8 million related primarily to the Company's North American and U.K. facilities.

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

[2] *Multiple Voting Shares (five votes per share) are convertible into Subordinate Voting Shares on a 1 to 1 basis.*

RESULTS OF OPERATIONS – for the year ended February 28, 2018 compared to the year ended February 28, 2017
(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, 2018	Year ended February 28, 2017
Sales	$338.0	$331.8

Sales increased by $6.2 million or 1.9% from the prior year. Sales were positively impacted by an increase in shipments from the Company's Italian subsidiary, which was offset by decreased shipments from the Company's North American operations. One reason for such decreased shipments was due to delays in shipments of certain large project orders caused by various customer-related, supply chain and internal operational issues. One particular project order, destined to an oil and gas project in Mexico, totalling approximately $11 million, has been ready to ship since the first quarter of the prior fiscal year but was delayed due to the customer having put the order on hold. While the customer has maintained its commitment to eventually take possession of these goods, it is currently unclear as to the timing of their shipment. Sales were also negatively impacted by lower shipments of non-project commodity valves, particularly in North America. At first, the weakness in this segment, which mainly sells into the oil and gas sector, was perceived to be temporary and largely related to market conditions. However, as competition has intensified and competitors have gained market share, it is now apparent that the decline is more permanent. As such, it has become imperative for the Company to shift its focus and target discrete market segments where its engineering know-how and agile design capabilities can be a leverage for future growth.

Bookings and backlog

(millions)	Year ended February 28, 2018	Year ended February 28, 2017
Bookings	$320.9	$448.2

Bookings decreased by $127.3 million or 28.4% from the prior year. The decrease for the year is due primarily to lower project orders booked by the Company's French, German and Italian subsidiaries, all of which had recorded significant large project orders in the prior year, notably approximately $22 million in project orders won by the Company's Italian operations to supply valves to the oil and gas sector in the Middle East, approximately $91 million in project orders won by the Company's French operations to supply valves to the nuclear power market in China and the U.K., and approximately $21 million in project orders won by the Company's German operations to supply valves to the power market in Vietnam. Furthermore, bookings were negatively impacted by the cancellation of a $6 million oil and gas sector order at the Company's Italian subsidiary in the first quarter of the current year. While the Company's North American operations recorded higher bookings for the year, such amount remains low when compared to previous fiscal years. The current highly competitive environment in its various markets continues to put downward pressure on pricing and lead times. Given these trends, the Company has accelerated the assessment of its global manufacturing footprint, supply chain and cost structure as per its Velocity 2020 strategic plan. Consequently, the Company is pursuing its global cost reduction and efficiency initiative with the goal of reducing annual supply chain, production and overhead costs by approximately $20 million by the end of the fiscal year ending February 29, 2020. Approximately $5.2 million in annual cost savings have been identified under this initiative to date.

(millions)	**February 2018**	**February 2017**	**February 2016**
Backlog	$464.5	$438.2	$331.2
For delivery within the subsequent fiscal year	$286.7	$270.5	$256.2
For delivery beyond the subsequent fiscal year	$177.8	$167.7	$75.0
Percentage – beyond the subsequent fiscal year	38.3%	38.3%	22.7%

As a result of sales outpacing bookings in the current fiscal year, the Company's book-to-bill ratio was 0.95 for the year. Despite this low ratio, the total backlog increased by $26.3 million or 6.0% since the beginning of the fiscal year, settling at $464.5 million. This improvement in the backlog was achieved as a result of the positive impact of the strengthening of the euro spot rate against the U.S. dollar at the end of the current year when compared to the spot rate at the beginning of the year.

Gross profit

(millions)	Year ended February 28, 2018	Year ended February 28, 2017
Gross profit	$68.6	$88.5
Gross profit percentage	20.3%	26.7%

Gross profit decreased by $19.9 million for the fiscal year, while the gross profit percentage decreased by 640 basis points from 26.7% to 20.3%. The decrease for the year is due primarily to the Company's North American operations, which shipped a product mix with a greater proportion of projects with lower margins. Pricing pressure brought on by fierce competition, continued weakness in certain markets, and warranty provisions also had a negative impact on the gross profit percentage. This loss of margin was only partially offset by the material cost savings achieved by the Company's supply chain improvement initiatives. Furthermore, the Company's North American operations were impacted by a backlog of project valves which they had difficulty delivering due to various customer-related issues. In addition, the upgrade of the Company's enterprise resource planning ("ERP") system, which was completed successfully and on time at the beginning of the current year, created normally expected learning pains and compounded those delivery challenges, resulting in the disruption of the critical path of several projects within the Company's North American operations. This turbulence reached a peak in the third quarter, at a time where a significant order from Asia was received. The issues created by the deployment of the new ERP system were addressed by the end of the current year, but these shipping delays resulted in increased provisions for inventory ageing which were a further drag on the Company's gross profit percentage.

Administration costs

(millions)	Year ended February 28, 2018	Year ended February 28, 2017
Administration costs*	$85.4	$75.9
As a percentage of sales	25.3%	22.9%
*Includes asbestos-related costs of:	$8.2	$6.8

Administration costs increased by $9.5 million or 12.5% for the fiscal year. This increase was primarily attributable to an increase in sales commissions and freight charges resulting from the higher sales volume, an increase in technology license fees paid on the sale of certain highly-engineered cryogenic valves by the Company's French operations, and an increase in costs recognized in connection with the Company's ongoing asbestos litigation (see *Contingencies* section). The fluctuation in asbestos costs for both years 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 create a hazard 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.

Other expense (income)

(millions)	Year ended February 28, 2018	Year ended February 28, 2017
Other expense (income)	$1.5	$(0.4)

Other expense increased by $1.9 million for the fiscal year. The increase for the year is primarily attributable to mark-to-market losses of $1.8 million incurred on foreign exchange forward contracts used by the Company to hedge the net monetary position of its European subsidiaries, which is denominated in euros. On similar instruments used in the prior year, the Company incurred mark-to-market gains of $0.7 million. The euro spot rate appreciated 15.3% against the U.S. dollar since the beginning of the current fiscal year, resulting in an increase to net loss[1]. This euro appreciation also had a positive impact on the Company's statement of financial position since it resulted in a positive cumulative translation adjustment of $15.9 million for the year, which was recorded directly in equity through other comprehensive income (loss). As such, the net impact of the euro appreciation was generally positive on the Company's equity, even though the Company's net loss[1] was depressed as a result.

Net finance costs

(millions)	Year ended February 28, 2018	Year ended February 28, 2017
Net finance costs	$0.2	$0.1

Net finance costs increased by $0.1 million for the fiscal year. While long-term debt remained relatively stable when compared to the prior fiscal year, the Company's overall debt load increased over the course of the current fiscal year, particularly its bank indebtedness in its North American and Italian operations, resulting in an increase in its finance costs (see *Liquidity and Capital Resources* section).

Income taxes

(in thousands, excluding percentages)	Year ended February 28, 2018		Year ended February 28, 2017	
	$	%	$	%
Income (loss) before income taxes	(18,512)	100.0	12,994	100.0
Tax calculated at domestic tax rates applicable to earnings in the respective countries	(3,562)	19.2	5,020	38.6
Tax effects of:				
Non-deductible (taxable) foreign exchange loss (gain)	(303)	1.6	(344)	(2.6)
Losses not tax effected	1,151	(6.2)	1,552	11.9
Losses utilized not previously tax effected	-	-	(444)	(3.4)
Benefit attributable to a financing structure	(917)	5.0	(927)	(7.1)
Effect of U.S. Tax Reform	4,259	(23.1)	-	-
Other	(267)	1.5	(177)	(1.4)
Provision for income taxes	361	(2.0)	4,680	36.0

U.S. Tax Reform was substantially enacted on December 22, 2017 under its official name "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018". As a result of the enactment of this legislation, the Company's U.S. subsidiary recorded a one-time tax expense of $4.3 million, of which $2.3 million was due to the new mandatory repatriation tax and $2.0 million was due to the effect of the tax rate reduction on its net deferred income tax assets.

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

Net earnings (loss)[1]

(millions)	Year ended February 28, 2018	Year ended February 28, 2017
Net earnings (loss)[1]	$(17.8)	$7.7
As a percentage of sales	(5.3)%	2.3%
EBITDA[2]	$(4.4)	$26.2
As a percentage of sales	(1.3)%	7.9%

Net loss[1] amounted to $17.8 million or $0.82 per share compared to net earnings[1] of $7.7 million or $0.36 per share last year. EBITDA[2] amounted to a negative balance of $4.4 million or $0.20 per share compared to a positive balance of $26.2 million or $1.21 per share last year. Despite an increase in sales, the $25.5 million decrease in net earnings[1] is primarily attributable to significantly weaker margins, increased administration costs and the negative effects of the U.S. tax reform legislation passed during the fourth quarter of the current fiscal year, which resulted in a one-time tax expense inclusion of $4.3 million.

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

								QUARTERS ENDED
	February 2018	**November 2017**	**August 2017**	**May 2017**	**February 2017**	**November 2016**	**August 2016**	**May 2016**
Sales	$102,607	$87,738	$76,531	$71,087	$102,835	$80,396	$71,137	$77,409
Net earnings (loss)[1]	(8,221)	305	(5,591)	(4,304)	3,707	1,501	2,001	528
Net earnings (loss)[1] per share								
- Basic	(0.38)	0.02	(0.26)	(0.20)	0.17	0.07	0.10	0.02
- Diluted	(0.38)	0.02	(0.26)	(0.20)	0.17	0.07	0.10	0.02

Sales can vary from one quarter to the next due to the timing of the shipment of large project orders. Sales were higher in the quarters ended in February 2017 and February 2018 due to increased shipments of such orders, while the lower sales amounts for the quarters ended in May 2016, August 2016, November 2016, May 2017, August 2017 and November 2017 were due to delayed execution on the shipments of such orders. Net earnings[1] for the quarters ended in August 2016, November 2016 and February 2017 were higher due to a more efficient product mix. A net loss[1] was recorded in the quarters ended in May 2017 and August 2017 due to lower sales volume and a less efficient product mix. Net earnings[1] for the quarters ended May 2016 and November 2017 were lower due to a less efficient product mix. The net loss[1] for the quarter ended in February 2018 was due to a less efficient product mix, shipping delays caused by internal operational issues and a $4.3 million one-time income tax charge resulting from the U.S. tax reform legislation passed in December 2017.

[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.*

RESULTS OF OPERATIONS – quarter ended February 28, 2018 compared to the quarter ended February 28, 2017
(unless otherwise noted, all amounts are in U.S. dollars and all comparisons are to the fourth quarter of the prior fiscal year)

Sales

(millions)	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Sales	$102.6	$102.8

Sales remained relatively stable for the quarter, decreasing by $0.2 million or 0.2%. While sales were lower in the current quarter when compared to the comparative period in the prior year, they were stronger when compared to the previous three quarters of the current fiscal year. Sales for the quarter were improved in the Company's Italian subsidiary, while its North American operations realized lower sales due to delays in shipments of certain large project orders caused by various customer-related, supply chain and internal operational issues.

Bookings

(millions)	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Bookings	$72.9	$125.9

Bookings decreased by $53.0 million or 42.1% for the quarter. The decrease in bookings is primarily attributable to the Company's French operations which had won $55 million in large project orders in the prior year comparable quarter to supply valves towards the construction of a nuclear power plant in the U.K. While bookings remained relatively flat if these orders are not taken into account, the Company's North American operations continue to struggle as the current highly competitive environment in many of its markets continues to put downward pressure on pricing and lead times, despite the fact that the outlook in most of these markets are beginning to show signs of improvement.

Gross profit

(millions)	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Gross profit	$17.3	$28.9
Gross profit percentage	16.9%	28.1%

Gross profit decreased by $11.6 million for the quarter, while the gross profit percentage decreased by 1,120 basis points from the prior year quarter. Despite the fact that sales remained relatively stable and that the Company maintained control over its labour and overhead costs, both the gross profit and the gross profit percentage decreased significantly due primarily to shipping a product mix with a greater proportion of projects with lower margins, a decrease in production which reduced the amount of current period direct labour and production overhead costs that could be capitalized, and warranty provisions. In addition, shipping delays due to customer-related and internal operational issues resulted in an increase in provisions for inventory ageing, which had a direct negative impact on the Company's margins. The lingering pricing pressure and the Company's inherent fixed overhead costs due to its large global manufacturing footprint continue to have a negative impact on its gross profit percentage, particularly in its North American operations which saw a 320 basis point increase in its material cost as a percentage of sales in the quarter. The Company aims to address these latter issues through its strategic initiatives, namely materials management, targeting higher margin segments and overhead reduction.

Administration costs

(millions)	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Administration costs*	$22.7	$19.0
As a percentage of sales	22.1%	18.5%
*Includes asbestos-related costs of:	$2.0	$1.2

Administration costs for the quarter increased by $3.7 million or 19.5% for the quarter. The increase is primarily attributable to an increase in sales commissions and freight charges as well as an increase in 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.

Net finance costs

(millions)	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Net finance costs	$0.1	$0.3

Net finance costs decreased by $0.2 million for the quarter. The Company did not incur any new long-term debt borrowings over the course of the quarter.

Income taxes

(in thousands, excluding percentages)	Three-month period ended February 28, 2018		Three-month period ended February 28, 2017	
	$	%	$	%
Income (loss) before income taxes	(5,333)	100.0	9,067	100.0
Tax calculated at domestic tax rates applicable to earnings in the respective countries	(605)	11.3	4,241	46.8
Tax effects of:				
Non-deductible (taxable) foreign exchange loss (gain)	(92)	1.7	(181)	(2.0)
Losses not tax effected	645	(12.1)	1,514	16.7
Losses utilized not previously tax effected	-	-	(158)	(1.8)
Benefit attributable to a financing structure	(230)	4.3	(220)	(2.4)
Effect of U.S. Tax Reform	4,259	(79.8)	-	-
Other	(292)	5.5	(215)	(2.4)
Provision for income taxes	3,685	(69.1)	4,981	54.9

U.S. Tax Reform was substantially enacted on December 22, 2017 under its official name "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018". As a result of the enactment of this legislation, the Company's U.S. subsidiary recorded a one-time tax expense of $4.3 million, of which $2.3 million was due to the new mandatory repatriation tax and $2.0 million was due to the effect of the tax rate reduction on its net deferred income tax assets.

Net earnings (loss)[1]

(millions)	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Net earnings (loss)[1]	$(8.2)	$3.7
As a percentage of sales	(8.0)%	3.6%
EBITDA[2]	$(1.2)	$12.6
As a percentage of sales	(1.2)%	12.3%

Net loss[1] amounted to $8.2 million or $0.38 per share compared to net earnings[1] of $3.7 million or $0.17 per share last year. EBITDA[2] amounted to a negative balance of $1.2 million or $0.05 per share compared to a positive balance of $12.6 million or $0.58 per share last year. Despite relatively stable sales in the quarter, the $11.9 million decrease in net earnings[1] is primarily attributable to significantly weaker margins, increased administration costs and the negative effects of the U.S. tax reform legislation passed during the current quarter, which resulted in a one-time tax expense inclusion of $4.3 million.

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

	As at February 28, 2018				
	Total $	Less than 1 year $	1 to 3 Years $	4 to 5 Years $	After 5 years $
Long-term debt	22,129	8,151	5,371	3,548	5,059
Accounts payable and accrued liabilities	63,411	63,411	-	-	-
Customer deposits	48,963	48,963	-	-	-
Accrual for performance guarantees	32,655	32,655	-	-	-
Bank indebtedness and short-term bank loans	21,922	21,922	-	-	-
Derivative liabilities	1,615	1,615	-	-	-

On February 28, 2018, the Company's order backlog was $464.5 million and its net cash[1] plus unused credit facilities amounted to $144.0 million, which it believes, along with future cash flows generated from operations, is sufficient to meet its financial obligations, increase its capacity, satisfy its working capital requirements, and execute on its business strategy. However, there can be no assurance that the risk of another sharp downturn in the economy will not materially adversely affect the Company's results of operations or financial condition. The Company continues to closely monitor the continued weakness of the price of oil and the euro currency, as well as recent trade protectionist measures and economic sanctions. The Company is in compliance with all covenants related to its debt and credit facilities.

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

Proposed transactions

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

[1] *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 2018	November 2017	February 2017	November 2016	February 2016
Net cash[1]	$61.0	$73.2	$72.5	$72.6	$82.0

The Company's net cash[1] decreased by $12.2 million or 16.7% over the course of the quarter and by $11.5 million or 15.9% since the beginning of the current fiscal year. This decrease is primarily attributable to cash used in operating activities, investments in property, plant and equipment, long-term debt repayments, as well as distributions to shareholders via dividends and share repurchases.

Cash provided by (used in) operating activities

(millions)	Fiscal Year ended February 28, 2018	Fiscal Year ended February 28, 2017	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Cash provided by (used in) operating activities	$(1.9)	$7.1	$(8.9)	$0.3

Cash used in operating activities amounted to $8.9 million for the current quarter compared to cash provided by operating activities of $0.3 million in the prior year. The current quarter's negative variance consisted of negative cash net losses[2] of $13.5 million and positive non-cash working capital movements of $4.6 million. Cash used in operating activities amounted to $1.9 million for the current year compared to cash provided by operating activities of $7.1 million in the prior year. The current year's negative variance consisted of negative cash net losses[2] of $12.5 million and positive non-cash working capital movements of $10.6 million.

Accounts receivable

(millions)	Fiscal Year ended February 28, 2018	Fiscal Year ended February 28, 2017	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Accounts receivable increase	$10.3	$5.9	$23.9	$21.9

Accounts receivable balances are a function of the timing of sales and cash collections. The accounts receivable balance increased in both the current quarter and fiscal year due primarily to a greater proportion of the Company's accounts receivable, which consist primarily of sales for large project orders that generally entail longer collection terms, being recorded closer to the end of the current quarter.

Inventories

(millions)	Fiscal Year ended February 28, 2018	Fiscal Year ended February 28, 2017	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Inventories decrease (increase)	$2.6	$(10.6)	$12.8	$6.0
Customer deposits increase	$5.7	$15.8	$2.8	$5.8

Inventories typically increase in times of rising backlog and order bookings and decrease when the opposite occurs. Inventories are also a function of timing between receipts and shipments. For the current quarter and fiscal year, inventories decreased since the Company had large shipments closer to the end of the quarter without replenishing its stock. In order to help finance its investment in inventories, the Company, where possible, obtains customer deposits for large orders. Customer deposits increased for both the current quarter and fiscal year due to higher customer deposits on certain large export project orders in the Company's North American and German operations.

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

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

Accounts payable and accrued liabilities

(millions)	Fiscal Year ended February 28, 2018	Fiscal Year ended February 28, 2017	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Accounts payable and accrued liabilities (decrease) increase	$3.2	$(2.3)	$(0.8)	$1.7

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, 2018	Fiscal Year ended February 28, 2017	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Additions to property, plant and equipment	$6.2	$7.7	$1.8	$1.7

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

Long-term debt

(millions)	Fiscal Year ended February 28, 2018	Fiscal Year ended February 28, 2017	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Increase in long-term debt	$ -	$5.1	$ -	$5.1
Repayment of long-term debt	$3.2	$5.9	$0.9	$0.6

During the current quarter and fiscal year, the Company continued to pay down its outstanding long-term debt without undertaking any new debt issuances.

Dividends paid and repurchase of shares

(millions)	Fiscal Year ended February 28, 2018	Fiscal Year ended February 28, 2017	Three-month period ended February 28, 2018	Three-month period ended February 28, 2017
Dividends paid	$6.7	$6.6	$1.7	$1.6
Repurchase of shares	$0.6	$0.9	$ -	$0.6

While, the Company maintained its current dividend policy of CA$0.10 per share per quarter in the current fiscal year, it adjusted it down to CA$0.03 per share per quarter, beginning in June 2018. Furthermore, pursuant to its Normal Course Issuer Bid, the Company repurchased for cancellation a total of 45,300 Subordinate Voting Shares for a cash consideration of $0.6 million over the course of the current fiscal year. None of these repurchases occurred in the current quarter.

FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

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

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

Risk overview

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

	Risks			
	Market			
Financial instrument	**Currency**	**Interest rate**	**Credit**	**Liquidity**
Cash and cash equivalents	x	x	x	
Short-term investments	x	x	x	
Accounts receivable	x		x	
Derivative assets	x		x	
Bank indebtedness	x	x		x
Short-term bank loans	x	x		x
Accounts payable and accrued liabilities	x			x
Customer deposits	x			x
Dividend payable	x			x
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, 2018 and 2017 are as follows:

	Range of exchange rates		Gain (loss) (In thousands of U.S. dollars)		Notional amount (In thousands of indicated currency)	
	February 28, 2018	**February 28, 2017**	**February 28, 2018 $**	**February 28, 2017 $**	**February 28, 2018**	**February 28, 2017**
Foreign exchange forward contracts						
Sell US$ for CA$ – 0 to 12 months	1.26-1.28	1.32	(1,558)	(615)	US$92,000	US$40,000
Buy US$ for CA$ – 0 to 12 months	1.25	1.30-1.31	433	337	US$92,000	US$40,000
Sell US$ for € – 0 to 12 months	1.18-1.19	1.09-1.16	(2)	(20)	US$2,190	US$336
Buy US$ for € – 0 to 12 months	1.18-1.24	1.06-1.28	92	249	US$4,785	US$4,295
Sell US$ for KW – 0 to 12 months	-	1,193-1,200	-	99	-	US$1,668
Sell € for US$ – 0 to 12 months	1.24-1.28	1.06-1.08	(39)	(155)	€16,297	€16,122
Buy € for US$ – 0 to 12 months	1.18	1.06-1.08	64	509	€15,390	€33,600
Buy £ for € – 0 to 12 months	0.89	0.84-0.85	(1)	(1)	£281	£144

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

The following table provides a sensitivity analysis of the Company's most significant foreign exchange exposures related to its net position in the foreign currency financial instruments, which includes cash and cash equivalents, short-term investments bank indebtedness, short-term bank loans, derivative financial instruments, accounts receivable, accounts payable and accrued liabilities, customer deposits, accrual for performance guarantees and long-term debt, including interest payable. A hypothetical strengthening of 5.0% of the following currencies would have had the following impact for the fiscal years ended February 28, 2018 and 2017:

	Net income (loss)	
	2018 $	**2017 $**
Canadian dollar strengthening against the U.S. dollar	(524)	(121)
Euro strengthening against the U.S. dollar	396	496

A hypothetical weakening of 5.0% of the above currencies would have had the opposite impact for both fiscal years.

For the purposes of the above analysis, foreign exchange exposure does not include the translation of subsidiaries into the Company's reporting currency. For those subsidiaries whose functional currency is other than the reporting currency (U.S. dollar) of the Company, such exposure would impact other comprehensive income or loss.

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, 2018, four (2017 – four) customers accounted for more than 5% each of its trade accounts receivable, of which one customer accounted for 9.6% (2017 – 8.5%), and the Company's ten largest customers accounted for 57.3% (2017 – 52.4%). In addition, one customer accounted for 9.86% of the Company's sales (2017 – 13.3%).

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, 2018 $	As at February 28, 2017 $
Current	91,534	77,262
Past due 0 to 30 days	12,421	19,330
Past due 31 to 90 days	8,546	7,625
Past due more than 90 days	18,714	16,508
	131,215	120,725
Less: Allowance for doubtful accounts	1,088	1,239
Trade accounts receivable	130,127	119,486
Other receivables	7,255	6,026
Total accounts receivable	137,382	125,512

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

	As at February 28, 2018 $	As at February 28, 2017 $
Balance – Beginning of year	1,239	1,653
Bad debt expense	212	414
Recoveries of trade accounts receivable	(444)	(598)
Write-off of trade accounts receivable	(122)	(214)
Foreign exchange	203	(16)
Balance – End of year	1,088	1,239

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. 1,190 claims were outstanding at the end of the reporting period (February 28, 2017 – 1,146). These claims were filed in the states of Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Missouri, New Jersey, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Texas, Virginia, Washington, West Virginia and Wisconsin. During the current fiscal year, the Company resolved 457 claims (February 28, 2017 – 376) and was the subject of 501 new claims (February 28, 2017 – 488). 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 $1,960 for the quarter (February 28, 2017 - $1,186) and $8,213 for the year (February 28, 2017 - $6,839).

On December 3, 2014, San Diego Gas & Electric Company ("SDG") filed a claim against Velan Valve Corp., a wholly- owned subsidiary of the Company, in the Superior Court of the State of California, concerning high pressure valves supplied to SDG and installed at its Palomar Energy Center ("Facility"). This lawsuit alleges damages to the Facility in excess of $9,000 related to allegedly defective valves supplied by Velan Valve Corp. The claim is for alleged strict product liability and alleged negligence. It is the Company's position that this claim is without merit. The Company is vigorously defending its position and is undertaking all actions necessary to protect its reputation. While the Company cannot predict the final outcome of this claim, based on information currently available, the Company believes the resolution of this claim will not have a material adverse effect on its financial position, results of operations or liquidity.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has entered into certain off-balance sheet arrangements. They are fully described in notes 10, 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 the Company's plants.

	Three months ended		Twelve months ended	
	Feb. 28, 2018	Feb. 28, 2017	Feb. 28, 2018	Feb. 28, 2017
Purchases of material components	$900	$150	$1,230	$955
Sales of raw material	$-	$-	$-	$8

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) 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. Note that this lease agreement was terminated over the course of the current fiscal year.

	Three months ended		Twelve months ended	
	Feb. 28, 2018	Feb. 28, 2017	Feb. 28, 2018	Feb. 28, 2017
Rent	$-	$9	$12	$27

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, 2018 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 (2013)"* 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, 2018.

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, 2018 that have materially affected, or are reasonably likely to have materially affected, the Company's internal control over financial reporting.

CRITICAL ACCOUNTING ESTIMATES & ASSUMPTIONS

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.

Inventories
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.

Impairment of non-financial assets
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. 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.

CRITICAL JUDGEMENTS IN APPLYING THE COMPANY'S ACCOUNTING POLICIES

Consolidation
The Company consolidates the accounts of Juwon Special Steel Co. Ltd. in these financial statements. It was determined that the Company has substantive rights over this structured entity that are currently exercisable and for which there is no barrier, despite the fact that its percentage ownership in this entity is only 50%. These substantive rights are obtained through the shareholders' agreement signed between the Company and the non-controlling interest which gives the Company the ultimate decision right on any decision taken for which both parties in the joint arrangement are not in agreement. As per the shareholders' agreement, the Board of Directors, representing the interests of shareholders, has responsibility to establish operating decisions (including budgets), approve capital transactions and determine key management personnel remuneration. Consequently, the Company, through its rights set out in the shareholders' agreement, has substantive rights that give it the ability to direct the relevant activities of Juwon Special Steel Co. Ltd. while being exposed to variable returns. As such, it was determined that this entity should be consolidated.

ACCOUNTING STANDARDS AND AMENDMENTS ADOPTED IN THE YEAR

The Company has applied the following standards and amendments for the first time in the fiscal year, starting on March 1st, 2017.

(i) Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12; and

(ii) Disclosure initiative – amendments to IAS 7.

The adoption of these amendments did not have a significant impact on the amounts recognized in prior periods. The amendments also do not affect the current or future periods significantly. The amendments to IAS 7 require disclosure of changes in liabilities arising from financing activities, which is presented in note 29.

ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

(i) In July 2014, the IASB issued IFRS 9, *Financial Instruments*. The IASB has previously published versions of IFRS 9 that introduced new classification and measurement requirements (in 2009 and 2010) and a new hedge accounting model (in 2013). The July 2014 publication represents the final version of the Standard, replaces earlier versions of IFRS 9 and substantially completes the IASB's project to replace IAS 39, *Financial Instruments: Recognition and Measurement*.

This standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only three classification categories: amortized cost and fair value through other comprehensive income and fair value through profit or loss. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset or liability. The standard introduces a new, expected loss impairment model that will require more timely recognition of expected credit losses. Specifically, the new Standard requires entities to account for expected credit losses from when financial instruments are first recognised and it lowers the threshold for recognition of full lifetime expected losses. The new standard also introduces a substantially-reformed model for hedge accounting with enhanced disclosures about risk management activity and aligns hedge accounting more closely with risk management. The new standard is effective for annual periods beginning on or after January 1, 2018 with earlier adoption permitted. The Company is in the final stages of analyzing the impact of the adoption of this new standard. The impact is not expected to be material.

(ii) IFRS 15, *Revenue from Contracts with Customers*, was issued in May 2014 and specifies how and when revenue will be recognized as well as requiring the provision of more informative and relevant disclosures. Its core principle is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This core principle is delivered in a five-step model framework: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. IFRS 15 replaces IAS 11, *Construction contracts*, IAS 18, *Revenue*, IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and SIC-31, *Revenue - Barter Transactions Involving Advertising Services*.

The new standard is effective for annual periods beginning on or after January 1, 2018 with earlier adoption permitted. For the Company, the standard comes into effect on March 1, 2018. As a result, IFRS 15 will be adopted in the first quarter of the fiscal year ending February 28, 2019. At that time, the Company plans to use the retrospective transition alternative whereby it will restate its comparative results for the current year, with an opening adjustment to retained earnings as at March 1, 2017, if applicable.

The Company has determined that late delivery penalties, which are currently recorded as an expense in cost of sales, will be recorded as a reduction of sales when this standard comes into effect. The preliminary assessment of the effect of this change on the current year's results is a $1,452 decrease in consolidated sales and a corresponding decrease in consolidated cost of sales.

The new standard will not have a significant impact on the timing of the Company's revenues from the sale of goods as most of such revenues will continue to be recognized upon the delivery of the said goods as per the agreed-upon shipping terms. However, if certain criteria are met, the Company has determined that separate elements in a sale of goods contract

may be classified as separate performance obligations. These could include, but are not limited to the delivery of drawings and documentation, the provision of services (commissioning, inspection, shipping and testing), and warranties. The preferred method of allocating revenue to multiple elements in a sale of goods contract where separate performance obligations have been identified will be the adjusted market assessment approach. While the above changes may have an impact on revenues in future fiscal years, the Company has determined that they will not have a material impact on the current and prior years' consolidated revenues.

(iii) In January 2016, the IASB issued IFRS 16, *Leases*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract. It eliminates the classification of leases as either operating leases or finance leases and introduces a single lessee accounting model. It also substantially carries forward the lessor accounting requirements. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. IFRS 16 replaces IAS 17, *Leases*, IFRIC 4, *Determining whether an Arrangement contains a Lease*, SIC-15, *Operating Leases – Incentives*, and SIC-27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. The new standard is effective for annual periods beginning on or after January 1, 2019 with earlier adoption permitted only if IFRS 15 has been adopted. While the Company is currently assessing the impact of this new standard, it has determined that it will not early adopt it. The operating leases, as disclosed in the commitment note of the Company's annual financial statements (note 22 (c)) are within the scope of IFRS 16.

(iv) In November 2016, the IFRS Interpretations Committee ("IFRIC") issued IFRIC 22, *Foreign Currency Transactions and Advance Consideration*. This interpretation addresses the exchange rate to use when reporting transactions that are denominated in a foreign currency in accordance with IAS 21, *The Effects of Changes in Foreign Exchange Rates*, in the circumstance in which a customer paid for goods or services in advance. The interpretation is effective for annual periods beginning on or after January 1, 2018 with earlier adoption permitted. For the Company, the interpretation comes into effect on March 1, 2018. As a result, IFRIC 22 will be adopted in the first quarter of the fiscal year ending February 28, 2019.

(v) In June 2017, IFRIC issued IFRIC 23, *Uncertainty over Income Tax Treatments*. This interpretation clarifies how the recognition and measurement requirements of IAS 12, *Income Taxes*, are applied where there is uncertainty over income tax treatments that have yet to be accepted by tax authorities. The interpretation is effective for annual periods beginning on or after January 1, 2019 with earlier adoption permitted. While the Company is currently assessing the impact of this new standard, it has determined that it will not early adopt it.

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, such as the current downturn in the oil and gas industry, 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 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 become, from time to time, in short supply for periods 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. There are uncertainties with regards to the outcome of trilateral negotiations regarding the North American Free Trade Agreement ("NAFTA") as well as of Brexit negotiations, and such processes could derail at any time. The Company's business and operating results could be adversely impacted by trade protection measures resulting from breakdowns in NAFTA and Brexit negotiations, as well as from changes in tax laws, possibility of expropriation and embargo, foreign exchange restrictions and political, military and/or terrorist disruptions or changes in regulatory environments.

NAFTA negotiations may potentially impact the price and demand of steel as well as the potential for the imposition of quotas or of a tax on the importation of goods into the United States.

Canada and ten other countries recently concluded discussions and agreed on the draft text of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("CPTPP"), which is intended to allow for preferential market access among the countries that are parties to the CPTPP. The text of CPTPP has not been finalized or published and the agreement remains subject to ratification by the governments of the countries that are parties to the CPTPP. It is uncertain what effect CPTPP will have on the Company, its customers, its suppliers and the industrial products industry.

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 92.8% 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, which may negatively affect the price and liquidity of the Subordinated Voting Shares. 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 negatively impact upon the market price and liquidity of the Subordinate Voting Shares.

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.

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 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.

Cybersecurity
The Company's information technology networks are critical to the day-to-day operation of its business, and include information about its finances, employees, products, customers and suppliers. Cybersecurity risks are becoming increasingly sophisticated, varied and numerous. The potential consequences of a material cybersecurity breach could include loss of key information, reputational damage and disruption of operations, with consequential material negative financial consequences. While the Company devotes substantial resources to maintaining and securing its information technology networks, there can be no assurance that it will be able to prevent, detect or respond to a potential breach of its information technology networks because of, among other things, the evolving nature of cybersecurity threats, the difficulty in anticipating such threats and the difficulty in immediately detecting all such threats.

RECONCILIATIONS OF NON-IFRS MEASURES

In this MD&A and other sections of the 2018 Annual Report, 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

(in thousands)	As at Feb. 28, 2018	As at Nov. 30, 2017	As at Feb. 28, 2017	As at Nov. 30, 2016	As at Feb. 29, 2016	As at Feb. 28, 2015	As at Feb. 28, 2014
Cash and cash equivalents	85,391	88,241	84,019	81,303	89,368	99,578	106,716
Short-term investments	647	1,461	974	149	3,225	847	239
Bank indebtedness	(20,848)	(12,220)	(7,792)	(4,960)	(5,028)	(15,616)	(31,876)
Short-term bank loans	(1,074)	(1,086)	(1,650)	(1,313)	(1,319)	(2,134)	(916)
Current portion of long-term bank borrowings	(3,068)	(3,148)	(3,070)	(2,558)	(4,197)	(7,063)	(6,402)
	61,048	73,248	72,481	72,621	82,049	75,612	67,761

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

(in thousands)

For the fiscal year ended:	Feb. 28, 2018	Feb. 28, 2017	Feb. 29, 2016	Feb. 28, 2015	Feb. 28, 2014
Net income (loss) attributable to Subordinate Voting Shares and Multiple Voting Shares	(17,811)	7,737	3,641	18,580	29,400
Adjustments for:					
Goodwill impairment loss	-	-	11,510	-	-
Depreciation of property, plant and equipment	11,035	11,943	13,301	13,749	12,241
Amortization of intangible assets	1,842	1,767	2,008	2,374	2,525
Finance costs (income) - net	197	74	(199)	590	1,510
Income taxes	361	4,680	8,302	9,773	11,759
	(4,376)	26,201	38,563	45,066	57,435

For the quarter ended:	Feb. 28, 2018	Feb. 28, 2017
Net income (loss) attributable to Subordinate Voting Shares and Multiple Voting Shares	(8,221)	3,707
Adjustments for:		
Depreciation of property, plant and equipment	2,792	3,156
Amortization of intangible assets	545	467
Finance costs (income) - net	64	295
Income taxes	3,685	4,981
	(1,135)	12,606

Velan Inc.

Consolidated Financial Statements
For the years ended February 28, 2018 and 2017

May 24, 2018

Independent Auditor's Report

To the Shareholders of
Velan Inc.

We have audited the accompanying consolidated financial statements of Velan Inc., which comprise the consolidated statements of financial position as at February 28, 2018 and 2017 and the consolidated statements of income (loss), comprehensive income (loss), changes in equity and 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.

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

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

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Velan Inc. as at February 28, 2018 and 2017 and its financial performance and its 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

As at February 28, 2018 and 2017
(in thousands of U.S. dollars)

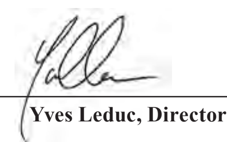
	February 28, 2018 $	February 28, 2017 $
Assets		
Current assets		
Cash and cash equivalents	85,391	84,019
Short-term investments	647	974
Accounts receivable	137,382	125,512
Income taxes recoverable	8,012	7,145
Inventories (note 5)	170,790	173,089
Deposits and prepaid expenses	4,222	3,391
Derivative assets	604	1,202
	407,048	395,332
Non-current assets		
Property, plant and equipment (notes 7 and 12)	89,864	91,535
Intangible assets and goodwill (notes 4 and 8)	20,210	19,023
Deferred income taxes (note 20)	22,034	12,951
Other assets	1,037	456
	133,145	123,965
Total assets	540,193	519,297
Liabilities		
Current liabilities		
Bank indebtedness (note 10)	20,848	7,792
Short-term bank loans	1,074	1,650
Accounts payable and accrued liabilities (note 9)	63,441	60,641
Income taxes payable	2,186	946
Dividend payable	1,678	1,631
Customer deposits	48,963	43,953
Provisions (note 11)	10,798	10,600
Accrual for performance guarantees	32,655	26,943
Derivative liabilities	1,615	799
Current portion of long-term debt (note 12)	8,151	7,115
	191,409	162,070
Non-current liabilities		
Long-term debt (note 12)	13,978	15,318
Income taxes payable	2,078	-
Deferred income taxes (note 20)	2,889	2,784
Other liabilities	8,222	7,214
	27,167	25,316
Total liabilities	218,576	187,386
Equity		
Equity attributable to Subordinate and Multiple Voting shareholders		
Share capital (note 13)	73,090	73,584
Contributed surplus	6,057	6,017
Retained earnings	256,668	281,343
Accumulated other comprehensive loss	(19,790)	(35,550)
	316,025	325,394
Non-controlling interests (note 6)	5,592	6,517
Total equity	321,617	331,911
Total liabilities and equity	540,193	519,297

Commitments and contingencies (note 22)

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

Approved by the Board of Directors

T.C. Velan, Director



Yves Leduc, Director

Velan Inc.

Consolidated Statements of Income (Loss)

For the years ended February 28, 2018 and 2017
(in thousands of U.S. dollars, excluding per share amounts)

	2018 $	2017 $
Sales (notes 14 and 24)	337,963	331,777
Cost of sales (notes 5, 14, 15 and 19)	269,378	243,249
Gross profit	68,585	88,528
Administration costs (notes 16 and 19)	85,437	75,868
Other expense (income)	1,463	(408)
Operating profit (loss)	(18,315)	13,068
Finance income	1,102	992
Finance costs	(1,299)	(1,066)
Finance costs – net	(197)	(74)
Income (loss) before income taxes	(18,512)	12,994
Income taxes (note 20)	361	4,680
Net income (loss) for the year	(18,873)	8,314
Net income (loss) attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	**(17,811)**	**7,737**
Non-controlling interests	(1,062)	577
	(18,873)	8,314
Earnings (loss) per share (note 21)		
Basic	(0.82)	0.36
Diluted	(0.82)	0.36
Dividends declared per Subordinate and Multiple Voting Share	0.31 (CA$0.40)	0.31 (CA$0.40)

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, 2018 and 2017
(in thousands of U.S. dollars)

	2018 $	2017 $
Comprehensive income (loss)		
Net income (loss) for the year	(18,873)	8,314
Other comprehensive income (loss)		
Foreign currency translation adjustment on foreign operations whose functional currency is other than the reporting currency (U.S. dollar)	15,938	(2,014)
Comprehensive income (loss)	(2,935)	6,300
Comprehensive income (loss) attributable to:		
Subordinate Voting Shares and Multiple Voting Shares	(2,051)	5,276
Non-controlling interests	(884)	1,024
	(2,935)	6,300

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

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, 2018 and 2017
(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 interests	Total equity
Balance - February 29, 2016	74,345	5,941	(33,089)	280,380	327,577	5,542	333,119
Net income for the year	-	-	-	7,737	7,737	577	8,314
Other comprehensive income (loss)	-	-	(2,461)	-	(2,461)	447	(2,014)
	74,345	5,941	(35,550)	288,117	332,853	6,566	339,419
Effect of share-based compensation (note 13(d))	-	76	-	-	76	-	76
Dividends							
Multiple Voting Shares	-	-	-	(4,745)	(4,745)	-	(4,745)
Subordinate Voting Shares	-	-	-	(1,864)	(1,864)	-	(1,864)
Non-controlling interests	-	-	-	-	-	(49)	(49)
Share repurchase (note 13(c))	(761)	-	-	(165)	(926)	-	(926)
Balance - February 28, 2017	73,584	6,017	(35,550)	281,343	325,394	6,517	331,911
Net loss for the year	-	-	-	(17,811)	(17,811)	(1,062)	(18,873)
Other comprehensive income	-	-	15,760	-	15,760	178	15,938
	73,584	6,017	(19,790)	263,532	323,343	5,633	328,976
Effect of share-based compensation (note 13(d))	-	40	-	-	40	-	40
Dividends							
Multiple Voting Shares	-	-	-	(4,824)	(4,824)	-	(4,824)
Subordinate Voting Shares	-	-	-	(1,904)	(1,904)	-	(1,904)
Non-controlling interests	-	-	-	-	-	(41)	(41)
Share repurchase (note 13(c))	(494)	-	-	(136)	(630)	-	(630)
Balance - February 28, 2018	73,090	6,057	(19,790)	256,668	316,025	5,592	321,617

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

Velan Inc.

Consolidated Statements of Cash Flows

For the years ended February 28, 2018 and 2017
(in thousands of U.S. dollars)

Cash flows from	2018 $	2017 $
Operating activities		
Net income (loss) for the year	(18,873)	8,314
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities (note 27)	6,994	10,267
Changes in non-cash working capital items (note 28)	9,986	(11,434)
Cash provided by (used in) operating activities	(1,893)	7,147
Investing activities		
Short-term investments	327	2,251
Additions to property, plant and equipment	(6,202)	(7,721)
Additions to intangible assets	(437)	(910)
Proceeds on disposal of property, plant and equipment, and intangible assets	141	399
Net change in other assets	(507)	482
Cash used in investing activities	(6,678)	(5,499)
Financing activities		
Dividends paid to Subordinate and Multiple Voting shareholders	(6,681)	(6,584)
Dividends paid to non-controlling interests	(41)	(49)
Repurchase of shares (note 13(c))	(630)	(926)
Short-term bank loans (note 29)	(576)	331
Increase in long-term debt (note 29)	-	5,079
Repayment of long-term debt (note 29)	(3,206)	(5,904)
Cash used in financing activities	(11,134)	(8,053)
Effect of exchange rate differences on cash	8,021	(1,708)
Net change in cash during the year	(11,684)	(8,113)
Net cash – Beginning of the year	76,227	84,340
Net cash – End of the year	64,543	76,227
Net cash is composed of:		
Cash and cash equivalents	85,391	84,019
Bank indebtedness	(20,848)	(7,792)
	64,543	76,227
Supplementary information		
Interest received	532	641
Income taxes paid	(3,752)	(7,722)

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 its subsidiaries. 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, Montreal, 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 24, 2018.

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 (note 6).

Consolidation

These financial statements represent the consolidation of the accounts of the Company and its subsidiaries. Control exists when the Company is exposed to, or has rights to, variable returns from its involvement with an investee, including a structured entity, and has the ability to affect those returns through its power to direct the activities of an investee. Subsidiaries are fully consolidated from the date control has been transferred to the Company and deconsolidated from the date control ceases.

All subsidiaries 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 subsidiaries translate foreign currency transactions and balances into their functional currencies. 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 (loss) for the year.

Translation of accounts of foreign subsidiaries

The financial statements of the Company's foreign subsidiaries 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 (loss) 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 (loss) 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 subsidiaries 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 4.3% on an annual basis. Interest is paid on bank indebtedness at rates ranging from 1.2% to 3.5%.

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 1.0% to 8.8%.

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 (loss) 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.

Amortization expense is recognized in the consolidated statement of income (loss) 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	5 to 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.

Impairment of non-financial assets

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 or CGU's fair value less costs of disposal 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. Taxes are recognized in the consolidated statement of income (loss), except to the extent that it relates to items recognized in other comprehensive income (loss) or directly in equity, in which case the taxes are recognized in other comprehensive income (loss) or equity, respectively.

Current income taxes

The current income taxes 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 taxes payable is recognized for any

taxes payable in the current period. Current tax liabilities are recognized for current taxes to the extent that they remain 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 taxes

Deferred income taxes are 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 taxes are not accounted for if they arise 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 taxes are 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 taxes are provided on temporary differences arising on investments in subsidiaries, 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 income 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 income 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, 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 (loss) 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, performance share units (“PSUs”) and deferred share units (“DSUs”).

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-quarter per year over four years from the grant date. This non-market performance condition is factored into the estimate of the number of options expected to vest. If 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.

PSUs and DSUs

PSUs and DSUs may be granted to certain of its independent directors and full-time employees as part of their long-term compensation package entitling them to receive payout in cash based on the Company’s share price at the relevant time. A liability for PSUs and DSUs is measured at fair value on the grant date and is subsequently adjusted at each balance sheet date for changes in fair value according to the estimation made by management of the number of PSUs and DSUs that will eventually vest. The liability is recognized to accounts payable and accrued liabilities over the vesting period, with a corresponding charge to compensation expense.

Critical accounting estimates and assumptions

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.

Inventories

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.

Impairment of non-financial assets

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. 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.

Critical judgements in applying the Company's accounting policies

Consolidation

The Company consolidates the accounts of Juwon Special Steel Co. Ltd. in these financial statements. It was determined that the Company has substantive rights over this structured entity that are currently exercisable and for which there is no barrier, despite the fact that its percentage ownership in this entity is only 50%. These substantive rights are obtained through the shareholders' agreement signed between the Company and the non-controlling interest which gives the Company the ultimate decision right on any decision taken for which both parties in the joint arrangement are not in agreement. As per the shareholders' agreement, the Board of Directors, representing the interests of shareholders, has responsibility to establish operating decisions (including budgets), approve capital transactions and determine key management personnel remuneration. Consequently, the Company, through its rights set out in the shareholders' agreement, has substantive rights that give it the ability to direct the relevant activities of Juwon Special Steel Co. Ltd. while being exposed to variable returns. As such, it was determined that this entity should be consolidated.

3 New accounting standards and amendments

New accounting standards and amendments adopted in the year

The Company has applied the following standards and amendments for the first time in the fiscal year, starting on March 1st, 2017.

(i) Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12; and

(ii) Disclosure initiative – amendments to IAS 7.

The adoption of these amendments did not have a significant impact on the amounts recognized in prior periods. The amendments also do not affect the current or future periods significantly. The amendments to IAS 7 require disclosure of changes in liabilities arising from financing activities, which is presented in note 29.

New accounting standards and amendments issued but not yet adopted

(i) In July 2014, the IASB issued IFRS 9, *Financial Instruments*. The IASB has previously published versions of IFRS 9 that introduced new classification and measurement requirements (in 2009 and 2010) and a new hedge accounting model (in 2013). The July 2014 publication represents the final version of the Standard, replaces earlier versions of IFRS 9 and substantially completes the IASB's project to replace IAS 39, *Financial Instruments: Recognition and Measurement*.

This standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only three classification categories: amortized cost and fair value through other comprehensive income and fair value through profit or loss. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset or liability. The standard introduces a new, expected loss impairment model that will require more timely recognition of expected credit losses. Specifically, the new Standard requires entities to account for expected credit losses from when financial instruments are first recognised and it lowers the threshold for recognition of full lifetime expected losses. The new standard also introduces a substantially-reformed model for hedge accounting with enhanced disclosures about risk management activity and aligns hedge accounting more closely with risk management.

The new standard is effective for annual periods beginning on or after January 1, 2018 with earlier adoption permitted. The Company is in the final stages of analyzing the impact of the adoption of this new standard. The impact is not expected to be material.

(ii) IFRS 15, *Revenue from Contracts with Customers*, was issued in May 2014 and specifies how and when revenue will be recognized as well as requiring the provision of more informative and relevant disclosures. Its core principle is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This core principle is delivered in a five-step model framework: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. IFRS 15 replaces IAS 11, *Construction contracts*, IAS 18, *Revenue*, IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and SIC-31, *Revenue - Barter Transactions Involving Advertising Services*.

The new standard is effective for annual periods beginning on or after January 1, 2018 with earlier adoption permitted. For the Company, the standard comes into effect on March 1, 2018. As a result, IFRS 15 will be adopted in the first quarter of the fiscal year ending February 28, 2019. At that time, the Company plans to use the retrospective transition alternative whereby it will restate its comparative results for the current year, with an opening adjustment to retained earnings as at March 1, 2017, if applicable.

The Company has determined that late delivery penalties, which are currently recorded as an expense in cost of sales, will be recorded as a reduction of sales when this standard comes into effect. The preliminary assessment of the effect of this change on the current year's results is a $1,452 decrease in consolidated sales and a corresponding decrease in consolidated cost of sales.

The new standard will not have a significant impact on the timing of the Company's revenues from the sale of goods as most of such revenues will continue to be recognized upon the delivery of the said goods as per the agreed-upon shipping terms. However, if certain criteria are met, the Company has determined that separate elements in a sale of goods contract may be classified as separate performance obligations. These could include, but are not limited to the delivery of drawings and documentation, the provision of services (commissioning, inspection, shipping and testing), and warranties. The preferred method of allocating revenue to multiple elements in a sale of goods contract where separate performance obligations have been identified will be the adjusted market assessment approach. While the above changes may have an impact on revenues in future fiscal years, the Company has determined that they will not have a material impact on the current and prior years' consolidated revenues.

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

The new standard is effective for annual periods beginning on or after January 1, 2019 with earlier adoption permitted only if IFRS 15 has been adopted. While the Company is currently assessing the impact of this new standard, it has determined that it will not early adopt it. The operating leases, as disclosed in the commitment note (note 22 (c)) are within the scope of IFRS 16.

(iv) In November 2016, the IFRS Interpretations Committee ("IFRIC") issued IFRIC 22, *Foreign Currency Transactions and Advance Consideration*. This interpretation addresses the exchange rate to use when reporting transactions that are denominated in a foreign currency in accordance with IAS 21, *The Effects of Changes in Foreign Exchange Rates*, in the circumstance in which a customer paid for goods or services in advance.

The interpretation is effective for annual periods beginning on or after January 1, 2018 with earlier adoption permitted. For the Company, the interpretation comes into effect on March 1, 2018. As a result, IFRIC 22 will be adopted in the first quarter of the fiscal year ending February 28, 2019.

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

The interpretation is effective for annual periods beginning on or after January 1, 2019 with earlier adoption permitted. While the Company is currently assessing the impact of this new standard, it has determined that it will not early adopt it.

4 Intangible asset and goodwill impairment analysis

Intangible asset impairment test at February 28, 2017

As a result of losses incurred by the Company's Italian subsidiary, ABV, the Company determined that there was an indication that the amortizable intangible assets associated with this CGU may be impaired at February 28, 2017. As

such, the Company tested for impairment the carrying amount of such intangible assets, which consists primarily of patents, products and designs, as well as customer lists. Based on this test, the Company determined that the recoverable amount of such assets exceeded the carrying amount of $15,578 by $4,898. Accordingly, no intangible asset impairment loss was recorded for this CGU at February 28, 2017.

The recoverable amount was determined based on the fair value less costs of disposal 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 four-year period taking into consideration the following assumptions and trends:

- Expected Earnings before interest, taxes, depreciation and amortization ("EBITDA") as a percentage of sales for the CGU of 6.8% in 2018, 7.9% in 2019, 10.1% in 2020, and 14.7% in 2021.
- 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 $530 in 2018, 2019 and 2020, and $1,060 for 2021.

The discounted cash flow model was established using a discount rate of 18.0% and a terminal growth rate of 2%.

After three successive years of positive earnings, ABV incurred a significant loss in the current fiscal year. This loss was primarily due to a large project order, which was expected to ship in 2017, but is now expected to ship in 2018. As a result, management revised its assumptions related to sales and expected EBITDA that were used in the prior year to test the goodwill related to this CGU in order to account for this delay. All other assumptions remained relatively consistent with the prior year.

The following table provides a sensitivity analysis of the Company's recoverable amount of the intangible assets 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	(2,577)
Increase in discount rate	1,354
Increase in terminal growth rate	(1,106)

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 intangible assets associated with the CGU related to its ABV subsidiary:

	Decrease (Increase) in recoverable amount $
Decrease in expected EBITDA as a percentage of sales	2,550
Decrease in discount rate	(1,541)
Decrease in terminal growth rate	976

Summarized below is the amount by which each key assumption must change, after incorporating consequential effects of the change on the other variables used to measure the recoverable amount, in order for the CGU's recoverable amount to be equal to its carrying amount:

- Decrease of 1.25% in the expected EBITDA as a percentage of sales for the CGU for each referenced year.
- Increase in working capital cash absorption ratio for the CGU from 19% to 24.3% of annual incremental sales increases.
- Increase in expected discount rate from 18.0% to 22.4%.
- Decrease of expected terminal growth rate from 2% to -4.7%.

Goodwill impairment test at February 28, 2018

In the context of its annual impairment testing, 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.

The Company 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 significantly exceeded the carrying amount of $9,493 by $69,309. Accordingly, no goodwill impairment loss was recorded for this CGU at February 28, 2018.

The recoverable amount was determined based on the fair value less costs of disposal 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 three-year period taking into consideration the following assumptions and trends:

- Expected EBITDA as a percentage of sales for the CGU of 21.8% in 2019, 20.7% in 2020, and 18.9% in 2021.
- 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 $1,880 in 2019, 2020 and 2021.

The discounted cash flow model was established using a discount rate of 15.0% and a terminal growth rate of 2%.

Management based its selection of assumptions upon its assessment of the ability of the CGU to deliver on its past levels of growth and profitability based on its current backlog of orders, as well as its evaluation of the longer term potential of its key end-user markets, particularly nuclear power and cryogenics. The margin assumptions used were in line with actual margins generated by the CGU in prior years.

Goodwill impairment test at February 28, 2017

In the context of its annual impairment testing, 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.

The Company 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 significantly exceeded the carrying amount of $8,236 by $52,039. Accordingly, no goodwill impairment loss was recorded for this CGU at February 28, 2017.

The recoverable amount was determined based on the fair value less costs of disposal 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 three-year period taking into consideration the following assumptions and trends:

- Expected EBITDA as a percentage of sales for the CGU of 22.1% in 2018, 20.8% in 2019, and 17.8% in 2020.
- 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 $2,119 in 2018, 2019 and 2020.

The discounted cash flow model was established using a discount rate of 15.0% and a terminal growth rate of 2%.

Management based its selection of assumptions upon its assessment of the ability of the CGU to deliver on its past levels of growth and profitability based on its current backlog of orders, as well as its evaluation of the longer term potential of its key end-user markets, particularly nuclear power and cryogenics. The margin assumptions used were in line with actual margins generated by the CGU in prior years.

5 Inventories

	As at February 28, 2018 $	As at February 28, 2017 $
Raw materials	32,381	33,621
Work in process and finished parts	101,629	94,562
Finished goods	36,780	44,906
	170,790	173,089

As a result of variations in the ageing of its inventories, the Company recognized a net additional inventory provision for the year of $828 (2017 – $2,146), including reversals of $5,476 (2017 – $6,555).

6 Subsidiaries and transactions with non-controlling interests

a) Interest in subsidiaries

Set out below are the Company's principal subsidiaries at February 28, 2018. Unless otherwise stated, the subsidiaries 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	Functional Currency	Country of incorporation	% of ownership interest held by the Company		% of ownership interest held by the non-controlling interests		Principal Activities
			2018	2017	2018	2017	
Velan Valve Corp.	U.S. Dollar	U.S.A.	100	100	-	-	Valve Manufacture
Velan Ltd.	U.S. Dollar	Korea	100	100	-	-	Valve Manufacture
Juwon Special Steel Co. Ltd.	Korean Won	Korea	50	50	50	50	Foundry
Velan Valvulas Industrias, Lda.	Euro	Portugal	100	100	-	-	Valve Manufacture
Velan S.A.S.	Euro	France	100	100	-	-	Valve Manufacture
Segault S.A.S.	Euro	France	75	75	25	25	Valve Manufacture
Velan GmbH	Euro	Germany	100	100	-	-	Valve Distribution
Velan ABV S.r.l.	Euro	Italy	100	100	-	-	Valve Manufacture
Velan Valvac Manufacturing Co. Ltd.	U.S. Dollar	Taiwan	90	90	10	10	Valve Manufacture
Velan Valve (Suzhou) Co. Ltd.	U.S. Dollar	China	85	85	15	15	Valve Manufacture
Velan Valves India Private Limited	Indian Rupee	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 as less than 7% of the Company's cash and short-term investments are subject to such restrictions. The total amount of cash and short-term investments subject to such restrictions as at February 28, 2018 was $5,424 (2017 – $1,785).

c) Non-controlling interests

Set out below is summarized financial information for each subsidiary company and structured entity 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(o)). 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.**	
	As at February 28, 2018	**As at February 28, 2017**	**As at February 28, 2018**	**As at February 28, 2017**
	$	**$**	**$**	**$**
Current assets	6,521	8,440	4,903	5,293
Current liabilities	3,344	3,318	1,355	1,367
Current net assets	3,177	5,122	3,548	3,926
Non-current assets	13,452	13,206	1,873	1,857
Non-current liabilities	8,948	8,544	79	68
Non-current net assets	4,504	4,662	1,794	1,789
Net assets	7,681	9,784	5,342	5,715
Accumulated non-controlling interest	4,932	5,844	660	673

Summarized statement of comprehensive income (loss)	**Juwon Special Steel Co. Ltd.**		**Velan Valvac Manufacturing Co. Ltd.**	
	2018	**2017**	**2018**	**2017**
	$	**$**	**$**	**$**
Sales	12,298	12,531	6,192	7,518
Net income (loss) for the year	(2,460)	(471)	44	992
Other comprehensive income	357	895	-	-
Total comprehensive income (loss) for the year	(2,103)	424	44	992
Net income (loss) allocated to non-controlling interest	(1,090)	461	28	116
Dividends paid to non-controlling interest	-	-	41	49

Summarized statement of cash flows	Juwon Special Steel Co. Ltd.		Velan Valvac Manufacturing Co. Ltd.	
	2018	2017	2018	2017
	$	$	$	$
Cash flows from operating activities	(1,188)	(580)	(102)	245
Cash flows from investing activities	(662)	100	(14)	(45)
Cash flows from financing activities	(4)	(4)	(404)	(487)
Net decrease in cash and cash equivalents	(1,854)	(484)	(520)	(287)

7 Property, plant and equipment

	Land	Buildings	Machinery & equipment	Furniture & fixtures	Data processing equipment	Rolling stock	Leasehold improvements	Total
	$	$	$	$	$	$	$	$
At February 29, 2016								
Cost	19,866	53,175	148,597	7,984	6,737	3,128	3,581	243,068
Accumulated depreciation	-	(24,445)	(107,225)	(6,194)	(5,643)	(2,241)	(2,063)	(147,811)
	19,866	28,730	41,372	1,790	1,094	887	1,518	95,257
Year ended February 28, 2017								
Beginning balance	19,866	28,730	41,372	1,790	1,094	887	1,518	95,257
Additions	-	1,353	5,293	254	532	149	140	7,721
Disposals	-	-	(10)	(1)	(1)	(267)	(11)	(290)
Depreciation	-	(1,813)	(8,431)	(332)	(829)	(316)	(222)	(11,943)
Exchange differences	925	(11)	(90)	(15)	(1)	15	(33)	790
	20,791	28,259	38,134	1,696	795	468	1,392	91,535
At February 28, 2017								
Cost	20,791	54,389	149,077	8,079	7,077	2,948	3,318	245,679
Accumulated depreciation	-	(26,130)	(110,943)	(6,383)	(6,282)	(2,480)	(1,926)	(154,144)
	20,791	28,259	38,134	1,696	795	468	1,392	91,535
Year ended February 28, 2018								
Beginning balance	20,791	28,259	38,134	1,696	795	468	1,392	91,535
Additions	44	1,396	3,632	258	406	399	67	6,202
Disposals	-	-	(48)	(3)	-	(3)	-	(54)
Depreciation	-	(1,830)	(7,527)	(555)	(524)	(303)	(296)	(11,035)
Exchange differences	780	763	1,337	132	15	8	181	3,216
	21,615	28,588	35,528	1,528	692	569	1,344	89,864
At February 28, 2018								
Cost	21,615	57,775	155,632	8,705	6,782	3,081	3,848	257,438
Accumulated depreciation	-	(29,187)	(120,104)	(7,177)	(6,090)	(2,512)	(2,504)	(167,574)
	21,615	28,588	35,528	1,528	692	569	1,344	89,864

Depreciation expense of $11,035 (2017 – $11,943) is included in the consolidated statement of income (loss): $9,950 (2017 – $10,703) in 'cost of sales' and $1,085 (2017 – $1,240) in 'administration costs'.

8 Intangible assets and goodwill

	Goodwill	Computer software	Patents, products & designs	Customer lists	Other	Total
At February 29, 2016						
Cost	8,529	7,552	12,461	5,881	1,526	35,949
Accumulated amortization	-	(7,089)	(4,159)	(2,844)	(1,505)	(15,597)
	8,529	463	8,302	3,037	21	20,352
Year ended February 28, 2017						
Beginning balance	8,529	463	8,302	3,037	21	20,352
Additions	-	168	723	-	19	910
Disposals and transfers	-	-	-	-	-	-
Amortization	-	(155)	(994)	(594)	(24)	(1,767)
Impairment loss	-	-	-	-	-	-
Exchange differences	(228)	(13)	(169)	(61)	(1)	(472)
	8,301	463	7,862	2,382	15	19,023
At February 28, 2017						
Cost	8,301	7,574	12,872	5,723	649	35,119
Accumulated amortization	-	(7,111)	(5,010)	(3,341)	(634)	(16,096)
	8,301	463	7,862	2,382	15	19,023
Year ended February 28, 2018						
Beginning balance	8,301	463	7,862	2,382	15	19,023
Additions	-	67	275	-	80	422
Disposals and transfers	-	-	-	-	-	-
Amortization	-	(139)	(1,082)	(621)	-	(1,842)
Impairment loss	-	-	-	-	-	-
Exchange differences	1,267	55	954	324	7	2,607
	9,568	446	8,009	2,085	102	20,210
At February 28, 2018						
Cost	9,568	8,063	14,845	6,596	832	39,904
Accumulated amortization	-	(7,617)	(6,836)	(4,511)	(730)	(19,694)
	9,568	446	8,009	2,085	102	20,210

Amortization expense of $1,842 (2017 – $1,767) is included in the consolidated statement of income (loss): $1,397 (2017 – $1,354) in 'cost of sales' and $445 (2017 – $413) in 'administration costs'.

As at February 28, 2018, the Company capitalized $275 (2017 – $723) of development costs, net of research and development tax credits of $142 (2017 – $211), as patents, products and designs.

9 Accounts payable and accrued liabilities

	As at February 28, 2018 $	As at February 28, 2017 $
Trade accounts payable	23,635	25,969
Accrued liabilities	35,597	30,668
Other	4,209	4,004
	63,441	60,641

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, 2018:

Unsecured

Credit facilities available	Borrowing rates
$66,360 (CA$85,000) (2017 – $64,005 (CA$85,000)) (note 25)	Prime to prime + 0.75% (2017 – 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, 2018, an amount of nil (2017 – nil) was drawn against these unsecured credit facilities in the form of demand operating lines of credit and bank overdrafts. An additional $25,227 (2017 – $9,765) 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, 2018, $6,794 (2017 – $8,162) was drawn against this facility.

b) Foreign subsidiaries and structured entities have the following credit facilities available as at February 28, 2018:

Secured by corporate guarantees

Credit facilities available	Borrowing rates
Foreign subsidiaries $56,497 (€40,057; KW3,712,300; INR270,000) (2017 – $50,066 (€41,672; KW3,791,730; INR170,000)) (note 25)	0.20% to 8.84% (2017 – 0.30% to 9.25%)
Foreign structured entities $3,938 (KW4,262,000) (2017 – $4,746 (KW5,363,200)) (note 25)	1.50% to 4.29% (2017 – 1.50% to 3.09%)

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, 2018 and February 28, 2017. 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 $2,530 (2017 – $2,842).

As at February 28, 2018, an amount of $13,066 (2017 – $7,792) was drawn against these secured credit facilities in the form of demand operating lines of credit and bank overdrafts. An additional $5,548 (2017 – $1,824) was drawn against these secured credit facilities in the form of letters of credit and letters of guarantee.

11 Provisions

	As at February 28, 2018 $	As at February 28, 2017 $
Balance – Beginning of year	10,600	9,333
Additional provisions	2,328	4,322
Used during the year	(3,563)	(2,754)
Exchange differences	1,433	(301)
Balance – End of year	10,798	10,600

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, 2018 $	As at February 28, 2017 $
French subsidiaries		
Unsecured bank loan (€2,402; February 28, 2017 – €3,000) (note 12(a))	2,934	3,179
Unsecured bank loan (€228; February 28, 2017 – €327) (note 12(b))	278	347
Italian subsidiary		
Unsecured bank loan (€359; February 28, 2017 – €464) (note 12(c))	438	492
Unsecured bank loan (€355; February 28, 2017– €462) (note 12(d))	434	490
Unsecured state bank loan (€168; February 28, 2017 – €236) (note 12(e))	206	250
Unsecured bank loan (€153; February 28, 2017 – €253) (note 12(f))	187	268
Unsecured bank loan (€182; February 28, 2017 – €545) (note 12(g))	222	578
Unsecured bank loan (€400; February 28, 2017 – €667) (note 12(h))	489	706
Unsecured bank loan (€170; February 28, 2017 – €505) (note 12(i))	207	535
Unsecured bank loan (€563; February 28, 2017 – €938) (note 12(j))	687	993
Unsecured bank loan (€198; February 28, 2017 – €533) (note 12(k))	241	565
Unsecured state bank loan (€1,610; February 28, 2017 – €1,610) (note 12(l))	1,967	1,706
Korean structured entity		
Secured bank loan (KW8,400; February 28, 2017 – KW13,200) (note 12(m))	8	12
Secured bank loan (KW8,000,000; February 28, 2017 – KW8,000,000) (note 12(n))	7,392	7,080
Other (note 12(o))	6,439	5,232
	22,129	22,433
Less: Current portion	8,151	7,115
	13,978	15,318

a) The unsecured bank loan of $2,934 (€2,402) bears interest at 0.20% and is repayable in variable monthly instalments of $61, expiring in 2022.

b) The unsecured bank loan of $278 (€228) bears interest at 0.89% and is repayable in monthly instalments of $12, expiring in 2020.

c) The unsecured bank loan of $438 (€359) bears interest at 2.91% and is repayable in monthly instalments, expiring in 2021.

d) The unsecured bank loan of $434 (€355) bears interest at 4.90% and is repayable in variable monthly instalments, expiring in 2021.

e) The unsecured state bank loan of $206 (€168) is non-interest bearing and is repayable in variable semi-annual instalments, expiring in 2020.

f) The unsecured bank loan of $187 (€153) bears interest at the 3-month Euribor rate plus 1.7% and is repayable in quarterly instalments of $33, expiring in 2019.

g) The unsecured bank loan of $222 (€182) bears interest at the 6-month Euribor rate plus 1.25% and is repayable in quarterly instalments of $118, expiring in 2018.

h) The unsecured bank loan of $489 (€400) bears interest at the 3-month Euribor rate plus 1.8% and is repayable in quarterly instalments of $86, expiring in 2019.

i) The unsecured bank loan of $207 (€170) bears interest at the 3-month Euribor rate plus 1.6% and is repayable in quarterly instalments of $111, expiring in 2018.

j) The unsecured bank loan of $687 (€563) bears interest the 3-month Euribor rate plus 1.6% and is repayable in quarterly instalments of $121, expiring in 2019.

k) The unsecured bank loan of $241 (€198) bears interest at 1.37% and is repayable in monthly instalments of $35, expiring in 2018.

l) The unsecured state bank loan of $1,967 (€1,610) bears interest at 3% and is repayable in variable semi-annual instalments, expiring in 2024.

m) The secured bank loan of $8 (KW8,400) 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.

n) The secured bank loan of $7,392 (KW8,000,000) bears interest at 2.21% and is repayable in quarterly instalments of $241, expiring in 2025.

o) Included in Other is an amount of $5,083 (€4,162) (February 28, 2015 – $4,045 (€3,817)) 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 structured entity. 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 (loss).

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

	$
February 28, 2019	8,151
February 29, 2020	2,970
February 28, 2021	2,401
February 28, 2022	2,212
February 28, 2023	1,336
Subsequent years	5,059
	22,129

The aggregate net book value of the assets pledged as collateral under long-term debt agreements amounted to $12,411 (2017 – $12,519).

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

13 Share capital

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, 2018 $	As at February 28, 2017 $
6,055,368 Subordinate Voting Shares (February 28, 2017 – 6,100,668) (notes 13(c) and (d))	65,964	66,458
15,566,567 Multiple Voting Shares	7,126	7,126
	73,090	73,584

c) Pursuant to its Normal Course Issuer Bid, the Company is entitled to repurchase for cancellation a maximum of 151,549 of the issued Subordinate Voting Shares of the Company, representing approximately 2.5% of the issued shares of such class as at October 18, 2017, during the ensuing 12-month period ending October 30, 2018. During the year ended February 28, 2018, 45,300 (2017 – 69,900) Subordinate Voting Shares were purchased for a cash consideration of $630 (2017 – $926) and cancelled. The amount by which the repurchase amount is above the stated capital of the shares has been debited to retained earnings.

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 $40 (2017 – $76) was recorded in the consolidated statement of income (loss) and credited to contributed surplus.

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

	Number of shares	Weighted average exercise price	Weighted average contractual life in months
Outstanding – February 29, 2016	140,000	$14.24 (CA$19.26)	50.4
Outstanding – February 28, 2017	140,000	$14.50 (CA$19.26)	38.4
Exercisable – February 28, 2017	60,000	$15.01 (CA$19.94)	
Outstanding – February 28, 2017	140,000	$14.50 (CA$19.26)	38.4
Outstanding – February 28, 2018	140,000	$15.04 (CA$19.26)	26.4
Exercisable – February 28, 2018	95,000	$15.37 (CA$19.69)	

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

achievement of certain performance objectives over such cycle, as determined by the Company's CGHR Committee.

As at February 28, 2018, the Company had a total of 25,250 (2017 – nil) PSUs outstanding. A compensation cost of $82 (2017 – nil) was recorded in the consolidated statement of income (loss) and credited to accounts payable and accrued liabilities. No payments have been made in relation to PSUs since the inception of the plan and no PSUs have vested as at February 28, 2018.

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

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

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

As at February 28, 2018, the Company had a total of 12,464 (2017 – nil) DSUs outstanding. A compensation cost of $78 (2017 – nil) was recorded in the consolidated statement of income (loss) and credited to accounts payable and accrued liabilities. No payments have been made in relation to DSUs since the inception of the plan and 4,918 (2017 – nil) DSUs have vested as at February 28, 2018.

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 fiscal year are included in sales, cost of sales, and other income (loss) and amounted to:

	2018 $	2017 $
Sales	(1,212)	56
Cost of sales	(1,215)	949
Other income (loss)	(1,823)	496

15 Cost of sales

	2018 $	2017 $
Change in inventories of finished goods and work in progress	10,868	(17,467)
Raw materials and consumables used	133,498	141,335
Employee expenses, excluding scientific research investment tax credits (note 17)	75,072	73,657
Depreciation and amortization (notes 7, 8 and 19)	11,347	12,057
Movement in inventory provision – net (note 5)	828	2,146
Foreign exchange loss (gain) (note 14)	1,215	(949)
Other production overhead costs	36,550	32,470
	269,378	243,249

16 Administration costs

	2018 $	2017 $
Employee expenses, excluding scientific research investment tax credits (note 17)	42,757	39,467
Scientific research investment tax credits (notes 17 and 18)	(2,978)	(2,999)
Commissions	7,619	5,293
Freight to customers	4,344	4,120
Professional fees	13,509	13,087
Movement in allowance for doubtful accounts (note 25)	(354)	(398)
Depreciation and amortization (notes 7, 8 and 19)	1,530	1,653
Other	19,010	15,645
	85,437	75,868

17 Employee expenses

	2018 $	2017 $
Wages and salaries	84,259	80,538
Social security costs	27,732	26,271
Scientific research investment tax credits (note 18)	(2,978)	(2,999)
Share-based compensation (note 13(d), (e) and (f))	200	76
Other	5,638	6,239
	114,851	110,125

18 Research and development expenses

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

	2018 $	2017 $
Research and development expenditures	9,608	7,969
Less: Scientific research and development investment tax credits	(2,978)	(2,999)
	6,630	4,970

19 Depreciation and amortization costs

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

	2018 $	2017 $
Depreciation of property, plant and equipment	11,035	11,943
Amortization of intangible assets	1,842	1,767
	12,877	13,710

20 Income taxes

	2018 $	2017 $
Current taxes:		
Current tax on profits for the year	8,929	4,533
Adjustments in respect of prior years	-	(26)
	8,929	4,507
Deferred taxes:		
Origination and reversal of temporary differences	(8,568)	314
Adjustments in respect of prior years	-	(141)
	(8,568)	173
Income tax expense	361	4,680

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

	2018 $	2017 $
Income tax at statutory rate of 26.78% (2017 – 26.88%)	(4,958)	3,493
Tax effects of:		
Difference in statutory tax rates in foreign jurisdictions	1,396	1,527
Effect of U.S. Tax Reform*	4,259	-
Taxable foreign exchange gain	(303)	(344)
Losses not tax effected	1,151	1,552
Losses utilized not previously tax effected	-	(444)
Benefit attributable to a financing structure	(917)	(927)
Other	(267)	(177)
Income tax expense	361	4,680

* U.S. Tax Reform was substantially enacted on December 22, 2017 under its official name "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018". As a result of the enactment of this legislation, the Company's U.S. subsidiary recorded a one-time tax expense of $4,259, of which $2,258 is due to the new mandatory repatriation tax and $2,001 is due to the effect of the tax rate reduction on its net deferred income tax assets.

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

	2018 $	2017 $
Deferred income tax assets:		
To be realized after more than 12 months	17,479	8,631
To be realized within 12 months	4,555	4,320
Deferred income tax liabilities:		
To be realized after more than 12 months	(2,272)	(2,279)
To be realized within 12 months	(617)	(505)
Net deferred income tax asset	19,145	10,167

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

	2018 $	2017 $
Balance – Beginning of year	10,167	10,129
Recovery to consolidated statement of income	8,568	173
Exchange differences	410	(135)
Balance – End of year	19,145	10,167

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

	2018 $	2017 $
Property, plant and equipment	(2,917)	(4,897)
Intangible assets	(3,180)	(3,141)
Non-deductible provisions and reserves	8,034	7,538
Investment tax credits	(1,505)	(1,184)
Inventories	8,836	10,107
Non-capital loss carryforwards	9,505	2,920
Other	372	(1,176)
	19,145	10,167

The Company did not recognize deferred income tax assets of $3,287 (2017 – $2,779) in respect of non-capital losses amounting to $14,086 (2017 – $11,646) that can be carried forward to reduce taxable income in future years. These losses expire between 2021 and indefinitely.

The Company did not recognize deferred income tax assets of $368 (2017 – $369) in respect of capital losses amounting to $2,745 (2017 – $2,745) that can be carried forward indefinitely against future taxable capital gains.

Deferred tax liabilities of $6,594 (2017 – $7,475) 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, 2018 totalled $295,379 (2017 – $317,598).

21 Earnings (loss) per share

a) Basic

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

	2018	2017
Net income (loss) attributable to Subordinate and Multiple Voting shareholders	$(17,811)	$7,737
Weighted average number of Subordinate and Multiple Voting Shares outstanding	21,640,632	21,722,089
Basic earnings (loss) per share	$(0.82)	$0.36

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.

	2018	2017
Net income (loss) attributable to Subordinate and Multiple Voting shareholders	$(17,811)	$7,737
Weighted average number of Subordinate and Multiple Voting Shares outstanding	21,640,632	21,722,089
Adjustments for stock options	-	5,608
Weighted average number of Subordinate and Multiple Voting Shares for diluted earnings (loss) per share	21,640,632	21,727,697
Diluted earnings (loss) per share	$(0.82)	$0.36

As at February 28, 2018, 140,000 stock options have an antidilutive effect (2017 – nil).

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, 2017, the aggregate maximum value of these guarantees, if exercised, amounted to $80,437 (2017 –$79,145). The guarantees expire as follows:

	$
February 28, 2019	29,037
February 29, 2020	13,434
February 28, 2021	15,948
February 28, 2022	4,654
February 28, 2023	443
Subsequent years	16,921
	80,437

b) The Company has outstanding purchase commitments with foreign suppliers, due within one year, amounting to $3,430 (2017 – $3,356), 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, 2019	1,628
February 29, 2020	1,584
February 28, 2021	853
February 28, 2022	272
February 28, 2023	8
	4,345

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, 2018, legal and related costs for these matters amounted to $8,213 (2017 – $6,839).

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.

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

This lawsuit alleges damages to the Facility in excess of $9,000 related to allegedly defective valves supplied by Velan Valve Corp. The claim is for alleged strict product liability and alleged negligence. It is the Company's position that this claim is without merit.

The Company is vigorously defending its position and is undertaking all actions necessary to protect its reputation. While the Company cannot predict the final outcome of this claim, based on information currently available, the Company believes the resolution of this claim will not have a material adverse effect on its financial position, results of operations or liquidity.

23 Related party transactions

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

	2018 $	2017 $
Affiliated company owned by certain relatives of controlling shareholder		
Purchases – Material components	1,230	955
Sales – Material components	-	8
Amount charged by the controlling shareholder to one of the Company's subsidiaries and certain of its executives		
Rent based on weekly usage	12	27
Accounts payable and accrued liabilities		
Affiliated companies	342	72
Controlling shareholder	-	8
Key management[1] compensation		
Salaries and other short-term benefits	4,291	4,177
Share-based compensation – Options	40	76
Share-based compensation – PSUs & DSUs	160	-

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

24 Segment reporting

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

February 28, 2018

	Canada	United States	France	Italy	Other	Consolidation Adjustment	Consolidated
	$	$	$	$	$	$	$
Sales							
Customers -							
Domestic	18,176	81,026	39,095	20,134	24,936	-	183,367
Export	58,033	-	60,485	14,993	21,085	-	154,596
Intercompany (export)	28,461	7,331	445	1,426	32,685	(70,348)	-
Total	104,670	88,357	100,025	36,553	78,706	(70,348)	337,963
Property, plant and equipment	33,441	6,688	13,322	2,548	33,865	-	89,864
Intangible assets and goodwill	1,403	-	392	124	67	18,224	20,210
Other identifiable assets	213,553	20,531	169,190	40,953	114,796	(128,904)	430,119
Total identifiable assets	248,397	27,219	182,904	43,625	148,728	(110,680)	540,193

February 28, 2017

	Canada	United States	France	Italy	Other	Consolidation Adjustment	Consolidated
	$	$	$	$	$	$	$
Sales							
Customers -							
Domestic	15,885	113,640	38,861	1,815	14,270	-	184,471
Export	62,691	-	50,688	13,896	20,031	-	147,306
Intercompany (export)	50,660	17,851	1,522	1,494	64,421	(135,948)	-
Total	129,236	131,491	91,071	17,205	98,722	(135,948)	331,777
Property, plant and equipment	34,963	7,577	12,119	2,862	34,014	-	91,535
Intangible assets and goodwill	1,429	-	8,612	8,967	16	-	19,023
Other identifiable assets	213,167	30,581	149,310	40,104	112,976	(137,406)	408,739
Total identifiable assets	249,559	38,158	170,041	51,933	147,006	(137,406)	519,297

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

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, 2018 and February 28, 2017 are as follows:

	Range of exchange rates		**Gain (loss)** (In thousands of U.S. dollars)		**Notional amount** (In thousands of indicated currency)	
	February 28, 2018	**February 28, 2017**	**February 28, 2018 $**	**February 28, 2017 $**	**February 28, 2018**	**February 28, 2017**
Foreign exchange forward contracts						
Sell US$ for CA$ – 0 to 12 months	1.26-1.28	1.32	(1,558)	(615)	US$92,000	US$40,000
Buy US$ for CA$ – 0 to 12 months	1.25	1.30-1.31	433	337	US$92,000	US$40,000
Sell US$ for € – 0 to 12 months	1.18-1.19	1.09-1.16	(2)	(20)	US$2,190	US$336
Buy US$ for € – 0 to 12 months	1.18-1.24	1.06-1.28	92	249	US$4,785	US$4,295
Sell US$ for KW – 0 to 12 months	-	1,193-1,200	-	99	-	US$1,668
Sell € for US$ – 0 to 12 months	1.24-1.28	1.06-1.08	(39)	(155)	€16,297	€16,122
Buy € for US$ – 0 to 12 months	1.18	1.06-1.08	64	509	€15,390	€33,600
Buy £ for € – 0 to 12 months	0.89	0.84-0.85	(1)	(1)	£281	£144

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

The following table provides a sensitivity analysis of the Company's most significant foreign exchange exposures related to its net position in the foreign currency financial instruments, which includes cash and cash equivalents, short-term investments bank indebtedness, short-term bank loans, derivative financial instruments, accounts receivable, accounts payable and accrued liabilities, customer deposits, accrual for performance guarantees and long-term debt, including interest payable. A hypothetical strengthening of 5.0% of the following currencies would have had the following impact for the fiscal years ended February 28, 2018 and February 28, 2017:

	Net income (loss)	
	2018 $	**2017 $**
Canadian dollar strengthening against the U.S. dollar	(524)	(121)
Euro strengthening against the U.S. dollar	396	496

A hypothetical weakening of 5.0% of the above currencies would have had the opposite impact for both fiscal years.

For the purposes of the above analysis, foreign exchange exposure does not include the translation of subsidiaries into the Company's reporting currency. For those subsidiaries whose functional currency is other than the reporting currency (U.S. dollar) of the Company, such exposure would impact other comprehensive income or loss.

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, 2018, four (2017 – four) customers accounted for more than 5% each of its trade accounts receivable, of which one customer accounted for 9.6% (2017 – 8.5%), and the Company's ten largest customers accounted for 57.3% (2017 – 52.4%). In addition, one customer accounted for 9.86% of the Company's sales (2017 – 13.3%).

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, 2018 $	As at February 28, 2017 $
Current	91,534	77,262
Past due 0 to 30 days	12,421	19,330
Past due 31 to 90 days	8,546	7,625
Past due more than 90 days	18,714	16,508
	131,215	120,725
Less: Allowance for doubtful accounts	1,088	1,239
Trade accounts receivable	130,127	119,486
Other receivables	7,255	6,026
Total accounts receivable	137,382	125,512

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

	As at February 28, 2018 $	As at February 28, 2017 $
Balance – Beginning of year	1,239	1,653
Bad debt expense	212	414
Recoveries of trade accounts receivable	(444)	(598)
Write-off of trade accounts receivable	(122)	(214)
Foreign exchange	203	(16)
Balance – End of year	1,088	1,239

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, 2018				
	Total $	**Less than 1 year $**	**1 to 3 Years $**	**4 to 5 Years $**	**After 5 years $**
Long-term debt	22,129	8,151	5,371	3,548	5,059
Accounts payable and accrued liabilities	63,411	63,411	-	-	-
Customer deposits	48,963	48,963	-	-	-
Accrual for performance guarantees	32,655	32,655	-	-	-
Bank indebtedness and short-term bank loans	21,922	21,922	-	-	-
Derivative liabilities	1,615	1,615	-	-	-

	As at February 28, 2017				
	Total $	**Less than 1 year $**	**1 to 3 Years $**	**4 to 5 Years $**	**After 5 years $**
Long-term debt	22,433	7,115	6,214	4,194	4,910
Accounts payable and accrued liabilities	60,641	60,641	-	-	-
Customer deposits	43,953	43,953	-	-	-
Accrual for performance guarantees	26,943	26,943	-	-	-
Bank indebtedness and short-term bank loans	9,442	9,442	-	-	-
Derivative liabilities	799	799	-	-	-

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, 2018			
Financial position classification and nature	**Total $**	**Level 1 $**	**Level 2 $**	**Level 3 $**
Assets				
Derivative assets	604	-	604	-
Liabilities				
Derivative liabilities	1,615	-	1,615	-

	As at February 28, 2017			
Financial position classification and nature	**Total $**	**Level 1 $**	**Level 2 $**	**Level 3 $**
Assets				
Derivative assets	1,202	-	1,202	-
Liabilities				
Derivative liabilities	799	-	799	-

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, 2018 $	As at February 28, 2017 $
Bank indebtedness	20,848	7,792
Short-term bank loans	1,074	1,650
Current portion of long-term debt	8,151	7,115
Long-term debt	13,978	15,318
Total debt	44,051	31,875
Equity	321,617	331,911
Total debt-to-equity ratio	13.7%	9.6%

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 (loss) to cash provided by (used in) operating activities

	2018 $	2017 $
Depreciation of property, plant and equipment	11,035	11,943
Amortization of intangible assets	1,842	1,767
Deferred income taxes	(8,568)	173
Share-based compensation expense	40	76
Gain on disposal of property, plant and equipment	(87)	(109)
Net change in derivative assets and liabilities	1,595	(1,751)
Net change in other liabilities	1,137	(1,832)
	6,994	10,267

28 Changes in non-cash working capital items

	2018 $	2017 $
Accounts receivable	(10,349)	(5,946)
Inventories	2,594	(10,572)
Income taxes recoverable	(756)	(1,472)
Deposits and prepaid expenses	(724)	195
Accounts payable and accrued liabilities	3,159	(2,303)
Income tax payable	3,743	(4,802)
Customer deposits	5,652	15,822
Provisions	223	1,266
Accrual for performance guarantees	6,444	(3,622)
	9,986	(11,434)

29 Net debt reconciliation

	2018 $	2017 $
Cash and cash equivalents	85,391	84,019
Long-term debt - repayable within one year (including Bank indebtedness and Short-term bank loans)	(30,073)	(16,557)
Long-term debt - repayable after one year	(13,978)	(15,318)
Net debt	41,340	52,144
Cash and cash equivalents	85,391	84,019
Gross debt - fixed interest rates	(21,411)	(21,003)
Gross debt - variable interest rates	(22,640)	(10,872)
Net debt	41,340	52,144

	Other Assets	Other Liabilities		
	Cash and cash equivalents / Bank indebtedness	Short-term bank loans and current portion of long-term debt	Long-term debt	Total
Net debt as at March 1st, 2017	**76,227**	**(8,766)**	**(15,318)**	**52,144**
Cash flows	(19,705)	2,578	1,204	(15,923)
Foreign exchange adjustments	8,021	(443)	(1,238)	6,340
Other non-cash movements	-	(2,595)	1,374	(1,221)
Net debt as at February 28th, 2018	**64,543**	**(9,226)**	**(13,978)**	**41,340**

Directors and officers

Corporate directors

T. Velan	Chairman of the Board
W. Sheffield	Lead Director
P. Velan	Director
R. Velan	Director
C. Hooper	Director
J. Latendresse	Director
Y. Leduc	Director
K. MacKinnon	Director

Corporate officers

Y. Leduc	President and Chief Executive Officer
I. Velan	Special Advisor to the President
M. Allen	Executive Vice-President, Manufacturing Operations and Global Supply Chain
W. Maar	Executive Vice-President, Global Sales and Overseas Operations
J. Ball	Chief Financial Officer
V. Apostolescu	Vice-President, Quality Assurance
S. Bruckert	Vice-President, Human Resources and General Counsel, Corporate Secretary
J. Calabrese	Vice-President, Technical Sales, Multi-Turn Products
J. Del Buey	Vice-President, Technical Sales, Quarter-Turn Products
P. Dion	Vice-President, Sales, Process Industries
P. Lee	Vice-President, Commercial Sales (Eastern Division)
G. Perez	Vice-President, Product Technology and Strategic Initiatives
C. Pogue	Vice-President, Commercial Sales (Western Division)
R. Sossoyan	Vice-President, Global Financial Reporting
D. Tran	Vice-President, Engineering
D. Velan	Vice-President, Marketing
R. Velan	Vice-President, Customer Service
S. Velan	Vice-President, Information Technology and Strategic Planning

Shareholder information

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Montreal, Quebec, Canada H4T 1G2

Website

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Tel.: (514) 748-7743, Ext. 5537
Fax: (514) 748-8635

Auditors

PricewaterhouseCoopers LLP

Transfer agent

CST Trust Company

Shares outstanding as at February 28, 2017

6,055,368 Subordinate Voting Shares
15,566,567 Multiple Voting Shares

Listing

Symbol: VLN

Price range

High CA $20.49
Low CA $17.00

Closing on February 28, 2017: CA $17.55

Annual meeting

The Annual Meeting of Shareholders will be held July 12, 2018, at 3:00 p.m. in the Salle Saint-Denis of the:
Club Saint James
1145 Union Avenue
Montreal, Quebec, Canada H3B 3C2

Velan worldwide

Head Office

Montreal, QC, Canada
Velan Inc.

An extensive global network

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

Manufacturing - Canada

Plant 1 and 5

Montreal, QC, Canada
Velan Inc.

Plant 2 and 7

Montreal, QC, Canada
Velan Inc.

Plant 4 and 6

Granby, QC, Canada
Velan Inc.

Manufacturing - U.S.A.

Plant 3

Williston, VT, USA
Velan Valve Corp.

Manufacturing - Europe

Plant

Lyon, France
Velan S.A.S.

Plant

Mennecy, France
Segault S.A.S.

Plant

Lisbon, Portugal
Velan Valvulas Industriais, Lda.

Plant 1

Lucca, Italy
Velan ABV S.r.l.

Plant 2

Lucca, Italy
Velan ABV S.r.l.

Manufacturing - Asia

Plant 1

Ansan City, South Korea
Velan Ltd.

Plant 2

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

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Willich, Germany
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Stocking and distribution

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