Form 51-102F4
Business Acquisition Report

1.1 Name and Address of Company

Covalon Technologies Ltd.
1660 Tech Ave, Unit 5
Mississauga, Ontario, Canada
L4W 5S7

1.2 Executive Officer

Danny Brannagan, Chief Financial Officer
905-366-0942

2.1 Nature of Business Acquired

AquaGuard is a division of Cenorin LLC, a privately held limited liability company which is incorporated under the laws of Washington, with a head office in Kent, Washington.

AquaGuard is a United States-based medical technology business that specializes in infection protection products that protect surgical incisions, intravenous (IV) sites, catheters, PICC lines, and other dressings from water and other moisture while a patient showers. AquaGuard's family of products provide protection for sites and dressings all over the body, and can be applied by most patients without the need of assistance from medical professionals.

2.2 Acquisition Date

October 1, 2018.

2.3 Consideration

The purchase price for the AquaGuard assets was as follows:

- $3,617,392 (USD) in cash paid on closing
- $20,608 (USD) in cash within 5 business days of closing
- $500,000 (USD) of shares of Covalon issued on closing, which will be held in escrow for up to two years
- $2,552,300 (USD) payable 12 months from the date hereof
- $5,000,000 (USD) payable 24 months from date hereof

- 102,892 common shares of Covalon Technologies Ltd., valued at $684,700 (USD), to settle liabilities payable to management and key staff of AquaGuard
- Contingent consideration of up to $900,000(USD) payable upon achievement of certain revenue targets by December 31, 2018.

The upfront payment was funded through a draw against an acquisition facility that totals $9m (CAD).

2.4 Effect on Financial Position

No immediate changes are contemplated.

2.5 Prior Valuations

Not applicable.

2.6 Parties to Transaction

Not applicable.

2.7 Date of Report

December 14, 2018

Item 3 Financial Statements and Other Information

The following financial statements are attached as Schedule A to the business acquisition report

- Audited carve-out financial statements of AquaGuard as at and for each of the years ended December 31, 2017 and 2016

The following financial statements are attached as Schedule B to the business acquisition report

- Unaudited carve-out condensed interim financial statements of AquaGuard as at September 30, 2018 and for the three and nine months then ended

Management has neither requested nor obtained any consent from the applicable auditors to include the audit report(s) attached to any of the foregoing carve-out financial statements incorporated into this business acquisition report.

## Schedule A

- Audited carve-out financial statements of AquaGuard as at December 31, 2017 and 2016 and for each of the years then ended.

# AquaGuard, a division of Cenorin LLC
## CARVE-OUT FINANCIAL STATEMENTS

**For the years ended December 31, 2017, and 2016**

## Contents

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BDO Canada LLP
TD Bank Tower
66 Wellington Street West
Suite 3600, PO Box 131
Toronto ON M5K 1H1 Canada

# Independent Auditor's Report

**To the Directors of Covalon Technologies Ltd.**

We have audited the accompanying carve-out financial statements of Aqua Guard, a division of Cenorin, LLC (the "Aqua Guard Division"), which comprise the carve-out statements of financial position as at December 31, 2017, December 31, 2016 and January 1, 2016 and the carve-out statements of comprehensive income, changes in equity and cash flows for the years ended December 31, 2017 and December 31, 2016, and a summary of significant accounting policies and other explanatory information (the "carve-out financial statements").

**Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these carve-out financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of carve-out 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 carve-out 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 carve-out financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the carve-out financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the carve-out financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Aqua Guard Division's preparation and fair presentation of the carve-out 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 Aqua Guard Division'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 carve-out financial statements.

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

**Basis for Qualified Opinion**

Because we were appointed auditors of the Aqua Guard Division during 2018, we were unable to observe the counting of physical inventories as at December 31, 2016 and January 1, 2016 or satisfy ourselves concerning those inventory quantities by alternative means. Therefore, we were unable to determine whether adjustments might be necessary to inventory as at December 31, 2016 and January 1, 2016 and therefore, whether adjustments might be necessary to the financial position as at December 31, 2016 and January 1, 2016 and the financial performance and cash flows for the year ended December 31, 2016.

**Qualified Opinion**

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the carve-out financial statements present fairly, in all material respects, the financial position of the Aqua Guard Division as at December 31, 2017, December 31, 2016 and January 1, 2016 and its financial performance and its cash flows for the years ended December 31, 2017 and December 31, 2016 in accordance with International Financial Reporting Standards.

BDO Canada LLP

Chartered Professional Accountants, Licensed Public Accountants

September 26, 2018
Toronto, Ontario

# AquaGuard, a division of Cenorin LLC

CARVE-OUT STATEMENTS OF FINANCIAL POSITION

**Expressed in Canadian Dollars**

| | | **December 31, 2017** | December 31, 2016 | January 1, 2016 |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current assets** | | | | |
| Accounts receivable | Note 6 | **$ 1,279,721** | $ 1,432,367 | $ 1,171,027 |
| Prepaid expenses | | **56,518** | 83,949 | 24,483 |
| Inventories | Note 4 | **664,432** | 700,469 | 609,529 |
| **Total current assets** | | **$ 2,000,671** | $ 2,216,785 | $ 1,805,039 |
| **Non-current assets** | | | | |
| Property, plant and equipment | Note 5 | **6,547** | 8,446 | 13,894 |
| Intangible assets | Note 12 | **33,988** | 51,524 | 43,011 |
| **Total non-current assets** | | **$ 40,535** | $ 59,970 | $ 56,905 |
| **Total Assets** | | **$ 2,041,206** | $ 2,276,755 | $ 1,861,944 |
| **Liabilities and Equity** | | | | |
| **Current liabilities** | | | | |
| Accounts payable and accrued liabilities | | **$ 1,264,394** | $ 1,220,653 | $ 710,100 |
| **Total Liabilities** | | **1,264,394** | 1,220,653 | 710,100 |
| **Equity** | | | | |
| Foreign exchange reserve | | **(103,125)** | (38,667) | - |
| Retained earnings | | **879,937** | 1,094,769 | 1,151,844 |
| **Total Equity** | | **776,812** | 1,056,102 | 1,151,844 |
| **Total Liability and Equity** | | **$ 2,041,206** | $ 2,276,755 | $ 1,861,944 |

**Subsequent Events (Note 16)**

The accompanying notes are an integral part of these carve-out financial statements.

# AquaGuard, a division of Cenorin LLC

CARVE-OUT STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

**Expressed in Canadian Dollars**

| | | Year ended December 31, **2017** | 2016 |
|---|---|---|---|
| **Revenue** | | | |
| Product | | **$ 11,055,395** | $ 10,649,781 |
| **Cost of product sales** | Note 4 | **3,376,711** | 3,221,383 |
| **Gross profit before operating expenses** | | **$ 7,678,684** | $ 7,428,398 |
| **Operating expenses** | | | |
| Marketing | | **353,789** | 318,469 |
| Selling, general and administration | Note 8 | **6,658,857** | 6,103,169 |
| **Total operating expenses** | | **$ 7,012,646** | $ 6,421,638 |
| **Income before taxes** | | **666,038** | 1,006,760 |
| Current income tax | | **296,546** | 406,705 |
| Deferred income tax | | **2,850** | 12,413 |
| **Net income before other comprehensive income** | | **366,642** | 587,642 |
| **Other comprehensive income** | | | |
| Foreign currency translation adjustment | Note 2 (c) | **(64,458)** | (38,667) |
| **Total comprehensive income** | | **$ 302,184** | $ 548,975 |

The accompanying notes are an integral part of these carve-out financial statements.

# AquaGuard, a division of Cenorin LLC

CARVE-OUT STATEMENTS OF CHANGES IN EQUITY

**Expressed in Canadian Dollars**

| | | Retained Earnings | | Foreign Exchange Reserve | | Total |
|---|---|---|---|---|---|---|
| **Balance at January 1, 2016** | $ | 1,151,844 | $ | - | $ | 1,151,844 |
| Foreign currency translation | | - | | (38,667) | | (38,667) |
| Net income | | 587,642 | | - | | 587,642 |
| Equity distribution | | (644,717) | | - | | (644,717) |
| **Balance at December 31, 2016** | $ | 1,094,769 | $ | (38,667) | $ | 1,056,102 |
| **Foreign currency translation** | | **-** | | **(64,458)** | | **(64,458)** |
| **Net income** | | **366,642** | | **-** | | **366,642** |
| **Equity distribution** | | **(581,474)** | | **-** | | **(581,474)** |
| **Balance at December 31, 2017** | **$** | **879,937** | **$** | **(103,125)** | **$** | **776,812** |

The accompanying notes are an integral part of these carve-out financial statements.

# AquaGuard, a division of Cenorin LLC

CARVE-OUT STATEMENTS OF CASH FLOWS

**Expressed in Canadian Dollars**

| | | Year ended December 31, **2017** | 2016 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net income for the year | | **$ 366,642** | $ 587,642 |
| Adjustments to reconcile net income to net cash used in operating activities: | | | |
| Depreciation - property, plant and equipment | | **3,839** | 4,047 |
| Amortization - intangible assets | | **26,135** | 22,586 |
| Change in non-cash working capital | Note 11 | **259,855** | 35,382 |
| **Total cash flows from operating activities** | | **$ 656,471** | $ 649,657 |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of property, plant and equipment | | **(2,037)** | (1,565) |
| Purchase of intangible assets | | **(14,533)** | (36,520) |
| Disposal of property, plant and equipment | | **420** | 2,481 |
| Disposal of intangible assets | | **2,776** | 4,271 |
| **Total cash flows from investing activities** | | **$ (13,374)** | $ (31,333) |
| | | | |
| **Cash flows from financing activities** | | | |
| Equity distributions | | **(581,474)** | (644,717) |
| **Total cash flows from financing activities** | | **$ (581,474)** | $ (644,717) |
| | | | |
| **Foreign exchange rate changes on cash** | | **(61,623)** | 26,393 |
| | | | |
| **Total cash flows during the period** | | **-** | - |
| **Cash and cash equivalents, beginning and end of period** | | **$ -** | $ - |

The accompanying notes are an integral part of these carve-out financial statements.

## CORPORATE INFORMATION

AquaGuard (the "Division") is a division of Cenorin LLC (the "Company"), a privately held limited liability company which is incorporated under the laws of Washington and is engaged in the business of manufacturing, and selling medical products. The Company has received regulatory approval on numerous products and is currently generating revenue. The Division has adopted a business model that utilizes sales channels in hospitals, and other healthcare facilities, in the United States to sell their branded medical products. The Division generates its revenues through direct sales to hospitals or sales to distribution partners in the United States.

The address of the Company's corporate office and principal place of business is 6324 S. 199$^{th}$ Place, Suite 107, Kent, Washington 98032.

## BASIS OF PRESENTATION

**a) Statement of Compliance**

These carve-out financial statements of the Division have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). These are the Division's first carve-out financial statements. An explanation of the effects of the application of IFRS on the carve-out financial statements is provided in Note 15.

The carve-out financial statements were authorized for issue by management on September 26, 2018.

**b) Basis of Measurement**

The carve-out financial statements as at and for the years ended December 31, 2017 and 2016 include the assets, liabilities, revenues and expenses of the Division. They have been derived from the accounting records of the Company and have been prepared on a historical cost basis. All inter-entity balances and transactions have been eliminated.

The Company performs various shared and corporate functions for the Division. Allocations for shared and corporate expenses are reflected in the general and administration expenses in the carve-out statement of operations and comprehensive income. These allocations are based on a number of factors including revenue, headcount and personnel time allocations which are considered to be reasonable reflections of the historical utilization levels of these services required in support of the Division's business. Additionally, no interest or return on the Division's equity has been included in these carve-out financial statements and the income taxes are "imputed" on a notional basis using the estimated effective income tax rates of the Company. In the opinion of the management, the methodology used to allocate the carve-out statement of financial position and carve-out statement of operations and comprehensive income and all other assumptions underlying the carve-out financial statements are reasonable and have been applied consistently in the carve-out financial statements of the Division.

The carve-out financial statements included herein may not necessarily reflect the financial position, financial performance and cash flows of the Division in the future or what the financial position, financial performance and cash flow would have been had the Division been a stand-alone entity during the periods presented. Future financial performance and financial position could differ materially from the amounts presented herein.

**c) Functional and Presentation Currency**

The functional currency is determined based on the currency of the primary economic environment in which the Division operates. As the Division generates and expends cash in predominantly the United States dollar, it maintains a functional currency of the same.

The Division has adopted a presentation currency of Canadian dollars for these carve-out financial statements effective January 1, 2016. The results and financial position of the Division are translated into the Canadian dollar as follows:

i) Assets and liabilities are translated at the closing rate at the date of the carve-out statement of financial position;
ii) Income and expenses are translated at average exchange rates. The Company uses yearly average exchange rates due to the volume of transactions each month; and,
iii) All resulting exchange differences are recognized in other comprehensive income.

These financial statements are rounded to the nearest Canadian dollar, unless otherwise indicated.

**d) Segment Information**

The Division has been identified as one reportable business segment since the Division has a singular nature of products and services, production process and customer base. All assets, liabilities, revenues and operations are located in the United States.

**e) Critical Accounting Estimates and Judgments**

The preparation of financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the carve-out financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from estimates and such differences could be material.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change affects that period only, or in the period of the change and future periods, if the change affects both. Areas involving the most critical judgments and estimates are:

i) Inventory allowance – Note 4
ii) Allowance for doubtful accounts – Note 6
iii) Shared and corporate expense allocation – Note 2(b)
iv) Revenue recognition – Note 3

**REVENUE**

Revenue arising from product sales is recognized once the risks and rewards of ownership have passed to the customer. This occurs once the product has left the Division’s facility for shipment to a customer. In all cases, revenue is recognized only when the amounts are fixed, or determinable, and when the Division can be reasonably assured of collection.

**INVENTORIES**

Raw materials and finished goods are stated at the lower of weighted average cost and net realizable value. Cost comprises all costs of purchase and costs of conversion, which includes directly attributable production labour and overheads. The Company determines its provision for obsolete inventory based on the quantities on hand at the reporting dates, compared to foreseeable needs over the upcoming periods.

Expressed in Canadian Dollars

Inventories consist of the following:

| | **December 31, 2017** | December 31, 2016 | January 1, 2016 |
|---|---|---|---|
| Raw materials | **$ 359,082** | $ 338,132 | $ 273,058 |
| Finished goods | **305,350** | 362,337 | 336,471 |
| | **$ 664,432** | $ 700,469 | $ 609,529 |

Cost of product sales include $2,474,484 (2016 - $2,397,108) in inventoried materials.

**PROPERTY, PLANT AND EQUIPMENT**

Measurement

On initial recognition property, plant and equipment are valued at cost, being the purchase price and directly attributable cost of acquisition or construction required to bring the asset to the location and condition necessary to be capable of operating in the manner intended by the Division. When parts of an item of property, plant and equipment have different useful lives they are accounted for as separate items (major components) of property, plant and equipment. Property, plant and equipment is subsequently measured at cost less accumulated depreciation, and any accumulated impairment losses.

Depreciation

Depreciation methods, useful lives, and residual values are reviewed at each financial reporting date and adjusted if appropriate. Depreciation is recognized in operations and is calculated using the following annual rates:

| | |
|---|---|
| Production equipment | 20% straight-line |

Expressed in Canadian Dollars

| | | Production Equipment | | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| **Balance at January 1, 2016** | $ | 20,333 | $ | 20,333 |
| Additions | | 1,565 | | 1,565 |
| Disposals | | (3,381) | | (3,381) |
| Foreign exchange | | 280 | | 280 |
| **Balance at December 31, 2016** | $ | 18,797 | $ | 18,797 |
| **Additions** | | 2,037 | | **2,037** |
| **Disposals** | | (840) | | **(840)** |
| **Foreign exchange** | | (465) | | **(465)** |
| **Balance at December 31, 2017** | $ | 19,529 | **$** | **19,529** |
| | | | | |
| **Accumulated depreciation** | | | | |
| **Balance at January 1, 2016** | | 6,439 | | 6,439 |
| Depreciation | | 4,048 | | 4,048 |
| Disposals | | (900) | | (900) |
| Foreign exchange | | 764 | | 764 |
| **Balance at December 31, 2016** | $ | 10,351 | $ | 10,351 |
| **Depreciation** | | 3,839 | | **3,839** |
| **Disposals** | | (420) | | **(420)** |
| **Foreign exchange** | | (788) | | **(788)** |
| **Balance at December 31, 2017** | $ | 12,982 | **$** | **12,982** |
| | | | | |
| **Carrying amounts** | | | | |
| **At January 1, 2016** | $ | 13,894 | $ | 13,894 |
| **At December 31, 2016** | $ | 8,446 | $ | 8,446 |
| **At December 31, 2017** | **$** | **6,547** | **$** | **6,547** |

**FINANCIAL RISK MANAGEMENT**

Financial instruments

The Division's financial instruments consist of accounts receivable and accounts payable and accrued liabilities. Accounts receivable are classified as loans and receivables at the time of initial recognition. Loans and receivables are non- derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognized at fair value plus transaction costs and subsequently carried at amortized cost using the effective interest rate method. Accounts payable and accrued liabilities are initially recognized at fair value less transaction costs and subsequently carried at amortized cost using the effective interest rate method. The fair value of these financial instruments approximates their carrying value because of their short term to maturity.

The following is a discussion of credit and liquidity risks and related mitigation strategies that have been identified. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks listed.

Credit risk

Expressed in Canadian Dollars

The Division is exposed to credit risk associated primarily with its accounts receivables. Management reviews the accounts receivables at each reporting date and makes an allowance for doubtful accounts when the expected recovery could be less than the actual accounts receivable. The expected recovery amount can vary from the actual cash received.

The accounts receivable are subject to normal industry risks in each geographic region in which the Division operates. The Division attempts to manage these risks by dealing with creditworthy customers; however, this is not always possible. As at December 31, 2017, ten customers accounted for 76% (2016 – ten customers for 79%) of the accounts receivable balance. These customers, who are distributors and health care institutions, represent substantially all of the Division's sales. Credit risk exposure is mitigated by strong credit granting policies and due diligence procedures for new customers. The Division has recorded an allowance for doubtful accounts in the amount of $nil (2016 – $nil) resulting in a bad debt expense of $nil (2016 - $nil). Management reviews the outstanding amounts on a regular basis and determines the collectability of the outstanding balances on a case by case basis.

Pursuant to their collective terms the accounts receivable, net, are aged as follows:

| | **December 31, 2017** | December 31, 2016 |
|---|---|---|
| Current | **$ 578,408** | $ 975,995 |
| 30 - 60 days past due | **602,373** | 452,675 |
| 60 - 90 days past due | **98,940** | 3,697 |
| Total | **$ 1,279,721** | $ 1,432,367 |

Liquidity risk

The Division continually monitors working capital to ensure sufficient cash is available to meet operational and capital expenditure requirements. The Division has contractual repayments related to accounts payable and accrued liabilities that are due within a year.

**MANAGEMENT OF CAPITAL**

The Division defines capital that it manages as its equity which was $818,651 at December 31, 2017 (2016 - $1,086,310). Its objectives when managing capital are to ensure that the Division will continue as a going concern, so that it can provide services to its customers and returns to its stakeholders.

The Division manages its capital structure and makes adjustments to it in light of economic conditions. There were no changes to the definition or the management of capital during the year.

The Division is not subject to any externally imposed capital requirements and the Division's overall strategy with respect to management of capital remains unchanged.

Expressed in Canadian Dollars

### SELLING, GENERAL AND ADMINISTRATION EXPENSES

The breakdown of the selling, general and administration expenses is as follows:

| | | **December 31, 2017** | | December 31, 2016 |
|---|---|---|---|---|
| Personnel expenses | **$** | **5,730,120** | $ | 5,135,910 |
| Professional and legal fees | | **398,295** | | 348,758 |
| Depreciation | | **29,974** | | 26,633 |
| Travel, meals and entertainment | | **88,374** | | 97,144 |
| Office and other expenses | | **176,444** | | 252,547 |
| Rent and facilities | | **235,650** | | 242,177 |
| | **$** | **6,658,857** | **$** | **6,103,169** |

### INCOME TAXES

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in net income except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

The Division imputed a notional income tax provision for the Division at the following rates.

**Reconciliation between statutory rate (2017 - 34%;** 2016 – 34%**) and effective rate**

| | | **December 31, 2017** | | December 31, 2016 |
|---|---|---|---|---|
| Income tax computed at statutory rates | **$** | **226,453** | $ | 342,298 |
| Non-deductible expenses | | **37,628** | | 42,780 |
| Washington business and occupation tax | | **(18,193)** | | (17,505) |
| | | **245,888** | | 367,573 |
| Washington business and occupation (gross receipts) tax | | **53,508** | | 51,545 |
| | **$** | **299,396** | $ | 419,118 |

### CONTINGENCIES

From time to time, the Division is party to legal proceedings arising out of the normal course of business. The results of these litigations cannot be predicted with certainty, and management is of the opinion that the outcome of these types of proceedings is generally not determinable. Any loss resulting from these proceedings will be charged to operations in the period the loss is determined.

Expressed in Canadian Dollars

### CHANGE IN NON-CASH WORKING CAPITAL ITEMS

Net changes in non-cash working capital balances are as follows:

| | | **December 31, 2017** | | December 31, 2016 |
|---|---|---|---|---|
| Accounts receivable | **$** | **152,646** | $ | (296,824) |
| Prepaid expenses | | **27,431** | | (60,197) |
| Inventories | | **36,037** | | (109,129) |
| Accounts payable and accrued liabilities | | **43,741** | | 501,532 |
| | **$** | **259,855** | $ | 35,382 |

### INTANGIBLE ASSETS

Recognition and Amortization

Intangible assets include expenditures related to obtaining patents and technology rights associated with patents, trademarks, and computer software. Patents are amortized on a straight-line basis over the remaining life of the patent, being 20 years less the number of years since application for the patent and are stated at cost less accumulated amortization and impairment. Trademarks are considered to have an indefinite useful life and as such are recorded at cost less accumulated impairment. Computer software is amortized using the 20% diminishing balance basis. Amortization methods, useful lives, and residual values are reviewed at each reporting date and adjusted if appropriate. Expenditures on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, are recognized in operations as incurred.

Development activities involve a plan or design for the production of new, or substantially improved, products and processes related to the Division’s technology platforms. Development expenditures are capitalized only if the relevant IFRS criteria are met. Capitalized development expenditures are amortized from the beginning of commercial production and sales and are amortized on a straight-line basis over the remaining life of the related patent(s). Development expenditures not satisfying the above criteria are recognized in operations as incurred.

Impairment

Impairment tests on intangible assets with indefinite useful economic lives are undertaken annually at the financial year-end. Other non-financial assets, including property plant and equipment, computer software, patents, deferred development, and other definite life assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the asset is written down accordingly. Where it is not possible to estimate the recoverable amount of an individual asset the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets. An impairment loss is charged to operations.

Expressed in Canadian Dollars

| | Software | Patents | Trademarks | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| **Balance at January 1, 2016** | $ 88,851 | $ 7,678 | $ 3,355 | $ 99,884 |
| Disposals | (8,542) | - | - | (8,542) |
| Additions | 11,200 | 25,002 | 318 | 36,520 |
| Foreign exchange | (135) | 114 | (96) | (117) |
| **Balance at December 31, 2016** | $ 91,374 | $ 32,794 | $ 3,577 | $ 127,745 |
| **Disposals** | **(5,747)** | **-** | **-** | **(5,747)** |
| **Additions** | **8,181** | **6,352** | **-** | **14,533** |
| **Foreign exchange** | **(6,085)** | **(2,370)** | **(236)** | **(8,691)** |
| **Balance at December 31, 2017** | **$ 87,723** | **$ 36,776** | **$ 3,341** | **$ 127,840** |
| | | | | |
| **Accumulated depreciation** | | | | |
| **Balance at January 1, 2016** | $ 55,403 | $ 1,470 | $ - | $ 56,873 |
| Depreciation | 18,616 | 3,970 | - | 22,586 |
| Disposals | (4,271) | - | - | (4,271) |
| Foreign exchange | 958 | 75 | - | 1,033 |
| **Balance at December 31, 2016** | $ 70,706 | $ 5,515 | $ - | $ 76,221 |
| **Depreciation** | **19,986** | **7,216** | **-** | **27,202** |
| **Disposals** | **(2,971)** | **-** | **-** | **(2,971)** |
| **Foreign exchange** | **(5,764)** | **(836)** | **-** | **(6,600)** |
| **Balance at December 31, 2017** | **$ 81,957** | **$ 11,895** | **$ -** | **$ 93,852** |
| | | | | |
| **Carrying amounts** | | | | |
| At January 1, 2016 | $ 33,448 | $ 6,208 | $ 3,355 | $ 43,011 |
| At December 31, 2016 | $ 20,668 | $ 27,279 | $ 3,577 | $ 51,524 |
| **At December 31, 2017** | **$ 5,766** | **$ 24,881** | **$ 3,341** | **$ 33,988** |

## RELATED PARTY TRANSACTIONS

Transactions between the Division and the Company have been identified as related party transaction.

Expenses incurred by the Company that were allocated to the Division are as follows:

| | **December 31, 2017** | December 31, 2016 |
|---|---|---|
| Personnel expenses | **$ 255,144** | $ 213,188 |
| Professional and legal fees | **229,026** | 138,341 |
| Rent and facilities | **235,650** | 242,177 |
| Office and other expenses | **193,985** | 260,385 |
| | **$ 913,805** | $ 854,091 |

All related party transactions are in the normal course of operations and are measured at the amounts established and agreed to by the related parties.

**STANDARDS, AMENDMENTS AND INTERPRETATIONS NOT YET EFFECTIVE**

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are mandatory for accounting periods beginning after January 1, 2018 or later periods. None of these are expected to have a significant effect on the carve-out financial statements, except for the following standards and interpretations that have been issued but are not yet effective:

**i) IFRS 9 - Financial Instruments**
IFRS 9, Financial Instruments is part of the IASB's wider project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard is effective for annual periods beginning on or after January 1, 2018. The Division is in the process of evaluating the impact of the new standard.

**ii) IFRS 15 - Revenue from Contracts with Customers**
IFRS 15, Revenue from Contracts with Customers establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. The standard is effective for annual periods beginning on or after January 1, 2018. The Division is in the process of evaluating the impact of adopting this standard.

**iii) IFRS 16 - Leases**
IFRS 16, Leases specifies how to recognize, measure, present and disclose leases. It also provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a small value. Accounting for the lessor will remain substantially unchanged. The standard is effective for periods beginning on or after January 1, 2019, with earlier application permitted for companies that also apply IFRS 15, Revenue from Contracts with Customers. The Division is in the process of evaluating the impact of the new standard.

**APPLICATION OF IFRS FOR CARVE-OUT FINANCIAL STATEMENTS**

As disclosed in Note 2, these are the Division's first carve-out financial statements, which are prepared in accordance with IFRS. The comparative information presented in these carve-out financial statements is prepared in accordance with IFRS standards effective as at the reporting date as described in the notes to the carve-out financial statements above.

In applying IFRS to these carve-out financial statements, the following policies and disclosures have been applied:

- Presentation of Comparative Opening Statement of Financial Position

These carve-out financial statements include a third statement of financial position as at the beginning of the preceding comparative period, January 1, 2016, to provide additional comparable information in the Division's first carve-out financial statements.

- Foreign Currency Translation – Presentation Currency

These carve-out financial statements have been prepared using a presentation currency of Canadian dollars. Due to the carve-out nature of the financial statements, the historic functional currency amounts giving rise to the retained earnings balance of the Division prior to January 1, 2016 were impracticable to determine and any foreign exchange reserve balance accumulated up to January 1, 2016 would otherwise be included in Equity in the carve-out statement of financial position. Therefore, the foreign exchange reserve as at January 1, 2016 was deemed to be zero.

- Estimates

Estimates used in the preparation of these carve-out financial statements are based on information available as at the respective reporting dates and have not been revised for the purposes of preparation of these carve-out financial statements except where necessary to reflect any changes in accounting policy; the Division has not used hindsight to revise its estimates.

**SUBSEQUENT EVENTS**

Subsequent to the year end, the Company entered into a definitive agreement with a Canadian publicly listed company – Covalon Technologies Ltd for the sale of its AquaGuard division.

Schedule B

- Unaudited carve-out condensed interim financial statements of AquaGuard as at September 30, 2018 and for the three and nine months then ended

# AquaGuard, a division of Cenorin LLC
## INTERIM CONDENSED CARVE-OUT FINANCIAL STATEMENTS (UNAUDITED)

**For the three and nine months ended September 30, 2018, and 2017**

## Contents

# AquaGuard, a division of Cenorin LLC

## INTERIM CONDENSED CARVE-OUT STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

**Expressed in Canadian Dollars**

| | | **September 30, 2018** | December 31, 2017 |
|---|---|---|---|
| **Assets** | | | |
| **Current assets** | | | |
| Accounts receivable | Note 5 | **$ 1,413,913** | $ 1,279,721 |
| Prepaid expenses | | **41,971** | 56,518 |
| Inventories | Note 4 | **629,517** | 664,432 |
| **Total current assets** | | **2,085,401** | 2,000,671 |
| | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | | **$ 9,964** | $ 6,547 |
| Intangible assets | | **21,743** | 33,988 |
| **Total non-current assets** | | **31,707** | 40,535 |
| **Total assets** | | **$ 2,117,108** | $ 2,041,206 |
| | | | |
| **Liabilities and equity** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities | | **$ 1,429,529** | $ 1,264,394 |
| **Total liabilities** | | **1,429,529** | 1,264,394 |
| | | | |
| **Equity** | | | |
| Foreign exchange reserve | | **$ (130,744)** | $ (103,125) |
| Retained earnings | | **818,323** | 879,937 |
| **Total equity** | | **$ 687,579** | $ 776,812 |
| **Total liability and equity** | | **$ 2,117,108** | $ 2,041,206 |

**Subsequent Events (Note 10)**

The accompanying notes are an integral part of these interim condensed carve-out financial statements.

# AquaGuard, a division of Cenorin LLC

## INTERIM CONDENSED CARVE-OUT STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (UNAUDITED)

**Expressed in Canadian Dollars**

| | | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|---|
| | | **2018** | 2017 | **2018** | 2017 |
| **Revenue** | | | | | |
| Product | | **$3,251,193** | $2,680,602 | **$9,442,603** | $8,312,920 |
| **Cost of product sales** | Note 4 | **1,111,652** | 833,442 | **3,064,431** | 2,534,458 |
| **Gross profit before operating expenses** | | **2,139,541** | 1,847,160 | **6,378,172** | 5,778,462 |
| **Operating expenses** | | | | | |
| Marketing | | **66,783** | 63,214 | **296,808** | 267,757 |
| Selling, general and administration | | **1,721,832** | 1,566,578 | **5,102,693** | 4,846,860 |
| **Total operating expenses** | | **1,788,615** | 1,629,792 | **5,399,501** | 5,114,617 |
| **Income before taxes** | | **$350,926** | $217,368 | **$978,671** | $663,845 |
| Current income tax | | **89,430** | 92,588 | **270,451** | 313,996 |
| **Net income before other comprehensive income** | | **$261,496** | $124,780 | **$708,220** | $349,849 |
| **Other comprehensive income** | | | | | |
| Foreign currency translation adjustment | Note 2 (c) | **(9,206)** | 18,490 | **(27,619)** | 55,469 |
| **Total comprehensive income** | | **$252,290** | $143,270 | **$680,601** | $405,318 |

The accompanying notes are an integral part of these interim condensed carve-out financial statements.

# AquaGuard, a division of Cenorin LLC

**INTERIM CONDENSED CARVE-OUT STATEMENTS OF CHANGES IN EQUITY (UNAUDITED)**

**Expressed in Canadian Dollars**

| | Retained earnings | Foreign exchange reserve | Total |
|---|---|---|---|
| **Balance at January 1, 2017** | $1,094,769 | $(38,667) | $1,056,102 |
| Foreign currency translation | - | 55,469 | 55,469 |
| Net income | 349,849 | | 349,849 |
| Equity distribution | (675,539) | | (675,539) |
| **Balance at September 30, 2017** | $769,079 | $16,802 | $785,881 |
| **Balance at December 31, 2017** | **$879,937** | **$(103,125)** | **$776,812** |
| **Foreign currency translation** | - | (27,619) | **(27,619)** |
| **Net income** | 708,220 | - | **708,220** |
| **Equity distribution** | (769,834) | - | **(769,834)** |
| **Balance at September 30, 2018** | **$818,323** | **$(130,744)** | **$687,579** |

The accompanying notes are an integral part of these interim condensed carve-out financial statements.

# AquaGuard, a division of Cenorin LLC

**INTERIM CONDENSED CARVE-OUT STATEMENTS OF CASH FLOWS (UNAUDITED)**

**Expressed in Canadian Dollars**

| | | Nine months ended September 30, | |
|---|---|---|---|
| | | **2018** | 2017 |
| **Cash flows from operating activities** | | | |
| Net income for the year | | **$708,220** | $349,849 |
| Adjustments to reconcile net income to net cash used in operating activities: | | | |
| Depreciation - property, plant and equipment | | **4,871** | 3,839 |
| Amortization - intangible assets | | **22,390** | 22,586 |
| Change in non-cash working capital | Note 6 | **113,136** | 359,353 |
| **Total cash flows from operating activities** | | **$848,617** | $735,627 |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of property, plant and equipment | | **(8,013)** | (2,037) |
| Purchase of intangible assets | | **(10,356)** | (14,533) |
| Disposal of property, plant and equipment | | **-** | 1,260 |
| Disposal of intangible assets | | **-** | 2,971 |
| **Total cash flows from investing activities** | | **$(18,369)** | $(12,339) |
| | | | |
| **Cash flows from financing activities** | | | |
| Equity distributions | | **(769,834)** | (675,539) |
| **Total cash flows from financing activities** | | **$(769,834)** | $(675,539) |
| | | | |
| **Foreign exchange rate changes on cash** | | **(60,414)** | 82,709 |
| | | | |
| **Total cash flows during the period** | | **-** | - |
| **Cash and cash equivalents, beginning and end of period** | | **$ -** | $ - |

The accompanying notes are an integral part of these interim condensed carve-out financial statements.

## CORPORATE INFORMATION

AquaGuard (the "Division") is a division of Cenorin LLC (the "Company"), a privately held limited liability company which is incorporated under the laws of Washington and is engaged in the business of manufacturing, and selling medical products. The Company has received regulatory approval on numerous products and is currently generating revenue. The Division has adopted a business model that utilizes sales channels in hospitals and other healthcare facilities in the United States to sell their branded medical products. The Division generates its revenues through direct sales to hospitals or sales to distribution partners in the United States.

The address of the Company's corporate office and principal place of business is 6324 S. 199$^{th}$ Place, Suite 107, Kent, Washington 98032.

## BASIS OF PRESENTATION

**f) Statement of Compliance**

These interim condensed carve-out financial statements ("interim financial statements") of the Division have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting.

The interim financial statements have been prepared using accounting policies consistent with those used in the Division's annual carve-out financial statements, which have been prepared in accordance with IFRS as issued by the IASB, as well as any amendments, revisions and new IFRS, which have been issued subsequently and are relevant to the Division. As a result, these interim financial statements should be read in conjunction with the Division's annual carve-out financial statements.

The interim financial statements were authorized for issue by management on December 14, 2018.

**g) Basis of Measurement**

The interim financial statements as at and for the three and nine months ended September 30, 2018 and 2017 include the assets, liabilities, revenues and expenses of the Division. They have been derived from the accounting records of the Company and have been prepared on a historical cost basis. All inter-entity balances and transactions have been eliminated.

The Company performs various shared and corporate functions for the Division. Allocations for shared and corporate expenses are reflected in the general and administration expenses in the interim condensed carve-out statements of operations and comprehensive income. These allocations are based on a number of factors including revenue, headcount and personnel time allocations which are considered to be reasonable reflections of the historical utilization levels of these services required in support of the Division's business. Additionally, no interest or return on the Division's equity has been included in these interim financial statements and the income taxes are "imputed" on a notional basis using the estimated effective income tax rates of the Company. In the opinion of the management, the methodology used to allocate the carve-out statement of financial position and interim condensed carve-out statements of operations and comprehensive income and all other assumptions underlying the interim financial statements are reasonable and have been applied consistently in the interim financial statements of the Division.

The interim financial statements included herein may not necessarily reflect the financial position, financial performance and cash flows of the Division in the future or what the financial position, financial performance and cash flow would have been had the Division been a stand-alone entity during the periods presented. Future financial performance and financial position could differ materially from the amounts presented herein.

**h) Functional and Presentation Currency**

The functional currency is determined based on the currency of the primary economic environment in which the Division operates. As the Division generates and expends cash in predominantly the United States dollar, it maintains a functional currency of the same.

These interim financial statements are rounded to the nearest Canadian dollar, unless otherwise indicated.

**i) Segment Information**

The Division has been identified as one reportable business segment since the Division has a singular nature of products and services, production process and customer base. All assets, liabilities, revenues and operations are located in the United States.

**j) Critical Accounting Estimates and Judgments**

The preparation of these interim financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the interim financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from estimates and such differences could be material.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change affects that period only, or in the period of the change and future periods, if the change affects both. Areas involving the most critical judgments and estimates are:

v) Inventory allowance – Note 4
vi) Allowance for doubtful accounts – Note 5
vii) Shared and corporate expense allocation – Note 2(b)
viii) Revenue recognition – Note 3

**REVENUE**

The Division transitioned to IFRS 15, *Revenue from Contracts with Customers,* as of January 1, 2018 with no material impact on the opening retained earnings using the cumulative transition method. The Division generates its revenue from one revenue stream – ie. product sales, which is recognized once the Division completes its performance obligation of passing the ownership to the customer. This occurs once the product has left the Division's facility for shipment to a customer. Applying the five-step model required by IFRS 15, revenue is recognized as follows:

Step 1: Identify the contract – contractual arrangements are executed with the client, specifying the timing, scope and compensation;

**Expressed in Canadian Dollars**

Step 2: Identify distinct performance obligation(s) – single performance obligation to provide goods to customers;

Step 3: Estimate the transaction price – fixed price established in the contract;

Step 4: Allocate transaction price to performance obligations – total revenue is allocated to the single performance obligation;

Step 5: Recognize revenue as performance obligations are satisfied – revenue is recognized at a point in time upon transfer of control of the goods to the customer.

### INVENTORIES

Inventories consist of the following:

| | **September 30, 2018** | December 31, 2017 |
|---|---|---|
| Raw materials | **$ 380,630** | $ 359,082 |
| Finished goods | **248,887** | 305,350 |
| | **$ 629,517** | $ 664,432 |

Cost of product sales for the nine-months ended September 30, 2018 include $2,103,085 (2017 - $1,858,949) in inventoried materials.

### FINANCIAL RISK MANAGEMENT

Financial instruments

The Division transitioned to IFRS 9, *Financial Instruments,* as of January 1, 2018 with no material impact on the opening retained earnings using the cumulative transition method. All financial instruments are initially recorded at fair value and designated upon inception into one of the following three categories: amortized cost, fair value through profit or loss, or fair value through other comprehensive income. The Division's financial instruments consist of accounts receivable and accounts payable and accrued liabilities. Accounts receivable are classified as amortized cost at the time of initial recognition. These assets arise principally from the provision of goods to customers where the objective is to hold these assets in order to collect contractual cash flows and the contractual cash flows are solely the payments of principal and interest. Impairment provisions for accounts receivable are recognized based on the simplified approach within IFRS 9 using the lifetime expected credit losses. During the process of reviewing accounts receivable for impairment, the probability of non-payment of the accounts receivable is assessed. This probability is then multiplied by the amount of the expected loss arising from default to determine the lifetime expected credit loss for accounts receivable. For accounts receivable, which are reported net, such provisions are recorded in a separate provision account with the loss being recognized within operating expenses in the interim condensed carve-out statements of operations and comprehensive income. On confirmation that the accounts receivable will not be collectible, the gross carrying value of the asset is written off against the associated provision.

The methodology used to determine the amount of provision recognized is based on whether there has been a significant increase in credit risk since the initial recognition of the financial asset.

The following is a discussion of credit and liquidity risks and related mitigation strategies that have been identified. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks listed.

**Expressed in Canadian Dollars**

Credit risk

The Division is exposed to credit risk associated primarily with its accounts receivables which are subject to normal industry risks in each geographic region in which the Division operates. Management reviews the credit worthiness of its customers by performing background checks on all new customers focusing on publicity, reputation in the market and relationships with customers and vendors. Further, management monitors the frequency of payments from the Division's ongoing customers and performs frequent reviews of outstanding balances. The Division considers a receivable to be in default when contractual payments are 120 days past due. However, in certain cases, the Division may also consider a financial asset to be in default when internal or external information indicates that the Division is unlikely to receive the outstanding contractual amounts in full before taking into account any credit enhancements held by the Division. accounts receivables at each reporting date and makes an allowance for doubtful accounts when the expected recovery could be less than the actual accounts receivable.

As at September 30, 2018, ten customers accounted for 71% (December 2017 – ten customers for 76%) of the accounts receivable balance. These customers, who are distributors and health care institutions, represent substantially all of the Division's sales. The Division has recorded an allowance for doubtful accounts in the amount of $nil (2017 – $nil) resulting in a bad debt expense of $nil (2017 - $nil). Management reviews the outstanding amounts on a regular basis and determines the collectability of the outstanding balances on a case by case basis.

Pursuant to their collective terms the accounts receivable, net, are aged as follows:

| | **September 30, 2017** | December 31, 2017 |
|---|---|---|
| Current | **$ 1,183,549** | $ 578,408 |
| 30 - 60 days past due | **222,369** | 602,373 |
| 60 - 90 days past due | **7,995** | 98,940 |
| Total | **$ 1,413,913** | $ 1,279,721 |

Liquidity risk

The Division continually monitors working capital to ensure sufficient cash is available to meet operational and capital expenditure requirements. The Division has contractual repayments related to accounts payable and accrued liabilities that are due within a year.

### CHANGE IN NON-CASH WORKING CAPITAL ITEMS

Net changes in non-cash working capital balances are as follows:

| | **September 30, 2018** | September 30, 2017 |
|---|---|---|
| Accounts receivable | **$ (72,364)** | $ 346,253 |
| Prepaid expenses | **16,908** | 24,243 |
| Inventories | **65,131** | 323,524 |
| Accounts payable and accrued liabilities | **103,460** | (334,666) |
| | **$ 113,136** | $ 359,353 |

Expressed in Canadian Dollars

During the nine months ended September 30, 2018 non-cash working capital generated a foreign exchange translation adjustment amount of ($32,731) (2017 - $(40,494)).

**RELATED PARTY TRANSACTIONS**

Transactions between the Division and the Company have been identified as related party transaction.

Expenses incurred by the Company that were allocated to the Division are as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | **2018** | 2017 | **2018** | 2017 |
| Personnel expenses | **$1,256** | $63,786 | **$3,768** | $191,358 |
| Professional and legal fees | **2,777** | 57,257 | **8,330** | 171,770 |
| Rent and facilities | **49,197** | 58,913 | **147,590** | 176,738 |
| Office and other expenses | **16,045** | 48,496 | **48,135** | 145,489 |
| | **$69,274** | $228,451 | **$207,823** | $685,354 |

All related party transactions are in the normal course of operations and are measured at the amounts established and agreed to by the related parties.

**STANDARDS, AMENDMENTS AND INTERPRETATIONS NOT YET EFFECTIVE**

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are mandatory for accounting periods beginning after January 1, 2019 or later periods. The adoption of these pronouncements is not expected to have a significant effect on the interim condensed carve-out financial statements, except for the following standards and interpretations that have been issued but are not yet effective:

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IFRS 16, Leases specifies how to recognize, measure, present and disclose leases. It also provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a small value. Accounting for the lessor will remain substantially unchanged. The standard is effective for periods beginning on or after January 1, 2019, with earlier application permitted for companies that also apply IFRS 15, Revenue from Contracts with Customers. The Division is in the process of evaluating the impact of the new standard.

**SUBSEQUENT EVENTS**

Subsequent to the year end, the Company entered into a definitive agreement with a Canadian publicly listed company – Covalon Technologies Ltd for the sale of its AquaGuard division.