Covalon Technologies Ltd.

CONSOLIDATED FINANCIAL STATEMENTS

For the years ended September 30, 2019 and 2018

Contents

Independent auditor's report

To the Shareholders of Covalon Technologies Ltd.

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Covalon Technologies Ltd. and its subsidiaries (together, the Company) as at September 30, 2019 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

What we have audited
The Company's consolidated financial statements comprise:

- the consolidated statement of financial position as at September 30, 2019;
- the consolidated statement of operations and comprehensive income (loss) for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

Independence
We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Comparative information

The financial statements of the Company for the year ended September 30, 2018 were audited by another auditor who expressed an unmodified opinion on those statements on December 17, 2018.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor’s report is Neil Rostant.

(Signed) "PricewaterhouseCoopers LLP"

Chartered Professional Accountants, Licensed Public Accountants

Oakville, Ontario
January 28, 2020

Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

Expressed in Canadian Dollars

	September 30, 2019	September 30, 2018
Assets		
Current assets		
Cash and cash equivalents	**$9,575,149**	$5,483,087
Accounts receivable	**3,635,281**	5,132,693
Inventories (Note 6)	**8,581,378**	5,564,539
Prepaid expenses	**601,333**	959,915
Total current assets	**22,393,141**	17,140,234
Non-current assets		
Restricted cash	**36,624**	36,052
Property, plant and equipment (Note 8)	**1,894,568**	1,161,201
Intangible assets (Note 7)	**2,358,188**	1,370,346
Goodwill (Note 7)	**12,924,412**	-
Total non-current assets	**17,213,792**	2,567,599
Total assets	**$39,606,933**	$19,707,833
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	**$5,681,415**	$4,721,381
Short-term debt (Note 10)	**8,422,966**	1,526,928
Acquisition note payable (Note 5)	**3,380,011**	-
Deferred revenue (Note 9)	**459,315**	206,811
Total current liabilities	**17,943,707**	6,455,120
Non-current liabilities		
Deferred revenue (Note 9)	**139,052**	-
Deferred rent	**299,856**	127,937
Acquisition note payable (Note 5)	**6,294,200**	-
Total non-current liabilities	**6,733,108**	127,937
Total liabilities	**24,676,815**	6,583,057
Shareholders' equity		
Share capital (Note 11)	**44,607,119**	39,257,032
Contributed surplus (Note 11)	**10,717,141**	5,572,839
Foreign exchange translation reserve	**372,612**	(76,114)
Accumulated deficit	**(40,766,754)**	(31,628,981)
Total shareholders' equity	**14,930,118**	13,124,776
Total liabilities and shareholders' equity	**$39,606,933**	$19,707,833

On behalf of the Board:

(signed) "Abe Schwartz" — *Director*

(signed) "Brian Pedlar" — *Director*

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

Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

Expressed in Canadian Dollars

	Year ended September 30,	
	2019	2018
Revenue		
Product	**$30,147,854**	$19,990,663
Development and consulting services	**3,265,636**	1,782,368
Licensing and royalty fees	**591,132**	4,950,311
Total revenue	**34,004,622**	26,723,342
Cost of sales	**12,182,263**	7,058,506
Gross profit before operating expenses	**21,822,359**	19,664,836
Operating expenses		
Operations	**1,909,748**	1,990,549
Research and development activities	**1,359,417**	1,416,640
Sales, marketing and agency fees	**14,952,989**	8,186,811
General and administrative	**11,848,837**	6,453,188
	30,070,991	18,047,188
Financing expenses	**889,141**	-
Net income (loss)	**$(9,137,773)**	$1,617,648
Other comprehensive income		
Amount that may be reclassified to profit or loss		
Foreign currency translation adjustment	**448,726**	376,321
Total comprehensive income (loss)	**$(8,689,047)**	$1,993,969
Basic earnings (loss) per share (Note 18)	**$(0.41)**	$0.08
Diluted earnings (loss) per share (Note 18)	**$(0.41)**	$0.07

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

Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Expressed in Canadian Dollars

	Number of shares	Share capital	Contributed surplus	Accumulated deficit	Foreign exchange translation reserve	Total
Balance at October 1, 2017	21,325,587	$37,879,335	$4,800,816	$(33,246,629)	$(452,435)	$8,981,087
Share-based payment expense	-	-	1,252,577	-	-	$1,252,577
Exercise of stock options	452,170	1,001,539	(480,554)	-	-	$520,985
Exercise of warrants (Note 11)	231,373	376,158	-	-	-	$376,158
Net income for the year	-	-	-	1,617,648	-	$1,617,648
Foreign currency translation adjustment	-	-	-	-	376,321	$376,321
Balance at September 30, 2018	**22,009,130**	**$39,257,032**	**$5,572,839**	**$(31,628,981)**	**$(76,114)**	**$13,124,776**
Balance at October 1, 2018	22,009,130	$39,257,032	$5,572,839	$(31,628,981)	$(76,114)	$13,124,776
Share-based payment expense	-	-	1,717,091	-	-	$1,717,091
Exercise of stock options	77,669	277,284	(120,744)	-	-	$156,540
Exercise of warrants (Note 11)	803,850	1,848,857	-	-	-	$1,848,857
Issuance of common shares on acquisition (Note 5)	178,028	1,271,901	-	-	-	$1,271,901
Issuance of common shares on private placement (Note 11)	2,750,000	1,952,045	3,547,955	-	-	$5,500,000
Net loss for the year	-	-	-	(9,137,773)	-	$(9,137,773)
Foreign currency translation adjustment	-	-	-	-	448,726	$ 448,726
Balance at September 30, 2019	**25,818,677**	**$44,607,119**	**$10,717,141**	**$(40,766,754)**	**$372,612**	**$14,930,118**

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

Covalon Technologies Ltd.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Expressed in Canadian Dollars

	Year ended September 30, 2019	2018
Cash flows from (used in) operating activities		
Net (loss) income for the year	**$(9,137,773)**	$1,617,648
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation of property, plant and equipment	**405,746**	207,931
Amortization of intangible assets	**224,142**	148,464
Impairment of intangible assets	**-**	63,371
Share-based payment expense (Note 11)	**1,717,091**	1,252,577
Interest expense and accretion	**889,141**	-
Cash generated by operating activities before change in non-cash working capital balances	**(5,901,653)**	3,289,991
Change in non-cash working capital (Note 21)	**3,076,174**	(3,893,515)
Total cash flows used in operating activities	**(2,825,479)**	(603,524)
Cash flows from (used in) investing activities		
Purchase of property, plant and equipment	**(1,263,642)**	(726,483)
Purchase of intangible assets	**(19,943)**	(13,610)
Acquisition of AquaGuard (Note 5)	**(5,811,532)**	-
Restricted cash	**(572)**	(120)
Total cash flows used in investing activities	**(7,095,689)**	(740,213)
Cash flows from financing activities		
Exercise of stock options and warrants (Note 11)	**2,005,397**	897,144
Interest paid	**(409,563)**	-
Proceeds from private placement	**5,500,000**	-
Repayment of debt	**(1,406,928)**	-
Proceeds from debt	**8,291,005**	1,521,470
Total cash flows from financing activities	**13,979,911**	2,418,614
Foreign exchange rate changes on cash	**33,319**	252,327
Total cash flows during the year	**4,092,062**	1,327,204
Cash and cash equivalents, beginning of the year	**$5,483,087**	$4,155,883
Cash and cash equivalents, end of the year	**$9,575,149**	$5,483,087

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

1. CORPORATE INFORMATION

Covalon Technologies Ltd. ("the Company") is incorporated under the laws of Ontario and is engaged in the business of developing, licensing, and selling medical technologies and products. The consolidated financial statements of Covalon Technologies Ltd. for the year ended September 30, 2019 comprise the results of the Company and its wholly owned subsidiaries. The Company has received regulatory approval on numerous products and is currently generating revenue. The Company has adopted a business model that predominantly contracts the manufacturing and distribution of its commercialized products through partners. The Company generates its revenues through development contracts, licensing agreements and distribution contracts, and sales of products.

On October 1, 2018 the Company completed the acquisition of AquaGuard, a division of a Seattle-based medical company (Note 5). The Company acquired all of the assets of AquaGuard, to allow the Company to carry on the operations of the business, including the AquaGuard family of moisture barrier products as well as their specialised salesforce in the United States.

The Company is listed on the TSX Venture Exchange, having the symbol COV. The Company also trades on the OTCQX Best Market, having the symbol of CVALF.

The address of the Company's corporate office and principal place of business is 1660 Tech Avenue, Unit 5, Mississauga, Ontario, Canada.

2. LIQUIDITY

The Company entered into an Acquisition Note Payable ("Acquisition Note") agreement (discussed in Note 5) with the prior owners of the AquaGuard assets ("Vendor") pursuant to which a milestone payment of $2.5m USD became due on October 1, 2019 and a milestone payment of $5m USD will become due on October 1, 2020. The Company had intended to fund the Acquisition Note milestone payments through the Acquisition Line Facility ("Facility") with HSBC Bank Canada ("HSBC").

As of September 30, 2019, the Company did not meet one covenant related to the Facility with HSBC that required the Company to have a Fixed Charge Coverage ratio of 1.00 to 1.00. As a result, the Company was prohibited from making the first instalment payment of the Acquisition Note using funds made available under the Facility as originally intended in order to meet the commitments to the Vendor. The first payment to the Vendor of $2.5m USD was due October 1, 2019. The Company was also unable to use cash on hand to make the payment to the Vendor without being offside on future covenant calculations. When entering into the purchase and banking agreements described above, the Company, the Vendor, and HSBC entered into a subordination agreement which states that no Acquisition Note amounts will be due if the Company is in breach of the Facility agreement.

Subsequent to September 30, 2019, the Company obtained a waiver from HSBC that addressed the breach of the Facility for the quarter then ended. The Facility agreement was also amended to address both ratios, and definitions, that will provide relief to the Company in future quarters. The Company will be required to maintain a minimum cash balance of $1.5m and the Company is not currently permitted to make any cash payments to the Vendor.

The Vendor can only make a claim against the Company for non-payment under the Acquisition Note in accordance with the terms of the subordination agreement. The Acquisition Note, as outlined in the subordination agreement, is unconditionally and irrevocably deferred, postponed and subordinated in all respects until repayment in full has been made to HSBC, and therefore the Vendor currently have no recourse under the subordination agreement.

Expressed in Canadian Dollars

While the Company believes that based on cash on hand and amounts available under the HSBC operating line discussed in Note 10, it has sufficient future cash flow to support its operating needs for the near future, without access to remaining funds from the Facility, the Company may not generate sufficient operating cash flows to be able to repay the Acquisition Note and/or the Facility, should they both become due and payable during fiscal 2020, without refinancing these liabilities, or though the issuance of additional equity of the Company. While the company does not anticipate the need to raise capital, this may be required. Therefore it is essential that the Company maintains compliance with the amended covenants.

To address the future payments required the Company: a) is in negotiations with the Vendor to renegotiate the terms of the Acquisition Note which could favorably impact the revised covenant calculations beginning in Q3 2020; and, b) continues to look for ways to expand its business, with both new, and existing clients globally.

The Company continually monitors working capital to ensure sufficient cash is available to meet operational and capital expenditure requirements. The following table shows the Company's significant contractual maturities, on an undiscounted cash flow basis, as at September 30, 2019:

	Carrying amount ($)	Future cash flows ($)	Less than 1 year ($)	Between 1 and 5 years ($)	Greater than 5 years ($)
Accounts payable and accrued liabilities	5,681,415	5,681,415	5,681,415	-	-
Debt	8,422,966	8,422,966	8,422,966	-	-
Acquisition note payable	9,674,211	10,001,511	3,380,011	6,621,500	-
Total	**23,778,592**	**24,105,892**	**17,484,392**	**6,621,500**	-

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

Basis of preparation

The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS").The consolidated financial statements were authorized for issue by the Board of Directors on January 27, 2020.

Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries over which the Company has control: Covalon Technologies Inc.; Covalon Technologies (USA) Ltd.; Covalon Medical Device Shanghai Co., Ltd.; Covalon Technologies (Israel) Ltd.; Covalon Technologies (Europe) Limited; and, Covalon Technologies AG Ltd. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The wholly owned subsidiaries of the Company are consolidated from the date control is obtained. All intercompany transactions, balances, income and expenses have been eliminated upon consolidation.

Business combinations

The acquisition method of accounting is used to account for business combinations. The consideration transferred in a business combination is measured at fair value at the date of acquisition. Acquisition-related transaction costs are recognized in the consolidated statements of operations and comprehensive income (loss) as incurred. At the acquisition date, the identifiable assets acquired and the liabilities assumed are initially recognized at their fair value. Goodwill is measured as the excess of the sum of the consideration transferred and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed. When the consideration transferred by the Company in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition date fair value and is included as part of the consideration transferred in a business combination. Changes in the acquisition date fair values of the identifiable assets, liabilities and contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the measurement period (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

Other than measurement period adjustments, contingent consideration that is classified as a financial liability is remeasured at subsequent reporting dates, with the corresponding gain or loss recognized in the consolidated statements of operations and comprehensive income (loss).

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker has been identified as the chief executive officer.

Foreign currency translation

The Company has a functional currency of Canadian dollars and the functional currency of each subsidiary is determined based on facts and circumstances relevant for each subsidiary. Where the Company's presentation currency of Canadian dollars differs from the functional currency of a subsidiary, the assets and liabilities of the subsidiary are translated from the functional currency into the presentation currency at the exchange rates as at the reporting date. The income and expenses of the subsidiaries are translated at rates approximating the exchange rates at the dates of the transactions. Exchange differences arising on the translation of the consolidated financial statements of the Company's subsidiaries are recognized in other comprehensive loss (income).

Foreign currency transactions are translated into the functional currency of the Company or its subsidiaries, using the exchange rates prevailing at the dates of these transactions. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in currencies other than an entity's functional currency are recognized in the consolidated statements of operations and comprehensive income (loss).

Accounting policy applied from October 1, 2018 – financial assets

From October 1, 2018, the Company classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value (either through other comprehensive income (loss), or through profit or loss); and

- those to be measured at amortized cost.

The classification depends on the Company's business model for managing the financial assets and the contractual terms of the cash flows. The Company does not currently have any assets measured subsequently at fair value.

At initial recognition, the Company measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset.

Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

The Company assesses on a forward-looking basis the expected credit losses associated with its financial assets carried at amortized cost. For accounts receivable, the Company applies the simplified approach permitted by IFRS 9, which requires lifetime expected credit losses to be recognized at the time of initial recognition of the receivables.

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 the estimated costs of completion and the estimated costs necessary to make the sale. Cost is determined using either the first-in, first-out method or the weighted average cost method.

Property, plant and equipment

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

Furniture and fixtures	20% diminishing balance basis
Lab equipment	20% diminishing balance basis
Leasehold improvements	20% straight-line

Intangible assets

Intangible assets include expenditures related to obtaining patents and technology rights associated with patents, trademarks, computer software, and brands. Intangible assets are stated at cost, less accumulated amortization except for trademarks, which are considered to have an indefinite useful life. 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 Company's technology platforms. Development expenditures are capitalized only if the relevant 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 patents.

Amortization is calculated using the following methods and rates:

Patents	5% straight-line
Computer software	20% diminishing balance basis
Brand	5% straight-line

Goodwill

Goodwill represents the excess fair value of the consideration transferred over the fair value of the underlying net assets in a business combination and is measured at cost less accumulated impairment losses. Goodwill is not amortized but is tested for impairment on an annual basis or more frequently if there are indications the goodwill may be impaired. For the purposes of impairment testing, goodwill is allocated to each of the Company's cash generating units (CGUs) or group of CGUs that are expected to benefit from the synergies of the acquisition. If the recoverable amount of the CGU or group of CGUs is less than the carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill and then to other assets of the CGU or group of CGUs.

Impairment of non-financial assets

Property, plant and equipment and intangible assets are tested for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flow CGUs.

The recoverable amount is the higher of an asset's fair value, less costs of disposal and value in use (which is the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized as the amount by which the asset's carrying amount exceeds its recoverable amount.

The Company evaluates impairment losses for potential reversals when events or circumstances warrant such consideration.

Accounts payable and accrued liabilities

These amounts represent liabilities for goods and services provided to the Company before the end of the financial year, which are unpaid. Accounts payable and accrued liabilities are presented as current liabilities unless payment is not due within 12 months after the reporting period.

Debt

Debt is initially recognized at fair value, net of transaction costs incurred. Debt is subsequently measured at amortized cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognized in the consolidated statements of operations and comprehensive income (loss) over the period of the debt using the effective interest method.

Debt is removed from the consolidated balance sheets when the obligation specified in the contract is discharged, cancelled or expired. The difference between the carrying amount of a financial liability that has been extinguished and the consideration paid is recognized in the consolidated statements of operations and comprehensive income (loss) within finance expenses.

Revenue

The Company generates revenue from product sales, development and consulting services, as well as licensing, and royalty fees.

Product revenue is recognized when control over products has been transferred to the customer and this either occurs when products are shipped or delivered based upon the contractual agreements in place. The amount of revenue is recorded as the amount that the Company expects to be entitled to in exchange for transferring the promised goods net of estimated returns, chargebacks, or discounts.

Development, and consulting revenue is recognized over the period in which the services are performed.

The Company may enter into product development, consulting, licensing, and royalty agreements with customers. The terms of the agreements may include non-refundable signing fees, milestone payments, hourly rates, or royalty fees. These multiple element arrangements are analysed to determine whether the deliverables can be separated or whether they must be accounted for as a single unit of accounting. Upfront fees are recognized as revenue when persuasive evidence of an arrangement exists, the fee is fixed or determinable, delivery or performance has been substantially completed and collection is reasonably assured. If there are no substantive performance obligations over the life of the contract, the upfront non-refundable payment is recognized when the underlying performance obligation is satisfied. If substantive contractual obligations are satisfied over time or over the life of the contract, revenue is deferred and recognized over the performance period. The term over which upfront fees are recognized is revised if the period over which the Company maintains substantive contractual obligations changes. Service revenue is recognized over the period in which the services are performed.

In some instances, cash is received before the Company has satisfied the performance obligations and this amount is recorded as deferred revenue.

Income taxes

Income taxes are accounted for using the liability method. Deferred tax assets and liabilities are recognized for the differences between the tax basis and carrying amounts of assets and liabilities, for operating losses and for tax credit carry-forwards. Deferred tax assets are recognized to the extent that it is probable that future taxable income will be available against which temporary differences can be utilized. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws.

Share-based compensation

The Company grants stock options periodically to certain directors, officers, employees or service providers.

Options currently outstanding vest over three years and have a contractual life of five years. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the tranche's vesting period using the graded vesting method by increasing contributed surplus based on the number of awards expected to vest.

Leases

Leases are classified as finance leases when the lease arrangement transfers substantially all of the risks and rewards related to the ownership of the leased asset. All other leases are treated as operating leases. Payments on operating lease agreements are recognized as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

Earnings (loss) per share

Basic earnings (loss) per share is calculated by dividing the net loss by the weighted average number of common shares outstanding during the year. Diluted earnings (loss) per share is calculated by dividing the applicable net loss by the sum of the weighted average number of shares outstanding during the year and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the year.

Adoption of new accounting standards

A number of new amended standards became applicable for the current reporting period and the Company had to change its accounting policies as a result. The impact of the adoption of these standards is disclosed below:

IFRS 9, Financial Instruments ("IFRS 9")

IFRS 9, Financial Instruments replaces the provisions of International Accounting Standard (IAS) 39, Financial Instruments – Recognition and Measurement ("IAS 39") that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting. The adoption of IFRS 9 from October 1, 2018 resulted in changes in the Company's accounting policies but it did not result in any adjustments.

Expressed in Canadian Dollars

The Company has applied IFRS 9 retrospectively, but has elected not to restate comparative information. As a result, the comparative information provided continues to be accounted for in accordance with the Company's previous accounting policy.

The Company has one type of financial asset that is subject to IFRS 9's new expected credit loss model, which is accounts receivable. The Company was required to revise its impairment methodology under IFRS 9 for accounts receivable and this resulted in no adjustments as at October 1, 2018. The Company applies the IFRS 9 simplified approach to measuring expected credit losses, which uses a lifetime expected loss allowance for all accounts receivable. To measure the expected credit losses, accounts receivable have been grouped based on shared credit risk characteristics and the days past due. On that basis, the loss allowance as at October 1, 2018 and September 30, 2019 is nominal and has not incurred significant credit losses.

Accounts receivable are written off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, among others, failure to make contractual payments for an extended period of time.

There was no impact on the Company's financial liabilities as a result of the adoption of IFRS 9 and no material change to the Company's accounting policies for financial liabilities.

The following table shows the original financial instrument classification under IAS 39 and the new classification under IFRS 9:

Financial instrument	Classification under IFRS 9	Classification under IAS 39
Cash and cash equivalents	Amortized cost	Loans and receivables
Accounts receivable	Amortized cost	Loans and receivables
Restricted cash	Amortized cost	Loans and receivables
Debt	Amortized cost	Other financial liabilities
Acquisition note payable	Amortized cost	Other financial liabilities
Trade and other payables	Amortized cost	Other financial liabilities

IFRS 15, Revenue from Contracts with Customers ("IFRS 15")

IFRS 15, Revenue from Contracts with Customers amends revenue recognition requirements and establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The adoption of IFRS 15 from October 1, 2018 did not result in any adjustments. In accordance with the transitional provisions in IFRS 15, the Company has adopted the new rules on a full retrospective basis.

Accounting standards issued but not yet adopted

IFRS 16, Leases ("IFRS 16")

On January 13, 2016, the IASB published a new standard, IFRS 16. The new standard will eliminate the distinction between operating and finance leases and will bring most leases onto the consolidated balance sheet for lessees. This standard is effective for annual reporting periods beginning on or after January 1, 2019. The Company intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning

October 1, 2019. As the Company has significant contractual obligations in the form of operating leases under current IFRS, there will be a material increase to both assets and liabilities on adoption of IFRS 16, and changes to the timing of recognition of expenses associated with the lease arrangements. The Company is analyzing the new standard to determine its impact on the Company's consolidated balance sheets and consolidated statements of operations and comprehensive income (loss). The Company expects to adopt IFRS 16 using the modified retrospective transition method. Further, the Company currently expects to apply the following practical expedients: (i) grandfather the assessment of which transactions are leases; (ii) recognition exemption of short-term leases; and (iii) recognition exemption leases of low-value items.

IFRIC 23, Uncertainty over Income Tax Treatments ("IFRIC 23")

In June 2017, the IASB issued IFRIC 23, with a mandatory effective date of January 1, 2019. The interpretations provide guidance on how to value uncertain income tax positions based on the probability of whether the relevant tax authorities will accept the Company's tax treatments. A Company is to assume that a taxation authority with the right to examine any amounts reported to it will examine those amounts and will have full knowledge of all relevant information when doing so. IFRIC 23 is to be applied by recognizing the cumulative effect of initially applying these guidelines in opening deficit without adjusting comparative information. The Company currently expects no impact in applying the new standard.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Accounting for acquisitions

The Company assessed whether an acquisition should be accounted for as an asset acquisition or a business combination under IFRS 3, Business Combinations ("IFRS 3"). This assessment requires management to assess whether the assets acquired and liabilities assumed constitute a business as defined in IFRS 3 and if the integrated set of activities, including input and processes acquired, is capable of being conducted and managed as a business and the Company obtains control of the business. The Company's acquisition has been accounted for as a business combination. Areas of estimation include the determination and fair value measurement of the contingent consideration, the probability of the contingency being achieved, and the discount rate. Management is also required to make estimates of the fair value of assets acquired and liabilities assumed.

Impairment of non-financial assets

The Company reviews amortized non-financial assets for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may be impaired. It also reviews goodwill annually for impairment. If the recoverable amount of the respective non-financial asset is less than its carrying amount, it is considered to be impaired. In the process of measuring the recoverable amount, management makes assumptions about future events and circumstances. The actual results may vary and may cause significant adjustments.

5. BUSINESS COMBINATION

On October 1, 2018, Covalon completed the acquisition of AquaGuard, a Seattle, Washington-based division of medical technologies company Cenorin, LLC. AquaGuard's specialized products provide patients with crucial moisture protection for wound, surgical, and vascular access sites throughout the body while showering.

Expressed in Canadian Dollars

Covalon acquired all of the assets and employed all staff dedicated to the AquaGuard business from Cenorin, LLC. The consideration of approximately $15.9 million (USD $12 million) also includes a contingent payment of $1.1 million (USD $0.9m) which required certain revenue targets to be completed during the calendar year 2018. The contingent consideration was classified as a Level 3 financial liability within the fair value hierarchy given its fair value was estimated using the discounted value of the estimated future payment. The key assumptions in valuing the contingent consideration included: estimated projected net sales; the likelihood of the contingent milestone being achieved and a discount rate of 5.2%. During the year the change in fair value of the contingent consideration was $30,370. The revenue target for the twelve month period ended December 31, 2018 was achieved and the full contingent amount of $1.2 million (USD $0.9m) was paid.

The Company accounted for this transaction as a business combination and has applied the acquisition method of accounting. The purchase price allocation of assets acquired and the fair value of the consideration is as follows:

Assets acquired	
Accounts receivable	$1,385,029
Prepaid expenses	41,113
Inventories	889,808
Property, plant and equipment	20,040
Brand intangible asset	1,088,255
Other intangible assets	34,688
Goodwill	12,484,611
Total assets acquired	**$15,943,544**

Goodwill of $12,484,611 arising from the acquisition is attributable to the acquired workforce and synergies expected from combining the acquired assets with the Company.

Consideration paid or payable	
At closing	
Cash	$4,657,731
Common shares issued (not held in escrow) 102,892	859,891
Common shares issued (held in escrow) 75,136	412,010
Post closing	
Fair value of contingent consideration	1,123,431
Fair value of future cash payments	8,890,481
Total consideration paid or payable	**$15,943,544**

The shares held in escrow will be released evenly at 12 months; 18 months; and, 24 months from the closing date subject to certain acceleration clauses and restrictions.

The fair value of future cash payments is comprised of two payments. The first payment of US$2,552,300 was due 12 months from the acquisition date; and a second payment of US$5,000,000 is due 24 months after the acquisition date. The Company, HSBC, and the Vendor are all party to a subordination agreement that restricts the rights of the Vendor. The Vendor can only make a claim against the Company for non-payment under the Acquisition Note Payable in accordance with the terms of the subordination agreement. The Acquisition Note Payable, as outlined in the subordination agreement, is unconditionally and irrevocably deferred, postponed and subordinated in all respects until repayment in full has been made to HSBC. The first payment of approximately US$2.5m has not been paid as of the date of these financial statements (see Note 2). Areas of estimation include the determination and fair value measurement of the future payments, which includes a discount rate of 5.2%. The following is a summary of the changes during the year:

Expressed in Canadian Dollars

	Fair value ($)
Balance at acquisition	8,890,481
Accretion	479,578
Foreign exchange	304,152
Balance at September 30, 2019	**9,674,211**

Acquisition related costs of $473,015 have been charged to general and administrative expense during the year.

During the year ended September 30, 2019, there was revenue of $13,521,092 and a net loss and comprehensive loss of $(2,468,059) recorded in the consolidated statements of operations and comprehensive income (loss) related to the former AquaGuard business.

6. INVENTORIES

Inventories consist of the following:

	September 30, 2019	September 30, 2018
Raw materials	**$2,347,981**	$1,546,489
Finished goods	**6,293,426**	4,083,155
Inventory provision	**(176,124)**	(65,105)
	$8,581,378	$5,564,539

Cost of product sales for the year ended September 30, 2019 include $10,213,576 (2018 - $6,751,698), respectively in inventoried materials.

7. INTANGIBLE ASSETS AND GOODWILL

Goodwill is comprised of the following amounts:

	Goodwill ($)
Balance at September 30, 2018	-
Acquisition	12,484,611
Foreign exchange	439,801
Balance at September 30, 2019	**12,924,412**

In accordance with the Company’s accounting policy, the carrying value of goodwill is assessed annually as well as assessed for impairment triggers at each reporting date to determine whether there exists any indicators of impairment. When there is an indicator of impairment of non-current assets within a CGU or group of CGUs containing goodwill, the Company tests the non-current assets for impairment first and recognizes any impairment loss on goodwill before applying any remaining impairment loss against the non-current assets within the CGU.

The Company completed its annual goodwill impairment testing on the goodwill related to the AquaGuard CGU, which comprises all of the goodwill of the Company at September 30, 2019. The recoverable amount of the AquaGuard CGU was calculated using fair value less costs of disposal (FVLCD).

Expressed in Canadian Dollars

The calculation of the recoverable amount of the AquaGuard CGU was determined using discounted cash flow projections based on financial forecasts approved by management covering a five-year period (Level 3 of the fair value hierarchy) and a terminal growth assumption of 2%. The key assumptions and estimates used in determining the FVLCD are related to revenue and EBITDA assumptions, which are based on the financial forecast and assumed growth rates, working capital assumptions, the effective tax rate of 21% and the discount rate of 15.5% applied to the cash flow projections. As a result of the impairment testing performed, it was determined that the recoverable amount of the AquaGuard CGU of $18.2m exceeded the carrying value of $14.8m and no impairment writedown was required.

Intangible assets are comprised of the following amounts:

	Deferred Development Costs ($)	**Brand ($)**	**Patents ($)**	**Trademarks ($)**	**Computer Software ($)**	**Total ($)**
Cost						
Balance at September 30, 2017	2,036,709	-	954,041	74,989	142,078	3,207,817
Additions	-	-	13,610	-	-	13,610
Impairment	-	-	(66,578)	-	-	(66,578)
Foreign exchange	122,549	-	16,189	2,794	5,294	146,826
Balance at September 30, 2018	2,159,258	-	917,262	77,783	147,372	3,301,675
Acquisition	-	1,088,255	25,395	3,411	5,882	1,122,943
Additions	-	-	-	-	19,943	19,943
Foreign exchange	49,707	37,400	21,988	1,908	3,516	114,519
Balance at September 30, 2019	2,208,965	1,125,655	964,645	83,102	176,713	4,559,080
Accumulated amortization						
Balance at September 30, 2017	1,251,943	-	281,231	-	139,265	1,672,439
Amortization	107,023	-	40,862	-	579	148,464
Impairment	-	-	(3,207)	-	-	(3,207)
Foreign exchange	94,250	-	14,189	-	5,194	113,633
Balance at September 30, 2018	1,453,216	-	333,075	-	145,038	1,931,329
Amortization	110,674	56,257	50,993	-	6,218	224,142
Foreign exchange	33,228	26	8,847	-	3,320	45,421
Balance at September 30, 2019	1,597,118	56,283	392,915	-	154,576	2,200,892
Carrying amounts						
At September 30, 2018	706,042	-	584,187	77,783	2,334	1,370,346
At September 30, 2019	**611,847**	**1,069,372**	**571,730**	**83,102**	**22,137**	**2,358,188**

Expressed in Canadian Dollars

8. PROPERTY, PLANT AND EQUIPMENT

	Furniture and Fixtures ($)	Lab Equipment ($)	Leasehold Improvements ($)	Total ($)
Cost				
Balance at September 30, 2017	406,946	1,245,627	128,640	1,781,213
Additions	104,098	560,255	62,130	726,483
Foreign exchange	11,540	54,449	5,674	71,663
Balance at September 30, 2018	522,584	1,860,331	196,444	2,579,359
Additions	387,287	551,815	324,540	1,263,642
Acquisition	3,290	16,750	-	20,040
Foreign exchange	(62,095)	22,877	(77,815)	(117,033)
Balance at September 30, 2019	851,066	2,451,773	443,169	3,746,008
Accumulated depreciation				
Balance at September 30, 2017	300,478	774,235	90,747	1,165,460
Depreciation	31,966	157,187	18,778	207,931
Foreign exchange	11,424	29,863	3,480	44,767
Balance at September 30, 2018	343,868	961,285	113,005	1,418,158
Depreciation	97,956	258,246	49,544	405,746
Foreign exchange	4,332	20,712	2,492	27,536
Balance at September 30, 2019	446,156	1,240,243	165,041	1,851,440
Carrying amounts				
At September 30, 2018	178,716	899,046	83,439	1,161,201
At September 30, 2019	**404,910**	**1,211,530**	**278,128**	**1,894,568**

9. DEFERRED REVENUE

	September 30, 2019	September 30, 2018
Balance, beginning of year	**$206,811**	$524,885
Add:		
Deferred licensing fees	**299,138**	-
Deferred product and services revenue	**2,540,057**	2,936,275
Less:		
Recognition of deferred product and services revenue	**(2,305,990)**	(3,194,460)
Recognition of deferred licensing fees	**(135,360)**	(74,274)
Foreign exchange	**(6,289)**	14,385
Balance, end of year	**598,367**	206,811
Current portion	**(459,315)**	(206,811)
Non-current portion	**$139,052**	$ -

Expressed in Canadian Dollars

10. DEBT

During the year ended September 30, 2018, the Company entered into the Facility with HSBC. This Facility provides credit of up to approximately $17 million and is comprised of:

- An Acquisition Line of $9,000,000;
- A revolving operating line of $5,000,000;
- A guarantee facility of $2,000,000 (USD); and,
- Other facilities of $480,000 (USD) and $100,000 for other liabilities.

The Facility is secured by a General Security Agreement which also includes the wholly owned subsidiaries. The Company is also subject to financial covenant and certain reporting requirements. These covenants include: 1) funded debt to adjusted EBIDTA; 2) fixed charged coverage ratio; and, 3) current ratio. As of September 30, 2019, the Company was not able to fulfill all financial covenants as stipulated under the Facility, for the Acquisition Line, which constituted an event of default. Since the Company did not have an unconditional right to defer the settlement of the debt for at least 12 months, IFRS requires the liability to be classified as current as at September 30, 2019. The carrying amount of the acquisition line is $4,872,966 as of September 30, 2019. Subsequent to September 30, 2019, the Company obtained a waiver and amendment to the Facility from HSBC for the breach of covenants thereof as described in Note 2.

A reconciliation of the operating line is as follows:

	September 30, 2019 ($)
Balance – October 1, 2018	1,526,928
Proceeds received	2,350,000
Interest accrued during the year	149,715
Interest paid during the year	(149,715)
Repayment of principal	(326,928)
Balance – Ending	3,550,000
Less: Current portion	3,550,000
Non-current portion	-

As of September 30, 2019, the Company has $3,550,000 drawn and outstanding on the revolving operating line. This facility is repayable on demand by HSBC which could occur if there was a deficiency in the borrowing base of assets used to support this line. The interest rate associated with the operating line is Prime Rate plus 1.0%. During the year ended September 30, 2019, the Company recognized $149,715 of interest expense on this loan.

Expressed in Canadian Dollars

A reconciliation of the Acquisition Line is as follows:

	September 30, 2019 ($)
Balance – October 1, 2018	-
Proceeds received	5,941,005
Repayments of principal	(1,080,000)
Interest accrued during the year	240,557
Interest paid during the year	(259,848)
Accretion	31,252
Balance – Ending	4,872,966
Less: Current portion	4,872,966
Non-current portion	-

To facilitate the AquaGuard acquisition (discussed in Note 5) the Company drew funds against the Acquisition Line. This facility is repayable on demand by HSBC which could occur if there was a default on the financial covenants. As of September 30, 2019, the Company has $4,872,966 drawn and outstanding on the acquisition line. During the year ended September 30, 2019, the Company recognized $240,557 of interest and accretion expense on the Acquisition Line. The Company will require HSBC approval to further access funds available under this line (as discussed in Note 2).

11. SHAREHOLDERS' EQUITY

Common shares

The Company is authorized to issue an unlimited number of common shares with no par value. All shares are fully paid.

On September 18, 2019, the Company completed a non-brokered private placement offering comprised of 2,750,000 units (each, a "Unit") of the Corporation at a price of $2.00 per unit for aggregate gross proceeds of $5,500,000 (the "Offering"). Each Unit is comprised of one common share of the Company (a "Common Share") and one Common Share purchase warrant (a "Warrant"). Each Warrant entitles the holder to acquire an additional Common Share at a price of $2.00 per share for a period of five years from the closing date.

During the year ended September 30, 2019, 803,850 warrants were exercised for common shares of the Company for aggregate proceeds of $1,848,857.

During the year ended September 30, 2019, 77,669 stock options were exercised for proceeds of $156,540. Additionally, $120,744 of contributed surplus related those stock options was reclassified to share capital.

On October 1, 2018, Covalon acquired AquaGuard, a division of Cenorin LLC., and issued 102,891 common shares as a closing share payment (see Note 5). These shares were valued at $859,891 based on the Company's closing share price at the acquisition date. In addition, 75,136 common shares of the Company were issued in escrow with release at 12 months, 18 months and 24 months after the acquisition date. These shares were valued at $412,010 based on the share price at the date of acquisition, reduced for the implied cost of synthetically calculated put options to reflect the escrow release dates.

Warrants

As a result of the September 18, 2019 private placement, the Company issued 2,750,000 warrants. The Company estimated the fair value of the warrants using the Black-Scholes option pricing model with the following assumptions: share price - $1.91, average risk-free rate of interest - 1.23%, dividend rate - Nil, volatility – 87.67% and a term of 5 years. The fair value of the warrants issued was $3,547,955, or $1.29 per warrant, and was included in contributed surplus.

Expressed in Canadian Dollars

The following is a summary of all warrants:

	Number of Warrants	Weighted average exercise Price	Weighted Average Expiry (years)
Balance at October 1, 2017	**1,310,671**	**$2.18**	
Exercised during the year	231,373	$1.63	
Balance at September 30, 2018	**1,079,298**	**$2.30**	**1.67**
Exercised during the year	803,851	$2.30	
Issued during the year	2,750,000	$2.00	
Balance at September 30, 2019	**3,025,447**	**$2.03**	**4.58**

12. SHARE-BASED PAYMENTS

Option plan details

The Company has a Stock Option Plan ("the Plan") under which non-transferable options to purchase common shares of the Company may be granted to directors, officers, employees, or service providers of the Company. The terms of the Plan provide that the Directors have the right to grant options to acquire common shares of the Company at not less than the closing market price of the shares on the day preceding the grant at terms of up to five years. No amounts are paid or payable by the recipient on receipt of the option, and the options granted are not dependent on any performance-based criteria. Unless the board of directors decides otherwise, options granted under the plan will vest as follows: 33% of the options vest in one year, with a further 33% vesting in each of the subsequent two years on the anniversary of the initial grant date.

Expressed in Canadian Dollars

The following is a summary of change in stock options from October 1, 2017 to September 30, 2018:

Grant Date	Expiry Date	Exercise Price	Opening Balance	Granted	Exercised	Expired	Forfeited	Closing Balance	Vested	Unvested	Weighted Average Expiry (years)
16-Aug-13	16-Aug-18	$0.16	40,000	-	(35,000)	(5,000)	-	-	-	-	-
26-Sep-13	26-Sep-18	$0.85	230,000	-	(230,000)	-	-	-	-	-	0.01
13-Jun-14	13-Jun-19	$2.00	85,001	-	(50,000)	-	-	35,001	35,001	-	0.70
26-Mar-15	26-Mar-20	$1.40	134,666	-	(34,000)	-	-	100,666	100,666	-	1.49
7-Mar-16	7-Mar-21	$1.13	164,166	-	(29,169)	-	(10,000)	124,997	80,275	44,722	2.44
23-Jun-16	23-Jun-21	$1.29	174,999	-	(31,667)	-	-	143,332	84,999	58,333	2.73
14-Sep-16	14-Sep-21	$2.29	65,000	-	-	-	(35,000)	30,000	20,000	10,000	2.96
8-Feb-17	8-Feb-22	$2.20	260,000	-	(23,333)	-	(5,000)	231,667	63,334	168,333	3.36
20-Jun-17	20-Jun-22	$2.47	422,500	-	(19,000)	-	(20,000)	383,500	121,833	261,667	3.72
25-Oct-17	25-Oct-22	$3.80	-	60,000	-	-	-	60,000	-	60,000	4.07
21-Dec-17	21-Dec-22	$4.65	-	187,500	-	-	-	187,500	-	187,500	4.23
24-Jan-18	24-Jan-23	$6.02	-	60,000	-	-	-	60,000	-	60,000	4.32
27-Sep-18	27-Sep-23	$8.50	-	155,000	-	-	-	155,000	-	155,000	4.99
			1,576,332	**462,500**	**(452,169)**	**(5,000)**	**(70,000)**	**1,511,663**	**506,108**	**1,005,555**	**3.46**
Weighted Average Exercise Price			**$1.74**	**$6.01**	**$1.15**	**$0.16**	**$2.17**	**$3.20**	**$1.77**	**$3.92**	

The following is a summary of changes in stock options from October 1, 2018 to September 30, 2019:

Grant Date	Expiry Date	Exercise Price	Opening Balance	Granted	Exercised	Forfeited	Closing Balance	Vested	Unvested	Weighted Average Expiry (years)
13-Jun-14	13-Jun-19	$2.00	35,001	-	(30,001)	(5,000)	-	-	-	-
26-Mar-15	26-Mar-20	$1.40	100,666	-	(21,667)	(5,000)	73,999	73,999	-	0.49
7-Mar-16	7-Mar-21	$1.13	124,997	-	(12,499)	(12,498)	100,000	100,000	-	1.44
23-Jun-16	23-Jun-21	$1.29	143,332	-	(6,668)	(20,832)	115,832	115,832	-	1.73
14-Sep-16	14-Sep-21	$2.29	30,000	-	-	(10,000)	20,000	20,000	-	1.96
8-Feb-17	8-Feb-22	$2.20	231,667	-	(3,334)	(60,000)	168,333	112,222	56,111	2.36
20-Jun-17	20-Jun-22	$2.47	383,500	-	(3,500)	(31,667)	348,333	232,222	116,111	2.72
25-Oct-17	25-Oct-22	$3.80	60,000	-	-	-	60,000	20,000	40,000	3.07
21-Dec-17	21-Dec-22	$4.65	187,500	-	-	(20,000)	167,500	55,833	111,667	3.23
24-Jan-18	24-Jan-23	$6.02	60,000	-	-	-	60,000	20,000	40,000	3.32
27-Sep-18	27-Sep-23	$8.50	155,000	-	-	(12,500)	142,500	47,500	95,000	3.99
22-Dec-18	22-Dec-23	$4.28	-	425,000	-	(73,333)	351,667	-	351,667	4.23
15-Mar-19	15-Mar-24	$5.03	-	182,500	-	-	182,500	-	182,500	4.46
			1,511,663	**607,500**	**(77,669)**	**(250,830)**	**1,790,664**	**797,608**	**993,056**	**3.10**
Weighted Average Exercise Price			**$3.20**	**$4.51**	**$1.66**	**$3.21**	**$3.71**	**$2.62**	**$4.58**	

Fair value of options issued during the year

During the year ended September 30, 2019, the Company issued the following options:

On March 15, 2019, 182,500 options with a weighted average fair value of $3.37 were granted. The fair market value of options granted was determined using the Black-Scholes valuation model with the following implicit assumptions: average risk-free rate of interest – 1.79%, dividend rate – NIL, volatility – 89.15% and an expected life of 5 years. The estimated forfeiture rate is 7.47%.

On December 22, 2018, 425,000 options with a weighted average fair value of $2.93 were granted. The fair market value of options granted was determined using the Black-Scholes valuation model with the following implicit assumptions: average risk-free rate of interest – 2.26%, dividend rate – NIL, volatility – 91.6% and an expected life of 5 years. The estimated forfeiture rate is 7.52%.

During the year ended September 30, 2018, the Company issued the following options:

On September 27, 2018, 155,000 options with a weighted average fair value of $5.86 were granted. Trading price of the stock at the time of the grant was $8.50. The fair market value of options granted was determined using the Black-Scholes valuation model with the following implicit assumptions: average risk-free rate of interest – 2.2%, dividend rate – NIL, average volatility – 92.5% and an average term of 5 years. The estimated forfeiture rate is 6.71%.

On January 24, 2018, 60,000 options with a weighted average fair value of $4.44 were granted. Trading price of the stock at the time of the grant was $6.02. The fair market value of options granted was determined using the Black-Scholes valuation model with the following implicit assumptions: average risk-free rate of interest – 1.77%, dividend rate – NIL, average volatility – 103.31% and an average term of 5 years. The estimated forfeiture rate is 6.07%.

On December 21, 2017, 187,500 options with a weighted average fair value of $3.51 were granted. Trading price of the stock at the time of the grant was $4.65. The fair market value of options granted was determined using the Black-Scholes valuation model with the following implicit assumptions: average risk-free rate of interest – 1.57%, dividend rate – NIL, average volatility – 107.36% and an average term of 5 years. The estimated forfeiture rate is 5.87%.

On October 25, 2017, 60,000 options with a weighted average fair value of $3.05 were granted. Trading price of the stock at the time of the grant was $3.80. The fair market value of options granted was determined using the Black-Scholes valuation model with the following implicit assumptions: average risk-free rate of interest – 1.73%, dividend rate – NIL, average volatility – 119.81% and an average term of 5 years. The estimated forfeiture rate is 6.23%.

Share based payment expense

Total expense arising from share based payment transactions recognized during the year ended September 30, 2019, as part of employee benefit expense were $1,717,091 (2018 - $1,252,577).

13. FINANCIAL RISK MANAGEMENT

The following is a discussion of market, credit, and liquidity risks and related mitigation strategies that have been identified.

Credit risk

The Company is exposed to credit risk associated with its cash and cash equivalents and accounts receivable. The risk is reduced by having accounts receivables insured or obtaining letters of credit when the Company determines that it is warranted. The Company applies the simplified approach to providing for expected credit losses, which allows the use of a lifetime expected loss for all receivables. Receivables have been grouped based on shared credit risk characteristics and the days outstanding to measure the expected credit loss. On this basis the loss allowance at September 30, 2019, and September 30, 2018, is nominal.

Expressed in Canadian Dollars

Accounts receivable are written off when there is no reasonable expectation of recovery which may be supported by failure to make contractual payments for more than 180 days as well as other factors.

Accounts receivable are subject to normal industry risks in each geographic region in which the Company operates. The Company attempts to manage these risks by dealing with creditworthy customers; however, due to the limited number of potential customers in each market this is not always possible. As at September 30, 2019, three customers accounted for 43% (2018 – three customers for 80%) of the accounts receivable balance. These customers, who are distributors and strategic partners of the Company, represent substantially all of the Company's sales. Credit risk exposure is mitigated by strong credit granting policies, the use of Letters of Credit, and due diligence procedures for new customers.

The aging of accounts receivable is as follows:

	September 30, 2019	September 30, 2018
Current	**$3,399,503**	$4,972,810
30-60 days past due	**72,350**	159,883
Over 60 days past due	**163,428**	-
	3,635,281	5,132,693

Interest rate risk

The Company is subject to interest rate risk on its cash, cash equivalents and debt. The Company believes that interest rate risk is low due to market based variable interest rates. During fiscal 2019, the Company took on floating rate debt to fund the acquisition described in Note 5 and to fund working capital. At September 30, 2019, if interest rates had been 1% higher or lower then the interest expense would have been $84,230 higher or lower, respectively, during the year.

Currency risk

The Company's exposure to foreign currency risk at the end of the reporting period, expressed in Canadian dollars, was as follows:

	September 30, 2019				September 30, 2018			
	Canadian	USD	GBP	**Total**	Canadian	USD	GBP	**Total**
Cash and cash equivalents	$4,412,096	$5,083,036	$80,017	**$9,575,149**	$1,859,740	$3,169,309	$454,038	**$5,483,087**
Accounts Receivable	-	$3,429,338	$205,943	**$3,635,281**	-	$5,115,641	$17,052	**$5,132,693**
Acquisition note payable	-	$9,674,211	-	**$9,674,211**	-	-	-	**-**
Accounts Payable and accrued liabilities	$1,020,290	$4,356,278	$304,847	**$5,681,415**	$802,501	$3,454,104	$464,776	**$4,721,381**

Fair value

The fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and acquisition note payable approximate their carrying values, due to their relatively short periods to maturity. The fair value of debt approximates its carrying amount as it has a floating interest rate.

14. CAPITAL MANAGEMENT

The Company defines capital that it manages as its shareholders' equity comprising share capital, contributed surplus, foreign exchange translation reserve, accumulated deficit, and debt. Its objectives when managing capital are to ensure that the Company will continue as a going concern, so that it can provide services to its customers and returns to its shareholders. The capital at September 30, 2019 is $23,353,084 (September 30, 2018 – $14,651,704).

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will make changes to its capital structure as deemed appropriate under the specific circumstances.

During the year this definition was updated to include debt in the definition above; however, the Company's overall strategy with respect to management of capital remains unchanged.

15. 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.

Expressed in Canadian Dollars

The Company computes an income tax provision in each of the jurisdictions in which it operates. The operations in Canada and the United States are subject to income tax at average rates of 21.0% - 26.5% for the year ended September 30, 2019 (2018 – 21.0% - 26.5%).

Reconciliation between statutory rate and actual rate

	September 30, 2019	2018
Income tax computed at statutory tax rates	**$(2,292,500)**	$428,700
Permanent differences	**464,600**	344,100
Rate differences and other	**286,100**	114,000
Change in deferred tax assets not recognized	**1,541,800**	(886,800)
	$ -	$ -

Deferred tax assets

The tax effect of the temporary differences that gives rise to deferred tax assets (liabilities) as of September 30, 2019, and 2018 is presented below. No benefit has been recorded in these consolidated financial statements as there is no assurance that the Company will generate taxable income to utilize these differences.

	September 30, 2019	2018
Non-capital loss carry forwards	**$7,487,100**	$3,375,600
Capital loss carry forwards	**127,600**	127,600
Capital and other assets	**(257,400)**	(220,400)
Deferred development costs	**2,061,300**	2,061,300
Deferred revenue and other liabilities	**189,900**	88,700
Deferred tax assets not recognized	**(9,608,500)**	(5,432,800)
	$ -	$ -

The Company has non-capital losses carry forward available for income tax purposes as at September 30, 2019 which are available to reduce taxable incomes of future years. These losses expire as follows:

Year	Canada Amount	US Amount	UK Amount
2031	1,116,800	68,600	-
2032	3,267,300	140,000	-
2033	859,000	127,200	-
2034	89,400	161,600	-
2035	577,700	247,500	-
2036	2,183,300	287,500	-
2037	23,400	209,300	1,107,900
2038	484,100	1,355,200	1,864,300
2039	1,884,300	3,109,600	1,769,100
	$10,485,300	$5,706,500	$4,741,300

Other income tax items

The Company has capital losses carry forward for income tax purposes as at September 30, 2019 of approximately $962,883 (2018 - $962,883), which are available to reduce taxable capital gains in future years. These losses do not expire.

Expressed in Canadian Dollars

Investment tax credits

From time to time the Company receives investment tax credits. Investment tax credits are accrued when there is reasonable assurance of realization and these are reflected as a reduction of the related expense. In the event the investment tax credits received are less than the amount previously recognized, the difference will be reflected in operations for the period in which it is determined.

The Company is eligible for the Ontario Innovation Tax Credit ("OITC") at the rate of 10.0% on its research and development expenditures and refundable in cash to the Company. The Company is also eligible for a 20.0% federal research and development investment tax credit and a 4.5% Ontario Research and Development Tax Credit ("ORDTC") which are available to offset federal income taxes payable and Ontario income taxes payable, respectively, in the future.

The tax credits ultimately received by the Company are subject to review by Canada Revenue Agency and the Ontario Ministry of Finance.

At September 30, 2019, the Company has $1,679,947 (2018 - $1,679,947) of unclaimed investment tax credits available to reduce federal income taxes payable in future years. If not utilized, these investment tax credits will start expiring in 2023. These unclaimed investment tax credits have not been recognized as a deferred tax asset.

At September 30, 2019, the Company has $160,043 (2018 – $160,043) of unclaimed ORDTC available to reduce Ontario income taxes payable in future years. If not utilized, these ORDTC will start expiring in 2029. These unclaimed ORDTC have not been recognized as a deferred tax asset.

16. RELATED PARTY TRANSACTIONS

Key management personnel includes the Company's directors and senior management team. These individuals are responsible for planning, directing and controlling the activities of an entity. Key management personnel compensation comprised:

	Year ended September 30,	
	2019	2018
Compensation and short term employee benefits	**$2,807,973**	$1,365,291
Share based payment expense	**664,971**	603,232
	$3,472,944	$1,968,523

During the year end September 30, 2013, a non-interest bearing loan of $50,000 was made to a key employee. As of September 30, 2019, $10,000 of this loan remained outstanding.

Expressed in Canadian Dollars

17. EXPENSES BY NATURE

The consolidated statements of operations and comprehensive income (loss) include the following expenses by nature:

Employee costs

	Year ended September 30, **2019**	2018
Short-term wages & benefits, commissions, contract and director fees	**$17,516,624**	$7,246,434
Share based payments	**1,717,091**	1,252,577
Total employee costs	**$19,233,715**	$8,499,011
Included in		
Cost of product sales	**937,314**	887,792
Operations	**1,072,402**	1,026,305
Research and development activities	**1,066,463**	969,757
Sales, marketing and agency fees	**8,914,673**	2,360,260
General and administrative	**7,242,863**	3,254,897
Total employee costs	**$19,233,715**	$8,499,011

Depreciation and amortization

	Year ended September 30, **2019**	2018
Cost of product sales	**$328,056**	$237,182
Operations	**4,201**	5,079
Research and development activities	**36,008**	21,950
General and administrative	**261,623**	92,184
Total depreciation and amortization	**$629,888**	$356,395

18. EARNINGS (LOSS) PER SHARE

The weighted average number of shares outstanding during the year ended September 30, 2019 was 22,461,193 (September 30, 2018 – 21,560,162).

For the year ended September 30, 2019, the computation of diluted loss per share is equal to the basic loss per share due to the anti-dilutive effect of the stock options and warrants.

Details of dilutive securities outstanding that would be included in diluted earnings (loss) per share calculations as follows:

Potentially dilutive securities	**September 30, 2019**	September 30, 2018
Common shares potentially dilutive		
- stock options	**600,903**	994,844
- warrants	**647,431**	667,245
Total potentially dilutive shares	**1,248,334**	1,662,089

Expressed in Canadian Dollars

19. CONTINGENCIES AND COMMITMENTS

The Company has signed lease agreements for four locations in Mississauga, Ontario and one in each of: Shanghai, China; Leicestershire, United Kingdom; and, Seattle Washington. The leases range from a monthly term to a term of seven years. The minimum annual payments for the next five years are as follows:

Year	Annual Commitment
2020	582,001
2021	598,334
2022	589,319
2023	577,875
2024	577,875
Thereafter	$645,595

From time to time, the Company 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 that a loss becomes probable.

20. SEGMENT REPORTING

During the year ended September 30, 2019, there was one customer who individually accounted for approximately 25% of revenue (2018 – approximately 48%). The Company generated revenue of $24,083,097 (2018 – $12,768,225) in the US, $8,758,827 (2018 – $13,044,819) in the Middle East, $32,001 (2018 – $18,546) in Canada, and $1,130,697 (2018 – $891,752) in the rest of the world.

As of September 30, 2019, the Company had $2,797,245 of its property, plant, and equipment and intangible assets located in Canada and $1,455,511 in the rest of the world. Goodwill in the amount of $12,924,412 is attributed to US.

21. CHANGES IN NON-CASH WORKING CAPITAL ITEMS

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

	September 30, 2019	September 30, 2018
Accounts receivable	**$3,349,494**	$(2,316,843)
Prepaid expenses	**415,103**	(537,462)
Inventories	**(2,144,114)**	(2,998,642)
Accounts payable and accrued liabilities	**921,538**	2,329,252
Deferred revenue	**365,132**	(373,759)
Deferred rent	**169,021**	3,939
	$3,076,174	$(3,893,515)