Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

For the three months ended December 31, 2019 and 2018

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NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the interim financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed consolidated interim financial statements of Covalon Technologies Ltd. (the “Company”) have been prepared by and are the responsibility of the Company’s management. The unaudited condensed consolidated interim financial statements are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (“IFRS”) and reflect management’s best estimates and judgment based on information currently available. The Company’s independent auditor has not performed a review of these unaudited condensed consolidated interim financial statements.

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS OF FINANCIAL POSITION (UNAUDITED)
Expressed in Canadian Dollars

	December 31, 2019	September 30, 2019
Assets		
Current assets		
Cash and cash equivalents	**$4,115,806**	$9,575,149
Accounts receivable	**5,119,759**	3,635,281
Inventories (Note 4)	**9,250,016**	8,581,378
Prepaid expenses	**864,632**	601,333
Total current assets	**19,350,213**	22,393,141
Non-current assets		
Restricted cash	**36,058**	36,624
Property, plant and equipment (Note 6)	**1,838,503**	1,894,568
Intangible assets (Note 5)	**2,259,780**	2,358,188
Right-of-use assets (Note 3)	**3,119,010**	-
Goodwill (Note 5)	**12,675,546**	12,924,412
Total non-current assets	**19,928,897**	17,943,707
Total assets	**$39,279,110**	$39,606,933
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	**$3,907,280**	$5,681,415
Short-term debt (Note 7)	**8,104,186**	8,422,966
Lease liabilities (Note 3)	**465,642**	-
Acquisition note payable (Note 2)	**9,566,660**	3,380,011
Deferred revenue	**407,847**	459,315
Total current liabilities	**22,451,615**	17,943,707
Non-current liabilities		
Deferred revenue	**107,151**	139,052
Deferred rent	**-**	299,856
Lease liabilities (Note 3)	**2,978,623**	-
Acquisition note payable (Note 2)	**-**	6,294,200
Total non-current liabilities	**3,085,774**	6,733,108
Total liabilities	**25,537,389**	24,676,815
Shareholders' equity		
Share capital (Note 8)	**44,607,119**	44,607,119
Contributed surplus (Note 8)	**11,114,630**	10,717,141
Foreign exchange translation reserve	**(38,541)**	372,612
Accumulated deficit	**(41,941,487)**	(40,766,754)
Total shareholders' equity	**13,741,721**	14,930,118
Total liabilities and shareholders' equity	**$39,279,110**	$39,606,933

On behalf of the Board:

(signed) "Abe Schwartz" *Director*

(signed) "Brian Pedlar" *Director*

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

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) (UNAUDITED)
Expressed in Canadian Dollars

	Three months ended December 31,	
	2019	2018
Revenue		
Product	**$7,174,643**	$6,355,538
Development and consulting services	**733,128**	830,897
Licensing and royalty fees	**40,788**	75,051
Total revenue	**7,948,559**	7,261,486
Cost of sales	**3,112,775**	2,657,312
Gross profit before operating expenses	**4,835,784**	4,604,174
Operating expenses		
Operations	**460,934**	309,414
Research and development activities	**225,305**	374,990
Sales, marketing and agency fees	**2,912,492**	3,261,051
General and administrative	**2,186,046**	2,229,872
	5,784,777	6,175,327
Finance expenses	**225,740**	338,258
Net loss	**$(1,174,733)**	$(1,909,411)
Other comprehensive income		
Amount that may be reclassified to profit or loss		
Foreign currency translation adjustment	**(411,153)**	1,001,866
Total comprehensive loss	**$(1,585,886)**	$(907,545)
Basic loss per share (Note 14)	**$(0.05)**	$(0.09)
Diluted loss per share (Note 14)	**$(0.05)**	$(0.09)

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

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

Expressed in Canadian Dollars

	Number of shares	Share capital	Contributed surplus	Accumulated deficit	Foreign exchange translation reserve	Total
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	-	-	327,416	-	-	327,416
Exercise of stock options	8,500	35,524	(16,879)	-	-	18,645
Issuance of common shares on acquisition	178,028	1,271,901	-	-	-	1,271,901
Net loss for the period	-	-	-	(1,909,411)	-	(1,909,411)
Foreign currency translation adjustment	-	-	-	-	1,001,866	1,001,866
Balance at December 31, 2018	**22,195,658**	**$40,564,457**	**$5,883,376**	**$(33,538,392)**	**$925,752**	**$13,835,193**
Balance at October 1, 2019	25,818,677	$44,607,119	$10,717,141	$(40,766,754)	$372,612	$14,930,118
Share-based payment expense	-	-	397,489	-	-	397,489
Net loss for the period	-	-	-	(1,174,733)	-	(1,174,733)
Foreign currency translation adjustment	-	-	-	-	(411,153)	(411,153)
Balance at December 31, 2019	**25,818,677**	**$44,607,119**	**$11,114,630**	**$(41,941,487)**	**$(38,541)**	**$13,741,721**

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

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS (UNAUDITED)

Expressed in Canadian Dollars

	Three months ended December 31, **2019**	2018
Cash flows from (used in) operating activities		
Net loss for the period	**$(1,174,733)**	$(1,909,411)
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation of property, plant and equipment	**105,444**	69,452
Amortization of intangible assets	**55,936**	48,081
Depreciation - right of use assets (Note 3)	**131,998**	-
Share-based payment expense (Note 9)	**397,489**	327,416
Interest expense and accretion	**225,740**	338,258
Cash generated by operating activities before change in non-cash working capital balances	**(258,126)**	(1,126,204)
Change in non-cash working capital (Note 17)	**(4,379,209)**	(2,614,877)
Total cash flows used in operating activities	**(4,637,335)**	(3,741,081)
Cash flows from (used in) investing activities		
Purchase of property, plant and equipment	**(66,531)**	(185,022)
Acquisition of AquaGuard	**-**	(4,657,731)
Restricted cash	**(142)**	(97)
Total cash flows used in investing activities	**(66,673)**	(4,842,850)
Cash flows from financing activities		
Exercise of stock options and warrants (Note 9)	**-**	18,645
Interest paid	**(103,464)**	(142,482)
Repayment of debt	**(325,000)**	(366,928)
Proceeds from debt	**-**	6,310,972
Payment of lease liabilities	**(147,394)**	-
Total cash flows from financing activities	**(575,858)**	5,820,207
Foreign exchange rate changes on cash	**(179,477)**	(149,377)
Total cash flows during the period	**(5,459,343)**	(2,913,101)
Cash and cash equivalents, beginning of the period	**$9,575,149**	$5,483,087
Cash and cash equivalents, end of the period	**$4,115,806**	$2,569,986

The accompanying notes are an integral part of these condensed consolidated interim 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 unaudited condensed consolidated interim financial statements of Covalon Technologies Ltd. for the three months ended December 31, 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. 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

Related to the fiscal 2019 acquisition of AquaGuard, the Company entered into an Acquisition Note Payable ("Acquisition Note") 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").

Consistent with September 30, 2019, as of December 31, 2019, the Company did not meet certain covenants related to the Facility with HSBC under the original agreement. 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.

On January 24, 2020 the Facility agreement was 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 Company was in compliance with all covenants at December 31, 2019 following the amendment to the agreement on January 24, 2020.

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.

While the Company believes that based on cash on hand and amounts available under the HSBC operating line, 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

Statement of compliance

The Company’s unaudited condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (“IFRS”) applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting. These condensed consolidated interim financial statements are presented in Canadian dollars and should be read in conjunction with the Company’s annual financial statements for the year ended September 30, 2019, which were prepared in accordance with IFRS.

The accounting policies adopted are consistent with those of the previous financial year except for additional accounting policies added as a result of the adoption of IFRS 16, Leases (“IFRS 16”) outlined below.

The unaudited condensed consolidated interim financial statements were authorized for issue by the Board of Directors on March 2, 2020.

Basis of Consolidation

These unaudited condensed consolidated interim 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.

Accounting standards adopted

<u>IFRS 16, Leases</u>

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for most leases under a single on-balance sheet model. The Company adopted IFRS

Expressed in Canadian Dollars

16 using the modified retrospective method of adoption with the date of initial application of October 1, 2019. Under this method, the standard is retrospectively applied with the cumulative effect of initially applying the standard recognized at the date of initial application in opening interim condensed consolidated statement of financial position on October 1, 2019.

The Company elected to use the following practical expedients: a) the transition application practical expedient allowing the standard to only be applied to contracts that were previously identified as leases applying IAS 17, Leases ("IAS 17"); b) the transition application practical expedient to elect to not apply IFRS 16 to leases that expired within 12 months following the adoption date; and, c) the recognition exemption to not apply IFRS 16 to lease contracts for which the underlying asset is of low value.

As of October 1, 2019 the Company recognized lease liabilities in relation to leases, which had previously been classified as operating leases under the principles of IAS 17. These liabilities were measured at the present value of the remaining lease payments and discounted using the incremental borrowing rate as of October 1, 2019 of 4.8%.

The adoption of IFRS 16 had the following impacts as at October 1, 2019:

-Operating lease commitments as at September 30, 2019	$4,200,673
-Present value adjustment	$(583,861)
-Lease liabilities at October 1, 2019	$3,616,812

The change in accounting policy affected the following items in the interim condensed consolidated balance sheet on October 1, 2019:

	Increase (decrease) ($)
Right-of-use asset	3,321,034
Lease liabilities	3,616,812
Deferred rent	(295,778)

The change in Right-of-use asset from October 1, 2019 to December 31, 2019 is as follows:

	Right-of-use asset ($)
Balance at October 1, 2019	3,321,034
Depreciation	(131,998)
Foreign exchange	(70,026)
Balance at December 31, 2019	**3,119,010**

The change in Lease liabilities from October 1, 2019 to December 31, 2019 is as follows:

	Lease liabilities ($)
Balance at October 1, 2019	3,616,812
Interest	42,260
Payments	(147,394)
Foreign exchange	(67,412)
Balance at December 31, 2019	**3,444,265**

Expressed in Canadian Dollars

Accounting policy

The Company recognises a right-of-use asset and lease liability at the lease commencement date after the Company assesses whether a contract is, or contains, a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The right-of-use asset is initially measured based on the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received. The assets are depreciated to the earlier of the end of the useful life of the right-of-use asset or the lease term using the straight-line method as this most closely reflects the expected pattern of consumption of the future economic benefits. The lease term includes periods covered by an option to renew if the Company is reasonably certain to exercise that option. Lease terms range from seven to ten years for offices. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the Company's incremental borrowing rate if the implicit interest rate cannot be readily determined. The liability is subsequently increased by the interest cost associated with the lease and decreased by payments made against the least. If there is a change in future lease payments arising from a change in assessment related to a renewal, or termination, the liability is remeasured as appropriate. The Company has applied judgement to determine the lease term for some lease contract in which it is a lessee in a lease that includes a renewal option. The assessment of whether the Company is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right-of-use assets recognized.

4. INVENTORIES

Inventories consist of the following:

	December 31, 2019	September 30, 2019
Raw materials	**$2,460,223**	$2,347,981
Finished goods	**7,092,406**	6,293,426
Inventory provision	**(302,613)**	(176,124)
	$9,250,016	$8,581,378

Cost of product sales for the three month period ended December 31, 2019 include $2,436,466 (2018 - $2,488,701), in inventoried materials.

Expressed in Canadian Dollars

5. INTANGIBLE ASSETS AND GOODWILL

Goodwill is comprised of the following amounts:

	Goodwill ($)
Balance at October 1, 2019	12,924,412
Foreign exchange	(248,866)
Balance at December 31, 2019	**12,675,546**

Intangible assets are comprised of the following amounts:

	Deferred Development Costs ($)	Brand ($)	Patents ($)	Trademarks ($)	Computer Software ($)	Total ($)
Cost						
Balance at September 30, 2019	2,208,965	1,125,655	964,645	83,102	176,713	4,559,080
Additions	-	-	-	-	-	-
Foreign exchange	(42,534)	(21,675)	(18,575)	(1,600)	(3,403)	(87,787)
Balance at December 31, 2019	2,166,431	1,103,980	946,070	81,502	173,310	4,471,293
Accumulated amortization						
Balance at September 30, 2019	1,597,118	56,283	392,915	-	154,576	2,200,892
Amortization	27,522	14,025	13,001	-	1,388	55,936
Foreign exchange	(31,195)	(1,309)	(7,775)	-	(5,036)	(45,315)
Balance at December 31, 2019	1,593,445	68,999	398,141	-	150,928	2,211,513
Carrying amounts						
At September 30, 2019	611,847	1,069,372	571,730	83,102	22,137	2,358,188
At December 31, 2019	**572,986**	**1,034,981**	**547,929**	**81,502**	**22,382**	**2,259,780**

Expressed in Canadian Dollars

6. PROPERTY, PLANT AND EQUIPMENT

	Furniture and Fixtures ($)	Lab Equipment ($)	Leasehold Improvements ($)	Total ($)
Cost				
Balance at September 30, 2019	851,066	2,451,773	443,169	3,746,008
Additions	5,423	61,108	-	66,531
Foreign exchange	(16,248)	(48,191)	(8,534)	(72,973)
Balance at December 31, 2019	840,241	2,464,690	434,635	3,739,566
Accumulated depreciation				
Balance at September 30, 2019	446,156	1,240,243	165,041	1,851,440
Depreciation	25,038	63,462	16,944	105,444
Foreign exchange	(26,021)	(24,791)	(5,009)	(55,821)
Balance at December 31, 2019	445,173	1,278,914	176,976	1,901,063
Carrying amounts				
At September 30, 2019	404,910	1,211,530	278,128	1,894,568
At December 31, 2019	**395,068**	**1,185,776**	**257,659**	**1,838,503**

7. 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 EBITDA; 2) fixed charged coverage ratio; and, 3) current ratio. As of December 31, 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 December 31, 2019. The carrying amount of the acquisition line is $4,579,186 as of December 31, 2019. Subsequent to December 31, 2019, the Company obtained an amendment to the Facility from HSBC for the breach of covenants thereof as described in Note 2 and is in compliance with the amended covenants. The amendment adjusted the calculation of the covenants noted above and instituted a new covenant to maintain a minimum cash balance of $1,500,000.

Expressed in Canadian Dollars

A reconciliation of the operating line is as follows:

	December 31, 2019 ($)
Balance – October 1, 2019	3,550,000
Proceeds received	-
Interest accrued during the period	45,421
Interest paid during the period	(45,421)
Repayment of principal	(25,000)
Balance – Ending	3,525,000
Less: Current portion	3,525,000
Non-current portion	-

As of December 31, 2019, the Company has $3,525,000 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 three months ended December 31, 2019, the Company recognized $245,421 of interest expense on this loan.

A reconciliation of the Acquisition Line is as follows:

	December 31, 2019 ($)
Balance – October 1, 2019	4,872,966
Proceeds received	-
Repayments of principal	(300,000)
Interest accrued during the period	58,043
Interest paid during the period	(51,823)
Balance – Ending	4,579,186
Less: Current portion	4,579,186
Non-current portion	-

This facility is repayable on demand by HSBC which could occur if there was a default on the financial covenants. As of December 31, 2019, the Company has $4,579,186 drawn and outstanding on the acquisition line. During the three months ended December 31, 2019, the Company recognized $58,043 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).

8. 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 October 1, 2018, Covalon acquired AquaGuard, a division of Cenorin LLC., and issued 102,891 common shares as a closing share payment. 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. During the three months ended December 31, 2019 25,045 (nil – 2018) shares were released from escrow leaving a balance of 50,091.

Expressed in Canadian Dollars

Warrants

The following is a summary of all warrants:

	Number of Warrants	Weighted average exercise Price	Weighted Average Expiry (years)
Balance at September 30, 2019	**3,025,447**	**$2.03**	**4.58**
Exercised during the period	-	-	
Balance at December 31, 2019	**3,025,447**	**$2.03**	**4.33**

9. 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.

The following is a summary of changes in stock options from October 1, 2019 to December 31, 2019:

Grant Date	Expiry Date	Exercise Price	Opening Balance	Granted	Exercised	Forfeited	Closing Balance	Vested	Unvested	Weighted Average Expiry (years)
26-Mar-15	26-Mar-20	$1.40	73,999	-	-	-	73,999	73,999	-	0.24
7-Mar-16	7-Mar-21	$1.13	100,000	-	-	-	100,000	100,000	-	1.19
23-Jun-16	23-Jun-21	$1.29	115,832	-	-	-	115,832	115,832	-	1.48
14-Sep-16	14-Sep-21	$2.29	20,000	-	-	-	20,000	20,000	-	1.71
8-Feb-17	8-Feb-22	$2.20	168,333	-	-	-	168,333	112,222	56,111	2.11
20-Jun-17	20-Jun-22	$2.47	348,333	-	-	-	348,333	232,222	116,111	2.47
25-Oct-17	25-Oct-22	$3.80	60,000	-	-	-	60,000	40,000	20,000	2.82
21-Dec-17	21-Dec-22	$4.65	167,500	-	-	(1,667)	165,833	110,555	55,278	2.98
24-Jan-18	24-Jan-23	$6.02	60,000	-	-	-	60,000	20,000	40,000	3.07
27-Sep-18	27-Sep-23	$8.50	142,500	-	-	-	142,500	47,500	95,000	3.74
22-Dec-18	22-Dec-23	$4.28	351,667	-	-	(6,667)	345,000	115,000	230,000	3.98
15-Mar-19	15-Mar-24	$5.03	182,500	-	-	-	182,500	-	182,500	4.21
			1,790,664	**-**	**-**	**(8,334)**	**1,782,330**	**987,330**	**795,000**	**2.85**
Weighted Average Exercise Price			**$3.71**	**$0.00**	**$0.00**	**$4.35**	**$3.71**	**$2.95**	**$4.65**	

Expressed in Canadian Dollars

Share based payment expense

Total expense arising from share based payment transactions recognized during the three months ended December 31, 2019, as part of employee benefit expense were $397,489 (2018 - $327,416).

10. 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 December 31, 2019, and December 31, 2018, is nominal.

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 December 31, 2019, three customers accounted for 56% (2018 – three customers for 53%) 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:

	December 31, 2019	September 30, 2019
Current	**$4,489,762**	$3,399,503
30-60 days past due	**115,585**	72,350
Over 60 days past due	**514,412**	163,428
	5,119,759	3,635,281

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 an acquisition and working capital. At December 31, 2019, if interest rates had been 1% higher or lower then the interest expense would have been $20,260 higher or lower, respectively, during the period.

Currency risk

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

	December 31, 2019				September 30, 2019			
	Canadian	USD	GBP	**Total**	Canadian	USD	GBP	**Total**
Cash and cash equivalents	$1,370,895	$2,663,863	$81,048	**$4,115,806**	$4,412,096	$5,083,036	$80,017	**$9,575,149**
Accounts Receivable	-	$4,827,790	$291,969	**$5,119,759**	-	$3,429,338	$205,943	**$3,635,281**
Acquisition note payable	-	$9,566,660	-	**$9,566,660**	-	$9,674,211	-	**$9,674,211**
Accounts payable and accrued liabilities	$1,768,055	$1,780,262	$358,963	**$3,907,280**	$1,020,290	$4,356,278	$304,847	**$5,681,415**
Lease liabilities	$1,430,494	$2,013,771	-	**$3,444,265**	-	-	-	-

Fair value

The fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, acquisition note payable and lease liabilities 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.

11. 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 December 31, 2019 is $22,845,907 (September 30, 2018 – $23,353,084).

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.

Expressed in Canadian Dollars

12. 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:

	Three months ended December 31, 2019	2018
Compensation and short term employee benefits	**$287,262**	$641,959
Share based payment expense	**139,560**	168,276
	426,822	810,235

During the year end September 30, 2013, a non-interest bearing loan of $50,000 was made to a key employee. As of December 31, 2019, $10,000 of this loan remained outstanding.

13. EXPENSES BY NATURE

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

Employee costs

	Three months ended December 31, 2019	2018
Short-term wages & benefits, commissions, contract and director fees	**$ 3,273,861**	$ 3,678,748
Share based payments	**397,489**	327,416
Total employee costs	**$ 3,671,350**	$4,006,164
Included in		
Cost of product sales	**142,996**	563,205
Operations	**336,532**	140,807
Research and development activities	**186,343**	280,696
Sales, marketing and agency fees	**2,061,946**	1,777,353
General and administrative	**943,533**	1,244,103
Total employee costs	**$ 3,671,350**	$ 4,006,164

Depreciation and amortization

	For the three months ended December 31, 2019	2018
Cost of product sales	**$81,438**	$72,311
Operations	**836**	1,481
Research and development activities	**8,710**	8,974
General and administrative	**202,394**	34,767
Total depreciation and amortization	**$293,378**	$117,533

Expressed in Canadian Dollars

14. EARNINGS (LOSS) PER SHARE

The weighted average number of shares outstanding during the period ended December 31, 2019 was 25,818,677 (December 31, 2018 – 22,195,658).

For the three month periods ended December 31, 2019 and December 31, 2018, 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	**December 31, 2019**	December 31, 2018
Common shares potentially dilutive		
- stock options	**103,423**	855,717
- warrants	**-**	665,994
Total potentially dilutive shares	**103,423**	1,521,711

15. CONTINGENCIES AND COMMITMENTS

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.

16. SEGMENT REPORTING

During the three months ended December 31, 2019, there was one customer who individually accounted for approximately 11% of revenue (2018 – approximately 22%). The Company generated revenue of $6,422,854 (2018 – $5,503,595) in the US, $929,449 (2018 – $1,590,410) in the Middle East, $6,455 (2018 – $10,732) in Canada, and $589,801 (2018 – $156,749) in the rest of the world.

As of December 31, 2019, the Company had $4,085,539 of its property, plant, and equipment and intangible assets located in Canada and $3,131,754 in the rest of the world. Goodwill in the amount of $12,675,546 is attributed to the US.

17. CHANGES IN NON-CASH WORKING CAPITAL ITEMS

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

	Three months ended December 31,	
	2019	2018
Accounts receivable	**$(1,539,335)**	$ 275,832
Prepaid expenses	**(272,578)**	(362,311)
Inventories	**(829,516)**	(3,320,428)
Accounts payable and accrued liabilities	**(1,687,150)**	809,632
Deferred revenue	**(50,630)**	(18,991)
Deferred rent	**-**	1,389
	$(4,379,209)	$(2,614,877)