Covalon Technologies Ltd.

CONSOLIDATED FINANCIAL STATEMENTS

For the years ended September 30, 2020 and 2019

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, 2020 and 2019, and its financial performance and its cash flows for the years 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 statements of financial position as at September 30, 2020 and 2019;
- the consolidated statements of operations and comprehensive income (loss) for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

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.

Material uncertainty related to going concern

We draw attention to note 2 in the consolidated financial statements, which describes events or conditions that indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

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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 27, 2021

Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

Expressed in Canadian Dollars

	September 30, 2020	September 30, 2019
Assets		
Current assets		
Cash	**$3,506,991**	$9,575,149
Accounts receivable (Note 12)	**3,333,437**	3,635,281
Inventories (Note 6)	**7,199,774**	8,581,378
Prepaid expenses	**809,404**	601,333
Total current assets	**14,849,606**	22,393,141
Non-current assets		
Restricted cash	**37,309**	36,624
Property, plant and equipment (Note 8)	**1,824,959**	1,894,568
Intangible assets (Note 7)	**2,151,274**	2,358,188
Right-of-use assets (Note 3)	**2,815,724**	-
Goodwill (Note 7)	**13,018,102**	12,924,412
Total non-current assets	**19,847,368**	17,213,792
Total assets	**$34,696,974**	$39,606,933
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	**$3,899,266**	$5,681,415
Short-term debt (Notes 2 and 10)	**7,649,027**	8,422,966
Lease liabilities (Note 3)	**516,372**	-
Acquisition note payable (Notes 2 and 5)	**10,074,013**	3,380,011
Deferred revenue	**498,149**	459,315
Total current liabilities	**22,636,827**	17,943,707
Non-current liabilities		
Deferred revenue	**290,123**	139,052
Deferred rent	**-**	299,856
Lease liabilities (Note 3)	**2,663,346**	-
Acquisition note payable (Note 2)	**-**	6,294,200
Total non-current liabilities	**2,953,469**	6,733,108
Total liabilities	**25,590,296**	24,676,815
Shareholders' equity		
Share capital (Note 11)	**44,607,119**	44,607,119
Contributed surplus (Note 11)	**11,652,765**	10,717,141
Foreign exchange translation reserve	**565,772**	372,612
Accumulated deficit	**(47,718,978)**	(40,766,754)
Total shareholders' equity	**9,106,678**	14,930,118
Total liabilities and shareholders' equity	**$34,696,974**	$39,606,933

On behalf of the Board:

(signed) "Abe Schwartz" *Director*

(signed) "Brian Pedlar" *Director*

Going Concern (Note 2),

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,	
	2020	2019
Revenue		
Products	**$23,621,388**	$30,147,854
Development and consulting services	**1,979,282**	3,265,636
Licensing and royalty fees	**199,436**	591,132
Total revenue	**25,800,106**	34,004,622
Cost of sales	**13,313,976**	12,182,263
Gross profit before operating expenses	**12,486,130**	21,822,359
Operating expenses		
Operations	**1,355,851**	1,909,748
Research and development activities	**794,241**	1,359,417
Sales, marketing and agency fees	**7,789,305**	14,952,989
General and administrative	**8,638,800**	11,848,837
	18,578,197	30,070,991
Finance expenses	**860,157**	889,141
Net loss	**$(6,952,224)**	$(9,137,773)
Other comprehensive income		
Amount that may be reclassified to profit or loss		
Foreign currency translation adjustment	**193,160**	448,726
Total comprehensive loss	**$(6,759,064)**	$(8,689,047)
Basic loss per share (Note 18)	**$(0.27)**	$(0.41)
Diluted loss per share (Note 18)	**$(0.27)**	$(0.41)

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, 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**
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	-	-	935,624	-	-	$935,624
Net loss for the period	-	-	-	(6,952,224)	-	$(6,952,224)
Foreign currency translation adjustment	-	-	-	-	193,160	$193,160
Balance at September 30, 2020	**25,818,677**	**$44,607,119**	**$11,652,765**	**$(47,718,978)**	**$565,772**	**$9,106,678**

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, 2020	2019
Cash flows from (used in) operating activities		
Net loss for the year	**$(6,952,224)**	$(9,137,773)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of property, plant and equipment	**453,482**	405,746
Amortization of intangible assets	**223,605**	224,142
Depreciation - right of use assets (Note 3)	**529,007**	-
Share-based payment expense (Note 11)	**935,624**	1,717,091
Interest expense and accretion	**860,157**	889,141
Cash generated by operating activities before change in non-cash working capital balances	**(3,950,349)**	(5,901,653)
Change in non-cash working capital (Note 20)	**(75,092)**	3,076,174
Total cash flows used in operating activities	**(4,025,441)**	(2,825,479)
Cash flows from (used in) investing activities		
Purchase of property, plant and equipment	**(371,092)**	(1,263,642)
Purchase of intangible assets	**-**	(19,943)
Acquisition of AquaGuard	**-**	(5,811,532)
Restricted cash	**685**	(572)
Total cash flows used in investing activities	**(370,407)**	(7,095,689)
Cash flows from financing activities		
Exercise of stock options and warrants (Note 11)	**-**	2,005,397
Interest paid	**(343,013)**	(409,563)
Proceeds from private placement	**-**	5,500,000
Repayment of debt	**(1,365,000)**	(1,406,928)
Proceeds from debt	**570,000**	8,291,005
Payment of lease liabilities	**(614,755)**	-
Total cash flows from financing activities	**(1,752,768)**	13,979,911
Foreign exchange rate changes on cash	**80,458**	33,319
Total cash flows during the year	**(6,068,158)**	4,092,062
Cash, beginning of the year	**$9,575,149**	$5,483,087
Cash, end of the year	**$3,506,991**	$9,575,149

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 researching, developing, manufacturing, and marketing of patent-protected medical products that improve patient outcomes and save lives in the areas of infection management, advanced wound care and surgical procedures. The consolidated financial statements of Covalon Technologies Ltd. for the year ended September 30, 2020 comprise the results of the Company and its wholly owned subsidiaries. The Company leverages its patented medical technology platforms and expertise in two ways: (i) by developing products that are sold under the Company's name; and, (ii) by developing and commercializing medical products for other medical companies under development and license contracts. The Company has received regulatory approval on numerous products and leverages contract manufacturers to make its products and distribution contracts to sell its commercialized products to medical customers. The Company generates its revenues through development contracts, licensing agreements, 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. GOING CONCERN AND COVID-19

Going Concern

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS"), applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they come due for the foreseeable future.

Related to the fiscal 2019 acquisition of AquaGuard, the Company entered into an Acquisition Note Payable ("Acquisition Note"), as described 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 became 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 the prior year, the Company was prohibited from making a payment on the Acquisition Note using funds made available under the Facility as originally intended in order to meet the commitments to the Vendor. The Company was also unable to use cash on hand to make the payment to the Vendor without being offside on covenant calculations.

When entering into the purchase and banking agreements described above, the Company, the Vendor, and HSBC entered into a subordination agreement which provides that no Acquisition Note amounts will be due if the Company is in breach of the Facility agreement. 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 has no recourse under the subordination agreement.

As of September 30, 2020, the Company did not meet certain covenants related to the Facility with HSBC under the original Facility agreement. Subsequent to September 30, 2020 the Company obtained a waiver from HSBC related to the covenant breaches as of the year end. The Company is currently forecasting that it will not meet these covenants at various times in Fiscal 2021 as well. Should the Company not be successful in obtaining future waivers the Company would be in default of the Facility and HSBC could request repayment of principal and interest at any time. While the Company has a history of requesting and obtaining waivers, no assurances can be provided that the company will be able to continue to obtain waivers and therefore payment may be demanded on the outstanding loan amounts which results in a material uncertainty that may cast significant doubt upon the Company's ability to continue as a going concern and whether assets will be realized and liabilities extinguished in the normal course of business at the amounts stated on the consolidated financial statements. 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, should it become due and payable without refinancing this liability, or through the issuance of additional equity of the Company.

In addition, the Company has a $1m facility available through the Business Credit Availability Program ("BCAP") with the Business Development Bank of Canada ("BDC"), the Company is able to draw against this facility and make payments related to the repayment of other debts and working capital. If the BCAP funds are not drawn on, or before, March 29, 2021 the facility will expire.

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; b) is in discussions with HSBC to obtain waivers on its covenants for future quarters; c) has initiated a strategic review process to evaluate ways to enhance shareholder value and determine the highest and best use of the assets of the Company, and, d) has access to $1m of funds through the BCAP program.

The Company incurred a net loss of $6,952,224 for the year ended September 30, 2020 (September 2019 - $9,137,773) and cash used in operating activities was $4,025,441 (September 2019 - $2,825,479) for the same period. As of September 30, 2020, the Company had $3,506,991 of cash (September 2019 – $9,575,149) and intends to operate its business and satisfy its obligations as they come due in the ordinary course of business.

These consolidated financial statements do not reflect the adjustments to the carrying values of assets and liabilities or the reported expenses and consolidated statements of financial position classifications that would be necessary if the going concern assumption were inappropriate, and these adjustments could be material.

Expressed in Canadian Dollars

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, 2020:

	Carrying amount ($)	Future cash flows ($)	Less than 1 year ($)	Between 1 and 5 years ($)	Greater than 5 years ($)
Accounts payable and accrued liabilities	3,899,266	3,899,266	3,899,266	-	-
Debt	7,649,027	7,649,027	7,649,027	-	-
Acquisition note payable	10,074,013	10,074,013	10,074,013	-	-
Lease liabilities	3,179,718	3,601,006	654,706	2,644,272	302,028
Total	**24,802,024**	**25,223,312**	**22,277,012**	**2,644,272**	**302,028**

COVID-19

In March 2020, the World Health Organization characterized the outbreak of the novel strain of coronavirus, specifically identified as COVID-19, as a global pandemic. In response to the outbreak, governmental authorities in Canada and internationally have introduced various recommendations and measures to try to limit the pandemic, including travel restrictions, border closures, non-essential business closures, quarantines, self-isolations, shelters-in-place, and social distancing. The governmental responses have caused material disruption to business globally, economic slowdowns, and shifts in economic markets. The significant uncertainty related to the virus, and the governmental responses, has negatively impacted the Company's suppliers, as well as customers and their demand for our products and services.

During the year ended September 30, 2020, the Company applied for and was approved for a United States Paycheck Protection Program loan ("Loan") totaling $1,523,829 from the US Small Business Administration under the US Paycheck Protection Program. The Loan will be forgiven if certain conditions are met (including the funds being used for eligible payroll and rent expenses during the eligibility period) and a loan forgiveness application is completed. Any ineligible portion of the PPP will otherwise carry interest of 1% and will be repayable over a two-year term. The Company also applied and was approved for funding of $520,500 to date under the Canadian Emergency Wage Subsidy Program ("CEWS"). The Company also received funds from other subsidy programs of $102,845 during the year ended September 30, 2020. Subsequent to year end the company applied for, and received, $280,000 in subsequent CEWS assistance. The Company recognizes government grants when there is a reasonable assurance that it will comply with the conditions required to qualify for the grant, and that the grant will be received.

Operationally, the Company has been negatively impacted by the COVID-19 pandemic, and the efforts to mitigate the pandemic, as have many of the Company's employees, customers, and vendors regardless of geographic location. The Company's direct sale staff have been limited in their ability to call on customers in the United States and the United Kingdom. There have also been increased costs associated with shipping products, and a slow-down in receiving regulatory approvals. As a result of this uncertainty there is a higher level of estimation uncertainty as it relates to the assessment of impairment for intangibles, provisions for inventory and receivables, and general future cash flows. Our distribution relationships with a number of companies in North America and internationally have been impacted due to the material disruption to business globally, economic slowdowns, and shifts in economic markets caused by governmental responses to the COVID-19 pandemic. Demand for some of the Company's products also temporarily decreased as facilities adjust to patient demand and procedure types.

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 IFRS. The consolidated financial statements were authorized for issue by the Board of Directors on January 27, 2021.

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 within general and administrative expenses 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 Company's operations are categorized into one industry which is medical technology with a focus on infection prevention. The chief operating decision maker has been identified as the chief executive officer. The Company's revenue is managed geographically and disclosed accordingly.

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 income (loss).

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).

Financial Assets

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 the first-in, first-out method for the moisture barrier products and all other inventory is measured at 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 on September 30 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. Goodwill impairments are not subsequently reversed.

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 they are determined to be a distinct component and that performance obligations have been completed. If performance obligations are satisfied 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 - applicable to the year ended September 30, 2020

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.

Leases - applicable to the year ended September 30, 2019

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.

Government Grants

The Company recognizes government grants when there is reasonable assurance that the Company will comply with the conditions of the grant and the grant will be received. Government grants receivable are recorded in accounts receivable on the consolidated statements of financial position. The Company recognizes government grants in the consolidated statements of operations and comprehensive income (loss) in the same period as the expenses for which the grant is intended to compensate and nets the amount off the related expenses. In cases where a government grant becomes receivable as compensation for expenses already incurred in prior periods, the grant is recognized in profit or loss in the period in which it becomes receivable.

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 new amended standard 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 this standard is disclosed below:

IFRS 16, Leases

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 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 the opening consolidated statements 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.

Expressed in Canadian Dollars

As of October 1, 2019, the Company recognized lease liabilities in relation to real estate 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 weighted incremental borrowing rate as of October 1, 2019 of 4.8%. A right-of-use asset, representing the Company's right-to-use the underlying leased asset, will generally be equal to the lease obligation at adoption, adjusted for deferred rent and subsequently depreciated on a straight-line basis.

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

-Operating lease commitments as at September 30, 2019 (revised)	$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 consolidated balance sheet on October 1, 2019:

	Increase (decrease) ($)
Right-of-use asset	3,321,034
Lease liabilities	3,616,812
Deferred rent	(299,856)
Other	4,078

The change in right-of-use asset from October 1, 2019 to September 30, 2020 is as follows:

	Right-of-use asset ($)
Balance at October 1, 2019	3,321,034
Depreciation	(529,007)
Foreign exchange	23,697
Balance at September 30, 2020	**2,815,724**

The change in lease liabilities from October 1, 2019 to September 30, 2020 is as follows:

	Lease liabilities ($)
Balance at October 1, 2019	3,616,812
Interest	161,588
Payments	(614,755)
Foreign exchange	16,073
Balance at September 30, 2020	**3,179,718**
Less: Current portion	516,372
Non-current portion	2,663,346

The Company also had cash outflows related to variable payments not included in the lease liabilities of $119,174 during the year ended September 30, 2020.

Accounting standards issued but not yet adopted

IAS 1 – Presentation of Financial Statements

On October 31, 2018, the IASB issued amendments to IAS 1 and IAS 8 to clarify and align the definition of material and provide guidance to help improve consistency in the application of materiality when used in other IFRS standards. These amendments are effective on January 1, 2020 and are to be applied prospectively. The Company intends to adopt the amendments for the annual period beginning on October 1, 2020 and they are not expected to have a material impact on the consolidated financial statements.

On January 23, 2020, the IASB issued an amendment to IAS 1 to clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. The standard is effective for periods beginning on or after January 1, 2023 and the Company currently expects no impact in applying the new standard.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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.

Going Concern

The assessment of material uncertainties related to events and circumstances that may cast significant doubt on the Company’s ability to continue as a going concern involves significant judgement. In making this assessment, management considers all relevant information, as described in Note 2.

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.

Covalon acquired all 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.

Expressed in Canadian Dollars

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 and is expected to be deductible for tax purposes.

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 fair value of the shares held in escrow was determined using the 4-day, volume weighted average share price adjusted for the implied cost of synthetically calculated put options, and the exchange rate applicable on the business day prior to closing. All escrow shares have been released.

The fair value of future cash payments consists 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:

	Fair value ($)
Balance at October 1, 2019	9,674,211
Accretion	334,495
Foreign exchange	65,307
Balance at September 30, 2020	**10,074,013**

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

Expressed in Canadian Dollars

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, 2020	September 30, 2019
Raw materials	**$2,983,418**	$2,347,981
Finished goods	**6,300,288**	6,409,521
Inventory provision	**(2,083,932)**	(176,124)
	$7,199,774	$8,581,378

Cost of product sales for the year ended September 30, 2020 includes $11,233,765 (2019 - $10,213,576), respectively in inventoried materials.

7. INTANGIBLE ASSETS AND GOODWILL

Goodwill is comprised of the following amounts:

	Goodwill ($)
Balance at October 1, 2018	-
Additions	12,484,611
Foreign exchange	439,801
Balance at September 30, 2019	**12,924,412**
Balance at October 1, 2019	12,924,412
Foreign exchange	93,690
Balance at September 30, 2020	**13,018,102**

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 test at September 30, 2020 on the goodwill related to the AquaGuard CGU, which comprises all of the goodwill of the Company and is the level at which management monitors this goodwill. The recoverable amount of the AquaGuard CGU was calculated using fair value less costs of disposal (FVLCD).

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 29% and the discount rate of 19.4 % 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 $15.1m exceeded the carrying value of $13.6m and no impairment writedown was required. The following table presents a sensitivity to show the impact on the recoverable amount for changes in certain assumptions:

Expressed in Canadian Dollars

	Discount Rate		Terminal revenue growth assumption	
	+1%	**-1%**	**+1%**	**-1%**
Impact on impairment calculation	(1,170,000)	1,300,000	900,000	(900,000)

Intangible assets are comprised of the following amounts:

	Deferred Development Costs ($)	Brand ($)	Patents ($)	Trademarks ($)	Computer Software ($)	Total ($)
Cost						
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
Additions	-	-	-	-	-	-
Foreign exchange	16,013	8,160	6,993	602	1,281	33,049
Balance at September 30, 2020	2,224,978	1,133,815	971,638	83,704	177,994	4,592,129
Accumulated amortization						
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
Amortization	112,223	53,093	52,628	-	5,661	223,605
Foreign exchange	10,603	4,006	2,770	-	(1,021)	16,358
Balance at September 30, 2020	1,719,944	113,382	448,313	-	159,216	2,440,855
Carrying amounts						
At September 30, 2019	611,847	1,069,372	571,730	83,102	22,137	2,358,188
At September 30, 2020	**505,034**	**1,020,433**	**523,325**	**83,704**	**18,778**	**2,151,274**

Expressed in Canadian Dollars

8. PROPERTY, PLANT AND EQUIPMENT

	Furniture and Fixtures ($)	**Lab Equipment ($)**	**Leasehold Improvements ($)**	**Total ($)**
Cost				
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
Acquisitions	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
Additions	45,200	285,881	40,011	371,092
Foreign exchange	4,780	14,332	1,135	20,247
Balance at September 30, 2020	901,046	2,751,986	484,315	4,137,347
Accumulated depreciation				
Balance at September 30, 201	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
Depreciation	106,060	277,143	70,279	453,482
Foreign exchange	636	6,593	237	7,466
Balance at September 30, 2020	552,852	1,523,979	235,557	2,312,388
Carrying amounts				
At September 30, 2019	404,910	1,211,530	278,128	1,894,568
At September 30, 2020	**348,194**	**1,228,007**	**248,758**	**1,824,959**

9. DEFERRED REVENUE

	September 30, 2020	September 30, 2019
Balance, beginning of year	**$598,367**	$206,811
Add:		
Deferred licensing and services revenue	**1,740,309**	299,138
Deferred product	**2,568,033**	2,540,057
Less:		
Recognition of deferred product	**(2,681,896)**	(2,305,990)
Recognition of deferred licensing and services revenue	**(1,446,844)**	(135,360)
Foreign exchange	**10,303**	(6,289)
Balance, end of year	**788,272**	598,367
Current portion	**(498,149)**	(459,315)
Non-current portion	**$290,123**	$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 EBITDA; 2) fixed charged coverage ratio; 3) current ratio, and 4) maintaining a cash balance of $1,500,000, as well as other reporting requirements. As of September 30, 2020, 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, 2020. The carrying amount of the acquisition line is $3,955,000 as of September 30, 2020. Subsequent to September 30, 2020, the Company obtained a waiver for the breach of covenants thereof as described in Note 2.

A reconciliation of the operating line is as follows:

	September 30, 2020 ($)	September 30, 2019 ($)
Balance – October 1, 2019	3,550,000	1,526,928
Proceeds received	570,000	2,350,000
Interest accrued during the year	124,920	149,715
Interest paid during the year	(124,920)	(149,715)
Repayment of principal	(165,000)	(326,928)
Balance – Ending	3,955,000	3,550,000
Current portion	3,955,000	3,550,000

As of September 30, 2020, the Company has $3,955,000 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, 2020, the Company recognized $124,920 of interest expense on this loan.

A reconciliation of the Acquisition Line is as follows:

	September 30, 2020 ($)
Balance – October 1, 2019	4,872,966
Proceeds received	-
Repayments of principal	(1,200,000)
Interest accrued during the year	239,154
Interest paid during the year	(218,093)
Balance – Ending	3,694,027
Current portion	3,694,027

Expressed in Canadian Dollars

This facility is repayable on demand by HSBC which could occur if there was a default on the financial covenants. As of September 30, 2020, the Company has $3,694,027 drawn and outstanding on the acquisition line. During the year ended September 30, 2020, the Company recognized $239,154 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). In addition, the Company has a $1m facility available through the BCAP with BDC, the Company is able to draw against this facility and make payments related to the repayment of other debts and working capital.

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 to 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. 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 year ended September 30, 2020, 50,091 (2019-nil) shares were released from escrow leaving a balance of 25,045. After year end the remaining shares were released from escrow.

During the year ended September 30, 2020, 275,447 warrants expired unexercised.

Warrants

The following is a summary of all warrants:

	Number of Warrants	Weighted average exercise Price	Weighted Average Expiry (years)
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**
Expired during the period	275,447	2.30	
Balance at September 30, 2020	**2,750,000**	**$2.00**	**3.97**

Expressed in Canadian Dollars

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, 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**	

Expressed in Canadian Dollars

The following is a summary of changes in stock options from October 1, 2019 to September 30, 2020:

Grant Date	Expiry Date	Exercise Price	Opening Balance	Expired	Forfeited	Closing Balance	Vested	Unvested	Weighted Average Expiry (years)
26-Mar-15	26-Mar-20	$1.40	73,999	(73,999)	-	-	-	-	-
7-Mar-16	7-Mar-21	$1.13	100,000	-	-	100,000	100,000	-	0.44
23-Jun-16	23-Jun-21	$1.29	115,832	-	(4,998)	110,834	110,834	-	0.73
14-Sep-16	14-Sep-21	$2.29	20,000	-	-	20,000	20,000	-	0.96
8-Feb-17	8-Feb-22	$2.20	168,333	-	-	168,333	168,333	-	1.36
20-Jun-17	20-Jun-22	$2.47	348,333	-	-	348,333	348,333	-	1.72
25-Oct-17	25-Oct-22	$3.80	60,000	-	-	60,000	40,000	20,000	2.07
21-Dec-17	21-Dec-22	$4.65	167,500	-	(30,000)	137,500	91,667	45,833	2.23
24-Jan-18	24-Jan-23	$6.02	60,000	-	-	60,000	40,000	20,000	2.32
27-Sep-18	27-Sep-23	$8.50	142,500	-	(12,500)	130,000	86,667	43,333	2.99
22-Dec-18	22-Dec-23	$4.28	351,667	-	(29,166)	322,501	109,650	212,851	3.23
15-Mar-19	15-Mar-24	$5.03	182,500	-	(32,500)	150,000	51,000	99,000	3.46
			1,790,664	**(73,999)**	**(109,164)**	**1,607,501**	**1,166,484**	**441,017**	**2.17**
Weighted Average Exercise Price			**$3.71**	**$1.40**	**$4.95**	**$3.73**	**$3.27**	**$4.96**	

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%.

Share based payment expense

Total expense arising from share-based payment transactions recognized during the year ended September 30, 2020, as part of employee benefit expenses were $935,624 (2019 – $1,717,091).

12. 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 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, 2020, and September 30, 2019, 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. During the year there was $1,420,002 written off related to amounts where collection is not reasonably expected to be collected from a specific customer. The Company continues to pursue collection efforts for this amount.

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, 2020, three customers, who are distributors and strategic partners of the Company and, accounted for 51% (September 30, 2019 – three customers for 43%) of the accounts receivable balance. 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, 2020	September 30, 2019
Current	**$3,283,144**	$3,399,503
30-60 days past due	**22,053**	72,350
Over 60 days past due	**28,240**	163,428
	3,333,437	3,635,281

Interest rate risk

The Company is subject to interest rate risk on its cash 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 September 30, 2020, if interest rates had been 1% higher or lower then the interest expense would have been $76,490 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, 2020				September 30, 2019			
	CAD	USD	GBP	**Total**	CAD	USD	GBP	**Total**
Cash	$199,176	$3,267,280	$40,535	**$3,506,991**	$4,412,096	$5,083,036	$80,017	**$9,575,149**
Accounts Receivable	$2,283	$3,324,634	$6,520	**$3,333,437**	-	$3,429,338	$205,943	**$3,635,281**
Acquisition note payable	-	$10,074,013	-	**$10,074,013**	-	$9,674,211	-	**$9,674,211**
Accounts payable and accrued liabilities	$609,370	$3,122,046	$167,850	**$3,899,266**	$1,020,290	$4,356,278	$304,847	**$5,681,415**
Lease liabilities	$1,296,801	$1,882,917	-	**$3,179,718**	-	-	-	-

Fair value

The fair values of cash, 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.

13. CAPITAL MANAGEMENT

The Company defines capital that it manages as its 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, 2020 is $16,755,705 (September 30, 2019 – $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

14. INCOME TAXES

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

The 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, 2020 (2019 – 21.0% - 26.5%).

Reconciliation between statutory rate and actual rate

	September 30,	
	2020	2019
Income tax computed at statutory tax rates	**(1,768,700)**	$(2,292,500)
Permanent differences	**276,900**	464,600
Rate differences and other	**81,900**	286,100
Change in deferred tax assets not recognized	**1,409,900**	1,541,800
	$ -	$ -

Deferred tax assets

The tax effect of the temporary differences that gives rise to deferred tax assets (liabilities) as of September 30, 2020, and 2019 is presented below. No benefit has been recorded in these consolidated financial statements as it is not probable that the Company will generate taxable income in the future to utilize these differences.

	September 30,	
	2020	2019
Non-capital loss carry forwards	**$6,269,644**	$7,487,100
Capital loss carry forwards	**127,582**	127,600
Capital and other assets	**(647,374)**	(257,400)
Deferred development costs	**2,135,891**	2,061,300
Deferred revenue and other liabilities	**296,304**	189,900
Deferred tax assets not recognized	**(8,182,047)**	(9,608,500)
	$ -	$ -

The Company has non-capital losses carried forward available for income tax purposes as at September 30, 2020 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	5,800	-
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	1,108,000
2038	484,100	-	1,864,400
2039	2,153,400	-	1,894,900
2040	5,112,200	-	1,092,200
No expiry	-	3,262,600	-
	$15,866,600	$4,441,500	$5,959,500

Expressed in Canadian Dollars

Other income tax items

The Company has capital losses carry forward for income tax purposes as at September 30, 2020 of approximately $962,883 (2019 - $962,883), which are available to reduce taxable capital gains in future years. These losses do not expire.

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, 2020, the Company has $1,679,947 (2019 - $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, 2020, the Company has $160,043 (2019 – $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.

15. RELATED PARTY TRANSACTIONS

Key management personnel include 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,	
	2020	2019
Compensation and short-term employee benefits	**$1,173,661**	$2,807,973
Share-based payments	**441,990**	664,971
	1,615,651	$3,472,944

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, 2020, $10,000 of this loan remained outstanding.

Expressed in Canadian Dollars

16. EXPENSES BY NATURE

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

	Year ended September 30,	
	2020	2019
Inventoried materials	$11,233,765	$10,213,576
Wages, benefits, consulting fees, director compensation	14,530,018	19,435,672
Government subsidies	(2,147,174)	-
Share based payments	935,624	1,717,091
Depreciation and amortization	1,206,094	629,888
Professional fees	1,958,809	2,902,351
Accounts receivable write-off	1,420,002	-
Other expenses	2,755,035	7,354,676
Total	**$31,892,173**	**$42,253,254**

Depreciation and amortization

		Year ended September 30,	
		2020	2019
Cost of product sales		**$349,595**	$328,056
Operations		**3,408**	4,201
Research and development activities		**36,363**	36,008
General and administrative		**816,728**	261,623
Total depreciation and amortization		**$1,206,094**	$629,888

17. LOSS PER SHARE

The weighted average number of shares outstanding during the year ended September 30, 2020 was 25,818,677 (September 30, 2019 – 22,461,193).

For the years ended September 30, 2020 and 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 are as follows:

		September 30,
All dilutive securities	**2020**	2019
Common shares potentially dilutive		
- all stock options	**1,607,501**	1,709,664
- all warrants	**2,750,000**	3,025,447
Total potentially dilutive shares	**4,357,501**	4,735,111

Expressed in Canadian Dollars

18. 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.

The minimum annual payments for short-term and low-value leases for the next five years are as follows:

Year	Annual Commitment
2021	43,806
2022	7,608
2023	1,728
2024	-
2025	-
Thereafter	-

19. SEGMENT REPORTING

During the year ended September 30, 2020, there was no customer who individually accounted for a significant amount of overall revenue (2019 – one customer accounted for approximately 25% of total revenue). The Company generated revenue of $21,152,308 (2019 – $24,083,097) in the US, $2,335,856 (2019 – $8,758,827) in the Middle East, $109,711 (2019 – $32,001) in Canada, and $2,202,231 (2019 – $1,130,697) in the rest of the world.

As of September 30, 2020, the Company had $5,582,127 (2019 - $2,797,245) of its property, plant, and equipment, right-of-use assets and intangible assets located in Canada and $1,209,830 (2019 - $1,455,511) in the USA. Goodwill in the amount of $13,018,102 (2019 - $12,924,412) is attributed to the US.

20. CHANGES IN NON-CASH WORKING CAPITAL ITEMS

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

	Year ended September 30,	
	2020	2019
Accounts receivable	**$327,754**	$3,349,494
Prepaid expenses	**(203,437)**	415,103
Inventories	**1,441,863**	(2,144,114)
Accounts payable and accrued liabilities	**(1,820,874)**	921,538
Deferred revenue	**179,602**	365,132
Deferred rent	**-**	169,021
	$(75,092)	$3,076,174