Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

For the three months ended December 31, 2020 and 2019

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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, 2020	September 30, 2020
Assets		
Current assets		
Cash and cash equivalents	**$2,533,891**	$3,506,991
Accounts receivable	**3,469,628**	3,333,437
Inventories (Note 4)	**6,933,720**	7,199,774
Prepaid expenses	**501,995**	809,404
Total current assets	**13,439,234**	14,849,606
Non-current assets		
Restricted cash	**37,004**	37,309
Property, plant and equipment (Note 6)	**1,691,701**	1,824,959
Intangible assets (Note 5)	**1,999,444**	2,151,274
Right-of-use assets (Note 8)	**2,559,973**	2,815,724
Goodwill (Note 5)	**12,425,705**	13,018,102
Total non-current assets	**18,713,827**	19,847,368
Total assets	**$32,153,061**	$34,696,974
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	**$3,648,337**	$3,899,266
Short-term debt (Note 7)	**7,353,232**	7,649,027
Lease liabilities (Note 9)	**512,811**	516,372
Acquisition note payable (Note 2)	**9,615,588**	10,074,013
Deferred revenue	**307,900**	498,149
Total current liabilities	**21,437,868**	22,636,827
Non-current liabilities		
Deferred revenue	**248,274**	290,123
Lease liabilities (Note 9)	**2,458,643**	2,663,346
Total non-current liabilities	**2,706,917**	2,953,469
Total liabilities	**24,144,785**	25,590,296
Shareholders' equity		
Share capital (Note 10)	**44,607,119**	44,607,119
Contributed surplus (Note 10)	**11,776,843**	11,652,765
Foreign exchange translation reserve	**(284,365)**	565,772
Accumulated deficit	**(48,091,321)**	(47,718,978)
Total shareholders' equity	**8,008,276**	9,106,678
Total liabilities and shareholders' equity	**$32,153,061**	$34,696,974

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,	
	2020	2019
Revenue		
Product	**$5,386,072**	$7,174,643
Development and consulting services	**541,750**	733,128
Licensing and royalty fees	**60,590**	40,788
Total revenue	**5,988,412**	7,948,559
Cost of sales	**2,402,884**	3,112,775
Gross profit before operating expenses	**3,585,528**	4,835,784
Operating expenses		
Operations	**258,483**	460,934
Research and development activities	**217,228**	225,305
Sales, marketing and agency fees	**1,616,868**	2,912,492
General and administrative	**1,746,272**	2,186,046
	3,838,851	5,784,777
Finance expenses	**119,020**	225,740
Net loss	**$(372,343)**	$(1,174,733)
Other comprehensive income		
Amount that may be reclassified to profit or loss		
Foreign currency translation adjustment	**(850,137)**	(411,153)
Total comprehensive loss	**$(1,222,480)**	$(1,585,886)
Basic loss per share (Note 16)	**$(0.01)**	$(0.05)
Diluted loss per share (Note 16)	**$(0.01)**	$(0.05)

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, 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**
Balance at October 1, 2020	25,818,677	$44,607,119	$11,652,765	$(47,718,978)	$565,772	$9,106,678
Share-based payment expense	-	-	124,078	-	-	124,078
Net loss for the period	-	-	-	(372,343)	-	(372,343)
Foreign currency translation adjustment	-	-	-	-	(850,137)	(850,137)
Balance at December 31, 2020	**25,818,677**	**$44,607,119**	**$11,776,843**	**$(48,091,321)**	**$(284,365)**	**$8,008,276**

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,	
	2020	2019
Cash flows from (used in) operating activities		
Net loss for the period	**$(372,343)**	$(1,174,733)
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation of property, plant and equipment	**104,895**	105,444
Amortization of intangible assets	**55,198**	55,936
Depreciation - right of use assets (Note 8)	**130,607**	131,998
Share-based payment expense (Note 11)	**124,078**	397,489
Interest expense and accretion	**119,020**	225,740
Cash generated by operating activities before change in non-cash working capital balances	**161,455**	(258,126)
Change in non-cash working capital (Note 19)	**(354,437)**	(4,379,209)
Total cash flows used in operating activities	**(192,982)**	(4,637,335)
Cash flows from (used in) investing activities		
Purchase of property, plant and equipment	**(53,188)**	(66,531)
Restricted cash	**(305)**	(142)
Total cash flows used in investing activities	**(53,493)**	(66,673)
Cash flows from financing activities		
Interest paid	**(75,521)**	(103,464)
Repayment of debt	**(300,000)**	(325,000)
Payment of lease liabilities	**(160,509)**	(147,394)
Total cash flows from financing activities	**(536,030)**	(575,858)
Foreign exchange rate changes on cash	**(190,595)**	(179,477)
Total cash flows during the period	**(973,100)**	(5,459,343)
Cash and cash equivalents, beginning of the period	**$3,506,991**	$9,575,149
Cash and cash equivalents, end of the period	**$2,533,891**	$4,115,806

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, 2020 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.

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 Company's unaudited condensed consolidated interim financial statements have been prepared on a going concern basis which presumes that the Company will continue in operation for the foreseeable future and will be able to realize assets and discharge liabilities in the normal course of its operations.

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 milestone payments of $7.5 million USD have become due. The Company had intended to fund the Acquisition Note milestone payments through the Acquisition Line Facility ("Facility") with HSBC Bank Canada ("HSBC"), the Company's primary secured lender.

Consistent with September 30, 2020, at December 31, 2020, 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. The Company continues to repay the Facility with HSBC in accordance with the terms and conditions of the Facility, which is currently scheduled to be fully repaid by March 2024.

As of December 31, 2020, the Company did not meet certain covenants related to the Facility with HSBC under the original Facility agreement. Subsequent to December 31, 2020 the Company obtained a waiver from HSBC related to the covenant breaches as of the quarter end. The Company is currently forecasting that it may not meet all of these covenants at various times in Fiscal 2021 but the Company continues to repay the HSBC Facility in accordance with its term and conditions and the Vendor currently has no recourse under the subordination agreement. 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.

Expressed in Canadian Dollars

In addition, the Company has a $1 million 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) has been 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 $372,343 for the quarter ended December 31, 2020 (2019 - $1,174,733) and cash used in operating activities was $192,982 (2019 - $4,637,335) for the same period. As of December 31, 2020, the Company had $2,533,891 of cash (September 30, 2020 – $3,506,991) 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.

	Carrying amount ($)	**Future cash flows ($)**	**Less than 1 year ($)**	**Between 1 and 5 years ($)**	**Greater than 5 years ($)**
Accounts payable and accrued liabilities	3,648,337	3,648,337	3,648,337	-	-
Debt	7,353,232	7,353,232	7,353,232	-	-
Acquisition note payable	9,615,588	9,615,588	9,615,588	-	-
Lease liabilities	2,971,454	3,347,117	641,734	2,543,739	161,644
Total	**23,588,611**	**23,964,274**	**21,258,891**	**2,543,739**	**161,644**

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, selfisolations, 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 quarter ended December 31, 2020, the Company applied for and was approved for funding of $280,195 under the Canadian Emergency Wage Subsidy Program ("CEWS"). The Company also received funds from other subsidy programs of $22,259 during the quarter ended December 31, 2020. Subsequent to period end the company applied for, and received, $1,103,860 USD in a second draw of the United States Paycheck Protection Program loan ("Loan") 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%.

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

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, 2020, which were prepared in accordance with IFRS.

The accounting policies adopted are consistent with those of the previous financial year end.

On October 31, 2018, 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 were effective for years beginning on or after January 1, 2020 and are to be applied prospectively. The Company adopted the amendments on October 1, 2020 and there was no impact on the unaudited condensed consolidated interim financial statements.

The unaudited condensed consolidated interim financial statements were authorized for issue by the Board of Directors on February 26, 2021.

Expressed in Canadian Dollars

4. INVENTORIES

Inventories consist of the following:

	December 31, 2020	September 30, 2020
Raw materials	**$3,012,584**	$2,983,418
Finished goods	**5,910,237**	6,300,288
Inventory provision	**(1,989,101)**	(2,083,932)
	$6,933,720	$7,199,774

Cost of product sales for the three month period ended December 31, 2020 include $2,228,142 (2019 - $2,436,466), in inventoried materials.

5. INTANGIBLE ASSETS AND GOODWILL

Goodwill is comprised of the following amounts:

	Goodwill ($)
Balance at October 1, 2020	13,018,102
Foreign exchange	(592,397)
Balance at December 31, 2020	**12,425,705**

Intangible assets are comprised of the following amounts:

	Deferred Development Costs ($)	**Brand ($)**	**Patents ($)**	**Trademarks ($)**	**Computer Software ($)**	**Total ($)**
Cost						
Balance at September 30, 2020	2,224,978	1,133,815	971,638	83,704	177,994	4,592,129
Foreign exchange	(101,249)	(51,595)	(44,215)	(3,809)	(8,100)	(208,968)
Balance at December 31, 2020	2,123,729	1,082,220	927,423	79,895	169,894	4,383,161
Accumulated amortization						
Balance at September 30, 2020	1,719,944	113,382	448,313	-	159,216	2,440,855
Amortization	27,168	13,844	12,834	-	1,352	55,198
Foreign exchange	(78,890)	(5,476)	(20,694)	-	(7,276)	(112,336)
Balance at December 31, 2020	1,668,222	121,750	440,453	-	153,292	2,383,717
Carrying amounts						
At September 30, 2020	505,034	1,020,433	523,325	83,704	18,778	2,151,274
At December 31, 2020	455,507	960,470	486,970	79,895	16,602	1,999,444

Expressed in Canadian Dollars

6. PROPERTY, PLANT AND EQUIPMENT

	Furniture and Fixtures ($)	Lab Equipment ($)	Leasehold Improvements ($)	Total ($)
Cost				
Balance at September 30, 2020	901,046	2,751,986	484,315	4,137,347
Additions	12,633	39,337	1,218	53,188
Foreign exchange	(41,291)	(126,131)	(22,067)	(189,489)
Balance at December 31, 2020	872,388	2,665,192	463,466	4,001,046
Accumulated depreciation				
Balance at September 30, 2020	552,852	1,523,979	235,557	2,312,388
Depreciation	24,855	61,587	18,453	104,895
Foreign exchange	(26,039)	(70,757)	(11,142)	(107,938)
Balance at December 31, 2020	551,668	1,514,809	242,868	2,309,345
Carrying amounts				
At September 30, 2020	348,194	1,228,007	248,758	1,824,959
At December 31, 2020	**320,720**	**1,150,383**	**220,598**	**1,691,701**

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; 3) current ratio; and 4) maintaining a cash balance of $1,500,000 as well as other reporting requirements. As of December 31, 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 December 31, 2020. The carrying amount of the acquisition line is $3,398,232 as of December 31, 2020. Subsequent to December 31, 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:

	December 31, 2020 ($)
Balance – October 1, 2020	3,955,000
Interest accrued during the period	44,063
Interest paid during the period	(44,063)
Balance – Ending	3,955,000
Less: Current portion	3,955,000

Expressed in Canadian Dollars

As of December 31, 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 1.5%. During the three months ended December 31, 2020, the Company recognized $44,063 of interest expense on this loan.

A reconciliation of the Acquisition Line is as follows:

	December 31, 2020 ($)
Balance – October 1, 2020	3,694,027
Repayments of principal	(300,000)
Interest accrued during the period	35,663
Interest paid during the period	(31,458)
Balance – Ending	3,398,232
Less: Current portion	3,398,232
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, 2020, the Company has $3,398,232 drawn and outstanding on the acquisition line. During the three months ended December 31, 2020, the Company recognized $35,663 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. RIGHT-OF-USE ASSETS

	Right-of-use assets ($)
Balance at October 1, 2020	2,815,724
Depreciation	(130,607)
Foreign exchange	(125,144)
Balance at December 31, 2020	**2,559,973**

The Company leases office space in Mississauga, Canada and Seattle, USA.

9. LEASE LIABILITIES

Lease liabilities are comprised of the following amounts:

	Lease liabilities ($)
Balance at October 1, 2020	3,179,718
Interest	35,946
Payments	(160,509)
Foreign exchange	(83,701)
Balance at December 31, 2020	**2,971,454**
Less: Current portion	512,811
Long-term portion	2,458,643

Expressed in Canadian Dollars

10. 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 75,136 common shares of the Company in escrow with release dates of 12 months, 18 months and 24 months after the acquisition date. During the three months ended December 31, 2020 25,045 (2019 - 25,045) shares were released from escrow leaving a balance of nil.

Warrants

The following is a summary of all warrants:

	Number of Warrants	Weighted average exercise Price	Weighted Average Expiry (years)
Balance at September 30, 2020	**2,750,000**	**$2.00**	**3.97**
Exercised during the period	-	-	
Balance at December 31, 2020	**2,750,000**	**$2.00**	**3.72**

11. SHARE-BASED PAYMENTS

Option Plan Details

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

Expressed in Canadian Dollars

The following is a summary of changes in stock options from October 1, 2020 to December 31, 2020:

Grant Date	Expiry Date	Exercise Price	Opening Balance	Forfeited	Closing Balance	Vested	Unvested	Weighted Average Expiry (years)
7-Mar-16	7-Mar-21	$1.13	100,000	-	100,000	100,000	-	0.19
23-Jun-16	23-Jun-21	$1.29	110,834	-	110,834	110,834	-	0.48
14-Sep-16	14-Sep-21	$2.29	20,000	-	20,000	20,000	-	0.71
8-Feb-17	8-Feb-22	$2.20	168,333	-	168,333	168,333	-	1.11
20-Jun-17	20-Jun-22	$2.47	348,333	(2,500)	345,833	345,833	-	1.47
25-Oct-17	25-Oct-22	$3.80	60,000	-	60,000	60,000	-	1.82
21-Dec-17	21-Dec-22	$4.65	137,500	-	137,500	137,500	-	1.98
24-Jan-18	24-Jan-23	$6.02	60,000	-	60,000	40,000	20,000	2.07
27-Sep-18	27-Sep-23	$8.50	130,000	(834)	129,166	86,111	43,055	2.74
22-Dec-18	22-Dec-23	$4.28	322,501	(20,001)	302,500	99,825	202,675	2.98
15-Mar-19	15-Mar-24	$5.03	150,000	(3,300)	146,700	49,878	96,822	3.21
			1,607,501	**(26,635)**	**1,580,866**	**1,218,314**	**362,552**	**1.90**
Weighted Average Exercise Price			**$3.73**	**$4.34**	**$3.72**	**$3.32**	**$5.08**	

Share Based Payment Expense

Total expense arising from share based payment transactions recognized during the three months ended December 31, 2020, as part of employee benefit expense were $124,078 (2018 - $397,489).

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 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, 2020 and September 30, 2020 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, 2020, three customers accounted for 42% (2019 – three customers for 56%) 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, 2020	September 30, 2020
Current	**$3,428,588**	$3,283,144
30-60 days past due	**19,878**	22,053
Over 60 days past due	**21,162**	28,240
	3,469,628	3,333,437

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, 2020, if interest rates had been 1% higher or lower then the interest expense would have been $18,383 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, 2020				**September 30, 2020**			
	Canadian	USD	GBP	**Total**	CAD	USD	GBP	**Total**
Cash and cash equivalents	$2,204	$2,498,544	$33,143	**$2,533,891**	$199,176	$3,267,280	$40,535	**$3,506,991**
Accounts Receivable	$7,417	$2,987,120	$475,091	**$3,469,628**	$2,283	$3,324,634	$6,520	**$3,333,437**
Acquisition note payable	-	$9,615,588	-	**$9,615,588**	-	$10,074,013	-	**$10,074,013**
Accounts payable and accrued liabilities	$509,981	$2,930,312	$208,044	**$3,648,337**	$609,370	$3,122,046	$167,850	**$3,899,266**
Lease liabilities	$1,235,409	$1,736,045	-	**$2,971,454**	$1,296,801	$1,882,917	-	**$3,179,718**

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.

Expressed in Canadian Dollars

13. 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, 2020 is $15,361,508 (September 30, 2020 – $16,755,705).

The Company manages its capital structure and adjusts 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.

14. 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,	
	2020	2019
Compensation and short-term employee benefits	**$239,442**	$287,262
Share based payment expense	**37,504**	139,560
	276,946	426,822

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

15. EXPENSES BY NATURE

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

	Three months ended December 31,	
	2020	2019
Inventoried materials	$2,228,142	$2,463,466
Wages, benefits, consulting fees, director compensation	3,131,943	3,624,587
Government subsidies	(302,454)	-
Share based payments	124,078	397,489
Depreciation and amortization	290,700	293,378
Professional fees	487,541	548,832
Other expenses	281,785	1,569,800
Total	**$6,241,735**	**$8,897,552**

Expressed in Canadian Dollars

Depreciation and amortization

	For the three months ended December 31,	
	2020	2019
Cost of product sales	**$80,509**	$81,438
Operations	**660**	836
Research and development activities	**7,586**	8,710
General and administrative	**201,945**	202,394
Total depreciation and amortization	**$290,700**	$293,378

16. LOSS PER SHARE

The weighted average number of shares outstanding during the period ended December 31, 2020 was 25,818,677 (December 31, 2019 – 25,818,677).

For the three month periods ended December 31, 2020 and December 31, 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:

Potentially dilutive securities	**December 31, 2020**	December 31, 2019
Common shares potentially dilutive		
- all stock options	**1,580,866**	1,782,330
- all warrants	**2,750,000**	3,025,447
Total potentially dilutive shares	**4,330,866**	4,807,777

17. 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.

18. SEGMENT REPORTING

During the three months ended December 31, 2020, there was one customer who individually accounted for approximately 15% of revenue (2019 – approximately 11%). The Company generated revenue of $4,527,070 (2019 – $6,422,854) in the US, $752,440 (2019 – $929,449) in the Middle East, $24,283 (2019 – $6,455) in Canada, and $684,619 (2019 – $589,801) in the rest of the world.

As of December 31, 2020, the Company had $5,114,175 of its property, plant, and equipment, right-of-use assets and intangible assets located in Canada and $1,136,943 in the USA. Goodwill in the amount of $12,425,705 is attributed to the US.

Expressed in Canadian Dollars

19. CHANGES IN NON-CASH WORKING CAPITAL ITEMS

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

	Three months ended December 31,	
	2020	2019
Accounts receivable	**$(294,619)**	$(1,539,335)
Prepaid expenses	**276,910**	(272,578)
Inventories	**(63,018)**	(829,516)
Accounts payable and accrued liabilities	**(75,210)**	(1,687,150)
Deferred revenue	**(198,500)**	(50,630)
	$(354,437)	$(4,379,209)