# Covalon Technologies Ltd.

**CONSOLIDATED FINANCIAL STATEMENTS**

**For the years ended September 30, 2022, and 2021**

## 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, 2022 and 2021, 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, 2022 and 2021;
- 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.

## 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 Grant Redpath.

**/s/PricewaterhouseCoopers LLP**

Chartered Professional Accountants, Licensed Public Accountants

Oakville, Ontario
January 25, 2023

# Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

**Expressed in Canadian Dollars**

| | **September 30, 2022** | September 30, 2021 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | **$14,061,631** | $22,946,923 |
| Cash in escrow (Note 5) | **1,370,700** | 2,548,200 |
| Accounts receivable | **4,732,430** | 6,395,547 |
| Inventories (Note 7) | **4,965,668** | 4,702,201 |
| Prepaid expenses | **2,097,628** | 845,451 |
| **Total current assets** | **27,228,057** | 37,438,322 |
| **Non-current assets** | | |
| Restricted cash | **-** | 137,061 |
| Property, plant and equipment (Note 9) | **1,215,970** | 1,256,594 |
| Intangible assets (Note 8) | **1,277,327** | 897,865 |
| Right-of-use assets (Note 12) | **656,727** | 852,262 |
| **Total non-current assets** | **3,150,024** | 3,143,782 |
| **Total assets** | **$30,378,081** | $40,582,104 |
| **Liabilities and shareholders' equity** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | **$3,720,208** | $4,039,607 |
| Lease liabilities (Note 13) | **609,578** | 541,378 |
| Deferred revenue (Note 11) | **209,070** | 414,649 |
| **Total current liabilities** | **4,538,856** | 4,995,634 |
| **Non-current liabilities** | | |
| Deferred revenue (Note 11) | **51,401** | 162,448 |
| Lease liabilities (Note 13) | **1,559,063** | 2,049,495 |
| **Total non-current liabilities** | **1,610,464** | 2,211,943 |
| **Total liabilities** | **6,149,320** | 7,207,577 |
| | | |
| **Shareholders' equity** | | |
| Share capital (Note 14) | **43,843,344** | 44,676,999 |
| Contributed surplus (Note 14) | **11,277,493** | 11,833,354 |
| Foreign exchange translation reserve | **3,013,209** | 1,106,246 |
| Accumulated deficit | **(33,905,285)** | (24,242,072) |
| **Total shareholders' equity** | **24,228,761** | 33,374,527 |
| **Total liabilities and shareholders' equity** | **$30,378,081** | $40,582,104 |

**Contingencies and commitments (Note 23)**

On behalf of the Board:

*(signed) "Abe Schwartz"* *Director*

*(signed) "Brian Pedlar"* *Director*

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

# Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

**Expressed in Canadian Dollars**

| | | Year ended September 30, |
|---|---|---|
| | **2022** | 2021 |
| **Revenue** | | |
| Product | **$16,429,051** | $17,650,865 |
| Development and consulting services | **1,484,441** | 1,691,380 |
| Licensing and royalty fees | **232,898** | 219,056 |
| **Total revenue** | **18,146,390** | 19,561,301 |
| **Cost of sales** | **10,652,885** | 9,864,970 |
| **Gross profit before operating expenses** | **7,493,505** | 9,696,331 |
| **Operating expenses** | | |
| Operations | **2,064,808** | 995,158 |
| Research and development activities | **1,095,095** | 1,140,517 |
| Sales, marketing, and agency fees | **6,517,242** | 1,927,181 |
| General and administrative | **6,958,688** | 4,795,132 |
| | **16,635,833** | 8,857,988 |
| **Finance expenses** | **111,590** | 419,379 |
| **Net income (loss) from continuing operations** | **(9,253,918)** | 418,964 |
| **Net income (loss) from discontinued operations (Note 5)** | **(409,295)** | 23,057,942 |
| **Net income (loss)** | **$(9,663,213)** | $23,476,906 |
| **Other comprehensive income (loss)** | | |
| **Amount that may be reclassified to profit or loss** | | |
| Foreign currency translation adjustment continued operations | **1,906,963** | 746,227 |
| Foreign currency translation adjustment of discontinued operations | **-** | (356,665) |
| **Total comprehensive income (loss)** | **$(7,756,250)** | $23,866,468 |
| **Income (loss) per common share of continuing operations** | | |
| Basic earnings (loss) per share (Note 21) | **$(0.36)** | $0.02 |
| Diluted earnings (loss) per share (Note 21) | **$(0.36)** | $0.02 |
| **Income (loss) per common share of discontinued operations** | | |
| Basic earnings (loss) per share (Note 21) | **$(0.02)** | $0.89 |
| Diluted earnings (loss) per share (Note 21) | **$(0.02)** | $0.89 |
| **Income (loss) per common share** | | |
| Basic earnings (loss) per share (Note 21) | **$(0.38)** | $0.91 |
| Diluted earnings (loss) per share (Note 21) | **$(0.38)** | $0.91 |

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, 2020** | 25,818,677 | $44,607,119 | $11,652,765 | $(47,718,978) | $565,772 | $9,106,678 |
| Share-based payment expense | - | - | 97,740 | - | - | 97,740 |
| Exercise of stock options | 50,000 | 69,880 | (62,730) | - | - | 7,150 |
| Issuance of warrants (Notes 5 and 6) | - | - | 145,579 | - | - | 145,579 |
| Net income for the year | - | - | - | 23,476,906 | - | 23,476,906 |
| Foreign currency translation adjustment | - | - | - | - | 389,562 | 389,562 |
| Reclassification upon disposal of subsidiaries (Notes 5 and 6) | - | - | - | - | 150,912 | 150,912 |
| **Balance at September 30, 2021** | **25,868,677** | **$44,676,999** | **$11,833,354** | **$(24,242,072)** | **$1,106,246** | **$33,374,527** |
| | | | | | | |
| **Balance at October 1, 2021** | 25,868,677 | $44,676,999 | $11,833,354 | $(24,242,072) | $1,106,246 | $33,374,527 |
| Share-based payment expense | - | - | 211,438 | - | - | 211,438 |
| Exercise of stock options | 30,000 | 178,817 | (112,817) | - | - | 66,000 |
| Buyback of common shares (Note 14) | (640,900) | (1,111,177) | (615,777) | - | - | (1,726,954) |
| Exercise of warrants | 30,000 | 98,705 | (38,705) | - | - | 60,000 |
| Net loss for the year | - | - | - | (9,663,213) | - | (9,663,213) |
| Foreign currency translation adjustment | - | - | - | - | 1,906,963 | 1,906,963 |
| **Balance at September 30, 2022** | **25,287,777** | **$ 43,843,344** | **$11,277,493** | **$(33,905,285)** | **$3,013,209** | **$24,228,761** |

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, 2022 | 2021 |
|---|---|---|
| **Cash flows from (used in) operating activities** | | |
| Net income (loss) for the period from continuing operations | **$(9,253,918)** | $418,964 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation of property, plant and equipment | **634,106** | 308,434 |
| Amortization of intangible assets | **156,296** | 150,881 |
| Gain on sale of property, plant and equipment | **(11,311)** | - |
| Depreciation - right of use assets (Note 12) | **242,406** | 241,151 |
| Share-based payment expense (Note 15) | **211,438** | 163,769 |
| Interest expense and accretion | **110,797** | 419,379 |
| Cash generated by operating activities before change in non-cash working capital balances: | **(7,910,186)** | 1,702,578 |
| Net changes in non-cash working capital balances: | | |
| Accounts receivable | **1,842,085** | (3,193,970) |
| Prepaid expenses | **(1,169,683)** | (71,937) |
| Inventories | **(63,367)** | 2,162,894 |
| Accounts payable and accrued liabilities | **(444,207)** | 313,424 |
| Deferred revenue | **(248,212)** | (291,623) |
| Total net changes in non-cash working capital balances | **(83,384)** | (1,081,212) |
| **Total cash flows generated from (used in) operating activities** | **(7,993,570)** | 621,366 |
| **Cash flows from (used in) investing activities** | | |
| Purchase of property, plant and equipment | **(599,844)** | (175,802) |
| Purchase of intangible assets | **(481,908)** | (1,858) |
| Sale of property, plant and equipment | **101,668** | - |
| Restricted cash | **137,061** | (100,869) |
| **Total cash flows used in investing activities** | **(843,023)** | (278,529) |
| **Cash flows from (used in) financing activities** | | |
| Exercise of stock options | **66,000** | 7,150 |
| Interest paid | - | (293,175) |
| Repayment of debt | - | (8,660,529) |
| Proceeds from debt | - | 1,000,000 |
| Exercise of warrants | **60,000** | - |
| Buyback of common shares (Note 14) | **(1,726,954)** | - |
| Payment of lease liabilities | **(585,184)** | (305,613) |
| **Total cash flows used in financing activities** | **(2,186,138)** | (8,252,167) |
| Foreign exchange rate changes on cash | **1,448,917** | 731,902 |
| **Total cash flows during the year of continuing operations** | **(9,573,814)** | (7,177,428) |
| **Total cash flows during the year of discontinued operations** | **688,522** | 26,617,360 |
| **Total cash flows during the year** | **(8,885,292)** | 19,439,932 |
| **Cash and cash equivalents, beginning of the year** | **$22,946,923** | $3,506,991 |
| **Cash and cash equivalents, end of the year** | **$14,061,631** | $22,946,923 |

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, 2022, 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 July 29, 2021, the Company sold its AquaGuard product line and all its interest in two subsidiaries (see note 5).

The Company is listed on the TSX Venture Exchange (the "TSX-V"), 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. 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.

Included in continuing operations for the year ended September 30, 2022, the Company received funding of $nil (2021 - $535,275) under the Canadian Emergency Wage Subsidy Program. The Company also received funding of $nil (2021 - $65,631) from other government subsidy programs for the year ended September 30, 2022.

During the twelve months ended September 30, 2021 the Company applied for and received $1,384,581 in a second draw of the United States Paycheck Protection Program loan (the "Loan") from the US Small Business Administration ("SBA") under the US Paycheck Protection Program. The Loan was forgiven by the SBA during the three months ended September 30, 2021 as certain conditions were met (including the funds being used for eligible payroll and rent expenses during the eligibility period, and completion of a loan forgiveness application) and no repayments were required. As a result of the Loan being forgiven, during the twelve months ended September 30, 2021, the Company recorded $1,441,544 in relation to the Loan, by reducing the related operating expenses to which the Loan related to, and of the $1,441,544 of the Loan that was forgiven, $200,915 related to continuing operations, and $1,240,629 related to discontinued operations. The Company has no outstanding draws or amounts that have not been forgiven as of September 30, 2022, related to the Loan.

Operationally, the Company continues to be 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 supply chains emanating from China continue to be adversely affected as a result of COVID-19, and as a result, there continue to be increased costs associated with shipping product. Our distribution relationships with companies in China, and those internationally whom have supply chain connectivity with China, 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. The Company continues experiencing slow-downs in receiving regulatory approvals due to labour supply challenges, which could have adverse effects to revenue.

As a result of the supply chain issues emanating from China the Company continues to experience, demand for some of the Company's products can also be affected by higher lead times in sourcing product, which may have adverse impacts to revenue. The Company has not experienced material payment delays or defaults from customers as a result of the COVID-19 pandemic and its impact on their respective businesses.

As a result of these uncertainties there is a higher level of estimation uncertainty as it relates to the assessment provisions for inventory and receivables and related future cash flows. The Company continues to evaluate the current and potential impact of the COVID-19 pandemic on its business, affairs, operations, financial condition, liquidity, availability of credit, and results of operations.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

**Basis of preparation**

The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS). The consolidated financial statements were authorized for issue by the Board of Directors on January 24, 2023.

**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.; and, Covalon Technologies (Europe) Limited. The consolidated financial statements include the Former Subsidiaries: Covalon Technologies Holdings (USA), Ltd; and, Covalon Technologies AG Ltd. up until the AquaGuard Sale on July 29, 2021. The Company dissolved Covalon Medical Device Shanghai Co., Ltd. on September 8, 2022. 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.

### 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 | same as related right of use asset |

### 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 |

### Impairment of non-financial assets

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

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

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

**Accounts payable and accrued liabilities**

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

**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.

**Cost of sales**

The cost of sales includes the cost of finished goods, inventory provisions, distribution costs, rework costs, direct overhead expenses, and allocations of time spent on development work.

**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.

**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.

**Share-based compensation**

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

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**

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.

**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.

**Discontinued Operations**

The Company reports financial results for discontinued operations separately from continuing operations to distinguish the financial impact of disposal transactions from ongoing operations. Discontinued operations reporting occurs when the disposal of a component of the Company represents a strategic shift that will impact the Company's operations and financial results, and where the operations and cash flows can be distinguished from the rest of the Company.

**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**

**IAS 1 – Presentation of Financial Statements**

On October 31, 2018, amendments to IAS 1 and IAS 8 to clarify and align the definition of material information 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 consolidated financial statements.

**Accounting standards issued but not yet adopted**

**IAS 1 – Presentation of 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 has assessed that there will be no impact of applying the new standard on the consolidated financial statements.

**Definition of Accounting Estimates (Amendments to IAS 8)**

On February 12, 2021, the IASB issued Definition of Accounting Estimates (Amendments to IAS 8). The amendments will require the disclosure of material accounting policy information rather than disclosing significant accounting policies and clarifies how to distinguish changes in accounting policies from changes in accounting estimates. The amendments are effective for annual periods beginning on or after January 1, 2023. The Company intends to adopt this amendment in its Consolidated Financial Statements for the annual period beginning October 1, 2023. The adoption of this amendment is not expected to have a material impact on the consolidated financial statements.

**Expressed in Canadian Dollars**

## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

### Inventory Obsolescence

Management makes estimates of the future customer demand for products when establishing appropriate provisions for inventory. In making these estimates, management considers the product life of inventory and the profitability of recent sales of inventory. In many cases, product produced by the Company turns quickly and inventory on-hand values are low, thus reducing the risk of inventory obsolescence. However, expiry dates are very important in the determination of net realizable value of inventory. Management ensures that systems are in place to highlight and properly value that may be approaching expiry dates. To the extent that actual losses on inventory differ from those estimated, inventory, net loss, and comprehensive income (loss) will be affected in future periods.

## 5. AQUAGUARD SALE

On July 29, 2021, the Company sold the AquaGuard product line to TIDI Products, LLC (“TIDI”), an arm’s length party, for $37,837,852 including post-closing adjustments related to actual amounts of inventory and indebtedness (“AquaGuard Sale”). The financial information related to the AquaGuard product line is reported in the current, and comparative periods, as discontinued operations.

Under the terms of the purchase agreement, the Company sold all its interest in Covalon Technologies Holdings (USA), Ltd. and Covalon Technologies AG Ltd. (“Former Subsidiaries”) to TIDI. The transaction included the sale of moisture barrier products sold under the AquaGuard brand, certain trademarks and intellectual property, related customer contracts, and the manufacturing assets to support the AquaGuard business. The purchase price of $37,837,852 includes $2,513,200 placed in escrow for indemnity claims (which escrow amounts will be released 50% in 12 months following closing and the remaining 50% on September 30, 2022, assuming no claims). On August 2, 2022, 50% of the funds were received from escrow, and on October 3, 2022, the final 50% was received from escrow.

The Company used proceeds of $8,660,529 from the AquaGuard Sale to fully satisfy its indebtedness to its senior lender, HSBC, and the credit facility with HSBC Bank Canada (“HSBC”) has now been terminated (Note 10). The Company also paid off the Acquisition Note Payable (Note 6).

The following table outlines the gain on sale of AquaGuard:

| | |
|---|---|
| Purchase price | $37,837,852 |
| Less: | |
| Inventory | 672,986 |
| Property, plant and equipment | 106,530 |
| Intangible assets | 931,414 |
| Goodwill | 12,263,698 |
| Reclassification of foreign currency translation reserve upon disposal of subsidiaries | 150,912 |
| Transaction costs | 2,369,346 |
| **Gain on sale** | **21,342,966** |

**Expressed in Canadian Dollars**

The financial performance information presented for the years ended September 30, 2022 and September 30, 2021 are summarized below and included in the consolidated statements of operations and comprehensive income (loss) as net income from discontinued operations:

| | **September 30, 2022** | September 30, 2021 |
|---|---|---|
| Revenue | **483,010** | 10,558,447 |
| Cost of sales and operating expenses | **874,306** | 11,761,765 |
| Impairment of right of use asset (Note 12) | **-** | 1,310,191 |
| Finance expenses | **17,999** | 65,946 |
| Net income (loss) before gain on sale and gain on extinguishment of acquisition note payable | **(409,295)** | (2,579,455) |
| Gain on sale | **-** | 21,342,966 |
| Gain on extinguishment of acquisition note payable (Note 6) | **-** | 4,294,431 |
| Net income (loss) from discontinued operations | **(409,295)** | 23,057,942 |

Disclosures with respect to the consolidated statements of cash flows are as follows:

| | **September 30, 2022** | September 30, 2021 |
|---|---|---|
| Cash flows from operating activities | **(384,740)** | (314,329) |
| Cash flows from investing activities | **1,158,321** | 36,650,614 |
| Cash flows from financing activities | **(85,059)** | (9,718,925) |
| Total cash flow | **688,522** | 26,617,360 |

## 6. ACQUISITION NOTE PAYABLE

In March 2021, the Company entered into an agreement that allowed for the repayment of the acquisition note payable. This agreement allowed the debt to be settled with the repayment of USD$4,000,000 and the issuance of 200,000 common share purchase warrants with an exercise price of $4.00.

On July 29, 2021, the Company extinguished $9,490,221 of secured indebtedness owed to Cenorin, LLC (“Cenorin”) under a promissory note dated as of October 1, 2018, as amended, by making a cash payment of $5,026,400 (US$4,000,000) and issuing to 200,000 warrants for the purchase of common shares in the capital of the Company (the "Warrants") to Cenorin. The Company used proceeds from the AquaGuard sale (note 5) to make the required cash payment. Each Warrant entitles the holder to acquire a common share of the Company at an exercise price of $4.00 for a period of five years. The weighted average fair value of the warrants granted was $0.73 using the Black-Scholes option pricing model with a risk-free interest rate of 0.87%, and a term of 5 years.

**Expressed in Canadian Dollars**

| | **September 30, 2022** | September 30, 2021 |
|---|---|---|
| Balance - opening | **-** | 10,074,013 |
| Accretion | **-** | - |
| Repayment - cash | **-** | (5,026,400) |
| Fair value of Warrants | **-** | (145,579) |
| Gain on extinguishment | **-** | (4,294,431) |
| Foreign exchange | **-** | (607,603) |
| **Balance - ending** | **-** | **-** |

## 7. INVENTORIES

Inventories consist of the following:

| | **September 30, 2022** | September 30, 2021 |
|---|---|---|
| Raw materials | **$1,524,083** | $2,475,604 |
| Finished goods | **6,337,693** | 4,059,465 |
| Inventory provision | **(2,896,108)** | (1,832,868) |
| | **$4,965,668** | $4,702,201 |

Cost of product sales for the year ended September 30, 2022, includes $10,401,230 (2021 - $8,040,289), respectively in inventoried materials. Inventoried materials includes $2,264,853 (2021 - $361,556) in inventory provisions as a result of inventory obsolescence.

**Expressed in Canadian Dollars**

## 8. INTANGIBLE ASSETS

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 |
| Additions | - | - | - | - | 1,858 | 1,858 |
| Foreign exchange | (99,747) | (65,705) | (43,907) | (3,799) | (30,132) | (243,290) |
| Sale of assets (Note 5) | - | (1,068,110) | (24,925) | (3,348) | - | (1,096,383) |
| Balance at September 30, 2021 | 2,125,231 | - | 902,806 | 76,557 | 149,720 | 3,254,314 |
| Additions | - | - | 109,656 | - | 372,252 | 481,908 |
| Foreign exchange | 161,131 | - | 68,450 | 5,805 | 8,335 | 243,721 |
| Write-off of fully amortized assets not in use | - | - | - | - | (158,055) | (158,055) |
| **Balance at September 30, 2022** | **2,286,362** | **-** | **1,080,912** | **82,362** | **372,252** | **3,821,888** |
| **Accumulated amortization** | | | | | | |
| Balance at September 30, 2020 | 1,719,944 | 113,382 | 448,313 | - | 159,216 | 2,440,855 |
| Amortization | 105,680 | 40,390 | 48,663 | - | 4,247 | 198,980 |
| Foreign exchange | (76,526) | (2,887) | (19,645) | - | (19,359) | (118,417) |
| Sale of assets (Note 5) | - | (150,885) | (14,084) | - | - | (164,969) |
| Balance at September 30, 2021 | 1,749,098 | - | 463,247 | - | 144,104 | 2,356,449 |
| Amortization | 106,520 | - | 46,740 | - | 3,036 | 156,296 |
| Foreign exchange | 140,412 | - | 38,544 | - | 10,915 | 189,871 |
| Write-off of fully amortized assets not in use | - | - | - | - | (158,055) | (158,055) |
| **Balance at September 30, 2022** | **1,996,030** | **-** | **548,531** | **-** | **-** | **2,544,561** |
| Carrying amounts | | | | | | |
| At September 30, 2021 | 376,133 | - | 439,559 | 76,557 | 5,616 | 897,865 |
| **At September 30, 2022** | **290,332** | **-** | **532,381** | **82,362** | **372,252** | **1,277,327** |

As at September 30, 2022, included in computer software is an amount of $372,252 which primarily relates to new information systems where amortization has not yet commenced as they had not yet been placed into service.

**Expressed in Canadian Dollars**

## 9. 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 | 61,364 | 130,517 | 5,679 | 197,560 |
| Foreign exchange | (157,407) | (151,817) | (52,647) | (361,871) |
| Sale of assets (Note 5) | - | (156,650) | - | (156,650) |
| Balance at September 30, 2021 | 805,003 | 2,574,036 | 437,347 | 3,816,386 |
| Additions | 151,046 | 442,449 | 6,389 | 599,884 |
| Foreign exchange | (66,520) | (23,556) | (66,244) | (156,320) |
| Sale of assets | - | (199,172) | - | (199,172) |
| Write-off of fully depreciated assets not in use | (199,781) | (805,031) | - | (1,004,812) |
| Balance at September 30, 2022 | **689,748** | **1,988,726** | **377,492** | **3,055,966** |
| **Accumulated depreciation** | | | | |
| Balance at September 30, 2020 | 552,852 | 1,523,979 | 235,557 | 2,312,388 |
| Depreciation | 160,156 | 253,452 | 159,515 | 573,123 |
| Foreign exchange | (140,623) | (87,192) | (47,784) | (275,599) |
| Sale of assets (Note 5) | - | (50,120) | - | (50,120) |
| Balance at September 30, 2021 | 572,385 | 1,640,119 | 347,288 | 2,559,792 |
| Depreciation | 54,724 | 537,880 | 41,502 | 634,106 |
| Foreign exchange | (77,016) | (93,276) | (69,983) | (240,275) |
| Sale of assets | - | (108,815) | - | (108,815) |
| Write-off of fully depreciated assets not in use | (199,781) | (805,031) | - | (1,004,812) |
| Balance at September 30, 2022 | **350,312** | **1,170,877** | **318,807** | **1,839,996** |
| **Carrying amounts** | | | | |
| At September 30, 2021 | 232,618 | 933,917 | 90,059 | 1,256,594 |
| **At September 30, 2022** | **339,436** | **817,849** | **58,685** | **1,215,970** |

During the year ended September 30, 2022, the Company changed its estimate of the useful lives of certain items of property, plant and equipment included in lab equipment and furniture and fixtures. As a result of this change, an additional $320,704 of depreciation expense was recognized during the year.

**Expressed in Canadian Dollars**

## 10. DEBT

During the year ended September 30, 2018, the Company entered into the Facility with HSBC. This Facility provided credit comprised of: 1) an acquisition line of $9,000,000; 2) a revolving operating line of $5,000,000; 3) a guarantee facility of $2,000,000 (USD); and, 4) Other facilities of $480,000 (USD) and $100,000 for other liabilities.

This Facility was amended during the year ended September 30, 2020, to allow for an additional borrowing line supported by the Business Credit Availability Program ("BCAP") with the Business Development Bank of Canada ("BDC"), in the amount of $1,000,000. During the year ended September 30, 2021, the Company drew $1,000,000 against the BCAP facility through HSBC.

The Facility was secured by a General Security Agreement which also included all wholly owned subsidiaries.

During the year ended September 30, 2021, the Company completed the AquaGuard sale (Note 5) and used certain proceeds to satisfy all outstanding debt, including the BCAP facility, with HSBC. All facilities with HSBC, including the BCAP facility were terminated upon repayment.

A reconciliation of the Operating Line is as follows:

| | **September 30, 2022 ($)** | September 30, 2021 ($) |
|---|---|---|
| Balance – Opening | - | 3,955,000 |
| Interest accrued during the year | - | 148,547 |
| Interest paid during the year | - | (48,547) |
| Repayment of principal | - | (3,955,000) |
| Balance – Ending | - | - |

A reconciliation of the Acquisition Line is as follows:

| | **September 30, 2022 ($)** | September 30, 2021 ($) |
|---|---|---|
| Balance – Opening | - | 3,694,027 |
| Repayments of principal | - | (3,705,529) |
| Interest accrued during the period | - | 130,364 |
| Interest paid during the period | - | (130,364) |
| Accretion of finance expense | - | 11,502 |
| Balance – Ending | - | - |

A reconciliation of the BCAP facility is as follows:

| | **($)** |
|---|---|
| Balance – Opening at September 30, 2020 | - |
| Proceeds received | **1,000,000** |
| Repayments of principal | **(1,000,000)** |
| Interest accrued during the period | **14,264** |
| Interest paid during the period | **(14,264)** |
| Balance – Ending September 30, 2021 and 2022 | - |

**Expressed in Canadian Dollars**

## 11. DEFERRED REVENUE

| | **September 30, 2022** | September 30, 2021 |
|---|---|---|
| **Balance, beginning of year** | **$577,097** | $788,272 |
| Add: | | |
| Deferred licensing and services revenue | **444,214** | 488,490 |
| Deferred product | **709,654** | 1,121,085 |
| Less: | | |
| Recognition of deferred product | **(746,938)** | (1,312,094) |
| Recognition of deferred licensing and services revenue | **(791,970)** | (589,104) |
| Foreign exchange | **68,414** | 80,448 |
| Balance, end of year | **260,471** | 577,097 |
| **Current portion** | **(209,070)** | (414,649) |
| **Non-current portion** | **$51,401** | $162,448 |

## 12. RIGHT-OF-USE ASSETS

| | **Right-of-use assets ($)** |
|---|---|
| Balance at October 1, 2020 | 2,815,724 |
| Depreciation | (468,785) |
| Impairment of Seattle lease | (1,310,191) |
| Foreign exchange | (184,486) |
| **Balance at September 30, 2021** | **852,262** |
| Balance at October 1, 2021 | 852,262 |
| Depreciation | (242,406) |
| Foreign exchange | 46,871 |
| **Balance at September 30, 2022** | **656,727** |

The Company leases office space in Mississauga, Canada and Seattle, USA. Following the sale of AquaGuard (note 5) the leased facility in Seattle has been impaired during the year ended September 30, 2021, as it is not currently expected to generate any future cash in flows, and the amount of the impairment has been included within the net income from discontinued operations. The Company intends to pursue sublease arrangements and will assess for reversal of impairment should the facts change.

**Expressed in Canadian Dollars**

## 13. LEASE LIABILITIES

Lease liabilities are comprised of the following amounts:

| | **Lease liabilities ($)** |
|---|---|
| Balance at October 1, 2020 | 3,179,718 |
| Interest | 121,396 |
| Payments | (637,678) |
| Foreign exchange | (72,563) |
| **Balance at September 30, 2021** | **2,590,873** |
| Balance at October 1, 2021 | 2,590,873 |
| Interest | 110,797 |
| Payments | (652,244) |
| Foreign exchange | 119,215 |
| **Balance at September 30, 2022** | **2,168,641** |
| **Current portion** | 609,578 |
| **Non-current portion** | 1,559,063 |

Following the impairment of the right of use asset related to the Company's Seattle lease agreement, an onerous contract liability of $352,809 was recognized in accounts payable and accrued liabilities related to future variable lease payments that are not included in the lease liability.

## 14. 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 years ended September 30, 2021 and 2020, 25,045 were released from escrow in each year, respectively, leaving a balance of nil as at September 30, 2021.

During the year ended September 30, 2021, the Company issued 200,000 common share purchase warrants in relation to the AquaGuard Sale (Notes 5 and 6).

On May 25, 2022, the Company announced that it had filed its intention to make a normal course issuer bid ("NCIB") for its common shares with the TSX-V for up to 1,296,433 shares, representing 5% of the issued and outstanding common shares. Repurchases under the NCIB program were approved by the TSX-V and commenced on June 2, 2022 and are authorized to continue until the earlier of: (a) May 31, 2023; and (b) the date in which the maximum number of common shares purchasable under the NCIB have been acquired by the Company. All common shares that are repurchased by the Company under the NCIB program will be cancelled, with any excess or deficiency as compared to the weighted average cost of common shares, being charged to contributed surplus.

Under the NCIB, the Company is limited in making daily purchases of up to 8,000 common shares.

**Expressed in Canadian Dollars**

On June 29, 2022, in connection with the NCIB, the Company entered into an automatic share purchase plan ("ASPP") with a designated broker. The ASPP is intended to allow for the purchase of the Company's common shares under the NCIB at times when the Company would ordinarily not be permitted to purchase its common shares due to regulatory restrictions and customary self-imposed blackout periods. Pursuant to the ASPP, prior to entering into a blackout period, the Company may instruct the designated broker to make purchases under the NCIB in accordance with the terms of the ASPP. Such purchases will be made by the designated broker in its sole discretion based on parameters established by the Company prior to the blackout period in accordance with the rules of the TSX-V, applicable securities laws and the terms of the ASPP. In accordance with the terms of the ASPP, the Company is able to terminate any instructions given to the designated broker with minimal notice. The Company has continued with the ASPP since June 29, 2022 without notice to terminate.

As at September 30, 2022, the Company had purchased 640,900 of its common shares under the NCIB. Subsequent to September 30, 2022, the Company had purchased an additional 220,100 of its common shares under the NCIB.

**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** | **4.58** |
| Issued during the period | 200,000 | 4.00 | |
| **Balance at September 30, 2021** | **2,950,000** | **$2.14** | **3.10** |
| Exercised during the period | 30,000 | 2.00 | |
| **Balance at September 30, 2022** | **2,920,000** | **$2.14** | **2.10** |

## 15. 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: 34% 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 September 30, 2021:

| Grant Date | Expiry Date | Exercise Price | Opening Balance | Granted | Exercised | Forfeited/ Expired | Closing Balance | Vested | Unvested | Weighted Average Expiry (years) |
|---|---|---|---|---|---|---|---|---|---|---|
| 07-Mar-16 | 07-Mar-21 | $1.13 | 100,000 | - | - | (100,000) | - | - | - | 0.00 |
| 23-Jun-16 | 23-Jun-21 | $1.29 | 110,834 | - | (45,000) | (65,834) | - | - | - | 0.00 |
| 14-Sep-16 | 14-Sep-21 | $2.29 | 20,000 | - | (5,000) | (15,000) | - | - | - | 0.00 |
| 08-Feb-17 | 08-Feb-22 | $2.20 | 168,333 | - | - | (5,000) | 163,333 | 163,333 | - | 0.36 |
| 20-Jun-17 | 20-Jun-22 | $2.47 | 348,333 | - | - | (5,000) | 343,333 | 343,333 | - | 0.72 |
| 25-Oct-17 | 25-Oct-22 | $3.80 | 60,000 | - | - | - | 60,000 | 60,000 | - | 1.07 |
| 21-Dec-17 | 21-Dec-22 | $4.65 | 137,500 | - | - | (40,000) | 97,500 | 97,500 | - | 1.23 |
| 24-Jan-18 | 24-Jan-23 | $6.02 | 60,000 | - | - | - | 60,000 | 60,000 | - | 1.32 |
| 27-Sep-18 | 27-Sep-23 | $8.50 | 130,000 | - | - | (32,500) | 97,500 | 97,500 | - | 1.99 |
| 22-Dec-18 | 22-Dec-23 | $4.28 | 322,501 | - | - | (95,831) | 226,670 | 74,801 | 151,869 | 2.23 |
| 15-Mar-19 | 15-Mar-24 | $5.03 | 150,000 | - | - | (29,900) | 120,100 | 39,633 | 80,467 | 2.46 |
| | | | **1,607,501** | **-** | **(50,000)** | **(389,065)** | **1,168,436** | **936,100** | **232,336** | **1.36** |
| Weighted Average Exercise Price | | | **$3.73** | **-** | **$1.39** | **$3.29** | **$3.98** | **$3.84** | **$4.54** | |

The following is a summary of changes in stock options from October 1, 2021, to September 30, 2022:

| Grant Date | Expiry Date | Exercise Price | Opening Balance | Granted | Exercised | Forfeited/ Expired | Closing Balance | Vested | Unvested | Weighted Average Expiry (years) |
|---|---|---|---|---|---|---|---|---|---|---|
| 08-Feb-17 | 08-Feb-22 | $2.20 | 163,333 | - | (30,000) | (133,333) | - | - | - | - |
| 20-Jun-17 | 20-Jun-22 | $2.47 | 348,333 | - | - | (343,333) | - | - | - | - |
| 25-Oct-17 | 25-Oct-22 | $3.80 | 60,000 | - | - | - | 60,000 | 60,000 | - | 0.07 |
| 21-Dec-17 | 21-Dec-22 | $4.65 | 97,500 | - | - | (42,500) | 55,000 | 55,000 | - | 0.23 |
| 24-Jan-18 | 24-Jan-23 | $6.02 | 60,000 | - | - | - | 60,000 | 60,000 | - | 0.32 |
| 27-Sep-18 | 27-Sep-23 | $8.50 | 97,500 | - | - | (30,000) | 67,500 | 67,500 | - | 0.99 |
| 22-Dec-18 | 22-Dec-23 | $4.28 | 226,670 | - | - | (179,170) | 47,500 | 47,500 | - | 1.23 |
| 15-Mar-19 | 15-Mar-24 | $5.03 | 120,100 | - | - | (80,100) | 40,000 | 40,000 | - | 1.46 |
| 28-Mar-22 | 28-Mar-27 | $2.19 | - | 507,500 | - | (42,500) | 465,000 | - | 465,000 | 4.49 |
| 06-Sep-22 | 06-Sep-27 | $2.50 | - | 437,500 | - | - | 437,500 | - | 437,500 | 4.93 |
| | | | **1,168,436** | **945,000** | **(30,000)** | **(850,936)** | **1,232,500** | **330,000** | **902,500** | **3.62** |
| Weighted Average Exercise Price | | | **$3.98** | **$2.33** | **$2.20** | **$3.36** | **$3.19** | **$5.52** | **$2.34** | |

### Granting of Share Options

On March 28, 2022, 507,500 options with a weighted average fair value of $1.42 were granted. The trading price of the common shares of the Company at the time of the grant was $2.30. The fair market value of options granted was determined using the Black-Scholes valuation model with the following implicit assumptions: average risk-free rate of interest – 1.73%, dividend rate – nil, volatility – 77.90% and an expected life of 3.5 years. The estimated forfeiture rate is 12.94%.

On September 7, 2022, 437,500 options with a weighted average fair value of $1.32 were granted. The trading price of the common shares of the Company at the time of the grant was $2.46. 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 – 2.87%, dividend rate – nil, volatility – 75.23% and an expected life of 3.5 years. The estimated forfeiture rate is 12.66%.

### Share Based Payment Expense

Total share-based payment expense recognized during the year ended September 30, 2022 for continuing operations, as part of employee benefits was $211,438 (2021 - $163,769).

Total share-based payment expense recognized during the year ended September 30, 2022 for discontinued operations, as part of employee benefits was $nil (2021 - $(66,029)).

## 16. FINANCIAL RISK MANAGEMENT

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

### Credit Risk

The Company is exposed to credit risk associated with its cash and cash equivalents and accounts receivable. The risk is reduced by having accounts receivables insured or obtaining letters of credit when the Company determines that it is warranted. The Company applies the simplified approach to providing for expected credit losses, which allows the use of a lifetime expected loss for all receivables. Receivables have been grouped based on shared credit risk characteristics and the days outstanding to measure the expected credit loss. On this basis the loss allowance at September 30, 2022 and September 30, 2021 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 September 30, 2022, three customers accounted for 71% (2021 – three customers for 67%) of the accounts receivable balance. These customers, who are distributors and strategic partners of the Company, represent a large portion of the Company's sales. Credit risk exposure is mitigated by strong credit granting policies, the use of Letters of Credit, and due diligence procedures for new customers.

The aging of accounts receivable is as follows:

| | **September 30, 2022** | September 30, 2021 |
|---|---|---|
| Current | **$4,449,960** | $5,962,535 |
| 30-60 days past due | **203,988** | 388,241 |
| Over 60 days past due | **78,482** | 44,771 |
| | **4,732,430** | 6,395,547 |

**Interest Rate Risk**

The Company is subject to interest rate risk on its cash, cash equivalents. The Company believes that interest rate risk is low due to market based variable interest rates.

**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, 2022** | | | | **September 30, 2021** | | | |
|---|---|---|---|---|---|---|---|---|
| | Canadian | USD | GBP | **Total** | CAD | USD | GBP | **Total** |
| Cash and cash equivalents | $307,483 | $13,599,225 | $154,923 | **$14,061,631** | $135,807 | $22,783,541 | $27,575 | **$22,946,923** |
| Accounts receivable | $1,340 | $4,731,090 | - | **$4,732,430** | $6,181 | $6,138,265 | $251,101 | **$6,395,547** |
| Restricted cash and cash held in escrow | - | $1,370,700 | - | **$1,370,700** | $137,061 | $2,548,200 | - | **$2,685,261** |
| Accounts payable and accrued liabilities | $961,691 | $2,711,995 | $46,522 | **$3,720,208** | $292,110 | $3,581,504 | $165,993 | **$4,039,607** |
| Lease liabilities | $805,625 | $1,363,016 | - | **$2,168,641** | $1,046,758 | $1,544,115 | - | **$2,590,873** |

If exchange rates were to change by 5% at September 30, 2022 total comprehensive income (loss) would change by $786,720 (2021 - $1,322,853).

**Expressed in Canadian Dollars**

### Fair Value

The fair values of cash and cash equivalents, cash held in escrow, accounts receivable, accounts payable and accrued liabilities and lease liabilities approximate their carrying values, due to their relatively short periods to maturity.

### Liquidity risk

The Company continually monitors working capital to ensure sufficient cash is available to meet operational and capital expenditure requirements. The Company has contractual obligations related to lease liabilities and accounts payable and accrued liabilities that are due as reflected in the following table:

| | Carrying amount ($) | Future cash flows ($) | Less than 1 year ($) | Between 1 and 5 years ($) | Greater than 5 years ($) |
|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | 3,720,208 | 3,720,208 | 3,720,208 | - | - |
| Lease liabilities | 2,168,641 | 2,321,160 | 689,932 | 1,631,228 | - |
| **Total** | **5,888,849** | **6,041,368** | **4,410,140** | **1,631,228** | **-** |

## 17. CAPITAL MANAGEMENT

The Company defines capital that it manages as its shareholders' equity comprising share capital, contributed surplus, foreign exchange translation reserve and accumulated deficit. 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, 2022 is $24,228,761 (September 30, 2021 – $33,374,527).

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.

## 18. INCOME TAXES

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in net loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income (loss). The income tax expense has been calculated on a combined basis for continuing operations and discontinued operations given there is no income tax payable in either year presented.

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, 2022 (2021 – 21.0% - 26.5%).

**Expressed in Canadian Dollars**

**Reconciliation between statutory rate and actual rate**

| | **September 30,** | |
|---|---|---|
| | **2022** | 2021 |
| Income tax computed at statutory tax rates | **(2,560,751)** | 6,221,380 |
| Permanent differences | **(786,183)** | (2,409,700) |
| Rate differences and other | **293,394** | (135,800) |
| Change in deferred tax assets not recognized | **3,053,540** | (3,675,880) |
| | **$ -** | $ - |

**Deferred tax assets**

The tax effect of the temporary differences that gives rise to deferred tax assets (liabilities) as of September 30, 2022 and 2021 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,** | |
|---|---|---|
| | **2022** | 2021 |
| Non-capital loss carry forwards | **$4,228,895** | $2,154,645 |
| Capital loss carry forwards | **810,469** | - |
| Capital and other assets | **331,816** | 52,958 |
| Investment tax credits | **1,444,156** | 1,444,156 |
| Research and development expenditure pool | **2,222,531** | 2,222,531 |
| Deferred tax assets not recognized | **(9,037,867)** | (5,874,290) |
| | **$ -** | $ - |

The Company has non-capital losses carried forward available for income tax purposes as at September 30, 2022 which are available to reduce taxable income of future years. These losses expire as follows:

| Year | Canada | United States | United Kingdom |
|---|---|---|---|
| 2023 | - | - | 5,860,801 |
| 2031 | - | 32,196 | - |
| 2032 | - | 189,917 | - |
| 2033 | - | 171,311 | - |
| 2034 | - | 204,481 | - |
| 2035 | - | 275,647 | - |
| 2036 | - | 297,080 | - |
| 2037 | - | 206,076 | - |
| 2041 | 2,003,326 | - | - |
| 2042 | 3,158,576 | - | - |
| No expiry | - | 6,706,069 | - |
| | $5,161,902 | $8,082,777 | $5,860,801 |

**Expressed in Canadian Dollars**

On January 17, 2023, the Company made an application in the United Kingdom to winddown its operations as at September 30, 2022, and the winddown is anticipated to be finalized in 2023. As a result, the non-capital losses reflected for the United Kingdome are estimated to expire in 2023.

**Other items**

The Company has capital loss carry forwards for income tax purposes as at September 30, 2022 of approximately $6,116,747 (2021 - $nil), which are available to reduce taxable capital gains in future years. These losses do not expire.

**Investment tax credits**

At September 30, 2022, the Company has $1,964,838 (2021 - $1,839,990) of unclaimed federal and provincial investment tax credits for qualifying scientific research and experimental development activities which may be applied to reduce 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.

## 19. RELATED PARTY TRANSACTIONS

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

| | **Year ended September 30,** | |
|---|---|---|
| | **2022** | 2021 |
| Compensation and short-term employee benefits | **$1,107,805** | $1,003,055 |
| Share based payment expense | **64,360** | 90,247 |
| | **1,172,165** | 1,093,302 |

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, 2022, $10,000 of this loan remained outstanding.

## 20. EXPENSES BY NATURE

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

| | **Year ended September 30,** | |
|---|---|---|
| | **2022** | 2021 |
| Inventoried materials | **$10,401,230** | $8,040,289 |
| Wages, benefits, consulting fees, director compensation | **11,559,767** | 5,512,070 |
| Government subsidies | **-** | (801,821) |
| Share based payments | **211,438** | 163,769 |
| Depreciation and amortization | **1,032,807** | 700,466 |
| Professional fees | **1,275,017** | 687,262 |
| Other expenses | **2,808,459** | 4,420,923 |
| Total | **$27,288,718** | $18,722,958 |

**Expressed in Canadian Dollars**

| **Depreciation and amortization** | **For the year ended September 30,** | |
|---|---|---|
| | **2022** | 2021 |
| Cost of product sales | **$251,656** | $282,843 |
| Operations | **90,773** | 2,748 |
| Research and development activities | **34,387** | 29,848 |
| General and administrative | **655,991** | 385,027 |
| Total depreciation and amortization | **$1,032,807** | $700,466 |

During the twelve months ended September 30, 2021 the Company applied for and received $1,384,581 in a second draw of the United States Paycheck Protection Program loan (the "Loan") from the US Small Business Administration ("SBA") under the US Paycheck Protection Program. The Loan was forgiven by the SBA during the three months ended September 30, 2021 as certain conditions were met (including the funds being used for eligible payroll and rent expenses during the eligibility period, and completion of a loan forgiveness application) and no repayments were required. As a result of the Loan being forgiven, during the twelve months ended September 30, 2021, the Company recorded $1,441,544 in relation to the Loan, by reducing the related operating expenses to which the Loan related to. The Company has no outstanding draws or amounts that have not been forgiven as of September 30, 2022, related to the Loan.

## 21. EARNINGS (LOSS) PER SHARE

The weighted average number of shares outstanding during the year ended September 30, 2022, was 25,759,555 (September 30, 2021 – 25,821,239).

Details of dilutive securities outstanding at September 30, 2021 were as follows:

| Potentially dilutive securities | |
|---|---|
| Common shares potentially dilutive | |
| - stock options | 5,723 |
| - warrants | 3,914 |
| Total potentially dilutive shares | 9,637 |

For the period ended September 30, 2022, of the 1,232,500 stock options and 2,920,000 warrants not included in the calculation of diluted loss per share, 3,250,000 were exercisable.

## 22. SEGMENT REPORTING

The Company generated continuing operations revenue of $12,101,861 (2021 – $12,700,564) in the US, $4,025,923 (2021 – $4,466,500) in the Middle East, $57,328 (2021 – $243,668) in Canada, and $1,961,278 (2021 – $2,150,569) in the rest of the world.

As of September 30, 2022, the Company had $3,098,014 (2021 - $2,652,698) of its property, plant, and equipment, right-of-use assets and intangible assets located in Canada and $52,010 (2021 - $354,023) in the USA.

**Expressed in Canadian Dollars**

## 23. CONTINGENCIES AND COMMITMENTS

The following are additional commitments of the Company beyond September 30, 2022 during the following years ended:

| | September 30, | | |
|---|---|---|---|
| | 2023 | 2024 | 2025 |
| Purchase obligations | **$168,729** | **-** | **-** |
| Telecommunications and office equipment leases | **48,007** | **46,718** | 9,458 |
| | **$216,736** | **$46,718** | $9,458 |

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.