

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

For the three months ended December 31, 2023 and 2022

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**MANAGEMENT’S COMMENTS ON UNAUDITED
CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
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 Accounting Standards”) 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 STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

Expressed in Canadian Dollars

	December 31, 2023	September 30, 2023
Assets		
Current assets		
Cash and cash equivalents	\$8,292,480	\$8,794,650
Accounts receivable	3,470,624	6,162,069
Inventories (Note 4)	6,048,879	5,944,534
Prepaid expenses	585,154	390,060
Finance lease receivable (Note 10)	233,962	
Total current assets	18,631,099	21,291,313
Non-current assets		
Restricted cash	132,260	135,200
Property, plant and equipment (Note 6)	1,173,014	1,242,938
Intangible assets (Note 5)	1,635,211	1,791,305
Finance lease receivable (Note 10)	343,058	-
Right-of-use assets (Note 8)	371,399	439,837
Total non-current assets	3,654,942	3,609,280
Total assets	\$22,286,041	\$24,900,593
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	\$3,210,893	\$4,464,609
Lease liabilities (Note 9)	639,631	643,385
Deferred revenue (Note 7)	20,422	80,702
Total current liabilities	3,870,946	5,188,696
Non-current liabilities		
Lease liabilities (Note 9)	737,327	919,080
Accounts payable and accrued liabilities	7,838	-
Total non-current liabilities	745,165	919,080
Total liabilities	4,616,111	6,107,776
Shareholders' equity		
Share capital (Note 14)	42,770,879	42,770,879
Contributed surplus (Note 14)	11,552,755	11,436,826
Foreign exchange translation reserve	2,564,122	2,951,395
Accumulated deficit	(39,217,826)	(38,366,283)
Total shareholders' equity	17,669,930	18,792,817
Total liabilities and shareholders' equity	\$22,286,041	\$24,900,593

Contingencies and commitments (Note 19)

On behalf of the Board:

(signed) "Abe Schwartz"

Director

(signed) "Amir Boloor"

Director

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

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(UNAUDITED)

Expressed in Canadian Dollars

	Three months ended December 31,	
	2023	2022
Revenue		
Product	\$4,575,767	\$5,245,264
Development and consulting services	56,640	818,346
Licensing and royalty fees	30,650	121,795
Total revenue	4,663,057	6,185,405
Cost of sales	1,814,520	2,490,573
Gross profit before operating expenses	2,848,537	3,694,832
Operating expenses		
Operations	630,713	207,879
Research and development activities	311,411	285,975
Sales, marketing, and agency fees	1,646,303	2,029,936
General and administrative	1,731,625	1,526,895
	4,320,052	4,050,685
Gain on finance lease receivable (Note 10)	610,008	-
Finance (income) expenses	(9,964)	24,968
Net loss	\$(851,543)	\$(380,821)
Other comprehensive income (loss)		
Amount that may be reclassified to profit or loss		
Foreign currency translation adjustment	(387,273)	(16,785)
Total comprehensive loss	\$(1,238,816)	(397,606)
Loss per common share		
Basic loss per share (Note 17)	\$(0.03)	\$(0.02)
Diluted loss per share (Note 17)	\$(0.03)	\$(0.02)

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

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM STATEMENTS 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, 2022	25,287,777	\$43,843,344	\$11,277,493	\$(33,905,285)	\$3,013,209	\$34,228,761
Share-based payment expense	-	-	156,307	-	-	156,307
Buyback of common shares (Note 11)	(162,200)	(281,218)	(238,781)	-	-	(519,999)
Net loss for the period	-	-	-	(380,821)	-	(380,821)
Foreign currency translation adjustment	-	-	-	-	(16,785)	(16,785)
Balance at December 31, 2022	25,125,577	\$43,562,126	\$11,195,019	\$(34,286,106)	\$2,996,424	\$23,467,463
Balance at October 1, 2023	24,669,577	\$42,770,879	\$11,436,826	\$(38,366,283)	\$2,951,395	\$18,792,817
Share-based payment expense	-	-	115,929	-	-	115,929
Net loss for the period	-	-	-	(851,543)	-	(851,543)
Foreign currency translation adjustment	-	-	-	-	(387,273)	(387,273)
Balance at December 31, 2023	24,669,577	\$ 42,770,879	\$11,552,755	\$(39,217,826)	\$2,564,122	\$17,669,930

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,	
	2023	2022
Cash flows from (used in) operating activities		
Net loss for the period	\$(851,543)	\$(380,821)
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation of property, plant and equipment	114,212	143,272
Amortization of intangible assets	69,291	47,582
Depreciation - right of use assets (Note 8)	56,691	59,231
Impairment of intangible assets	74,448	
Share-based payment expense (Note 12)	115,929	156,307
Interest expense and accretion	25,781	29,853
Gain on finance lease receivables (Note 10)	(610,008)	-
Cash (used in) generated by operating activities before net changes in non-cash working capital balances:	(1,005,199)	55,424
Net changes in non-cash working capital balances:		
Accounts receivable	2,707,881	(248,059)
Prepaid expenses	(197,091)	886,451
Inventories	(110,936)	(1,628,927)
Accounts payable and accrued liabilities	(1,239,757)	607,397
Deferred revenue	(59,857)	(79,407)
Total net changes in non-cash working capital balances	1,100,240	(462,545)
Total cash flows generated by (used in) operating activities	95,041	(407,121)
Cash flows from (used in) investing activities		
Purchase of property, plant and equipment	(74,215)	(127,895)
Purchase of intangible assets	(18,364)	(144,487)
Restricted cash	2,940	(135,440)
Total cash flows used in investing activities	(89,639)	(407,822)
Cash flows from (used in) financing activities		
Buyback of common shares (Note 11)	-	(519,999)
Finance lease receivable	29,097	-
Payment of lease liabilities	(179,144)	(170,191)
Total cash flows used in financing activities	(150,047)	(690,190)
Foreign exchange rate changes on cash	(357,525)	135,322
Total cash flows during the period of continuing operations	(502,170)	(1,369,811)
Total cash flows during the period of discontinued operations	-	1,370,700
Total cash flows during the period	(502,170)	899
Cash and cash equivalents, beginning of the period	\$8,794,650	\$14,061,631
Cash and cash equivalents, end of the period	\$8,292,480	\$14,062,520

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

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

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 unaudited condensed consolidated interim financial statements of Covalon Technologies Ltd. for the three ended December 31, 2023 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.

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. 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 Accounting Standards”) applicable to the preparation of interim financial statements, under 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, 2022, which were prepared in accordance with IFRS Accounting Standards.

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

The unaudited condensed consolidated interim financial statements were authorized for issue by the Board of Directors on February 27, 2024.

Accounting standards adopted during the period

Beginning on October 1, 2023, the Company adopted certain IFRS Accounting Standards and amendments. The nature and the effect of these changes are disclosed below:

Disclosure initiative – accounting policies (Amendments to IAS 1 and IFRS Practice Statement 2)

Beginning on October 1, 2023, the Company adopted the amendments to IAS 1 Presentation of financial statements (IAS 1) and IFRS Practice Statement 2 Making Materiality Judgements. These amendments help companies provide useful accounting policy disclosures and requires the disclosure of material accounting policy information rather than disclosing significant accounting policies. The adoption of these amendments did not have a material impact on the condensed consolidated interim financial statements.

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Expressed in Canadian Dollars

Definition of accounting estimates (Amendments to IAS 8)

Beginning October 1, 2023, the Company adopted the amendments to IAS 8 Accounting policies, changes in accounting estimates and errors. These amendments show how to distinguish changes in accounting policies from changes in accounting estimates. The adoption of the amendments did not have a material impact on the condensed consolidated interim financial statements.

International tax reform – Pillar Two model rules (Amendments to IAS 12)

Beginning on October 1, 2023, the Company adopted amendments to IAS 12 Income Taxes. This introduced a temporary exception to the requirements to recognize and disclose information about deferred tax assets and liabilities related to Pillar Two income taxes and targeted disclosure requirements for affected entities. The adoption of the amendments did not have a material impact on the condensed consolidated interim financial statements.

Accounting pronouncements issued but not yet effective

IFRS Accounting Standards and amendments issued but not yet effective have been assessed by the Company and are not expected to have a material impact on the condensed consolidated interim financial statements and none have been early adopted.

3. 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. The purchase price of \$37,837,852 included \$2,513,200 placed in escrow for indemnity claims (which escrow amounts would be released 50% in 12 months following closing and the remaining 50% on September 30, 2022, assuming there were 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 financial information related to the AquaGuard product line is reported in the comparative period as discontinued operations.

Disclosures with respect to the condensed consolidated interim statements of cash flows for the three months ended December 31, 2023 and December 31, 2022 are as follows:

	December 31, 2023	December 31, 2022
Cash flows from investing activities	-	1,370,700
Total cash flow	-	1,370,700

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

4. INVENTORIES

Inventories consist of the following:

	December 31, 2023	September 30, 2023
Raw materials	2,140,418	\$2,107,970
Finished goods	5,232,359	5,775,340
Inventory provision	(1,323,898)	(1,938,776)
	6,048,879	\$5,944,534

Cost of product sales for the period ended December 31, 2023, includes \$1,814,520 (2022 - \$2,490,573), respectively in inventoried materials. Write-downs of inventories to net realizable value amounted to \$(192,771) (2022 - \$nil) and is included in cost of sales in the condensed consolidated interim statements of operations and comprehensive loss.

5. INTANGIBLE ASSETS

Intangible assets are comprised of the following amounts:

	Deferred Development Costs (\$)	Patents (\$)	Trademarks (\$)	Computer Software (\$)	Total (\$)
Cost					
Balance at September 30, 2023	2,430,494	1,066,166	81,238	963,172	4,541,070
Additions	-	-	-	18,364	18,364
Impairment	-	-	-	(74,448)	(74,448)
Foreign exchange	(46,634)	(23,185)	(1,767)	(20,944)	(92,530)
Balance at December 31, 2023	2,383,860	1,042,981	79,471	886,144	4,392,456
Accumulated amortization					
Balance at September 30, 2023	2,081,557	593,567	-	74,641	2,749,765
Amortization	28,402	13,220	-	27,669	69,291
Foreign exchange	(46,091)	(13,293)	-	(2,427)	(61,811)
Balance at December 31, 2023	2,063,868	593,494	-	99,883	2,757,245
Carrying amounts					
At September 30, 2023	348,937	472,599	81,238	888,531	1,791,305
At December 31, 2023	319,992	449,487	79,471	786,261	1,635,211

As at December 31, 2023, included in computer software is an amount of \$432,296 (September 30, 2023 - \$413,932) which primarily relates to new information systems where amortization has not yet commenced as they had not yet been placed into service.

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

6. PROPERTY, PLANT AND EQUIPMENT

	Furniture and Fixtures (\$)	Production and Lab Equipment (\$)	Leasehold Improvements (\$)	Total (\$)
Cost				
Balance at September 30, 2023	746,627	2,451,827	383,351	3,581,805
Additions	8,633	65,582	-	74,215
Foreign exchange	(16,236)	(59,535)	(8,336)	(84,107)
Balance at December 31, 2023	739,024	2,457,874	375,015	3,571,913
Accumulated depreciation				
Balance at September 30, 2023	506,800	1,476,479	355,588	2,338,867
Depreciation	33,246	71,894	9,072	114,212
Foreign exchange	(11,987)	(34,197)	(7,996)	(54,180)
Balance at December 31, 2023	528,059	1,514,176	356,664	2,398,899
Carrying amounts				
At September 30, 2023	239,827	975,348	27,763	1,242,938
At December 31, 2023	210,965	943,698	18,351	1,173,014

As at September 30, 2023, included in production and lab equipment is an amount of \$211,980 (September 30, 2023 - \$205,683) which primarily relates to new production equipment where amortization has not yet commenced as they had not yet been placed into service.

7. DEFERRED REVENUE

	December 31, 2023
Balance, beginning of period	\$80,702
<u>Add:</u>	
Deferred product	138,010
<u>Less:</u>	
Recognition of deferred product	(168,955)
Recognition of deferred licensing and services revenue	(29,758)
Foreign exchange	423
Balance, end of period	20,422
Current portion	(20,422)
Non-current portion	\$ -

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

8. RIGHT-OF-USE ASSETS

	Right-of-use assets (\$)
Balance at October 1, 2023	439,837
Depreciation	(56,691)
Foreign exchange	(11,747)
Balance at December 31, 2023	371,399

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 September 30, 2023	1,562,465
Interest	29,062
Payments	(179,144)
Foreign exchange	(35,425)
Balance at December 31, 2023	1,376,958
Current portion	639,631
Non-current portion	737,327

Following the impairment of the right of use asset related to the Company's Seattle lease agreement, an onerous contract liability at December 31, 2023 of \$283,131 (September 30, 2023 - \$309,562) has been recognized in accounts payable and accrued liabilities related to future variable lease payments that are not included in the lease liability.

10. FINANCE LEASE RECEIVABLES

During the first quarter, the Company entered into two sublease agreements for a total of 10,451 square feet out of a total of 18,246 square feet that comprises its Seattle facility. Both of these subleases are considered finance leases as it is reasonably certain that the sublease term will match that of the Company's existing lease agreements to April 2026. As a result of this transaction the company has recognized a finance lease receivable at the inception of the subleases in the amount of \$610,008 with an offsetting gain recognized in the condensed consolidated interim statements of operations and comprehensive loss.

The movement in lease receivables during the period is as follows:

	Finance lease receivables (\$)
Balance at October 1, 2023	-
Addition	610,008
Interest income	5,463
Payments received	(29,097)
Foreign exchange	(9,354)
Balance at December 31, 2023	577,020
Current portion	233,962
Non-current portion	343,058

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

A maturity analysis of the lease payments receivable is as follows:

2024	207,648
2025	244,297
2026	146,391
Total future minimum payments receivable	598,336
Imputed interest	11,672
Finance lease receivable	610,008

11. SHAREHOLDERS' EQUITY

Common Shares

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

Warrants

The following is a summary of all warrants outstanding:

	Number of Warrants	Weighted average exercise Price	Weighted Average Expiry (years)
Balance at September 30, 2023	2,920,000	\$2.14	1.10
Exercised during the period	-	-	-
Balance at December 31, 2023	2,920,000	\$2.14	0.85

12. SHARE-BASED PAYMENTS

Long-Term Incentive Plan

On March 8, 2023, the shareholders approved the Long-Term Incentive Plan (the Plan).

Stock Options

Stock options outstanding are non-transferable options to purchase common shares of the Company which may be granted to Directors, officers, employees, or service providers of the Company. The terms of the stock options 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 ten years. No amounts are paid or payable by the recipient on receipt of the stock option, and the stock options granted to date are not dependent on any performance-based criteria, however, future stock options may be granted so as to be dependent on performance-based criteria. All stock options issued to date 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. Future grants of stock options may vest over alternative periods as authorized by the Directors.

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

Issuance of RSUs and DSUs

RSUs and DSUs vest over a period of three years on each anniversary of the grant date unless a different vesting schedule is approved by the Board of Directors. DSUs are only eligible to be converted into common shares of the Company when the holder ceases its relationship with the Company.

The maximum number of common shares which may be issued under the Plan cannot exceed 10% of the common shares issued and outstanding at any given time, calculated on a non-diluted basis. Grants held by non-employee directors of the Company are at all times limited to no more than 1% of the common shares issued and outstanding, calculated on a non-diluted basis, and the total annual grant to any one non-employee director under the Plan cannot exceed a grant value of \$150,000 in total equity.

The following is a summary of changes in stock options from October 1, 2023, to December 31, 2023:

Grant Date	Expiry Date	Exercise Price	Opening Balance	Granted	Forfeited/ Expired	Closing Balance	Vested	Unvested	Weighted Average Expiry (years)
22-Dec-18	22-Dec-23	\$4.28	35,000	-	(35,000)	-	-	-	-
15-Mar-19	15-Mar-24	\$5.03	40,000	-	-	40,000	40,000	-	0.21
28-Mar-22	28-Mar-27	\$2.19	417,500	-	-	417,500	141,950	275,550	3.24
06-Sep-22	06-Sep-27	\$2.50	432,500	-	(10,000)	422,500	143,650	278,850	3.68
			925,000	-	(45,000)	880,000	325,600	554,400	3.32
Weighted Average Exercise Price			\$2.54	\$0.00	\$3.88	\$2.47	\$2.68	\$2.35	

Issuance of Deferred Share Units

On October 20, 2023 Company's Board of Directors approved the grant of 295,000 DSUs to certain of its directors and officers which vest annually over a period of three years.

Grant Date	Exercise Price	Opening Balance	Granted	Exercised	Forfeited/ Expired	Closing Balance	Vested	Unvested
20-Oct-23	\$1.44	-	295,000	-	-	295,000	-	295,000
		-	295,000	-	-	295,000	-	295,000

Issuance of Share Options Subsequent to December 31, 2023

On January 10, 2024 Company's Board of Directors approved the grant of 800,000 share options to the President and Chief Executive Officer. Of the 800,000 share options, 400,000 share options will vest over four years, with 25% vesting on each anniversary date, and the remaining 400,000 share options will vest based on increases in the Company's share price as follows:

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

- i) 100,000 share options will vest only after the first anniversary date and if the Company's share price is \$2.50 for 120 days after the first anniversary date;
- ii) 100,000 share options will vest only after the first anniversary date and if the Company's share price is \$3.00 for 120 days after the first anniversary date;
- iii) 100,000 share options will vest only after the second anniversary date and if the Company's share price is \$3.50 for 120 days after the first anniversary date; and
- iv) 100,000 share options will vest only after the third anniversary date and if the Company's share price is \$4.00 for 120 days after the first anniversary date.

Share Based Payment Expense

Total share-based payment expense recognized during the three months ended December 31, 2023 as part of employee benefits was \$115,929 (2022 - \$156,307).

13. FINANCIAL RISK MANAGEMENT

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

Credit Risk

The Company is exposed to credit risk associated with its cash and cash equivalents and accounts receivable. The risk is reduced by having accounts receivables insured or obtaining letters of credit when the Company determines that it is warranted. The Company applies the simplified approach to providing for expected credit losses, which allows the use of a lifetime expected loss for all receivables. Receivables have been grouped based on shared credit risk characteristics and the days outstanding to measure the expected credit loss. On this basis the loss allowance at December 31, 2023 and September 30, 2023 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, 2023, three customers accounted for 59% (September 30, 2023 – three customers for 64%) 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:

	December 31, 2023	September 30, 2023
Current	\$3,022,969	\$5,755,494
30-60 days past due	247,887	192,489
Over 60 days past due	199,768	214,086
	3,470,624	6,162,069

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

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:

	<u>December 31, 2023</u>				<u>September 30, 2023</u>			
	<u>Canadian</u>	<u>USD</u>	<u>GBP</u>	<u>Total</u>	<u>CAD</u>	<u>USD</u>	<u>GBP</u>	<u>Total</u>
Cash and cash equivalents	\$71,141	\$8,221,339	-	\$8,292,480	\$178,723	\$8,615,927	-	\$8,794,650
Accounts receivable	\$530,932	\$2,878,090	\$61,602	\$3,470,624	\$385,193	\$5,713,905	\$62,971	\$6,162,069
Finance lease receivable	-	\$577,020	-	\$577,020	-	-	-	-
Restricted cash	-	\$132,260	-	\$132,260	-	\$135,200	-	\$135,200
Accounts payable and accrued liabilities	\$430,263	\$2,763,248	\$25,220	\$3,218,731	\$344,159	\$4,092,500	\$27,950	\$4,464,609
Lease liabilities	\$456,541	\$920,417	-	\$1,376,958	\$537,808	\$1,024,657	-	\$1,562,465

If exchange rates were to change by 5% at December 31, 2023 total comprehensive loss would change by \$408,071 (September 30, 2023 - \$469,145).

Fair Value

The fair values of cash and cash equivalents, cash held in escrow, accounts receivable, finance lease 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:

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

	Carrying amount (\$)	Future cash flows (\$)	Less than 1 year (\$)	Between 1 and 5 years (\$)	Greater than 5 years (\$)
Accounts payable and accrued liabilities	3,218,731	3,218,731	3,210,893	7,838	-
Lease liabilities	1,376,958	1,443,546	698,868	744,678	-
Total	4,595,689	4,662,277	3,909,761	752,516	-

14. CAPITAL MANAGEMENT

The Company defines capital that it manages as its shareholders' equity comprising share capital, contributed surplus, and foreign exchange translation reserve 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 December 31, 2023 is \$17,669,930 (September 30, 2023 – \$18,792,817).

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.

15. RELATED PARTY TRANSACTIONS

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

	Three months ended December 31,	
	2023	2022
Compensation and short-term employee benefits	\$315,035	\$288,456
Share based payment expense	56,191	20,752
	371,226	309,208

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, 2023, \$10,000 of this loan remained outstanding.

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

16. EXPENSES BY NATURE

The condensed consolidated interim statements of operations and comprehensive loss include the following expenses by nature:

	Three months ended December 31,	
	2023	2022
Inventoried materials	\$1,761,972	\$2,434,540
Wages, benefits, consulting fees, director compensation	2,265,518	2,633,377
Share based payments	115,929	156,307
Depreciation and amortization	240,194	250,085
Facilities	57,604	62,683
Patent and trademark maintenance	31,343	66,188
Insurance	102,946	110,511
Information technology system costs	188,606	148,335
Professional fees	234,230	241,116
Impairment of intangible asset	74,448	-
Other expenses	1,061,782	438,116
Total	\$6,134,572	\$6,541,258

Depreciation and amortization

	For three months ended December 31,	
	2023	2022
Cost of product sales	\$52,548	\$56,033
Operations	-	22,255
Research and development activities	47,480	37,419
General and administrative	140,166	134,378
Total depreciation and amortization	\$240,194	\$250,085

17. LOSS PER SHARE

The weighted average number of shares outstanding during the period ended December 31, 2023, was 24,669,577 (December 31, 2022 – 25,177,915).

For both the three months ended December 31, 2023, and December 31, 2022, the computation of diluted loss per share is equal to the basic loss per share due to the Company incurring losses.

For the period ended December 31, 2023, of the 880,000 (2022 – 1,102,500) stock options, 295,000 DSUs and 2,920,000 (2022 – 2,920,000) warrants not included in the calculation of diluted loss per share, 3,245,600 (2022 – 3,127,500) were exercisable.

18. SEGMENT REPORTING

During the three months ended December 31, 2023, the Company generated revenue of \$4,133,801 (2022 – \$3,891,659) in the US, \$378,788 (2022 – \$1,364,057) in the Middle East, \$14,085 (2022 – \$37,433) in Canada, and \$136,383 (2022 – \$892,256) in the rest of the world.

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

As of December 31, 2023, the Company had \$3,149,990 (September 30, 2023 - \$3,444,738) of its property, plant, and equipment, right-of-use assets and intangible assets located in Canada and \$67,349 (September 30, 2023 - \$29,342) in the USA.

19. CONTINGENCIES AND COMMITMENTS

The following are commitments of the Company beyond December 31, 2023:

	2024	September 30,	
		2025	2026
Telecommunications & office equipment leases	52,674	15,414	4,192
	\$52,674	\$15,414	\$4,192

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.