

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended March 31, 2024 and 2023

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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

	March 31, 2024	September 30, 2023
Assets		
Current assets		
Cash and cash equivalents	\$7,259,953	\$8,794,650
Accounts receivable	5,785,612	6,162,069
Inventories (Note 4)	5,687,424	5,944,534
Prepaid expenses	795,435	390,060
Finance lease receivable (Note10)	247,869	-
Total current assets	19,776,293	21,291,313
Non-current assets		
Restricted cash	135,740	135,200
Property, plant and equipment (Note 6)	1,199,844	1,242,938
Intangible assets (Note 5)	1,567,479	1,791,305
Finance lease receivable (Note 10)	288,071	-
Right-of-use assets (Note 8)	320,528	439,837
Total non-current assets	3,511,662	3,609,280
Total assets	\$23,287,955	\$24,900,593
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	\$2,240,102	\$4,464,609
Lease liabilities (Note 9)	667,114	643,385
Deferred revenue (Note 7)	-	80,702
Total current liabilities	2,907,216	5,188,696
Non-current liabilities		
Lease liabilities (Note 9)	588,301	919,080
Accounts payable	4,448	-
Total non-current liabilities	592,749	919,080
Total liabilities	3,499,965	6,107,776
Shareholders' equity		
Share capital (Note 11)	42,770,879	42,770,879
Contributed surplus	11,634,219	11,436,826
Foreign exchange translation reserve	3,140,300	2,951,39,5
Accumulated deficit	(37,757,408)	(38,366,283)
Total shareholders' equity	19,787,990	18,792,817
Total liabilities and shareholders' equity	\$23,287,955	\$24,900,593

Contingencies and commitments (Note 18)

On behalf of the Board:

(signed) "Amir Boloor"

Director

(signed) "Brent Ashton"

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 INCOME
(LOSS) (UNAUDITED)

Expressed in Canadian Dollars

	Three months ended		Six months ended	
	2024	March 31, 2023	2024	March 31, 2023
Revenue				
Product	\$8,388,022	\$6,105,694	\$12,963,789	\$11,350,958
Development and consulting services	-	1,108,466	56,640	1,926,812
Licensing and royalty fees	25,588	30,434	56,238	152,229
Total revenue	8,413,610	7,244,594	13,076,667	13,429,999
Cost of sales	3,103,148	3,072,566	4,917,668	5,563,139
Gross profit before operating expenses	5,310,462	4,172,028	8,158,999	7,866,860
Operating expenses				
Operations	423,239	542,755	1,053,952	750,634
Research and development activities	450,510	279,491	761,921	565,466
Sales, marketing and agency fees	1,262,960	2,209,894	2,909,263	4,239,830
General and administrative	1,690,995	1,861,677	3,422,620	3,388,572
	3,827,704	4,893,817	8,147,756	8,944,502
Finance expenses (income)	22,340	(23,708)	12,376	1,260
Gain on finance lease receivable	-	-	(610,008)	-
Net income (loss)	\$1,460,418	\$(698,081)	\$608,875	\$(1,078,902)
Other comprehensive income (loss)				
Amount that may be reclassified to profit or loss				
Foreign currency translation adjustment	576,178	(246,523)	188,905	(263,308)
Total comprehensive income (loss)	\$2,036,596	\$(944,604)	\$797,780	\$(1,342,210)
Income (loss) per common share				
Basic income (loss) per share (Note 16)	\$0.06	\$(0.03)	\$0.02	\$(0.04)
Diluted income (loss) per share (Note 16)	\$0.06	\$(0.03)	\$0.02	\$(0.04)

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	\$24,228,761
Share-based payment expense (Note 11)	-	-	329,457	-	-	329,457
Buyback of common shares	(383,100)	(563,824)	(489,557)	-	-	(1,053,381)
Net loss for the period	-	-	-	(1,078,905)	-	(1,078,902)
Foreign currency translation adjustment	-	-	-	-	(263,308)	(263,308)
Balance at March 31, 2023	24,904,677	\$43,279,520	\$11,117,393	\$(34,984,187)	\$2,749,901	\$22,162,627
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 (Note 11)	-	-	197,393	-	-	197,393
Net loss for the period	-	-	-	608,875	-	608,875
Foreign currency translation adjustment	-	-	-	-	188,905	188,905
Balance at March 31, 2024	24,669,577	\$42,770,879	\$11,634,219	\$(37,757,408)	\$3,140,300	\$19,787,990

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

	Six months ended March 31,	
	2024	2023
Cash flows from (used in) operating activities		
Net income (loss) for the period	\$608,875	\$(1,078,902)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation of property, plant and equipment (Note 6)	233,381	260,346
Amortization of intangible assets (Note 5)	137,619	102,391
Depreciation of right of use assets (Note 8)	116,950	120,672
Impairment of intangible assets	176,025	-
Share-based payment expense (Note 11)	197,393	329,457
Accrued interest income	-	(15,061)
Interest expense and accretion	28,923	42,757
Gain on finance lease receivable	(610,008)	-
Cash flows from (used in) operating activities before change in non-cash working capital balances	889,158	(238,340)
Net changes in non-cash working capital balances:		
Accounts receivable	483,209	(1,114,566)
Prepaid expenses	(393,867)	982,451
Inventories	365,875	(1,976,565)
Accounts payable and accrued liabilities	(2,160,155)	(109,661)
Deferred revenue	(80,073)	(18,124)
Total net changes in non-cash working capital balances	(1,785,011)	(2,236,465)
Total cash flows used in operating activities	(895,853)	(2,474,805)
Cash flows from (used in) investing activities		
Purchase of property, plant and equipment (Note 6)	(185,667)	(315,077)
Purchase of intangible assets (Note 5)	(82,864)	(286,129)
Restricted cash	(540)	(135,329)
Total cash flows used in investing activities	(269,071)	(736,535)
Cash flows from (used in) financing activities		
Buyback of common shares (Note 10)	-	(1,053,381)
Finance lease receivable	90,812	-
Payment of lease liabilities (Note 9)	(345,638)	(340,026)
Total cash flows used in financing activities	(254,826)	(1,393,407)
Foreign exchange rate changes on cash	(114,947)	(60,629)
Total cash flows during the period of continuing operations	(1,534,697)	(4,665,376)
Total cash flows during the period of discontinued operations	-	1,370,700
Total cash flows during the period	(1,534,697)	(3,294,676)
Cash and cash equivalents, beginning of the period	\$8,794,650	\$14,061,631
Cash and cash equivalents, end of the period	\$7,259,953	\$10,766,955

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 and six months ended March 31, 2024 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 except for the accounting policy shown below.

Share-based payments

The Company operates a long-term incentive plan under which the Company issues equity instruments of the Company as consideration in exchange for employee or director services (the "Plan"). The Plan is open to certain directors and employees of the Company. The Plan regulates the issuance of the following equity instruments: stock options, deferred share units ("DSUs") and restricted share units ("RSUs").

Stock options currently outstanding vest over three or four years and have a contractual life between five and ten 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. For performance based stock options these are measured at the grant date fair value of the awards and are recognized over the vesting period of four years on a straight-line basis. The Company employs the Monte Carlo simulation model to determine the fair value of performance-based stock options, due to the model's ability to incorporate the complexities and specific conditions of these awards.

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

For each DSU or RSU granted under the Plan, the Company recognizes an expense equal to the market value of a common share at the date of grant based on the number of DSUs or RSUs expected to vest, recognized over the term of the vesting period, with a corresponding credit to contributed surplus for share-based compensation anticipated to be equity settled or a corresponding credit to a liability for those anticipated to be cash settled. Share-based compensation expense is adjusted for subsequent changes in management's estimate of the number of DSUs or RSUs that are expected to vest, for DSUs or RSUs anticipated to be cash settled and changes in the market value of a common share. The effect of these changes are recognized in the period of the change. Vested DSUs or RSUs are settled either in common shares or in cash or a combination thereof at the discretion of the Company.

The unaudited condensed consolidated interim financial statements were authorized for issue by the Board of Directors on May 28, 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.

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.

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

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 current and comparative periods as discontinued operations.

Disclosures with respect to the condensed consolidated interim statements of cash flows for the three months ended March 31, 2024 and March 31, 2023 are as follows:

	March 31, 2024	March 31, 2023
Cash flows from investing activities	-	1,370,700
Total cash flow	-	1,370,700

4. INVENTORIES

Inventories consist of the following:

	March 31, 2024	September 30, 2023
Raw materials	2,537,359	\$2,107,970
Finished goods	5,187,792	5,775,340
Inventory provision	(2,037,727)	(1,938,776)
	5,687,424	\$5,944,534

Cost of sales for the three and six months ended March 31, 2024, included \$3,044,826 (2023 - \$3,019,516) and \$4,806,798 (2023 - \$5,454,056), respectively, in inventoried materials. Write-downs of inventories to net realizable value for the three and six months ended March 31, 2024 amounted to \$674,866 (2023 - (\$158,724)) and \$482,095 (2023 - (\$158,724)) and are included in cost of sales in the condensed consolidated interim statements of operations and comprehensive loss.

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

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
Impairment	(176,025)	-	-	-	(176,025)
Additions	-	-	-	82,864	82,864
Foreign exchange	9,709	4,258	324	3,847	18,138
Balance at March 31, 2024	2,264,178	1,070,424	81,562	1,049,883	4,466,047
Accumulated amortization					
Balance at September 30, 2023	2,081,557	593,567	-	74,641	2,749,765
Amortization	56,522	26,035	-	55,062	137,619
Foreign exchange	8,397	2,408	-	379	11,184
Balance at March 31, 2024	2,146,476	622,010	-	130,082	2,898,568
Carrying amounts					
At September 30, 2023	348,937	472,599	81,238	888,531	1,791,305
At March 31, 2024	117,702	448,414	81,562	919,801	1,567,479

As at March 31, 2024, included in computer software is an amount of \$498,450 (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

	Computer Hardware, 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	12,451	173,216	-	185,667
Foreign exchange	2,982	9,793	1,531	14,306
Balance at March 31, 2024	762,060	2,634,836	384,882	3,781,778
Accumulated depreciation				
Balance at September 30, 2023	506,800	1,476,479	355,588	2,338,867
Depreciation	65,711	149,616	18,054	233,381
Foreign exchange	2,121	6,118	1,447	9,686
Balance at March 31, 2024	574,632	1,632,213	375,089	2,581,934
Carrying amounts				
At September 30, 2023	239,827	975,348	27,763	1,242,938
At March 31, 2024	187,428	1,002,623	9,793	1,199,844

As at March 31, 2024, included in production and lab equipment is an amount of \$217,557 (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

	March 31, 2024	September 30, 2023
Balance, beginning of year	\$80,702	\$260,471
<u>Add:</u>		
Deferred product	\$474,963	689,538
<u>Less:</u>		
Recognition of deferred product	(505,751)	(724,867)
Recognition of deferred licensing and services revenue	(50,120)	(141,034)
Foreign exchange	206	3,406
Balance, end of year	-	80,702
Current portion	-	(80,702)

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	(116,950)
Foreign exchange	(2,359)
Balance at March 31, 2024	320,528

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

9. LEASE LIABILITIES

Lease liabilities are comprised of the following amounts:

	Lease liabilities (\$)
Balance at October 1, 2023	1,562,465
Interest	32,253
Payments	(345,638)
Foreign exchange	6,335
Balance at March 31, 2024	1,255,415
Less: Current portion	667,114
Long-term portion	588,301

Following the impairment of the right of use asset related to the Company's Seattle lease agreement, an onerous contract liability at March 31, 2024 of \$268,826 (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	3,330
Payments received	(90,812)
Foreign exchange	13,414
Balance at March 31, 2024	535,940
Current portion	247,869
Non-current portion	288,071

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	136,910
2025	244,297
2026	146,391
Total future minimum payments receivable	527,598
Imputed interest	8,342
Finance lease receivable	535,940

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:

	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 March 31, 2024	2,920,000	\$2.14	0.60

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.

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.

Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

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 March 31, 2024:

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)	-	-	-	-
28-Mar-22	28-Mar-27	\$2.19	417,500	-	-	417,500	137,775	279,725	2.99
06-Sep-22	06-Sep-27	\$2.50	432,500	-	(262,500)	170,000	57,800	112,200	3.43
10-Jan-24	10-Jan-29	\$1.50	-	800,000	-	800,000	-	800,000	4.78
			925,000	800,000	(337,500)	1,387,500	195,575	1,191,925	4.08
Weighted Average Exercise Price			\$2.54	\$1.50	\$2.98	\$1.83	\$2.28	\$0.75	

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
Weighted Average Exercise Price		\$1.44	\$1.44	-	-	\$1.44	-	\$1.44

Issuance of Stock Options

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

Covalon Technologies Ltd.

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Expressed in Canadian Dollars

- i) 100,000 stock 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 stock 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 stock 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 stock 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.

The fair value of performance-based stock options issued during the period that have market based vesting conditions was estimated using the Monte Carlo simulation model. The Monte Carlo model was chosen due to its ability so simulate the complex vesting conditions tied to the performance targets, providing a more accurate reflection of the potential outcome. The assumptions used in the model were: weighted average probability of expected time to maturity, share volatility, risk free rates and the assumption that the Company will not pay dividends.

The fair value of the remaining stock options granted was determined using the Black-Scholes valuation model with the following assumptions: average risk-free rate of 3.58%, dividend rate – nil, volatility – 90% and an expected life of 5 years. The estimated forfeitures rate is 2.95%.

Share Based Payment Expense

Total share-based payment expense recognized during the three and six months ended March 31, 2024 for continuing operations, as part of employee benefits were \$81,464 (2023 - \$173,150) and \$197,393 (2023 - \$329,457), respectively.

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 March 31, 2024 and September 30, 2023 is not significant.

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 March 31, 2024, three customers accounted for 79% (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

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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:

	March 31, 2024	September 30, 2023
Current	\$5,442,882	\$5,755,494
30-60 days past due	181,696	192,489
Over 60 days past due	161,034	214,086
	<u>5,785,612</u>	<u>6,162,069</u>

Interest Rate Risk

The Company is subject to interest rate risk on its cash and 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>March 31, 2024</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	\$122,442	\$7,137,511	-	\$7,259,953	\$178,723	\$8,615,927	-	\$8,794,650
Accounts receivable	\$263,226	\$5,459,164	63,222	\$5,785,612	\$385,193	\$5,713,905	\$62,971	\$6,162,069
Finance lease receivable	-	\$535,940	-	\$535,940	-	-	-	-
Restricted cash	-	\$135,740	-	\$135,740	-	\$135,200	-	\$135,200
Accounts payable and accrued liabilities	\$259,954	\$1,967,296	\$17,300	\$2,244,550	\$344,159	\$4,092,500	\$27,950	\$4,464,609
Lease liabilities	\$395,909	\$859,506	-	\$1,255,415	\$537,808	\$1,024,657	-	\$1,562,465

If exchange rates were to change by 5% at March 31, 2024 total comprehensive income (loss) would change by \$524,374 (September 30, 2023 - \$469,145).

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Fair Value

The fair values of cash and cash equivalents, 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:

	Carrying amount (\$)	Future cash flows (\$)	Less than 1 year (\$)	Between 1 and 5 years (\$)	Greater than 5 years (\$)
Accounts payable and accrued liabilities	2,244,550	2,244,550	2,240,102	4,448	-
Lease liabilities	1,255,415	1,274,575	703,297	571,278	-
Total	3,499,965	3,519,125	2,943,399	575,726	-

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 March 31, 2024 is \$19,787,990 (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 March 31		Six months ended March 31,	
	2024	2023	2024	2023
Compensation and short-term employee benefits	\$400,716	\$300,956	\$715,751	\$589,411
Share based payment expense	199,865	26,024	256,056	46,776
	600,581	326,980	971,807	636,187

The Company had previously accrued \$667,969 for termination benefits related to a former senior management team member during the last fiscal year. The amount continues to represent management's best estimate of the termination benefits owed. On April 5, 2024, this former senior executive filed a claim for wrongful dismissal.

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An additional amount of \$1,832,031 has been claimed, which the Company has not accrued for and believes to be unwarranted. There can be no assurance as to the final outcome of the claim and termination benefits owed.

During the year end September 30, 2013, a non-interest-bearing loan of \$50,000 was made to a key employee. As of March 31, 2024, \$10,000 of this loan remained outstanding.

16. EXPENSES BY NATURE

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

	Three months ended March 31,		Six months ended March 31,	
	2024	2023	2024	2023
Inventoried materials	\$3,044,826	\$3,019,516	\$4,806,798	\$5,454,056
Wages, benefits, consulting fees, director compensation	2,880,547	3,232,472	5,146,065	5,865,849
Share based payments	81,464	173,150	197,393	329,457
Depreciation and amortization	247,756	233,324	487,950	483,409
Facility	75,500	(5,404)	133,104	57,279
Patent and trademark maintenance	70,674	32,770	102,017	98,958
Insurance	99,092	113,046	202,038	223,557
Information technology system costs	183,087	174,163	371,693	322,498
Professional fees	178,188	256,620	412,418	497,736
Impairment of intangible asset	101,577	-	176,025	-
Other expenses	(31,859)	736,726	1,029,923	1,174,842
Total	\$6,930,852	\$7,966,383	\$13,065,424	\$14,507,641

Depreciation and amortization	Three months ended		Six months ended	
	March 31,		March 31,	
	2024	2023	2024	2023
Cost of product sales	\$58,322	\$53,050	\$110,870	\$109,083
Operations	14,097	22,985	14,097	45,240
Research and development activities	30,139	34,340	77,619	71,759
General and administrative	145,198	122,949	285,364	257,327
Total depreciation and amortization	\$247,756	\$233,324	\$487,950	\$483,409

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17. EARNINGS PER SHARE

Details of the basic and diluted weighted average common shares outstanding for the respective periods are the following:

	Three months ended March 31		Six Months Ended March 31	
	2024	2023	2024	2023
Weighted average number of common shares outstanding – basic and diluted	24,669,577	24,972,631	24,669,577	25,076,062

For the period ended March 31, 2024, of the 1,387,500 (2023 – 1,022,500) stock options, 295,000 (2023 – nil) DSUs and 2,920,000 (2023 – 2,920,000) warrants not included in the calculation of diluted gain (loss) per share 3,115,575 (2023 – 3,214,650) were exercisable. None of the stock options, DSUs or warrants were dilutive as at March 31, 2024 and therefore were excluded from the calculation of diluted earnings per share.

18. SEGMENT REPORTING

During the three months ended March 31, 2024, the Company generated revenue of \$6,636,589 (2023 – \$5,397,205) in the US, \$946,390 (2023 – \$1,668,412) in the Middle East, \$9,343 (2023 – \$3,850) in Canada, and \$821,288 (2023 – \$175,127) in the rest of the world.

During the six months ended March 31, 2024, the Company generated revenue of \$10,770,390 (2023 – \$9,288,863) in the US, \$1,325,178 (2023 – \$3,032,469) in the Middle East, \$23,428 (2023 – \$41,284) in Canada, and \$957,671 (2023 – \$1,067,383) in the rest of the world.

As of March 31, 2024, the Company had \$3,063,751 (September 30, 2023 - \$3,444,738) of its property, plant, and equipment, right-of-use assets and intangible assets located in Canada and \$24,100 (September 30, 2023 - \$29,342) in the USA.

19. CONTINGENCIES AND COMMITMENTS

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

	September 30,		
	2024	2025	2026
Telecommunications and office equipment leases	26,450	15,640	4,192
	\$26,450	\$15,640	\$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.