

# Covalon Technologies Ltd.

## CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

For the three and nine months ended June 30, 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

|                                                   | June 30, 2024       | September 30,<br>2023 |
|---------------------------------------------------|---------------------|-----------------------|
| <b>Assets</b>                                     |                     |                       |
| <b>Current assets</b>                             |                     |                       |
| Cash and cash equivalents                         | \$9,406,600         | \$8,794,650           |
| Accounts receivable                               | 6,082,173           | 6,162,069             |
| Inventories (Note 4)                              | 6,747,248           | 5,944,534             |
| Prepaid expenses                                  | 765,354             | 390,060               |
| Finance lease receivable (Note 10)                | 248,635             | -                     |
| <b>Total current assets</b>                       | <b>23,250,010</b>   | <b>21,291,313</b>     |
| <b>Non-current assets</b>                         |                     |                       |
| Restricted cash                                   | 136,870             | 135,200               |
| Property, plant and equipment (Note 6)            | 1,100,220           | 1,242,938             |
| Intangible assets (Note 5)                        | 1,544,249           | 1,791,305             |
| Finance lease receivable (Note 10)                | 231,536             | -                     |
| Right-of-use assets (Note 8)                      | 262,873             | 439,837               |
| <b>Total non-current assets</b>                   | <b>3,275,748</b>    | <b>3,609,280</b>      |
| <b>Total assets</b>                               | <b>\$26,525,758</b> | <b>\$24,900,593</b>   |
| <b>Liabilities and shareholders' equity</b>       |                     |                       |
| <b>Current liabilities</b>                        |                     |                       |
| Accounts payable and accrued liabilities          | \$3,765,240         | \$4,464,609           |
| Lease liabilities (Note 9)                        | 666,673             | 643,385               |
| Deferred revenue (Note 7)                         | 3,112               | 80,702                |
| <b>Total current liabilities</b>                  | <b>4,435,025</b>    | <b>5,188,696</b>      |
| <b>Non-current liabilities</b>                    |                     |                       |
| Lease liabilities (Note 9)                        | 412,682             | 919,080               |
| Accounts payable                                  | 4,485               | -                     |
| <b>Total non-current liabilities</b>              | <b>417,167</b>      | <b>919,080</b>        |
| <b>Total liabilities</b>                          | <b>4,852,192</b>    | <b>6,107,776</b>      |
| <b>Shareholders' equity</b>                       |                     |                       |
| Share capital (Note 11)                           | 42,770,879          | 42,770,879            |
| Contributed surplus                               | 11,784,319          | 11,436,826            |
| Foreign exchange translation reserve              | 3,427,726           | 2,951,39,5            |
| Accumulated deficit                               | (36,309,358)        | (38,366,283)          |
| <b>Total shareholders' equity</b>                 | <b>21,673,566</b>   | <b>18,792,817</b>     |
| <b>Total liabilities and shareholders' equity</b> | <b>\$26,525,758</b> | <b>\$24,900,593</b>   |

### 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<br>June 30, |                    | Nine months ended<br>June 30, |                      |
|----------------------------------------------------------|--------------------------------|--------------------|-------------------------------|----------------------|
|                                                          | 2024                           | 2023               | 2024                          | 2023                 |
| <b>Revenue</b>                                           |                                |                    |                               |                      |
| Product                                                  | \$9,206,808                    | \$6,034,652        | \$22,170,597                  | \$17,385,610         |
| Development and consulting services                      | -                              | 205,169            | 56,540                        | 2,131,981            |
| Licensing and royalty fees                               | 17,499                         | 30,218             | 73,837                        | 182,447              |
| <b>Total revenue</b>                                     | <b>9,224,307</b>               | <b>6,270,039</b>   | <b>22,300,974</b>             | <b>19,700,038</b>    |
| <b>Cost of sales</b>                                     | <b>3,792,582</b>               | <b>2,665,602</b>   | <b>8,710,250</b>              | <b>8,228,741</b>     |
| <b>Gross profit</b>                                      | <b>5,431,725</b>               | <b>3,604,437</b>   | <b>13,590,724</b>             | <b>11,471,297</b>    |
| <b>Operating expenses</b>                                |                                |                    |                               |                      |
| Operations                                               | 608,476                        | 627,001            | 1,662,428                     | 1,377,635            |
| Research and development activities                      | 378,647                        | 365,922            | 1,140,568                     | 931,388              |
| Sales, marketing, and agency fees                        | 1,387,869                      | 1,826,912          | 4,297,132                     | 6,066,742            |
| General and administrative                               | 1,581,319                      | 1,372,243          | 5,003,939                     | 4,760,815            |
|                                                          | <b>3,956,311</b>               | <b>4,192,078</b>   | <b>12,104,067</b>             | <b>13,136,580</b>    |
| <b>Finance expenses (income)</b>                         | <b>27,364</b>                  | <b>(85,874)</b>    | <b>39,740</b>                 | <b>(84,614)</b>      |
| <b>Gain on finance lease receivable</b>                  | <b>-</b>                       | <b>-</b>           | <b>(610,008)</b>              | <b>-</b>             |
| <b>Net income (loss)</b>                                 | <b>\$1,448,050</b>             | <b>\$(501,767)</b> | <b>\$2,056,925</b>            | <b>\$(1,580,669)</b> |
| <b>Other comprehensive income (loss)</b>                 |                                |                    |                               |                      |
| <b>Amount that may be reclassified to profit or loss</b> |                                |                    |                               |                      |
| Foreign currency translation adjustment                  | 287,426                        | (235,941)          | 476,331                       | (499,249)            |
| <b>Total comprehensive income (loss)</b>                 | <b>\$1,735,476</b>             | <b>\$(737,708)</b> | <b>\$2,533,256</b>            | <b>\$(2,079,918)</b> |
| <b>Income (loss) per common share</b>                    |                                |                    |                               |                      |
| Basic income (loss) per share (Note 16)                  | \$0.06                         | \$(0.02)           | \$0.08                        | \$(0.06)             |
| Diluted income (loss) per share (Note 16)                | \$0.06                         | \$(0.02)           | \$0.08                        | \$(0.06)             |

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<br>shares | Share capital       | Contributed<br>surplus | Accumulated<br>deficit | Foreign<br>exchange<br>translation<br>reserve | Total               |
|--------------------------------------------|---------------------|---------------------|------------------------|------------------------|-----------------------------------------------|---------------------|
| <b>Balance at October 1, 2022</b>          | 25,287,777          | \$43,843,344        | \$11,277,493           | \$(33,905,285)         | \$3,013,209                                   | \$24,228,761        |
| Share-based payment expense<br>(Note 11)   | -                   | -                   | 437,282                | -                      | -                                             | 437,282             |
| Buyback of common shares                   | (618,200)           | (1,072,465)         | (399,821)              | -                      | -                                             | (1,472,286)         |
| Net income (loss) for the period           | -                   | -                   | -                      | (1,580,669)            | -                                             | (1,580,669)         |
| Foreign currency translation<br>adjustment | -                   | -                   | -                      | -                      | (499,249)                                     | (499,249)           |
| <b>Balance at June 30, 2023</b>            | <b>24,669,577</b>   | <b>\$42,770,879</b> | <b>\$11,314,954</b>    | <b>\$(34,485,954)</b>  | <b>\$2,513,960</b>                            | <b>\$21,113,839</b> |
| <b>Balance at October 1, 2023</b>          | 24,669,577          | \$42,770,879        | \$11,436,826           | \$(38,366,283)         | \$2,951,395                                   | \$18,792,817        |
| Share-based payment expense<br>(Note 11)   | -                   | -                   | 347,493                | -                      | -                                             | 347,493             |
| Net income (loss) for the period           | -                   | -                   | -                      | 2,056,925              | -                                             | 2,056,925           |
| Foreign currency translation<br>adjustment | -                   | -                   | -                      | -                      | 476,331                                       | 476,331             |
| <b>Balance at June 30, 2024</b>            | <b>24,669,577</b>   | <b>\$42,770,879</b> | <b>\$11,784,319</b>    | <b>\$(36,309,358)</b>  | <b>\$3,427,726</b>                            | <b>\$21,673,566</b> |

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

|                                                                                                   | Nine months ended June 30, |                     |
|---------------------------------------------------------------------------------------------------|----------------------------|---------------------|
|                                                                                                   | 2024                       | 2023                |
| <b>Cash flows from (used in) operating activities</b>                                             |                            |                     |
| Net income (loss) for the period                                                                  | \$2,056,925                | \$(1,580,669)       |
| Adjustments to reconcile net income (loss) to net cash used in operating activities:              |                            |                     |
| Depreciation of property, plant and equipment (Note 6)                                            | 346,307                    | 402,869             |
| Amortization of intangible assets (Note 5)                                                        | 206,857                    | 170,916             |
| Depreciation of right of use assets (Note 8)                                                      | 181,202                    | 180,819             |
| Share-based payment expense (Note 11)                                                             | 347,493                    | 437,282             |
| Impairment of intangible assets                                                                   | 177,490                    | -                   |
| Loss on disposal of property and equipment                                                        | 85,021                     | -                   |
| Accrued interest income                                                                           | -                          | (21,319)            |
| Interest expense and accretion                                                                    | 44,249                     | 16,148              |
| Gain on finance lease receivable                                                                  | (610,008)                  | -                   |
| Cash flows from (used in) operating activities before change in non-cash working capital balances | 2,835,536                  | (393,954)           |
| Net changes in non-cash working capital balances:                                                 |                            |                     |
| Accounts receivable                                                                               | 222,883                    | (645,489)           |
| Prepaid expenses                                                                                  | (359,019)                  | 1,178,278           |
| Inventories                                                                                       | (656,002)                  | (2,788,481)         |
| Accounts payable and accrued liabilities                                                          | (616,680)                  | (327,091)           |
| Deferred revenue                                                                                  | (76,952)                   | (101,920)           |
| Total net changes in non-cash working capital balances                                            | (1,485,770)                | (2,684,703)         |
| <b>Total cash flows from (used in) operating activities</b>                                       | <b>1,349,766</b>           | <b>(3,078,657)</b>  |
| <b>Cash flows from (used in) investing activities</b>                                             |                            |                     |
| Purchase of property, plant and equipment (Note 6)                                                | (273,982)                  | (469,175)           |
| Purchase of intangible assets (Note 5)                                                            | (116,518)                  | (632,605)           |
| Restricted cash                                                                                   | (1,670)                    | (132,399)           |
| <b>Total cash flows used in investing activities</b>                                              | <b>(392,170)</b>           | <b>(1,234,179)</b>  |
| <b>Cash flows from (used in) financing activities</b>                                             |                            |                     |
| Buyback of common shares (Note 10)                                                                | -                          | (1,472,286)         |
| Finance lease receivable                                                                          | 61,574                     | -                   |
| Payment of lease liabilities (Note 9)                                                             | (522,254)                  | (511,964)           |
| <b>Total cash flows used in financing activities</b>                                              | <b>(460,680)</b>           | <b>(1,984,250)</b>  |
| Foreign exchange rate changes on cash                                                             | 115,034                    | 54,863              |
| <b>Total cash flows during the period of continuing operations</b>                                | <b>611,950</b>             | <b>(6,242,223)</b>  |
| <b>Total cash flows during the period of discontinued operations</b>                              | <b>-</b>                   | <b>1,370,700</b>    |
| <b>Total cash flows during the period</b>                                                         | <b>611,950</b>             | <b>(4,871,523)</b>  |
| <b>Cash and cash equivalents, beginning of the period</b>                                         | <b>\$8,794,650</b>         | <b>\$14,061,631</b> |
| <b>Cash and cash equivalents, end of the period</b>                                               | <b>\$9,406,600</b>         | <b>\$9,190,108</b>  |

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

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## 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 nine months ended June 30, 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, 2023, 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

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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 August 20, 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**

The IASB has issued classification, measurement and disclosure amendments to IFRS 9, Financial Instruments and IFRS 7, Financial Instruments: Disclosures with an effective date for annual reporting periods beginning on or after January 1, 2026. The amendments clarify the date of recognition and derecognition of some financial assets and liabilities and introduce a new exception for some financial liabilities settled through an electronic payment system. Other changes include a clarification of the requirements when assessing whether a financial asset meets the solely payments of principal and interest criteria and new disclosures for certain instruments with



# Covalon Technologies Ltd.

## NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

### Expressed in Canadian Dollars

contractual terms that can change cash flows (including instruments where cash flows changes are linked to environment, social or governance targets).

IFRS 18, Presentation and Disclosure in Financial Statements (IFRS 18) is a new standard that will provide new presentation and disclosure requirements and which will replace IAS 1, Presentation of Financial Statements (IAS 1). IFRS 18 introduces changes to the structure of the income statement; provides required disclosures in financial statements for certain profit or loss performance measures that are reported outside an entity's financial statements; and provides enhanced principles on aggregation and disaggregation in financial statements. Many other existing principles in IAS 1 have been maintained. IFRS 18 is effective for years beginning on or after January 1, 2027.

The impact of the adoption of these pronouncements is currently being assessed.

### 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 June 30, 2024 and June 30, 2023 are as follows:

|                                      | June 30, 2024 | June 30, 2023 |
|--------------------------------------|---------------|---------------|
| Cash flows from investing activities | -             | 1,370,700     |
| Total cash flow                      | -             | 1,370,700     |

### 4. INVENTORIES

Inventories consist of the following:

|                     | June 30,<br>2024 | September 30,<br>2023 |
|---------------------|------------------|-----------------------|
| Raw materials       | 3,008,988        | \$2,107,970           |
| Finished goods      | 6,217,682        | 5,775,340             |
| Inventory provision | (2,479,422)      | (1,938,776)           |
|                     | 6,747,248        | \$5,944,534           |

Cost of sales for the three and nine months ended June 30, 2024, included \$3,734,565 (2023 - \$2,606,136) and \$8,541,363 (2023 - \$8,060,192), respectively, in inventoried materials. Write-downs of inventories to net realizable value for the three and nine months ended June 30, 2024 amounted to \$424,606 (2023 - (\$221,225)) and \$906,701 (2023 - (\$379,949)) 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<br>Development<br>Costs (\$) | Patents<br>(\$)  | Trademarks<br>(\$) | Computer<br>Software<br>(\$) | Total<br>(\$)    |
|---------------------------------|---------------------------------------|------------------|--------------------|------------------------------|------------------|
| <b>Cost</b>                     |                                       |                  |                    |                              |                  |
| Balance at September 30, 2023   | 2,430,494                             | 1,066,166        | 81,238             | 963,172                      | 4,541,070        |
| Impairment                      | (177,490)                             | -                | -                  | -                            | (177,490)        |
| Additions                       | -                                     | -                | -                  | 116,518                      | 116,518          |
| Foreign exchange                | 30,022                                | 13,169           | 1,003              | 11,897                       | 56,091           |
| <b>Balance at June 30, 2024</b> | <b>2,283,026</b>                      | <b>1,079,335</b> | <b>82,241</b>      | <b>1,091,587</b>             | <b>4,536,189</b> |
| <b>Accumulated amortization</b> |                                       |                  |                    |                              |                  |
| Balance at September 30, 2023   | 2,081,557                             | 593,567          | -                  | 74,641                       | 2,749,765        |
| Amortization                    | 85,057                                | 38,927           | -                  | 82,873                       | 206,857          |
| Foreign exchange                | 26,268                                | 7,585            | -                  | 1,465                        | 35,318           |
| <b>Balance at June 30, 2024</b> | <b>2,192,882</b>                      | <b>640,079</b>   | <b>-</b>           | <b>158,979</b>               | <b>2,991,940</b> |
| <b>Carrying amounts</b>         |                                       |                  |                    |                              |                  |
| At September 30, 2023           | 348,937                               | 472,599          | 81,238             | 888,531                      | 1,791,305        |
| <b>At June 30, 2024</b>         | <b>90,144</b>                         | <b>439,256</b>   | <b>82,241</b>      | <b>932,608</b>               | <b>1,544,249</b> |

As at June 30, 2024, included in computer software is an amount of \$534,898 (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<br>Hardware,<br>Furniture<br>and Fixtures<br>(\$) | Production<br>and Lab<br>Equipment<br>(\$) | Leasehold<br>Improvements<br>(\$) | Total<br>(\$)    |
|---------------------------------|------------------------------------------------------------|--------------------------------------------|-----------------------------------|------------------|
| <b>Cost</b>                     |                                                            |                                            |                                   |                  |
| Balance at September 30, 2023   | 746,627                                                    | 2,451,827                                  | 383,351                           | 3,581,805        |
| Additions                       | 38,133                                                     | 235,849                                    | -                                 | 273,982          |
| Foreign exchange                | 9,222                                                      | 30,284                                     | 4,734                             | 44,240           |
| Disposal of assets              | (75,139)                                                   | (9,882)                                    | -                                 | (85,021)         |
| Write-off of fully amortized    | (231,734)                                                  | (3,871)                                    | -                                 | (235,605)        |
| <b>Balance at June 30, 2024</b> | <b>487,109</b>                                             | <b>2,704,207</b>                           | <b>388,085</b>                    | <b>3,579,401</b> |
| <b>Accumulated depreciation</b> |                                                            |                                            |                                   |                  |
| Balance at September 30, 2023   | 506,800                                                    | 1,476,479                                  | 355,588                           | 2,338,867        |
| Depreciation                    | 99,605                                                     | 227,296                                    | 19,406                            | 346,307          |
| Foreign exchange                | 5,392                                                      | 19,701                                     | 4,519                             | 29,612           |
| Write-off of fully amortized    | (231,734)                                                  | (3,871)                                    | -                                 | (235,605)        |
| <b>Balance at June 30, 2024</b> | <b>380,063</b>                                             | <b>1,719,605</b>                           | <b>379,513</b>                    | <b>2,479,181</b> |
| <b>Carrying amounts</b>         |                                                            |                                            |                                   |                  |
| At September 30, 2023           | 239,827                                                    | 975,348                                    | 27,763                            | 1,242,938        |
| <b>At June 30, 2024</b>         | <b>107,046</b>                                             | <b>984,602</b>                             | <b>8,572</b>                      | <b>1,100,220</b> |

As at June 30, 2024, included in production and lab equipment is an amount of \$245,773 (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

|                                                        | June 30,<br>2024 | September 30,<br>2023 |
|--------------------------------------------------------|------------------|-----------------------|
| <b>Balance, beginning of year</b>                      | <b>\$80,702</b>  | \$260,471             |
| <u>Add:</u>                                            |                  |                       |
| Deferred product                                       | \$502,432        | 689,538               |
| <u>Less:</u>                                           |                  |                       |
| Recognition of deferred product                        | (528,685)        | (724,867)             |
| Recognition of deferred licensing and services revenue | (50,120)         | (141,034)             |
| Foreign exchange                                       | (1,217)          | 3,406                 |
| Balance, end of year                                   | 3,112            | 80,702                |
| <b>Current portion</b>                                 | <b>3,112</b>     | (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                    | (181,202)                |
| Foreign exchange                | 4,238                    |
| <b>Balance at June 30, 2024</b> | <b>262,873</b>           |

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                        | 45,609                 |
| Payments                        | (522,254)              |
| Foreign exchange                | (6,465)                |
| <b>Balance at June 30, 2024</b> | <b>1,079,355</b>       |
| Less: Current portion           | 666,673                |
| Long-term portion               | 412,682                |

Following the impairment of the right of use asset related to the Company's Seattle lease agreement, an onerous contract liability at June 30, 2024 of \$248,774 (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 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                 | 1,360                          |
| Payments received               | (61,574)                       |
| Foreign exchange                | (69,623)                       |
| <b>Balance at June 30, 2024</b> | <b>480,171</b>                 |
| <b>Current portion</b>          | <b>248,635</b>                 |
| <b>Non-current portion</b>      | <b>231,536</b>                 |

# Covalon Technologies Ltd.

## NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

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

|                                                 |                |
|-------------------------------------------------|----------------|
| 2024                                            | 64,010         |
| 2025                                            | 254,993        |
| 2026                                            | 147,066        |
| <b>Total future minimum payments receivable</b> | <b>466,069</b> |
| Imputed interest                                | 14,102         |
| <b>Finance lease receivable</b>                 | <b>480,171</b> |

### 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:

|                                      | <b>Number of<br/>Warrants</b> | <b>Weighted average<br/>exercise Price</b> | <b>Weighted Average<br/>Expiry (years)</b> |
|--------------------------------------|-------------------------------|--------------------------------------------|--------------------------------------------|
| <b>Balance at September 30, 2023</b> | <b>2,920,000</b>              | <b>\$2.14</b>                              | <b>1.10</b>                                |
| Exercised during the period          | -                             | -                                          | -                                          |
| <b>Balance at June 30, 2024</b>      | <b>2,920,000</b>              | <b>\$2.14</b>                              | <b>0.35</b>                                |

### 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. 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)

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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 June 30, 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         | -              | (5,000)           | 412,500          | 136,125        | 276,375          | 2.74                            |
| 06-Sep-22                       | 06-Sep-27   | \$2.50         | 432,500         | -              | (262,500)         | 170,000          | 57,800         | 112,200          | 3.18                            |
| 10-Jan-24                       | 10-Jan-29   | \$1.50         | -               | 800,000        | -                 | 800,000          | -              | 800,000          | 4.53                            |
|                                 |             |                | <b>925,000</b>  | <b>800,000</b> | <b>(342,500)</b>  | <b>1,382,500</b> | <b>193,925</b> | <b>1,188,575</b> | <b>3.83</b>                     |
| Weighted Average Exercise Price |             |                | <b>\$2.54</b>   | <b>\$1.50</b>  | <b>\$2.97</b>     | <b>\$1.83</b>    | <b>\$2.28</b>  | <b>\$1.75</b>    |                                 |

### 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        |
|                                 |                | -               | <b>295,000</b> | -         | -                 | <b>295,000</b>  | -      | <b>295,000</b> |
| Weighted Average Exercise Price |                | <b>\$1.44</b>   | <b>\$1.44</b>  | -         | -                 | <b>\$1.44</b>   | -      | <b>\$1.44</b>  |

### 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:

- 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;

# Covalon Technologies Ltd.

## NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

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- 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 to 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 nine months ended June 30, 2024, as part of employee benefits were \$150,100 (2023 - \$107,825) and \$347,493 (2023 - \$437,282), 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 June 30, 2024 and September 30, 2023 is not significant.

Accounts receivables 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 receivables 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 June 30, 2024, five customers accounted for 78% (September 30, 2023 – five customers for 66%) 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:

**June 30,**      September 30,

# Covalon Technologies Ltd.

## NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Expressed in Canadian Dollars

|                       | 2024             | 2023             |
|-----------------------|------------------|------------------|
| Current               | \$5,102,449      | \$5,755,494      |
| 30-60 days past due   | 832,567          | 192,489          |
| Over 60 days past due | 147,157          | 214,086          |
|                       | <b>6,082,173</b> | <b>6,162,069</b> |

### 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>June 30, 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                | \$214,086            | \$9,192,514 | -          | \$9,406,600  | \$178,723                 | \$8,615,927 | -          | \$8,794,650  |
| Accounts receivable                      | \$178,859            | \$5,839,565 | \$63,749   | \$6,082,173  | \$385,193                 | \$5,713,905 | \$62,971   | \$6,162,069  |
| Finance lease receivable                 | -                    | \$480,171   | -          | \$480,171    | -                         | -           | -          | -            |
| Restricted cash                          | -                    | \$136,870   | -          | \$136,870    | -                         | \$135,200   | -          | \$135,200    |
| Accounts payable and accrued liabilities | \$254,832            | \$3,497,449 | \$17,444   | \$3,769,725  | \$344,159                 | \$4,092,500 | \$27,950   | \$4,464,609  |
| Lease liabilities                        | \$302,484            | \$776,871   | -          | \$1,079,355  | \$537,808                 | \$1,024,657 | -          | \$1,562,465  |

If exchange rates were to change by 5% at June 30, 2024 total comprehensive income (loss) would change by \$571,055 (September 30, 2023 - \$469,145).

### 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.



# Covalon Technologies Ltd.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

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## 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 | 3,769,725            | 3,769,725              | 3,765,240             | 4,485                      | -                         |
| Lease liabilities                        | 1,079,355            | 1,204,901              | 689,737               | 515,164                    | -                         |
| <b>Total</b>                             | <b>4,849,080</b>     | <b>4,974,626</b>       | <b>4,454,977</b>      | <b>519,649</b>             | <b>-</b>                  |

## 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 June 30, 2024 is \$21,673,566 (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 June 30 |           | Nine months ended June 30, |           |
|-----------------------------------------------|----------------------------|-----------|----------------------------|-----------|
|                                               | 2024                       | 2023      | 2024                       | 2023      |
| Compensation and short-term employee benefits | <b>\$392,107</b>           | \$307,206 | <b>\$1,107,858</b>         | \$896,618 |
| Share based payment expense                   | <b>79,821</b>              | 9,446     | <b>335,877</b>             | 56,222    |
|                                               | <b>471,928</b>             | 316,652   | <b>1,443,735</b>           | 952,840   |

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. 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 June 30, 2024, \$10,000 of this loan remained outstanding.

# Covalon Technologies Ltd.

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## 16. EXPENSES BY NATURE

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

|                                                         | Three months ended June 30, |             | Nine months ended June 30, |              |
|---------------------------------------------------------|-----------------------------|-------------|----------------------------|--------------|
|                                                         | 2024                        | 2023        | 2024                       | 2023         |
| Inventoried materials                                   | \$3,734,565                 | \$2,606,136 | \$8,541,363                | \$8,060,192  |
| Wages, benefits, consulting fees, director compensation | 2,389,777                   | 2,976,147   | 7,535,842                  | 8,841,996    |
| Share based payments                                    | 150,100                     | 107,825     | 347,493                    | 437,282      |
| Depreciation and amortization                           | 246,416                     | 271,184     | 734,366                    | 754,604      |
| Facility                                                | 65,551                      | 100,735     | 198,655                    | 158,014      |
| Patent and trademark maintenance                        | 33,740                      | 108,020     | 135,757                    | 204,978      |
| Insurance                                               | 98,605                      | 98,093      | 300,643                    | 321,547      |
| Information technology system costs                     | 208,486                     | 164,972     | 580,179                    | 487,504      |
| Professional fees                                       | 218,100                     | 155,174     | 630,518                    | 652,910      |
| Impairment of intangible asset                          | -                           | -           | 176,025                    | -            |
| Other expenses                                          | 603,553                     | 269,394     | 1,633,476                  | 1,446,294    |
| Total                                                   | \$7,748,893                 | \$6,857,680 | \$20,814,317               | \$21,365,321 |

### Depreciation and amortization

|                                     | Three months ended June 30, |           | Nine months ended June 30, |           |
|-------------------------------------|-----------------------------|-----------|----------------------------|-----------|
|                                     | 2024                        | 2023      | 2024                       | 2023      |
| Cost of product sales               | \$58,017                    | \$59,466  | \$168,887                  | \$168,560 |
| Operations                          | 28,323                      | 15,076    | 42,420                     | 60,316    |
| Research and development activities | 41,362                      | 41,362    | 118,981                    | 113,121   |
| General and administrative          | 118,714                     | 155,280   | 404,078                    | 412,607   |
| Total depreciation and amortization | \$246,416                   | \$271,184 | \$734,366                  | \$754,604 |

## 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 June 30 |            | Nine Months Ended June 30 |            |
|--------------------------------------------------------------|----------------------------|------------|---------------------------|------------|
|                                                              | 2024                       | 2023       | 2024                      | 2023       |
| Weighted average number of common shares outstanding – basic | 24,669,577                 | 25,000,323 | 24,669,577                | 24,961,280 |
| Dilutive effect of securities outstanding                    |                            |            |                           |            |
| Stock Options/DSU's                                          | 6,358                      | -          | 2,119                     | 14,606     |
| Warrants                                                     | -                          | -          | -                         | 237,912    |

# Covalon Technologies Ltd.

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|                                                                |            |            |            |            |
|----------------------------------------------------------------|------------|------------|------------|------------|
| Weighted average number of common shares outstanding – diluted | 24,675,935 | 25,000,323 | 24,671,696 | 25,213,798 |
|----------------------------------------------------------------|------------|------------|------------|------------|

For the three month and nine month periods ended June 30, 2023, diluted loss per share is equal to the basic loss per share due to the anti dilutive effect of the stock options, DSUs and warrants.

### 18. SEGMENT REPORTING

During the three months ended June 30, 2024, the Company generated revenue of \$8,019,618 (2023 – \$4,452,749) in the US, \$964,106 (2023 – \$1,368,998) in the Middle East, \$10,614 (2023 – \$3,924) in Canada, and \$229,969 (2023 – \$444,368) in the rest of the world.

During the nine months ended June 30, 2024, the Company generated revenue of \$18,790,008 (2023 – \$13,741,612) in the US, \$2,289,284 (2023 – \$4,401,467) in the Middle East, \$34,042 (2023 – \$45,208) in Canada, and \$1,187,640 (2023 – \$1,511,751) in the rest of the world.

As of June 30, 2024, the Company had \$2,889,973 (September 30, 2023 - \$3,444,738) of its property, plant, and equipment, right-of-use assets and intangible assets located in Canada and \$17,369 (September 30, 2023 - \$29,342) in the USA.

### 19. CONTINGENCIES AND COMMITMENTS

The following are commitments of the Company beyond June 30, 2024:

|                                                | September 30, |          |         |
|------------------------------------------------|---------------|----------|---------|
|                                                | 2024          | 2025     | 2026    |
| Telecommunications and office equipment leases | 13,233        | 15,671   | 4,192   |
|                                                | \$13,233      | \$15,671 | \$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.