

Covalon Technologies Ltd.

Management's Discussion and Analysis of Financial
Condition and Results of Operations

March 31, 2020

MANAGEMENT'S DISCUSSION & ANALYSIS

For the six months ended March 31, 2020

July 14, 2020

The following discussion of Covalon Technologies Ltd.'s ("Covalon" or the "Company") financial condition and results of operations should be read in conjunction with our audited consolidated financial statements for the year ended September 30, 2019, and with our unaudited condensed consolidated interim financial statements for the six month period ended March 31, 2020. Additional information on Covalon Technologies Ltd., including Covalon's annual information form, can be obtained on SEDAR at www.sedar.com, as well as the Company's website at www.covalon.com. Unless otherwise indicated, all references to the terms "we", "us", "our", "Covalon" and "Company" refer to Covalon Technologies Ltd. and its subsidiaries.

In this management discussion and analysis document ("MD&A"), financial information for the six months ended March 31, 2020 and 2019 is based on the audited consolidated financial statements of the Company, unaudited condensed consolidated interim financial statements of the Company, which were prepared in accordance with International Financial Reporting Standards ("IFRS"), and are presented in Canadian dollars unless otherwise specified. In accordance with its terms of reference, the Audit Committee of the Company's Board of Directors reviews the contents of the MD&A and recommends its approval to the Board of Directors. The Board of Directors approved this MD&A on July 14, 2020. Disclosure contained in this document is current to that date, unless otherwise noted.

Impact of COVID-19

On March 11, 2020, the World Health Organization declared COVID-19 a global pandemic. The COVID-19 pandemic, which has continued to spread globally, and any related adverse public health developments, have adversely affected workforces, economies and financial markets globally, potentially leading to an economic downturn. The COVID-19 pandemic poses the risk that the Company or its clients, contractors, suppliers, and other partners may be unable to conduct regular business activities for an indefinite period of time. While it is not possible at this time to estimate the long-term impact that COVID-19 could have on the Company's business, the continued spread of COVID-19 and the measures taken by federal, provincial and municipal governments to contain its impact may adversely impact the Company's business, financial condition or results of operations in the future. The extent to which the COVID-19 outbreak impacts the Company's results will depend on future developments that are highly uncertain and cannot be predicted, including new information that may emerge concerning the spread of the virus and government actions. The Company continues to monitor and actively manage the developing impacts from COVID-19, including but not limited to, the potential future effects on its assets, cash flow and liquidity, and will continue to assess impacts to the Company's operations, going concern assumption and the value of assets and liabilities reported.

Management's Responsibility for Financial Reporting

The consolidated financial statements and MD&A have been prepared by Management, who, when necessary, have made informed judgments and estimates of the outcome of events and transactions with due consideration given to materiality. Management acknowledges its responsibility for the fairness,

integrity, and objectivity of all information provided in the consolidated financial statements and in the MD&A. As a means of fulfilling its responsibility, Management relies on the Company's system of internal controls. This system has been established to ensure, within reasonable limits, that assets are safeguarded, transactions are properly recorded and are executed with Management's authorization, and that the accounting records provide a solid foundation from which to prepare the consolidated financial statements and the MD&A. The Board of Directors carries out its responsibility for the consolidated financial statements principally through its Audit Committee. This committee meets periodically, reviews the scope of the external audit, the adequacy of the systems of internal control and the appropriateness of financial reporting, and then makes its recommendations to the Board of Directors. Based on those recommendations, the Board approves the consolidated financial statements and the MD&A.

Non-IFRS Financial Measures

In this MD&A, we refer to terms that are not specifically defined under IFRS and have no standardized meanings. Accordingly, these measures may not be comparable to similar measures presented by other companies. These measures are used to provide additional financial information to complement the IFRS measures. The Company's working capital is a non-IFRS metric and is calculated as: Current Assets less Current Liabilities as of the reporting date.

Forward-looking Statements

This MD&A contains forward-looking statements which reflect the Company's current expectations regarding future events. The forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "estimate", "expect", "intend" and statements that an event or result "may", "will", "should", "could", or "might" occur or be achieved and other similar expressions. More specifically, this MD&A contains forward-looking statements which include, but are not limited to statements regarding: the Company's corporate strategy and strategic objectives; the availability of external financing to fund the Company's ongoing liabilities and commitments; the direct and indirect impact of the COVID-19 pandemic on the Company's business and operations, including supply chain, manufacturing, research and development costs, contracted service providers and employees, and general business and economic events. These forward-looking statements involve risk and uncertainties, including the impact on the Company given its current liquidity situation, the difficulty in predicting product approvals, acceptance of and demands for new products, the impact of the products and pricing strategies of competitors, delays in developing and launching new products, the regulatory environment, fluctuations in operating results, and other risks, any of which could cause results, performance, or achievements to differ materially from the results discussed or implied in the forward-looking statements. Many risks are inherent in the industry; others are more specific to the Company. Investors should consult the "Risks & Uncertainties" section of this MD&A as well as the Company's ongoing quarterly filings for additional information on risks and uncertainties relating to these forward-looking statements. Investors should not place undue reliance on any forward-looking statements. Management assumes no obligation to update or alter any forward-looking statements whether as a result of new information, further events, or otherwise.

Nature of Our Business

Covalon Technologies Ltd. is a researcher, developer, manufacturer, and marketer of patent-protected medical products that improve patient outcomes and save lives in the areas of advanced wound care, infection management and surgical procedures. Our head office and laboratories are located in Mississauga, Ontario, Canada.

Covalon leverages its patented medical technology platforms and expertise in two ways: (i) we develop products that we sell under Covalon's name; and, (ii) we develop and commercialize medical products for other medical companies under development and license contracts.

The majority of Covalon-branded products are sold through independent distributors to various health care providers such as hospitals, wound care centers, burn centers, extended/alternate care facilities, acute care facilities, home health care agencies, and physicians' offices. Many of our products require regulatory clearances and are sold on a prescription basis in the United States, Canada, the Middle East, Europe, Asia, Latin America and a number of other international countries.

We also license our technologies and products to large medical device companies as well as work with niche start-ups to create novel technology to advance their product offerings in various medical device markets. Covalon has worked with many medical companies including leaders in vascular access devices, I.V. infusion, orthopedics, device and patient care distributors, wound care product companies, specialty medical device manufacturers and major contract manufacturers.

On October 1, 2018, Covalon completed the acquisition of AquaGuard, a Seattle, Washington-based division of medical technologies company Cenorin, LLC. AquaGuard's specialized products provide patients with crucial moisture protection for wound, surgical, and vascular access sites throughout the body while showering. As part of the acquisition, the Company acquired all of the operating assets of the business, including AquaGuard's specialized product line and employed its experienced sales force that has been building relationships with clinicians and hospital staff throughout the United States.

Covalon currently has five proprietary platform technologies that have the potential to be developed into dozens of medical devices and products: (i) Collagen matrix; (ii) Antimicrobial silicone adhesive; (iii) Medical coating technology; (iv) AquaGuard moisture barrier technology and (v) CovaGuard antimicrobial sanitizing technology. These platform technologies are protected by patents, patent applications and patents pending, patented and proprietary manufacturing processes, trade secrets, brands, trademarks, and trade names.

Collagen Matrix: The Company's patented collagen matrix platform is used to manufacture a family of products that treat chronic and infected wounds including diabetic ulcers (including diabetic foot ulcers), pressure ulcers, venous ulcers (including venous leg ulcers), donor and graft sites, traumatic wounds healing by secondary intention, dehisced surgical wounds, and first and second degree burns. These dressings begin from a collagen base, which is generally biocompatible with the human body, and enable the release of beneficial materials, such as antimicrobials, into the wound site and/or enhance the removal of undesirable materials, such as wound exudate from the wound. Covalon's patented manufacturing process for creating our collagen matrix results in products that have certain clinical advantages over other dressings, such as open binding sites for destructive enzymes, effective antimicrobial activity, and exudate management properties that help chronic wounds heal.

Antimicrobial Silicone Adhesive Platform: Covalon’s patent-pending antimicrobial silicone adhesive platform is the basis for a family of pre-surgical, post surgical and vascular access products that are designed to kill 99.99% or more of any bacteria or yeast that comes into contact with the antimicrobial silicone. The Company’s Antimicrobial silicone adhesive platform is unique because the silicone adhesive contains both silver and chlorhexidine which provides broad-spectrum antimicrobial activity for a minimum of 7 days, while maintaining the beneficial properties of a silicone adhesive. Our technology meets the current United States Food and Drug Administration’s “greater than 4 log reduction” standard for an antimicrobial claim against bacteria, and yeast, most commonly associated with healthcare acquired infections. The soft silicone adhesive also provides greater patient comfort, does not macerate or damage the skin, and was shown to be up to 10 times less painful upon removal when compared to acrylic adhesives, which are commonly used in medical products containing adhesives.

Medical Coating Platforms (“CovaCoat” and “Centaur”): Covalon’s patented coating technology is a proprietary “grafting from” process which utilizes photo-polymerization to create active grafting sites where new polymer chains are initiated and propagated from the surface of an existing medical device. The CovaCoat and Centaur processes enable these grafting sites to slightly penetrate the surface of the medical device forming a strong, permanent continuum, rather than a discreet coating layer, which is more susceptible to delamination and particulate generation as compared to the resulting CovaCoat surface. This is unlike many competitors’ coatings, which use a cure catalyst. As a result, the CovaCoat and Centaur processes create a functionalizable micron level covalently bound polymeric surface while preserving the bulk mechanical properties of the underlying medical device. The Company’s CovaCoat and Centaur processes will not decrease or adversely affect the physical properties of the underlying device, which is critical for regulatory submissions and clinical use. The new coated surface created during the CovaCoat and Centaur processes has inherent lubricious and biocompatible properties and can be further functionalized to meet the specific needs of an application. CovaCoat has been proven effective on many polymeric medical device surfaces including silicones, polyurethanes, polyethylenes, polycarbonates, polyesters, Pebax®, Nylon, and PEEK. Centaur is ideally suited to improve the safety and functionality of intravascular medical devices such as vascular access catheters, where the presence of unwanted particulate can cause significant patient complications.

AquaGuard moisture barrier technology: AquaGuard® is an impermeable moisture barrier that allows the clinician or patient to cover wounds, dressings and intravenous sites and keep them dry when showering to minimize the chances of infection and post-operative complications. AquaGuard is the #1 Shower Protection Brand in the USA.

CovaGuard antimicrobial sanitizing technology: Covalon’s patent pending antimicrobial sanitizing technology platform (the CovaGuard™ Platform) incorporates Benzalkonium Chloride (BAC) into a unique lipid delivery system that can be applied to a variety of surfaces (porous and non-porous), and skin, to provide immediate and sustained kill of viruses and bacteria. When applied, CovaGuard forms an invisible antimicrobial lipid barrier that is designed to enhance the activity of BAC and preserve its ability to deactivate and kill pathogens for up to 4 days. This platform technology has been commercialized into consumer sanitizing products in several countries, including Canada and the United States. The platform is currently used in a hand sanitizer, hard surface disinfectant and mask sanitizer with other applications under development. Each product derived from the CovaGuard platform is restricted in its efficacy claims to those that are allowed in the individual jurisdictions where the resulting product is registered.

Performance capabilities of the CovaGuard Platform are not reflective of the efficacy claims of any individual product.

Our Products

We have obtained regulatory clearance on approximately 25 families of medical devices and approximately 150 separate sku's, many of which are derived from our platform technologies. Our products that are currently available for sale include the following:

Advanced Wound Care Dressings	
ColActive Plus	Collagen matrix dressing
ColActive Plus Ag	Collagen matrix dressing with silver
ColActive Transfer	Wound contact layer
CovaWound Silicone	Self-adherent soft silicone foam dressing
CovaWound Silicone with Border	Self-adherent soft silicone foam dressing with border
CovaWound Silicone Sacrum	Self-adherent soft silicone foam dressing with border for use on the sacrum
CovaWound Silicone Heel	Self-adherent soft silicone foam dressing with border for use on the heel
CovaWound Foam	Non-adherent foam dressing
CovaWound Foam with Border	Non-adherent foam dressing with adhesive border
CovaWound Alginate	Alginate dressing
CovaWound Alginate Ag	Alginate dressing with silver
CovaWound Super Absorbent	Soft hydrophilic wound contact layer with super absorbent polymer core
CovaWound Hydrocolloid	Absorbent hydrocolloid matrix dressing
CovaView Transparent IV Dressing	Transparent IV vascular access dressing

Surgical and Peri-Operative Products	
SurgiClear	Antimicrobial clear silicone adhesive post-surgical dressing with chlorhexidine and silver
MediClear Post-Op Absorb	Self-adherent silicone dressing with absorbent pad
MediClear Scar	Self -adherent silicone dressing for scar care

Infection Management Products	
IV Clear	Antimicrobial clear silicone adhesive vascular access dressing with chlorhexidine and silver
MediClear Pre-Op	Antimicrobial silicone film for pre-operative skin
SilverCoat Foley Catheter	Silicone Foley catheter with silver
Moisture Barriers	
AquaGuard Sheet	AquaGuard moisture barriers make it easy to keep wounds, dressing, and intravenous sites dry and reduce the changes of infection. Specifically tailored for general body protection.
AquaGuard Glove	AquaGuard moisture barriers make it easy to keep wounds, dressing, and intravenous sites dry and reduce the changes of infection. Specifically tailored for upper extremities.

AquaGuard Boot	AquaGuard moisture barriers make it easy to keep wounds, dressing, and intravenous sites dry and reduce the changes of infection. Specifically tailored for lower extremities.
CovaGuard	
CovaGuard Antimicrobial Hand Sanitizer (“CovalonGuard Antimicrobial Hand Sanitizer” in Canada)	CovaGuard Antimicrobial Hand Sanitizer with Benzalkonium Chloride provides persistent protection on hands by trapping and deactivating microbes over an extended period of time.
CovaGuard Mask Antimicrobial Sanitizer	CovaGuard Mask Antimicrobial Sanitizer with Benzalkonium Chloride provides immediate sanitization as well as persistent protection by trapping and deactivating microbes over an extended period of time.

Our Product Pipeline

The Company continues to leverage its strong research and development capabilities and talented technical staff to continuously add to our product pipeline. Covalon utilizes an internal development team to invent and commercialize new products, as well as continuously investigating in-licensing opportunities for intellectual property that can be commercialized by the Company into successful products. The Company believes that a number of the technologies and product prototypes have significantly large market opportunities once they have been cleared by the relevant regulatory authorities.

Our Business Model

The Company distributes products under the Covalon brand name through multiple channels to market, including through third-party distribution networks and directly through the Company’s direct sales force. The Company also sells certain of its products through private label arrangements with other medical device companies and licenses certain of its technologies and provides services through an OEM business model to realize value in the marketplace.

Currently the Company has a direct sales force in the United States and the United Kingdom that sell directly into acute care hospitals and associated institutions. As restrictions have been put in place related to COVID-19 on hospitals, and those who are able to enter hospitals, our sales force has had to adapt and modify their approach. This has resulted in limited access for our sales force to service these customers.

The Company has set up distribution relationships with a number of companies in North America, the Middle East, Latin America, Asia, and Europe. The governmental responses have caused material disruption to business globally, economic slowdowns, and shifts in economic markets. The significant uncertainty related to the virus, and the governmental responses, is likely to negatively impact the Company’s suppliers, as well as our customers and their demand for our products and services. A significant number of the Company’s products are consumed during elective and other procedures at hospitals, clinics and other medical institutions that were materially impacted by the quarantine measures

undertaken at these facilities. As a result the usage and therefore the demand for the Company's products will be temporarily materially negatively impacted by the global pandemic.

Covalon continues to utilize an OEM revenue model based on selling or licensing our technologies to large medical companies. Some medical companies and distributors license our technologies for incorporation into their own product offerings, which they sell to healthcare providers under their own brand names. Referred to by the industry as an OEM sales model (original equipment manufacturer), this approach assigns the major cost of selling to our customers who are able to penetrate the market with a large sales force in geographical locations where Covalon does not have staff or offices. Our revenue streams are typically generated from product sales, services, technology licensing fees, and royalties from the sale or commercialization of products.

Covalon's technology also lends itself to developing and consulting projects. These projects allow Covalon to showcase our proprietary technology, explore new areas of application, and build industry relationships with larger companies.

OEM models, and project-based activities, may not produce consistent revenues on a quarterly basis. Consequently, any one quarter's results are not particularly indicative of the Company's prospects. Most OEM, and project based, sales models involve a long sales cycle – from initial discussion, product evaluation, regulatory filings, contract negotiation, performance of services, and then to market roll-out. This process generally takes twelve to eighteen months although there are exceptions for both shorter and longer times for the completion of a project. The start and finish of projects is dependent on many factors, many of which are outside the control of Covalon.

Operational Highlights for the six months ended March 31, 2020

- On January 24, 2020, the Company obtained a waiver, and an amendment, from HSBC Bank Canada for covenant breaches related to the quarters ended September 30, 2019, and December 31, 2019, respectively under the Company's Facility (as defined herein). The Facility was concurrently amended to provide the Company with more room under its future covenants. For further information, please see "Liquidity & Capital Resources".
- On March 30, 2020, the Company announced a breakthrough antimicrobial technology formulated to kill the viruses, bacteria, and other pathogens. This release was followed by a conference call to further discuss the technology and the potential products associated with the formulation.

Operational Highlights Subsequent to March 31, 2020

- On April 14, 2020, the Company announced that the Annual Meeting of Shareholders would be postponed due to the extraordinary circumstance of the ongoing COVID-19 pandemic and the resulting restrictions on public gatherings.
- On April 23, 2020, the Company announced that Martin Goldfarb, O.C., had joined Covalon's Board of Directors. Mr. Goldfarb is well-recognized as a successful entrepreneur and a leading expert in the study of human behavior as it relates to the marketplace and society. He is Chairman of Almada Inc., President of Goldfarb Ventures, private equity companies and Principal at Goldfarb Intelligence Marketing.

- On April 27, 2020, the Company announced that Amir Bloor had joined Covalon's Board of Directors. Mr. Bloor is the President of Caspian Equity Partners, Inc. of Vancouver, British Columbia, a private investment firm he founded in 2012. He has specialized in helping entrepreneurs accelerate growth and optimize performance, while propelling long-term profitability and value.
- On June 3, 2020, the Company announced that key antimicrobial patents had been granted by the United States Patent and Trademark Office, the Canadian Intellectual Property Officer, and the European Patent Office. The patents are integral to the Company's CovaClear, IVClear, MediClear PreOp, and SurgiClear products.
- The Company applied for and was approved for a United States Paycheck Protection loan totalling USD\$1,103,861 from the US Small Business Administration under the US Paycheck Protection Program. The Loan will be forgiven if certain conditions are met, and otherwise carries interest of 1% and will be repayable over a two-year term. The Company also applied and was approved for funding of CAD\$256,106 to date under the Canadian Emergency Wage Subsidy Program. Both loans are expected to be reflected in the Company's third quarter financial statements.
- COVID-19 has caused material disruption to business globally, economic slowdowns, and shifts in economic markets. The significant uncertainty related to the virus, and the governmental responses, are likely to negatively impact the Company's suppliers, as well as our customers and their demand for our products and services. A significant number of the Company's products are consumed during elective and other procedures at hospitals, clinics and other medical institutions that were materially impacted by the quarantine measures undertaken at these facilities as a result of the COVID-19 pandemic. As a result, the usage and therefore the demand for the Company's products has been and will continue to be temporarily materially negatively impacted by the global pandemic.
- On July 14, 2020, the Company obtained a waiver from HSBC Bank Canada for covenant breaches related to the quarter ended March 31, 2020 under the Company's Facility (as defined herein). For further information, please see "Liquidity & Capital Resources".

Financial Highlights for the three months ended March 31, 2020

- Total revenue for the three months ended March 31, 2020, decreased 60% to \$5,258,572 compared to \$13,312,543 for the same period of the prior year.
- Product revenue for the three-month period ended March 31, 2020, decreased 62% to \$4,626,805 compared to \$12,109,456 for the same period last year. This decrease relates primarily to the timing of major shipments under our previously announced contracts awarded to the Company in Saudi Arabia. The Company was in the process of transferring its contracts to a new agent in the region, when COVID-19 became a pandemic and the process was delayed due to the impact of COVID-19 on the government processes in the respective Middle East countries.
- Development and consulting services revenue for the three-month period ended March 31, 2020, decreased by 27% to \$599,893 compared to \$821,018 for the same period of the prior year. Revenue from development and consulting services varies based on opportunities and the length of the sales cycle for given projects.

- Licensing and royalty fees for the three months ended March 31, 2020, were \$31,874 compared to \$382,069 for the three months ended March 31, 2019.
- Gross margin for the three-month period ended March 31, 2020, decreased to 53% compared to 69% for the same period of the prior year. The gross margin is significantly influenced by source of revenue and by the relative mix of products sold in any given financial period.
- Operating expenses for the three months ended March 31, 2020, decreased \$2,883,507 to \$6,475,036 compared to \$9,358,543 for the prior year's comparative period. The Company has made strides to reduce operating expenses during this fiscal year as it relates to headcount and discretionary spending.
- Net loss for the three months ended March 31, 2020, was \$3,908,622 or \$0.15 per share, compared to a net loss of \$232,227 or \$0.01 per share for the three months ended March 31, 2019.

Financial Highlights for the six months ended March 31, 2020

- Total revenue for the six months ended March 31, 2020 decreased 36% to \$13,207,131 compared to \$20,574,029 for the same period of the prior year.
- Product revenue for the six-month period ended March 31, 2020 decreased 36% to \$11,801,448, compared to \$18,464,994 for the same period of the prior year. This decrease relates to the timing of major shipments in Q2 under our previously announced contracts awarded to the Company in Saudi Arabia.
- Development and consulting services revenue for the six-month period ended March 31, 2020 decreased by 19% to \$1,333,021 compared to \$1,651,915 for the same period of the prior year. Revenue from development and consulting services varies based on opportunities and the length of the sales cycle for given projects.
- Licensing and royalty fees for the period ended March 31, 2020 were \$72,662 compared to \$457,120 for the six months ended March 31, 2019. The timing of this revenue will vary depending on length and timing of projects and discussions with customers.
- Gross margin for the period ended March 31, 2020 decreased to 58% compared to 67% for the same period of the prior year. The gross margin is significantly influenced by source of revenue and by the relative mix of products sold in any given financial period.
- Operating expenses for the six months ended March 31, 2020 decreased \$3,274,057 to \$12,259,813, compared to \$15,533,870 for the prior year's comparative period.
- Net loss for the period ended March 31, 2020 was \$5,083,355 or \$0.20 per share, compared to a net loss of \$2,141,638 or \$0.10 per share for the period ended March 31, 2019.

Business outside of direct sales in the United States is primarily comprised of distributing bulk shipments, which result in 'lumpy' or uneven revenue recognition quarter-to-quarter, depending on when bulk orders are placed, shipped to distributors, and delivered to hospitals. As is typical with many companies, including many in the healthcare field, Covalon's lumpy revenue model results in significant variations in quarter-to-quarter revenue.

	Three months ended, March 31,		Six months ended March 31,	
	2020	2019	2020	2019
Revenue				
Product	\$4,626,805	\$12,109,456	\$11,801,448	\$18,464,994
Development and consulting services	599,893	821,018	1,333,021	1,651,915
Licensing and royalty fees	31,874	382,069	72,662	457,120
Total revenue	5,258,572	13,312,543	13,207,131	20,574,029
Cost of product sales	2,466,453	4,068,587	5,579,228	6,725,899
Gross profit before operating expenses	2,792,119	9,243,956	7,627,903	13,848,130
Operating expenses				
Operations	530,146	598,373	991,080	907,787
Research and development activities	223,346	395,109	448,651	770,099
Sales, marketing and agency fees	2,323,469	5,659,328	5,235,961	8,920,379
General and administrative	3,398,075	2,705,733	5,584,121	4,935,605
	6,475,036	9,358,543	12,259,813	15,533,870
Financing expenses	225,705	117,640	451,445	455,898
Net loss	\$(3,908,622)	\$(232,227)	\$(5,083,355)	\$(2,141,638)
Other comprehensive loss				
Foreign currency translation adjustment	1,770,263	(821,675)	1,359,110	180,191
Other comprehensive loss	\$(2,138,359)	\$(1,053,902)	\$(3,724,245)	\$(1,961,447)
Basic loss per share	\$(0.15)	\$(0.01)	\$(0.20)	\$(0.10)
Diluted loss per share	\$(0.15)	\$(0.01)	\$(0.20)	\$(0.10)

Revenue and Gross Profit

Total revenue decreased \$8,053,971 or 60% to \$5,258,572 for the quarter ended March 31, 2020, compared to \$13,312,543 in the comparative period. The decrease in revenue was primarily a result of fewer product sales during the quarter. Product revenue was \$4,626,805 for the quarter ended March 31, 2020, compared to \$12,109,456 in the prior year. During the quarter, the Company recognized \$181,497 of revenue from sales into the Middle East, compared to \$6,187,052 in the previous year. There were no shipments under the Middle East contracts recognized in revenue during the quarter. The Company was in the process of transferring its contracts to a new agent in the region, when COVID-19 became a pandemic and the process was delayed due to the impact of COVID-19 on the government processes in the respective Middle East countries. The Company expects shipments to resume once the contracts are fully transferred to its new distribution partner.

Revenue in the United States was down \$2,248,528, primarily as a result of a slow-down in orders due to the uncertainties of COVID-19 and its impact on the usage of the Company's products in healthcare

facilities in the United States that were focusing on COVID-19 and not performing the normal level of elective procedures. This slow-down in the ordering and usage of certain of the Company's products in the United States is anticipated to continue until hospitals and healthcare facilities are able to resume elective procedures that utilize the Company's products.

Development and consulting services revenue for the quarter ended March 31, 2020, was \$599,893 which represents revenue earned from the Company's work on development and consulting projects; a decrease from prior year's services revenue of \$821,018. Development work was adversely impacted by COVID-19 as one of the Company's major development customers deemed their research and development team non-essential. As a result, the Company could not continue its development efforts fully without the participation of the customer's staff in the project. The decline in development revenue is expected to continue until the major customer's development team is allowed to return to their facility. Licensing revenue was \$31,874 for the quarter ended March 31, 2020, compared to \$382,069 for the prior year's comparative period.

Gross margin was 53% for the quarter ended March 31, 2020, compared to 69% for the prior year's period. The decline in the higher-margin Middle East revenue and the higher-margin United States revenue significantly influenced the gross margin for the quarter, resulting in a significant decline compare to the prior year and the first quarter of this fiscal year. Gross margin is highly influenced by the mix of collagen-based dressings, silicone-based dressings, medical coated devices, passive dressings, moisture barriers, and related service revenues generated in the periods. Gross margin fluctuates as a result of the mix of products sold in any given quarter, or year, by product type and geography.

Total revenue for the six months ended March 31, 2020, decreased 36% to \$13,207,131 compared to \$20,574,029 for the same period of the prior year. Product revenue for the six-month period ended March 31, 2020, decreased to \$11,801,448 compared to \$18,464,994 for the same period last year. The decline in product revenue during the six months compared to last year is primarily attributed to the decline in Middle East shipments during the second quarter. Development and consulting services revenue was \$1,333,021 for the six months ended March 31, 2020, compared to \$1,651,915 in the same period of the prior year. Licensing and royalty fees for the six months ended March 31, 2020, were \$72,662 compared to \$457,120 for the six months ended March 31, 2019.

Gross margin for the six-month period ended March 31, 2020, decreased to 58% compared to 67% for the same period of the prior year. The decline in gross margin was primarily a result of the lower product sales in the second quarter of fiscal 2020 compared to the prior year. Gross margin is highly influenced by the mix of collagen-based dressings, silicone-based dressings, medical coated devices, passive dressings, moisture barriers, and related service revenues generated in the periods. Gross margin fluctuates as a result of the mix of products sold in any given quarter, or year, by product type and geography.

Operating Expenses

	Three months ended		Six months ended	
	March 31,		March 31,	
	2020	2019	2020	2019
Operations				
Wages, benefits and consulting fees	\$463,316	\$500,954	\$845,067	\$715,463
Depreciation and amortization	852	2,069	1,688	3,550
Other	65,978	95,350	144,325	188,774
	530,146	598,373	991,080	907,787
Research and development activities				
Wages, benefits and consulting fees	187,669	345,827	387,349	673,335
Depreciation and amortization	8,874	18,794	17,584	27,768
Other	26,803	30,488	43,718	68,996
	223,346	395,109	448,651	770,099
Sales, marketing and agency fees				
Wages, benefits and consulting fees	1,785,570	2,535,951	3,885,192	4,383,764
Travel	336,964	426,254	841,025	812,846
Other	200,935	2,697,123	509,744	3,723,769
	2,323,469	5,659,328	5,235,961	8,920,379
General and administrative				
Wages, benefits and consulting fees	927,685	1,510,035	1,815,380	2,756,966
Directors compensation	53,912	44,992	109,751	88,478
Professional and related costs	483,953	692,686	1,032,786	1,385,352
Facility	213,970	291,373	509,702	476,610
Depreciation and amortization	73,155	97,627	143,551	132,394
Allowance for doubtful accounts	1,420,002	-	1,420,002	-
Other	225,398	69,020	552,949	95,805
	3,398,075	2,705,733	5,584,121	4,935,605
Total operating expenses	\$6,475,036	\$9,358,543	\$12,259,813	\$15,533,870

Operating expenses for the three months ended March 31, 2020, decreased \$2,883,507 to \$6,475,036 compared to \$9,358,543 for the prior year's comparative period. Included in operating expenses is a provision for doubtful accounts of \$1,420,002 related to the change of distribution partners in the Middle East. The Company is continuing to aggressively pursue collection of the receivables underlying the provision, however, the ability for the Company to collect is not certain, and therefore the Company has recorded a provision against the outstanding receivables. Excluding the allowance for doubtful accounts, the reduction in operating expenses for the quarter ended March 31, 2020 compared to the same quarter of the prior year was \$4,303,509. The decrease in operating expenses is primarily related to a decrease in personnel costs of approximately \$1.5 million, a general reduction in facility, travel and other costs, as well as agency fees related to sales under the Company's contracts in the Middle East.

Wages, benefits, and consulting fees (for all departments) include a non-cash expense related to stock options that the Company had previously granted. The six months ended March 31, 2020 had stock option related expenses of \$221,387 compared to \$491,694 in the prior year. This expense is a reflection of the number of options outstanding and their respective exercise prices.

Operating expenses for the six months ended March 31, 2020, decreased \$3,274,057 to \$12,259,813 compared to \$15,533,870 for the prior year's comparative period. The decrease in operating expenses is primarily related to a decrease in personnel costs and agency fees related to deliveries for tenders in the Middle East.

Wages, benefits, and consulting fees (for all departments) include a non-cash expense related to stock options that the Company had previously granted. The six months ended March 31, 2020 had stock option related expenses of \$618,876 compared to \$819,110 in the prior year. This expense is a reflection of the number of options outstanding and their respective exercise prices.

Related Party Transactions

The following is a summary of the Company's compensation to key management personnel.

	Three months ended		Six months ended	
	March 31		March 31	
	2020	2019	2020	2019
Compensation and short-term employee benefits	\$287,411	\$469,758	\$574,673	\$1,111,717
Share-based payments	115,640	140,549	255,200	308,825
Total	\$403,051	\$610,307	\$829,873	\$1,420,542

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

Accounting Standards adopted

IFRS 16, Leases ("IFRS 16")

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for most leases under a single on-balance sheet model. The Company adopted IFRS 16 using the modified retrospective method of adoption with the date of initial application of October 1, 2019. Under this method, the standard is retrospectively applied with the cumulative effect of initially applying the standard recognized at the date of initial application in opening interim condensed consolidated statement of financial position on October 1, 2019.

The adoption of IFRS 16 had the following impacts as at October 1, 2019:

-Right-of-use assets	\$(583,861)
-Lease liabilities	\$3,616,812

The Company elected to use the following practical expedients: a) the transition application practical expedient allowing the standard to only be applied to contracts that were previously identified as leases applying IAS 17, Leases (“IAS 17”); b) the transition application practical expedient to elect to not apply IFRS 16 to leases that expired within 12 months following the adoption date; and, c) the recognition exemption to not apply IFRS 16 to lease contracts for which the underlying asset is of low value.

As of October 1, 2019, the Company recognized lease liabilities in relation to leases, which had previously been classified as operating leases under the principles of IAS 17. These liabilities were measured at the present value of the remaining lease payments and discounted using the incremental borrowing rate as of October 1, 2019 of 4.8%.

Accounting policy

The Company recognizes a right-of-use asset and lease liability at the lease commencement date after the Company assesses whether a contract is, or contains, a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The right-of-use asset is initially measured based on the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received. The assets are depreciated to the earlier of the end of the useful life of the right-of-use asset or the lease term using the straight-line method as this most closely reflects the expected pattern of consumption of the future economic benefits. The lease term includes periods covered by an option to renew if the Company is reasonably certain to exercise that option. Lease terms range from seven to ten years for offices. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the Company’s incremental borrowing rate if the implicit interest rate cannot be readily determined. The liability is subsequently increased by the interest cost associated with the lease and decreased by payments made against the least. If there is a change in future lease payments arising from a change in assessment related to a renewal, or termination, the liability is remeasured as appropriate. The Company has applied judgement to determine the lease term for some lease contract in which it is a lessee in a lease that includes a renewal option. The assessment of whether the Company is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right-of-use assets recognized.

Summary of Quarterly Results and Financial Position

	2020 Second Quarter	2020 First Quarter	2019 Fourth Quarter	2019 Third Quarter	2019 Second Quarter	2019 First Quarter	2018 Fourth Quarter	2018 Third Quarter
Revenue	\$ 5,258,572	\$ 7,948,559	\$ 6,576,601	\$ 6,853,992	\$ 13,312,543	\$ 7,261,486	\$ 6,657,686	\$ 7,933,676
Net income (loss) before amortization and depreciation	(3,332,968)	(881,355)	(3,325,046)	(3,293,735)	20,306	(1,791,878)	(268,687)	2,322,108
Net income (loss)	(3,908,622)	(1,174,733)	(3,515,000)	(3,481,135)	(232,227)	(1,909,411)	(625,082)	2,198,467
Net income (loss) per share	(0.15)	(0.05)	(0.16)	(0.16)	(0.01)	(0.09)	(0.03)	0.09
Cash and cash equivalents	3,850,062	4,115,806	9,575,149	1,144,489	1,811,732	2,569,986	\$5,483,087	\$1,721,427
Net working capital	(6,454,096)	(3,101,402)	4,449,434	(263,689)	6,840,803	6,327,346	10,685,114	10,662,108
Current ratio	0.7	0.9	1.2	1.0	1.5	1.4	2.7	4.8

Revenue of the Company continues to be inherently unpredictable due to our business model and fluctuates from quarter to quarter depending on both the composition of contractual arrangements entered into in each quarter and the timing of completed coating and development services milestones in any period.

Liquidity & Capital Resources

	March 31, 2020	September 30, 2019
Cash and cash equivalents	\$3,850,062	\$9,575,149
Total assets	\$38,725,130	\$39,606,933
Deferred revenue	\$1,033,693	\$598,367

On March 31, 2020, cash and cash equivalents totaled \$3,850,062 compared to \$9,575,149 at September 30, 2019. During the six-month period ended March 31, 2020, the Company had negative cash flow of \$5,725,087.

Accounts receivable at March 31, 2020, decreased \$1,158,142 from the prior year end. The timing of cash flows from customers will continue to be unpredictable due to payment terms which may include upfront advances, payment on shipment as well as standard and extended credit terms. The Company also accepts letters of credit on large transactions which provides more certainty of collection. The Company uses EDC insurance, when appropriate, to allow it to extend credit terms to specific customers.

The Company had an additional \$36,910 assigned as collateral to secure the Company’s credit cards. These funds are expected to be restricted for more than one year and are not included in cash and cash equivalents. As at July 14, 2020, cash, cash equivalents totaled approximately \$3.4 million.

Total assets at March 31, 2020 were \$38,725,130 compared to \$39,606,933 at September 30, 2019. Cash and cash equivalents comprised 10% of total assets at March 31, 2020. The Company’s accounts receivable and inventories are liquid, with collection periods and turnover ratios generally in the 60 to 180 day range. The balance of the Company’s assets are comprised of property, plant and equipment, and the Company’s intangible assets; these have low liquidity but represent much of the intellectual property assets that are used to generate Covalon’s revenue streams.

Deferred revenue increased by \$435,326 to \$1,033,693 at March 31, 2020, compared to \$598,367 at September 30, 2019.

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 short term debt, lease liabilities, and accounts payable and accrued liabilities that are due within a year.

	Carrying amount (\$)	Future cash flows (\$)	Less than 1 year (\$)	Between 1 and 5 years (\$)	Greater than 5 years (\$)
Accounts payable and accrued liabilities	4,012,784	4,012,784	4,012,784	-	-
Debt	7,669,504	7,669,504	7,669,504	-	-
Acquisition note payable	10,536,912	10,714,448	10,714,448	-	-
Lease liability	3,647,488	4,185,448	683,631	2,890,598	611,219
Total	25,866,688	26,582,184	23,080,367	2,890,598	611,219

Related to the fiscal 2019 acquisition of AquaGuard, the Company entered into an Acquisition Note Payable (“Acquisition Note”), with the prior owners of the AquaGuard assets (“Vendor”) pursuant to which a milestone payment of \$2.5m USD became due on October 1, 2019 and a milestone payment of \$5m USD will become due on October 1, 2020. The Company had intended to fund the Acquisition Note milestone payments through the Acquisition Line Facility (“Facility”) with HSBC Bank Canada (“HSBC”).

Consistent with September 30, 2019, as of March 31, 2020, the Company did not meet certain covenants related to the Facility with HSBC under the original Facility agreement; and, subsequent to March 31, 2020 the Company did obtain a waiver from HSBC related to the covenants that were not met as of the quarter end. Management is in continued discussions with HSBC regarding the Company’s acquisition and operating banking credit facility and is working with HSBC to amend the agreement for any covenants that the Company projects it will be unable to meet. Based on discussions to date, the Company continues to believe that it will obtain the necessary amendment in due course; however, no assurance can be provided. Should the Company not be successful in amending the agreement, and or not meet the covenants going forward, the Company would be in default of the Facility and HSBC could request repayment of principal and interest at any time.

Consistent with the prior two quarters, the Company was prohibited from making the first instalment payment of the Acquisition Note using funds made available under the Facility as originally intended in order to meet the commitments to the Vendor. The Company was also unable to use cash on hand to make the payment to the Vendor without being offside on future covenant calculations.

When entering into the purchase and banking agreements described above, the Company, the Vendor, and HSBC entered into a subordination agreement which provides that no Acquisition Note amounts will be due if the Company is in breach of the Facility agreement. The Vendor can only make a claim against the Company for non-payment under the Acquisition Note in accordance with the terms of the subordination agreement. The Acquisition Note, as outlined in the subordination agreement, is unconditionally and irrevocably deferred, postponed and subordinated in all respects until repayment in full has been made to HSBC, and therefore the Vendor currently has no recourse under the subordination agreement.

While the Company believes that based on cash and cash equivalents on hand and amounts available under the HSBC operating line, it has sufficient future cash flow to support its operating needs for the near future, without access to remaining funds from the Facility, the Company may not generate sufficient operating cash flows to be able to repay the Acquisition Note and/or the Facility, should they both become due and payable without refinancing these liabilities, or through the issuance of additional equity of the Company. While the Company does not anticipate the need to raise capital, this may be required.

To address the future payments required the Company: a) is in negotiations with the Vendor to renegotiate the terms of the Acquisition Note which could favorably impact the revised covenant calculations; b) is in negotiations with HSBC to obtain an amendment to give the Company more room on its covenants for future quarters; and, c) continues to look for ways to expand its business, with both new, and existing clients globally.

The Company incurred a net loss of \$5,083,355 for the six-month period ended March 31, 2020 and cash used in operating activities was \$4,548,894 for the same period. Future liquidity and operations of the Company are dependent on the ability to obtain from HSBC and amended covenants for future quarters and achieving profitable commercial operations. The Company has not yet amended covenants that will provide relief on debt covenants in future quarters.

As of March 31, 2020, the Company had \$3.9m of cash and cash equivalents (\$9.6m – September 2019) and intends to operate its business and satisfy its obligations as they come due in the ordinary course of business.

COVID-19

In March 2020, the World Health Organization characterized the outbreak of the novel strain of coronavirus, specifically identified as COVID-19, as a global pandemic. In response to the outbreak, governmental authorities in Canada and internationally have introduced various recommendations and measures to try to limit the pandemic, including travel restrictions, border closures, non-essential business closures, quarantines, self-isolations, shelters-in-place, and social distancing. The governmental responses have caused material disruption to business globally, economic slowdowns, and shifts in economic markets. The significant uncertainty related to the virus, and the governmental responses, has negatively impacted the Company's suppliers, as well as customers and their demand for our products and services.

Subsequent to March 31, 2020, the Company applied for and was approved for a United States Paycheck Protection loan totaling USD\$1,103,861 from the US Small Business Administration under the US Paycheck Protection Program. The Loan will be forgiven if certain conditions are met, and otherwise carries interest

of 1% and will be repayable over a two-year term. The Company also applied and was approved for funding of CAD\$256,106 to date under the Canadian Emergency Wage Subsidy Program. Both programs are expected to be reflected in the Company's third quarter financial statements.

The duration and impact of the COVID-19 outbreak is unknown at this time. It is not possible to reliably estimate the length and severity of these developments or quantify the impact this pandemic may have on the financial results and condition of the Company in future periods.

Shareholder's Equity

Common Shares

The Company is authorized to issue an unlimited number of common shares with no par value (the "Common Shares"). As at March 31, 2020, the Company had a total of 25,818,677 Common Shares issued and outstanding.

As of the date of this MD&A, the Company had the following securities outstanding:

Security Type	Number Outstanding
Common Shares	25,818,677
Options	1,740,663
Warrants	3,025,447

Sources and Uses of Cash

	Six months ended March 31,	
	2020	2019
Cash flows used in operating activities	(4,548,894)	(3,794,246)
Cash flows used in investing activities	(248,922)	(6,424,907)
Cash flows from financing activities	(1,229,009)	6,616,463

Operating Activities

Cash used in operating activities for the quarter ended March 31, 2020 was \$4,548,894, compared to \$3,794,246 used for the prior year's comparative period. Non-cash working capital used \$1,111,514 of cash during the period ended March 31, 2020, compared cash used of \$3,180,149 in the prior year. At March 31, 2020, accounts receivable decreased by \$1,158,142 over September 30, 2019, due mainly to the timing of shipments and the granting of credit terms to key customers. The Company also accepts letters of credit on large transactions which provides more certainty of collection. The Company continues to insure certain receivables with EDC, allowing the Company to extend credit terms on select occasions.

Investing Activities

Investing activities comprise expenditures on general office furniture, lab equipment, investing cash, and expenditures on intangible assets relate to filing and maintaining patents and trademarks.

Financing Activities

During the period ended March 31, 2020 the Company repaid \$765,000 against the banking facilities used to facilitate the initial payments of the AquaGuard acquisition and to fund working capital.

Financial Instruments

The Company is subject to interest rate risk on its cash, cash equivalents and debt. The Company believes that interest rate risk is low due to market based variable interest rate. The Company has floating rate debt to fund the acquisition described in the financial statements and to fund working capital.

The Company is exposed to currency risk arising from fluctuations in foreign exchange rates and the degree of volatility in those rates. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

Risks and Uncertainties

There are numerous and varied risks, both known and unknown, that may prevent the Company from achieving its goals. An investor should carefully consider the risks described in this document, the financial statements, and any other publicly available information from the Company. If any of the risks mentioned below, or other risks that are not mentioned below, are realized it is likely that Covalon's operations, financial condition, and overall business will see a material adverse effect. The risks and uncertainties described in this document contain forward-looking statements and our actual results may differ.

Without limiting the foregoing, the following risks are discussed in more detail:

Covalon faces risks related to the COVID-19 pandemic and related government responses.

The Company's business and its financial condition may be adversely impacted by the effects of COVID-19 and other infectious diseases. The extent to which COVID-19 and other infectious diseases may impact the Company's business, operations, financial condition and the market for its securities will depend on future developments and government responses, which are highly uncertain and cannot be predicted. These include the duration, severity and scope of the outbreak and the actions taken by governmental entities to address and mitigate the pandemic. The Company's business and operations could be adversely affected by the continued global spread of COVID-19 and any governmental actions to slow the spread of the infectious disease. Areas that may be impacted include, without limitation, workforce productivity and health, disruptions to supply chains, limitations on travel, a decreased in demand for the Company's products as elective surgeries are postponed, and the inability of our sales force, and distribution partners, to access hospitals, health care institutions, or facilities which may have a material negative impact on our ability to sell and market products. While the effects of COVID-19 are expected to be temporary, the duration of any potential business disruptions and related financial impact cannot be reasonably estimated at this time. The extent to which COVID-19 will impact the Company's will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of COVID-19 and actions or government mandated directives to contain COVID-19 or treat its impact, among others.

Leverage, Liquidity and Restrictive Covenants.

Our ability to meet our debt-services requirements will depend on our ability to generate cash in the future, which depends on many factors, including our financial performance, working capital and future capital-expenditure requirements. The Facility contains restrictive covenants that may limit the discretion of management with respect to certain business matters and capital allocation decisions, including, for example, any prospective return of capital to shareholders through dividends or share repurchases. In addition, our ability to borrow funds in the future may depend on the satisfaction of the covenants contained in the Facility. A failure to comply with any covenants or obligations under the Facility could result in a default, which, if not cured or waived, could result in the acceleration of the relevant indebtedness. If such indebtedness were to be accelerated, there can be no assurance that our assets would be sufficient to repay such indebtedness in full. There can also be no assurance that we will generate cash flow in amounts sufficient to pay outstanding indebtedness or to fund any other liquidity needs. If the amounts become repayable due to an inability to comply with covenants, or if we are unable to extend the terms of the facilities at time of renewal, the loss of the credit facilities could have an adverse effect on our business.

Consistent with September 30, 2019, as of March 31, 2020, the Company did not meet certain covenants related to the Facility with HSBC and, subsequent to March 31, 2020 the Company did obtain a waiver from HSBC related to the covenants that were not met as of the quarter end. As a result, the Company was prohibited from making the first instalment payment of the Acquisition Note using funds made available under the Facility as originally intended in order to meet the commitments to the Vendor. The Company was also unable to use cash on hand to make the payment to the Vendor without being offside on future covenant calculations.

When entering into the purchase and banking agreements described above, the Company, the Vendor, and HSBC entered into a subordination agreement which provides that no Acquisition Note amounts will be due if the Company is in breach of the Facility agreement. The Vendor can only make a claim against the Company for non-payment under the Acquisition Note in accordance with the terms of the subordination agreement. The Acquisition Note, as outlined in the subordination agreement, is unconditionally and irrevocably deferred, postponed and subordinated in all respects until repayment in full has been made to HSBC, and therefore the Vendor currently has no recourse under the subordination agreement.

While the Company believes that based on cash and cash equivalents on hand and amounts available under the HSBC operating line, it has sufficient future cash flow to support its operating needs for the near future, without access to remaining funds from the Facility, the Company may not generate sufficient operating cash flows to be able to repay the Acquisition Note and/or the Facility, should they both become due and payable without refinancing these liabilities, or through the issuance of additional equity of the Company. While the Company does not anticipate the need to raise capital, this may be required. Management is in continued discussions with HSBC regarding the Company's acquisition and operating banking credit facility and is working with HSBC to amend the agreement for any covenants that the Company projects it will be unable to meet. Based on discussions to date, the Company continues to believe that it will obtain the necessary amendment in due course; however, no assurance can be provided. Should the Company not be successful in amending the agreement, and or not meet the covenants going forward, the Company would be in default of the Facility and HSBC could request repayment of principal and interest at any time.

To address the future payments required the Company: a) is in negotiations with the Vendor to renegotiate the terms of the Acquisition Note which could favorably impact the revised covenant calculations; b) is in negotiations with HSBC to obtain an amendment to give the Company more room on its covenants for future quarters; and, c) continues to look for ways to expand its business, with both new, and existing clients globally. The Company incurred a net loss of \$5,083,355 for the six-month period ended March 31, 2020 and cash used in operating activities was \$4,548,894 for the same period. Future liquidity and operations of the Company are dependent on the ability to obtain from HSBC amended covenants for future quarters and achieving profitable commercial operations.

There is no guarantee that the Company will be able to maintain compliance with any future amended covenants under the Facility or that the Company will be able to renegotiate the terms of the Acquisition Note.

Covalon may not be able to correctly estimate future operating expenses, leading to cash shortfalls.

Covalon's operating expenses may fluctuate significantly in the future as a result of a variety of factors, many of which are outside of our control. These factors may include, but not be limited to:

- the time and resources required to develop, test, perform clinical assessments, and obtain or maintain regulatory approvals for our products;
- the costs to attract and retain personnel with the skills required for effective operations; or,
- the costs of preparing, filing, prosecuting, defending and enforcing patent claims and other patent related costs, including litigation costs and the results of such litigation.

If we do not accurately predict our operating expenses, we may not allocate resources appropriately, which could lead to cash shortfalls and force us to seek additional capital or curtail other projects or initiatives, all of which could have a significant negative effect on our business, results of operations and financial condition.

Covalon stock price may be volatile, which could result in substantial losses for investors.

The market price of our common stock is likely to be highly volatile and could fluctuate widely in response to various factors, many of which are beyond our control, including the following:

- technological innovations or new products and services by us or our competitors;
- additions or departures of key personnel;
- sales of our common stock, particularly under any registration statement for the purposes of selling any securities, including management shares;
- our ability to execute our business plan;
- the uncertainty regarding whether we will continue to generate sufficient revenues;
- operating results that fall below expectations;
- loss of any strategic relationship;
- industry developments;
- economic and other external factors; and
- period-to-period fluctuations in our financial results.

In addition, the securities markets have from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These market fluctuations may also significantly affect the market price of our common stock.

Covalon has not yet achieved consistent profitability year to year.

Covalon had a net loss for the period ended March 31, 2020, of \$5,083,355 and a net loss of \$9,137,773 for the year ended September 30, 2019. There is no guarantee that Covalon will be able to consistently achieve profitability in the future. Covalon has never paid a dividend on its common shares and does not expect to do so in the foreseeable future. Covalon's business and prospects must be considered in light of the risks, expenses, and difficulties frequently encountered by companies in new and rapidly evolving markets such as healthcare.

Control of our principal shareholders may impact Covalon's business and other matters.

Abe Schwartz, Covalon's Chairman, beneficially owns, controls, or directs an aggregate of 8,160,912 Common Shares (approx. 32% of the presently issued and outstanding Common Shares). The Goldfarb Corporation and its affiliates collectively beneficially own, control, or direct 4,077,063 Common Shares (approx. 16% of the presently issued and outstanding Common Shares). The principal shareholders own a sufficient number of Common Shares that they can effectively control substantially all of the actions taken by shareholders of the Company, including the election of directors and declaration of dividends. Such concentration of ownership could have the effect of delaying, deterring or preventing a change of control of the Company that might otherwise be beneficial to its shareholders and may discourage acquisition bids for the Company or limit the amount certain investors may be willing to pay for the Common Shares.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about Covalon's business, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. Although we currently do not have research coverage by securities and industry analysts, you should not invest in our common stock in anticipation that we will increase such coverage. If one or more analysts covering us at any given time downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If analysts cease coverage of us or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

Offers or availability for sale of a substantial number of shares of our common stock may cause the price of our common stock to decline.

Sales of a significant number of common shares could harm the market price of our common shares and make it more difficult for us to raise funds through future offerings of common shares. As additional shares of Covalon's common stock become available for resale in the public market, the supply of our common shares will increase, which could decrease the price of our common stock. In addition, if our shareholders sell substantial amounts of our common stock in the public market, or upon the exercise of outstanding options or warrants, it could create a circumstance commonly referred to as an "overhang," in anticipation

of which the market price of our common shares could fall. The existence of an overhang, whether or not sales have occurred or are occurring, could also make it more difficult for us to raise additional financing through the sale of equity or equity-related securities in the future at a time and price that we deem reasonable or appropriate.

Covalon may require additional capital in order to execute the Company's goals and objectives.

Covalon's goals and strategy will result in the increasing of our fixed costs. As a result of the time delay between outlays for working capital expenditures, such as costs to acquire rights to additional products, the hiring of personnel, marketing costs, the purchasing of inventory, and the collection of revenue, we expect to have a net cash outflow from operating activities as a result of these expenditures. Future results of operations involve significant risks and uncertainties, some of which are discussed in this document. In order to complete our future growth strategy, additional equity and/or debt financing may be required. If we are unable to raise additional capital or if we encounter circumstances that place unforeseen constraints on capital resources, we will be required to take even stronger measures to conserve liquidity, which may include, but are not limited to, eliminating all non-essential positions and ceasing all marketing efforts. We would have to curtail business development activities and suspend the pursuit of our business plan. There can be no assurance that we will be successful in improving revenues, reducing expenses, or securing additional capital both in sufficient amounts and on favorable terms.

Covalon's strategic business plan may not produce the intended revenue and income growth.

Covalon's growth goals rely on a strategy that includes making large investments in sales, marketing, product research, and controlling expenses. If we do not achieve the expected benefits from these investments, or otherwise fail to execute on our strategic initiatives, we may not achieve the growth we are targeting which could adversely affect our operations and financial position.

Covalon's acquisition strategy may not produce the intended growth in revenue and operating income.

As part of Covalon's strategy for growth, we may make acquisitions and enter into strategic alliances such as joint ventures or development agreements. These strategies may be subject to the availability of funds to the Company through operating cash flows, debt facilities, or equity raises. Covalon may not be able to identify suitable acquisition candidates, complete acquisitions, integrate acquisitions successfully, or our strategic alliances may not prove to be successful. Such acquisitions could reduce shareholders' ownership, cause us to incur debt, expose us to liabilities and result in amortization expenses related to intangible assets with definite lives. In addition, acquisitions involve other risks, including diversion of management resources otherwise available for ongoing development of our business and risks associated with entering new markets with which we have limited experience or where distribution alliances with experienced distributors are not available. Our future profitability may depend in part upon our ability to further develop our resources to adapt to these new products or business areas and to identify and enter into satisfactory distribution networks. Moreover, we may fail to realize the anticipated benefits of any acquisition as rapidly as expected, if at all, or the acquired business may not perform in accordance with our expectations. We may also incur significant expenditures in anticipation of an acquisition that is never realized. There can be

no assurance that difficulties encountered in connection with acquisitions will not have a material adverse effect on our business, financial condition and results of operations.

Covalon is dependent on significant customers.

A large portion of Covalon's revenue has been generated from a limited number of clients. Covalon has increased the number of customers over the prior periods, while we believe that an increase in revenue will correspond to an increase in customers it is not always the case. During the year Covalon entered tenders to bid on various contracts associated with a significant amount of revenue to Covalon. The certainty of the contracts being awarded to Covalon is uncertain, but this would further increase the concentration of revenue associated to individual customers. The loss of any of our significant customers would have a significant negative effect on our overall operations.

It may be difficult to replace some of Covalon's suppliers.

In general, raw materials essential to our businesses are readily available from multiple sources. However, for reasons of quality assurance, availability, or cost effectiveness, certain components and raw materials are available only from a sole supplier. Covalon works with contract manufacturers, in various capacities, to produce salable products. In order to mitigate any potential negative effects, Covalon works to ensure that inventory levels of both raw materials and finished products are at an adequate level for future forecasts. However, there is no guarantee that our inventory will be sufficient to carry us through any periods of turmoil. Covalon has no direct control over third-party suppliers and therefore interruptions or delays, in the products and services provided, may be difficult to remedy in a timely fashion. In addition, if such suppliers are unable or unwilling to deliver the necessary raw materials or products, we may be unable to redesign or adapt our technology to work without such raw materials or products or find alternative suppliers or manufacturers. In such events, we could experience interruptions, delays, increased costs, or quality control problems and all of these would likely have a materially adverse effect on our business and operations.

Any failure to obtain or protect intellectual property could adversely affect Covalon.

Covalon's success depends, in part, on its ability to obtain patents, or licenses to patents, maintain trade secret protection, and enforce its rights against others. Covalon has filed and is actively pursuing patent applications in Canada, the United States, and other global jurisdictions. Covalon may not be able to obtain patent protection for key elements of its technology.

There can be no assurance that:

- patent applications will result in the issuance of patents;
- additional proprietary products developed will be suitably protected from infringement;
- patents issued will provide adequate protection or any competitive advantages;
- patents will not be successfully challenged by any third parties; and,
- patents of others will not impede Covalon's ability to commercialize its technology.

Covalon may need to obtain licenses for the development of its products. Licenses may not be available on satisfactory terms or at all. If available, these licenses may obligate Covalon to exercise diligence in bringing its technology to market and may obligate Covalon to make minimum guarantees or milestone payments. These guarantees and milestone payments may be costly and could seriously harm Covalon's business. Covalon may also be obligated to make royalty payments on the sales, if any, of products resulting from licensed technology, and may be responsible for the costs of filing and prosecuting patent applications. These costs could affect Covalon's results of operations and decrease its earnings.

Covalon's intellectual property includes trade secrets and know-how that may not be protected by patents. There can be no assurance that Covalon will be able to protect its trade secrets. To help protect its rights, Covalon requires employees, consultants, advisors, and collaborators to enter into confidentiality agreements. These agreements may not adequately protect Covalon's trade secrets, know-how, or other proprietary information in the event of any unauthorized use or disclosure.

Covalon competes in a highly competitive industry against large multinational competitors, and new market entrants.

Competition from other companies, research facilities, and academic institutions is intense and Covalon expects it will only intensify further. In addition to competing with universities and other research institutions in the development of products, technologies and processes, we compete with other companies in acquiring rights to products or technologies from those institutions. A number of factors may limit the market acceptance of our products, including the timing of regulatory approvals and market entry relative to competitive products, the availability of alternative products, the price of our products relative to alternative products, the availability of third party reimbursement and the extent of marketing efforts by third party distributors or agents that we retain. There can be no assurance that our products will receive market acceptance in a commercially viable period of time, if at all. Furthermore, there can be no assurance that we can develop products that are more effective or achieve greater market acceptance than competitive products, or that our competitors will not succeed in developing or acquiring products and technologies that are more effective than those being developed by us, that would render our products and technologies less competitive or obsolete. Our competitors enjoy several competitive advantages over us, including some or all of the following:

- large and established distribution networks;
- greater financial, managerial and other resources for products research and development, sales and marketing efforts and protecting and enforcing intellectual property rights;
- greater name recognition;
- more expansive portfolios of intellectual property rights;
- established relations with physicians, hospitals, other healthcare providers and third party payors;
- products which have been approved by regulatory authorities for use in the U.S. or Europe, supported by long-term clinical data; and
- greater experience in obtaining and maintaining regulatory approvals or clearances from regulatory agencies.

Our competitors' products will compete directly with our products. In addition, our competitors as well as new market entrants may develop or acquire new treatments, products or procedures that will compete directly or indirectly with our products. The presence of this competition in our market may lead to pricing pressure which would make it more difficult to sell our products at a price that will make us profitable or prevent us from selling our products at all. Our failure to compete effectively would have a material and adverse effect on our business, results of operations and financial condition.

Covalon's development programs, and products subject it to the risk of product liability claims, for which Covalon may not be able to obtain adequate insurance coverage.

Medical devices involve the risk of product liability claims and associated adverse publicity. Covalon's principal risks relate to the sales of its products and currently their use in clinical trials. Claims may be made by consumers, healthcare providers, third party strategic collaborators, or others selling Covalon's products. There can be no assurance that Covalon will be able to obtain or maintain sufficient and affordable

insurance coverage for any of these claims. Without sufficient coverage any claim, any threat of such a claim, or any product withdrawal could seriously harm Covalon's business.

Some of Covalon's existing and potential future products will require regulatory approval before they can be marketed and sold to customers.

Inherent in the development of new medical products is the potential for delay because product testing, including clinical evaluation, is required before most products can be approved for human use. As Covalon has worldwide sales there are various requirements depending on regions and governing bodies. Though the process differs by location, outlined below are some of the potential issues and pathways with respect to the FDA of the United States as an example.

With respect to medical devices, such as those that we manufacture and licence, before a new medical device, or a new use of, or claim for, an existing product can be marketed, unless it is a Class I device, it must first receive either premarket clearance under Section 510(k) of the Federal Food, Drug and Cosmetic Act or premarket approval from the FDA, unless an exemption applies. In the 510(k) clearance process, the FDA must determine that the proposed device is "substantially equivalent" to a device legally on the market, known as a "predicate" device, with respect to intended use, technology and safety and effectiveness to clear the proposed device for marketing. Clinical data is sometimes required to support substantial equivalence. The premarket approval pathway requires an applicant to demonstrate the safety and effectiveness of the device for its intended use based, in part, on extensive data including, but not limited to, technical, preclinical, clinical trial, manufacturing and labeling data. The premarket approval process is typically required for devices that are deemed to pose the greatest risk, such as life sustaining, life-supporting or implantable devices. Both the 510(k) and premarket approval processes can be expensive and lengthy and entail significant user fees.

Failure to comply with applicable regulatory requirements can result in, among other things, suspensions or withdrawals of approvals or clearances, seizures or recalls of products, injunctions against the manufacture, holding, distribution, marketing and sale of a product, civil and criminal sanctions. Furthermore, changes in existing regulations or the adoption of new regulations could prevent us from obtaining, or affect the timing of, future regulatory approvals. Meeting regulatory requirements and evolving government standards around the world may delay marketing of our new products for a considerable period of time, impose costly procedures upon our activities and result in a competitive advantage to larger companies that compete against us. We cannot assure you that the FDA, or other regulatory agencies, will approve any products developed by us, on a timely basis, if at all; or, if granted, that approval will not entail limiting the indicated uses for which we may market the product, which could limit the potential market for any of these products.

Covalon may incur substantial costs as a result of litigation or other proceedings relating to patent and other intellectual property rights.

Covalon's future success and competitive position depends, in part, on its ability to obtain and maintain certain proprietary intellectual property rights used in its principal products. Any such success may be achieved in part by prosecuting claims against others who Covalon believes are infringing its rights, and by

defending claims of intellectual property infringement brought by its competitors and others. Covalon's involvement in intellectual property litigation could result in significant expenses adversely affecting the development of product candidates, sales of the challenged products, or sales of intellectual property. The litigation would also divert the efforts of Covalon's technical and management personnel whether or not such litigation is resolved in Covalon's favour. Some of Covalon's competitors may be able to sustain the costs of complex patent litigation more effectively than Covalon can because they have substantially greater resources. Uncertainties resulting from the initiation, and continuation, of any litigation could affect Covalon's ability to continue its operations.

In the event of an adverse outcome as a defendant in any such litigation, Covalon may, among other things, be required to:

- pay substantial damages;
- cease the development, manufacture, use, or sale of product candidates or products that infringe upon the intellectual property of others;
- expend significant resources to design around a patent, to develop, or acquire non-infringing intellectual property;
- discontinue processes incorporating infringing technology; and,
- obtain licenses to the infringed intellectual property.

If third-parties file patent applications or are issued patents claiming technology also claimed by Covalon in pending applications, Covalon may be required to participate in interference proceedings with the United States Patent and Trademark Office (or other proceedings outside the United States). The proceedings may include oppositions to determine priority of invention, or patentability which could result in substantial cost to Covalon even if the eventual outcome were favourable.

Covalon or its clients are frequently required to receive regulatory approval for each of Covalon's product candidates before they can be sold commercially in North America, or internationally, which can take significant time and be very costly.

The development, manufacture, and sale of both medical devices and human therapeutic products in Canada, the United States, and internationally is governed by a variety of statutes and regulations.

These laws require, among other things:

- approval of manufacturing facilities and practices;
- adequate and well-controlled research and testing of products in pre-clinical and clinical trials;
- review and approval of submissions containing manufacturing, pre-clinical and/or clinical data in order to obtain marketing approval based on establishing the safety and efficacy of the product for each use sought including adherence to good manufacturing practices during production and storage; and,
- control of marketing activities, including advertising and labelling.

Some product candidates currently under development by Covalon will require significant development, pre-clinical and clinical testing, pre-market review and approval, and investment of significant funds prior to their commercialization. The process of completing clinical testing and obtaining such approvals (if

required) is likely to take many years and require the expenditure of substantial resources. Covalon does not know whether any clinical studies will be successful, if regulatory approvals will be received, or if regulatory approvals will be obtained in a timely manner. Despite the time and resources expended by Covalon regulatory approval is never guaranteed.

Covalon's future success depends upon market acceptance of our existing and future products.

Covalon believes that our success will depend in part upon the acceptance of our existing and future products by the medical community, hospitals, physicians, other health care providers, and end-users. Such acceptance may depend upon the extent to which the medical community and end-users perceive our products as safer, more effective, technologically advanced, or cost-competitive than other similar products. For our new products to gain general market acceptance, it may also be necessary for us to develop marketing partners for the distribution of our products. There can be no assurance that our new products will achieve significant market acceptance on a timely basis, if at all. Failure of some or all of our future products to achieve significant market acceptance could have a material adverse effect on our business, financial condition, and results of operations.

Even if some of Covalon's products and manufacturing facilities receive regulatory approval those products and facilities may still face subsequent regulatory difficulties.

If Covalon receives regulatory approval to sell any of its products, regulatory agencies will limit the approval to certain diseases, conditions, or categories of patients who can use them. In addition, regulatory agencies subject a marketed product, its manufacturer, and the manufacturer's facilities to ongoing regulatory requirements. Regulatory agencies may also require expensive post-approval studies. Any adverse effects associated with Covalon's products must also be reported to regulatory authorities. If new data are developed, previously unknown adverse experiences with a product occur, deficiencies in Covalon's manufacturing and laboratory facilities are discovered, or Covalon fails to comply with applicable post-market regulatory requirements a regulatory agency may impose restrictions on that product or on Covalon. These may include the requirement to withdraw the product from the market; close the facility; suspend manufacturing; change the product's labels; or, pay substantial fines.

Covalon cannot determine what effect changes in regulations or legal interpretations by the various regulatory bodies or the courts, when and if promulgated or issued, may have on our business in the future. Changes could, among other things, require different labeling, monitoring of patients, interaction with physicians, education programs for patients or physicians, curtailment of necessary supplies, or limitations on product distribution. These changes, or others required by a regulatory body could have an adverse effect on the sales of these products. The evolving and complex nature of regulatory science and regulatory requirements, the broad authority and discretion of the regulatory bodies and the generally high level of regulatory oversight results in a continuing possibility that from time to time, we will be adversely affected by regulatory actions despite ongoing efforts and commitment to achieve and maintain full compliance with all regulatory requirements.

Modifications to Covalon's current products may require new marketing clearances or approvals or require Covalon to cease marketing or recall the modified products until such clearances or approvals are obtained.

Any modifications made to a product that has previously been cleared by a regulatory body could significantly affect its safety, effectiveness, or intended use would likely require clearance with the regulatory authorities. As an example, the FDA requires every manufacturer to make its own determination as to whether a modification requires a new 510(k) clearance or premarket approval, but the FDA may review and disagree with any decision reached by the manufacturer. In the future, Covalon may make additional modifications to our products after they have received FDA clearance or approval and, in appropriate circumstances, determine that new clearance or approval is unnecessary. Regulatory authorities may disagree with our past or future decisions not to seek new clearance or approval and may require us to obtain clearance or approval for modifications to our products. If that were to occur for a previously cleared or approved product, we may be required to cease marketing or recall the modified device until we obtain the necessary clearance or approval. Under these circumstances, we may also be subject to significant regulatory fines or other penalties. If any of the foregoing were to occur, our financial condition and results of operations could be negatively impacted.

Covalon is dependent on proprietary know-how.

Our manufacturing know-how as to mixing, coating and cross-linking may be able to be duplicated, even if it is difficult to do so. There is no assurance that, should we apply for intellectual property protection for our intellectual property, we would be able to obtain such protection. Further, with the international nature of our business there are no guarantees that even if Covalon is granted protection for intellectual property, that it would be legally enforceable around the world. Therefore, our competitors may develop or market technologies that are more effective or more commercially attractive than ours.

We also rely on trade secret protection to protect our interests in proprietary know-how and for processes for which patents are difficult to obtain or enforce. We may not be able to protect our trade secrets adequately. In addition, we rely on non-disclosure and confidentiality agreements with employees, consultants and other parties to protect, in part, trade secrets and other proprietary technology. These agreements may be breached, and we may not have adequate remedies for any breach. Moreover, others may independently develop equivalent proprietary information, and third parties may otherwise gain access to our trade secrets and proprietary knowledge. Any disclosure of confidential data into the public domain or to third parties could allow competitors to learn our trade secrets and use the information in competition against us.

Despite our efforts to protect our proprietary rights, there is no assurance that such protections will preclude our competitors from developing and/or marketing similar products. While we are not aware of any third party intellectual property that would materially affect our business, our failure or inability to obtain patents and protect our proprietary information could result in our business being adversely affected.

Covalon's products risk exposure to product liability claims.

Covalon is, and expects to increasingly be, exposed to potential product liability risks, which are inherent in the testing, manufacturing and marketing of such products. It is likely we will be contractually obligated, under any distribution agreements that we enter into with respect to products we sell, to indemnify the individuals and/or entities that distribute our products against claims relating to the manufacture and sale of products distributed by such distribution partners. This indemnification liability, as well as direct liability to consumers for any defects in the products sold, could expose us to substantial risks and losses. While we have obtained product liability insurance, there can be no assurance that we will be able to maintain such insurance on acceptable terms or that such insurance will provide adequate coverage against potential liabilities. As we begin to sell and distribute our new line of proprietary products, we intend to increase the limits of our product liability insurance. A successful product liability claim or series of claims brought against us could result in judgments, fines, damages and liabilities that could have a material adverse effect on our business, financial condition and results of operations. We may incur significant expense investigating and defending these claims, even if they do not result in liability. Moreover, even if no judgments, fines, damages or liabilities are imposed on us, our reputation could suffer, which could have a material adverse effect on our business, financial condition and results of operations.

Covalon may face intellectual property infringement claims that could be time-consuming, costly to defend and could result in our loss of significant rights and, in the case of patent infringement claims, the assessment of treble damages.

On occasion, we may receive notices of claims of our infringement, misappropriation or misuse of other parties could result in our loss of significant rights and, in the case of patent infringement claims, the assessment of treble damages. We may also initiate claims to defend our intellectual property. Intellectual property litigation, regardless of its outcome, is expensive and time-consuming, could divert management's attention from our business and have a material negative effect on our business, operating results or financial condition. In addition, the outcome of such litigation may be unpredictable. If there is a successful claim of infringement against us, we may be required to pay substantial damages—including treble damages if we were to be found to have willfully infringed a third party's patent—to the party claiming infringement, and to develop non-infringing technology, stop selling our products or using technology that contains the allegedly infringing intellectual property or enter into royalty or license agreements that may not be available on acceptable or commercially practical terms, if at all. Our failure to develop non-infringing technologies or license the proprietary rights on a timely basis could harm our business. In addition, modifying our products to exclude infringing technologies could require us to seek re-approval or clearance from various regulatory bodies for our products, which would be costly and time consuming. Also, we may be unaware of pending patent applications that relate to our technology. Parties making infringement claims on future issued patents may be able to obtain an injunction that would prevent us from selling our products or using technology that contains the allegedly infringing intellectual property, which could harm our business.

Covalon's success is partly dependent on its partners' success and the relationship with partners is governed by contracts.

Covalon is reliant on partners to execute certain key business processes. If its partners do not perform to Covalon's expectations, Covalon may be unable to enforce a change due to contractual terms. This may significantly impact Covalon's ability to generate revenues and profits.

Examples of such issues include:

- Outsourced manufacturing production may not be achieved within Covalon's timelines;
- Production quality measures may not be achieved;
- Sales expectations are not achieved; and,
- New products are not launched expeditiously.

If Covalon is not able to establish and maintain successful arrangements with third parties or successfully build our own sales and marketing infrastructure, we may not be able to commercialize our products, which would adversely affect our business and financial condition.

We are currently expanding our sales and marketing capabilities. To commercialize our products, we must continue to develop our own sales, marketing and distribution capabilities, which will be expensive and time consuming, or make arrangements with third parties to perform these services for us. The third parties may not be capable of successfully selling any of our products. We will have to commit significant resources to developing a marketing and sales force and supporting distribution capabilities. If we decide to enter into arrangements with third parties for performance of these services, we may find that they are not available on terms acceptable to us, or at all.

Covalon and our manufacturers will be required to comply with current good manufacturing practices and could be subject to suspensions or product withdrawals if found non-compliant.

The FDA regulates the facilities, processes and procedures used to manufacture and market medical products in the U.S. Manufacturing facilities must be registered with the FDA and all products made in such facilities must be manufactured in accordance with "current good manufacturing practices," or cGMP, regulations enforced by the FDA. Compliance with cGMP regulations requires the dedication of substantial resources and requires significant expenditures. The FDA periodically inspects the manufacturing facilities of our subcontractors and procedures to assure compliance. The FDA may cause a suspension or withdrawal of product approvals if regulatory standards are not maintained. In the event an approved manufacturing facility for a particular drug or medical device is required by the FDA to curtail or cease operations, or otherwise becomes inoperable, or a third party contract manufacturing facility faces manufacturing problems, obtaining the required FDA authorization to manufacture at the same or a different manufacturing site could result in product delay, which could adversely affect our business, results of operations, financial condition and cash flow.

Healthcare policy changes, including recent laws to reform the U.S. healthcare system, may have a material adverse effect on Covalon.

Covalon operates around the world but a significant portion of business is dependent on the United States. There have been, and continue to be, proposals by legislators, regulators, and third-party payors to keep healthcare costs down. Certain proposals, if passed, would impose limitations on the prices we will be able to charge for our products, or the amounts of reimbursement available for our products from governmental agencies or third-party payors. These limitations could have a material adverse effect on our financial position and results of operations. Various healthcare reform proposals have emerged at the federal and state levels. We cannot predict the exact effect newly enacted laws, or any future legislation or regulation will have on us. However, the implementation of new legislation and regulation may lower reimbursements for our products, reduce medical procedure volumes and adversely affect our business, possibly materially. In addition, the enacted excise tax may materially and adversely affect our operating expenses and results of operations.

If Covalon fails to hire and retain key management, scientific, and technical personnel it may be unable to successfully implement its business plan.

Covalon is highly dependent on its senior management, and its scientific and technical personnel for both their domain knowledge and technical expertise. The competition for qualified personnel in the healthcare field is intense and Covalon relies heavily on its ability to attract and retain qualified managerial, scientific, and technical personnel. Covalon's ability to manage growth effectively will require continued implementation and improvement of its management systems and the ability to recruit and train new employees. To obtain and retain the high quality of employee which Covalon desires will also come with potentially large expenditures. Covalon may not be able to successfully attract and retain skilled and experienced personnel which could harm its ability to develop products and generate revenues. If Covalon is unable to retain key employees, or hire quality candidates, this could have a material adverse effect.

There are inherent limitations in all control systems, and misstatements due to error or fraud may occur and not be detected.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints and the benefit of controls must be relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, in our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Further, controls can be circumvented by individual acts of some persons, by collusion of two or more persons, or by management override of the controls. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, a control may be inadequate because of changes in conditions, such as growth of the company or increased transaction volume, or the degree of compliance with the policies or procedures may deteriorate. Because of inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

In addition, discovery and disclosure of a material weakness, by definition, could have a material adverse impact on our financial statements. Such an occurrence could discourage certain customers or suppliers from doing business with us, cause downgrades in our future debt ratings leading to higher borrowing costs and affect how our stock trades. This could in turn negatively affect our ability to access public debt or equity markets for capital.

There are risks associated with any future acquisitions.

We may encounter difficulties completing or integrating our future acquisitions which could adversely affect our operating results. We expect to expand our presence in the United States hospital market, new end-markets and expand our capabilities, some of which may occur through acquisitions. These transactions may involve acquisitions of entire companies and/or acquisitions of selected assets of companies.

Potential difficulties related to our acquisitions include:

- integrating acquired operations, systems and businesses;
- retaining customer, supplier, employee or other business relationships of acquired operations;
- addressing unforeseen liabilities of acquired businesses;
- limited experience with new technologies; and
- not achieving anticipated business volumes.

Any of these factors could prevent us from realizing the anticipated benefits of an acquisition, including additional revenue, operational synergies and economies of scale. Our failure to realize the anticipated benefits of acquisitions could adversely affect our business and operating results. Our failure to support the carrying value of goodwill and intangible assets in periods subsequent to the acquisitions could require write-downs that adversely affect our operating results.

Inability to Successfully Integrate or to Attain the Expected Benefits from AquaGuard Acquisition.

In October 2018, we completed the acquisition of AquaGaurd, a Seattle, Washington-based division of medical technologies company Cenorin, LLC. The benefits we expect to achieve as a result of the acquisition of AquaGuard will depend, in part, on our ability to realize anticipated growth opportunities. There can be no assurance that our management will be able to fully realize the expected benefits of the acquisition of AquaGuard. Even if we are able to integrate the AquaGuard business and operations successfully, this integration may not result in the realization of the full benefits of the growth opportunities we currently expect within the anticipated time frame or at all.

Our ability to realize the anticipated benefits of our recent acquisition depends in part on successfully consolidating functions and integrating operations, procedures, systems, and personnel of our businesses in a timely and efficient manner, as well as on the ability to realize the anticipated growth, cross-selling opportunities and potential synergies from integrating operations. There is no assurance that improved operating results will be achieved as a result of growth or acquisition or that our businesses will be successfully integrated in a timely manner.

International Financial Reporting Standards

Standards, Amendments and Interpretations Not Yet Effective

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are mandatory for adoption by the Company for the accounting period beginning on October 1, 2020, or later periods. None of these are expected to have a significant effect on the consolidated financial statements.