

Covalon Technologies Ltd.

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

March 31, 2021

MANAGEMENT'S DISCUSSION & ANALYSIS

For the six months ended March 31, 2021

May 28, 2021

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, 2020, and with our unaudited condensed consolidated interim financial statements for the six-month period ended March 31, 2021. Additional information on Covalon Technologies Ltd. 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, 2021 and 2020 is based on the unaudited condensed consolidated interim financial statements of the Company, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS") applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting., 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 May 28, 2021. Disclosure contained in this document is current to that date, unless otherwise noted.

Going Concern

The unaudited condensed consolidated interim financial statements accompanied by this MD&A have been prepared on a going concern basis in accordance with IFRS which assumes that the Company will continue to operate for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business.

As of March 31, 2021, the Company did not meet certain covenants related to its Acquisition Line Facility (the "Facility") with HSBC Bank Canada ("HSBC"), the Company's primary secured lender. As a result, the Company was prohibited from making certain milestone payments from the Company's Facility with HSBC under the Acquisition Note Payable (the "Acquisition Note") entered into with the prior owners of the AquaGuard assets (the "Vendor") that have become due. The Company was also unable to use cash on hand to make the payments to the Vendor without being offside on covenant calculations under the Facility.

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 entered into between the Company, the Vendor and HSBC which provides that no Acquisition Note amounts will be due if the Company is in breach of the Facility with HSBC. 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. The Company continues to repay the Facility with HSBC in accordance with the terms and conditions of the Facility, which is currently scheduled to be fully repaid by June 2025. For further discussion of the Facility

and the Acquisition Note, as well as the subordination agreement, please see “Liquidity & Capital Resources”.

As consistent with prior quarters, on May 21, 2021, the Company obtained a waiver from HSBC related to the covenant breaches as of March 31, 2021. However, the Company is currently forecasting that it may not meet all of these covenants at various times in Fiscal 2021 which will require that future waivers be obtained. Even though the Company continues to repay the HSBC Facility in accordance with its terms and conditions and the Vendor currently has no recourse under the subordination agreement, the Company’s ability to continue as a going concern, realize its assets and discharge its liabilities in the normal course of business and meet its corporate administrative expenses in Fiscal 2021 is dependent upon management’s ability to negotiate waivers or amendments under the Facility, or obtain additional equity financing. While the Company is extending its best efforts in this regard, the outcomes of these matters cannot be predicted at this time. Should the Company not be successful in obtaining future waivers, the Company would be in default of the Facility and HSBC could request repayment of principal and interest at any time. While the Company has a history of requesting and obtaining waivers, no assurances can be provided that the Company will be able to continue to obtain waivers and therefore payment may be demanded on the outstanding loan amounts which results in a material uncertainty that may cast significant doubt upon the Company’s ability to continue as a going concern and whether assets will be realized and liabilities extinguished in the normal course of business at the amounts stated on the consolidated financial statements.

While the Company believes that based on cash 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, should it become due and payable without refinancing this liability, or through the issuance of additional equity of the Company. No assurance can be given that any such refinancing or additional financing will be available, or that it can be obtained on terms favourable to the Company.

On March 25, 2021, the Company and the Vendor entered into a call option agreement that allows the Company to settle, at its option, on or before October 1, 2021, the US\$7.5 million Acquisition Note for a payment of US\$4 million and, subject to the approval of the TSX Venture Exchange (“TSX-V”), the issuance of 200,000 common share purchase warrants with an exercise price of \$4.00. The exercise of the call option by the Company under the call option agreement is conditional on approval from HSBC. If the call option is not exercised and settled by October 1, 2021, then the Company remains obligated to settle the US\$7.5 million Acquisition Note in accordance with its original terms.

The Company’s unaudited condensed consolidated interim financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate for these unaudited condensed consolidated interim financial statements, then adjustments to the carrying amounts of the Company’s assets, liabilities, revenue and expenses, and balance sheet classifications may be necessary, and these adjustments may be material.

Impact of 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.

During the six months ended March 31, 2021, the Company applied for and was approved for funding of \$338,862 (2020 - \$nil) under the Canadian Emergency Wage Subsidy Program ("CEWS"). The Company applied for, and received, US\$1,103,860 in a second draw of the United States Paycheck Protection Program loan ("US PPP Loan") from the US Small Business Administration under the US Paycheck Protection Program. The US PPP Loan will be forgiven if certain conditions are met (including the funds being used for eligible payroll and rent expenses during the eligibility period) and a loan forgiveness application is completed. Amounts received but not yet used to offset eligible expenses were recorded as a liability and at March 31, 2021 this was US\$342,400 (2020 - \$nil). Any ineligible portion of the US PPP Loan will otherwise carry interest of 1%. The Company also received funds from other subsidy programs of \$43,093 during the six months ended March 31, 2021.

Subsequent to March 31, 2021, the Company's first draw of the US PPP Loan was forgiven by the US Small Business Administration. The full amount of US\$1,103,861 and all related interest has been forgiven with no repayments required.

Operationally, the Company has been negatively impacted by the COVID-19 pandemic, and the efforts to mitigate the pandemic, as have many of the Company's employees, customers, and vendors regardless of geographic location. The Company's direct sale staff have been limited in their ability to call on customers in the United States and the United Kingdom. There have also been increased costs associated with shipping products, and a slow-down in receiving regulatory approvals. As a result of this uncertainty there is a higher level of estimation uncertainty as it relates to the assessment of impairment for intangibles, provisions for inventory and receivables, and general future cash flows. Our distribution relationships with a number of companies in North America and internationally have been impacted due to the material disruption to business globally, economic slowdowns, and shifts in economic markets caused by governmental responses to the COVID-19 pandemic. Demand for some of the Company's products also temporarily decreased as facilities adjust to patient demand and procedure types. While the future negative impacts of the pandemic are uncertain, the Company has taken strides to reduce operating and discretionary expenses to help mitigate these risks. For the six months ended March 31, 2021 the operating expenses were reduced by \$5,317,622 compared to the six month period ended March 31, 2020. Overall, operating expense reductions included the reduction of headcount, travel, and tradeshow activities. The Company will also continue to assess subsidies and programs that are ongoing or made available in the future.

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 of Directors approves the consolidated financial statements and the MD&A.

Non-IFRS Financial Measures

This MD&A makes reference to certain non-IFRS measures. These measures are not recognized or defined measures under IFRS, do not have standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional financial information to complement those IFRS measures by providing further understanding of our results of operations from management's perspective. Accordingly, these measures should not be considered in isolation or as a substitute for analysis of our financial information reported under IFRS. The non-IFRS financial measures, adjustments, and reasons for adjustments should be carefully evaluated as these measures have limitations as analytical tools and should not be used in substitution for an analysis of the Company's results under IFRS. We use non-IFRS measures including "Current Assets", "Adjusted Gross Margin" and "Adjusted EBITDA" to provide investors with supplemental measures of our operating performance and thus highlight trends in our core business that may not otherwise be apparent when relying solely on IFRS measures. We believe that securities analysts, investors and other interested parties frequently use non-IFRS measures in the evaluation of issuers. Our management also uses non-IFRS measures in order to facilitate operating performance comparisons from period to period, to prepare annual operating budgets and forecasts and to determine components of management compensation. For definitions and reconciliations of these non-IFRS measures to the relevant reported measures, please see "Definitions and Reconciliations of Non-IFRS Financial Measures".

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 infection management, advanced wound care, 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 United States.

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 (as described below) 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 related to COVID-19 have been put in place 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 to the COVID-19 pandemic

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, have negatively impacted 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 has been 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, 2021

- On October 21, 2020, the Company announced that the Board of Directors had initiated a process to explore and evaluate a range of strategic alternatives available to the Company in order to enhance shareholder value.
- On November 13, 2020, the Company announced the appointment of Amir Bloor as Chair of the Company's Board of Directors. Mr. Bloor is an independent director of the Company, and also Chair of the Special Committee. The Special Committee's intention is to explore and evaluate a range of strategic alternatives available to the Company in order to enhance shareholder value.
- On January 6, 2021, the Company obtained a waiver from HSBC Bank Canada for covenant breaches related to the quarter ended September 30, 2020 under the Company's Facility. For further information, please see "Liquidity & Capital Resources".
- On February 19, 2021, the Company obtained a waiver from HSBC Bank Canada for covenant breaches related to the quarter ended December 31, 2020 under the Company's Facility (as defined herein). For further information, please see "Liquidity & Capital Resources".
- On March 25, 2021, the Company and the Vendor entered into a call option agreement that allows the Company to settle, at its option, on or before October 1, 2021 the US\$7.5 million Acquisition

Note for a payment of US\$4 million and subject to the approval of the TSX-V, issuance of 200,000 common share purchase warrants with an exercise price of CAD\$4.00. The exercise of the call option by the Company under the call option agreement is conditional on approval from HSBC. If the call option is not exercised and settled by October 1, 2021, then the Company remains obligated to settle the US\$7.5 million Acquisition Note in accordance with its original terms.

- On March 5, 2021, the Company drew \$1 million against its facility available through the Business Credit Availability Program (“BCAP”) with the Business Development Bank of Canada (“BDC”) facilitated through HSBC. For further information, please see “Liquidity & Capital Resources”.

Operational Highlights Subsequent to March 31, 2021

- On May 21, 2021, the Company obtained a waiver from HSBC Bank Canada for covenant breaches related to the quarter ended March 31, 2021 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, 2021

- Total revenue for the three months ended March 31, 2021 increased 28% to \$6,741,260, compared to \$5,258,572 for the same period of the prior year.
- Product revenue for the three-month period ended March 31, 2021 increased 38% to \$6,376,359, compared to \$4,626,805 for the same period of the prior year. Product revenue increased in the United States by 23% or \$919,808, and in the Middle East by \$947,209.
- Development and consulting services revenue for the three-month period ended March 31, 2021 decreased by 47% to \$315,145, compared to \$599,893 for the same period of the prior year. During the quarter, the Company engaged in 10 customer development projects of various sizes with approximately 3 medical product companies that included the various projects underway associated with the previously announced major contract with one of the world’s largest medical device companies that licensed Covalon’s proprietary medical coating technologies. 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, 2021 were \$49,756, compared to \$31,874 for the three months ended March 31, 2020. The timing of this revenue will vary depending on length and timing of projects and discussions with customers.
- Gross margin for the three-month period ended March 31, 2021 increased to 54% compared to 53% 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, 2021 decreased 52% or \$3,371,696 to \$3,103,340, compared to \$6,475,036 for the prior year’s comparative period. The Company has made strides to reduce operating expenses as it relates to headcount and discretionary spending. Main drivers of the decrease are compensation expenses across all departments, a reduction in travel recorded in Sales, Marketing and Agency Fees as well as General and Administrative expenses. The Company also recorded \$1,043,547 of government subsidies which were netted out against the related expenses. These amounts are excluded in the calculation of Adjusted EBITDA

(see “*Definitions and Reconciliations of Non-IFRS Financial Measures*” for definition of Non-IFRS measures) below.

- Net income for the three months ended March 31, 2021 was \$421,724 or \$0.02 per share, compared to a net loss of \$3,908,622 or \$0.15 per share for the three months ended March 31, 2020.
- Adjusted Gross Margin for the three-month period ended March 31, 2021, decreased to 55% compared to 59% for the same period of the prior year. The year over year change was consistent with the factors noted above. For further information about Adjusted Gross Margin, see “*Definitions and Reconciliations of Non-IFRS Financial Measures*” below.
- Adjusted EBITDA for the three months ended March 31, 2021, was a loss of \$141,023, compared to an Adjusted EBITDA loss of \$1,544,443 for the three months ended March 31, 2020. For further information about Adjusted EBITDA, see “*Definitions and Reconciliations of Non-IFRS Financial Measures*” below.

Financial Highlights for the six months ended March 31, 2021

- Total revenue for the six months ended March 31, 2021 decreased 4% to \$12,729,672 compared to \$13,207,131 for the same period of the prior year.
- Product revenue for the six month period ended March 31, 2021 was \$11,762,431, compared to \$11,801,448 for the same period of the prior year.
- Development and consulting services revenue for the six-month period ended March 31, 2021 decreased by 36% to \$856,895 compared to \$1,333,021 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 six-month period ended March 31, 2021 were \$110,346 compared to \$72,662 for the six months ended March 31, 2020. The timing of this revenue will vary depending on length and timing of projects and discussions with customers.
- Gross margin for the six-month period ended March 31, 2021 decreased to 57% compared to 58% 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, 2021 decreased 43% or \$5,317,622 to \$6,942,191, compared to \$12,259,813 for the prior year’s comparative period.
- Net income for the six-month period ended March 31, 2021 was \$49,381 or \$0.00 per share, compared to a net loss of \$5,083,355 or \$0.20 per share for the six-month period ended March 31, 2020.
- Adjusted Gross Margin for the six month period ended March 31, 2021, decreased to 58% compared to 63% for the same period of the prior year. The year over year change was consistent with the factors noted above. For further information about Adjusted Gross Margin, see “*Definitions and Reconciliations of Non-IFRS Financial Measures*” below.
- Adjusted EBITDA for the six months ended March 31, 2021, was a loss of \$275,869, compared to an Adjusted EBITDA loss of \$1,516,844 for the six months ended March 31, 2020. For further

information about Adjusted EBITDA, see “*Definitions and Reconciliations of Non-IFRS Financial Measures*” below.

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 makes it difficult to accurately estimate revenue recognition in any given quarter or quarter-to-quarter.

	Three months ended March 31,		Six months ended March 31,	
	2021	2020	2021	2020
Revenue				
Product	\$6,376,359	\$4,626,805	\$11,762,431	\$11,801,448
Development and consulting services	315,145	599,893	856,895	1,333,021
Licensing and royalty fees	49,756	31,874	110,346	72,662
Total revenue	6,741,260	5,258,572	12,729,672	13,207,131
Cost of sales	3,098,870	2,466,453	5,501,754	5,579,228
Gross profit before operating expenses	3,642,390	2,792,119	7,227,918	7,627,903
Operating expenses				
Operations	259,511	530,146	517,994	991,080
Research and development activities	327,948	223,346	545,176	448,651
Sales, marketing and agency fees	1,046,937	2,323,469	2,663,805	5,235,961
General and administrative	1,468,944	3,398,075	3,215,216	5,584,121
	3,103,340	6,475,036	6,942,191	12,259,813
Finance expenses	117,326	225,705	236,346	451,445
Net income (loss)	\$421,724	\$(3,908,622)	\$49,381	\$(5,083,355)
Other comprehensive income (loss)				
Amount that may be reclassified to profit or loss				
Foreign currency translation adjustment	(215,101)	1,770,263	(1,065,238)	1,359,110
Total comprehensive income (loss)	\$206,623	\$(2,138,359)	\$(1,015,857)	\$(3,724,245)
Basic earnings (loss) per share	\$0.02	\$(0.15)	\$0.00	\$(0.20)
Diluted earnings (loss) per share	\$0.02	\$(0.15)	\$0.00	\$(0.20)

Revenue and Gross Profit

Total revenue increased \$1,482,688 or 28% to \$6,741,260 for the quarter ended March 31, 2021, compared to \$5,258,572 in the prior year. Product revenue was \$6,376,359 for the quarter ended March 31, 2021,

compared to \$4,626,805 in the prior year. Product revenue increased in the United States by 23% or \$919,808, and in the Middle East by \$947,209.

Development and consulting services revenue for the quarter ended March 31, 2021 was \$315,145 which represents revenue earned from the Company's work on development and consulting projects; a decrease from prior year's services revenue of \$599,893. During the quarter, we engaged in 10 customer development projects of various sizes with approximately 3 medical product companies that included the various projects underway associated with the previously announced major contract with one of the world's largest medical device companies that licensed Covalon's proprietary medical coating technologies. Licensing revenue was \$49,756 for the quarter ended March 31, 2021, compared to \$31,874 for the quarter ended March 31, 2020.

Revenue fluctuates from quarter to quarter depending on the composition of contractual arrangements entered into in each quarter, the timing of product shipments, and completion of services in any period.

Gross margin was 54% for the quarter ended March 31, 2021, compared to 53% for the prior year. Adjusted Gross Margin was 55% for the three months ended March 31, 2021, compared to 59% for 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.

Total revenue for the six months ended March 31, 2021, decreased 4% to \$12,729,672 compared to \$13,207,131 for the same period of the prior year. Product revenue for the six-month period ended March 31, 2021, was \$11,762,431 compared to \$11,801,448 for the same period last year. Development and consulting services revenue was \$856,895 for the six months ended March 31, 2021, compared to \$1,333,021 in the same period of the prior year. Licensing and royalty fees for the six months ended March 31, 2021, were \$110,346 compared to \$72,662 for the six months ended March 31, 2020.

Gross margin for the six-month period ended March 31, 2021, decreased to 57% compared to 58% for the same period of 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,	
	2021	2020	2021	2020
Operations				
Wages, benefits and consulting fees	\$321,694	\$463,316	\$607,764	\$845,067
Depreciation and amortization	641	852	1,301	1,688
Government subsidies	(119,991)	-	(209,166)	-
Other	57,167	65,978	118,095	144,325
	259,511	530,146	517,994	991,080
Research and development activities				
Wages, benefits and consulting fees	303,558	187,669	551,515	387,349
Depreciation and amortization	7,464	8,874	15,050	17,584
Government subsidies	(16,883)	-	(81,502)	-
Other	33,809	26,803	60,113	43,718
	327,948	223,346	545,176	448,651
Sales, and marketing activities				
Wages, benefits and consulting fees	1,359,282	1,785,570	2,821,942	3,885,192
Travel	87,645	336,964	155,594	841,025
Government subsidies	(653,862)	-	(717,509)	-
Other	253,872	200,935	403,778	509,744
	1,046,937	2,323,469	2,663,805	5,235,961
General and administrative				
Wages, benefits and consulting fees	745,415	927,685	1,521,522	1,815,380
Directors compensation	59,611	53,912	116,306	109,751
Professional and related costs	332,482	483,953	820,023	1,032,786
Facility	254,799	213,970	462,456	509,702
Depreciation and amortization	194,877	73,155	396,822	143,551
Allowance for doubtful accounts	-	1,420,002	-	1,420,002
Government subsidies	(252,811)	-	(337,824)	-
Other	259,710	225,397	491,657	552,950
	1,468,944	3,398,075	3,215,216	5,584,121
Total operating expenses	\$3,103,340	\$6,475,036	\$6,942,191	\$12,259,813

Operating expenses for the three months ended March 31, 2021, decreased \$3,371,696 to \$3,103,340 compared to \$6,475,036 for the prior year's comparative period. The decrease in operating expenses is primarily related to a decrease in personnel costs of \$634,291, and a decrease in sales and marketing travel of \$249,319. The quarter also included government subsidies relating to COVID-19 relief that reduced operating expenses by \$1,043,547.

Wages, benefits, and consulting fees (for all departments) include a non-cash expense related to stock options that the Company had previously granted. The quarter ended March 31, 2021 had stock option related expenses of \$80,484 compared to \$221,387 in the prior year. This expense reflects the number of options outstanding and their respective fair values for accounting purposes.

Operating expenses for the six months ended March 31, 2021, decreased \$5,317,622 to \$6,942,191 compared to \$12,259,813 for the prior year’s comparative period. The decrease in operating expenses is primarily related to a decrease in personnel costs of \$1,430,245 and government subsidies relating to COVID-19 relief that reduced operating expenses by \$1,346,001.

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, 2021 had stock option related expenses of \$204,562 compared to \$618,876 in the prior year. This expense reflects 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 March 31,		Six months ended March 31,	
	2021	2020	2021	2020
Compensation and short term employee benefits	\$239,442	\$287,411	\$478,884	\$574,673
Share-based payments	24,902	115,640	62,406	255,200
	264,344	403,051	541,290	829,873

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, 2021, \$10,000 of this loan remained outstanding.

Critical Accounting Estimates and Judgements

The preparation of financial statements requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from estimates and such differences could be material.

The Company reviews amortized non-financial assets for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may be impaired. It also reviews goodwill annually for impairment. If the recoverable amount of the respective non-financial asset is less than its carrying amount, it is considered to be impaired. In the process of measuring the recoverable amount, management makes assumptions about future events and circumstances. The actual results may vary and may cause significant adjustments.

i) Impairment of Non-Financial Assets

The Company reviews amortized non-financial assets for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may be impaired. It also reviews goodwill annually for impairment. If the recoverable amount of the respective non-financial asset is less than

its carrying amount, it is considered to be impaired. In the process of measuring the recoverable amount, management makes assumptions about future events and circumstances. The actual results may vary and may cause significant adjustments.

ii) **Going Concern**

The assessment of material uncertainties related to events and circumstances that may cast significant doubt on the Company’s ability to continue as a going concern involves significant judgement. In making this assessment, management considers all relevant information, as described in Note 2 of the unaudited condensed consolidated interim financial statements.

Accounting Standards Adopted

On October 31, 2018, amendments to IAS 1 and IAS 8 to clarify and align the definition of material and provide guidance to help improve consistency in the application of materiality when used in other IFRS standards. These amendments were effective for years beginning on or after January 1, 2020 and are to be applied prospectively. The Company adopted the amendments on October 1, 2020 and there was no impact on the unaudited condensed consolidated interim financial statements.

Summary of Quarterly Results and Financial Position

	2021 Second Quarter	2021 First Quarter	2020 Fourth Quarter	2020 Third Quarter	2020 Second Quarter	2020 First Quarter	2019 Fourth Quarter	2019 Third Quarter
Revenue	\$ 6,741,260	\$ 5,988,412	\$ 5,919,581	\$ 6,673,394	\$ 5,258,572	\$ 7,948,559	\$ 6,576,601	\$ 6,853,992
Net income (loss) before amortization and depreciation	995,227	(81,643)	(1,898,770)	660,341	(892,457)	(3,615,244)	(3,325,046)	(3,293,735)
Net income (loss)	421,724	(372,343)	(2,183,036)	314,167	(3,908,622)	(1,174,733)	(3,515,000)	(3,481,135)
Net income (loss) per share	0.02	(0.01)	(0.08)	0.01	(0.15)	(0.05)	(0.16)	(0.16)
Cash	3,794,509	2,533,891	3,506,991	4,200,135	3,850,062	4,115,806	9,575,149	1,144,489
Net working capital	(7,430,778)	(7,998,634)	(7,787,221)	(5,818,351)	(6,454,096)	(3,101,402)	4,449,434	(263,689)
Current ratio	0.7	0.6	0.7	0.8	0.7	0.9	1.2	1.0

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, 2021	September 30, 2020
Cash	\$3,794,509	\$3,506,991
Total assets	\$33,196,297	\$34,696,974
Deferred revenue	\$595,647	\$788,272

On March 31, 2021, cash totaled \$3,794,509 compared to \$3,506,991 at September 30, 2020. During the six-month period ended March 31, 2021, the Company had positive cash flow of \$287,518.

Accounts receivable at March 31, 2021, increased \$837,798 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 \$37,027 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. As at May 28, 2021, cash totaled approximately \$3.8 million.

Total assets at March 31, 2021 were \$33,196,297 compared to \$34,696,974 at September 30, 2020. Cash comprised 11% of total assets at March 31, 2021. The Company's accounts receivable and inventories are liquid, and 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 decreased by \$192,625 to \$595,647 at March 31, 2021, compared to \$788,272 at September 30, 2020.

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, as reflected in the following table:

	Carrying amount (\$)	Future cash flows (\$)	Less than 1 year (\$)	Between 1 and 5 years (\$)	Greater than 5 years (\$)
Accounts payable and accrued liabilities	3,924,432	3,924,432	3,924,432	-	-
Debt	8,057,066	8,057,066	8,057,066	-	-
Acquisition note payable	9,497,017	9,497,017	9,497,017	-	-
Lease liabilities	2,826,752	3,244,735	638,400	2,478,050	128,285
Total	24,305,267	24,723,250	22,116,915	2,478,050	128,285

During the year ended September 30, 2018, the Company entered into the Facility with HSBC that was used to fund the Company's October 1, 2018 purchase of the AquaGuard business. The Facility is secured

by a general security interest over the assets of the Company and its wholly-owned subsidiaries. Pursuant to the Facility, the Company is also subject to financial covenants and certain reporting requirements customary with credit facilities of this nature. As of March 31, 2021, consistent with September 30, 2020, the Company was not able to fulfill all financial covenants related to the Facility. Under IFRS, this event of default meant the Company did not have the unconditional right to defer the settlement of the debt for at least 12 months and therefore the entire amount has been classified as current as of March 31, 2021.

Under the Company's Acquisition Note, milestone payments of US\$7.5 million have become due. The Company had intended to fund the Acquisition Note milestone payments through its Facility with HSBC. Consistent with the year ended September 30, 2020, at March 31, 2021, the Company was prohibited from making a payment on 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 covenant calculations.

During the six months ended March 31, 2021, the Company drew \$1 million against the BCAP facility through HSBC. The Company is able to draw against the BCAP facility and make payments related to the repayment of other debts and working capital. This facility is interest-only until July 2021 and then is repayable over a four-year term by equal monthly payments.

When entering into the AquaGuard purchase agreement and the Facility, 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. The Company continues to repay the Facility with HSBC in accordance with the terms and conditions of the Facility, which is currently scheduled to be fully repaid by June 2025.

As noted above, as of March 31, 2021, the Company did not meet certain covenants related to the Facility with HSBC under the original Facility agreement. Subsequent to March 31, 2021, the Company obtained a waiver from HSBC related to the covenant breaches as of the year end. The Company is currently forecasting that it may not meet all of these covenants at various times in Fiscal 2021 which will require that future waivers be obtained. Should the Company not be successful in obtaining future waivers, the Company would be in default of the Facility and HSBC could request repayment of principal and interest at any time. While the Company has a history of requesting and obtaining waivers, no assurances can be provided that the Company will be able to continue to obtain waivers and therefore payment may be demanded on the outstanding loan amounts which results in a material uncertainty that may cast significant doubt upon the Company's ability to continue as a going concern and whether assets will be realized and liabilities extinguished in the normal course of business at the amounts stated on the consolidated financial statements. While the Company believes that based on cash 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, should it become due and payable without refinancing this liability,

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.

On March 25, 2021, the Company and the Vendor entered into a call option agreement that allows the Company to settle, at its option, on or before October 1, 2021, the US\$7.5 million Acquisition Note for a payment of US\$4 million and, subject to the approval of the TSX Venture Exchange, the issuance of 200,000 common share purchase warrants with an exercise price of \$4.00. The exercise of the call option by the Company under the call option agreement is conditional on approval from HSBC. If the call option is not exercised and settled by October 1, 2021, then the Company remains obligated to settle the US\$7.5 million Acquisition Note in accordance with its original terms.

To address the future payments required, the Company: a) has been in negotiations with the Vendor to renegotiate the terms of the Acquisition Note – including the call option signed March 25, 2021; b) is in discussions with HSBC to obtain waivers on its covenants for future quarters; and, c) has initiated a strategic review process to evaluate ways to enhance shareholder value and determine the highest and best use of the assets of the Company.

The Company generated a net income of \$49,381 for the six months ended March 31, 2021 (net loss as of March 31, 2020 - \$5,083,355) and cash generated in operating activities was \$585,563 (cash used as of March 31, 2020 – \$4,548,894) for the same period. As of March 31, 2021, the Company had \$3,794,509 of cash (September 30, 2020 – \$3,506,991) and intends to operate its business and satisfy its obligations as they come due in the ordinary course of business.

During the six months ended March 31, 2021, the Company applied for and was approved for funding of \$338,862 under CEWS. The Company applied for, and received, US\$1,103,860 in a second draw of the US PPP Loan. The US PPP Loan will be forgiven if certain conditions are met (including the funds being used for eligible payroll and rent expenses during the eligibility period) and a loan forgiveness application is completed. Amounts received but not yet used to offset eligible expenses were recorded as a liability and at March 31, 2021 this was US\$342,400 (2020 - \$nil). Any ineligible portion of the US PPP Loan will otherwise carry interest of 1% and will be repayable over a five-year term. The Company also received funds from other subsidy programs of \$43,276 during the six months ended March 31, 2021.

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, 2021, 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	1,463,332
Warrants	2,750,000

Sources and Uses of Cash

	Six months ended March 31,	
	2021	2020
Cash flows used in operating activities	585,563	(4,548,894)
Cash flows used in investing activities	(91,313)	(248,922)
Cash flows from financing activities	(67,592)	(1,229,009)

Operating Activities

Cash generated in operating activities for the six-month period ended March 31, 2021 was \$585,563, compared to \$4,548,894 used for the prior year's comparative period. Non-cash working capital used \$478,229 of cash during the quarter ended March 31, 2021, compared to cash used of \$1,111,514 in the prior year. At March 31, 2021, accounts receivable increased by \$837,798 over September 30, 2020, 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 six-month period ended March 31, 2021 the Company repaid \$600,000 against the banking facilities used to facilitate the initial payments of the AquaGuard acquisition and to fund working capital.

During the six-month period ended March 31, 2021 the Company drew \$1 million against the BCAP facility with BDC and facilitated by HSBC.

Financial Instruments

The Company is subject to interest rate risk on its cash and debt. The Company believes that interest rate risk is low due to market based variable interest rate. The Company has floating rate debt that was used to fund the AquaGuard acquisition and 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.

Definitions and Reconciliations of 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 non-IFRS financial measures, adjustments, and reasons for adjustments should be carefully evaluated as these measures have limitations as analytical tools and should not be used in substitution for

an analysis of the Company’s results under IFRS. Adjusting items that are the same, or similar to, the adjusting items below may recur in the future and may not be included in similar non-IFRS measures used by other companies thereby diminishing their utility.

i) Working Capital

The Company’s working capital is a non-IFRS metric and is calculated as: Current Assets less Current Liabilities as of the reporting date.

ii) Adjusted Gross Margin

The Company’s Adjusted Gross Margin is a non-IFRS metric used by management to evaluate financial margins on revenue in a given period. We define Adjusted Gross Margin as gross profit before operating expenses, plus depreciation and amortization included in cost of sales, plus inventory provision amounts.

The table below provides a reconciliation of gross profit before operating expenses under IFRS in the unaudited condensed consolidated interim financial statements to Adjusted Gross Margin for the three and six months ended March 31, 2021. Management believes that Adjusted Gross Margin is useful in assessing the performance of the Company’s ongoing operations and its ability to generate cash flows from period to period. The adjusting items below are considered to be outside of the Company’s core operating results, and these items can distort the trends associated with the Company’s ongoing performance, even though some of those expenses may recur.

	Three months ended March 31,		Six months ended March 31,	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Gross profit before operating expenses	3,642,390	2,792,119	7,227,918	7,627,903
Add: Depreciation and amortization	79,821	86,547	160,330	167,985
Add: Inventory provisions	187	214,809	6,340	500,534
Adjusted Gross Margin	3,722,398	3,093,475	7,394,588	8,296,422
Adjusted Gross Margin (%)	55%	59%	58%	63%

iii) Adjusted EBITDA

The Company’s Adjusted EBITDA is a non-IFRS metric used by management to evaluate the Company’s earnings or loss. We define Adjusted EBITDA as net loss, plus interest expense, plus depreciation and amortization, plus stock-based compensation, less government subsidies, plus inventory provisions, plus accounts receivable write-off expenses.

The table below provides a reconciliation of net loss under IFRS in the unaudited condensed consolidated interim financial statements to Adjusted EBITDA for the three and six months ended March 31, 2021. Management believes that these non-IFRS measures are useful in assessing the performance of the Company’s ongoing operations and its ability to generate cash flows to funds its cash requirements from period to period. The adjusting items below are considered to be outside of the Company’s core operating results, and these items can distort the trends associated with the Company’s ongoing performance, even though some of those expenses may recur.

	Three months ended March 31,		Six months ended March 31	
	<u>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Net income (loss)	421,724	(3,908,622)	49,381	(5,083,355)
Add: Interest expense	117,326	225,705	236,346	451,445
Add: Depreciation and amortization	282,803	282,276	573,503	575,654
Add: Stock based compensation	80,484	221,387	204,562	618,876
Less: Government subsidies	(1,043,547)	-	(1,346,001)	-
Add: Inventory provisions	187	214,809	6,340	500,534
Add: Accounts receivable write-off	-	1,420,002	-	1,420,002
Adjusted EBITDA	(141,023)	(1,544,443)	(275,869)	(1,516,844)

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:

Going Concern.

The Company's ability to continue as a going concern, realize its assets and discharge its liabilities in the normal course of business and meet its corporate administrative expenses in Fiscal 2021 dependent upon management's ability to negotiate waivers or amendments under the Facility, or obtain additional equity financing. While the Company is extending its best efforts in this regard, the outcome of these matters cannot be predicted at this time. No assurance can be given that any such renegotiation, waiver or additional financing will be available, or that it can be obtained on terms favourable to the Company.

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.

Operationally, the Company has been negatively impacted by the COVID-19 pandemic, and the efforts to mitigate the pandemic, as have many of the Company's employees, customers, and vendors regardless of geographic location. The Company's direct sale staff have been limited in their ability to call on customers

in the United States and the United Kingdom. There have also been increased costs associated with shipping products, and a slow-down in receiving regulatory approvals. Our distribution relationships with a number of companies in North America and internationally have been impacted due to the material disruption to business globally, economic slowdowns, and shifts in economic markets caused by governmental responses to the COVID-19 pandemic. This has also negatively impacted the Company's suppliers.

The Company has seen volatility in demand for both products and services due to a significant number of the Company's products being 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. It is unclear how long these measures will be in place and will continue to impact the demand for our products and services at this time.

Other areas that may, or will continue to, impact our business include, without limitation, workforce productivity and health, disruptions to supply chains, limitations on travel, 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.

Additionally, the COVID-19 pandemic could result in a widespread health crisis or social unrest that could adversely affect the economies and financial markets of many regions and countries. There can be no assurance that a disruption in financial markets, regional economies and the world economy would not negatively affect the Company's access to capital or its financial performance.

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, 2020, as of March 31, 2021, the Company did not meet certain covenants related to the Facility with HSBC. As a result, the Company was prohibited from making 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. The Company has obtained a waiver from HSBC related to the covenants that were not met as of March 31, 2021.

While the Company believes that based on the cash on hand and the amounts available under the Facility 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 in Fiscal 2021 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.

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 income for the six-month period ended March 31, 2021, of \$49,381 and a net loss of \$6,952,224 for the year ended September 30, 2020. 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 4,111,563 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 fail 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 strategies, 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.

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.

IAS 1 – Presentation of Financial Statements

On January 23, 2020, the IASB issued an amendment to IAS 1 to clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. The standard is effective for periods beginning on or after January 1, 2022 and the Company currently expects no impact in applying the new standard.