Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(UNAUDITED)

For the six months ended March 31, 2013

Contents

MANAGEMENT'S COMMENTS ON

UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed consolidated interim financial statements of Covalon Technologies Ltd. (the "Company") have been prepared by and are the responsibility of the Company's management. The unaudited condensed consolidated interim financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") and reflect management's best estimates and judgment based on information currently available. The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION (UNAUDITED)

Expressed in Canadian Dollars

At March 31, 2013 and September 30, 2012

		March 31, 2013		September 30, 2012
Assets				
Current assets				
Cash and cash equivalents	**$**	**416,038**	$	1,142,667
Short-term investments		**500,000**		500,000
Accounts receivable, net (Note 5)		**269,538**		711,820
Prepaid expenses		**57,885**		53,126
Inventories (Note 8)		**1,070,588**		806,015
Total current assets		**2,314,049**		3,213,628
Non-current assets				
Restricted cash (Note 9)		**63,000**		63,000
Property, plant and equipment (Note 10)		**589,715**		602,135
Intangible assets (Note 11)		**2,076,756**		2,084,966
Total non-current assets		**2,729,471**		2,750,101
Total Assets	**$**	**5,043,520**	$	5,963,729
Liabilities and Shareholders' Equity				
Current liabilities				
Accounts payable and accrued liabilities	**$**	**1,452,426**	$	1,611,125
Deferred revenue (Note 12)		**864,438**		674,283
Total current liabilities		**2,316,864**		2,285,408
Non-current liabilities				
Deferred revenue (Note 12)		**343,209**		443,774
Total non-current liabilities		**343,209**		443,774
Total Liabilities		**2,660,073**		2,729,182
Shareholders' Equity				
Share capital (Note 13 a))		**32,165,573**		31,911,359
Contributed surplus (Note 13 b) and c))		**1,805,586**		1,805,586
Stock Options (Note 14)		**1,967,854**		1,947,389
Warrants (Note 13 c))		**227,522**		
Accumulated deficit (Note 13 c))		**(33,783,088)**		(32,429,787)
Total shareholders' equity		**2,383,447**		3,234,547
Total Liabilities and Shareholders' Equity	**$**	**5,043,520**	$	5,963,729

On behalf of the Board

(signed) "Abe Schwartz" **Director**

(signed) "Brian Pedlar" **Director**

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

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM STATEMENT OF COMPREHENSIVE LOSS (UNAUDITED)

Expressed in Canadian Dollars

For the three and six months ended March 31, 2013

	Three months ended March 31,		Six months ended March 31,	
	2013	2012	**2013**	2012
Revenue				
Product and Services				
Advanced wound care	$ 478,371	$ 524,247	$ 998,895	$ 759,961
Specialized medical device coatings	0	514,309	-	916,280
Licensing fees (Note 12)	51,482	51,482	102,965	102,964
Total revenue	529,853	1,090,038	1,101,860	1,779,205
Cost of sales	304,725	632,453	658,722	1,030,590
Gross Profit	225,128	457,585	443,138	748,615
Operating Expenses				
Operations	84,772	154,094	250,960	295,295
Research and development activities	105,968	142,523	236,877	296,156
Sales and marketing	240,924	436,499	596,848	842,590
General and administrative	357,666	338,799	723,387	744,497
	789,330	1,071,915	1,808,072	2,178,538
Loss before undernoted	(564,202)	(614,330)	(1,364,934)	(1,429,923)
Interest income	(5,371)	(10,184)	(11,633)	(25,723)
Net loss and comprehensive loss for the period	$ (558,831)	$ (604,146)	$ (1,353,301)	$ (1,404,200)
Basic and diluted loss per share (Note 21)	**$ (0.01)**	$ (0.01)	**$ (0.02)**	$ (0.02)

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

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (UNAUDITED)

Expressed in Canadian Dollars

For the three and six months ended March 31, 2013

	Share Capital	Contributed Surplus	Stock Options	Warrants	Accumulated Deficit	Total
Balance at October 1, 2011	$ 31,911,359	$ 1,805,586	$ 1,736,801		$ (28,438,405)	$ 7,015,341
Share based payments			126,008			126,008
Comprehensive loss for the period					(1,404,200)	(1,404,200)
Balance at March 31, 2012	$ 31,911,359	$ 1,805,586	$ 1,862,809		$ (29,842,605)	$ 5,737,149
Balance at October 1, 2012	$ 31,911,359	$ 1,805,586	$ 1,947,389		$ (32,429,787)	$ 3,234,547
Share based payments			20,465			20,465
Comprehensive loss for the period					(1,353,301)	(1,353,301)
Issue common shares and warrants, net	254,214			227,522		481,736
Balance at March 31, 2013	$ 32,165,573	$ 1,805,586	$ 1,967,854	$ 227,522	$ (33,783,088)	$ 2,383,447

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

Covalon Technologies Ltd.

CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS (UNAUDITED)

Expressed in Canadian Dollars

For the three and six months ended March 31, 2013

	Three months ended March 31,		Six months ended March 31,	
	2013	2012	**2013**	2012
Cash flows from operating activities				
Net loss and comprehensive loss for the period	**$ (558,831)**	$ (604,146)	**$ (1,353,301)**	$ (1,404,200)
Adjustments to reconcile net loss and comprehensive loss to net cash used in operating activities:				
Depreciation - property, plant and equipment	**32,723**	30,507	**69,896**	60,474
Amortization - intangible assets	**46,660**	55,113	**91,376**	110,351
Share based payments	**6,625**	55,754	**20,465**	126,008
Foreign exchange loss (gain) on cash held	**(9,502)**	2,979	**(1,502)**	1,717
Cash used by operating activities before change in non-cash working capital balances	**(482,326)**	(459,793)	**(1,173,066)**	(1,105,650)
Change in non-cash working capital (Note 17)	**226,775**	(462,659)	**103,841**	(627,669)
Total cash outflows from operating activities	**(255,550)**	(922,452)	**(1,069,225)**	(1,733,319)
Cash flows from investing activities				
Purchase of property, plant and equipment	**(40,441)**	(56,496)	**(57,476)**	(57,145)
Purchase of intangible assets	**(24,497)**	(29,721)	**(83,166)**	(56,467)
Total cash outflows from investing activities	**(64,938)**	(86,217)	**(140,642)**	(113,612)
Cash flows from financing activities				
Restricted cash (Note 9)		(63,000)		(63,000)
Net proceeds on issuance of share capital and warrants			**481,736**	
Total cash inflows from financing activities	**$ -**	(63,000)	**481,736**	(63,000)
Foreign exchange loss (gain) on cash held	**9,502**	(2,979)	**1,502**	(1,717)
Total net decrease in cash and cash equivalents during the period	**(310,986)**	(1,074,648)	**(726,629)**	(1,911,648)
Cash and cash equivalents, beginning of the period	**727,024**	3,926,152	**1,142,667**	4,763,152
Cash and cash equivalents, end of period	**$ 416,038**	$ 2,851,504	**$ 416,038**	$ 2,851,504
Represented by				
Cash	**$ 74,251**	$ 439,397	**$ 74,251**	$ 439,397
Cash equivalents	**341,787**	2,412,107	**341,787**	2,412,107
	$ 416,038	$ 2,851,504	**$ 416,038**	$ 2,851,504

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

1. CORPORATE INFORMATION

Covalon Technologies Ltd. is incorporated under the laws of Ontario and is engaged in the business of developing, licensing and selling medical technologies. The consolidated financial statements of Covalon Technologies Ltd. for the six months ended March 31, 2013 comprise the results of the Company and its subsidiaries. The Company has now received regulatory approval on numerous products and is currently generating revenue. The Company has adopted a business model that contracts the manufacturing and distribution of its commercialized products through partners. The Company generates its revenues through development contracts, licensing agreements and distribution contracts and sales. The Company is listed on the TSX Venture Exchange, having the symbol COV. The address of the Company's corporate office and principal place of business is 405 Britannia Road East, Suite 106, Mississauga, Ontario, Canada.

2. BASIS OF PRESENTATION

Statement of Compliance

a) Statement of Compliance

These condensed interim financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") in general and in accordance with International Accounting Standard 34, Interim Financial Reporting ("IAS 34") as issued by the International Accounting Standards Board ("IASB') which sets out standards for interim financial statements. These interim condensed financial statements do not include all the information and disclosures required in the annual financial statements. These interim condensed financial statements should be read in conjunction with the Company's 2012 annual financial statements, which were prepared in accordance with International Financial Reporting Standards.

These interim financial statements were authorized for issue by the Corporation's Board of Directors on May 29, 2013.

b) Basis of Measurement

The consolidated financial statements have been prepared on a historical cost basis.

c) Going Concern of Operations

These Consolidated Financial Statements have been prepared on a going-concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations for the forseeable future. The Company incurred a net loss of $558,831 and $1,353,301 during the three and six month periods ended March 31, 2013 and, as of that date the Company's accumulated deficit was $33,783,088. The Company's ability to continue as a going concern depends on its ability to achieve profitable operations through; (i) the success of its two recently cleared-for-sale products IV Clear and SurgiClear, as it earns revenue from these products in the form of royalties and product sales, (ii) continued growth in the form of revenues and cash collections from product sales of its cleared-for-sale products ColActive Plus and ColActive Plus Ag, (iii) the ability for the Company to significantly reduce its operating costs, and (iv) the ability to obtain additional capital through financing. Whether or when the Company can achieve the above is uncertain. The Company is still an early revenue stage medical device biotechnology commercialization company, and is subject to a number of risks and uncertainties that are inherent to the commercialization of new technology. The Company has invested in technology and patents which represent a large amount of the Company's value. The Company's current

2. BASIS OF PRESENTATION (CONTINUED)

business model includes a combination of distribution under the Covalon brand name and an OEM business model where it licenses and sells its technology to medical device companies and distributors. Most OEM sales models involve long sales cycles – from initial discussion, product evaluation, regulatory filings, contract negotiation and market roll-out and as such the timing of revenue agreements is unpredictable. There can be no assurance that the Company will have sufficient capital to fund its ongoing operations, develop or commercialize any further products without future financings. There can be no assurance, especially considering the current economic environment, that additional financing will be available on acceptable terms or at all. These material uncertainties cast significant doubt upon the Company's ability to continue as a going concern.

These Consolidated Financial Statements do not include any adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

There have been no changes in accounting policies since the Company's 2012 annual financial statements.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of financial statements requires that management makes 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 would be material.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change affects that period only, or in the period of the change and future periods, if the change affects both.

Information about critical judgments in applying accounting policies that have the most significant risk of causing material adjustment to the carrying amounts of assets and liabilities recognized in the consolidated financial statements within the next financial year are discussed below:

i) Property, plant and equipment (PP&E)

Measurement of PP&E involves the use of estimates for determining the expected useful lives of depreciable assets. Management's judgment is also required to determine depreciation methods and an asset's residual value and whether an asset is a qualifying asset for the purpose of capitalizing borrowing costs.

ii) Intangible Assets

The values calculated for intangible assets involve significant estimates and assumptions, including those with respect to future cash flows, discount rates and asset lives. These significant estimates and judgments could impact the Company's future results if the current estimates of future performance and fair value change and could affect the amount of amortization expense on intangible assets in future periods.

Expressed in Canadian Dollars

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

iii) Impairment of non-financial assets

The Company reviews the carrying value of non-financial assets for potential impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. The impairment test is carried out by comparing the carrying amount of the asset against the value computed using the discounted cash flow method values which requires numerous assumptions to estimate future cash flows. The recoverable amount is impacted significantly by the discount rate selected to be used in the discounted cash flow model, as well as the quantum and timing of expected future cash flows and the growth rate used for the extrapolation.

5. FINANCIAL RISK MANAGEMENT

Risk factors

The following is a discussion of market, credit and liquidity risks and related mitigation strategies that have been identified. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks listed.

Credit risk

The Company's cash and cash equivalents and short-term investments do not subject the Company to significant credit risk. The Company has guaranteed investment certificates and provincial bonds, as per its practice of protecting its capital rather than maximizing investment yield, of $1 million invested with two issuers; however, this risk is mitigated as the issuers are two major Canadian banks and the Province of Ontario.

The Company, in the normal course of business, is exposed to credit risk from its global customers in the medical device industry. The accounts and other receivable are subject to normal industry risks in each geographic region in which the Company operates. The Company attempts to manage these risks by dealing with creditworthy customers; however, due to the limited number of potential customers in each market this is not always possible. As at March 31, 2013, ten customers accounted for 90% (Sept 30, 2012 - 90%) of the accounts receivable balance. These customers, who are distributors and strategic partners of the Company, represent substantially all of the Company's sales. Credit risk exposure is mitigated by strong credit granting policies and due diligence procedures for new customers. The Company has recorded an allowance for bad debts in the amount of $985,600 (September 30, 2012 – $812,794).

Pursuant to their collective terms, accounts receivable, net, are aged as follows:

		March 31, 2013		September 30, 2012
Current	**$**	**80,930**	$	472,288
31-60 days past due		**71,731**		56,362
Over 60 days past due, (net of allowance for doubtful accounts of $895,600 , Sep 2012 - $581,491)		**116,877**		183,170
	$	**269,538**	$	711,820

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk

The Company has an ongoing need for substantial capital resources to research and develop, commercialize and manufacture its products and technologies. The Company believes that it has the capital resources and liquidity necessary to meet its commitments, support its operations and finance its current growth strategies. This risk has not changed from the prior year.

Interest rate risk

The Company is subject to interest rate risk on its cash and cash equivalents. The Company believes that interest rate risk is low as its cash and cash equivalents consists of low risks money market and fixed income securities with maturity dates of less than one year. This risk has not changed from the prior year.

Currency risk

The Company has suppliers and customers that are not based in Canada which gives rise to a risk that earnings and cash flows may be adversely affected by fluctuations in foreign currency exchange rates. The Company is primarily exposed to the US dollar. Part of the currency risk is mitigated by the fact that the company has both purchases and sales in US dollars, creating a natural hedge. The Company believes the remaining risk is acceptable and does not use financial instruments to hedge these risks. This risk has not changed from the prior year.

Foreign currency balances expressed in Canadian dollars consist of the following:

	March 31, 2013	September 30, 2012
Accounts receivable, net	**$ 192,008**	$ 664,505
Accounts payable	**507,603**	599,542
Deferred Revenue	**311,686**	293,352
Cash	**47,429**	400,392
Exchange rate ($USD / $CAD)	**0.9843**	0.9832

An increase of 5% and 10% in the US dollar exchange rate relative to the Canadian dollar would result in an increase of the net loss by approximately $29,000 and $58,000 respectively.

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

Fair Value

The Company categorizes its financial assets and liabilities measured at the fair value into one of three different levels depending on the observation of the inputs used in the measurement. As at March 31, 2013 the Company`s financial instruments are cash and cash equivalents and short-term investments for an amount of $979,038 (September 30, 2012 - $1,705,667) which are considered to be Level 1 investments. There were no transfers between levels during the year.

The three levels are defined as follows:

Level 1: Fair value is based on unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2: Fair value is based on inputs other than quoted prices included within Level 1 that are not observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

Level 3: Fair value is based on valuation techniques that require one or more significant unobservable inputs

Commodity risk

The Company is exposed to commodity risk related to purchases of key raw materials necessary for the manufacture of its bulk product from a limited number of suppliers around the world. The Company attempts to mitigate this risk by entering into long-term supply contracts at fixed pricing with capped annual increases. There is commodity risk for all ingredients in each of the Company's products. The company attempts to mitigate these risks through the use of multiple suppliers and fixed price contracts but due to the nature of some of the chemicals required and the regulatory paths to approving new suppliers, this is not always possible. This risk has not changed from the prior year.

6. MANAGEMENT OF CAPITAL

The Company defines capital that it manages as its shareholders' equity comprising of share capital, options, warrants, contributed surplus and deficit. Its objectives when managing capital are to ensure that the Company will continue as a going concern, so that it can provide services to its customers and returns to its shareholders. The capital at March 31, 2013 is $2,383,447 (September 30, 2012 - $3,234,547).

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will make changes to its capital structure as deemed appropriate under the specific circumstances. The Company's investment policy is to invest only in investment grade, highly liquid money market instruments.

There were no changes to the definition or the management of capital during the year.

The Company is not subject to any externally imposed capital requirements and the Company's overall strategy with respect to management of capital remains unchanged from the year ending September 30, 2012.

7. INVESTMENT TAX CREDITS

The Company is eligible for the Ontario Innovation Tax Credit ("OITC") at the rate of 10% refundable in cash to the Company. The refundable tax credits received by the Company are subject to review by Canada Revenue Agency and the Ontario Ministry of Finance. During the six month period ended March 31, 2013 the Company received no OITC payments (year ended September 30, 2012 - $217,058 for the fiscal years ended 2009 and 2010.)

Expressed in Canadian Dollars

8. INVENTORIES

Inventories consist of the following:

		March 31, 2013		September 30, 2012
Raw materials	**$**	**539,786**	$	339,798
Work in Process				2,109
Finished Goods		**530,802**		464,108
	$	**1,070,588**	$	806,015

Direct product expense included in cost of sales was $251,814 and $561,121 for the three and six month periods ended March 31, 2013 respectively.

9. RESTRICTED CASH

The Company assigned $63,000 of its cash equivalents as collateral to secure its credit card and automated clearing house (ACH) facilities with a major financial institution. These funds are expected to be restricted for more than one year.

10. PROPERTY PLANT AND EQUIPMENT

	Furniture and Fixtures $	Lab Equipment $	Leasehold Improvements $	Total $
Cost				
Balance at October 1, 2011	279,366	1,308,936	71,416	1,659,718
Additions	39,750	85,132	-	124,882
Balance at September 30, 2012	319,116	1,394,068	71,416	1,784,600
Additions	-	57,476	-	57,476
Balance at March 31, 2013	319,116	1,451,544	71,416	1,842,076
Accumulated depreciation				
Balance at October 1, 2011	176,002	805,081	71,416	1,052,499
Depreciation	26,390	103,576	-	129,966
Balance at September 30, 2012	202,392	908,657	71,416	1,182,465
Depreciation	13,122	56,775	-	69,896
Balance at March 31, 2013	215,514	965,432	71,416	1,252,361
Carrying amounts				
At October 1, 2011	103,364	503,855	-	607,219
At September 30, 2012	116,724	485,411	-	602,135
At March 31, 2013	103,602	486,112	-	589,715

Expressed in Canadian Dollars

11. INTANGIBLE ASSETS

	Deferred Development Costs	Patents	Trademarks	Computer Software	Total
	$	$	$	$	$
Cost					
Balance at October 1, 2011	4,134,415	1,094,041	59,049	149,163	5,436,668
Impairment losses		698,340			698,340
Additions	-	128,218	8,348	-	136,566
Balance at September 30, 2012	4,134,415	523,919	67,397	149,163	4,874,894
Additions		82,206	960		83,166
Balance at March 31, 2013	4,134,415	606,125	68,357	149,163	4,958,060
Accumulated amortization and impairment losses					
Balance at October 1, 2011	2,476,783	352,775	-	64,374	2,893,932
Impairment losses	-	326,333			326,333
Amortization	129,405	75,966	-	16,958	222,329
Balance at September 30, 2012	2,606,188	102,408	-	81,332	2,789,928
Amortization	65,414	18,257	-	7,706	91,376
Balance at March 31, 2013	2,671,602	120,665	-	89,038	2,881,304
Carrying amounts					
At October 1, 2011	1,657,632	741,266	59,049	84,789	2,542,736
At September 30, 2012	1,528,227	421,511	67,397	67,831	2,084,966
At March 31, 2013	1,462,813	485,461	68,357	60,125	2,076,756

Expressed in Canadian Dollars

12. DEFERRED REVENUE

Licensing fees are generally deferred and recognized over the term of the related agreement and deferred product and service revenue are recognized once the revenue recognition criteria are satisfied.

	(6 months) March 31, 2013	(12 months) September 30, 2012
Balance, beginning of period	**$ 1,118,057**	$ 1,103,512
Add:		
Deferred licensing fees		58,992
Deferred product and services revenue	**330,851**	985,375
Less:		
Recognition of deferred product and services revenue	**(138,296)**	(823,892)
Recognition of deferred licensing fees	**(102,965)**	(205,930)
Balance, end of period	**1,207,647**	1,118,057
Amount to be recognized within one year	**(864,438)**	(674,283)
Long term balance	**$ 343,209**	$ 443,774

13. SHARE CAPITAL AND RESERVES

a) **Common Shares and Share Purchase Warrants**

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

On October 26, 2012 the Company raised gross proceeds of $496,600 comprised of 9,550,000 units at a price of $.052 per unit. Each unit is comprised of one common share and one share purchase warrant. Each purchase warrant entitles the holder to acquire an additional common share at a price of $.10 for a period of five years from the closing date. All securities issued pursuant to the Offering were subject to a hold period expiring February 27, 2013. Directors and officers of Covalon participated in the non-brokered private placement for an aggregate of 1.8 million units. The remaining units were subscribed for by an individual who subsequently became a Director of the Company. Proceeds of the private placement will be used by Covalon to develop and commercialize new wound care products, expand international distribution channels and for general working capital.

Changes in common share capital from October 1, 2011 to March 31, 2013:

	Number of Shares	**Issue Price**	**Amount**
Balance at October 1, 2011 and September 30, 2012	83,211,708		$31,911,359
Shares issued via private placement	9,550,000	$0.05	496,600
Less value attributed to warrants			(227,522)
Less share and warrant issue costs			(14,864)
Balance at March 31, 2013	92,761,708		$ 32,165,573

Expressed in Canadian Dollars

13. SHARE CAPITAL AND RESERVES (CONTINUED)

Changes in warrants from October 1, 2011 to March 31, 2013:

	Number of Warrants	Exercise price Amount		Amount
Balance at October 1, 2011 and September 30, 2012	-			-
Warrants issued via private placement, net	9,550,000	$0.10	$	227,522
Balance at March 31, 2013	9,550,000		$	227,522

b) **Contributed Surplus**

The following is a summary contributed surplus from October 1, 2011 to March 31, 2013:

Balance October 1, 2011 and September 30, 2012	$	1,805,586
Balance March 31, 2013	$	1,805,586

c) **Nature and Purpose of Equity and Reserves**

The reserves recorded in equity on the Company's balance sheet include 'Contributed Surplus', and 'Accumulated Deficit'.

'Contributed Surplus' is used to recognize the value of vested stock option grants that were not exercised.

'Accumulated Deficit' is used to record the Company's change in deficit from earnings (loss) from period to period.

14. SHARE-BASED PAYMENTS

a) **Option Plan Details**

The Company has an incentive Stock Option Plan ("the Plan") under which non-transferable options to purchase common shares of the Company may be granted to directors, officers, employees or service providers of the Company. The terms of the Plan provide that the Directors have the right to grant options to acquire common shares of the Company at not less than the closing market price of the shares on the day preceding the grant at terms of up to five years. No amounts are paid or payable by the recipient on receipt of the option, and the options granted are not dependent on any performance-based criteria. Unless the board of directors decides otherwise, options granted under the plan will vest as follows: 33% of the options vest in one year, with a further 33% vesting in each of the subsequent two years on the anniversary of the initial grant date.

Expressed in Canadian Dollars

14. SHARE-BASED PAYMENTS (CONTINUED)

Changes in options for the 3 months ended	2013			2012		
	Options		Weighted Avg Exercise Price	Options		Weighted Avg Exercise Price
Outstanding, Beginning of Period	7,071,666	$	0.36	7,230,000	$	0.35
Granted	-			-		
Exercised	-			-		
Forfeited	86,668	$	0.20	0		
Expired	324,998	$	0.80	0		
Outstanding, End of Period	6,660,000	$	0.34	7,230,000	$	0.35
Exercisable End of Period	5,491,655	$	0.37	4,896,653	$	0.43
Unvested End of Period	1,168,345			2,333,347		

Changes in options for the 6 months ended	2013			2012		
	Options		Weighted Avg Exercise Price	Options		Weighted Avg Exercise Price
Outstanding, Beginning of Period	7,108,333	$	0.35	4,935,000	$	0.45
Granted				2,695,000	$	0.18
Exercised				-		
Forfeited	123,335	$	0.21	300,000	$	0.35
Expired	324,998	$	0.80	100,000	$	0.75
Outstanding, End of Period	6,660,000	$	0.34	7,230,000	$	0.35
Exercisable End of Period	5,491,655	$	0.37	4,896,653	$	0.43
Unvested End of Period	1,168,345			2,333,347		

b) **Fair Value of Options Issued During the Period**

No options were granted during the six month period ended March 31, 2013 (2012 – nil.)

c) **Expenses Arising from Share-based Payment Transactions**

Total expenses arising from share-based payment transactions recognized during the three month period as part of employee benefit expense were $6,625 (2012 - $55,754.)

Expressed in Canadian Dollars

15. INCOME TAXES

The Company has non-capital losses carry forward available for income tax purposes as at September 30, 2012 of approximately $18,126,000 which are available to reduce taxable incomes of future years. These losses expire as follows:

Year		Canada Amount		US Amount
2014	$	805,000	$	
2015		1,997,000		
2026		1,499,000		
2028		2,132,000		
2029		3,309,000		
2030		601,000		
2031		3,874,000		68,000
2032		3,655,000		140,000
	$	17,872,000	$	208,000

The Company had capital losses carry forward for income tax purposes as at September 30, 2012 of approximately $962,883 which are available to reduce taxable capital gains in future years. These losses do not expire.

The Company is eligible for a 20% federal credit on its SR&ED expenditures which can only be used to offset against income taxes payable. The Company is also eligible for the Ontario Innovation Tax Credit ("OITC") at the rate of 10% and refundable in cash to the Company. The refundable tax credits ultimately received by the Company are subject to review by Canada Revenue Agency and the Ontario Ministry of Finance.

Under the Income Tax Act of Canada, certain expenditures are classified as SR&ED expenditures and for tax purposes are grouped into a pool, which is 100% deductible in the year incurred. This SR&ED expenditure pool can also be carried forward indefinitely and deducted in full in any subsequent year. The balance of the SR&ED expenditure pool at September 30, 2012 was $6,844,635.

At September 30, 2012, the Company had $1,214,294 (2012 - $1,214,294) of unclaimed investment tax credits available to reduce federal income taxes payable in future years. If not utilized, these investment tax credits will start expiring in 2013.

16. COMMITMENTS

The Company has signed an offer to lease for its premises at 405 Britannia Rd, Mississauga commencing December 1, 2009 and expiring November 30, 2014. The annual rental payment for fiscal 2013 is $108,379 and increases annually over the remaining term of the lease.

The Company has also entered into three operating leases for its equipment. The equipment is leased at a total cost of $1,711 per month and expires in 2013 and 2014.

The minimum annual remaining lease payments for the next three years are as follows:

2013	$	81,284
2014		99,142
2015		15,271
	$	195,697

Expressed in Canadian Dollars

17. CONTINGENCIES

The Company is party to legal proceedings arising out of the normal course of business. The results of these litigations cannot be predicted with certainty, and management is of the opinion that the outcome of these proceedings is not determinable. Any loss resulting from these proceedings will be charged to operations in the period the loss is determined.

18. CHANGE IN NON-CASH WORKING CAPITAL ITEMS

Net changes in non-cash working capital balances are as follows:

	Three months ended March 31,		Six months ended March 31,	
	2013	2012	**2013**	2012
Accounts receivable, net	**$ 195,580**	$ (528,951)	**$ 442,282**	$ (553,900)
Prepaid expenses	**(18,638)**	29,134	**(4,759)**	(46,523)
Inventories	**(240,951)**	(31,611)	**(264,573)**	(73,611)
Accounts payable and accrued liabilities	**376,373**	115,178	**(158,699)**	133,205
Deferred revenue	**(85,589)**	(46,409)	**89,590**	(86,840)
	$ 226,775	$ (462,659)	**$ 103,841**	$ (627,669)

19. RELATED PARTY TRANSACTIONS

Key management personnel are persons responsible for planning, directing and controlling the activities of the entity. Directors are included in key management. Compensation for key management follows:

	Three months ended March 31,		Six months ended March 31,	
	2013	2012	**2013**	2012
Short term employee benefits	**$ 79,181**	$ 127,342	**$ 256,770**	$ 254,684
Share-based payments	**3,893**	23,602	**8,564**	61,534
	$ 83,074	$ 150,944	**$ 265,334**	$ 316,218

Expressed in Canadian Dollars

20. OPERATING SEGMENTS

The Company disclosed two product segments, Advanced Wound Care and Specialized Medical Device Coatings. Product segments have been identified based on the underlying technology of the product. Assets and other operating expenses are not allocated by segment for internal reporting purposes and therefore have not been allocated to operating segments.

For the three months ended March 31,	**2013**			2012		
	Advanced Wound Care	**Specialized Medical Device Coatings**	**Total**	Advanced Wound Care	Specialized Medical Device Coatings	Total
	$	$	$	$	$	$
Product and Services	478,371	-	478,371	524,247	514,309	1,038,556
Licensing Fee	-	51,482	51,482	-	51,482	51,482
	478,371	51,482	529,853	524,247	565,791	1,090,038
Segment earnings before the following:	173,646	51,482	225,128	196,028	261,557	457,585
Operations			84,772			154,094
Research and development activities			105,968			142,523
Sales and marketing			240,924			436,499
General and administrative			357,666			338,799
Interest income			(5,371)			(10,184)
			(558,831)			(604,146)

During the three months ended March 31, 2013, there were four customers who individually account for more than 10% of product and services revenue (2012 – 4 customers); $424,692 relates to advanced wound care (2012 – $432,608) and $0 relates to specialized medical device coatings (2012 - $473,558).

Expressed in Canadian Dollars

20. OPERATING SEGMENTS (CONTINUED)

For the six months ended March 31,	**2013**			2012		
	Advanced Wound Care	**Specialized Medical Device Coatings**	**Total**	Advanced Wound Care	Specialized Medical Device Coatings	Total
	$	$	$	$	$	$
Product and Services	998,895	-	998,895	759,961	916,280	1,676,241
Licensing Fee	-	102,965	102,965	-	102,964	102,964
	998,895	102,965	1,101,860	759,961	1,019,244	1,779,205
Segment earnings before the following:	340,173	102,965	443,138	288,221	460,394	748,615
Operations			250,960			295,295
Research and development activities			236,877			296,156
Sales and marketing			596,848			842,590
General and administrative			723,387			744,497
Interest income			(11,633)			(25,723)
			(1,353,301)			(1,404,200)

During the six months ended March 31, 2013, there were four customers who individually account for more than 10% of product and services revenue (2012 – 4 customers); $424,692 relates to advanced wound care (2012 - $645,496) and $0 relates to specialized medical device coatings (2012 - $873,536).

21. LOSS PER SHARE

Loss per share is calculated using the weighted average number of shares outstanding during the period. There were 9,550,000 shares issued during the six month period ended March 31,2013 (year ended September 30, 2012 – nil). Shares issued and outstanding at March 31, 2013 were 92,761,708 (September 30, 2012 - 83,211,708). As the Company experienced losses for the periods ended March 31, 2013 and 2012 all potential common shares outstanding from dilutive securities are considered anti-dilutive and are excluded from the calculation of loss per share for those periods.

Details of anti-dilutive potential securities outstanding not included in diluted EPS calculations are as follows:

Anti-dilutive potential securities	**March 31, 2013**	March 31, 2012
Common shares potentially assumable		
- under stock options	**6,660,000**	7,230,000
- under warrants	**9,550,000**	-
	16,210,000	7,230,000