Covalon Technologies Ltd.
CONSOLIDATED FINANCIAL STATEMENTS

For the years ended September 30, 2013 and 2012

Contents

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Independent Auditor's Report

To the Shareholders of Covalon Technologies Ltd.

We have audited the accompanying consolidated financial statements of Covalon Technologies Ltd., which comprise the consolidated statements of financial position as at September 30, 2013 and September 30, 2012, and the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years ended September 30, 2013 and September 30, 2012, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Covalon Technologies Ltd. as at September 30, 2013 and September 30, 2012, and its financial performance and its cash flows for the years ended September 30, 2013 and September 30, 2012 in accordance with International Financial Reporting Standards.

(signed) BDO Canada LLP

Chartered Accountants, Licensed Public Accountants

January 27, 2014

Toronto, Ontario

Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

Expressed in Canadian Dollars

		September 30, 2013		September 30, 2012
Assets				
Current assets				
Cash and cash equivalents	**$**	**633,103**	$	1,142,667
Short-term investments		**500,000**		500,000
Accounts receivable, net (Note 5)		**1,184,229**		711,820
Prepaid expenses		**84,743**		53,126
Inventories (Note 8)		**605,892**		806,015
Total current assets		**3,007,967**		3,213,628
Non-current assets				
Restricted cash (Note 9)		**63,000**		63,000
Other receivable (Note 17)		**40,000**		-
Property, plant and equipment (Note 10)		**558,249**		602,135
Intangible assets (Note 11)		**2,001,030**		2,084,966
Total non-current assets		**2,662,279**		2,750,101
Total Assets	**$**	**5,670,246**	$	5,963,729
Liabilities and Shareholders' Equity				
Current liabilities				
Accounts payable and accrued liabilities	**$**	**982,774**	$	1,611,125
Deferred revenue (Note 12)		**955,335**		674,283
Total current liabilities		**1,938,109**		2,285,408
Non-current liabilities				
Convertible Debenture (Note 13)		**516,017**		-
Deferred revenue (Note 12)		**269,772**		443,774
Total non-current liabilities		**785,789**		443,774
Total Liabilities		**2,723,898**		2,729,182
Shareholders' Equity				
Share capital (Note 14 a))		**32,393,095**		31,911,359
Contributed surplus (Note 14 b) and c))		**2,224,645**		1,805,586
Stock Options (Note 15)		**1,526,210**		1,947,389
Equity component of convertible debentures		**225,352**		
Accumulated deficit (Note 14 c))		**(33,422,954)**		(32,429,787)
Total shareholders' equity		**2,946,348**		3,234,547
Total Liabilities and Shareholders' Equity	**$**	**5,670,246**	$	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 consolidated financial statements.

Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

Expressed in Canadian Dollars

	Year ended September 30,	
	2013	2012
Revenue		
Product and Services		
Advanced wound care	**$ 3,762,969**	$ 1,897,425
Specialized medical device coatings	**71,092**	1,690,098
Licensing fees (Note 12)	**300,082**	205,928
Total revenue	**4,134,143**	3,793,451
Cost of sales	**2,045,325**	2,328,646
Gross Profit	**2,088,818**	1,464,805
Operating Expenses		
Operations	**416,803**	728,880
Research and development activities	**436,119**	559,488
Recovery refundable investment tax credit (note 7)	-	(217,058)
Sales and marketing	**879,692**	1,844,354
General and administrative	**1,363,620**	2,216,918
	3,096,234	5,132,582
Loss before undernoted	**(1,007,416)**	(3,667,777)
Write-down of patents	-	(372,007)
Interest income	**14,249**	48,402
Net loss and comprehensive loss for the year	**$ (993,167)**	$ (3,991,382)
Basic and diluted loss per share (Note 22)	**$ (0.11)**	$ (0.48)

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

Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Expressed in Canadian Dollars

For the years ended September 30, 2013 and September 30, 2012

	Share Capital	Contributed Surplus	Stock Options	Equity Component of Convertible Debentures	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			210,588			210,588
Comprehensive loss for the period					(3,991,382)	(3,991,382)
Balance at September 30, 2012	$ 31,911,359	$ 1,805,586	$ 1,947,389		$ (32,429,787)	$ 3,234,547
Balance at October 1, 2012	$ 31,911,359	$ 1,805,586	$ 1,947,389	$ -	$ (32,429,787)	$ 3,234,547
Share based payments			(2,120)			(2,120)
Options naturally expired		419,059	(419,059)			-
Comprehensive loss for the period					(993,167)	(993,167)
Issue of common shares	481,736					481,736
Issue convertible debenture				225,352		225,352
Balance at September 30, 2013	$ 32,393,095	$ 2,224,645	$ 1,526,210	$ 225,352	$ (33,422,954)	$ 2,946,348

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

Covalon Technologies Ltd.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Expressed in Canadian Dollars

	Year ended September 30, 2013	2012
Cash flows from operating activities		
Net loss and comprehensive loss for the period	**$ (993,167)**	$ (3,991,382)
Adjustments to reconcile net loss and comprehensive loss to net cash used in operating activities:		
Depreciation - property, plant and equipment	**128,318**	129,966
Amortization - intangible assets	**187,206**	222,329
Non-cash interest (Note 13)	**10,186**	
Write-down of patents	**-**	372,007
Share based payments	**(2,120)**	210,588
Foreign exchange loss (gain) on cash held	**8,832**	21,967
Cash used by operating activities before change in non-cash working capital balances	**(660,745)**	(3,034,525)
Change in non-cash working capital (Note 18)	**(825,204)**	(239,545)
Total cash outflows from operating activities	**(1,485,949)**	(3,274,070)
Cash flows from investing activities		
Purchase of property, plant and equipment	**(84,432)**	(124,882)
Purchase of intangible assets	**(103,270)**	(136,566)
Total cash outflows from investing activities	**(187,702)**	(261,448)
Cash flows from financing activities		
Restricted cash (Note 9)	**-**	(63,000)
Other receivable	**(40,000)**	**-**
Net proceeds on issuance of share capital (Note 14)	**481,735**	**-**
Net proceeds on issuance of convertible debenture	**731,184**	**-**
Total cash inflows from financing activities	**1,172,919**	(63,000)
Foreign exchange loss on cash held	**(8,832)**	(21,967)
Total net decrease in cash and cash equivalents during the period	**(509,564)**	(3,620,485)
Cash and cash equivalents, beginning of the period	**1,142,667**	4,763,152
Cash and cash equivalents, end of period	**$ 633,103**	$ 1,142,667
Represented by		
Cash	**$ 243,417**	$ 441,097
Cash equivalents	**389,686**	701,570
	$ 633,103	$ 1,142,667

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

1. CORPORATE INFORMATION

Covalon Technologies Ltd. ("the Company") 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 year ended September 30, 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

a) Statement of Compliance

These consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were authorized for issue by the Board of Directors on January 27, 2014.

b) Basis of Measurement

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

c) Functional Currency

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency, and all values presented in the Canadian dollar are rounded to the nearest dollar (CAD $), unless otherwise indicated.

d) Critical accounting estimates and judgments

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment of complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements for the purposes of the transition to IFRS, unless otherwise indicated.

a) Basis of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Covalon Technologies Inc. and COV Healthcare Innovations Corp. and have been prepared using the acquisition method of consolidation. The assets and liabilities of the acquired companies are initially recorded at fair value at the date of acquisition. The results of operations of the acquired companies are included from the dates of acquisition. All significant intercompany transactions and balances have been eliminated on consolidation.

b) Revenue Recognition

Revenue is recognized on an accrual basis as follows:

- Revenue arising from product sales is recognized once the product has been shipped to the customer.
- Revenue arising from licensing fees and royalties is initially recorded as deferred revenue and recognized over the period of the relevant agreements.
- Revenue arising from long term development contracts is recognized using the percentage of completion method.
- Revenue arising from interest is recognized as earned.

In all cases, revenue is recognized only when the amounts are fixed and determinable and when the Company can be reasonably assured of collection.

c) Cash and Cash Equivalents

Cash and cash equivalents are defined as highly liquid investments and consist of cash and short-term interest bearing instruments that are cashable at any time without penalty.

d) Inventories

Raw materials and supplies are stated at the lower of weighted average cost and net realizable value. Work in process and finished goods are stated at the lower of weighted average cost and net realizable value in accordance with IAS 2. Cost comprises all costs of purchase and costs of conversion including directly attributable production overheads.

e) Property, Plant and Equipment

i) Recognition and Measurement

On initial recognition, property, plant and equipment are valued at cost, being the purchase price and directly attributable cost of acquisition or construction required to bring the asset to the location and condition necessary to be capable of operating in the manner intended by the Company.

Property, plant and equipment is subsequently measured at cost less accumulated depreciation, less any accumulated impairment losses.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

ii) Subsequent Costs

The cost of replacing part of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in operations as incurred.

iii) Major Maintenance and Repairs

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to operations during the financial period in which they are incurred.

iv) Gains and Losses

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount, and are recognized in operations.

v) Depreciation

Depreciation is recognized in operations and is using the following annual rates:

Furniture and fixtures	20% diminishing balance basis
Lab equipment	20% diminishing balance basis
Leasehold improvements	20% straight-line

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

f) Intangible Assets

i) Patents, Trademarks and Computer Software

Intangible assets include expenditures related to obtaining patents and technology rights associated with patents, trademarks and computer software. Patents are amortized on a straight-line basis over the remaining life of the patent being 20 years less the number of years since application for the patent and are stated at cost less accumulated amortization and impairment. Trademarks are considered to have an indefinite useful life and as such are recorded at cost less accumulated impairment. Computer software is amortized using the 20% diminishing balance rate. Amortization methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Gains and losses on disposal of an item of other intangible assets are determined by comparing the proceeds from disposal with the carrying amount, and are recognized net within other income in operations.

ii) Deferred Development Costs/Research and Development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding is recognized in operations as incurred.

Development activities involve a plan or design for the production of new or substantially improved products and processes and relate to the Company's technology platforms, advanced wound dressings and specialized medical device coatings. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable and the Company intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalized includes the cost of materials, direct labour and overhead costs that are directly attributable to preparing the asset for its intended use.

Development expenditure not satisfying the above criteria and expenditure on the research phase of internal projects are recognized in operations as incurred.

Capitalized development expenditure is amortized from the beginning of commercial production and sales and is amortized on a straight-line basis over the remaining life of the related patent(s).

Gains and losses on disposal of an item of deferred development costs are determined by comparing the proceeds from disposal with the carrying amount, and are recognized net within other income in operations.

g) Impairment of Non-Financial Assets

Impairment tests on intangible assets with indefinite useful economic lives are undertaken annually at the financial year-end. Other non-financial assets, including property, plant and equipment, computer software, patents and deferred development costs, are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the asset is written down accordingly. Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets. The Company has identified two cash-generating units for which impairment testing is performed (1) advanced wound care and (2) specialized medical device coatings. An impairment loss is charged to operations, except to the extent it reverses gains previously recognized in other comprehensive loss/income.

h) Investment Tax Credits

From time to time the Company receives investment tax credits. Investment tax credits are accrued when there is reasonable assurance of realization and reflected as a reduction of the related expense. In the event the investment tax credits received are less than the amount previously recognized, the difference will be reflected in operations in the period in which it is determined.

i) Other Provisions

Provisions are recognized for liabilities of uncertain timing or amount that have arisen from past transactions, including legal or constructive obligations. The provision is measured at the best estimate of the expenditure required to settle the obligation at the reporting date.

j) Income Taxes

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Deferred tax assets and liabilities are recognized for the tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the year in which the change occurs.

Recognition of deferred tax assets is restricted to those instances where it is probable that taxable profit will be available against which the temporary difference or loss can be utilized.

Current tax and deferred tax are recognized in net income except to the extent that it relates to items recognized directly in equity or in other comprehensive loss/income.

k) Foreign Currency Transactions

Foreign currency amounts are translated into Canadian dollars (the functional currency) as follows:

At the transaction date, each asset, liability, revenue and expense denominated in a foreign currency is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the reporting date, unsettled monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at the reporting date and the related translation differences are recognized in net income.

Non-monetary assets and liabilities that are measured at historical cost are translated into Canadian dollars by using the exchange rate in effect at the date of the initial transaction and are not subsequently restated.

l) Financial Instruments

Financial instruments are classified as into one of the following categories based on the purpose for which the asset was acquired. All transactions related to financial instruments are recorded on a trade date basis. The Company's accounting policy for each category is as follows:

i) Loans and Receivables

Cash and cash equivalents, restricted cash, short term investments and accounts receivable are classified as loans and receivables. They are initially recognized at fair value and subsequently carried at amortized cost, using the effective interest rate method, less any impairment losses. Amortized cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognized in operations when the loans and receivables are derecognized or impaired, as well as through the amortization process.

ii) Financial Liabilities

Accounts payable and accrued liabilities are classified as other financial liabilities and are initially recognized at fair value (net of any transaction costs) and subsequently carried at amortized cost using the effective interest rate method.

Accounts payable and accrued liabilities represent liabilities for goods and services provided to the Company prior to the end of the period which are unpaid. Accounts payable amounts are unsecured and are usually paid within payment terms negotiated with the supplier.

m) Share Capital

Financial instruments issued by the Company are classified as equity only to the extent that they do not meet the definition of a financial liability or financial asset. The Company's common shares are classified as equity instruments.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

n) Loss Per Share

Loss per share is computed by dividing the net loss applicable to common shares of the Company by the weighted average number of common shares outstanding for the relevant period. As the Company experienced losses for the years ended September 30, 2013 and 2012, all potential common shares outstanding from dilutive securities are considered anti-dilutive and are excluded from the calculation of diluted loss per share for these periods.

o) Share-based Payments

Where equity-settled share options are awarded to employees, the fair value of the options at the date of grant is charged to the statement of comprehensive loss over the vesting period.

Where equity instruments are granted to employees, they are recorded at the fair value of the equity instrument granted at the grant date. The grant date fair value is recognized in comprehensive loss/income over the vesting period, described as the period during which all the vesting conditions are to be satisfied.

When the value of goods or services received in exchange for the share-based payment cannot be reliably estimated, the fair value is measured by use of a valuation model. The expected life used in the model is adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

p) Common Share Purchase Warrants

The Company periodically issues units to investors consisting of common shares combined with common share purchase warrants. Gross proceeds received from the issuance of units are accounted for as an increase in share capital. No separate valuation of the warrants is made for accounting purposes.

Similarly, the Company periodically issues units to investors consisting of debentures convertible into common shares combined with common share purchase warrants. Gross proceeds are allocated to the discounted current value of the debt and the equity component representing the value of the convertible feature of the debenture. No separate valuation of the warrants is made for accounting purposes.

q) Standards, Amendments and Interpretations Not Yet Effective

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are mandatory for accounting periods beginning after October 1, 2013 or later periods. None of these are expected to have a significant effect on the consolidated financial statements, except for the following standards and interpretations that have been issued but are not yet effective:

IFRS 9 Financial Instruments

IFRS 9 Financial Instruments is part of the IASB's wider project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard is effective for annual periods beginning on or after January 1, 2015. The Company is in the process of evaluating the impact of the new standard.

IFRS 10 Consolidated Financial Statements

IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. The Company is yet to assess the full impact of IFRS 10 and intends to adopt the standard no later than the accounting period beginning on or after January 1, 2013.

IFRS 12 Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12 Disclosure of Interests in Other Entities. IFRS 12 is a comprehensive new standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. This new standard is effective for the Company's interim and annual consolidated financial statements commencing on or after January 1, 2013.

IFRS 13 Fair Value Measurement

IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The Company has yet to assess the full impact of IFRS 13 and intends to adopt the standard no later than the accounting period beginning on or after October 1, 2013.

The Company is currently assessing the impact of the adoption of these standards on its Consolidated Financial Statements.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Company.

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.

ESTIMATES

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.

i) Share-based Payment Transactions

The Company measures the cost of equity-settled transactions with directors, officers and employees by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payment transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about them. The assumptions and models used for estimating fair value for share-based payment transactions are disclosed in Note 14.

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.

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.

iv) Income taxes

The Company recognizes deferred tax assets, related tax-loss carryforwards and other deductible temporary differences where it is probable that sufficient future taxable income can be generated in order to fully utilize such losses and deductions. This requires significant estimates and assumptions regarding future earnings, and the ability to implement certain tax planning opportunities in order to assess the likelihood of utilizing such losses and deductions.

Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Given the cross border business relationships, differences arising between the actual results and the assumptions made, or future changes in such assumptions, could necessitate future adjustments to tax income and expense already recorded. The Company established provisions, based on reasonable estimates, for possible consequences of audits by the tax authorities of the restive countries in which it operates. The amount of such provisions is based on various factors, such as experience of previous tax audits and differing interpretations of tax regulations by the taxable entity and the responsible tax authority. Such differences of interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective Company domicile.

JUDGMENTS

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) Foreign Currency translation:

The determination of functional currency for each of the Company's entities requires considerable judgment. The functional currency is determined based on the currency of the primary economic environment in which that entity operates. As the Company generates and expends cash in both the US and Canadian currencies, management considers several factors, including: the currency in which it receives its various revenue streams and the magnitude of each; the currency in which it purchases materials and pays its employees and the geographic environment influencing each of its consolidated entities and products.

ii) Provisions

A provision is a liability of uncertain timing or amount. Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. A legal obligation can arise through a contract, legislation or other operation of law. A constructive obligation arises from an entity's actions; whereby, through an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated it will accept certain responsibilities and has thus created a valid expectation that it will discharge those responsibilities. The amount recognized as a provision is the best estimate, at each period end, of the expenditures required to settle the present obligation considering the risks and uncertainties associated with the obligation. Judgment is necessary to determine the likelihood that pending litigation or other claims will succeed or a liability will arise and then to estimate the amount.

Expressed in Canadian Dollars

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 $924,686 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 September 30, 2013, ten customers accounted for 92% (2012 – ten customers for 77%) 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 $25,254 (2012 – $812,794) resulting in a provision for doubtful accounts expense of $1,121 (2012 - $758,325). Management reviews the outstanding amounts on a regular basis and determines the collectability of the outstanding balances on a case by case basis.

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

		September 30, 2013		September 30, 2012
Current	**$**	**1,154,098**	$	472,288
30-60 days past due		**29,115**		56,362
Over 60 days past due, (net of allowance for doubtful accounts of $1,121 , Sep 2012 - $895,600)		**1,016**		183,170
	$	**1,184,229**	$	711,820

Liquidity risk

The Company continually monitors working capital to ensure sufficient cash is available to meet operational and capital expenditure requirements.

The Company has contractual obligations related to accounts payable and accrued liabilities that are due within a year. The Company has contractual obligations related to its signed offer to lease for its premises at 405 Britannia Rd. Mississauga and for its operating leases which are payable from 2014 to 2015 in the amounts of $99,142 and $15,271 respectively.

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:

	September 30, 2013	September 30, 2012
Accounts receivable, net	**$ 1,093,765**	$ 664,505
Accounts payable	**319,154**	599,542
Deferred Revenue	**313,500**	293,352
Cash	**221,812**	400,392
Exchange rate ($USD / $CAD)	**1.0303**	0.9832

An increase of 5% and 10% in the US dollar exchange rate would result in a decrease of the net loss by approximately $34,146 (2012 – $23,222) and $68,292 (2012 - $46,444) respectively.

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.

Expressed in Canadian Dollars

6. MANAGEMENT OF CAPITAL

The Company defines capital that it manages as its shareholders' equity comprising of share capital, options, contributed surplus, equity component of convertible debentures and accumulated deficit. Its objectives when managing capital are to ensure that the Company will continue as a going concern, so that it can provide services to its customers and returns to its shareholders. The capital at September 30, 2013 is $2,870,458 (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.

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 year ended September 30, 2013, the Company received no payments. (2012 – $217,058).

8. INVENTORIES

Inventories consist of the following:

		September 30, 2013		September 30, 2012
Raw materials	**$**	**364,850**	$	341,907
Finished Goods		**241,041**		464,108
	$	**605,892**	$	806,015

Product expenses include $1,444,199 (2012 - $1,594,801) in inventoried materials.

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.

Expressed in Canadian Dollars

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	-	84,432	-	84,432
Balance at September 30, 2013	319,116	1,478,500	71,416	1,869,032
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	23,345	104,973	-	128,318
Balance at September 30, 2013	225,737	1,013,630	71,416	1,310,783
Carrying amounts				
At September 30, 2012	116,724	485,411	-	602,135
At September 30, 2013	93,379	464,870	-	558,249

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		97,885	5,385		103,270
Balance at September 30, 2013	4,134,415	621,804	72,782	149,163	4,978,164
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	121,703	30,958	-	34,545	187,206
Balance at September 30, 2013	2,727,891	133,366	-	115,877	2,977,134
Carrying amounts					
At September 30, 2012	1,528,227	421,511	67,397	67,831	2,084,966
At September 30, 2013	1,406,524	488,438	72,782	33,286	2,001,030

Certain patents were allowed to lapse in the current year resulting in impairment losses of $Nil (2012 – $372,007).

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.

	September 30, 2013	September 30, 2012
Balance, beginning of period	**$ 1,118,057**	$ 1,103,512
Add:		
Deferred licensing fees	**192,744**	58,992
Deferred product and services revenue	**1,044,093**	985,375
Less:		
Recognition of deferred product and services revenue	**(910,252)**	(823,892)
Recognition of deferred licensing fees	**(219,535)**	(205,930)
Balance, end of period	**1,225,107**	1,118,057
Amount to be recognized within one year	**(955,335)**	(674,283)
Long term balance	**$ 269,772**	$ 443,774

13. CONVERTIBLE DEBENTURE UNITS

On August 30, 2013 the Company issued a private placement consisting of 750 units for gross proceeds of $750,000. Units were priced at $1,000 each. Each unit consists of a $1,000 secured convertible debenture and 6,451 warrants. Each convertible debenture unit bears interest at 12% payable on maturity and is convertible into 6,451 common shares of the Company at a conversion price of $0.155 at any time prior to August 31, 2016. Each warrant entitles the holder to acquire one common share at a price of $0.155 at any time prior to August 31, 2016. The units are subject to a hold period expiring December 31, 2013. A portion of the units were issued to related parties.

The debenture is secured, ranking senior to all indebtedness of the Company.

Expressed in Canadian Dollars

At September 30, 2013 the convertible debenture units are reflected in the financial statements as follows:

Face value of convertible debenture at maturity August 31, 2016	$ 750,000
Fair value of the convertible debenture at date of issue, net	524,648
Less transaction costs	(19,733)
Interest at 12% accrued and compounded annually	7,500
Accretion	3,602
	516,017
Fair value of Equity component	225,352

14. SHARE CAPITAL AND RESERVES

a) Common Shares

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

On August 30, 2013 the Company issued a private placement consisting of 750 units for gross proceeds of $750,000. Units were priced at $1,000 each. Each unit consists of a $1,000 secured convertible debenture and 6,451 warrants. Each convertible debenture unit bears interest at 12% payable on maturity and is convertible into 6,451 common shares of the Company at a conversion price of $0.155 at any time prior to August 31, 2016. Each warrant entitles the holder to acquire one common share at a price of $0.155 at any time prior to August 31, 2016. The units are subject to a hold period expiring December 31, 2013. See Note 12.

On July 16, 2013 the Company consolidated its issued and outstanding common shares on the basis of one post-consolidation common share for each 10 pre-consolidation common shares. These Consolidated Financial Statements are prepared based on the number of post-consolidation shares, options and warrants outstanding.

On October 26, 2012 the Company issued 955,000 units at a price of $0.52 per unit for gross proceeds of $496,600. 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 $1.00 for a period of five years expiring October 26, 2017.

In fiscal 2006, Covalon acquired technology from Perfusion Therapeutics Inc. for 110,000 fully paid non-assessable common shares of Covalon Technologies Ltd., issued in escrow to be released on various success milestones. At September 30, 2013, 15,000 (2012 – 15,000) shares valued at $213,875 (2012 - $213,875) have been released from trust. The remaining balance of 95,000 shares are still being held in trust.

Expressed in Canadian Dollars

The following is a summary of changes in common share capital from October 1, 2011 to September 30, 2013:

	Number of Shares	Issue Price	Amount
Balance at September 30, 2011 and September 30, 2012	8,321,171		$31,911,359
Shares issued via private placement	955,000	$0.52	496,600
Less issue costs			(14,864)
Balance at September 30, 2013	9,276,171		$ 32,393,095

b) Contributed Surplus

The following is a summary of changes in contributed surplus from October 1, 2011 to September 30, 2013:

Balance September 30, 2011 and 2012	$	1,805,586
Options naturally expired		419,059
Balance September 30, 2013	$	2,224,645

c) Share Purchase Warrants

The following is a summary of changes in warrants from October 1, 2011 to September 30, 2013:

	Number of Warrants		Exercise Price	Expiry Date
Balance at September 30 , 2011 and 2012	-			
Warrants issued October 26, 2012	955,000	$	1.00	October 26, 2017
Warrants issued August 30, 2013	4,838,250	$	0.155	August 31, 2016
Balance at September 30, 2013	5,793,250			

d) 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 have naturally expired.

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

Expressed in Canadian Dollars

15. 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.

The following is a summary of changes in options from October 1, 2011 to September 30, 2012:

				During the Period						
Grant Date	Expiry Date	Exercise Price	Opening Balance	Granted	Exercised	Expired	Forfeited	Closing Balance	Vested and Exercisable	Unvested
31-Mar-08	31-Mar-13	$ 27.90	30,000	-	-	-	-	30,000	30,000	-
15-Oct-08	15-Oct-13	$ 7.50	9,000	-	-	-	(1,000)	8,000	8,000	-
22-May-09	22-May-14	$ 4.00	120,000	-	-	-	-	120,000	120,000	-
11-Dec-09	11-Dec-14	$ 2.90	9,000	-	-	-	(1,000)	8,000	8,000	-
27-Jan-10	27-Jan-15	$ 3.10	85,500	-	-	-	-	85,500	85,500	-
01-Sep-10	01-Sep-15	$ 2.00	140,000	-	-	-	-	140,000	93,333	46,667
02-Sep-10	02-Sep-15	$ 2.00	60,000	-	-	-	(10,167)	49,833	33,332	16,501
10-Jun-11	10-Jun-16	$ 2.00	98,500	-	-	-	-	98,500	32,833	65,667
13-Jun-11	13-Jun-16	$ 2.00	71,000	-	-	-	-	71,000	71,000	-
27-Sep-11	27-Sep-16	$ 1.40	100,000	-	-	-	-	100,000	100,000	-
			723,000	-	-	-	(12,167)	710,833	581,998	128,835
Weighted Average Exercise Price			$ 3.50	$ -	$ -	$ -	$ 2.50	$ 3.60	$ 3.90	$ 2.00

Expressed in Canadian Dollars

The following is a summary of changes in options from October 1, 2012 to September 30, 2013:

Grant Date	Expiry Date	Exercise Price	Opening Balance	During the Period: Granted	Exercised	Expired	Forfeited	Closing Balance	Vested and Exercisable	Unvested
31-Mar-08	31-Mar-13	$ 27.90	30,000	-	-	(22,500)	(7,500)	-	-	-
15-Oct-08	15-Oct-13	$ 7.50	8,000	-	-	-	(2,000)	6,000	6,000	-
22-May-09	22-May-14	$ 4.00	120,000	-	-	-	-	120,000	120,000	-
11-Dec-09	11-Dec-14	$ 2.90	8,000	-	-	-	(6,993)	1,007	1,007	-
27-Jan-10	27-Jan-15	$ 3.10	85,500	-	-	-	-	85,500	85,500	-
01-Sep-10	01-Sep-15	$ 2.00	140,000	-	-	-	(20,000)	120,000	120,000	-
02-Sep-10	02-Sep-15	$ 2.00	49,833	-	-	-	(21,337)	28,496	28,496	-
10-Jun-11	10-Jun-16	$ 2.00	98,500	-	-	-	(71,505)	26,995	17,997	8,998
13-Jun-11	13-Jun-16	$ 2.00	71,000	-	-	-	-	71,000	71,000	-
27-Sep-11	27-Sep-16	$ 1.40	100,000	-	-	-	-	100,000	100,000	-
16-Aug-13	16-Aug-18	$ 0.16	-	74,500				74,500	-	74,500
26-Sep-13	26-Sep-18	$ 0.85	-	235,000				235,000	-	235,000
			710,833	309,500	-	(22,500)	(129,335)	868,498	550,000	318,498
Weighted Average Exercise Price			$ 3.60	$ 0.68	$ -	$ 27.90	$ 3.64	$ 1.89	$ 2.56	$ 0.72

b) Fair Value of Options Issued During the Period

During the year ended September 30, 2013, the Company issued two tranches of options:

1) 74,500 options with a weighted average fair value of $0.1466 were granted. Trading price of the stock at the time of the grant was $0.155. The fair market value of options granted was determined using the Black-Scholes valuation model with
the following implicit assumptions: average risk-free rate of interest – 1.57%, dividend rate NIL, average volatility – 179.9% and an average term of 5 years. The estimated annualized forfeiture rate is 8.01%.

2) 235,000 options with a weighted average fair value of $0.8035 were granted. Trading price of the stock at the time of the grant was $0.85. The fair market value of options granted was determined using the Black-Scholes valuation model with the following implicit assumptions: average risk-free rate of interest – 1.72%, dividend rate NIL, average volatility – 179.5% and an average term of 5 years. The estimated annualized forfeiture rate is 8.01%.

No options were granted during the year ended September 30, 2012.

c) Expenses Arising from Share-based Payment Transactions

Total expenses arising from share-based payment transactions recognized during the year as part of employee benefit expense were $ (2,120) (year ended September 30, 2012 - $210,588).

Expressed in Canadian Dollars

16. INCOME TAXES

The Company computes an income tax provision in each of the jurisdictions in which it operates. The operations in Canada and the United States are subject to income tax at average rates of 26.5% - 39.5 (2012 – 26.9% - 39.5%)

(a) Reconciliation between statutory rate and actual rate

		2013		2012
Income tax recovery computed at statutory combined tax rates	$	**(279,500)**	$	(1,090,200)
Permanent differences		**800**		2,700
Change in deferred tax rates				(290,900)
Other		**(2,000)**		42,700
Change in deferred tax assets not recognized		**280,700**		1,335,700
	$	**-**	$	-

(b) Deferred tax assets

The tax effect of the temporary differences that gives rise to deferred tax assets (liabilities) as of September 30, 2013 and 2012 is presented below. No benefit has been recorded in these financial statements as there is no assurance that the Company will generate taxable income to utilize these differences.

		2013		2012
Non-capital loss carry forwards	$	**5,107,700**	$	4,817,600
Capital loss carry forwards		**127,600**		127,600
Capital and other assets		**100,600**		164,000
Deferred development costs		**1,441,100**		1,408,800
Deferred revenue and other liabilities		**340,700**		309,200
Convertible Debenture		**(64,600)**		
Deferred tax assets not recognized		**(7,053,100)**		(6,827,200)
	$	**-**	$	-

The Company has non-capital losses carry forward available for income tax purposes as at September 30, 2013 of approximately $19,113,000 which are available to reduce taxable incomes of future years. These losses expire as follows:

Expressed in Canadian Dollars

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	3,653,000	140,000
2033	908,000	127,000
	$ 18,778,000	$ 335,000

(c) The Company has capital losses carry forward for income tax purposes as at September 30, 2013 of approximately $962,883 (2012 - $962,883) which are available to reduce taxable capital gains in future years. These losses do not expire.

(d) The Company is eligible for the Ontario Innovation Tax Credit ("OITC") at the rate of 10% on its research and development expenditures and refundable in cash to the Company. The Company is also eligible for a 20% federal research and development investment tax credit and a 4.5% Ontario Research and Development Tax Credit (“ORDTC”) which are available to offset federal income taxes payable and Ontario income taxes payable, respectively, in the future.

The tax credits ultimately received by the Company are subject to review by Canada Revenue Agency and the Ontario Ministry of Finance.

At September 30, 2013, the Company has $1,414,446 (2012 - $1,414,446) 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 2023. These unclaimed investment tax credits have not been recognized as receivables.

At September 30, 2013, the Company has $90,115 (2012 – $90,115) of unclaimed ORDTC available to reduce Ontario income taxes payable in future years. If not utilized, these ORDTC will start expiring in 2029. These unclaimed ORDTC have not been recognized as receivables.

17. RELATED PARTY TRANSACTIONS

The following is a summary of the Company’s related party transactions during the period:

Key Management Compensation

Key management personnel are persons responsible for planning, directing and controlling the activities of an entity, and include directors.

During the year a non interest bearing loan of $50,000 was made to a key employee. The principal is repayable in annual instalments of $10,000 commencing August 16, 2014 with the final payment due August 16, 2018.

Expressed in Canadian Dollars

A portion of the Convertible Debenture Units (Note 13) were issued to related parties.

Key management personnel compensation comprised:

	Year ended September 30,	
	2013	2012
Short term employee benefits	**$ 319,725**	$ 509,617
Share-based payments	**22,881**	91,524
	$ 342,606	$ 601,141

18. COMMITMENTS

The Company signed an offer to lease for its premises at 405 Britannia Rd, Mississauga which commenced December 1, 2009 and expires November 30, 2014. The annual rental payment for fiscal 2014 through expiry is $91,627.

The Company has also entered into three operating leases for its equipment. The equipment is leased at a total cost of $4,956 per year and expires in 2018.

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

2014	$ 96,583
2015	20,227
2016	4,956
2017	4,956
thereafter	3,717
	$ 130,439

19. 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.

Expressed in Canadian Dollars

20. CHANGE IN NON-CASH WORKING CAPITAL ITEMS

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

	For the year ended September 30, **2013**	2012
Accounts receivable, net	**$ (472,409)**	$ (250,010)
Prepaid expenses	**(31,617)**	1,693
Inventories	**200,123**	(413,630)
Accounts payable and accrued liabilities	**(628,351)**	407,857
Deferred revenue	**107,050**	14,545
	$ (825,204)	$ (239,545)

21. 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 year ended September 30,	**2013**			2012		
	Advanced Wound Care	**Specialized Medical Device Coatings**	**Total**	Advanced Wound Care	Specialized Medical Device Coatings	Total
	$	$	$	$	$	$
Product and Services	**3,762,969**	**71,092**	**3,834,061**	1,897,425	1,690,098	3,587,523
Licensing Fee		**300,082**	**300,082**	-	205,928	205,928
	3,762,969	**371,173**	**4,134,143**	1,897,425	1,896,026	3,793,451
Segment earnings before the following:	**1,722,320**	**366,497**	**2,088,818**	629,888	834,917	1,464,805
Operations			**416,803**			728,880
Research and development activities			**436,119**			559,488
Recovery of refundable investment tax credit						(217,058)
Sales and marketing			**879,692**			1,844,354
General and administrative			**1,363,620**			2,216,918
Write-down of patents						372,007
Interest income			**14,249**			(48,402)
			(993,167)			(3,991,382)

Expressed in Canadian Dollars

Included in specialized medical device coatings revenue for 2013 is Nil (2012 -$851,630) related to development services.

During the year ended September 30, 2013, there were three customers who individually account for more than 10% of product and services revenue (Sep 2012 – 4 customers); $2,749,106 (2012 - $900,180) relates to advanced wound care and Nil (2012 - $1,391,276) relates to specialized medical device coatings.

The Company generated product and services sales and licensing fee of $1,974,063 (2012 - $3,059,220) in the US, $17,551(2012 - $511,952) in Canada and $2,142,529 (2012 - $222,279) internationally.

22. LOSS PER SHARE

Loss per share is calculated using the weighted average number of shares outstanding during the period. There were 955,000 (2012 – Nil) shares issued during the year ended September 30, 2013. Shares issued and outstanding at September 30, 2013 and 2012 were 9,276,171 and 8,321,171 respectively. As the Company experienced losses for the periods ended September 30, 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	**September 30, 2013**	September 30, 2012
Common shares potentially assumable		
- under stock options	**868,498**	710,833
- under warrants	**5,793,250**	-
- under terms of convertible debenture	**4,838,710**	
	11,500,458	710,833

Expressed in Canadian Dollars

23. EXPENSES BY NATURE

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

a) **Employee costs**

	Year ended September 30, **2013**	2012
Short-term wages, commissions and benefits	**2,183,992**	3,268,934
Share based payments	**(2,120)**	210,588
Total employee costs	**2,181,872**	3,479,522
Included in		
Cost of goods sold	**81,653**	502,929
Operations	**375,874**	541,221
Research and development activities	**366,389**	444,941
Sales and marketing	**638,247**	1,268,047
General and administrative	**719,710**	722,384
Total employee costs	**2,181,872**	3,479,522

b) **Depreciation and amortization**

	Year ended September 30, **2013**	2012
Cost of goods sold	**$ 184,799**	$ 176,810
Operations	**11,073**	13,842
Research and development activities	**30,793**	42,329
General and administrative	**23,345**	26,390
Intangibles	**65,511**	92,924
Total depreciation and amortization	**$ 315,521**	$ 352,295

24. SUBSEQUENT EVENT

Subsequent to year end, the Company executed an agreement with Molnlycke Health Care. Under the license agreement, the Company granted Molnlycke the exclusive rights to patent-pending antimicrobial silicone adhesive technology in the field of single-use surgical, wound care and vascular access medical dressings. The Company received $3.5 million USD in upfront license fees and is entitled to additional ongoing minimum royalties, milestone payments and other fees. The parties simultaneously signed a supply and distribution agreement under which the Company will provide to Molnlycke its United States Food and Drug Administration (FDA) cleared products, SurgiClear™ and IV Clear™, for distribution under the Molnlycke brand.