



MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the three month and nine month periods ended June 30, 2007

The following management's discussion and analysis ("MD&A"), dated August 22, 2007, provides an update to both the MD&A for the year ended September 30, 2006, as well as for the period ended March 31, 2007. It should be read in conjunction with the unaudited interim consolidated financial statements for the three and nine month periods ended June 30, 2007 and our audited consolidated financial statements for the year ended September 30, 2006. The interim statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") for interim financial information, but they have been subject to neither an audit nor a review by the Company's auditors.

Note Regarding Forward-looking Statements

The MD&A contains forward-looking statements which reflect the Company's current expectations regarding future events. The forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "estimate", "expect", "intend" and statements that an event or result "may", "will", "should", "could" or "might" occur or be achieved and other similar expressions. These forward-looking statements involve risk and uncertainties, including the difficulty in predicting product approvals, acceptance of and demands for new products, the impact of the products and pricing strategies of competitors, delays in developing and launching new products, the regulatory environment, fluctuations in operating results and other risks, any of which could cause results, performance, or achievements to differ materially from the results discussed or implied in the forward-looking statements. Many risks are inherent in the industry; others are more specific to the Company. Investors should consult the "Risks & Uncertainties" section of this MD&A as well as the Company's ongoing quarterly filings for additional information on risks and uncertainties relating to these forward-looking statements. Investors should not place undue reliance on any forward-looking statements. Management assumes no obligation to update or alter any forward-looking statements whether as a result of new information, further events or otherwise.

TABLE OF CONTENTS

Note Regarding Forward-looking Statements	1
Nature of the Business	2
Covalon Collagen Materials	2
Current Collagen Products	2
Collagen Technology Pipeline	3
Coatings	3
Current Coating Products	3
Coating pipeline	3
Overview of Financings	4
Significant Milestones	6
Results of Operations	7
Revenues for Q3, 2007	7
Revenue	7
Wound Care Sales	8
Coatings	8
Investment Income	8
License Revenues	8
Expenses	8
Cost of Goods Sold	9
Amortization	9
Consulting Fees	9
Director Fees	9
Management Fees	9
Marketing	10
Office and Administration	10
Professional Fees	10
Regulatory Expense	10
Research and Development	10
Cash Flow	10
Cash Flow from Operations	10
Cash Flow from Investing Activities	10
Cash Flow from Financing Activities	10
Liquidity and Capital Resources	11
Subsequent Events	11
Risks and Uncertainties	11
Additional Information	11



Nature of the Business

Covalon is a biotechnology company that has developed and patented advanced therapeutic biomaterials and medical coatings for advanced wound care, surgical applications and coatings that inhibit microbial invasion to help reduce infections. The anti-microbial silver ion-releasing technology has been shown to be effective against many microbes including antibiotic resistant bacteria such as methicillin resistant *Staphylococcus (MRSA)*, vancomycin resistant *Enterococcus (VRE)*, yeasts and other microbes. The Company’s core competencies in polymer chemistry and surface coatings have been combined to generate several proprietary technologies that create a range of time-release drug delivery platforms that can be applied to many medical devices for treating unmet medical needs. The Company creates drug-device combination products that deliver antimicrobial silver ions for helping to reduce hospital acquired infections. The Company intends to develop its collagen-based scaffolds to deliver other therapeutics and “biologicals” for inducing hemostasis, as well as treating problems related to ischemic diseases. The Company acquired EPAS1 technology that is intended to be used in developing a genetic-based approach to wound healing and congestive heart failure. EPAS1 technology relies on hypoxia inducible-factor-activity to stimulate angiogenesis for regenerative medicine. The technology is complimentary to Covalon’s wound healing program. The Company has identified unmet medical needs and developed products, received regulatory approvals and is manufacturing products that contain antimicrobial silver ion that have been shown to reduce microbial attachment and invasions. The Company has global distribution in place for collagen wound products, new products launched, is generating revenue and has a strong pipeline of increasingly sophisticated products.

Covalon Collagen Materials

Covalon collagen materials are bioresorbable collagen-based devices developed by the Company for delivery of therapeutics ranging from antimicrobial silver technology to cell therapy. The technology allows the Company to produce a variety of advanced convergent drug-devices including anti-infective wound dressings as well as cellular scaffolds for tissue regeneration. The Company’s initial focus with scaffolds is to develop, license and/or sell a series of OEM manufactured silver ion releasing collagen-based wound dressings that reduce bacterial contamination of chronic wounds, such as diabetic ulcers, bed sores, trauma wounds, burns and other conditions in which a wound presents with recalcitrant healing. Improvements to the Company’s wound dressings offerings have generated FDA-approved products that improve wound care by inactivating wound bed enzymes that are known to result in slow to heal wounds. The collagen technology platform is being used in R&D for a number of products for surgical interventions. It is expected that such products will enhance the Company’s value proposition for the platform.

Current Collagen Products

Covalon received FDA 510(k) pre-market notification for its collagen dressing (April 27, 2005), anti-microbial collagen dressing (June 06, 2005), hydrated anti-microbial collagen dressing (February 07, 2006) and advanced wound dressings with matrix metalloprotease (MMP) inhibiting activity (April 26, 2006). The following is a list of products developed by Covalon and approved for sale in the US and Canada.

Product	Regulatory Approval	Distribution	Launch
ColActive	FDA (April 27, 2005) Health Canada	Hartmann-Conco Smith & Nephew Inc.	June 2005 April 2007
ColActive Ag	FDA (June 06, 2005) Health Canada	Hartmann-Conco Smith & Nephew Inc.	June 2005 April 2007
CovaClearAg	FDA (February 07, 2005) Health Canada submitted	Smith & Nephew Inc.	Projected Q4 2007
Biostep	FDA (April 26, 2006) Health Canada submitted	Smith & Nephew Inc.	Q4 2007
Biostep Ag	FDA (April 26, 2006) Health Canada submitted	Smith & Nephew Inc.	Q4 2007

Collagen Technology Pipeline

Covalon has identified a number of product applications for its collagen-based technology platform. The applications are increasingly more sophisticated in therapeutic delivery and functions. The Company's goal is to take advantage of the collagen platform as an advanced combination device for delivery of certain therapeutics "biologicals" and cells. The current pipeline of collagen devices includes topical hemostatic dressings, a rapid hemostatic trauma dressing, a biologics delivery device for hormones and growth factors, and EPAS1-altered cells engineered for modulating angiogenesis. Angiogenesis is integral to regenerative medicine, including wound healing, treating ischemic heart disease, peripheral vascular disease as well as having other applications related to new blood vessel growth.

The following chart outlines the various collagen applications under development.

Application	Design Phase	Prototype	Process / Production Scale up	Animal Testing	Regulatory Approval
Hemostatic dressing	Completed	Completed	Completed	In process	-
Hemostatic dressing delivering PLT	In process	-	-	-	-
Hemostatic delivering FNS	In process	-	-	-	-
EPAS1 Cells for Tissue Regeneration	In process	-	-	-	-

Coatings

Covalon has developed an advanced proprietary coating platform for the emerging combination device market. The technology uses a proprietary ultraviolet light-mediated process to create biocompatible surface coatings capable of carrying a number of therapeutics. The initial focus is to use the platform for delivery of antimicrobial ionic silver from medical devices, such as urological (Foley) catheters where the risk of catheter associated infection in hospitals is high. Covalon recently announced that it has successfully completed the development of its new anti-microbial / anti-thrombogenic coating to prevent blood clotting on blood access catheters and devices. The development allows the company to market the technology for application on vascular access catheters, IV lines, hemodialysis lines and pain management ports where an antimicrobial and anti-thrombogenic coating would offer a clinical advantage in minimizing microbial ingress.

Current Coating Products

FDA 510(K) approval was received on Covalon's silver ion releasing coating for Foley catheters on February 20, 2006. The Company provides coating services for Medline Industries, Inc., one of the largest distributors in the US. Medline launched the "Silvertouch" Foley catheter in June 2006. In 2007, Medline has initiated a number of in-market clinical studies to show the efficacy of the coating. It is anticipated that these studies will show the coatings advantage over other anti-microbial coatings and accelerate adoption in the market.

Coating pipeline

Covalon has provided prototype, antimicrobial coated samples for a number of new customers for a variety of other applications including: peripherally inserted central catheters (PICCS), central venous lines (CV lines), sutures, intravenous lines (IV lines), feeding tubes, stomach anchors, stents and metal for orthopedic applications. The Company is in "fee for service" co-development with a number of customers for these coating applications and is pursuing exclusive licensing opportunities.

The chart below outlines the status of coating applications under development.

Application	Design Phase	Prototype	Process / Production Scale up
Central venous lines	Completed	Completed	-
PICC lines	Completed	Completed	-
Sutures	Completed	Completed	-
IV lines	In process	Completed	-
Catheter ports	In process	Completed	In process
Metals for orthopedics	In process	-	-

Overview of Financings

Covalon is a public company listed on the Toronto Venture Exchange (TSXV) trading under the symbol (COV).

The table below sets out the number of issued and outstanding common shares as well as the number of issued and outstanding warrants and options to purchase common shares, in each case as at June 30, 2007.

Common shares	59,391,872
Options to purchase common shares	3,845,582
Broker Compensation Warrants	10,000 ¹
Series III Warrants to purchase common shares	13,243,968 ²
Total diluted shares outstanding	76,491,422

1 Each Broker Compensation Warrant entitles the holder to acquire at any time until 4:00 p.m. (Toronto time) on September 22, 2007 (the "expiry time") a unit in the capital of the Company, each unit consisting of one fully paid and non-assessable common share and one common share purchase warrant at a price of \$0.50 per unit. Each common share purchase warrant entitles the holder to purchase an additional fully paid and non-assessable common share at a price of \$0.75 per common share until the expiry time.

2 Each Series III warrant entitles the holder to acquire at any time until 4:30 p.m. (Toronto time) on September 22, 2007 (the "expiry time") one fully paid and non-assessable common share in the capital of the Company above at a price of \$0.75 per common share.

Covalon became a publicly listed company on the Toronto Venture Exchange on December 21, 2004. At the beginning of the current fiscal year, October 01, 2006, the Company had 56,322,784 common shares issued and outstanding.

The following summarizes the Company's financings through equity transactions for the current year:

Date of issuance	Equity Issued
November 13, 2006	150,000 options to purchase common shares with a value of \$9,300 were exercised for cash consideration of \$60,000.
December 15, 2006	100,000 options to purchase common shares with a value of \$15,200 were exercised for cash consideration of \$40,000.
March 07, 2007	25,000 broker warrants to purchase common shares with a value of \$1,568 were exercised for cash consideration of \$12,500. A further 25,000 warrants to purchase common shares with a value of \$29,025 were issued upon the exercise of the Broker warrants.
March 27, 2007	40,000 warrants to purchase common shares with a value of \$2,508 were exercised for cash consideration of \$30,000.
March 27, 2007	25,000 options to purchase common shares with a value of \$5,925 were exercised for cash consideration of \$7,500.
April 2007	891,000 warrants to purchase common shares with a value of \$55,866 were exercised for cash consideration of \$668,250.
April 2007	471,480 broker warrants to purchase common shares with a value of \$29,562 were exercised for cash consideration of \$235,740. A further 471,480 warrants to purchase common shares with a value of \$857,067 were issued upon the exercise of the Broker warrants.
April 2007	25,000 warrants to purchase common shares with a value of \$29,025 (issued upon the exercise of Broker warrants) were exercised for cash consideration of \$18,750.
April 2007	20,000 options to purchase common shares with a value of \$4,635 were exercised for cash consideration of \$13,308.
May 2007	155,600 warrants to purchase common shares with a value of \$9,756 were exercised for cash consideration of \$116,700.
May 2007	491,280 broker warrants to purchase common shares with a value of \$30,803 were exercised for cash considerations of \$245,640. A further 491,280 warrants to purchase common shares with a value of \$1,214,334 were issued upon the exercise of the Broker warrants.
May 2007	301,760 warrants to purchase common shares with a value of \$766,271.36 (issued upon the exercise of Broker warrants) were exercised of cash consideration of \$226,320.
May 2007	18,750 options to purchase common shares with a value of \$3,949 were exercised for cash consideration of \$6,207
June 2007	97,968 broker warrants to purchase common shares with a value of \$6,142 were exercised for cash consideration of \$ 48,984. A further 97,968 warrants to purchase common shares with a value of \$220,403 were issued upon the exercise of the Broker warrants.
June 2007	125,000 warrants to purchase common shares with a value of \$282,625 (issued upon the exercise of Broker warrants) were exercised for cash consideration of \$93,750.
June 2007	131,250 options to purchase common shares with a value of \$27,641 were exercised for cash consideration of \$43,452.

The fair market value of options granted and warrants issued in the nine month period ending June 30, 2007 was determined using the Black-Scholes valuation model with the following implicit assumptions: risk-free rate of interest – 4.5%, dividend rate NIL, volatility – 66% and terms as defined by the various agreements.

Significant Milestones

Covalon's Board of Directors and management were very pleased to announce that Mr. Bradford Williams was elected independent Chairman of the Board, a position previously held by the Company's President and Chief Executive Officer, Dr. Frank DiCosmo. Mr. Williams' career spanned 30 years in medical devices with 21 years in various leadership positions at Stryker Corporation ("Stryker"). He started at Stryker in 1984 as an International Product Manager, and in 1987 he led the marketing efforts for Latin America. In 1988 Mr. Williams was promoted to Director of Stryker Canada, and later General Manager / Divisional Vice President, Stryker Canada, on the strength of his success building Stryker Canada's direct sales organization. Sales having multiplied seven-fold under his leadership. He joined Stryker's Osteonics Division in 1996 as their International VP where he led the efforts toward improving the division's market share outside the USA. In 1998, Mr. Williams was promoted to lead the Knee Business Unit for Stryker Orthopaedics as their Vice President and General Manager, where he focused on driving innovation and marketing on a global basis. In 2002, he was promoted to Senior Vice President for Reconstructive Marketing and R&D; in 2005 he assumed overall responsibility for the Marketing, Business Development and Intellectual Property functions. Mr. Williams has earned a reputation as a leader dedicated to the hiring and support of talented people focused on achieving results, and building great teams. He currently is a medical device consultant.

Regulatory and clinical affairs are becoming increasingly important to Covalon as the company begins to develop more bioactive coatings and increasingly sophisticated wound management products, as well as beginning to develop cellular therapy products. Management attracted and retained an experienced Vice President of Regulatory / Clinical Affairs and Operational Processes. Dr. Sonia Sanhueza has more than twenty years experience in regulatory affairs and quality systems. Dr Sanhueza will help to guide the Covalon's products through the complex regulatory/clinical pathways associated with bioactive devices, combination devices and cellular therapies.

Covalon achieved significant milestones for the period from October 01, 2006 to June 30, 2007. The Company completed the acquisition of technology from Perfusion Therapeutics Inc. The Company acquired a cell engineering platform for improving blood vessel development (angiogenesis). The technology uses endothelial PAS domain protein (EPAS1). EPAS1 is the subject of several US and European patent applications that Covalon has assumed through the acquisition. EPAS1 is a naturally occurring hypoxia-inducible transcription factor that is predominantly expressed in endothelial cells such as those lining the walls of blood vessels. Covalon has initiated a gene therapy program with the development and potential commercialization of EPAS1 for inducing angiogenesis.

Covalon acquired the technology from Perfusion Therapeutics Inc. for 1,100,000 common shares of Covalon Technologies Ltd. in escrow to be released as fully paid non-assessable common shares on various success milestones. The Company estimates 75,000 shares will be released from escrow in 2007. Covalon has agreed to fund the development of EPAS1 through various milestones and a budget of \$375,000 has been committed for the 12 month period ending September 30, 2007. A budget will be established on a year by year basis for the development of EPAS1 technology that will depend on the successful completion of each successive development milestone. Covalon entered into a one-year research contract with Dr. Jacques Galipeau, MD, FRCP(C), Associate Professor of Medicine and Oncology at the Sir Mortimer B. Davis Jewish General Hospital (McGill University) for isolation of cells required for Covalon's program in angiogenesis.

Covalon successfully applied its hydrophilic antimicrobial silver ion releasing coating to stainless steel. This development allows the Company to further develop its antimicrobial technology for orthopedic trauma and orthopedic surgical applications. Opportunities for the Company include hip, knee, shoulder, external and internal fracture fixation and stabilization devices. The development fits precisely with Covalon's strategy to deter infection and improve patient outcomes. According to Medtech Insight's Market & Technology Report: Trends and Opportunities in U.S. Orthopedic Markets for Implant, Reconstruction and Trauma Products, in 2004 the total market for orthopedic products for implant, reconstruction, and trauma applications was estimated to be \$11.5 billion; the market is expected to double to approximately \$23 billion by the year 2012.

Covalon and Smith & Nephew Inc. (NYSE:SNN; LSE: SN) entered into a five year exclusive distribution arrangement for collagen-based dressings in March 2007. The major financial component will be sales of product to Smith & Nephew Inc. for worldwide distribution. The value will vary depending on the commercial conditions in the markets in which Smith & Nephew Inc. will promote the products. The Company expects to receive total minimum milestone payments of US\$5 million (including an up-front exclusivity payment of \$2 million already received) over the five year term in addition to sales. Smith & Nephew Inc. is dedicated to helping improve people's lives. Smith & Nephew prides itself on the strength of its relationships with its surgeons and professional healthcare customers, with whom its name is synonymous with high standards of performance, innovation and trust. Smith & Nephew has over 8,500 employees and operates in 33 countries around the world, generating annual sales in excess of \$2.6 billion.

Results of Operations

Revenues for Q3, 2007

The financial results for the three and nine month periods for the current and prior year are summarized below.

(in Canadian \$)	Three months ended June 30,			Nine months ended June 30,		
	2007	2006	change	2007	2006	change
Revenues						
Product sales	203,421	351,226	(147,805)	898,589	612,453	286,136
Other income	356,820	51,837	304,983	513,458	63,704	449,754
Total Revenue	560,241	403,063	157,178	1,412,047	676,157	735,890
Expenses						
Cost of goods sold	138,433	230,233	(91,800)	526,276	360,652	165,624
Administrative expenses	1,164,412	690,927	473,485	2,537,102	1,835,827	701,275
Total Expenses	1,302,845	921,160	381,685	3,063,378	2,196,479	866,899
Net Loss	(742,604)	(518,097)	(224,507)	(1,651,331)	(1,520,322)	(131,009)
Loss per share	(0.01)	(0.009)	NA	(0.03)	(0.027)	NA

Revenue

The company launched the ColActive line, its first generation wound dressings, through Hartmann-Conco, Inc. of the US, late in the third quarter of 2005. In March of 2007, Covalon completed an exclusive distribution agreement with Smith & Nephew, the world leader in advanced wound care.

In the quarter ended June 30, 2007, Covalon transitioned production for, and distribution from Hartmann-Conco to Smith & Nephew. Hartmann AG is a company with a smaller share of the global market in traditional wound care; Hartmann-Conco is the US subsidiary of Hartmann AG. In sharp contrast, Smith & Nephew has globally the largest market share of 21% in advanced wound management with distribution in 33 countries. Smith & Nephew is a world leader in innovative wound management, with an excellent sales force of over 100 sales representatives in the US. Smith & Nephew's 2007, Q2 interim financial results showed US growth by 11% in advanced wound management. Smith & Nephew treats more wounds than anyone else.

Biostep/Biostep Ag, the new generation of higher gross margin bioactive collagen dressings developed by Covalon are now being delivered to Smith & Nephew. Major wound care centres have been sampled and key influential clinicians are using the products. The feed-back is excellent. Smith & Nephew has invested substantially in the development of marketing support and sales training of over 100 direct sales representatives to launch the Biostep brands throughout United States. Covalon achieved validation and scale-up during Q3 and is now producing and delivering product to Smith & Nephew for the upcoming Q4 launch. Biostep and Biostep Ag are promising new products that are expected to lead to a higher gross margin product mix in Q4 and 2008. Covalon's management is optimistic about launching its new generation of collagen dressings, Biostep and Biostep Ag into the US potential market of approximately US \$100 million with the distribution partner with the largest global market share..

A decrease in Q3 sales was expected as Covalon transitioned distribution from Hartmann-Conco to Smith & Nephew. Covalon sales were impacted by the draw-down of high stock levels of Hartmann-Conco product within the distribution chain. We expect the transition to Smith & Nephew product to occur throughout the remainder of this calendar year. The company has received total orders of \$682,613 which are now being produced. Management expects sales to grow month over month after the Q4 launch. The operational focus of Covalon in Q3 was on the scale-up and validation of the production of Biostep and Biostep Ag bioactive collagen dressings in preparation for the product launch by Smith & Nephew in Q4.



The revenue results for the three and nine month periods for the current and prior years are summarized below.

<i>(in Canadian \$)</i>	Three months ended June 30,			Nine months ended June 30,		
	2007	2006	change	2007	2006	change
Sales						
Wound care	185,026	320,616	(135,590)	712,478	544,212	168,266
Coated catheters	10,019	15,911	(5,892)	175,215	52,158	123,057
Coating services	8,376	14,699	(6,323)	10,896	16,083	(5,187)
Other Revenue						
Investment income	65,914	50,476	15,438	164,818	59,622	105,196
Licensing fees	290,906	1,361	289,545	348,640	4,082	344,558
Total	560,241	403,063	157,178	1,412,047	676,157	735,890

Wound Care Sales

Wound care sales decreased by 135,349 for Q3 2007 compared to Q3 2006 and increased by \$168,266 for the nine month period. The wound care sales declined as the Company focused its production capacity on the scale-up and validation of Biostep and Biostep Ag products. During Q3, Covalon completed the scale-up and validation, provided samples for over 100 key wound care centers, sampled over 60 key influential clinicians and assisted in the training of over 100 Smith & Nephew sales representatives. Based on the early clinician response to Biostep and Biostep Ag, it is anticipated that the conversion rate to the Biostep will be strong.

Coatings

Coating sales decreased by \$5,892 for Q3 2007 compared to Q3 2006. The distributor, Medline Industries, Inc., focused its marketing efforts on two major in-market clinical trials to prove the efficacy and economics of the "Silvertouch" anti-microbial catheters. The Company anticipates that on completion these studies will provide strong evidence of the catheter's performance and lead to a faster conversion rate of accounts as large accounts receive clinical evidence of the catheter's efficacy.

The Company continues to do contract research and development applying its anti-microbial coating on a number of medical devices. Covalon recently announced that it developed an anti-microbial coating with anti-thrombogenic properties (prevents blood from clotting on the surface of the device). Covalon expects to seek a distribution partner in the vascular access market with substantial market-share.

Investment Income

Investment income increased as a result of the increase in cash available for investments. All investments are made in accordance with the Company's audit committee investment guidelines.

License Revenues

License revenues increased as a result of the recognition of the US\$2 million milestone payment the Company received from Smith & Nephew Inc. The milestone payment is being recognized over a 2 year period.

Expenses

Covalon administrative and overhead expenses increased in total by \$473,485 in Q3 2007 compared to Q3 2006. The increase was primarily due to staff additions in marketing and regulatory affairs and the value of stock option compensation awarded to directors and key employees. Key staff members were added as part of the Company's distribution expansion into non-domestic markets. The investment in personnel was required to achieve the expansion.

The expenses for the three and nine month periods ended June 30 for 2007 and 2006 are summarized below.

<i>(in Canadian \$)</i>	Three months ended June 30,			Nine months ended June 30,		
	2007	2006	change	2007	2006	change
Cost of Goods Sold	138,433	230,233	(91,800)	526,276	360,652	165,624
Administrative and overhead						
Amortization	70,880	50,496	20,384	188,664	148,401	40,263
Bank Charges and interest	641	768	(127)	2,898	2,763	135
Consulting fees	0	27,703	(27,703)	0	99,109	(99,109)
Director fees	137,299	10,100	127,199	256,575	39,100	217,475
Foreign currency (gain) loss	37,382	(37)	37,419	39,199	(1,850)	41,049
Management fees	153,017	77,500	75,517	319,247	232,500	86,747
Marketing	49,068	69,706	(20,638)	177,721	139,066	38,655
Office and administrative	132,339	93,701	38,638	357,795	267,277	90,518
Patent maintenance	802	1,091	(289)	1,402	7,291	(5,889)
Professional fees	32,600	28,892	3,708	55,879	60,873	(4,994)
Property Maintenance	2,164	1,440	724	5,748	7,343	(1,595)
Regulatory	140,493	113,928	26,565	356,034	224,080	131,954
Research & Development	376,126	187,464	188,662	703,383	535,888	167,495
Training	3,458	0	3,458	13,064	977	12,087
Travel	28,143	28,175	(32)	59,493	73,009	(13,516)
Total admin. and overhead	1,164,412	690,927	473,485	2,537,102	1,835,827	701,275

Cost of Goods Sold

The cost of goods sold for Q3 in 2007 was 68% of sales. In Q3 Covalon addressed the scale-up and validation of Biostep and Biostep Ag. Fewer units of production were available for sale and this resulted in the higher costs of good sold, as the fixed manufacturing overhead costs were allocated across fewer units of production. For the nine months ended June 30, 2007 the cost of goods sold was 59% of sales. The Company expects a shift in sales orders to the two Biostep brands which should lead to better utilization of production capacity and higher profit margins in Q4, 2007.

Amortization

The amortization expense increased \$20,384 for Q3 in 2007 compared to Q3 in 2006. This was primarily due to an increase in fixed assets over the past twelve months. The increase in the amortization expense for the nine month period ended June 30, 2007 was primarily due to increase in fixed assets and the addition of amortization of deferred development costs for Q1, Q2 and Q3, 2007 while in Q1 2006 there was no amortization of deferred development costs.

Consulting Fees

Consulting fees for the period declined by \$27,703 compared to Q3 2006. No regulatory consultants have been engaged for 2007; all the regulatory work is done internally by the Company.

Director Fees

The Director fees increased by \$127,199 in Q3 2007 compared to Q3 2006. During the three month period ended June 30, 2007, director compensation included cash compensation of \$33,540 and stock compensation of \$103,759 in the form of options which vested in the quarter.

Management Fees

The Management fees for the Company increased by \$75,517 for Q3, 2007 compared to Q3, 2006. The cash compensation was unchanged and the increase was a result of the value of stock options vesting during the period.

Marketing

Marketing expenses increased by \$38,665 for the nine month period ended June 30, 2007 compared to the same period in 2006. Covalon has increased marketing head count and travel to support the Smith & Nephew distribution relationship. Marketing expenses will continue to increase as the Company continues to invest resources in support and growth of its distribution.

Office and Administration

Office and administration costs increased in Q3 2007 by \$38,638. A majority of this increase reflects the addition of one new accounting staff member and increases in general office expenses.

Professional Fees

Professional fees increased by \$3,708 in Q3 2007 compared to Q3, 2006 as a result of trademark registrations for ColActive and Covaclear.

Regulatory Expense

The majority of the increase of \$26,565 in regulatory expense during Q3 2007 compared to Q3 2006 was related to the addition of an experienced Vice President of Regulatory Affairs, Quality Affairs and Clinical Affairs. The Company increased the compensation for this position to attract a senior level candidate. In addition the TSXV increased its filing fees.

Research and Development

Research and Development expenses increased by \$188,662 in Q3 2007 compared to Q3 2006, because of activities related the Smith & Nephew Inc. distribution agreement and increased coatings research related to the development of the anti-thrombogenic coating. For the nine month period ended June 30, 2007 Research and Development expenses increase by \$167,495 compared to the prior year.

Cash Flow

The cash flow for the three month periods, April 01 to June 30, 2007 and 2006 improved as a result of cash consideration paid to Covalon for the exercise of warrants to purchase common shares. The cash flow for the three month periods is summarized as follows:

<i>(in Canadian \$)</i>	For the three months ended	
	2007	June 30, 2006
Cash flow deficiency from operations	(916,095)	(730,226)
Cash flow deficiency from investing activities	(236,788)	(45,943)
Cash flow from financing activities	1,717,101	261,378
Foreign exchange gain (loss) on cash held	(37,382)	0
Increase (decrease)	526,836	(514,791)

Cash Flow from Operations

Cash flow uses of funds for Covalon in Q3, 2007 consisted primarily of \$742,604 in operating losses, recognition of deferred revenue of \$290,906, an increase of account receivables and prepaid expenses, amortization of \$70,880, stock compensation of \$186,438 and an increase in accounts payable.

Cash Flow from Investing Activities

Cash flow uses from investing activities mostly consisted of the purchase of capital assets totaling \$159,427 and \$77,361 for the acquisition of patents and patent application filings.

Cash Flow from Financing Activities

Cash flow from financing activities resulted in net proceeds of \$1,717,101 from the exercise of options and warrants to purchase a total of 2,729,088 common shares.

Liquidity and Capital Resources

As at June 30, 2007, the Company had a current ratio of 2.99 (current assets to current liabilities). The working capital consisted of cash at \$6,985,051, trade receivables of \$413,877, inventory of \$359,209 and prepaid expenses of \$262,499 against \$686,007 in trade payables and \$1,993,276 in deferred development costs.

The Company has cash and marketable securities totaling \$6,985,051., The Company has the financial resources to internally finance its revenue growth strategy.

Subsequent Events

Subsequent to June 30, 2007 Covalon announced the following significant event:

Covalon successfully developed a covalently-bonded, silver-ion releasing antimicrobial and low-blood-clotting coating that can be applied to a wide variety of blood-contacting catheters and devices in order to minimize potential for blood-clot formation.

Covalon's antimicrobial and low-thrombogenic coating can be applied to a wide variety of in-dwelling, blood contacting devices for reducing the incidence of hospital acquired infection as well as reducing thrombogenicity. Effective antimicrobial and low-thrombogenic coated catheters may reduce infection and thrombus formation thus improving patient outcome. Antimicrobial CVC are expected to experience a growth rate approximately 5-fold greater than that of un-coated CVC. It is estimated that by 2009, sixty-nine percent (69%) of all CVC used will be antimicrobial (Frost and Sullivan, U.S. Antimicrobial Devices Markets, 2003). Hospital-acquired infections affect approximately 2 million people in the United States each year, and cost over \$11 billion to the healthcare system (Frost and Sullivan, U.S. Antimicrobial Coating Markets, 2006). The total antimicrobial catheters market is projected to attain revenues of US \$ 375 million by 2009 (Frost and Sullivan 2006).

Risks and Uncertainties

An investment in the securities of the Company is speculative due to the proposed nature of the Company's business and the present stage of Covalon's development. Consequently, an investment in the Company is subject to certain risks and investors should not invest in securities of the Company unless they can afford to lose their entire investment. In addition to the factors disclosed elsewhere in this MD&A, investors should consider the following risk factors in assessing the investment merits of such securities.

Biotechnology companies in the early revenue stage are subject to a number of risks and uncertainties that are inherent to the development of any new technology. General business risks include, among other things, uncertainty in product development and related clinical trials, the regulatory environment including delays or denial of approval to market products, the impact of technological change and competing technologies, the ability to protect and enforce its patent portfolio and intellectual property assets, the availability of capital to finance continued and new product development, the ability to secure strategic collaborators and its reliance on these collaborators for the development, regulatory approval, testing, manufacturing and commercialization of its products and the risk of product liability claims. In addition, market prices for securities of biotechnology companies are generally volatile, and may or may not move in a manner consistent with the progress being made by such company. To the extent possible, the Company's management pursues and implements strategies to reduce or mitigate the risks and uncertainties associated with its business. See "Information concerning the Resulting Issuer – Risk Factors" outlined in Seder Capital Corp.'s Filing Statement dated December 9, 2004 and available for review on SEDAR at www.sedar.com.

Additional Information

Additional information relating to the Company can be found on SEDAR at www.sedar.com.