

Covalon Technologies Ltd.

Interim Consolidated Financial Statements

For the three and nine-month periods ending June 30, 2008

(Unaudited – prepared by management)

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NOTICE OF NO REVIEW BY AUDITOR

In accordance with National Instrument 51-102 **Continuous Disclosure Obligations** of the Canadian Securities Administrators, WE HEREBY GIVE NOTICE THAT our financial statements for the three and nine-month periods ended June 30, 2008, which follow this notice, have not been reviewed by our auditors.

Covalon Technologies Ltd.

Interim Consolidated Balance Sheets

As at June 30, 2008 and September 30, 2007

(Unaudited - prepared by management)

	June 30, 2008	Audited September 30, 2007
Assets		
Current assets		
Cash and cash equivalents	\$ 13,886,375	\$ 6,917,897
Short term investments	-	9,252,103
Accounts receivable	223,044	320,239
Inventories	253,712	279,331
Prepaid expenses	106,634	204,512
Total Current Assets	14,469,765	16,974,082
Capital assets (Note 7)	727,348	580,661
Other assets (Note 8)	702,284	484,368
Deferred developments costs (Note 9)	2,554,128	2,205,350
Total Assets	\$ 18,453,525	\$ 20,244,461

Liabilities and Shareholders' Equity

Current		
Accounts payable and accrued liabilities	\$ 374,868	\$ 673,357
Deferred revenue (Note 10)	442,627	444,462
Total Current Liabilities	817,495	1,117,819
Deferred revenue (Note 10)	1,195,282	1,533,442
Total Liabilities	2,012,777	2,651,261
Shareholders' Equity		
Share Capital (Note 11 (b))	29,143,585	28,664,432
Contributed Surplus	329,004	329,004
Options (Note 11 (c))	1,426,552	925,625
Deficit	(14,458,393)	(12,325,861)
Total Shareholders' Equity	16,440,748	17,593,200
Total Liabilities and Shareholders' Equity	\$ 18,453,525	\$ 20,244,461

On behalf on the Board

Director

Director

See accompanying notes.

Covalon Technologies Ltd.

Interim Consolidated Statements of Operations and Comprehensive Income

For the three and nine months ended June 30, 2008 and June 30, 2007

(Unaudited - prepared by management)

	Three months ended		Nine months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Revenues				
Product sales and coating services	\$ 226,300	\$ 203,421	\$ 1,142,048	\$ 898,589
Licensing fee	110,962	290,906	333,193	348,640
Total revenue	<u>337,262</u>	<u>494,327</u>	<u>1,475,241</u>	<u>1,247,229</u>
Operating Expenses				
Product	113,070	138,433	599,476	526,276
Regulatory	240,242	140,493	733,884	356,034
Marketing	23,720	49,068	112,540	177,721
General and administrative	740,158	598,725	2,092,865	1,299,964
Total operating expenses	<u>1,117,190</u>	<u>926,719</u>	<u>3,538,765</u>	<u>2,359,995</u>
Loss before undernoted items	(779,928)	(432,392)	(2,063,524)	(1,112,766)
Interest income	130,477	65,914	578,017	164,818
Research and development activities	150,502	(376,126)	(647,025)	(703,383)
Loss and comprehensive income for the period	\$ (498,949)	\$ (742,604)	\$ (2,132,532)	\$ (1,651,331)
Basic and fully diluted loss per share (Note 11 (d))	\$ (0.01)	\$ (0.01)	\$ (0.03)	\$ (0.03)

See accompanying notes.

Covalon Technologies Ltd.
Interim Consolidated Statements of Cash Flows

For the three and nine months ended June 30, 2008 and June 30, 2007
(Unaudited - prepared by management)

	Three months ended		Nine months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Cash flows from operating activities				
Loss and comprehensive income for the period	\$ (498,949)	\$ (742,604)	\$ (2,132,532)	\$ (1,651,331)
Add (deduct) items not involving cash:				
Amortization of capital assets	52,118	36,707	113,302	86,132
Amortization of patent and technology rights	7,700	5,323	22,065	15,982
Amortization of deferred development costs	29,183	28,850	87,549	86,551
Deferred revenue recognized	(117,765)	(290,906)	(339,996)	1,972,561
Stock compensation expense	194,464	186,438	599,828	250,243
Foreign exchange loss	4,990	37,382	5,123	39,199
Cash provided by operating activities before change in non-cash working capital balances	(328,259)	(738,810)	(1,644,661)	799,337
Change in non-cash working capital (Note 15)	326,294	(177,285)	(77,794)	(292,781)
	(1,965)	(916,095)	(1,722,455)	506,556
Cash flows from investing activities				
Purchase of capital assets (net of disposals and investment tax credits)	(251,600)	(159,427)	(259,989)	(152,479)
Expenditure on deferred development cost	(436,328)	-	(436,328)	
Purchase of patents and technology rights	(23,259)	(77,361)	(47,482)	(208,570)
Redemption of short term investments	9,082,699	-	9,252,103	-
	8,371,512	(236,788)	8,508,304	(361,049)
Cash flows from financing activities				
Net proceeds on issuance of share capital	109,110	1,717,101	187,752	1,867,101
Foreign exchange loss on cash held	(4,990)	(37,382)	(5,123)	(39,199)
Net Change in cash and cash equivalents during the period	8,473,667	526,836	6,968,478	1,973,409
Cash and cash equivalents, beginning of period	5,412,708	6,458,215	6,917,897	5,011,642
Cash and cash equivalents, end of period	\$ 13,886,375	\$ 6,985,051	\$ 13,886,375	\$ 6,985,051

See accompanying notes.

Covalon Technologies Ltd.

Interim Consolidated Statements of Shareholders' Equity

For the period ending June 30, 2008

(Unaudited - prepared by management)

	Share Capital		Contributed Surplus	Warrants	Options	Deficit	Total
	Number of Shares	Amount					
Balance, September 30, 2006	56,322,784	\$ 15,828,922	\$ 340,297	\$ 927,479	\$ 418,739	\$ (9,249,484)	\$ 8,265,953
Issue of warrants pursuant to the exercise of broker compensation warrants		(2,338,229)		2,338,229			-
Issue of common shares for cash pursuant to the exercise of warrants	15,888,056	14,907,819		(3,265,708)			11,642,111
Issue of common shares for cash pursuant to the exercise of stock options	501,194	265,920			(71,287)		194,633
Options reinstated to consultant			(23,693)		23,693		-
Stock based compensation					566,880		566,880
Expired stock options			12,400		(12,400)		-
Net loss and comprehensive income						(3,076,377)	(3,076,377)
Balance, September 30, 2007	72,712,034	\$ 28,664,432	\$ 329,004	\$ -	\$ 925,625	\$ (12,325,861)	\$ 17,593,200
Issue of common shares for cash pursuant to the exercise of stock options	476,881	286,653	-		(98,901)	-	187,752
Issue of common shares to Perfusion Therapeutics Inc.	75,000	192,500	-				192,500
Stock based compensation					599,828	-	599,828
Net loss and comprehensive income						(2,132,532)	(2,132,532)
Balance, June 30, 2008	73,263,915	\$ 29,143,585	\$ 329,004	\$ -	\$ 1,426,552	\$ (14,458,393)	\$ 16,440,748

See accompanying notes.

Covalon Technologies Ltd.
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Nature of Business The Company is incorporated under the laws of Ontario and is engaged in the business of developing medical products. In prior years, up to and including the year ending September 30, 2005, the Company focused its efforts on research and development and the raising of capital to fund the development of medical products. Accordingly, the Company was considered to be in the development stage. The Company has now received regulatory approval on numerous products and is currently generating revenue. The Company's main business function continues to be research and development along with manufacturing and sales.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation The accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and on a basis consistent with the Company's annual audited financial statements for the year ended September 30, 2007 except that the financial statements for the year ended September 30, 2007 have been reclassified to conform with the financial statement presentation adopted in the current period. These statements should be read in conjunction with the September 30, 2007 audited financial statements. Refer to Note 2 for changes in accounting policies.

The current period's consolidated financial statements include the operations of the Company for the three and nine month period ended June 30, 2008. These consolidated financial statements have not been reviewed by the Company's auditor.

Going Concern Covalon is considered to be a going concern and as such, no provisions are made for the valuation of assets or the cost to discharge liabilities, other than in the normal course of operations. To sustain the business in the future, there must be profitable operations or support from shareholders and other financial parties.

Basis of Consolidation These financial statements have been prepared using the purchase method of consolidation. The assets and liabilities of the acquired companies are initially recorded at cost. 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.

Revenue Recognition Revenue is recognized on an accrual basis as follows:

- a) Revenue arising from product sales is recognized once the product has been shipped to the customer.
- b) Revenue arising from licensing fees and royalties is initially recorded as deferred revenue and recognized over the period of the relevant agreements.
- c) Revenue arising from interest is recognized as earned.

Covalon Technologies Ltd.
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liabilities of a change in tax rates is recognized in operations in the year in which the change occurs.

Foreign Currency Translation Foreign currency accounts are translated into Canadian dollars as follows:

At the transaction date, each asset, liability, revenue and expense is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the reporting date, monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date. The resulting foreign exchange gains and losses are included in income in the current period.

Stock Based Compensation Direct awards of stock are based on the price of common stock measured at fair value at each reporting date, with the change in fair value reported in the statement of operations.

The Company uses the fair value based method of accounting for all its stock-based compensation. Accordingly, the fair value method of accounting is applied for stock options granted to directors, officers, employees and consultants whereby the weighted average fair value of options granted is recognized in the financial statements over the vesting period. When the awards are exercised, share capital is credited by the sum of the consideration paid together with the related portion previously credited to options.

Use of Estimates The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Actual results could differ from management's best estimate as additional information becomes available in the future.

Loss per Common Share Loss per common share has been computed by dividing the loss applicable to common shareholders by the weighted average number of shares of common stock outstanding during the respective years.

Impairment of Long-Lived Assets An impairment charge is recognized for long-lived assets, including intangible assets with definite lives, when an event or change in circumstances causes the assets' carrying value to exceed the total undiscounted cash flows expected from its use and eventual disposition. The impairment loss is calculated as the difference between the fair value of the asset and its carrying value. Management has determined that there is no impairment of long-lived assets.

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2. CHANGES IN ACCOUNTING POLICIES

CICA Handbook New Section 1506, based on International Reporting IAS 8—Accounting Policies, Changes in Accounting Policies together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates, and the correction of errors. The notes describe disclosure, on an interim and annual basis, of the description and the impact on financial statements of any new primary source of GAAP that has been issued but not yet instituted. It is effective for interim and annual periods beginning on or after January 1, 2007. At this time, there is no impact of this section on our financial position or on the results of our operations.

For interim and fiscal years beginning on or after October 1, 2007, the CICA Handbook Section 3862, Financial Instruments – Disclosure, and CICA Handbook Section 3863, Financial Instruments - Presentation applies. These new standards revise and enhance the disclosure requirements, and carry forward, substantially unchanged, the presentation requirements. Sections 3862 and 3863 emphasize the significance of financial instruments for the entity's financial position and performance, the nature and extent of risks arising from financial instruments, and how these risks are managed. Management has determined that the application of Sections 3862 and 3863 did not have any impact on the unaudited interim consolidated financial statements for the three and nine-month period ending June 30, 2008, however, it did result in expanded note disclosure (see note 4).

For interim and fiscal years beginning on or after October 1, 2007, the CICA Handbook Section 1535, Capital Disclosures applies. This section specifies disclosures of information about a company's objectives, policies and processes for managing capital structure; quantitative data about what the company regards as capital; and whether the company has complied with externally imposed capital requirements, like bank covenants, and if it has not complied, the consequences of such non-compliance. The adoption of this new accounting standard did not impact the amounts reported in the Company's financial statements, however, it did result in expanded note disclosure (see note 5).

Section 3031, Inventories, is effective for annual and interim periods beginning on or after January 1, 2008. This new section requires inventory to be measured at the lower of cost or net realizable value and provides guidance on the methodology used to assign costs to inventory, it disallows the use of the last-in first-out inventory costing methodology and requires that, when circumstances which previously caused inventories to be written down below cost no longer exist, the amount of the write-down is to be reversed. Upon adoption, the impact on the financial statements was immaterial.

3. RECENT ACCOUNTING PRONUCEMENTS

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. Section 3064, which replaces Section 3062, Goodwill and Other Intangible Assets, and section 3450, Research and Development Costs, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This new standard is effective for the Company's fiscal year commencing January 1, 2009. Management is assessing the impact of this new standard on its consolidated financial statements.

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3. RECENT ACCOUNTING PRONOUNCEMENTS (continued)

In March 2006, the Accounting Standards Board of the CICA released its new strategic plan which will abandon Canadian GAAP and affect a complete convergence to the International Financial Reporting Standards. At the end of a transitional period of approximately five years, Canadian GAAP will cease to exist as a separate, distinct basis of financial reporting for public companies. Management will closely monitor changes arising from this convergence.

4. FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between willing parties.

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies. Accordingly, these estimated values are not necessarily indicative of the amounts the Company could realize in a current market exchange. The estimated fair value amounts can be materially affected by the use of different assumptions or methodologies. The methods and assumptions used to estimate the fair value of each class of financial instruments are discussed below.

The fair values of short term financial assets and liabilities, including cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities, as presented in the consolidated balance sheets approximate their carrying amounts due to the short period to maturity of these financial instruments.

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 does not subject the Company to significant credit risk. The Company has discount note and provincial bonds, as per its practice of protecting its capital rather than maximizing investment yield, of \$13.7 million invested with two issuers; however, this risk is mitigated as the issuers are a major Canadian bank and the Province of Ontario.

The Company, in the normal course of business, is exposed to credit risk from its global customers most of whom are in the pharmaceutical industry. The accounts and other receivable are subject to normal industry risks in each geographic region in which the Company operates. In addition, the Company is exposed to credit related losses on sales to its customers outside North America and the European Union due to potentially higher risks of enforceability and collectability. 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 June 30, 2008, two customers accounted for 61% (September 2007 – three customers for 95%) of the accounts receivable balance. These customers, who act as distributors of the Company's product, represent

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4. FINANCIAL INSTRUMENTS (continued)

substantially all of the Company's sales. Credit risk exposure is mitigated by strong credit granting policies and due diligence procedures for new customers.

Pursuant to their collective terms, accounts receivable are aged as follows at June 30, 2008:

Current	\$221,112
31-60 days past due	<u>1,932</u>
	<u>\$223,044</u>

Liquidity risk

The Company has an ongoing need for substantial capital resources to research and develop, commercialize and manufacture its products and technologies. The Company believes that it has the capital resources and liquidity necessary to meet its commitments, support its operations and finance its current growth strategies.

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.

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. The Company believes this risk is minimal and does not use financial instruments to hedge these risks.

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. Silver is the Company's most significant cost subject to commodity risk. There is commodity risk for all other 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.

5. MANAGEMENT OF CAPITAL

The Company defines capital that it manages as the aggregate of its cash and cash equivalents, short-term investments and equity comprising of share capital, contributed surplus and deficit. Its objectives when managing capital are to ensure that the Company will continue as a going concern, so that it can provide services to its customers and returns to its shareholders.

The 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

Covalon Technologies Ltd.
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5. MANAGEMENT OF CAPITAL (continued)

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.

The Company is not subject to any externally imposed capital requirements and the Company's overall strategy with respect to management of capital remains unchanged from the period ending June 30, 2008.

6. INVENTORIES

Inventories consist of the following as at:

	<u>June 30, 2008</u>	Audited <u>September 30, 2007</u>
Raw materials	\$ 201,112	\$ 175,412
Work in process	1,497	-
Finished goods	<u>51,103</u>	<u>103,919</u>
	<u>\$ 253,712</u>	<u>\$ 279,331</u>

7. CAPITAL ASSETS

	<u>June 30, 2008</u>		Audited <u>September 30, 2007</u>	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Furniture and fixtures	\$ 247,737	\$ 72,144	\$ 160,295	\$ 50,458
Lab equipment	893,117	364,808	734,849	285,543
Leasehold improvements	<u>62,409</u>	<u>38,963</u>	49,656	28,138
	<u>1,203,263</u>	<u>475,915</u>	944,800	364,139
Cost less accumulated amortization		<u>\$ 727,348</u>		<u>\$ 580,661</u>

Covalon Technologies Ltd.
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June 30, 2008 and 2007

8. OTHER ASSETS

	<u>June 30, 2008</u>	<u>Audited September 30, 2007</u>
Patents and technology rights (net of \$141,997 accumulated amortization; Sep 2007 - \$119,932)	\$ 702,284	\$ 484,368

9. DEFERRED DEVELOPMENT COSTS

	<u>June 30, 2008</u>	<u>Audited September 30, 2007</u>
Cost	\$ 2,870,394	\$ 2,434,066
Less: accumulated amortization	316,266	228,716
	\$ 2,554,128	\$ 2,205,350

10. DEFERRED REVENUE

Deferred revenue is as follows.

	<u>Three months ended June 30,</u>		<u>Nine months ended June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Balance, beginning of period	\$ 1,755,673	\$ 2,284,182	\$ 1,977,904	\$ 20,715
Add:				
Exclusivity milestone payment (1)	-	-	-	2,321,200
Less:				
Amortization of license and supply agreements	110,962	290,906	333,193	348,639
Offset of related costs	6,802	-	6,802	-
Balance, end of period	1,637,909	1,993,276	1,637,909	1,993,276
Amount to be recognized within one year	442,627	444,462	442,627	444,462
Long term balance	\$ 1,195,282	\$ 1,548,814	\$ 1,195,282	\$ 1,548,814

(1) The Company received an initial exclusivity payment from Smith and Nephew; the Company is recording this licensing fee revenue monthly over the five year term of the agreement.

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Notes to Interim Consolidated Financial Statements
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11. SHARE CAPITAL

a) **Authorized** - Unlimited number of Common Shares

b) **Issued** – Common shares and warrants

	Number of Common Shares	Number of Warrants	Stated Capital	Warrants
Balance, September 30, 2006	56,322,784	14,792,328	\$ 15,828,922	\$ 927,479
Options exercised	501,194		265,920	
Warrants granted		1,095,728	(2,338,229)	2,338,229
Warrants exercised	15,888,056	(15,888,056)	14,907,819	(3,265,708)
Balance, September 30, 2007	72,712,034	-	28,664,432	-
Issued to Perfusion Therapeutics Inc.	75,000	-	192,500	-
Options exercised	476,881	-	286,653	-
Balance, June 30, 2008	73,263,915	-	\$ 29,143,585	\$ -

At June 30, 2008, 5,615,502 (2007 – 9,179,772) shares were held in escrow.

In fiscal 2007, 501,194 options to purchase common shares with a value of \$71,287 were exercised for cash consideration of \$194,633. 200,000 options to purchase common shares expired, resulting in a corresponding increase to contributed surplus of \$12,400.

In fiscal 2007, 1,095,728 broker warrants were exchanged for Series III warrants.

In fiscal 2007, 15,888,056 Series III warrants to purchase 15,888,056 common shares, with a value of \$3,265,708 were exercised for cash consideration of \$11,642,111.

During fiscal 2007, the Company issued a total of 16,389,250 common shares.

During the period, the Company issued a total of 561,881 common shares.

The Company issued 1,100,000 shares in escrow in December 2007 relating to the acquisition of technology from Perfusion Therapeutics Inc. to be released on various successful milestones. To date, 75,000 shares valued at \$192,500 have been released from escrow.

In the period, 476,881 options (valued at \$98,901) to purchase common shares were exercised for cash consideration of \$187,752.

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11. SHARE CAPITAL (continued)

c) Stock Option Plan

The Company has Stock Option Agreements with its employees, directors and consultants, granting options to them exercisable in whole or part. Common shares have been reserved for fully exercisable stock options on the following basis:

	Number of Shares	Value	Exercise Price
Balance, September 30, 2006	3,103,082	\$ 418,739	
Options reinstated to consultant	112,500	23,693	\$ 0.33
Granted to related parties	975,000	473,336	\$ 1.53
Granted to employees	100,000	40,494	\$ 0.75
Vested to related parties		53,050	\$ 0.50
Exercised	(501,194)	(71,287)	
Expired	(200,000)	(12,400)	
Balance, September 30, 2007	3,589,388	\$ 925,625	
Granted to related parties	375,000	155,141	\$ 2.79
Granted to employees	360,000	188,073	\$ 2.93
Vested to related parties		242,621	\$ 1.01
Vested to employees		13,993	\$ 1.22
Exercised	(476,881)	(98,901)	
Balance June 30, 2008	3,847,507	\$ 1,426,552	

In fiscal 2007, the fair market value of options granted 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 a term of 3 and 5 years respectively.

Total value of options granted to related parties during fiscal 2007 was \$728,475, of which \$473,336 vested, total value of options granted to employees during fiscal 2007 was \$57,300 of which \$40,494 vested. Stock Options granted to related parties during fiscal 2007 expire on March 27, 2010 (675,000), July 10, 2010 (150,000), July 10, 2012 (150,000), Stock options granted to employees during fiscal 2007 expire on March 20, 2010.

501,194 stock options with a value of \$71,287 were exercised for common shares for cash consideration of \$194,633 in fiscal 2007.

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11. SHARE CAPITAL (continued)

200,000 stock options granted to related parties with an exercise price of \$0.30 expired in February 2007.

During the period ended June 30, 2008, 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 – 3.75%, dividend rate NIL, volatility – 66% and a term of 5 years.

Total value of options granted to related parties during the period was \$600,000 of which \$155,141 vested, total value of options granted to employees during the period was \$609,900 of which \$188,073 vested. Stock options granted to related parties during the period expire on March 31, 2013. Stock options granted to employees during the period expire on September 30, 2012 (100,000) and on March 31, 2013 (260,000).

During the period, 476,881 stock options with a value of \$98,901 were exercised for common shares for cash consideration of \$187,752.

As at June 30, 2008, 2,822,280 (2007 – 2,468,707) options were available for exercise.

(d) Loss per Share

Loss per share is calculated using the weighted average number of common shares outstanding during the period ended June 30, 2008, which is 72,903,367 (2007 – 57,283,379) shares. As the Company experienced losses for the period ended June 30, 2008 and 2007, all potential common shares outstanding from dilutive securities are considered anti-dilutive and are excluded from the calculation of loss per share for those years.

Details of anti-dilutive potential securities outstanding not included in diluted EPS calculations at June 30, 2008 and 2007 are as follows:

Anti-dilutive potential securities	2008	2007
Common shares potentially assumable:		
- pursuant to warrants	-	14,752,328
- under stock options	<u>3,847,507</u>	<u>4,015,582</u>
	<u>3,847,507</u>	<u>18,767,910</u>

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12. RELATED PARTY TRANSACTIONS

- a. During the period the Company paid fees to related parties as follows:
- (i) Management fees totaling \$426,804 (2007 – \$319,247) to two corporations controlled by officers and directors, included in management fees are stock option benefits that have been valued at \$162,670 (2007 – \$86,747).
 - (ii) Directors fees include cash compensation of \$110,708 (2007 - \$107,406) paid to certain of the independent directors and stock option benefits that have been valued at \$209,045 (2007 – \$107,406).
- b. The management fees are paid pursuant to two separate management agreements, expiring September 30, 2008. The commitments for the 2008 fiscal year are \$330,000.

These transactions are in the normal course of operations and are measured at the exchange amount (the amount of consideration established and agreed by the related parties).

13. COMMITMENTS

The Company has entered into an operating lease for its premises at 405 Britannia, Mississauga commencing December 1, 2004 and expiring November 30, 2009. The annual rental payments for the first two years are \$68,627 payable monthly and \$91,855 payable monthly for the remaining portion of the lease.

The Company has also entered into an operating lease for its equipment. The equipment is leased at \$477 per month under a lease expiring in 2013.

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

2009	\$	100,624
2010		21,541
2011		5,724
2012		5,724
2013		5,724
	\$	<u>139,337</u>

14. SUPPLEMENTAL CASH FLOW INFORMATION

	<u>2008</u>	<u>2007</u>
<i>Non-Cash Financing and Investing</i>		
Shares issued on payment of agent fee	\$ -	\$ 68,702
Issuance of shares for technology rights	\$ 192,500	\$ -

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15. CHANGE IN NON-CASH OPERATING WORKING CAPITAL ITEMS

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

	Three months ending June 30,		Nine months ending June 30,	
	2008	2007	2008	2007
Accounts receivable	\$ 363,843	\$ (177,586)	\$ 97,196	\$ (181,724)
Inventory	(3,928)	4,190	25,619	(89,810)
Prepaid expenses	38,534	(161,536)	97,878	(200,528)
Accounts payable and accrued liabilities	(72,155)	157,647	(298,487)	179,281
	\$ 326,294	\$ (177,285)	\$ (77,794)	\$ (292,781)