

# Innovotech Inc.

## Management's Discussion and Analysis of Financial Conditions and Results of Operations for the twelve-months ended December 31, 2018

*The following Management's Discussion and Analysis (MD&A) of results of operations and financial position as at April 25<sup>th</sup>, 2019 should be read in conjunction with the audited financial statements of Innovotech Inc. ("Innovotech", "we", or "the Company") for the year ended December 31, 2018 and the related notes thereto.*

*Management is responsible for the information contained in the MD&A and its consistency with information presented, reviewed and approved by the Audit Committee and Board of Directors.*

*Additional information pertaining to the Company can be found on the System for Electronic Document Analysis and Retrieval (SEDAR) web site at [www.sedar.com](http://www.sedar.com).*

This MD&A and other materials filed with the Canadian securities regulators contain forward-looking statements that are subject to risks and uncertainties that cannot be predicted or quantified; consequently, actual results may differ materially from past results and those expressed or implied by any forward-looking statements.

Forward-looking statements may include words such as "expects", "plans", "will", "believes", "estimates", "intends", "may", and other words of similar meaning and may relate to future financial performance, business strategies, or safety and efficacy of unapproved products. Such forward looking statements are subject to risks, uncertainties and other factors many of which are beyond the control of Innovotech.

Factors that could cause or contribute to such risks or uncertainties include, but are not limited to: the regulatory environment including the difficulty of predicting regulatory outcomes; changes in the value of the Canadian dollar; the Company's reliance on a small number of customers including government organizations; the demand for new products and the impact of competitive products, service and pricing; availability and cost of raw materials; fluctuations in operating results; government policies or actions; progress and cost of clinical trials; reliance on key strategic relationships; uncertainty related to intellectual property protection and potential costs associated with its defense; the Company's exposure to lawsuits and other matters beyond the control of management; the impact of the adoption of new accounting standards on Company's financial results.

Scientific information that relates to unapproved products or unapproved uses of products is preliminary and investigative. No conclusions can or should be drawn regarding the safety or effectiveness of such products. Only regulatory authorities can determine whether products are safe and effective for the uses being investigated.

The cautionary statements referred to above should be considered in connection with all written or oral statements, especially forward-looking statements that are made by the Company or by persons acting on its behalf and in conjunction with its periodic filings with Securities Commissions, including those contained in the Company's news releases and most recently filed AIF.

Should known or unknown risks or uncertainties materialize, or should management's assumptions prove inaccurate, actual results could vary materially from those anticipated. The Company undertakes no obligation to publicly make or update any forward-looking statements, except as required by applicable law.

### **OVERVIEW OF THE BUSINESS**

Innovotech was incorporated in 2001 under the Alberta Business Corporations Act. The Company was listed on the TSX Venture Exchange in 2003. Since that time, the Company has become a leader in the field of contract research in connection with the susceptibility of medical devices to microbial biofilm formations and the efficacy of products that claim to limit, mitigate or eliminate such formations. Innovotech occupies offices and laboratories in Edmonton, Alberta, Canada.

The Company also manufactures and sells globally the MBEC Assay® Kit, a high throughput biofilm growth device approved as an ASTM International Standard test kit used to test anti-biofilm product claims.

The Company recently acquired and improved upon a second device that accelerates its ability to conduct its anti-microbial contract research to the benefit of its clients.

Innovotech has developed and patented an anti-biofilm silver periodate compound for wound care called InnovoSIL™-1, a silver based antimicrobial compound that has the unique feature that it is not rapidly inactivated by chloride (salts) that is present in all body tissues.

The Company maintains an active search for a contributive acquisition to expand and diversify its revenue sources.

## **BUSINESS STRATEGY**

The Company has two businesses, contract research and the production and sale of the MBEC Assay® Kit. In respect of its contract research business the Company is a leader in a niche market related, primarily, to testing and qualifying medical devices and products for their susceptibility to, or resistance to the formation of microbial biofilms. The Company has developed methodologies and designed equipment that it believes give it certain proprietary advantages and efficiencies. Innovotech pursues new accounts by direct contact through business trips, e-mail and telephone. These methods have proven effective, and the number of new accounts serviced grows annually.

Innovotech's manufacture and sale of the MBEC Assay® Kits helps to keep the Company's name in the forefront of research and medical device testing on a global basis. The consistent revenues from the Kits helps mitigate the volatility inherent in contract research services. The Company believes that the association of the Kit with its contract research capabilities is contributory to its marketing efforts.

In order to conduct its two businesses on a profitable basis going forward, the Company reviewed its R&D efforts and G&A expenses in the second half of the 2018 year and determined to curtail R&D efforts to patent maintenance for our InnovoSIL™ family of anti-bacterial compounds. Our R&D expenditures were wound down and our G&A expenses were reduced during the second half of the year.

The Company continues to speak with agricultural and medical device companies in an effort to interest them in the anti-microbial biofilm properties of our InnovoSIL™ compounds to advance those products toward commercial application. There is third-party testing of our InnovoSIL™-1 product in that regard.

We believe that our focus on our core businesses following R&D curtailment may result in improved revenues, and our focus on controlling G&A costs may allow more of that revenue to reach our bottom line. Accordingly, our third focus is to maintain our existing accounts while working to add new accounts to obtain more consistency in the trend of our quarterly revenues. The Company also continues to look for merger or acquisition opportunities to diversify its business activities and provide greater consistency of recurring revenues. It is the Company's strategy that becoming a profitable platform will benefit its search for a constructive M&A partner.

## **OVERALL PERFORMANCE**

The 2018 year was one of financial underperformance and yet it was also one of constructive change in strategy and direction.

- The Company experienced reduced revenues from both contract research and MBEC Assay® plate sales and recorded a net loss of \$127,634 on gross sales of \$826,935.
- Recognizing reduced revenues, the Company curtailed its proprietary R&D program, thus reducing R&D costs to selected patent maintenance.
- Prior to winding down R&D activities, the Company developed a stable gel formulation as a functional carrier for InnovoSIL™ - 1 so as to enable possible partners to test its performance.
- In further response to reduced revenues the Company was successful in materially reducing its G&A expenses.

- Our COO and his team worked all year to successfully obtain ISO 17025 certification early in 2019. While this effort contributed to higher costs in 2018, it was considered essential to enable us to compete with other contract research organizations. ISO 17025 is an audited program that focuses on the excellence and reliability of testing and equipment calibration in laboratories.
- We acquired and improved on a proprietary device that enables us to more efficiently conduct our contract research business.
- In the 2018 year, 19.5% of the contract research side of our business came from new accounts opened during the year.

### SELECTED ANNUAL FINANCIAL INFORMATION

The following table sets forth financial data for the fiscal years ended December 31, 2018, 2017 and 2016.

	2018	2017	2016
Revenue	826,935	990,343	1,005,598
Net income (loss) for the year	(127,634)	753,385	(215,535)
Per share income (loss), basic and fully diluted	0.00	0.02	(0.01)
Total assets	272,330	527,265	352,270
Total liabilities	178,860	345,757	(1,218,475)

### RESULTS OF OPERATIONS

For the year ended December 31, 2018, Innovotech recorded a net loss of \$127,634 compared to a net profit of \$753,385 in 2017. The decrease in net profit in 2018 is explained by the prior year gain on debt settlement of \$857,389 compared with \$49,599 in 2018, coupled with a decline in sales revenue of \$163,408. R&D and associated patent costs of \$39,129 contributed to the 2018 net loss offset by a recovery of \$49,599 of debt forgiveness. A \$23,444 increase in share-based compensation to \$39,596 also contributed to the 2018 net loss.

	2018	2017	2016
Contract research fees	579,472	685,296	686,551
Product sales	247,463	305,047	319,047
Gross revenue	826,935	990,343	1,005,598
Cost of goods sold	220,614	290,560	272,334
<b>Gross profit</b>	<b>606,321</b>	<b>699,783</b>	<b>733,264</b>

Contract research revenues decreased by \$105,824 from \$685,296 in the prior year to \$579,472 in the 2018 year, a decline of 15%. Mergers and acquisitions took place within our client base, which postponed a number of in-place contracts, however, we did add new customers during the year to the extent of 19.5% of revenue. Our customers repeated orders with the Company, but their orders were of lower value than in prior years. Management is focused on adding new accounts and re-visiting accounts that in the past have been active with the Company.

MBEC Assay® plate sales also decreased to \$247,463 from \$305,047 in the prior year, a decline of 19%. Similar to our contract research experience, there were repeat orders during all of 2018, but orders were smaller; perhaps in part because the Company has recently enabled smaller packets of the Kits to be ordered through its product catalogue.

Operating Expenses and Net Profit (Loss):

	<b>2018</b>	<b>2017</b>	<b>2016</b>
General and administrative (G & A)	696,447	606,830	497,506
Sales and marketing	1,035	1,146	1,111
Research & development (R & D)	39,129	67,497	148,584
Scientific research tax credits	(3,303)	(11,711)	(14,290)
Total operating expenses	733,308	663,762	632,911
Interest expense	(650)	(27,872)	(69,559)
Loss on carrying value adjustment	-	-	(246,437)
Interest income	3	43	108
Forgiveness of debt	-	745,193	-
Total financing cost	(647)	717,364	(315,888)
Net profit (loss)	<b>(127,634)</b>	<b>753,385</b>	<b>(215,535)</b>
Per share, basic and diluted	(0.00)	0.02	(0.01)

Operating expenses in 2017 is net of \$112,196 forgiveness of accounts payable included in G&A. Operating expenses in 2018 is net of \$49,599 of forgiveness of accounts payable included in R&D. Operating expenses, excluding the effects of forgiveness of accounts payable, increased from \$775,958 in the prior year to \$782,907 in 2018. The 2018 expenses resulted from an increase in salaries and wages, and share-based compensation expenses of \$58,678 which was partially offset by decreases in professional and consulting fees, and other expenses.

**ASSETS, LIABILITIES AND SHAREHOLDER'S EQUITY**

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Current assets	211,425	459,013	252,917
Equipment	60,905	68,252	72,353
Total assets	272,330	527,265	352,270
Current liabilities	178,860	345,757	1,543,745
Shareholder's equity (deficiency)	93,470	181,508	(1,218,475)

## EBITDAS

This non-GAAP measure is not defined under IFRS and may not be comparable to similar measures presented by other companies. For the Company, it is defined as earnings before interest, taxes, dividends, amortization and depreciation, and share-based compensation (EBITDAS). Management believes that EBITDAS as defined here is useful in providing investors with additional information to assist them in understanding the operational performance.

	2018	2017	2016
Net income (loss) for the year	(127,634)	753,385	(215,535)
Depreciation	15,368	16,827	19,440
Loss (gain) on disposal of equipment	1,297	(1,158)	(3,021)
Interest expense (net)	650	27,829	69,559
Forgiveness of debts	-	(745,193)	246,437
Forgiveness of accounts payable	(49,559)	(112,196)	-
Share-based compensation	39,596	16,152	-
	<b>(120,282)</b>	<b>(44,311)</b>	<b>116,880</b>

## RESEARCH AND DEVELOPMENT

Included in operating expenses, above, are R&D costs that include patent expenses and those are material factors in the net operating losses of the past few years. The Board of Directors has determined that short of clinical trials, which are financially beyond the capacity of Innovotech, the Company has brought its InnovoSIL™ compound to a level where its effectiveness is able to be tested, evaluated and measured by potential third parties at a 2018 R&D cost of \$39,129. Therefore, the Board has determined to curtail further proprietary R&D expenditures beyond the fourth quarter of fiscal 2018.

## SUMMARY OF QUARTERLY RESULTS

	2018			
	Q4	Q3	Q2	Q1
Gross revenue	199,615	216,536	194,988	215,796
Cost of sales	57,937	44,332	53,933	64,412
Gross profit	141,678	172,204	141,055	151,384
Expenses	109,186	188,987	207,225	227,910
<b>Net income (loss)</b>	<b>31,845</b>	<b>(16,783)</b>	<b>(66,170)</b>	<b>(76,526)</b>
Net income (loss) per share	0.00	(0.00)	(0.00)	(0.00)

	2017			
	Q4	Q3	Q2	Q1
Gross revenue	195,087	258,500	208,690	328,060
Cost of sales	44,196	111,325	67,666	80,484
Gross profit	150,891	147,175	141,030	247,576
Expenses	121,602	(537,141)	167,386	181,440
<b>Net income (loss)</b>	<b>29,289</b>	<b>684,316</b>	<b>(26,356)</b>	<b>66,136</b>
Net income (loss) per share	0.00	0.02	(0.00)	0.00

#### **FOURTH QUARTER OF 2018 (Q4)**

Q4, 2018 benefited from lower G&A costs and a net recovery of R&D expenses of \$33,129 as a result of the forgiveness of accounts payable of \$49,599. Q4 in the prior year benefited from debt forgiveness of \$112,196, offset by R&D expenses of \$36,535.

Quarterly revenue is variable, and subject to the size and timing of contract research services. During Q4 of 2018, contract research volume was low partly because of timing at year end when some contracts trailed over into Q1 of 2019. MBEC Assay® Kit sales were \$68,618 in the 4<sup>th</sup> quarter, working to offset lower contract research levels.

#### **OUTLOOK**

During the third and fourth quarter of 2018 the Company addressed reduced revenues by focusing on cost management. The Board agreed to curtail R&D expenditures by year end. G&A costs were reviewed and reduced. Employees were reallocated to improve efficiencies, and the employee count reduced by one part-time employee. These changes are designed to improve financial performance in 2019.

#### **LIQUIDITY AND CAPITAL RESOURCES**

Innovotech has a history of frequent quarterly and annual losses exacerbated by varying levels of expensed R&D costs. The Company has funded its operations primarily from equity financing, shareholder loans and government grants. As of December 31, 2018, the Company had \$28,808 of cash and cash equivalents versus \$324,522 at December 31, 2017, and \$32,565 of working capital versus \$113,256 at December 31, 2017.

#### **CONTRACTUAL OBLIGATIONS**

Included in 2018 current liabilities is a due to shareholder for \$100,000 comprising the full amount of a working capital line of credit. The line of credit bears interest at 6% per annum paid monthly, is unsecured, and is payable on October 22<sup>nd</sup>, 2019. There are no other material contractual obligations or off-balance sheet arrangements.

#### **RISK MANAGEMENT:**

##### Capital risk:

Innovotech's objectives when managing capital are to ensure its ability to continue as a going concern in order to pursue product sales, contract research, and further corporate development. The Company attempts to maximize return to shareholders by minimizing shareholder dilution and utilizing non-dilutive funding arrangements where possible, such as shareholder loans and government grants. Innovotech includes equity comprised of issued share capital, contributed surplus and deficit in its definition of capital. The Company has financed its operations and capital requirements primarily through share issuances and government grants since inception.

The Company manages its capital structure and adjusts it in light of changes in economic conditions and the risk and characteristics of its income and underlying assets. The Company may issue new shares or raise debt.

Credit risk:

The Company is exposed to credit risk through its cash and accounts receivable.

The Company's products and services are priced in United States dollars. Its customers are global and therefore its receivables may have an extended duration. Innovotech's customers tend to be large multi-national companies and universities, and the Company's allowance for doubtful accounts is small to non-existent as the Company has no history of default. We bill a portion of contract research costs before starting contract work. We do not insure our credit risk. Therefore, we are exposed to such risk.

Currency risk:

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

We incur costs in terms of Canadian dollars and earn revenue in terms of United States dollars. Thus, the Company is exposed to fluctuations in income and expenses through fluctuations and timing of foreign exchange rates. We have not used derivative instruments to reduce this exposure. In 2018 we incurred a foreign exchange gain of \$22,409. In the 2017 year we incurred a foreign exchange loss of \$14,683.

Liquidity risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities.

We manage accounts payable against accounts receivable and carry a balance of cash to accommodate that. As at December 31, 2018, our cash, receivables and inventory totalled \$204,747, while our accounts payable totalled \$78,860. The Company has a \$100,000 shareholder line of credit as a current liability, and therefore, the Company's working capital at year end was \$32,565.

Interest rate risk:

Interest rate risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company has a shareholder line of credit of \$100,000 included in current liabilities which carries a fixed rate of interest of 6% and matures on October 22<sup>nd</sup>, 2019.

The Company is exposed to nominal interest rate risk arising from fluctuations in interest rates on its cash balances.

**OUTSTANDING SHARE CAPITAL**

As of April 25, 2019, there are 36,239,612 common shares issued and outstanding.

The Company had stock options outstanding and exercisable under its incentive stock option program of 2,043,000, at a weighted average exercise price of \$0.21.

Subsequent to the 2018 yearend, three employees were granted a total of 36,000 stock options at an exercise price of \$0.05 for a period of 5 years. There are, as of the date of this MD&A 2,079,000 outstanding stock options.

## RELATED PARTY TRANSACTIONS

### Transactions with Related Parties:

In December 2017, Lonsdale Capital Corporation, beneficially owned by Alan Savage, a Director of the Company exercised 2,500,000 warrants at \$0.10 per warrant share and the Company received \$250,000. The acquired shares were issued in the 2018 year.

During 2018, Bruce Hirsche who was a director and corporate secretary of the Company was also legal counsel to the Company through Parlee McLaws LLP where he received \$4,196 of legal fees. Subsequent to his untimely and regretted death, David Tam was appointed as director and Corporate Secretary of the Company. As legal counsel to the Company Mr. Tam received \$21,279 of legal fees in 2018.

Bernard Grobbelaar, a director of the Company received \$\$68,290 of professional fees as CFO of the Company and for providing full cycle accounting services.

Dr. James Timourian CEO of the Company received \$18,000 of professional fees for his services.

### Accounts Payable to Related Parties:

In October of 2018, Lonsdale Capital Corporation, a company beneficially owned by Alan Savage provided a letter of credit to the Company under the terms of which the Company borrowed \$100,000 at 6% interest repayable on October 22<sup>nd</sup>, 2019.

	<b>2018</b>	<b>2017</b>
Salaries and short-term employee benefits	135,414	51,000
Termination benefit	-	-
Share based payments	39,596	16,152
	<b>175,010</b>	<b>67,152</b>

## GEOGRAPHIC SUMMARY OF REVENUE:

	<b>2018</b>	<b>2017</b>
Canada	46,366	20,705
United States	624,194	700,014
Rest of world	156,375	269,624
	<b>826,935</b>	<b>990,343</b>

## SUBSEQUENT TRANSACTIONS

Subsequent to yearend 2018, three employees were granted a total of 36,000 stock options at an exercise price of \$0.05 for a period of 5 years.