



Quarterly Report

June 30, 2016



Nanotech Security Corp.

Management's Discussion and Analysis

For the three and nine months ended June 30, 2016

For purposes of this discussion "Nanotech", the "Company", "we", or "us" refers to Nanotech Security Corp. and its subsidiaries. This quarter means the three months ended June 30, 2016.

ADVISORY

This management's discussion and analysis (the "MD&A"), dated as of August 15, 2016 should be read in conjunction with the cautionary statement regarding forward-looking statements below and the Company's condensed consolidated interim financial statements for the three and nine months ended June 30, 2016, as well as with the Company's consolidated financial statements and MD&A for the year ended September 30, 2015. The results reported herein have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are presented in Canadian dollars. All quarterly information disclosed in the MD&A is based on unaudited figures.

Unless otherwise indicated, the Company's significant accounting policies and estimates, contractual obligations, commitments, contingencies, and business risks and uncertainties, as described in its MD&A for the year ended September 30, 2015, are substantially unchanged. The MD&A and condensed consolidated interim financial statements were reviewed by the Company's Audit Committee and approved by the Company's Board of Directors.

Additional information relating to the Company is filed on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

The following discussion and analysis of the financial conditions and results of operations contains forward-looking statements concerning anticipated developments in our operations in future periods, the adequacy of our financial resources, and the events or conditions that may occur in the future. Forward-looking statements are frequently, but not always, identified by words such as "expects", "anticipates", "believes", "intends", "estimates", "predicts", "potential", "targeted", "plans", "possible" and similar expressions, or statements that events, conditions or results "will", "may", "could" or "should" occur or be achieved.

These forward-looking statements include, without limitation, statements about our market opportunities, strategies, competition, and the Company's views that its nano-optical and optical thin film technologies will continue to show promise for mass production and commercial application. Other forward-looking statements imply that the Company will remain capable of being financed and/or will be able to partner development until commercial sales are eventually realized. The principal risks related to these forward-looking statements are that the Company's intellectual property claims will not prove sufficiently broad or enforceable to provide the necessary commercial protection and to attract the necessary capital and/or that the Company's products will not be able to displace entrenched hologram, metalized strip tagging, and other conventional anti-counterfeiting technologies sufficiently to allow for profitability.

Our forward-looking statements are based on the beliefs, expectations and opinions of management on the date the statements are made. Consequently, all forward-looking statements made in this discussion and analysis of the financial conditions and results of operations or the documents incorporated by reference are qualified by this cautionary statement and there can be no assurance that actual results or developments we anticipate will be realized. For additional information with respect to certain of these risks or factors reference should be made to the "Business Risks and Uncertainties" section of this MD&A and notes to the consolidated financial statements for the year ended September 30, 2015, as well as with the Company's continuous disclosure materials filed from time-to-time with Canadian securities regulatory authorities, which are available online at www.sedar.com. Nanotech disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than as required by law, rule or regulation. You should not place undue reliance on forward-looking statements.

Nanotech Security Corp.

Management's Discussion and Analysis
For the three and nine months ended June 30, 2016

GENERAL OVERVIEW

Nanotech was incorporated under the laws of British Columbia, is listed on the TSX Venture Exchange (trading symbol: NTS) and quoted in the United States on the OTCQX Market (trading symbol: NTSFF). The Company's head office is located at #505 - 3292 Production Way, Burnaby, BC, Canada V5A 4R4. The Company's registered and records office is #1500 - 1055 West Georgia, Vancouver, BC, Canada V6E 4N7.

The Company operates its business through two business divisions – Security Features and Surveillance. The Company's reportable segments are strategic business divisions that offer different products and services. They are managed separately because each business is in a different stage in its life cycle and they require different sales and marketing strategies.

Security Features

Security Features provides nano-optics and optical thin film ("OTF") for use in anti-counterfeiting and authentication processes and products including currency, legal documents and commercial products. The Company conducts research at its Burnaby, BC head office, its research and production facility in Thurso, QC, and at 4D Labs nanofabrication facility, a federal government sponsored facility located at Simon Fraser University in Burnaby, BC.

The Security Features division is developing nanotechnology and OTF for use in anti-counterfeiting and commercial product authentication systems. The Company is developing specialized optical features for use in banknotes and other products. The nanotechnology employs arrays of billions of nano-holes that are impressed or embossed onto a substrate material such as polymer and metal. These arrays yield unique light signatures (visual images) that cannot be easily reproduced by a third party without access to the technology and equipment needed to create the arrays. These optical features can be directly applied to banknotes and other valuable documents and products creating unique optical signatures that are both overt (naked-eye-visible) and machine (only) readable. These features are being designed to be suitable for a variety of other commercial security applications and branding formats. Images of these features are available on the Company's website at: www.nanosecurity.ca

Surveillance

Surveillance designs and sells a wide range of sophisticated surveillance and intelligence gathering equipment and conducts surveillance training for the law enforcement and defense industries primarily in the United States and Canada. The Company conducts its research, production, and training at its facility in Holmes, PA, USA.

The Surveillance division has developed the P-25 digital transmission system allowing federal, state and local law enforcement agencies to communicate with each other over a single frequency using both digital and analog frequencies, and the release of the Echo 8i that converts analog audio signals to digital, enabling secure, wireless smart-phone connectivity. They also customize and retrofit surveillance vans and mobile command centers for various government authorities.

Nanotech Security Corp.

Management's Discussion and Analysis
For the three and nine months ended June 30, 2016

RESULTS OF OPERATIONS

The following table provides selected financial information for the three and nine months ended June 30, 2016 and 2015:

Select financial information

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Revenue	\$ 1,157,905	\$ 1,359,088	\$ 3,615,365	\$ 4,424,440
Cost of sales	614,194	660,784	1,830,232	2,479,866
	543,711	698,304	1,785,133	1,944,574
Expenses				
Research and development	1,306,598	1,146,416	4,049,817	3,422,550
General and administration	663,537	514,200	2,013,024	1,731,022
Sales and marketing	597,831	585,503	1,799,712	1,410,397
	2,567,966	2,246,119	7,862,553	6,563,969
Loss before other expenses	(2,024,255)	(1,547,815)	(6,077,420)	(4,619,395)
Other expenses (income)	95,976	(268,173)	239,156	(1,513,960)
Loss before income tax recovery	\$ (2,120,231)	\$ (1,279,642)	\$ (6,316,576)	\$ (3,105,435)
Deferred income tax recovery	162,797	-	162,797	-
Net loss	\$ (1,957,434)	\$ (1,279,642)	\$ (6,153,779)	\$ (3,105,435)

Revenue

Revenues for the three months ended June 30, 2016 decreased by \$201,183 to \$1,157,905 compared to \$1,359,088 in the same period last year. This included the Security Features division delivering revenue of \$497,114 compared to \$865,219 during the same period last year, primarily from development contracts. The development contracts continue to progress well and are advancing both our KolourOptik® and colour-shifting OTF technologies to be integrated into future banknotes.

OTF production continued to be negatively impacted as the Company continues to focus on a large Asian issuing authority. On November 17, 2015 the Company announced the signing of a Memorandum of Understanding which contemplates an operational agreement with Hueck Folien to collaborate in the production of volume colour-shifting OTF. This integration has continued to consume internal resources in bringing the new manufacturing facility online. In May 2016 the Company completed the supplier acceptance process with the Asian issuing authority and had commenced production and delivery of colour-shifting OTF through its licensed production partner Hueck Folien. To date, the initial deliveries continue to be scrutinized and reviewed by the customer as they work to ensure the deliveries are seamlessly integrated into their production facility. As a result, it is anticipated that this process will continue through the fourth quarter with the expectation that production should resume either late in the quarter or early fiscal 2017. Although there have been unforeseen delays, management is still confident that once production resumes, the Company will be well positioned to deliver throughout the life of this banknote.

The Surveillance division achieved revenues of \$660,791 for the three months ended June 30, 2016 compared to \$493,869 during the same period last year. This increase reflected growth in the number of surveillance vans delivered during the period.

Revenues for the nine months ended June 30, 2016 decreased by \$809,075 to \$3,615,365 compared to \$4,424,440 in the same period last year. This included the Security Features division delivering revenue of \$1,711,530 compared to \$2,775,185 during the same period last year, primarily from development

Nanotech Security Corp.

Management's Discussion and Analysis

For the three and nine months ended June 30, 2016

contracts. The OTF production continued to be negatively impacted as the team focused on bringing the new production facility online.

The Surveillance division achieved revenues of \$1,903,835 for the nine months ended June 30, 2016 compared to \$1,649,255 during the same period last year. This increase reflected growth in the number of surveillance vans delivered during the period.

Gross margin

Gross margin for the three months ended June 30, 2016 decreased by \$154,593 to \$543,711 compared to \$698,304 in the same period last year. Overall, the gross margin percentage was 47% for the three months ended June 30, 2016, a slight decrease from the 51% in the same period last year. The gross margins continue to reflect strong margins on the Security Features division's development contracts and Surveillance division sales partially offset by an inventory write-off of \$82,087.

Gross margin for the nine months ended June 30, 2016 decreased \$159,441 to \$1,785,133 compared with \$1,944,574 in the same period last year. Overall, the gross margin percentage reached 49% for the nine months ended June 30, 2016, an improvement from the 44% in the same period last year. This increase is again reflected in higher margins on the Security Features division's development contracts and Surveillance division sales partially offset by an inventory write-off of \$119,126.

Research and development

Research and development expenditures for the three months ended June 30, 2016 increased by \$160,182 to \$1,306,598 compared to \$1,146,416 in the same period last year. This is primarily a result of an increase in depreciation of \$198,169 reflecting a 2015 revision of the Company's depreciation policy. Research and development activity for the three months ended June 30, 2016 continued to focus on bringing the new Hueck Folien production facility online as well as new security features targeted for the banknote market.

Research and development expenditures for the nine months ended June 30, 2016 increased by \$627,267 to \$4,049,817 compared to \$3,422,550 in the same period last year. This is primarily a result of an increase in depreciation and amortization of \$681,865 reflecting a 2015 revision of the Company's depreciation policy. Research and development activity for the nine months ended June 30, 2016 also continued to focus on bringing the new Hueck Folien production facility online as well as new security features targeted for the banknote market.

General and administration

General and administration expenditures for the three months ended June 30, 2016 were \$663,537, an increase of \$149,337 compared to \$514,200 in the same period last year which reflected higher office rent, overheads and professional fees.

General and administration expenditures for the nine months ended June 30, 2016 were \$2,013,024, an increase of \$282,002 compared to \$1,731,022 in the same period last year which again reflected higher office rent, overheads and professional fees.

Sales and marketing

Sales and marketing expenditures for the three months ended June 30, 2016 were \$597,831, an increase of \$12,328 compared to \$585,503 in the same period last year which was due to increased sales and marketing activity related to the Security Features division, including increased salaries and international travel.

Sales and marketing expenditures for the nine months ended June 30, 2016 were \$1,799,712, an increase of \$389,315 compared to \$1,410,397 in the same period last year which was due to increased sales and marketing activity related to the Security Features division, including increased salaries and international travel.

Nanotech Security Corp.

Management's Discussion and Analysis

For the three and nine months ended June 30, 2016

Net loss

The net loss for the three months ended June 30, 2016 was \$1,957,434 compared to \$1,279,642 during the same period last year. The increase in net loss is reflected in lower sales, an increase in general and administrative costs and sales and marketing activities, an increase in non-cash amortization, and foreign exchange. The prior year figures also include a \$290,000 gain on the revaluation of contingent shares.

The net loss for the nine months ended June 30, 2016 was \$6,153,779 compared to \$3,105,435 during the same period last year. The increase in net loss is reflected in an increase in general and administrative costs and sales and marketing activities, an increase in non-cash amortization, and foreign exchange. The prior year figures also include a \$1,450,000 gain on the revaluation of contingent shares.

SEGMENT RESULTS

The Company analyzes financial performance by segments, which groups related activities within the Company. The Company's two reportable operating segments are Security Features and Surveillance. Inter-segment transactions have been eliminated from the segmented financial information discussed below.

Security Features

Security Features provides light based recognition nanotechnology and OTF for use in anti-counterfeiting and authentication processes and products including currency, legal documents, and commercial products.

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Revenue	\$ 497,114	\$ 865,219	\$ 1,711,530	\$ 2,775,185
Net loss before income taxes	(2,139,269)	(1,239,453)	(6,255,950)	(3,143,072)

Revenues from Security Features for the three months ended June 30, 2016 decreased to \$497,114 from \$865,219 for the same period last year. The decreased revenue was primarily due to decreased delivery of OTF as the Company focused on bringing Hueck Folien online.

The loss before income taxes from Security Features for the three months ended June 30, 2016 increased by \$899,816 to \$2,139,269 from \$1,239,453 for the same period last year. The increase in net loss reflects lower sales, an increase in sales and marketing activities, and an increase in non-cash amortization and foreign exchange. The prior year figures also include a \$290,000 gain on the revaluation of contingent shares.

Revenues from Security Features for the nine months ended June 30, 2016 decreased to \$1,711,530 from \$2,775,185 for the same period last year. The decreased revenue was primarily due to decreased delivery of OTF as the Company focused on bringing Hueck Folien online.

The loss before income taxes from Security Features for the nine months ended June 30, 2016 increased by \$3,112,878 to \$6,255,950 from \$3,143,072 for the same period last year. The increase in net loss reflects, an increase in sales and marketing activities, and an increase in non-cash amortization and foreign exchange. The prior year figures also include a \$1,450,000 gain on the revaluation of contingent shares.

Surveillance

Surveillance designs and sells sophisticated surveillance and intelligence gathering equipment for the law enforcement and defense industries in the United States and Canada.

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Revenue	\$ 660,791	\$ 493,869	\$ 1,903,835	\$ 1,649,255
Net income (loss) before income taxes	19,038	(40,189)	(60,626)	37,637

Nanotech Security Corp.

Management's Discussion and Analysis

For the three and nine months ended June 30, 2016

Revenues from Surveillance for the three months ended June 30, 2016 increased to \$660,791 from \$493,869 in the same period last year. This increase reflected strong revenues from surveillance vans.

Net income from Surveillance for the three months ended June 30, 2016 increased to \$19,038 from net loss of \$40,189 in the same period last year. The net income was as a result of increased sales during the quarter.

Revenues from Surveillance for the nine months ended June 30, 2016 increased to \$1,903,835 from \$1,649,255 in the same period last year. This increase reflected growth in the number of surveillance vans delivered during the period.

Net loss from Surveillance for the nine months ended June 30, 2016 increased to \$60,626 from net income of \$37,637 in the same period last year. The net income in the prior period included a \$146,180 foreign exchange gain.

QUARTERLY RESULTS

	Q3 2016	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014
(\$ thousands, except common share amounts)								
Revenue	\$1,158	\$948	\$1,509	\$728	\$1,359	\$1,528	\$1,537	\$498
Net income (loss)	(1,957)	(2,450)	(1,746)	(1,565)	(1,280)	(895)	(931)	2,284
Net income (loss) per common share:								
Basic	(0.04)	(0.05)	(0.03)	(0.03)	(0.03)	(0.02)	(0.02)	0.06
Diluted	(0.04)	(0.05)	(0.03)	(0.03)	(0.03)	(0.02)	(0.02)	0.05

There are no seasonal effects or other trends in the Company's business over the quarters presented. The net income in Q4 2014 was the result of a non-recurring deferred income tax recovery of \$3,892,000. The recovery was triggered by the application of previously unrecognized income tax assets of the Company being utilized to offset deferred tax liabilities which were created on the acquisitions of IDME Technologies Corp., IDIT Technologies Corp., and Fortress Optical Features Ltd.

RELATED PARTY TRANSACTIONS

For the three and nine months ended June 30, 2016, the Company had no transactions with related parties as defined in IAS 24, *Related Party Disclosures*, except those pertaining to transactions with key management personnel in the ordinary course of their employment or as disclosed below.

- (a) The remuneration of key management personnel is as follows:

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Salaries, accrued bonuses, and employee benefits	\$ 211,239	\$ 212,088	\$ 773,783	\$ 656,724
Share based payments	138,734	127,801	380,103	339,233
	\$ 349,973	\$ 339,889	\$ 1,153,886	\$ 995,957

- (b) Management fees and accrued bonuses totaling \$83,450 for the three months ended June 30, 2016 (June 30, 2015 - \$89,250) and \$308,450 for the nine months ended June 30, 2016 (June 30, 2015 - \$238,000) by a company controlled by an officer and director of the Company, were included

Nanotech Security Corp.

Management's Discussion and Analysis

For the three and nine months ended June 30, 2016

in salaries and employee benefits expense. As of June 30, 2016, amounts owing to this company included in accounts payable and accrued liabilities were \$262,258 (September 30, 2015 - \$338,752).

(c) Legal and professional fees, taxes and disbursements totaling \$53,458 for the three months ended June 30, 2016 (June 30, 2015 - \$41,500) and \$120,743 for the nine months ended June 30, 2016 (June 30, 2015 - \$130,382) were incurred with a law firm of which a director of the Company is a partner. As of June 30, 2016, amounts owing to this company included in accounts payable and accrued liabilities were \$214,519 (September 30, 2015 - \$171,895).

(d) During the three months ended June 30, 2016 certain directors and officers of the Company participated in the convertible debentures financing amounting to \$350,000.

The above transactions are in the normal course of business and are measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of liquidity are cash provided by operations, including collection of accounts receivable, and access to equity capital resources. The Company's primary short-term cash requirement is to fund operations and working capital, including supplier payables, capital expenditures, and fixed overhead costs. Cash is also used to finance other long-term strategic business initiatives. As at June 30, 2016, cash and cash equivalents totaled \$4,172,908, compared to \$3,021,928 as at September 30, 2015.

Summary of statement of cash flow

	Three months ended		Nine months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Cash used in operating activities ¹	\$(1,158,641)	\$ (816,749)	\$(3,499,732)	\$(2,248,316)
Changes in operating assets and liabilities	20,994	279,331	476,669	(557,625)
Cash used in operating activities	(1,137,647)	(537,418)	(3,023,063)	(2,805,941)
Cash provided by (used in) investing activities	42,664	(407,663)	(166,205)	(666,347)
Cash provided by financing activities	4,120,289	133,255	4,300,289	869,230
Effect of foreign currency translation on cash and cash equivalents	5,862	8,718	39,959	(80,672)
Cash and cash equivalents, beginning of period	1,141,740	2,084,023	3,021,928	3,964,645
Cash and cash equivalents, end of period	\$ 4,172,908	\$ 1,280,915	\$ 4,172,908	\$ 1,280,915

¹ Before changes in operating assets and liabilities

Operating activities

Cash used in operating activities was \$1,137,647 for the three months ended June 30, 2016, an increase from the \$537,418 for the same period last year. This increase was a result of lower sales during the quarter and the prior period being aided by an increase in cash collected from operating assets and liabilities.

Cash used in operating activities was at \$3,023,063 for the nine months ended June 30, 2016, compared to \$2,805,941 for the same period last year. This improvement was as a result of an increase in cash collected from operating assets and liabilities partially offset by lower sales and increased foreign exchange and losses in the Surveillance division.

Nanotech Security Corp.

Management's Discussion and Analysis

For the three and nine months ended June 30, 2016

Investing activities

Cash provided by investing activities was \$42,664 for the three months ended June 30, 2016, compared to \$407,663 used in the same period last year. This reflects an investment tax credit recorded during the current period compared to improvements made to the production equipment during the same period last year.

Cash used in investing activities was \$166,205 for the nine months ended June 30, 2016, down from the \$666,347 for the same period last year where significant upgrades were made to the production equipment.

Financing activities

Cash provided by financing activities was \$4,120,289 for the three months ended June 30, 2016, compared to \$133,255 during the same period last year. The current period reflects proceeds of a non-brokered private placement of unsecured subordinated convertible debentures.

Cash provided by financing activities was \$4,300,289 for the nine months ended June 30, 2016, compared to \$869,230 during the same period last year. The current period reflects proceeds of a non-brokered private placement of unsecured subordinated convertible debentures.

Capital resources

The Company's objectives when managing capital are to safeguard the ability to continue as a going concern, to provide adequate return to shareholders, to meet external capital requirements and preserve financial flexibility in order to benefit from potential opportunities that may arise. Our principal cash requirements are for operations, working capital, and capital expenditures. The Company has recurring operating losses and an accumulated deficit of \$29,443,019 as of June 30, 2016 (September 30, 2015 - \$23,289,240). The Company also expects to continue to incur substantial expenses relating to its research and development efforts in light based recognition nanotechnology. As a result, the Company expects to incur significant losses in the next year unless it is able to realize revenue after commercialization of its products currently under development. The timing and amount of such revenues, if any, cannot be predicted with certainty. The Company's ability to continue as a going concern is dependent on its ability to obtain significant additional financing in order to meet its planned business objectives and to be able to commercialize products currently in development. The Company will need to raise funds and is pursuing additional funds through grants, strategic collaborations, public or private equity or debt financing or other funding sources. This funding may not be available on acceptable terms, or at all, and may be dilutive to shareholder interests. However, there can be no assurance that the Company will be able to obtain additional financial resources. If the Company is unable to generate positive cash flows or obtain adequate financing, the Company will need to curtail operations and development activities. These factors cast significant doubt regarding the Company's ability to continue as a going concern. Should the Company be unable to realize its assets and discharge its liabilities in the normal course of business the net realizable value of its assets may be materially less than the amounts on the statement of financial position.

The Company's officers are responsible for managing the Company's capital and do so through quarterly meetings and regular review of financial information. The Board of Directors is responsible for overseeing this process. In managing its capital, the Company considers changes in economic conditions, risks that impact consolidated operations, and future significant capital investment opportunities. For the nine months ended June 30, 2016, there were no other changes in our approach to capital management.

The capital of the Company consists of the items included in the Condensed Consolidated Balance Sheet in the shareholders' equity section and the secured note payable. As at June 30, 2016 shareholders' equity was \$17,941,414 compared to \$22,924,873 as at September 30, 2015.

As at June 30, 2016 cash and cash equivalents amounted to \$4,172,908, compared to \$3,021,928 as at September 30, 2015.

As at June 30, 2016, the Company had working capital of \$3,690,064, as compared to \$3,015,753 at September 30, 2015.

Nanotech Security Corp.

Management's Discussion and Analysis

For the three and nine months ended June 30, 2016

The Company has a note payable outstanding of \$3,000,000 as at June 30, 2016 and September 30, 2015. The note bears interest at 4% per annum and the principal is due in September 2017. Monthly interest payments are required prior to the maturity date. The note payable was used to finance some of the real estate assets acquired on the acquisition of Fortress Optical Features Ltd. The note payable is secured by the assets of the Company.

The Company has convertible debentures outstanding with a face value amounting to \$4,185,000 as at June 30, 2016 which will be repaid upon maturity on May 31, 2018. The convertible debentures accrue interest at a rate of 12% per annum payable quarterly in arrears and are convertible into common shares of the Company at a price of \$1.25 per share. The debentures are redeemable at the Company's option, at a price equal to their principal amount provided that the Company's common shares trade on the TSXV at or above \$2.00 for ten consecutive days any time after four months from issuance.

The Company had 53,612,215 common shares issued and outstanding at June 30, 2016 and 53,387,215 at September 30, 2015.

The Company had 2,153,500 stock options outstanding at June 30, 2016 with a weighted average exercise price of \$1.33 compared to 1,982,000 outstanding as at September 30, 2015 with a weighted average exercise price of \$1.30.

The Company had 688,100 restricted share units outstanding at June 30, 2016 compared to 319,598 as at September 30, 2015.

The Company had 1,327,500 warrants outstanding as at June 30, 2016 and September 30, 2015 with a weighted average exercise price of \$1.50.

The Company had no commitments for material capital expenditures as of June 30, 2016.

The Company had no lines of credit and no exposure to asset backed commercial paper.

Management has reviewed its projected funding requirements and expects that through the generation and collection of revenues and or being able to raise additional funds, that the Company will maintain sufficient liquidity to meet its requirements through June 30, 2017.

Financial instruments

The Company considers the management of financial risk to be an important part of its overall corporate risk management policy. The nature and extent of risks arising from financial instruments, and their related risk management are described in note 13 of the Consolidated Financial Statements for the year ended September 30, 2015. In the three and nine months ended June 30, 2016, there was no material change to the nature of the risks arising from our classification of financial instruments, or related risk management objectives.

Nanotech Security Corp.

Management's Discussion and Analysis
For the three and nine months ended June 30, 2016

ADDITIONAL INFORMATION

Outstanding share data

The Company's articles of incorporation authorize the issuance of an unlimited number of common shares and an unlimited number of preferred shares.

The Company's outstanding share data as at August 8, 2016 is as follows:

Issued common shares	53,627,215
Warrants	1,327,500
Stock options	2,138,500
Restricted share units	688,100

Condensed Consolidated Interim Financial Statements of

Nanotech Security Corp.

Three and nine months ended June 30, 2016 and 2015
(Unaudited)

Nanotech Security Corp.

Condensed Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

Three and nine months ended June 30, 2016 and 2015

(In Canadian dollars)

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Revenue	\$ 1,157,905	\$ 1,359,088	\$ 3,615,365	\$ 4,424,440
Cost of sales (note 9)	614,194	660,784	1,830,232	2,479,866
Gross profit	543,711	698,304	1,785,133	1,944,574
Expenses (note 9)				
Research and development	1,306,598	1,146,416	4,049,817	3,422,550
General and administration	663,537	514,200	2,013,024	1,731,022
Sales and marketing	597,831	585,503	1,799,712	1,410,397
	2,567,966	2,246,119	7,862,553	6,563,969
Loss before other expenses	(2,024,255)	(1,547,815)	(6,077,420)	(4,619,395)
Other expenses (income)				
Foreign exchange (gain) loss	27,067	(8,321)	103,283	(160,192)
Finance expense	68,909	30,148	135,873	96,232
Gain on revaluation of contingent shares	-	(290,000)	-	(1,450,000)
	95,976	(268,173)	239,156	(1,513,960)
Loss before income taxes	(2,120,231)	(1,279,642)	(6,316,576)	(3,105,435)
Deferred income tax recovery (note 4)	162,797	-	162,797	-
Net loss	(1,957,434)	(1,279,642)	(6,153,779)	(3,105,435)
Other comprehensive income (loss):				
Items that may be subsequently reclassified to earnings:				
Unrealized foreign exchange gain (loss)				
on translation of foreign operation	5,665	7,524	38,912	(76,239)
Total comprehensive loss for the period	\$ (1,951,769)	\$ (1,272,118)	\$ (6,114,867)	\$ (3,181,674)
Loss per share				
Basic and diluted	\$ (0.04)	\$ (0.03)	\$ (0.12)	\$ (0.06)
Weighted average number of common shares				
Basic and diluted	53,612,215	49,125,684	53,470,153	48,735,041

See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Financial Position
(Unaudited)

(In Canadian dollars)

	June 30, 2016	September 30, 2015
Assets		
Current assets:		
Cash and cash equivalents (note 7(c))	\$ 4,172,908	\$ 3,021,928
Accounts receivable	524,704	879,266
Inventory (note 3)	381,892	770,342
Prepaid expenses and other assets	134,890	76,840
	<u>5,214,394</u>	<u>4,748,376</u>
Property, plant and equipment	17,787,651	18,921,396
Intangible assets	1,704,099	2,725,629
Goodwill	1,388,458	1,388,458
	<u>\$ 26,094,602</u>	<u>\$ 27,783,859</u>
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,524,330	\$ 1,732,623
	<u>1,524,330</u>	<u>1,732,623</u>
Long term liabilities:		
Note payable	3,000,000	3,000,000
Convertible debentures (note 4)	3,523,173	-
Tenant inducement	105,685	126,363
	<u>8,153,188</u>	<u>4,858,986</u>
Shareholders' equity		
Share capital (note 5)	44,930,433	44,666,497
Share based payment reserve	2,151,077	1,726,780
Equity component of convertible debentures	443,175	-
Deficit	(29,443,019)	(23,289,240)
Accumulated other comprehensive loss	(140,252)	(179,164)
	<u>17,941,414</u>	<u>22,924,873</u>
	<u>\$ 26,094,602</u>	<u>\$ 27,783,859</u>

Nature of operations and going concern (note 1(b)).

Related party transactions (note 6).

See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Changes in Equity
(Unaudited)

Nine months ended June 30, 2016 and 2015

(In Canadian dollars)

	Number of shares	Share capital	Share based payment reserve	Equity component of convertible debentures	Deficit	Accumulated other comprehensive loss	Total shareholders' equity
Balance as at September 30, 2014	48,307,934	\$ 39,557,066	\$ 1,143,570	\$ -	\$ (18,618,407)	\$ (54,549)	\$ 22,027,680
Net loss	-	-	-	-	(3,105,435)	-	(3,105,435)
Unrealized foreign exchange loss on translation	-	-	-	-	-	(76,239)	(76,239)
Share based payments	-	-	552,873	-	-	-	552,873
Warrants exercised	817,750	735,975	-	-	-	-	735,975
Balance as at June 30, 2015	49,125,684	\$ 40,293,041	\$ 1,696,443	\$ -	\$ (21,723,842)	\$ (130,788)	\$ 20,134,854
Balance as at September 30, 2015	53,387,215	\$ 44,666,497	\$ 1,726,780	\$ -	\$ (23,289,240)	\$ (179,164)	\$ 22,924,873
Net loss	-	-	-	-	(6,153,779)	-	(6,153,779)
Unrealized foreign exchange loss on translation	-	-	-	-	-	38,912	38,912
Fair value of equity component of convertible debentures on issuance, net of transaction costs	-	-	-	605,972	-	-	605,972
Deferred tax liability relating to convertible debentures	-	-	-	(162,797)	-	-	(162,797)
Share based payments (note 5)	-	-	508,233	-	-	-	508,233
Options exercised (note 5a)	225,000	263,936	(83,936)	-	-	-	180,000
Balance as at June 30, 2016	53,612,215	\$ 44,930,433	\$ 2,151,077	\$ 443,175	\$ (29,443,019)	\$ (140,252)	\$ 17,941,414

See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Operating activities:				
Net loss	\$ (1,957,434)	\$ (1,279,642)	\$ (6,153,779)	\$ (3,105,435)
Items not involving cash:				
Depreciation and amortization	772,364	592,688	2,320,433	1,754,246
Deferred income taxes	(162,797)	-	(162,797)	-
Share based compensation	187,263	160,205	508,233	552,873
Amortization of tenant inducement	(6,893)	-	(20,678)	-
Accretion of convertible debentures	8,856	-	8,856	-
Gain on revaluation of contingent shares	-	(290,000)	-	(1,450,000)
Non-cash working capital changes (note 7(a))	20,994	279,331	476,669	(557,625)
Cash used in operating activities	(1,137,647)	(537,418)	(3,023,063)	(2,805,941)
Investing activities:				
Purchase of property and equipment, net of tax credits	42,664	(407,663)	(166,205)	(666,347)
Cash provided by (used in) investing activities	42,664	(407,663)	(166,205)	(666,347)
Financing activities:				
Proceeds on issuance of convertible debentures, net of costs	4,120,289	-	4,120,289	-
Issuance of shares for options exercised	-	-	180,000	-
Issuance of shares for warrants exercised	-	-	-	735,975
Tenant inducement	-	133,255	-	133,255
Cash provided by financing activities	4,120,289	133,255	4,300,289	869,230
Effect of foreign exchange on cash and cash equivalents	5,862	8,718	39,959	(80,672)
Increase (decrease) in cash and cash equivalents	3,031,168	(803,108)	1,150,980	(2,683,730)
Cash and cash equivalents, beginning of period	1,141,740	2,084,023	3,021,928	3,964,645
Cash and cash equivalents, end of period	\$ 4,172,908	\$ 1,280,915	\$ 4,172,908	\$ 1,280,915

See accompanying notes to condensed consolidated interim financial statements.

See supplementary cash flow information (note 7).

Nanotech Security Corp.

Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

1. Summary of business and nature of operations and going concern:

(a) Summary of business

Nanotech Security Corp. (the “Company” or “Nanotech”) is incorporated under the laws of British Columbia with common shares listed on the TSX Venture Exchange (trading symbol: NTS) and quoted in the United States on the OTCQX Market (trading symbol: NTSFF). The Company’s head office is located at #505 – 3292 Production Way, Burnaby, British Columbia, Canada V5A 4R4.

Nanotech is an identity company, providing light based nanotechnology and optical thin film (“OTF”) for use in anti-counterfeiting, branding and authentication processes and products including currency, legal documents, and commercial products. Its wholly-owned subsidiary, Tactical Technologies Inc. (“TTI”), designs and sells sophisticated surveillance and intelligence gathering equipment for the law enforcement and defense industries in the United States and Canada.

(b) Nature of operations and going concern

These condensed consolidated interim financial statements have been prepared on the basis that the Company will continue as a going concern. The Company has recurring operating losses and an accumulated deficit of \$29,443,019 as of June 30, 2016 (September 30, 2015 - \$23,289,240). The Company also expects to continue to incur substantial expenses relating to its research and development efforts in nano-optics and OTF. As a result, the Company expects to incur significant losses in the next few years until it is able to realize revenue following the recent commercialization of its products. The timing and amount of such revenues, if any, cannot be predicted with certainty.

The Company’s ability to continue as a going concern is dependent on its ability to generate revenues or additional financing in order to meet its planned business objectives and to be able to commercialize future products currently in development. The Company may need to raise funds through grants, strategic collaborations, public or private equity, debt financing, or other funding sources. This funding may not be available on acceptable terms, or at all, and may be dilutive to shareholder interests. If the Company is unable to generate positive cash flows or obtain adequate financing, the Company may need to curtail operations and development activities. These factors cast significant doubt on the Company’s ability to continue as a going concern. Should the Company be unable to realize its assets and discharge its liabilities in the normal course of business the net realizable value of its assets may be materially less than the amounts on the statement of financial position.

2. Basis of preparation:

These condensed consolidated interim financial statements were prepared using the same accounting policies and methods as those used in the Company’s consolidated financial statements for the year ended September 30, 2015. These condensed consolidated interim financial statements have been prepared in compliance with IAS 34 – *Interim Financial Reporting*. Accordingly, certain disclosures normally included in annual financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”) have been omitted or condensed. These condensed consolidated interim financial statements should be read in conjunction with the Company’s consolidated financial statements for the year ended September 30, 2015, which are included in the Company’s 2015 annual report as filed with Canadian securities regulatory authorities.

Nanotech Security Corp.

Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

2. Basis of preparation (continued):

These condensed consolidated interim financial statements include the accounts of the Company and its wholly-owned subsidiary, TTI. All intercompany balances and transactions are eliminated on consolidation.

These condensed consolidated interim financial statements were approved by the Company's Board of Directors and authorized for issue on August 15, 2016.

3. Inventory:

	June 30, 2016	September 30, 2015
Raw materials	\$ 320,787	\$ 408,703
Work in progress	61,105	258,227
Finished goods	-	103,412
	<u>\$ 381,892</u>	<u>\$ 770,342</u>

During the three months ended June 30, 2016, the write-down of inventories to net realizable value amounted to \$82,087 (June 30, 2015 - \$25,930). During the nine months ended June 30, 2016, the write-down of inventories to net realizable value amounted to \$119,126 (June 30, 2015 - \$25,930).

For the three months ended June 30, 2016, the Company recognized inventories of \$450,394 (June 30, 2015 - \$302,843) as expensed through cost of sales. For the nine months ended June 30, 2016, the Company recognized inventories of \$1,284,119 (June 30, 2015 - \$1,690,568) as expensed through cost of sales.

4. Convertible debentures:

On June 9, 2016, the Company completed an initial tranche of a non-brokered private placement of unsecured subordinated convertible debentures in the amount of \$2,505,000, with a second and final tranche closing on June 21, 2016 in the amount of \$1,680,000 for total gross proceed of \$4,185,000 which will be repaid upon maturity on May 31, 2018.

The convertible debentures accrue interest at a rate of 12% per annum payable quarterly in arrears and are convertible into common shares of the Company at a price of \$1.25 per share. The debentures are redeemable for shares at the Company's option, at a price equal to their principal amount provided that the Company's common shares trade on the TSXV at or above \$2.00 for ten consecutive days any time after four months from issuance.

The convertible debentures are compound financial instruments and the gross proceeds are allocated between each component of the instrument based on fair value at the issuance date. Transaction costs related to the issuance in the amount of \$64,711 are allocated proportionately and each of the components are recorded in the financial statements net of allocated transaction costs. The Company identified two components: a debt-host instrument, and an equity conversion option encompassing both the holders option and the Company's call option.

Nanotech Security Corp.

Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

4. Convertible debentures (continued):

The Company determined that on the date of issuance, the fair value of the debt-host instrument determined with reference to market interest rates and credit spreads for similar debt without the equity conversion options was \$3,569,511. The remaining value of \$615,489 was allocated to the equity conversion option (net of allocated issuance costs) as prescribed under IFRS.

	Convertible debentures	Equity component of convertible debentures	Total
Gross proceeds on issuance	\$ 3,569,511	\$ 615,489	\$ 4,185,000
Transaction costs	(55,194)	(9,517)	(64,711)
Net proceeds on issuance	3,514,317	605,972	4,120,289
Deferred tax liability	-	(162,797)	(162,797)
Interest expense	34,801	-	34,801
Interest paid	(25,945)	-	(25,945)
Balance at June 30, 2016	\$ 3,523,173	\$ 443,175	\$ 3,966,348

The effective interest rate applied to accrete the carrying value of the debt-host instrument to the redemption value upon maturity is approximately 22.3%.

At June 30, 2016 the convertible debentures had a fair value equal to its face value amounting to \$4,185,000.

5. Share capital:

(a) Share capital:

Authorized:

Unlimited number of common shares with no par value

Unlimited number of preferred shares with no par value

Common shares issued and fully paid:

	Number of shares	Amount
Balance as at September 30, 2015	53,387,215	\$ 44,666,497
Options exercised	225,000	263,936
Balance as at June 30, 2016	53,612,215	\$ 44,930,433

(b) Share option plan:

Stock options outstanding as at June 30, 2016 are as follows:

	Number of options	Weighted average exercise price
Balance, September 30, 2015	1,982,000	\$ 1.30
Granted	446,500	1.23
Exercised	(225,000)	0.80
Forfeited	(50,000)	1.70
Balance, June 30, 2016	2,153,500	\$ 1.33

Nanotech Security Corp.

Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

5. Share capital (continued):

(b) Share option plan (continued):

The following table summarizes information pertaining to the Company's stock options outstanding as at June 30, 2016:

Range of exercise prices	Options outstanding			Options exercisable	
	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
\$0 - \$1.00	257,000	0.25	\$0.80	257,000	\$0.80
\$1.01 - \$1.75	1,896,500	3.35	1.40	1,429,750	1.47
	2,153,500	2.98	\$1.33	1,686,750	\$1.39

The exercise price of all stock options granted during the period are equal to the closing market price at the grant date. The Company calculates the fair value of stock options using the Black-Scholes option-pricing model with assumptions noted below.

There were no options granted during the three months ended June 30, 2016 and 2015. The weighted average assumptions used to estimate the fair value of options granted during the nine month periods ended June 30, 2016 and 2015 are as follows:

	Nine months ended June 30,	
	2016	2015
Risk free interest rate	0.65%	0.70%
Expected life	4.2	4.4
Vesting period	1.5 years	1.5 years
Expected volatility	53%	54%
Expected dividends	Nil	Nil
Average fair value	\$0.52	\$0.49
Forfeiture rate	10.2%	8.3%

The Company charged the following share based payments to expenses in connection with the Company's stock option plan, with a corresponding increase in the share based payment reserve:

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Total compensation – stock options	\$ 66,920	\$ 72,831	\$ 235,578	\$ 406,667

Nanotech Security Corp.

Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

5. Share capital (continued):

(c) Restricted Share Unit Plan:

RSUs outstanding as at June 30, 2016 are as follows:

	Number of RSUs
Balance as at September 30, 2015	319,598
Granted	387,900
Forfeited	(19,398)
Balance as at June 30, 2016	688,100

Using an estimated forfeiture rate of 10% for the nine months ended June 30, 2016 and 2015, the Company charged the following share based payments to operating expenses in connection with the Company's RSU plan, with a corresponding increase in the share based payment reserve:

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Total compensation – RSUs	\$ 120,343	\$ 87,374	\$ 272,655	\$ 146,206

(d) Warrants:

Warrants outstanding as at June 30, 2016 are as follows:

	Number of warrants	Weighted average exercise price
Balance as at September 30, 2015 and June 30, 2016	1,327,500	\$ 1.50

6. Related party transactions:

(a) The remuneration of key management personnel is as follows:

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Salaries, accrued bonuses, and employee benefits	\$ 211,239	\$ 212,088	\$ 773,783	\$ 656,724
Share based payments	138,734	127,801	380,103	339,233
	\$ 349,973	\$ 339,889	\$ 1,153,886	\$ 995,957

(b) Management fees and accrued bonuses totaling \$83,450 for the three months ended June 30, 2016 (June 30, 2015 - \$89,250) by a company controlled by an officer and director of the Company, were included in salaries and benefits expense. Management fees totaling \$308,450 for the nine months ended June 30, 2016 (June 30, 2015 - \$238,000) by a company controlled by an officer and director of the Company, were included in salaries and employee benefits expense. As of June 30, 2016, amounts owing to this company included in accounts payable and accrued liabilities were \$262,258 (September 30, 2015 - \$338,752).

Nanotech Security Corp.

Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

6. Related party transactions (continued):

- (c) Legal and professional fees, taxes and disbursements totaling \$53,458 for the three months ended June 30, 2016 (June 30, 2015 - \$41,500) and \$120,743 for the nine months ended June 30, 2016 (June 30, 2015 - \$130,382) were incurred with a law firm of which a director of the Company is a partner. As of June 30, 2016, amounts owing to this company included in accounts payable and accrued liabilities were \$214,519 (September 30, 2015 - \$171,895).
- (d) During the three months ended June 30, 2016 certain directors and officers of the Company participated in the convertible debentures financing amounting to \$350,000.

The above transactions are in the normal course of business and are measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

7. Supplementary cash flow information:

- (a) *Change in non-cash operating working capital:*

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Accounts receivable	\$ (119,679)	\$ (201,885)	\$ 354,562	\$(1,035,938)
Inventory	205,276	116,824	388,450	(8,652)
Prepaid expenses and other assets	(46,395)	75,139	(58,050)	36,703
Accounts payable and accrued liabilities	(18,208)	289,253	(208,293)	475,262
Deferred revenue	-	-	-	(25,000)
	\$ 20,994	\$ 279,331	\$ 476,669	\$ (557,625)

- (b) *Interest and income taxes:*

During the nine months ended June 30, 2016, the Company paid \$119,403 in interest (2015 - \$93,384). The Company did not pay any income taxes.

- (c) *Cash and cash equivalents:*

Cash and cash equivalents are comprised of:

	June 30, 2016	September 30, 2015
Cash	\$ 872,908	\$ 1,521,928
Term deposit	3,300,000	1,500,000
	\$ 4,172,908	\$ 3,021,928

8. Segmented information:

Segmented information is prepared using the accounting policies described in note 17 of the Company's consolidated financial statements for the year ended September 30, 2015. The Company's business operates primarily through two business segments – Security Features and Surveillance. Security Features provides nano-optics and OTF for use in anti-counterfeiting and authentication processes and products including currency, legal documents, and commercial products. Surveillance designs and sells sophisticated surveillance and intelligence gathering equipment for the law enforcement and defense industries in the United States and Canada.

Nanotech Security Corp.

Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

8. Segmented information (continued):

During the three months ended June 30, 2016, the Company had two customers who represented greater than 10% each of total revenues. Those customers represented approximately 35% from our Security Features segment and 27% from our Surveillance segment respectively of total revenues (June 30, 2015 - two customers represented approximately 18% and 41% from our Security Features segment).

During the nine months ended June 30, 2016, the Company had two customers who represented greater than 10% each of total revenues. Those customers represented approximately 35% from our Security Features segment and 24% from our Surveillance segment respectively of total revenues (June 30, 2015 - three customers represented approximately 16%, 17%, and 23% of total revenues from our Security Features segment).

June 30, 2016	Security Features	Surveillance	Total
Total current assets	\$ 4,642,885	\$ 571,509	\$ 5,214,394
Property, plant and equipment	17,754,683	32,968	17,787,651
Intangible assets	1,701,548	2,551	1,704,099
Goodwill	1,388,458	-	1,388,458
Total current liabilities	1,457,777	66,553	1,524,330
Total liabilities	8,086,635	66,553	8,153,188

September 30, 2015	Security Features	Surveillance	Total
Total current assets	\$ 3,889,907	\$ 858,469	\$ 4,748,376
Property, plant and equipment	18,881,278	40,118	18,921,396
Intangible assets	2,722,477	3,152	2,725,629
Goodwill	1,388,458	-	1,388,458
Total current liabilities	1,440,121	292,502	1,732,623
Total liabilities	4,566,484	292,502	4,858,986

Three months ended June 30, 2016	Security Features	Surveillance	Total
Revenue	\$ 497,114	\$ 660,791	\$ 1,157,905
Cost of sales	209,552	404,642	614,194
Gross profit	287,562	256,149	543,711
Expenses	2,331,801	236,165	2,567,966
Other expenses (income)	95,030	946	95,976
Deferred income tax recovery	(162,797)	-	(162,797)
Net income (loss)	\$ (1,976,472)	\$ 19,038	\$ (1,957,434)

Nanotech Security Corp.

Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

8. Segmented information (continued):

Three months ended June 30, 2015	Security Features	Surveillance	Total
Revenue	\$ 865,219	\$ 493,869	\$ 1,359,088
Cost of sales	314,121	346,663	660,784
Gross profit	551,098	147,206	698,304
Expenses	2,039,117	207,002	2,246,119
Other expenses (income)	(248,566)	(19,607)	(268,173)
Net loss	\$ (1,239,453)	\$ (40,189)	\$ (1,279,642)

Nine months ended June 30, 2016	Security Features	Surveillance	Total
Revenue	\$ 1,711,530	\$ 1,903,835	\$ 3,615,365
Cost of sales	620,785	1,209,447	1,830,232
Gross profit	1,090,745	694,388	1,785,133
Expenses	7,112,342	750,211	7,862,553
Other expenses (income)	234,353	4,803	239,156
Deferred income tax recovery	(162,797)	-	(162,797)
Net loss	\$ (6,093,153)	\$ (60,626)	\$ (6,153,779)

Nine months ended June 30, 2015	Security Features	Surveillance	Total
Revenue	\$ 2,775,185	\$ 1,649,255	\$ 4,424,440
Cost of sales	1,342,444	1,137,422	2,479,866
Gross profit	1,432,741	511,833	1,944,574
Expenses	5,943,593	620,376	6,563,969
Other expenses (income)	(1,367,780)	(146,180)	(1,513,960)
Net income (loss)	\$ (3,143,072)	\$ 37,637	\$ (3,105,435)

Nanotech Security Corp.

Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)

Three and nine months ended June 30, 2016 and 2015
(In Canadian dollars)

9. Nature of expenses:

Cost of sales and expenses are comprised of the following:

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Cost of sales				
Direct cost of sales	607,926	633,208	1,817,133	2,326,430
Depreciation and amortization	6,268	27,576	13,099	153,436
	614,194	660,784	1,830,232	2,479,866
Research and development				
Direct expenses	552,188	624,603	1,801,190	1,948,963
Depreciation and amortization	754,410	556,241	2,272,242	1,590,377
Government grants	-	(34,428)	(23,615)	(116,790)
	1,306,598	1,146,416	4,049,817	3,422,550
General and administration				
Direct expenses	651,851	505,329	1,977,932	1,720,589
Depreciation and amortization	11,686	8,871	35,092	10,433
	663,537	514,200	2,013,024	1,731,022
Sales and marketing				
Direct expenses	597,831	585,503	1,799,712	1,410,397
	597,831	585,503	1,799,712	1,410,397
Supplementary information				
Salaries and benefits	1,146,941	1,592,515	3,679,980	3,876,318
Share based compensation	187,263	160,205	508,233	552,873

The Company reclassified certain items in the condensed consolidated interim statements of operations and comprehensive loss to conform to the current period's presentation. This reclassification had no impact on the net loss or total comprehensive loss.