Quarterly Report

June 30, 2017

NANOTECH SECURITY CORP.

For purposes of this management discussion and analysis ("MD&A"), "Nanotech", the "Company", "we", or "us" refers to Nanotech Security Corp. and its subsidiaries. This quarter means the three months ended June 30, 2017.

ADVISORY

This MD&A dated August 2, 2017, 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, 2017 as well as with the Company's consolidated financial statements and management's discussion and analysis for the year ended September 30, 2016. The results reported herein have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and are presented in Canadian dollars. All quarterly information disclosed in the MD&A is unaudited.

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 the Company's operations in future periods, the adequacy of Nanotech's 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 the Company's market opportunities, strategies, competition, and the Company's views that its optics based technologies will continue to show promise for large scale production. Other forward-looking statements imply that the Company will remain capable of being financed and/or will be able to partner development until profitability is eventually realized. The principal risks related to these forward-looking statements are that the Company's products receive market acceptance, that its intellectual property claims will be sufficiently broad or enforceable to provide the necessary protection or attract the necessary capital.

These 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 certainty that actual results or developments the Company anticipates 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 the management discussion and analysis and notes to the consolidated financial statements for the year ended September 30, 2016, 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. Caution needs to be used when taking forward-looking statements into account when evaluating the Company.

GENERAL OVERVIEW

Nanotech is 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 - Optics and Tactical. The Company's reportable segments are strategic business divisions that offer different products and services. They are managed separately as each business is in a different stage in its life cycle and they require different sales and marketing strategies.

Optics

The Optics division (previously named Security Features) designs, manufactures and markets nano-optic optical variable devices ("OVDs") and optical thin film ("OTF") products. These products have brand authentication and enhancement applications across a wide range of markets including banknotes, secure government documents, commercial branding, and the pharmaceutical industry. Nanotech is initially focusing its efforts on the banknote market due to its high margins and the Company has established a strong customer base.

The Company's nano-optic technology employs arrays of billions of nano-indentations that are impressed or embossed onto a substrate material such as polymer, paper, metal, or fabric. By using sophisticated algorithms to direct an electron beam, the Company creates arrays of unique light signatures (visual images). These nano-indentation structures create images with colour-shifting effects that provide visual features such as 3D, high-definition, and motion-impression, and can also display distinct colours including skin tones, white, and black, which are not possible using current holographic technology.

The OTF technology security features are manufactured using precision engineered nanometer thick layers of metals and ceramics to form filters designed to uniquely manipulate visible and non-visible light. This unique manipulation of light properties is used to create specialized security features in the form of threads, stripes and patches that are applied to banknotes and other secure documents. By using sophisticated electron beam and sputtered deposition methods Nanotech precisely controls the construction and inherent properties to provide custom tailored colour-shifting solutions. An individual looking at these threads, stripes and patches sees an obvious colour-shift (e.g. green to magenta) when it is tilted or rotated.

Tactical

The Company's legacy Tactical division (previously named Surveillance) designs and sells a wide range of sophisticated surveillance and officer protection equipment and conducts technical surveillance training for the law enforcement and defense industries in the United States and Canada. These products include outfitting surveillance vans for covert operations, mobile command centre trailers, and services include teaching accredited classes in electronic surveillance. The Tactical division conducts research, production, and training at its facility in Holmes, PA, USA.

The Tactical division customizes surveillance vans for government agencies and has successfully developed surveillance products, including most recently 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 smart phone wireless connectivity.

RESULTS OF OPERATIONS

Select financial information for the three and nine months ended June 30, 2017 and 2016:

Select Financial Information

	Three months ended June 30, 2017	Three months ended June 30, 2016	Nine months ended June 30, 2017	Nine months ended June 30, 2016
Revenue	$ 2,906,649	$ 1,157,905	$ 5,577,262	$ 3,615,365
Cost of sales	650,107	614,194	1,638,632	1,830,232
	2,256,542	543,711	3,938,630	1,785,133
Expenses				
Research and development	483,511	552,188	1,389,172	1,777,574
General and administration	790,761	651,851	2,207,257	1,977,933
Sales and marketing	573,330	597,831	1,624,139	1,799,712
Depreciation and amortization	666,766	766,096	2,087,159	2,307,334
	2,514,368	2,567,966	7,307,727	7,862,553
Loss before other expenses	(257,826)	(2,024,255)	(3,369,097)	(6,077,420)
Other expenses	647,442	95,976	1,084,341	239,156
Loss before income tax recovery	$ (905,268)	$ (2,120,231)	$ (4,453,438)	$ (6,316,576)
Deferred income tax recovery	-	162,797	-	162,797
Net loss	$ (905,268)	$ (1,957,434)	$ (4,453,438)	$ (6,153,779)

Revenue

Consolidated revenues for the three months ended June 30, 2017 increased by $1,748,744 or 151% to $2,906,649 compared to $1,157,905 in the same period last year. Optics' revenue increased by $2,071,902 or 417% to $2,569,016 compared to $497,114 last year representing increased revenue from paid development contracts and OTF deliveries from our Thurso facility. Tactical's revenue decreased by $323,158 or 49% to $337,633 compared to $660,791 in the previous year due to lower van and equipment sales.

Customer paid development revenues continue to grow and the projects are progressing well as we continue to advance our optic based technologies into the development of new security features for future banknotes. In addition, management is beginning to see new OTF opportunities and is working with several partners to expand our customer base to provide further growth. Management continues to work with our production partner Hueck Folien to demonstrate their ability to produce large volume OTF for several customer opportunities.

Consolidated revenues for the nine months ended June 30, 2017 increased by $1,961,897 or 54% to $5,577,262 compared to $3,615,365 in the same period last year. Optics' revenue increased by $2,970,601 or 174% to $4,682,131 compared to $1,711,530 last year primarily due to increased revenue from paid development contracts. Tactical's revenue was lower by $1,008,704 or 53% to $895,131 compared to $1,903,835 in the same period last year due to lower van and equipment sales.

Overall revenue growth reflected a strong increase in Optics' revenue that was significantly offset by Tactical's poor performance. Management is reviewing the strategic options available to Tactical including generating new revenue opportunities, selling the business or significantly altering the operation. Management expects to make strategic decisions on Tactical within the next four months.

Gross Margin

Gross margin for the three months ended June 30, 2017 increased by $1,712,831 or 315% to $2,256,542 compared to $543,711 in the same period last year. Overall, the gross margin percentage improved to

78% for the three months ended June 30, 2017, an increase from 47% in the same period last year. The increased gross margins reflect continued strong margins in the Optics division.

Gross margin for the nine months ended June 30, 2017 increased by $2,153,497 or 121% to $3,938,630 compared to $1,785,133 in the same period last year. Overall, the gross margin percentage improved to 71% for the nine months ended June 30, 2017, an increase from 49% in the same period last year. The increased gross margins continue to reflect strong margins in the Optics division.

Research and Development

Research and development expenditures for the three months ended June 30, 2017 decreased by $68,677 or 12% to $483,511 compared to $552,188 in the same period last year due to a larger portion of salaries and other expenses being allocated to cost of sales as a result of increased development projects.

Research and development expenditures for the nine months ended June 30, 2017 decreased by $388,402 or 22% to $1,389,172 compared to $1,777,574 in the same period last year, again due to a larger portion of salaries and other expenses being allocated to cost of sales as a result of increased development projects.

General and Administration

General and administration expenditures for the three months ended June 30, 2017 were $790,761, an increase of $138,910 or 21% compared to $651,851 in the same period last year which reflects higher utilities costs at our Thurso production facility and an increase in stock based compensation.

General and administration expenditures for the nine months ended June 30, 2017 were $2,207,257, an increase of $229,324 or 12% compared to $1,977,933 in the same period last year which again reflects higher utilities costs at our Thurso production facility and an increase in stock based compensation.

Sales and Marketing

Sales and marketing expenditures for the three months ended June 30, 2017 were $573,330, a decrease of $24,501 or 4% compared to $597,831 in the same period last year. The decrease mainly relates to a reduction in travel and marketing expenses in the Optics division along with lower sales commissions in the Tactical division.

Sales and marketing expenditures for the nine months ended June 30, 2017 were $1,624,139, a decrease of $175,573 or 10% compared to $1,799,712 in the same period last year. The decrease again mainly relates to a reduction in travel and marketing expenses in the Optics division along with lower sales commissions in the Tactical division.

Depreciation and Amortization

Depreciation and amortization expenditures for the three months ended June 30, 2017 were $666,766, compared to $766,096 in the same period last year, reflecting the Company's declining balance depreciation policy and fewer fixed asset additions in the current period.

Depreciation and amortization expenditures for the nine months ended June 30, 2017 were $2,087,159, compared to $2,307,334 in the same period last year, again reflecting the Company's declining balance depreciation policy and fewer fixed asset additions in the current period.

Other Expenses

Other expenses for the three months ended June 30, 2017 were $647,442, an increase of $551,466 compared to $95,976 in the same period last year. The increase includes $540,828 of interest expense representing $105,557 of interest paid and $435,271 of accretion that was a result of the Company's decision to repay the convertible debentures and an increased foreign exchange loss in the current period.

Other expenses for the nine months ended June 30, 2017 were $1,084,341, an increase of $845,185 compared to $239,156 in the same period last year. The increase includes $945,827 of interest expense representing $355,969 of interest paid, $589,858 of accretion that was a result of the Company's decision to repay the convertible debentures and a decreased foreign exchange loss in the current period.

Net Loss

The net loss for the three months ended June 30, 2017 was $905,268 compared to $1,957,434 during the same period last year. The decrease in net loss reflects an increase in revenues, reduced expenses and higher margins.

The net loss for the nine months ended June 30, 2017 was $4,453,438 compared to $6,153,779 during the same period last year. The decrease in net loss also reflects an increase in revenues, reduced expenses and higher margins.

SEGMENT RESULTS

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

Optics

The Optics division designs, manufactures and markets nano-optic OVDs and OTF products. These products have brand protection and enhancement applications across a wide range of markets including banknotes, secure government documents, commercial branding, and the pharmaceutical industry.

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Revenue	$ 2,569,016	$ 497,114	$ 4,682,131	$ 1,711,530
Net loss	(748,795)	(1,976,472)	(3,980,436)	(6,093,153)

Revenues from Optics for the three months ended June 30, 2017 increased to $2,569,016 from $497,114 for the same period last year, representing increased revenue from paid development contracts and OTF deliveries from our Thurso facility.

The loss from Optics for the three months ended June 30, 2017 was reduced by $1,227,677 to $748,795 from $1,976,472 for the same period last year. The decrease in net loss reflects increased sales, partially offset by increased financing costs.

Revenues from Optics for the nine months ended June 30, 2017 increased to $4,682,131 from $1,711,530 for the same period last year. The increased revenue was primarily due to increased paid development contracts revenue.

The loss from Optics for the nine months ended June 30, 2017 was reduced by $2,112,717 to $3,980,436 from $6,093,153 for the same period last year. The decrease in net loss reflects increased sales and reduced expenses, partially offset by increased financing costs.

Tactical

The Tactical division designs and sells a wide range of sophisticated surveillance and officer protection equipment and conducts surveillance training for the law enforcement and defense industries in the United States and Canada.

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Revenue	$ 337,633	$ 660,791	$ 895,131	$ 1,903,835
Net income (loss)	(156,473)	19,038	(473,002)	(60,626)

Revenues from Tactical for the three months ended June 30, 2017 decreased to $337,633 from $660,791 in the same period last year due to lower van and equipment sales.

The net loss from Tactical for the three months ended June 30, 2017 increased to $156,473 from net income of $19,038 in the same period last year. The net loss was the result of significantly lower revenue.

Revenues from Tactical for the nine months ended June 30, 2017 decreased to $895,131 from $1,903,835 in the same period last year due to lower van and equipment sales.

The net loss from Tactical for the nine months ended June 30, 2017 increased to $473,002 from a net loss of $60,626 in the same period last year. Overall, management is reviewing the strategic options available to Tactical including generating new revenue opportunities, selling the business or significantly altering the operation. Management expects to make strategic decisions on Tactical within the next four months.

QUARTERLY RESULTS

	Q3 2017	Q2 2017	Q1 2017	Q4 2016	Q3 2016	Q2 2016	Q1 2016	Q4 2015
($ thousands, except common share amounts)								
Revenue	$2,907	$1,764	$ 907	$1,511	$1,158	$ 948	$1,509	$ 728
Net loss	(905)	(1,695)	(1,853)	(1,677)	(1,957)	(2,450)	(1,746)	(1,565)
Net loss per common share:								
Basic	(0.02)	(0.03)	(0.03)	(0.03)	(0.04)	(0.05)	(0.03)	(0.03)
Diluted	(0.02)	(0.03)	(0.03)	(0.03)	(0.04)	(0.05)	(0.03)	(0.03)

There are no seasonal effects or other trends in the Company's business over the quarters presented.

RELATED PARTY TRANSACTIONS

For the three and nine months ended June 30, 2017, 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) Remuneration of key management personnel:

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Salaries, accrued bonuses, and employee benefits	$ 304,788	$ 211,239	$ 775,710	$ 773,783
Share-based payments	174,851	138,734	572,386	380,103
	$ 479,639	$ 349,973	$ 1,348,096	$ 1,153,886

(b) As of June 30, 2017, amounts owing to a company controlled by an officer and director of the Company included in accounts payable and accrued liabilities were $324,067 (September 30, 2016 - $285,509).

(c) Legal and professional fees, taxes and disbursements totaling $76,189 for the three months ended June 30, 2017 (June 30, 2016 - $50,438) and $137,743 for the nine months ended June 30, 2017 (June 30, 2016 - $115,515) were incurred with a law firm of which a director of the Company is a partner. As of June 30, 2017, amounts owing to this company included in accounts payable and accrued liabilities were $166,452 (September 30, 2016 - $52,826).

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, working capital, including customer receivables, inventory, supplier payables, capital expenditures, and fixed overhead costs. Cash is also used to finance other long-term strategic business initiatives.

Summary of Statements of Cash Flows

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Cash provided by (used in) operating activities[1]	$ 486,771	$(1,158,641)	$ (944,370)	$(3,499,732)
Changes in operating assets and liabilities	209,346	20,994	(400,590)	476,669
Cash provided by (used in) operating activities	696,117	(1,137,647)	(1,344,960)	(3,023,063)
Cash provided by (used in) investing activities	(6,837)	42,664	(95,402)	(166,205)
Cash provided by financing activities	11,116,784	4,120,289	11,339,784	4,300,289
Effect of foreign exchange on cash and cash equivalents	38,328	5,862	23,793	39,959
Cash and cash equivalents, beginning of period	1,391,514	1,141,740	3,312,691	3,021,928
Cash and cash equivalents, end of period	$ 13,235,906	$ 4,172,908	$13,235,906	$ 4,172,908

[1] Before changes in operating assets and liabilities

Operating Activities

Cash provided by operating activities was $696,117 for the three months ended June 30, 2017, compared to cash used in operating activities of $1,137,647 for the same period last year. This improvement was a result of increased development revenue, strong margins and a working capital decrease during the quarter.

Cash used in operating activities was $1,344,960 for the nine months ended June 30, 2017, compared to $3,023,063 for the same period last year. This improvement was a result of increased development revenue, strong margins and a working capital decrease during the quarter.

Investing Activities

Cash used in investing activities was $6,837 for the three months ended June 30, 2017, compared to cash provided by investing activities of $42,664 in the same period last year.

Cash used in investing activities was $95,402 for the nine months ended June 30, 2017, compared to $166,205 used in the same period last year. This reflects reduced expenditures on production equipment in the current period as our production equipment upgrades were concluded early in the previous year.

Financing Activities

Cash provided by financing activities was $11,116,784 for the three months ended June 30, 2017, compared to $4,120,289 during the same period last year. This reflects the proceeds of a private placement during the current period, offset by the repayment of convertible debentures during the current period.

Cash provided by financing activities was $11,339,784 for the nine months ended June 30, 2017, compared to $4,300,289 during the same period last year. This reflects the proceeds of a private placement, the repayment of convertible debentures, and the exercise of stock options during the current period.

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'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, 2017 there were no changes in our approach to capital management.

As at June 30, 2017, cash and cash equivalents amounted to $13,235,906, compared to $3,312,691 as at September 30, 2016. On May 18, 2017, the Company completed a bought deal private placement with a syndicate of underwriters whereby a total of 11,586,870 common shares of the Company were issued at a price of $1.15 per share, for total gross proceeds of $13,324,901.

The Company issued convertible debentures outstanding with a face value amounting to $4,185,000 with a maturity date of May 31, 2018. The convertible debentures accrued 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. On May 18, 2017, the Company provided notice to the debenture holders of the Company's intention to repay the convertible debentures on June 21, 2017. Several debenture holders elected to convert their debentures into common shares at $1.25 per share. As a result, the Company issued 2,252,000 common shares valued at $2,815,000. The remaining $1,370,000 was repaid.

The Company has a note payable outstanding of $3,000,000 as at June 30, 2017. The note payable was used to finance some of the real estate assets acquired on the acquisition of Fortress Optical Features Ltd. It 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 is secured by the assets of the Company. The Company plans to repay or refinance the secured note.

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

The Company had no commitments for material capital expenditures as of June 30, 2017.

Management has reviewed its projected funding requirements and expects that through the generation and collection of revenues and/or being able to raise additional financing, that the Company will maintain sufficient liquidity to meet its requirements through June 30, 2018.

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 11 of the consolidated financial statements for the year ended September 30, 2016. In the three and nine months ended June 30, 2017, there was no material change to the nature of the risks arising from our classification of financial instruments, or related risk management objectives.

CAPITAL STRUCTURE AND OUTSTANDING SHARE DATA

The Company maintains an equity incentive plan consisting of a stock option plan and a restricted share unit ("RSU") plan to grant options and RSUs to eligible participants. The maximum number of shares that may be reserved for issuance under the option plan at any point in time is 7% of the Company's issued and outstanding shares. As at June 30, 2017 the shareholders have approved the Company to grant up to an additional 816,369 RSUs.

During the three months ended June 30, 2017, nil options (June 30, 2016 - nil) and nil RSUs (June 30, 2016 – nil) were granted. During the nine months ended June 30, 2017, 413,500 options (June 30, 2016 -

446,500) and 489,000 RSUs (June 30, 2016 – 387,900) were granted. Of the 413,500 options granted during the nine months ended June 30, 2017, 150,000 were forfeited during the period.

The common shares, options, and RSUs outstanding and exercisable as at the following dates are:

	June 30, 2017		September 30, 2016	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Common shares outstanding	67,975,155		53,864,285	
Options				
Outstanding	2,040,000	$ 1.35	2,488,500	$ 1.29
Exercisable	1,647,250	$ 1.38	1,954,625	$ 1.35
RSUs				
Outstanding	940,030	N/A	451,030	N/A

As at August 2, 2017, the Company has 67,975,155 common shares issued and outstanding. There are no preferred shares issued and outstanding.

ADDITIONAL INFORMATION

Outlook

Nanotech is a leader in next-generation anti-counterfeiting products. These products have brand protection and enhancement applications across a wide range of markets including banknotes, secure government documents, commercial branding, and the pharmaceutical industry. Nanotech is initially focusing its efforts on the banknote market due to its high margins and established customer base. Management continues to believe that the Company is well positioned to supply OTF, however the additional time required for product acceptance and integration into their production processes has taken longer than anticipated. With the recent signing of the $30 million paid development contract, the Company is focusing on further developing business with its established customer base and, as a result, is well positioned to expand its authentication development contract revenue and other nano-optic and OTF opportunities in the years ahead.

In 2017, management established a goal to double its revenue and make significant progress towards becoming cash flow positive. During the most recent quarter, the Company delivered its first ever quarter generating positive cash flow from operations and is on track to more than double its Optics' revenue for the year. The Company's legacy business segment, Tactical, has had a negative impact with both a significant reduction in revenue and the generation of a loss of $473,002. Looking ahead to the fourth quarter, management expects to make strategic decisions on Tactical and deliver strong financial results consistent with this past quarter. Looking ahead to 2018, the Company is well positioned to continue to expand its development revenue, begin supplying high volume OTF and begin receiving licensing revenue from tax stamps.

Achieving these results is not certain and involves known and unknown risks that may cause actual results to differ materially from this goal. These risks and uncertainties include, among other things, risks related to uncertainty of amount and timing of purchase orders, the ability of Hueck Folien to successfully deliver volume production, our ability to expand our Optics development revenue and our ability to maintain sufficient liquidity through June 30, 2018 to facilitate any business ramp-up. These and other risk factors are further discussed under the "Business Risks and Uncertainties" segment of the September 30, 2016 management's discussion and analysis.

Public Securities Filings

Additional information about Nanotech, is available on the Company's website at www.nanosecurity.ca, or on SEDAR at www.sedar.com.

Condensed Consolidated Interim Financial Statements of

Nanotech Security Corp.

Three and nine months ended June 30, 2017 and 2016
(Unaudited)

Nanotech Security Corp.

Condensed Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

Three and nine months ended June 30, 2017 and 2016
(In Canadian dollars)

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Revenue	$ 2,906,649	$ 1,157,905	$ 5,577,262	$ 3,615,365
Cost of sales (note 10)	650,107	614,194	1,638,632	1,830,232
Gross profit	2,256,542	543,711	3,938,630	1,785,133
Expenses (note 10)				
Research and development	483,511	552,188	1,389,172	1,777,574
General and administration	790,761	651,851	2,207,257	1,977,933
Sales and marketing	573,330	597,831	1,624,139	1,799,712
Depreciation and amortization	666,766	766,096	2,087,159	2,307,334
	2,514,368	2,567,966	7,307,727	7,862,553
Loss before other expenses	(257,826)	(2,024,255)	(3,369,097)	(6,077,420)
Other expenses				
Foreign exchange loss	84,022	27,067	56,841	103,283
Finance expense (note 5)	563,420	68,909	1,027,500	135,873
	647,442	95,976	1,084,341	239,156
Loss before income taxes	(905,268)	(2,120,231)	(4,453,438)	(6,316,576)
Deferred income tax recovery	-	162,797	-	162,797
Net loss	(905,268)	(1,957,434)	(4,453,438)	(6,153,779)
Other comprehensive loss:				
Items that may be subsequently reclassified to earnings:				
Unrealized foreign exchange gain on translation of foreign operation	37,817	5,665	23,715	38,912
Total comprehensive loss for the period	$ (867,451)	$(1,951,769)	$(4,429,723)	$(6,114,867)
Loss per share				
Basic and diluted	$ (0.02)	$ (0.04)	$ (0.08)	$ (0.12)
Weighted average number of common shares				
Basic and diluted	60,027,320	53,612,215	56,006,062	53,470,153

See accompanying notes to Condensed Consolidated Interim Financial Statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Financial Position
(Unaudited)

(In Canadian dollars)

	June 30, 2017	September 30, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 13,235,906	$ 3,312,691
Accounts receivable	1,416,279	597,414
Inventory (note 3)	373,934	385,753
Prepaid expenses and other assets	147,961	127,719
	15,174,080	4,423,577
Property, plant and equipment	16,259,341	17,338,312
Intangible assets	340,309	1,361,239
Goodwill	1,388,458	1,388,458
	$ 33,162,188	$ 24,511,586
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,822,266	$ 1,395,568
Note payable (note 4)	3,000,000	3,000,000
	4,822,266	4,395,568
Non-current liabilities:		
Convertible debentures (note 5)	-	3,595,142
Tenant inducement	78,115	98,793
	4,900,381	8,089,503
Shareholders' equity		
Share capital (note 6(a))	60,858,578	45,210,507
Contributed surplus (note 5)	3,106,507	2,485,131
Deficit	(35,572,483)	(31,119,045)
Accumulated other comprehensive loss	(130,795)	(154,510)
	28,261,807	16,422,083
	$ 33,162,188	$ 24,511,586

Related party transactions (note 7).
See accompanying notes to Condensed Consolidated Interim Financial Statements.

Approved on behalf of the Board of Directors:

"Doug Blakeway"	*"Ken Tolmie"*
Doug Blakeway, Director	Ken Tolmie, Director

Nanotech Security Corp.

Condensed Consolidated Statements of Changes in Equity
(Unaudited)

Nine months ended June 30, 2017 and 2016
(In Canadian dollars)

	Number of shares	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Total shareholders' equity
Balance as at October 1, 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 6(b) and (c))	-	-	508,233	-	-	508,233
Options exercised	225,000	263,936	(83,936)	-	-	180,000
Balance as at June 30, 2016	53,612,215	$ 44,930,433	$ 2,594,252	$ (29,443,019)	$ (140,252)	$ 17,941,414
Balance as at October 1, 2016	53,864,285	$ 45,210,507	$ 2,485,131	$ (31,119,045)	$ (154,510)	$ 16,422,083
Net loss	-	-	-	(4,453,438)	-	(4,453,438)
Unrealized foreign exchange loss on translation	-	-	-	-	23,715	23,715
Private placement	11,586,870	12,486,784	-	-	-	12,486,784
Shares issued on conversion of convertible debentures	2,252,000	2,815,000	-	-	-	2,815,000
Share-based payments (note 6(b) and (c))	-	-	744,663	-	-	744,663
Options exercised (note 6(b))	272,000	346,287	(123,287)	-	-	223,000
Balance as at June 30, 2017	67,975,155	$ 60,858,578	$ 3,106,507	$ (35,572,483)	$ (130,795)	$ 28,261,807

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, 2017 and 2016
(In Canadian dollars)

	Three months ended June 30, 2017	Three months ended June 30, 2016	Nine months ended June 30, 2017	Nine months ended June 30, 2016
Cash flows provided by (used in):				
Operating activities:				
Net loss	$ (905,268)	$(1,957,434)	$ (4,453,438)	$(6,153,779)
Items not involving cash:				
Depreciation and amortization	733,245	772,364	2,196,839	2,320,433
Deferred income taxes	-	(162,797)	-	(162,797)
Share-based compensation	230,416	187,263	744,663	508,233
Accretion of convertible debentures	435,271	8,856	589,858	8,856
Other	(6,893)	(6,893)	(22,292)	(20,678)
Non-cash working capital changes (note 8(a))	209,346	20,994	(400,590)	476,669
Cash provided by (used in) operating activities	696,117	(1,137,647)	(1,344,960)	(3,023,063)
Investing activities:				
Purchase of property and equipment, net of disposal	(6,837)	42,664	(95,402)	(166,205)
Cash provided by (used in) investing activities	(6,837)	42,664	(95,402)	(166,205)
Financing activities:				
Issuance of shares for options exercised	-	-	223,000	180,000
Proceeds on financing, net of costs (note 6(a))	12,486,784	-	12,486,784	-
Proceeds on issuance of convertible debentures, net of costs	-	4,120,289	-	4,120,289
Repayment of convertible debentures (note 5)	(1,370,000)	-	(1,370,000)	-
Cash provided by financing activities	11,116,784	4,120,289	11,339,784	4,300,289
Effect of foreign exchange on cash and cash equivalents	38,328	5,862	23,793	39,959
Increase in cash and cash equivalents	11,844,392	3,031,168	9,923,215	1,150,980
Cash and cash equivalents, beginning of period	1,391,514	1,141,740	3,312,691	3,021,928
Cash and cash equivalents, end of period	$13,235,906	$ 4,172,908	$13,235,906	$ 4,172,908

See supplementary cash flow information (note 8).
See accompanying notes to Condensed Consolidated Interim Financial Statements.

1. 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 a global optics company, focusing on light based recognition nano-optics and optical thin film ("OTF") for use in authentication and brand enhancement products including currency, legal documents, and commercial products. Its wholly-owned subsidiary, Tactical Technologies Inc., designs and sells a wide range of sophisticated surveillance and officer protection equipment for the law enforcement and defense industries primarily in the United States and Canada.

2. Basis of preparation:

(a) *Statement of compliance:*

These condensed consolidated interim financial statements are prepared in accordance with International Accounting Standards ("IAS") 34, Interim Financial Reporting, as issued by the International Accounting Standards board ("IASB") on a basis consistent with those followed in the most recent annual consolidated financial statements.

These condensed consolidated interim financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Company's consolidated financial statements for the year ended September 30, 2016.

Certain comparative figures in the consolidated statements of operations and comprehensive loss have been reclassified to conform to the current period's presentation. This reclassification had no impact on the net loss or total comprehensive loss.

These condensed consolidated interim financial statements were approved and authorized for issue by the Company's Board of Directors on Aug 2, 2017.

(b) *Basis of measurement:*

These condensed consolidated interim financial statements are presented in Canadian dollars and have been prepared on a historical cost basis, except for certain financial instruments which are measured at fair value.

(In Canadian dollars)

3. Inventory:

	June 30, 2017	September 30, 2016
Raw materials	$ 282,021	$ 309,055
Work in progress	91,913	76,698
	$ 373,934	$ 385,753

During the three and nine months ended June 30, 2017, there were no write-downs of inventories to net realizable value. During the three months ended June 30, 2016, the write-down of inventories to net realizable value amounted to $82,087. During the nine months ended June 30, 2016, the write-down of inventories to net realizable value amounted to $119,126.

For the three months ended June 30, 2017, the Company recognized inventories of $650,107 (June 30, 2016 - $614,194) as expensed through cost of sales. For the nine months ended June 30, 2017, the Company recognized inventories of $1,638,632 (June 30, 2016 - $1,830,232) as expensed through cost of sales.

4. Note payable:

The note payable is fully secured against the assets of the Company. It bears interest at a fixed rate of 4% per annum and is repayable, interest only with payment of the principal due on September 16, 2017.

5. 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 proceeds of $4,185,000, which were payable upon maturity on May 31, 2018.

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

The Company had the option to pre-pay the principal sum, in whole or in part, twelve months following the closing, after providing twenty business days notice to the holder.

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

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 embedded call option was determined to have a fair value of $Nil at the issuance date. The remaining value of $615,489 was allocated to the equity conversion option and included in contributed surplus (net of allocated issuance costs) as prescribed under International Financial Reporting Standards ("IFRS").

(In Canadian dollars)

5. Convertible debentures (continued):

On May 18, 2017, the Company provided notice to the debenture holders of the Company's intention to repay the convertible debentures on June 21, 2017. On May 18, 2017, the Company recorded accretion expense to bring the carrying value of the debentures to face value of $4,185,000.

Several debenture holders elected to convert their debentures into common shares at $1.25 per share. As a result the Company issued 2,252,000 common shares valued at $2,815,000. The remaining $1,370,000 was repaid.

A continuity of the amounts recorded for the total convertible debentures issued and the related equity component was as follows:

	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	233,352	-	233,352
Interest paid	(152,527)	-	(152,527)
Balance as at September 30, 2016	3,595,142	443,175	4,038,317
Interest expense	945,827	-	945,827
Interest paid	(355,969)	-	(355,969)
Common shares issued	(2,815,000)	-	(2,815,000)
Convertible debentures repaid	(1,370,000)	-	(1,370,000)
Balance as at June 30, 2017	$ -	$ 443,175	$ 443,175

Interest expense related to the convertible debentures for the period was as follows:

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Interest paid	$ 105,557	$ 25,945	$ 355,969	$ 25,945
Accretion of convertible debentures	435,271	8,856	589,858	8,856
Interest expense	$ 540,828	$ 34,801	$ 945,827	$ 34,801

(In Canadian dollars)

6. 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, 2016	53,864,285	$ 45,210,507
Options exercised	272,000	346,287
Debentures converted	2,252,000	2,815,000
Private placement	11,586,870	12,486,784
Balance as at June 30, 2017	67,975,155	$ 60,858,578

There are no preferred shares issued and outstanding.

On May 18, 2017, the Company completed a bought deal private placement with a syndicate of underwriters pursuant to which the Company issued 11,586,870 common shares at a price of $1.15 per share, for gross proceeds to the Company of $13,324,901. The Company incurred share issue costs of $838,117.

(b) *Stock option plan:*

Stock options outstanding as at June 30, 2017:

	Number of options	Weighted average exercise price
Balance, September 30, 2016	2,488,500	$ 1.29
Granted	413,500	1.48
Exercised	(272,000)	0.82
Forfeited	(590,000)	1.42
Balance as at June 30, 2017	2,040,000	$ 1.35

The following table summarizes information pertaining to the Company's stock options outstanding as at June 30, 2017:

	Options outstanding			Options exercisable	
Range of exercise prices	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
$1.01 - $1.65	2,040,000	3.04	$ 1.35	1,647,250	$ 1.38

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 the options at the grant date using the Black-Scholes option-pricing model with assumptions noted below.

(In Canadian dollars)

6. Share capital (continued):

(b) *Stock option plan (continued):*

The weighted average assumptions used to estimate the fair value of options granted during the three and nine month periods ended June 30, 2017 and 2016:

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Risk free interest rate	Nil	Nil	1.21%	0.65%
Expected life	Nil	Nil	4.4	4.2
Vesting period	Nil	Nil	1.5 years	1.5 years
Expected volatility	Nil	Nil	46%	53%
Expected dividends	Nil	Nil	Nil	Nil
Average fair value	Nil	Nil	$0.58	$0.52
Forfeiture rate	Nil	Nil	11.4%	10.2%

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

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Total compensation - stock options	$ 58,601	$ 66,920	$ 333,699	$ 235,578

(c) *Restricted share unit plan:*

During the quarter ended December 31, 2016, the Company granted 489,000 restricted share units ("RSUs") to employees and directors with a fair value of $1.48 per share. 25% of these RSUs will vest on September 1, 2017, 35% will vest on September 1, 2018, and the remaining 40% will vest on September 1, 2019.

RSUs outstanding as at June 30, 2017:

	Number of RSUs
Balance as at September 30, 2016	451,030
Granted	489,000
Balance as at June 30, 2017	940,030

Using an estimated forfeiture rate of 10% for the nine months ended June 30, 2017 and 2016, the Company charged the following share-based payments to operating expenses in connection with the Company's RSU plan, with a corresponding increase in contributed surplus:

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Total compensation - RSUs	$ 171,815	$ 120,343	$ 410,964	$ 272,655

(In Canadian dollars)

6. Share capital (continued):

(d) *Warrants:*

Warrants outstanding as at June 30, 2017:

	Number of warrants	Weighted average exercise price
Balance as at September 30, 2016	1,327,500	$ 1.50
Expired, February 26, 2017	(1,327,500)	1.50
Balance as at June 30, 2017	-	$ -

7. Related party transactions:

(a) The remuneration of key management personnel:

	Three months ended June 30, 2017	Three months ended June 30, 2016	Nine months ended June 30, 2017	Nine months ended June 30, 2016
Salaries, accrued bonuses, and employee benefits	$ 304,788	$ 211,239	$ 775,710	$ 773,783
Share-based payments	174,851	138,734	572,386	380,103
	$ 479,639	$ 349,973	$ 1,348,096	$ 1,153,886

(b) As of June 30, 2017, amounts owing to a company controlled by an officer and director of the Company included in accounts payable and accrued liabilities were $324,067 (September 30, 2016 - $285,509).

(c) Legal and professional fees, taxes and disbursements totaling $76,189 for the three months ended June 30, 2017 (June 30, 2016 - $50,438) and $137,743 for the nine months ended June 30, 2017 (June 30, 2016 - $115,515) were incurred with a law firm of which a director of the Company is a partner. As of June 30, 2017, amounts owing to this company included in accounts payable and accrued liabilities were $166,452 (September 30, 2016 - $52,826).

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.

8. Supplementary cash flow information:

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

	Three months ended June 30, 2017	Three months ended June 30, 2016	Nine months ended June 30, 2017	Nine months ended June 30, 2016
Accounts receivable	$ 148,983	$ (119,679)	$ (818,865)	$ 354,562
Inventory	21,098	205,276	11,819	388,450
Prepaid expenses and other assets	(40,920)	(46,395)	(20,242)	(58,050)
Accounts payable and accrued liabilities	80,185	(18,208)	426,698	(208,293)
	$ 209,346	$ 20,994	$ (400,590)	$ 476,669

(In Canadian dollars)

8. Supplementary cash flow information (continued):

(b) *Interest and income taxes:*

During the three months ended June 30, 2017, the Company paid $134,655 in interest (June 30, 2016 - $65,601). During the nine months ended June 30, 2017, the Company paid $445,206 in interest (June 30, 2016 - $119,403). The Company did not pay any income taxes during the three and nine months ended June 30, 2017 and 2016.

(c) *Cash and cash equivalents:*

Cash and cash equivalents are comprised of:

	June 30, 2017	September 30, 2016
Cash	$ 1,369,621	$ 644,490
Term deposit	11,866,285	2,668,201
	$ 13,235,906	$ 3,312,691

9. Segmented information:

Segmented information is prepared using the accounting policies described in note 16 of the Company's consolidated financial statements for the year ended September 30, 2016. The Company's business operates primarily through two business segments - Optics and Tactical. Optics provides nano-optics and OTF for use in authentication and brand enhancement products including currency, legal documents, and commercial products. Tactical designs and sells sophisticated surveillance and officer protection equipment for the law enforcement and defense industries in the United States and Canada.

During the three months ended June 30, 2017, the Company had two customers who represented greater than 10% of total revenues. These customers, from our Optics segment, represented approximately 55% and 31% of total revenues (June 30, 2016 - two customers represented approximately 35% from our Optics segment and 27% from our Tactical segment).

During the nine months ended June 30, 2017, the Company had two customers who represented greater than 10% of total revenues. These customers, from our Optics segment, represented approximately 63% and 16% of total revenues (June 30, 2016 - two customers represented approximately 35% from our Optics segment and 24% from our Tactical segment).

June 30, 2017	Optics	Tactical	Total
Total current assets	$ 14,724,436	$ 449,644	$ 15,174,080
Property, plant and equipment	16,237,394	21,947	16,259,341
Intangible assets	340,309	-	340,309
Goodwill	1,388,458	-	1,388,458
Total current liabilities	4,642,219	180,047	4,822,266
Total liabilities	4,720,334	180,047	4,900,381

September 30, 2016	Optics	Tactical	Total
Total current assets	$ 3,920,822	$ 502,755	$ 4,423,577
Property, plant and equipment	17,306,698	31,614	17,338,312
Intangible assets	1,361,239	-	1,361,239
Goodwill	1,388,458	-	1,388,458
Total current liabilities	4,319,162	76,406	4,395,568
Total liabilities	8,013,097	76,406	8,089,503

(In Canadian dollars)

9. Segmented information (Continued):

Three months ended June 30, 2017	Optics	Tactical	Total
Revenue	$ 2,569,016	$ 337,633	$ 2,906,649
Cost of sales	411,143	238,964	650,107
Gross profit	2,157,873	98,669	2,256,542
Expenses	2,260,721	253,647	2,514,368
Other expenses	645,947	1,495	647,442
Net loss	$ (748,795)	$ (156,473)	$ (905,268)

Three months ended June 30, 2016	Optics	Tactical	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	95,030	946	95,976
Deferred income tax recovery	(162,797)	-	(162,797)
Net income (loss)	$ (1,976,472)	$ 19,038	$ (1,957,434)

Nine months ended June 30, 2017	Optics	Tactical	Total
Revenue	$ 4,682,131	$ 895,131	$ 5,577,262
Cost of sales	1,010,456	628,176	1,638,632
Gross profit	3,671,675	266,955	3,938,630
Expenses	6,569,218	738,509	7,307,727
Other expenses	1,082,893	1,448	1,084,341
Net loss	$ (3,980,436)	$ (473,002)	$ (4,453,438)

Nine months ended June 30, 2016	Optics	Tactical	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	234,353	4,803	239,156
Deferred income tax recovery	(162,797)	-	(162,797)
Net loss	$ (6,093,153)	$ (60,626)	$ (6,153,779)

(In Canadian dollars)

10. Nature of expenses:

The expenses presented below represent total cost of sales, sales and marketing, research and development, general and administration expenses, and depreciation and amortization.

	Three months ended June 30,		Nine months ended June 30,	
	2017	2016	2017	2016
Salaries and benefits	$ 1,148,852	$ 944,813	$ 3,158,369	$ 3,146,894
Share-based compensation	230,416	187,263	744,663	508,233
Depreciation and amortization	733,245	772,364	2,196,839	2,320,433
Travel and entertainment	93,277	126,365	228,126	339,823
Professional fees and insurance	168,432	256,862	538,363	673,573
Public company costs	167,653	183,409	505,575	529,907
Rent and utilities	263,317	187,205	567,096	557,685
Maintenance and office expenses	78,798	46,665	299,867	166,446
Materials consumed	280,485	477,214	707,461	1,449,791
	$ 3,164,475	$ 3,182,160	$ 8,946,359	$ 9,692,785