NANOTECH

September 30, 2018

Financial Statements

Consolidated Financial Statements of

Nanotech Security Corp.

Years ended September 30, 2018 and 2017

Nanotech Security Corp.
September 30, 2018 and 2017

Table of Contents

KPMG LLP
PO Box 10426 777 Dunsmuir Street
Vancouver BC V7Y 1K3
Canada
Telephone (604) 691-3000
Fax (604) 691-3031

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Nanotech Security Corp.

We have audited the accompanying consolidated financial statements of Nanotech Security Corp., which comprise the consolidated statements of financial position as at September 30, 2018 and September 30, 2017, the consolidated statements of operations and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Nanotech Security Corp. as at September 30, 2018 and September 30, 2017 and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants

December 18, 2018
Vancouver, Canada

Nanotech Security Corp.

Consolidated Statements of Operations and Comprehensive Loss
Years ended September 30, 2018 and 2017

(In Canadian dollars)

	2018	2017
Revenue (note 16)	$ 9,199,710	$ 7,343,791
Cost of sales (note 17)	2,051,890	1,429,371
	7,147,820	5,914,420
Expenses (note 17)		
Research and development	1,407,430	1,475,437
General and administration	2,532,156	2,308,846
Sales and marketing	2,018,055	2,043,514
Depreciation and amortization (note 7 and 8(b))	1,485,024	2,755,882
	7,442,665	8,583,679
Loss from continuing operations before other expenses	(294,845)	(2,669,259)
Other (income) expenses		
Foreign exchange (gain) loss	(250,023)	169,815
Finance (income) expense (note 9)	(121,878)	1,014,779
	(371,901)	1,184,594
Net income (loss) from continuing operations	77,056	(3,853,853)
Net loss from discontinued operations (note 19(c))	(123,322)	(900,279)
Net loss	(46,266)	(4,754,132)
Other comprehensive loss:		
Items that may be subsequently reclassified to earnings:		
Unrealized foreign exchange gain (loss) on translation of foreign operation (note 19(c))	(98,908)	85,605
Total comprehensive loss	$ (145,174)	$ (4,668,527)
Basic and diluted earnings (loss) per share:		
Continuing operations	$ 0.00	$ (0.07)
Discontinued operations	$ 0.00	$ (0.01)
Net loss	$ 0.00	$ (0.08)
Weighted average number of common shares		
Basic and diluted	68,425,673	59,056,353

See accompanying notes to the consolidated financial statements.

Nanotech Security Corp.

Consolidated Statements of Financial Position
as at September 30, 2018 and 2017

(In Canadian dollars)

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	$ 2,014,764	$ 10,883,919
Short-term investments (note 5)	7,598,857	-
Accounts receivable (note 12(b))	1,962,969	1,374,442
Inventory (note 6)	173,636	151,708
Prepaid expenses and other assets	125,514	187,874
Assets held for sale (note 19(a))	-	216,225
	11,875,740	12,814,168
Property, plant and equipment (note 7)	16,964,857	15,856,998
Goodwill (note 8(a))	1,388,458	1,388,458
	$ 30,229,055	$ 30,059,624
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,265,282	$ 1,431,466
Deferred revenue	-	157,171
Liabilities directly associated with assets held for sale (note 19(a))	16,204	200,226
	1,281,486	1,788,863
Non-current liabilities:		
Tenant inducement	43,653	71,223
	1,325,139	1,860,086
Shareholders' equity		
Share capital (note 10(a))	61,892,395	61,426,483
Contributed surplus	2,930,964	2,715,137
Deficit	(35,919,443)	(35,873,177)
Accumulated other comprehensive loss	-	(68,905)
	28,903,916	28,199,538
	$ 30,229,055	$ 30,059,624

Related party transactions (note 14)
Commitments (note 18)
See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board of Directors:

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

Nanotech Security Corp.

Consolidated Statements of Changes in Shareholders' Equity
Years ended September 30, 2018 and 2017

(In Canadian dollars)

	Number of shares	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Total shareholders' equity
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	-	-	-	(4,754,132)	-	(4,754,132)
Unrealized foreign exchange gain on translation	-	-	-	-	85,605	85,605
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 compensation - options (note 10(b)(i))			364,649			364,649
Share-based compensation - RSUs (note 10(b)(ii))	-	-	556,549	-	-	556,549
Options exercised (note 10(b)(i))	272,000	346,287	(123,287)	-	-	223,000
RSUs vested (note 10(b)(ii))	420,670	567,905	(567,905)	-	-	-
Balance as at September 30, 2017	68,395,825	$ 61,426,483	$ 2,715,137	$ (35,873,177)	$ (68,905)	$ 28,199,538
Balance as at October 1, 2017	68,395,825	$ 61,426,483	$ 2,715,137	$ (35,873,177)	$ (68,905)	$ 28,199,538
Net loss	-	-	-	(46,266)	-	(46,266)
Unrealized foreign exchange loss on translation	-	-	-	-	(98,908)	(98,908)
Share-based compensation - options (note 10(b)(i))			264,627			264,627
Share-based compensation - RSUs (note 10(b)(ii))	-	-	417,112	-	-	417,112
Foreign exchange reclassified upon disposal of foreign operation (note 19(c))	-	-	-	-	167,813	167,813
RSUs vested (note 10(b)(ii))	375,676	465,912	(465,912)	-	-	-
Balance as at September 30, 2018	68,771,501	$ 61,892,395	$ 2,930,964	$ (35,919,443)	$ -	$ 28,903,916

See accompanying notes to the consolidated financial statements.

Nanotech Security Corp.

Consolidated Statements of Cash Flows
Years ended September 30, 2018 and 2017

(In Canadian dollars)

	2018	2017
Cash flows provided by (used in):		
Operating activities:		
Net income (loss) from continuing operations	$ 77,056	$ (3,853,853)
Items not involving cash:		
Depreciation and amortization	1,611,891	2,917,883
Share-based compensation	681,739	921,198
Accretion of convertible debentures	-	589,858
Other	(27,570)	(27,570)
Non-cash working capital changes (note 15(a))	(889,380)	(720,420)
	1,453,736	(172,904)
Net cash provided by (used in) discontinued operations (note 19(b))	76,694	(574,313)
Cash provided by (used in) operating activities	1,530,430	(747,217)
Investing activities:		
Purchase of property and equipment (note 7 and 15(d))	(2,701,820)	(106,944)
Acquisition of short-term investments (note 5)	(7,598,857)	-
Cash used in investing activities	(10,300,677)	(106,944)
Financing activities:		
Issuance of shares for options exercised	-	223,000
Proceeds on financing, net of costs (note 9)	-	12,486,784
Repayment of note payable (note 9)	-	(3,000,000)
Repayment of convertible debentures (note 9)	-	(1,370,000)
Cash provided by financing activities	-	8,339,784
Effect of foreign exchange on cash and cash equivalents	(98,908)	85,605
Increase (decrease) in cash and cash equivalents	(8,869,155)	7,571,228
Cash and cash equivalents, beginning of year	10,883,919	3,312,691
Cash and cash equivalents, end of year	$ 2,014,764	$ 10,883,919

See supplementary cash flow information (note 15)
See accompanying notes to the consolidated 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 researches, creates, and produces nano-optic structures and colour-shifting materials used in authentication and brand enhancement applications across a wide range of markets including banknotes, tax stamps, secure government documents, commercial branding, and the pharmaceutical industry.

2. Basis of preparation:

(a) *Statement of compliance:*

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The financial statements were approved by the Company’s Board of Directors and authorized for issue on December 18, 2018.

(b) *Basis of measurement:*

These consolidated 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.

(c) *Use of estimates, assumptions and judgments*:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The estimates and underlying assumptions are reviewed by management on an ongoing basis. Revisions to accounting estimates are accounted for prospectively. The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities are discussed below:

(i) Valuation of goodwill:

Goodwill arising on an acquisition of a business is carried at cost, as established at the date of acquisition of the business less impairment losses, if any. For purposes of impairment testing, goodwill is allocated to each of the Company’s cash-generating units (“CGU”) that is expected to benefit from the synergies of the combination. A CGU to which goodwill has been allocated is tested for impairment annually, or more frequently when there is an indication that the CGU may be impaired.

2. Basis of preparation (continued):

(c) *Use of estimates, assumptions and judgments (continued):*

(i) Valuation of goodwill (continued):

Management evaluates goodwill for impairment annually as of September 30th. Impairment tests involve considerable use of judgement and require management to make estimates and assumptions. The fair values of CGUs are derived from certain valuation models, which consider various factors such as discount rates, future earnings, and revenue growth rates. While management uses their best estimate and assumptions to assess goodwill impairment, there are inherent uncertainties in projecting future cash flows.

(ii) Judgments:

Management uses judgment when applying accounting policies and when making estimates and assumptions as described above. The most significant areas that require judgment include determination of functional currency, the estimated useful life of property, plant and equipment, and determination of CGUs and segments.

(d) *Basis of consolidation:*

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Tactical Technologies Inc. (“Tactical”) up to September 28, 2018, the date of its dissolution (note 19). All intercompany balances and transactions are eliminated on consolidation. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences.

(e) *Foreign currency translation:*

The consolidated financial statements of the Company are presented in Canadian dollars. The functional currency of the Company is the Canadian dollar. Tactical’s functional currency was the U.S. dollar.

(i) Transactions in foreign currency:

Each entity within the consolidated group records transactions using its functional currency, being the currency of the primary economic environment in which it operates. Foreign currency transactions are translated into the respective functional currency of each entity using the foreign currency rates prevailing at the date of the transaction. Period end balances of monetary assets and liabilities in foreign currency are translated to the respective functional currencies using period end foreign currency rates. Foreign currency gains and losses arising from settlement of foreign currency transactions are recognized in earnings.

(ii) Foreign operations translation:

The assets and liabilities of foreign operations are translated into Canadian dollars at period end foreign currency rates. Revenues and expenses of foreign operations are translated into Canadian dollars at average rates for the period. Foreign currency translation gains and losses are recognized in other comprehensive loss. The relevant amount in accumulated other comprehensive loss is reclassified into earnings upon disposition of a foreign operation (note 19(c)).

3. Significant accounting policies:

(a) *Revenue recognition:*

Revenue is measured at the fair value of consideration received or receivable, net of discounts and after eliminating intercompany sales.

The Company's contracts with customers may include multiple deliverables that fall within one or more of the revenue categories described below. Where revenue arrangements have separate identifiable components, the consideration received is allocated to each identifiable component and the applicable revenue recognition criteria are applied to each of the components.

Revenue from the sale of products is recognized when all of the following conditions have been met:

- title and risk involving the products are transferred to the buyer;
- the Company's managerial involvement over the goods ceases to exist;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the Company; and
- the costs incurred in respect of the transaction can be measured reliably.

If there is a requirement for customer acceptance of any products shipped, revenue is recognized only after customer acceptance has been received. Payments received in advance of the satisfaction of the Company's revenue recognition criteria are recorded as deferred revenue.

Revenue from development contracts are recognized by reference to the stage of completion based on services performed to date as a percentage of total services to be performed or on a straight-line basis over the term of the contract, if revenue is determined to be earned evenly.

(b) *Earnings (loss) per common share:*

Basic net earnings (loss) per common share is calculated using the weighted average number of common shares outstanding during the year.

Diluted net loss per share reflects the potential dilution of common share equivalents, such as outstanding stock options and restricted share units ("RSU"), in the weighted average number of common shares outstanding during the year, if dilutive. For this purpose, the "treasury stock method" is used for the assumed proceeds upon the exercise of outstanding stock options that are used to purchase common shares at the average market price during the period. For the periods recording a loss, basic and diluted figures are the same, as the exercise of all stock options and RSUs would be anti-dilutive.

(c) *Research and development:*

Research costs are expensed in the period incurred. Development costs are capitalized and recorded as an intangible asset only if technical feasibility has been established and the Company expects to generate probable future economic benefits from the asset created on completion of development. The costs capitalized include materials, direct labour, directly attributable overhead expenditures, and borrowing costs on qualifying assets. Other development costs are expensed in the period incurred. During the years ended September 30, 2018 and 2017, all development costs have been expensed.

3. Significant accounting policies (continued):

(d) *Government assistance and investment tax credits:*

Government assistance includes government grants and investment tax credits and is recognized when there is reasonable assurance that the Company will comply with the relevant conditions and that the government assistance will be received. Government assistance that meets the recognition criteria and relates to current expenses is recorded as a reduction of research and development expense.

Government assistance that meets the recognition criteria and relates to the acquisition of an asset is recorded as a reduction of the cost of the related asset. If government assistance becomes repayable, the inception to date impact of assistance previously recognized in earnings is reversed immediately in the period that the assistance becomes repayable.

Investment tax credits are recorded using the cost-reduction method whereby the credits are deducted from the cost of the related asset or expenditure when there is reasonable assurance that the investment tax credit will be realized. Where a valuation allowance has been recorded against prior year's investment tax credits, the Company applies the credits on a first-in first-out basis with a recovery of prior year's investment tax credits recognized as an income tax recovery.

(e) *Financial instruments:*

Financial assets and financial liabilities are initially measured at fair value and are subsequently re-measured based on their classification as described below. Transaction costs that are directly attributable to the acquisition or issuance of a financial asset or liability, other than financial assets and liabilities recorded at fair value through earnings, are added or deducted from the fair value of the respective financial asset or financial liability on initial recognition. Transaction costs that are directly attributable to the acquisition of a financial asset or financial liability recorded at fair value through earnings are recognized immediately in earnings.

Financial assets and liabilities are offset and the net amount is reported in the Statement of Financial Position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

(i) Financial assets:

Financial assets are classified into the following categories: financial assets at fair value through earnings, loans and receivables, and available-for-sale. The classification depends on the nature and purpose of the financial asset and is determined at the time of initial recognition.

- Financial assets at fair value through earnings:
  Financial assets are classified as fair value through earnings when held for trading or if designated into this category. Financial assets classified as financial assets at fair value through earnings are measured at fair value with any gains or losses arising on remeasurement recognized in earnings. The Company does not have any financial assets classified as fair value through earnings.

3. Significant accounting policies (continued):

(e) *Financial instruments (continued):*

(i) Financial assets (continued):

- Loans and receivables:
  Loans and receivables include cash and cash equivalents, short-term investments, and accounts receivable. Loans and receivables are initially measured at fair value and are subsequently remeasured at amortized cost using the effective interest method, less any impairment losses. The Company has classified cash and cash equivalents and accounts receivables as loans and receivables.

- Available-for-sale financial assets:
  Available-for-sale financial assets are non-derivative financial assets that are either designated in this category or not classified into any of the other categories. Available-for-sale financial assets are measured at fair value with any gains or losses on remeasurement recognized in other comprehensive income until the financial asset is derecognized or is determined to be permanently impaired, at which time the gain or loss accumulated in equity is transferred to earnings. The Company does not have any financial assets classified as available-for-sale assets.

Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred, and the Company has transferred substantially all of the risks and rewards of ownership.

(ii) Financial liabilities:

Financial liabilities are classified as either financial liabilities at fair value through earnings or as other financial liabilities.

- Other financial liabilities:
  Other financial liabilities include trade and other payables, non-trade payables, and long-term debt. They are initially measured at fair value and are subsequently measured at amortized cost using the effective interest method. The Company has classified accounts payables and accrued liabilities as other financial liabilities.

(iii) Embedded derivatives:

Derivatives embedded in non-derivative host contracts are treated as separate derivatives when they meet the definition of a derivative, their risks and characteristics are not closely related to those of the host contracts and the contracts are not measured at the fair value through earnings. Embedded derivatives are recorded at the fair value through earnings. During the years ended September 30, 2018 and 2017, the Company did not have any embedded derivatives.

(f) *Cash and cash equivalents:*

Cash and cash equivalents consist of cash balances with banks, investments with original maturities of three months or less, and investments that are both readily convertible to cash and subject to insignificant changes in market value.

3. Significant accounting policies (continued):

(g) *Short-term investments*

Short-term investments consist of short-term interest-bearing term deposits which are highly liquid with maturity dates greater than three months but less than one year at the time of purchase.

(h) Inventory:

Inventory is measured at the lower of cost and net realizable value and consists primarily of raw materials used in the manufacturing of optical thin film. Raw materials cost is determined on a weighted average basis. The cost of work in progress and finished goods includes the cost of raw material, direct labour and an allocation of related overheads. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(i) *Property, plant and equipment:*

Property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. The initial cost of an asset comprises its purchase price and any costs directly attributable to bringing the asset into working condition for its intended use. Assets acquired in a business combination are measured at the fair value of the assets at the time of acquisition. Repairs and maintenance costs are charged directly to the statement of operations as incurred. Depreciation is calculated using the following methods and annual rates:

	Estimated useful life
Software	100% declining balance
Laboratory and office equipment	20 – 55% declining balance
Manufacturing equipment	10% declining balance
Building	4% declining balance
Leasehold improvements	straight line over the lesser of lease term or estimated useful life

The Company reviews the estimated useful lives and the depreciation methods of its property, plant and equipment annually.

(j) *Intangible assets and goodwill:*

(i) Intangible assets:

Intangible assets with finite lives consist of acquired intellectual property and are measured at cost less accumulated amortization and accumulated impairment losses. Cost for intangible assets acquired in a business combination represents the fair value of the asset at the time of the acquisition. Intangible assets with finite lives are amortized over four years. At September 30, 2018 and 2017, the Company did not have any indefinite life intangible assets other than goodwill.

(ii) Goodwill:

Goodwill arising on an acquisition of a business is carried at cost, as established at the date of acquisition of the business less accumulated impairment losses, if any. Goodwill is not amortized but is tested for impairment annually or whenever there is an indication of impairment.

3. Significant accounting policies (continued):

(k) *Impairment:*

(i) Financial assets:

Financial assets not carried at fair value through earnings are assessed for impairment at each reporting date. A financial asset is impaired if objective evidence indicates that a loss event which negatively affected the estimated future cash flows has occurred after the initial recognition of the asset. For financial assets measured at amortized cost, the impairment loss is the difference between the carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate. If an impairment has occurred, the carrying amount of the asset is reduced to its recoverable amount, with the amount of the loss recognized in earnings. A permanent impairment loss for an available-for-sale investment is recognized by transferring the cumulative loss previously recognized in other comprehensive income to earnings.

(ii) Non-financial assets:

Goodwill and non-financial assets are tested for impairment annually, or whenever events or changes in circumstances indicate that an asset's carrying amount may be less than its recoverable amount. Management uses judgment to estimate the inputs to these assessments and any changes to these inputs could have a material impact on the impairment calculation. For impairment testing, non-financial assets that do not generate independent cash flows are grouped together into a CGU, which represent the level at which largely independent cash flows are generated. Goodwill is allocated to groups of CGUs based on the level at which it is monitored for internal reporting purposes. An impairment loss is recognized in earnings to the extent that the carrying value of an asset, CGU or group of CGUs exceeds its estimated recoverable amount. The recoverable amount of an asset, CGU or group of CGUs is the greater of its value in use and its fair value less cost to sell. Value in use is calculated as the present value of the estimated future cash flows discounted at appropriate discount rates. An impairment loss relating to a specific asset reduces the carrying value of the asset.

An impairment loss relating to a CGU or group of CGUs reduces the carrying value of the goodwill allocated to the CGU or group of CGUs, then reduces the carrying value of the other assets of the CGU or group of CGUs on a pro-rata basis. An impairment loss in respect of goodwill is not reversed. A previously recognized impairment loss related to other non-financial assets is assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss related to other non-financial assets is reversed if there is a subsequent increase in recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying value does not exceed the carrying value that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(l) *Provisions:*

Provisions represent liabilities for which the amount or timing is uncertain. Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Where appropriate, the future cash flow estimates are adjusted to reflect risks specific to the liability.

3. Significant accounting policies (continued):

(m) *Share-based payments:*

The Company makes share-based payments to directors, consultants and employees. The compensation expense for share-based payment is determined based on the fair value at the grant date using the Black-Scholes option-pricing model and is recorded in the statement of operations over the vesting period. Management uses judgment to determine the inputs to the Black-Scholes option-pricing model including the expected award lives, underlying share price volatility and forfeiture rates. Volatility is estimated by considering the Company's historic share price volatility over similar periods to the expected life of the awards under consideration. Changes in these assumptions will impact the calculation of fair value and the amount of compensation expense recognized in earnings. When stock options are exercised, any consideration paid by directors, consultants and employees, as well as the related stock-based compensation, is credited to share capital.

(n) *Restricted share units:*

During the year ended September 30, 2015, the Company adopted a RSU plan. The obligations under the RSU plan can be settled at the Company's discretion through either cash or the issuance of common shares. The Company measures the cost of equity-settled share-based transactions by reference to the fair value of the equity instruments at the date at which they are granted and is recorded in the statement of operations over the vesting period. For RSUs, the Company uses the TSX Venture Exchange share price at the grant date as fair value of the RSUs. The resulting fair value is then adjusted for an estimated forfeiture amount. Determination of the forfeiture rate is based on historical experience. The actual number of RSUs that vest is likely to be different from estimation.

(o) *Income taxes:*

Income tax expense is comprised of current and deferred tax. Current and deferred tax are recognized into earnings except to the extent that it relates to a business combination or items recognized directly in other comprehensive income or share capital.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is not recognized for the following temporary differences; the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable earnings, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

3. Significant accounting policies (continued):

(o) *Income taxes (continued):*

Deferred tax assets are recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(p) *Leases:*

Leasing contracts are classified as either finance or operating leases based on the substance of the contractual arrangement at inception date. A lease is classified as a finance lease if it transfers substantially all of the risks and rewards of ownership of the leased asset. Where the contracts are classified as finance leases, upon initial recognition, the asset and liability are recorded at the lower of fair value and the present value of the minimum lease payments, net of executory costs. Finance lease payments are apportioned between interest expense and repayments of the liability. Where the contracts are classified as operating leases, they are not recognized in the Company's Consolidated Statements of Financial Position and lease payments are charged to earnings as they are incurred on a straight-line basis over the lease term.

(q) *Segment reporting:*

The Company's continuing operations currently consists of one operating segment.

(r) *Assets held for sale and discontinued operations:*

(i) Assets held for sale:

The Company classifies assets, or disposal groups, as held for sale when it expects to recover their carrying amounts primarily through sale rather than through continuing use. To meet criteria to be held for sale, the sale must be highly probable, and the assets or disposal groups must be available for immediate sale in their present condition. The Company must be committed to a plan to sell the assets or disposal group, and the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.

The Company measures assets or disposal groups at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on a disposal group is first allocated to goodwill, and then to remaining assets and liabilities on a pro-rata basis, except that no loss is allocated to inventories or financial assets. Impairment losses on initial classification as held for sale and subsequent losses on remeasurement are recognized in the statement of income. Upon classifying asset or disposal groups as held for sale, the Company presents the assets separately as a single amount and the associated liabilities separately as a single amount on the Consolidated Statements of Financial Position. Comparative period Consolidated Statements of Financial Position are not restated. Assets held for sale are not depreciated, depleted, or amortized.

3. Significant accounting policies (continued):

(r) *Assets held for sale and discontinued operations (continued):*

(ii) Discontinued operations:

A discontinued operation is a component of the Company's business that represents a separate major line of business or geographical area of operations that has been disposed of or classified as held for sale. The operations and cash flows can be clearly distinguished from the rest of the Company, both operationally and for financial reporting purposes. When the Company classifies an operation as a discontinued operation, it represents the comparative Consolidated Statements of Operations as if the operation had been discontinued from the start of the comparative year. In doing this, the Company excludes the results for the discontinued operations and any gain or loss from disposal from the consolidated statements of operations from continuing operations and presents them on a separate line as profit or loss (net of tax) from the discontinued operation. Per share information and changes to other consolidated comprehensive loss related to discontinued operations are presented separately from continuing operations. Cash flows from discontinued operations are presented separately from cash flows from continuing operations in the Consolidated Statements of Cash Flows.

4. New standards and interpretations not yet adopted:

(a) *IFRS 9 – Financial Instruments:*

In July 2014, the IASB issued IFRS 9 – *Financial Instruments*, which replaces the earlier versions of IFRS 9 (2009, 2010, and 2013) and completes the IASB's project to replace IAS 39 – *Financial Instruments: Recognition and Measurement*. IFRS 9 includes a logical model for classification and measurement of financial assets and a single, forward-looking 'expected credit loss' impairment model. IFRS 9 is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions.

The Company will adopt the standard on October 1, 2018 using the modified retrospective application method, under which comparatives are not restated and a cumulative catch up adjustment is recorded on October 1, 2018, for any differences identified including adjustments to opening retained deficit balances. The Company has analyzed the impact of adopting IFRS 9 and anticipates that there will not be any material changes as a result of adopting this new standard.

(b) *IFRS 15 – Revenue from contracts with customers:*

In May 2014, the IASB issued IFRS 15 – *Revenue from Contracts with Customers*, which supersedes IAS 18 – *Revenue,* IAS 11 – *Construction Contracts* and other interpretive guidance associated with revenue recognition. IFRS 15 provides a single, principles-based five-step model to be applied to all contracts with customers to determine how and when an entity should recognize revenue. The standard also provides guidance on whether revenue should be recognized at a point in time or over time as well as requirements for more informative, relevant disclosures. IFRS 15 is effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. The Company has completed an assessment of the impact that the initial application of IFRS 15 will have on its financial statements and does not expect that there will be a significant impact, other than additional required disclosures. The Company will adopt IFRS 15 in its financial statements for the annual period beginning on October 1, 2018 using the full retrospective transitional approach.

(Expressed in Canadian dollars)

4. New standards and interpretations not yet adopted (continued):

(c) *IFRS 16 – Leases:*

In January 2016, the IASB issued IFRS 16 – *Leases*, which supersedes IAS 17 – *Leases*. IFRS 16 establishes principles for the recognition, measurement, presentation and disclosure of leases. The standard establishes a single model for lessees to bring leases on balance sheet while lessor accounting remains largely unchanged and retains the finance and operating lease distinctions. IFRS 16 is effective for annual periods beginning on or after January 1, 2019 with earlier adoption permitted, but only if also applying IFRS 15 – *Revenue from Contracts with Customers*. The Company is currently evaluating the impact of IFRS 16 on its financial statements and plans to adopt the new standard on the required effective date.

5. Short-term Investments

Short-term investments of $7,598,857 (2017 - $nil) consist of cashable term deposits held with a Canadian chartered bank. The term deposits have maturity dates between October 23, 2018 and June 25, 2019. Interest rates range between 1.8% and 2.0%.

6. Inventory:

	2018	2017
Raw materials	$ 160,550	$ 123,619
Work in progress	13,086	28,089
	$ 173,636	$ 151,708

As at September 30, 2018, work in progress includes $nil of depreciation (2017 - $1,600).

There were no inventory write-downs during the years ended September 30, 2018 and 2017.

For the year ended September 30, 2018, the Company recognized inventories of $2,051,890 (2017 - $1,429,371) through cost of sales.

(Expressed in Canadian dollars)

7. Property, plant and equipment:

	Land	Building and leasehold improvement	Manufacturing equipment	Laboratory, software, and office equipment	Total
Cost:					
Balance as at October 1, 2016	$ 141,700	$ 3,807,378	$ 15,922,956	$ 520,413	$ 20,392,447
Additions	-	92,009	-	14,935	106,944
Assets held for sale	-	(27,809)	-	(290,293)	(318,102)
Balance as at September 30, 2017	141,700	3,871,578	15,922,956	245,055	20,181,289
Additions	-	487,549	2,083,180	149,021	2,719,750
Balance as at September 30, 2018	$ 141,700	$ 4,359,127	$ 18,006,136	$ 394,076	$ 22,901,039
Accumulated depreciation:					
Balance as at October 1, 2016	$ -	$ 354,128	$ 2,307,509	$ 392,498	$ 3,054,135
Depreciation expense	-	167,144	1,361,544	27,956	1,556,644
Assets held for sale	-	(27,810)	-	(258,678)	(286,488)
Balance as at September 30, 2017	-	493,462	3,669,053	161,776	4,324,291
Depreciation expense	-	203,203	1,329,549	79,139	1,611,891
Balance as at September 30, 2018	$ -	$ 696,665	$ 4,998,602	$ 240,915	$ 5,936,182
Net book value:					
September 30, 2018	$ 141,700	$ 3,662,462	$ 13,007,534	$ 153,161	$ 16,964,857
September 30, 2017	$ 141,700	$ 3,378,116	$ 12,253,903	$ 83,279	$ 15,856,998

Additions, disposals and depreciation for the years ended September 30, 2018 and 2017 are for continuing operations.

Included in amortization is an impairment charge of $29,872 recorded during the year against certain assets in order to bring them down to their recoverable values (2017 - $nil).

(Expressed in Canadian dollars)

8. Intangible assets and goodwill:

(a) *Goodwill impairment:*

The Company performs a goodwill impairment test at least annually on September 30 and whenever there is an indication of impairment. No impairment of goodwill was identified as a result of the Company's most recent annual impairment test.

The key assumptions used in performing the impairment tests:

- Recoverable amount:
  Management's past experience and future expectations of the business' performance are used to make a best estimate of the expected revenues, earnings before interest, taxes, depreciation and amortization, and operating cash flows covering a five year forecast period, with a terminal value extrapolated into the future over the estimated useful life of the CGU using a steady growth rate.

- Discount rate:
  Management applied a discount rate of 12% (2017 – 12%) in calculating the value in use. This is a pre-tax rate which reflects the time value of money and risk associated with the business. Management has determined its discount rate to reflect the risk of an emerging technology company.

- Revenue growth:
  Revenue growth is projected taking into account the average growth levels experienced over the past five years and the estimated growth for the next five years based on projected market acceptance. It is assumed that sales pricing and margins would decrease as volume orders are realized.

- Sensitivity analysis:
  Management performs sensitivity analysis on the key assumptions. Sensitivity analysis indicates reasonable changes to key assumptions will not result in an impairment loss.

(b) *Finite life intangible assets:*

Finite life intangible assets consist of intellectual property acquired by the Company in a 2013 business acquisition. The estimated fair value of $5,444,954 was amortized over four years and was fully depreciated by September 30, 2017. Amortization of $1,361,239 was recorded during the year ended September 30, 2017.

9. Finance (income) expense:

	2018	2017
Interest income from cash and cash equivalents and short-term investments	$ (132,774)	$ (49,772)
Other interest expenses	10,896	11,950
Interest on note payable	-	106,774
Interest on convertible debenture	-	355,969
Accretion of convertible debentures	-	589,858
	$ (121,878)	$ 1,014,779

(Expressed in Canadian dollars)

9. Finance (income) expense (continued):

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 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.

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 on June 21, 2017.

On August 21, 2017, the Company repaid a fully secured note payable in the amount of $3,000,000 which required interest only payments at a fixed rate of 4% per annum.

10. 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 October 1, 2016	53,864,285	$	45,210,507
Private placement	11,586,870		12,486,784
Debentures converted	2,252,000		2,815,000
Options exercised	272,000		346,287
RSUs vested	420,670		567,905
Balance as at September 30, 2017	68,395,825	$	61,426,483
RSUs vested	375,676		465,912
Balance as at September 30, 2018	68,771,501	$	61,892,395

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.

(Expressed in Canadian dollars)

10. Share capital (continued):

(b) *Share-based payment plans:*

(i) Stock option plan:

Under the Company's share incentive plan, the maximum number of shares that may be reserved for grant of options at any point in time is 10.0% of the outstanding shares less any shares reserved for issuance under the RSU plan. The following stock options were outstanding as at September 30, 2018:

	Number of options	Weighted average exercise price
Balance as at October 1, 2016	2,488,500	$ 1.29
Granted	413,500	1.48
Exercised	(272,000)	0.82
Forfeited or expired	(590,000)	1.42
Balance as at September 30, 2017	2,040,000	$ 1.35
Granted	567,500	1.35
Balance as at September 30, 2018	2,607,500	$ 1.35

The following table summarizes information pertaining to the Company's stock options outstanding as at September 30, 2018:

	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 - $1.25	1,126,500	2.23	$ 1.14	1,001,500	$ 1.13
$1.26 - $1.65	1,481,000	1.89	1.52	1,272,250	1.53
	2,607,500	2.04	$ 1.35	2,273,750	$ 1.35

The Company calculates the fair value of the options at the grant date using the Black-Scholes option-pricing model. The table below outlines the weighted average assumptions used to estimate the fair value of options granted during the years ended September 30, 2018 and 2017:

	2018	2017
Risk free interest rate	1.9%	1.2%
Expected life	4.6 years	4.4 years
Vesting period	1.6 years	1.5 years
Expected volatility	43%	46%
Expected dividends	Nil	Nil
Average fair value	$ 0.52	$ 0.58
Forfeiture rate	10.2%	11.4%

(Expressed in Canadian dollars)

10. Share capital (continued):

(b) *Share-based payment plans (continued):*

(i) Stock option plan (continued):

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:

	2018	2017
Total compensation - stock options	$ 264,627	$ 364,649

(ii) Restricted share unit plan:

Under the Company's RSU plan, the maximum number of shares that may be reserved for issuance is fixed at 2,100,000. As at September 30, 2018, 589,447 RSUs remain available to be granted. The obligations under the RSU plan can be settled at the Company's discretion through either cash or issuance of common shares. The Company intends to settle the obligation through the issuance of common shares.

RSUs outstanding as at September 30, 2018:

	Number of RSUs
Balance as at October 1, 2016	451,030
Granted	499,200
Vested	(420,670)
Balance as at September 30, 2017	529,560
Forfeited	(22,060)
Granted	238,782
Vested	(375,676)
Balance as at September 30, 2018	370,606

During the year ended September 30, 2017 the Company granted 499,200 RSUs. The weighted average fair value was $1.48 per share. 25% of these RSUs vested on September 1, 2017, 35% vested on September 1, 2018, and the remaining 40% will vest on September 1, 2019.

During the year ended September 30, 2018 the Company granted 238,782 RSUs. The weighted average fair value was $1.40 per share. 25% of these RSUs vested on September 1, 2018, 35% will vest on September 1, 2019, and the remaining 40% will vest on September 1, 2020.

(Expressed in Canadian dollars)

10. Share capital (continued):

(b) *Share-based payment plans (continued):*

(ii) Restricted share unit plan (continued):

Using an estimated forfeiture rate of 10.0% for the years ended September 30, 2018 and 2017, 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:

	2018	2017
Total compensation - RSUs	$ 417,112	$ 556,549

11. Capital risk management:

The Company's objectives and policies for managing capital are to maintain a strong capital base to maintain investor, creditor and market confidence, to sustain future development of the business and to safeguard the Company's ability to support the Company's normal operating requirements on an ongoing basis.

The capital of the Company consists of the items included in the Consolidated Statements of Financial Position in the shareholders' equity section. The Company manages its capital structure and makes changes based on economic conditions, risks that impact the consolidated operations and future significant capital investment opportunities. To manage the Company's capital requirements, the Company has in place a planning and budgeting process which helps determine the funds required to ensure the Company has the appropriate liquidity to meet its operating and growth objectives. 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.

12. Financial instruments and risk exposures:

(a) *Fair value measurement:*

The Company's financial assets include cash and cash equivalents, short-term investments, and accounts receivable. The Company's financial liabilities include accounts payable and accrued liabilities.

Cash and cash equivalents, short-term investments, and accounts receivable are classified as loans and receivables, measured at amortized cost using the effective interest rate method. Accounts payable and accrued liabilities are classified as other financial liabilities, measured at amortized cost using the effective interest rate method. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability.

The carrying value of the Company's financial assets and liabilities is considered to be a reasonable approximation of fair value due to their immediate or short-term maturity, or their ability for liquidation at comparable amounts.

(b) *Credit risk:*

Credit risk is the risk of a financial loss if a customer or counterparty to a financial instrument fails to meet its obligations under a contract. This risk primarily arises from the Company's receivables from customers.

(Expressed in Canadian dollars)

12. Financial instruments and risk exposures (continued):

(b) *Credit risk (continued):*

The Company's exposure to credit risk is dependent upon the characteristics of each customer. Each customer is assessed for credit worthiness, using third party credit scores and through direct monitoring of their financial well-being on a continual basis. In some cases, where customers fail to meet the Company's credit worthiness benchmark, the Company may choose to transact with the customer on a prepayment basis or to seek other means of guarantees.

The Company does not have credit insurance or other financial instruments to mitigate its credit risk as management has determined that the exposure is minimal due to the composition of its customer base.

The Company regularly reviews the collectability of its accounts receivable and establishes an allowance account for credit losses based on its best estimate of any potentially uncollectable accounts. As at September 30, 2018, the balance of the allowance account for credit losses was $nil (2017 - $nil).

Pursuant to their respective terms, accounts receivable was aged as at September 30, 2018 and 2017:

	2018	2017
0 – 30 days	$ 1,127,001	$ 754,381
31 – 60 days	553,536	397,102
61 – 90 days	-	-
Greater than 90 days	282,432	222,959
Total accounts receivable	$ 1,962,969	$ 1,374,442

There is a possibility of increased customer credit risk due to the ongoing global recessionary trends. As at September 30, 2018, the Company's accounts receivable are made up of approximately 46% (2017 - 70%) government trade receivables and the balance of the outstanding accounts receivable are spread over several other customers.

During the year ended September 30, 2018, the Company had one customer who represented greater than 10% of total revenues. This customer represents approximately 79% of total revenues (2017 - two customers represented approximately 75% and 21%).

The Company may also have credit risk relating to cash and cash equivalents and short-term investments, which it manages by dealing with large banks and investing in highly liquid investments. The Company's objective is to minimize its exposure to credit risk in order to prevent losses on financial assets by placing its investments in highly liquid instruments such as guaranteed investment funds. The Company's cash and cash equivalents carrying value as at September 30, 2018 totaled $2,014,764 (2017 - $10,883,919), short-term investments of $7,598,857 (2017 - $nil) and accounts receivables of $1,962,969 (2017 - $1,374,442), representing the maximum exposure to credit risk of these financial assets.

(c) *Liquidity risk:*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due.

The Company has in place a planning and budgeting process which helps determine the funds required to ensure the Company has the appropriate liquidity to meet its operating and growth objectives.

(Expressed in Canadian dollars)

12. Financial instruments and risk exposures (continued):

(c) *Liquidity risk (continued):*

As at September 30, 2018, the Company had cash and cash equivalents of $2,014,764 (2017 - $10,883,919), short-term investments of $7,598,857 (2017 - $nil), and accounts receivable of $1,962,969 (2017 - $1,374,442) for a total of $11,576,590 (2017 - $12,258,361). The liquidity and additional financing are adequate for the settlement of short-term financial obligations.

(d) *Currency risk:*

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

The Company is exposed to currency risk as a result of components of cost being denominated in currencies other than the Canadian dollar, primarily the United States dollar. The Company holds cash and has liabilities (primarily accounts payable and accrued liabilities) in currencies other than the Canadian dollar, primarily the United States dollar. In addition, the Company also has United States dollar denominated accounts receivable that are subject to currency risk.

The Company manages currency risk by holding cash in foreign currencies to support forecasted foreign currency denominated liabilities and does not use derivative instruments to reduce its exposure to foreign currency risk.

(e) *Interest rate risk:*

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's exposure to the risk of changes in market interest rates relates primarily to cash equivalents and short-term investments. The Company does not enter into any interest rate swaps to mitigate interest rate risk.

13. Income taxes:

(a) *Income tax expense:*

Income tax expense differs from the expected expense if the Canadian federal and provincial statutory income tax rates were applied to earnings from continuing operations before income taxes. The principal factors causing these differences are shown below:

	2018	2017
Income (loss) from continuing operations before income taxes	$ 77,056	$ (3,853,853)
Statutory tax rate	26.73%	26.53%
Expected tax expense (recovery)	20,597	(1,022,427)
Effective tax rate change and other	(381,819)	(30,450)
Permanent differences	171,849	260,525
Non-refundable investment tax credits	(139,148)	-
Changes in deferred tax assets arising from discontinued operations	(469,263)	-
Changes recognized in equity	-	(224,463)
Change in unrecognized deferred tax assets	797,784	1,016,815
Income tax recovery	$ -	$ -

(Expressed in Canadian dollars)

13. Income taxes (continued):

(b) *Recognized deferred tax assets and liabilities:*

The Company has recognized deferred taxes in respect of the following:

	2018	2017
Deferred tax assets:		
Non-capital losses carried forward	$ 2,790,683	$ 2,890,617
Deferred tax liabilities:		
Property, plant, and equipment and intangible assets	(2,790,683)	(2,890,617)
Net deferred tax asset	$ -	$ -

(c) *Deferred income tax assets and liabilities:*

The Company did not recognize deferred tax assets for the following deductible temporary differences:

	2018	2017
Non-capital loss carry forwards	$ 8,520,026	$ 8,789,958
Net capital loss carry forwards	5,732,539	2,385,221
Non-refundable investment tax credits	668,251	-
Other temporary differences	7,345,635	8,223,233
Unrecognized deferred income tax assets	$ 22,266,451	$ 19,398,412

(d) *Loss carry forwards:*

As at September 30, 2018, the Company has tax loss carry forwards of approximately $18,948,528 (2017 - $19,583,000). The Company's tax loss carry forwards will expire, if not utilized, commencing in 2029. The Company recognizes the benefit of tax losses only to the extent of anticipated future taxable income. As at September 30, 2018, the Company has capital losses of approximately $5,732,539 (2017 - $2,385,221) that may be carried forward indefinitely to apply against future years' capital gains.

(e) *R&D and tax credit attributes:*

As at September 30, 2018, the Company had unclaimed tax deductions of scientific research and experimental development expenditures of $2,322,000 (2017 - $1,908,000) that is available to reduce taxable income in future years and may be carried forward indefinitely. As at September 30, 2018, the Company has federal investment tax credits of $555,000 (2017 - $418,000) and provincial investment tax credits of $114,000 that may be carried forward to apply against future years' income tax payable. These investment tax credits begin to expire in 2031 and 2022 respectively.

(Expressed in Canadian dollars)

14. Related party transactions:

(a) *The remuneration of key management personnel:*

	2018	2017
Salaries, accrued bonuses, and employee benefits	$ 1,208,306	$ 1,233,741
Share-based payments	493,881	699,138
	$ 1,702,187	$ 1,932,879

(b) As of September 30, 2018, amounts owing to a company controlled by an officer and director of the Company included in accounts payable and accrued liabilities were $191,433 (2017 - $262,854) in the ordinary course of his employment arrangement.

(c) Legal and professional fees, taxes and disbursements totaling $81,776 for the year ended September 30, 2018 (2017 - $160,664) were incurred with a law firm of which a director of the Company is a partner. As of September 30, 2018, amounts owing to this company included in accounts payable and accrued liabilities were $50,780 (2017 - $93,219).

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.

15. Supplementary cash flow information:

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

	2018	2017
Accounts receivable	$ (588,527)	$ (904,902)
Inventory	(21,928)	150
Prepaid expenses and other assets	62,360	(85,143)
Accounts payable and accrued liabilities (note 15(d))	(184,114)	112,304
Deferred revenue	(157,171)	157,171
	$ (889,380)	$ (720,420)

(b) *Interest and income taxes:*

	2018	2017
Interest received	$ 98,892	$ 42,475
Interest paid	2,905	461,980

The Company did not pay any income taxes during the years ended September 30, 2018 and 2017.

(c) *Cash and cash equivalents:*

Cash and cash equivalents consist of cash balances with banks, investments with original maturities of three months or less, and investments that are both readily convertible to cash and subject to insignificant changes in market value:

	2018	2017
Cash	$ 292,688	$ 914,378
Cash equivalents	1,722,076	9,969,541
	$ 2,014,764	$ 10,883,919

(Expressed in Canadian dollars)

15. Supplementary cash flow information (continued):

(d) *Supplemental disclosure of non-cash financing activities:*

As at September 30, 2018, property, plant and equipment included in accounts payable was $17,930 (2017 - $nil).

16. Segmented information

The Company's continuing operations currently consist of one operating segment. For the year ended September 30, 2018, sales within Canada were $1,113,177 (2017 - $328,531) and sales outside Canada were $8,086,533 (2017 - $7,015,260).

17. 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.

	2018	2017
Salaries and benefits	$ 3,480,731	$ 3,452,013
Share-based compensation	681,739	921,198
Depreciation and amortization	1,613,491	2,916,283
Travel and entertainment	332,586	282,233
Professional fees and insurance	858,417	613,837
Public company costs	573,305	668,058
Rent and utilities	645,560	520,957
Maintenance and office expenses	234,917	278,353
Materials consumed	1,073,809	360,118
	$ 9,494,555	$ 10,013,050

18. Commitments:

(a) As at September 30, 2018, the Company is committed under operating leases, primarily related to office space, and other purchases for the following amounts:

2019	$ 335,549
2020	217,966
2021	96,196
2022	90,277
2023	64,736
	$ 804,724

(b) Certain nano-optic products are subject to a 3% sales royalty in favor of Simon Fraser University where certain elements of the nano-optic technology originated. No royalties were paid during the years ended September 30, 2018 and 2017.

(Expressed in Canadian dollars)

19. Discontinued operations:

On September 21, 2017, the Directors of the Company made the determination that it would pursue the possible sale of the assets of its subsidiary, Tactical, to a third party. At September 30, 2017, Tactical was classified as a separate disposal group held for sale and as a discontinued operation.

On June 29, 2018, the assets used in connection with Tactical's surveillance equipment and van conversion business were sold to an employee of Tactical for a nominal amount and on September 28, 2018, Tactical was wound-up and struck from the corporate register.

The major classes of assets and liabilities of Tactical classified as held for sale as at September 30, 2018 are as follows:

(a) Assets and liabilities of Tactical classified as held for sale:

		2018		2017
Cash	$	-	$	30,280
Accounts receivable		-		116,538
Inventory		-		54,525
Prepaid expenses		-		12,401
Property, plant and equipment		-		2,481
Assets held for sale	$	-	$	216,225
Accounts payable and accrued liabilities	$	16,204	$	200,226
Liabilities directly associated with assets held for sale	$	16,204	$	200,226
Cumulative loss in accumulated other comprehensive loss	$	-	$	(68,905)

(b) Net cash flows provided by (used in) discontinued operations:

		2018		2017
Net loss from discontinued operations	$	(123,322)	$	(900,279)
Depreciation		-		12,804
Foreign exchange reclassified upon disposal of foreign operation		167,813		-
Non-cash working capital changes		32,203		313,162
	$	76,694	$	(574,313)

(Expressed in Canadian dollars)

19. Discontinued operations (continued):

(c) Net loss on discontinued operations, net of income taxes, is as follows:

	2018	2017
Revenue	$ 827,256	$ 1,259,066
Cost of sales	454,573	874,133
Gross Profit	372,683	384,933
Expenses		
Research and development	-	269,310
General and administration	311,217	542,227
Sales and marketing	14,994	246,630
Depreciation	-	12,804
	326,211	1,070,971
Income (loss) before other expenses	46,472	(686,038)
Other expenses	3,419	3,465
Gain on disposal of foreign operation (note 19(d))	(1,438)	-
Loss on remeasurement to fair value less costs to dispose	-	210,776
Foreign exchange reclassified on disposal of foreign operation	167,813	-
	169,794	214,241
Net loss from discontinued operations	$ (123,322)	$ (900,279)
Other comprehensive income (loss):		
Unrealized foreign exchange gain (loss) on translation of foreign operation	(98,908)	85,605
Net comprehensive loss from discontinued operations	$ (222,230)	$ (814,674)

(d) The effect of the disposal of Tactical on the financial position of the Company on June 28, 2018 is as follows:

Cash proceeds	$ 1
Cash	(66,385)
Accounts receivable	(22,933)
Inventory	(51,749)
Prepaid expenses	(894)
Accounts payable and accrued liabilities	143,400
Net assets disposed	1,439
Gain on disposal of foreign operations	$ (1,438)