Quarterly Report

December 31, 2017

NANOTECH SECURITY CORP.

For purposes of this management's 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 December 31, 2017.

ADVISORY

This MD&A dated February 21, 2018, 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 months ended December 31, 2017 as well as with the Company's consolidated financial statements and management's discussion and analysis for the year ended September 30, 2017. 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 and 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, 2017, 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 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, BC, Canada V5A 4R4. The Company's registered and records office is #1500 - 1055 West Georgia, Vancouver, BC, Canada V6E 4N7.

Nanotech designs, manufactures and markets nano-optic products that have brand protection and enhancement applications across a wide range of markets including banknotes, tax stamps, secure government documents, commercial branding, and the pharmaceutical industry.

The Company's KolourOptik® 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 visual images with colour-shifting effects such as 3D, perceived movement, and can also display high-definition colours including skin tones, and whites and blacks, which are not possible using holographic technology.

The Company's optical thin film ("OTF") 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.

On September 21, 2017, the Directors of the Company made the determination that it would pursue the possible sale of its subsidiary Tactical Technologies Inc. ("Tactical") to a third party. The Company is actively pursuing potential purchasers and has engaged a business broker to pursue interested parties. At September 30, 2017, Tactical was classified as a separate disposal group held for sale and as a discontinued operation. Accordingly, the Company's Comparative Consolidated Statements of Operations have been restated to exclude the discontinued operations for the three months ended December 31, 2016.

RESULTS OF OPERATIONS

Select financial information for the three months ended December 31, 2017 and 2016:

Select Financial Information	Three months ended December 31, 2017	Three months ended December 31, 2016
Revenue	$2,233,227	$ 694,471
Cost of sales	563,851	116,469
	1,669,376	578,002
Expenses		
Research and development	346,187	374,996
General and administration	541,619	542,701
Sales and marketing	456,750	425,504
Depreciation and amortization	310,043	720,837
	1,654,599	2,064,038
Income (loss) from continuing operations before other expenses	14,777	(1,486,036)
Other (income) expenses	(81,043)	186,725
Net income (loss) from continuing operations	95,820	(1,672,761)
Net loss from discontinued operations	-	(180,519)
Net income (loss)	$ 95,820	$ (1,853,280)
Adjusted EBITDA(1)	$ 459,645	$ (555,581)

(1)Adjusted EBITDA is a non-IFRS measure as described in the Non-IFRS Financial Measures section of this MD&A.

Revenue

Consolidated revenues for the three months ended December 31, 2017 increased by $1,538,756 or 222% to $2,233,227 compared to $694,471 in the same period last year. Revenue growth was primarily due to increased revenue from paid development contracts and from increased revenues from its Thurso operations.

During the year ended September 30, 2017, the Company disclosed a development contract for up to $30.0 million over a period of up to five years. These development activities incorporate both nano-optic and OTF technologies and are focused on developing authentication features for future banknotes.

Gross Margin

Gross margin for the three months ended December 31, 2017 increased by $1,091,374 or 189% to $1,669,376 compared to $578,002 in the same period last year. Overall, the gross margin percentage was 75% for the three months ended December 31, 2017, down from 83% in the same period last year. This decrease reflects increased labour and materials costs in the development contracts and low margins on Thurso operation revenues.

Research and Development

Research and development expenditures for the three months ended December 31, 2017 decreased by $28,809 or 8% to $346,187 compared to $374,996 in the same period last year. A larger portion of salaries and other expenses were allocated to cost of sales in 2017 as a result of increased development project activities, offset by increased patent work and overall higher salary costs related to additional technical staff who were hired in the second quarter of 2017.

General and Administration

General and administration expenditures for the three months ended December 31, 2017 were $541,619, consistent with $542,701 in the same period last year.

Sales and Marketing

Sales and marketing expenditures for the three months ended December 31, 2017 were $456,750, an increase of $31,246 or 7% compared to $425,504 in the same period last year. The increase mainly relates to an increase in travel and marketing expenses.

Depreciation and Amortization

Depreciation and amortization expenditures for the three months ended December 31, 2017 were $310,043, compared to $720,837 in the same period last year, reflecting the Company's declining balance depreciation policy and the intangible assets being completely amortized as at September 30, 2017.

Other Income

Other income for the three months ended December 31, 2017 was $81,043, an increase of $267,768 compared to other expenses of $186,725 in the same period last year. The increase is primarily due to the repayment of the convertible debentures and long-term debt during 2017, which reduced interest expense by $232,606 in the current quarter compared to 2016, in combination with an increase in cash on hand, which generated interest income of $36,150 in the current quarter.

Adjusted EBITDA

Adjusted EBITDA for the three months ended December 31, 2017 was $459,645, compared to negative $555,581 during the same period last year. The improvement reflects an increase in revenues and reduced expenses, offset by lower margins.

Net Income

Net income for the three months ended December 31, 2017 was $95,820 compared to a net loss of $1,853,280 during the same period last year. The increase in net income reflects an increase in revenues and reduced expenses, offset by lower margins.

QUARTERLY RESULTS

	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017	Q4 2016	Q3 2016	Q2 2016
($ thousands, except per share data)								
Revenue	$ 2,233	$ 2,662	$ 2,569	$ 1,419	$ 694	$ 1,177	$ 497	$ 645
Income (loss) from continuing operations	96	127	(749)	(1,559)	(1,673)	(1,566)	(1,976)	(2,280)
Net income (loss)	96	(301)	(905)	(1,695)	(1,853)	(1,677)	(1,957)	(2,450)
Adjusted EBITDA[1]	460	1,134	858	(268)	(556)	(444)	(1,088)	(1,091)
Basic earnings (loss) per share:								
Continuing operations	0.00	0.00	(0.01)	(0.03)	(0.03)	(0.03)	(0.04)	(0.04)
Net income (loss)	0.00	0.00	(0.02)	(0.03)	(0.03)	(0.03)	(0.04)	(0.05)
Diluted earnings (loss) per share:								
Continuing operations	0.00	0.00	(0.01)	(0.03)	(0.03)	(0.03)	(0.04)	(0.04)
Net income (loss)	0.00	0.00	(0.02)	(0.03)	(0.03)	(0.03)	(0.04)	(0.05)

[1]Adjusted EBITDA is a non-IFRS measure as described in the Non-IFRS Financial Measures section of this MD&A.

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

RELATED PARTY TRANSACTIONS

For the three months ended December 31, 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 December 31,	
	2017	2016
Salaries, accrued bonuses, and employee benefits	$ 301,415	$ 223,365
Share-based payments	73,821	147,787
	$ 375,236	$ 371,152

(b) As of December 31, 2017, amounts owing to a company controlled by an officer and director of the Company included in accounts payable and accrued liabilities were $286,188 (September 30, 2017 - $262,854).

(c) Legal and professional fees, taxes and disbursements totaling $20,038 for the three months ended December 31, 2017 (December 31, 2016 - $34,553) were incurred with a law firm of which a director of the Company is a partner. As of December 31, 2017, amounts owing to this company included in accounts payable and accrued liabilities were $39,485 (September 30, 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.

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 December 31,	
	2017	2016
Cash provided by (used in) continuing operations	$ 113,331	$ (774,528)
Cash provided by (used in) discontinued operations	95,329	(213,820)
Cash provided by (used in) operating activities	208,660	(988,348)
Cash used in investing activities	(168,541)	(16,233)
Cash provided by financing activities	-	23,000
Effect of foreign exchange on cash and cash equivalents	(25,125)	(24,969)
Cash and cash equivalents, beginning of period	10,883,919	3,312,691
Cash and cash equivalents, end of period	$10,898,913	$ 2,306,141

Operating Activities

Cash provided by operating activities was $208,660 for the three months ended December 31, 2017, compared to cash used in operating activities of $988,348 for the same period last year. This improvement was a result of increased development revenue, partially offset by increased cash used in working capital.

The cash used in working capital included a prepayment of $570,000 towards a new electron beam system ("E-beam"). The new E-beam will cost a further $1.4 million and will be delivered in the second quarter of fiscal 2018. This E-beam will be utilized in paid development contracts and will enable the Company to produce further advanced KolourOptik® designs.

Investing Activities

Cash used in investing activities was $168,541 for the three months ended December 31, 2017, compared to cash used in investing activities of $16,233 in the same period last year reflecting purchases related to a larger steam boiler for our Thurso facility during the quarter.

Financing Activities

Cash provided by financing activities was $nil for the three months ended December 31, 2017, compared to $23,000 during the same period last year related to the exercise of stock options.

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 to 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 three months ended December 31, 2017, there were no changes in our approach to capital management.

As at December 31, 2017, cash and cash equivalents amounted to $10,898,913 compared to $10,883,919 as at September 30, 2017.

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

The Company had commitments of $2,236,024 as of December 31, 2017.

Management has reviewed its projected funding requirements and expects that, through the generation and collection of revenues, the Company will maintain sufficient liquidity to meet its requirements through December 31, 2018.

Non-IFRS Financial Measures

In addition to results reported in accordance with IFRS, the Company discloses Adjusted EBITDA as a supplemental indicator of its financial performance.

The Company defines Adjusted EBITDA as net income (loss) excluding the impact of interest and financing costs (net of interest income), income taxes, depreciation and amortization, share-based compensation, net loss from discontinued operations, and foreign exchange gain. The Company believes Adjusted EBITDA is a useful measure because it provides information to management about the operating and financial performance of the Company and its ability to generate operating cash flow to fund future working capital needs, and fund future growth. Adjusted EBITDA may also be used by investors and analysts for the purpose of valuing the Company.

Readers are cautioned that these non-IFRS definitions are not recognized measures under IFRS, do not have standardized meanings prescribed by IFRS, and should not be construed to be alternatives to net earnings determined in accordance with IFRS or as indicators of performance or liquidity or cash flows. The Company's method of calculating these measures may differ from methods used by other entities and accordingly our measures may not be comparable to similarly titled measures used by other entities or in other jurisdictions. The Company uses these measures because it believes they provide useful information to both management and investors with respect to the operating and financial performance of the Company.

	Three months ended December 31,	
	2017	2016
Net income (loss)	$ 95,820	$ (1,853,280)
Finance (income) expense	(34,042)	231,119
Foreign exchange gain	(47,001)	(44,394)
Depreciation and amortization	356,763	726,504
Share-based compensation	88,105	203,951
Net loss from discontinued operations	-	180,519
Adjusted EBITDA	$ 459,645	$ (555,581)

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 12 of the consolidated financial statements for the year ended September 30, 2017. In the three months ended December 31, 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 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.

	December 31, 2017		September 30, 2017	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Common shares outstanding	68,395,825		68,395,825	
Options				
Outstanding	2,040,000	$ 1.35	2,040,000	$ 1.35
Exercisable	1,873,500	$ 1.36	1,770,125	$ 1.37
RSUs				
Outstanding	512,280	N/A	529,560	N/A

As at February 21, 2018, the Company has 68,395,825 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 strong margins and established customer base. With the signing of the $30.0 million 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.

The Company has now recorded its third consecutive quarter of positive Adjusted EBITDA. For 2018, the Company is well positioned financially to pursue opportunities in the banknote, tax stamp and commercial markets. In our business, there is an inherent variability in development contract revenue with government organizations. As a result, management projects second quarter revenue of $1.9 million. With a strong balance sheet, including $10,898,913 in cash and no debt, management continues to be on track to deliver strong annual financial performance in line with its September 30, 2017 guidance.

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, the loss of a key customer, 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 development revenue and our ability to maintain sufficient liquidity through December 31, 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, 2017 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 months ended December 31, 2017 and 2016
(Unaudited)

Nanotech Security Corp.

Condensed Consolidated Interim Statements of Operations and Comprehensive Income (Loss)
(Unaudited)

Three months ended December 31, 2017 and 2016
(In Canadian dollars)

	2017	2016
Revenue	$ 2,233,227	$ 694,471
Cost of sales (note 10)	563,851	116,469
	1,669,376	578,002
Expenses (note 10)		
Research and development	346,187	374,996
General and administration	541,619	542,701
Sales and marketing	456,750	425,504
Depreciation and amortization	310,043	720,837
	1,654,599	2,064,038
Income (loss) from continuing operations before other expenses	14,777	(1,486,036)
Other (income) expenses		
Foreign exchange gain	(47,001)	(44,394)
Finance (income) expense (note 5)	(34,042)	231,119
	(81,043)	186,725
Net income (loss) from continuing operations	95,820	(1,672,761)
Net loss from discontinued operations (note 11)	-	(180,519)
Net income (loss)	95,820	(1,853,280)
Other comprehensive loss:		
Items that may be subsequently reclassified to earnings:		
Unrealized foreign exchange loss on translation of foreign operation	(25,125)	(24,969)
Total comprehensive income (loss)	$ 70,695	$ (1,878,249)
Basic and diluted earnings (loss) per share:		
Continuing operations	$ 0.00	$ (0.03)
Discontinued operations	$ 0.00	$ 0.00
Net income (loss)	$ 0.00	$ (0.03)
Weighted average number of common shares		
Basic	68,395,825	53,871,231
Diluted	68,658,858	53,871,231

See accompanying Notes to the Condensed Consolidated Interim Financial Statements.

Nanotech Security Corp.

Condensed Consolidated Interim Statements of Financial Position
(Unaudited)

(In Canadian dollars)

	December 31, 2017	September 30, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 10,898,913	$ 10,883,919
Accounts receivable	1,120,389	1,374,442
Inventory (note 4)	130,684	151,708
Prepaid expenses and other assets	713,441	187,874
Assets held for sale (note 11)	259,794	216,225
	13,123,221	12,814,168
Property, plant and equipment	15,740,449	15,856,998
Goodwill	1,388,458	1,388,458
	$ 30,252,128	$ 30,059,624
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,333,165	$ 1,431,466
Deferred revenue	157,171	157,171
Liabilities directly associated with assets held for sale (note 11)	339,124	200,226
	1,829,460	1,788,863
Non-current liabilities:		
Tenant inducement	64,330	71,223
	1,893,790	1,860,086
Shareholders' equity		
Share capital (note 6(a))	61,426,483	61,426,483
Contributed surplus	2,803,242	2,715,137
Deficit	(35,777,357)	(35,873,177)
Accumulated other comprehensive loss	(94,030)	(68,905)
	28,358,338	28,199,538
	$ 30,252,128	$ 30,059,624

Related party transactions (note 7)
See accompanying Notes to the 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 Interim Statements of Changes in Shareholders' Equity
(Unaudited)

Three months ended December 31, 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, 2016	53,864,285	$ 45,210,507	$ 2,485,131	$ (31,119,045)	$ (154,510)	$ 16,422,083
Net loss	-	-	-	(1,853,280)	-	(1,853,280)
Unrealized foreign exchange loss on translation	-	-	-	-	(24,969)	(24,969)
Share-based payments (note 6(b) and (c))	-	-	203,951	-	-	203,951
Options exercised	22,000	30,509	(7,509)	-	-	23,000
Balance as at December 31, 2016	53,886,285	$ 45,241,016	$ 2,681,573	$ (32,972,325)	$ (179,479)	$ 14,770,785
Balance as at October 1, 2017	68,395,825	$ 61,426,483	$ 2,715,137	$ (35,873,177)	$ (68,905)	$ 28,199,538
Net income	-	-	-	95,820	-	95,820
Unrealized foreign exchange loss on translation	-	-	-	-	(25,125)	(25,125)
Share-based payments (note 6(b) and (c))	-	-	88,105	-	-	88,105
Balance as at December 31, 2017	68,395,825	$ 61,426,483	$ 2,803,242	$ (35,777,357)	$ (94,030)	$ 28,358,338

See accompanying Notes to the Condensed Consolidated Interim Financial Statements.

Nanotech Security Corp.

Condensed Consolidated Interim Statements of Cash Flows
(Unaudited)

Three months ended December 31, 2017 and 2016
(In Canadian dollars)

	2017	2016
Cash flows provided by (used in):		
Operating activities:		
Net income (loss) from continuing operations	$ 95,820	$ (1,672,761)
Items not involving cash:		
Depreciation and amortization	356,763	726,504
Share-based compensation	88,105	203,951
Accretion of convertible debentures	-	76,024
Other	(6,893)	(6,893)
Non-cash working capital changes (note 8(a))	(420,464)	(101,353)
	113,331	(774,528)
Discontinued operations (note 11):		
Net loss from discontinued operations	-	(180,519)
Depreciation	-	3,197
Non-cash working capital changes	95,329	(36,498)
Cash provided by (used in) operating activities	208,660	(988,348)
Investing activities:		
Purchase of property and equipment (note 8(d))	(168,541)	(16,233)
Cash used in investing activities	(168,541)	(16,233)
Financing activities:		
Issuance of shares for options exercised	-	23,000
Cash provided by financing activities	-	23,000
Effect of foreign exchange on cash and cash equivalents	(25,125)	(24,969)
Increase (decrease) in cash and cash equivalents	14,994	(1,006,550)
Cash and cash equivalents, beginning of period	10,883,919	3,312,691
Cash and cash equivalents, end of period	$ 10,898,913	$ 2,306,141

See supplementary cash flow information (note 8)
See accompanying Notes to the 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 designs, produces and markets nano-optic products that have brand protection and enhancement applications across a wide range of markets including banknotes, tax stamps, and commercial branding.

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, 2017.

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

These condensed consolidated interim financial statements were approved and authorized for issue by the Company's Board of Directors on February 21, 2018.

(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.

3. 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; a single, forward-looking 'expected credit loss' impairment model and a substantially-reformed approach to hedge accounting to better link the economics of risk management with its accounting treatment. IFRS 9 is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively, with some exceptions. Earlier adoption is permitted. The Company is currently evaluating the impact of IFRS 9 on its financial statements, and plans to adopt the new standard on the required effective date.

(In Canadian dollars)

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

(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 its assessment of the impact that the initial application of IFRS 15 will have on its consolidated 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 consolidated financial statements for the annual period beginning October 1, 2018.

(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.

4. Inventory:

	December 31, 2017	September 30, 2017
Raw materials	$ 115,687	$ 123,619
Work in progress	11,135	28,089
Finished goods	3,862	-
	$ 130,684	$ 151,708

There were no inventory write-downs during the three months ended December 31, 2017 (December 31, 2016 - $nil).

For the three months ended December 31, 2017, the Company recognized inventories of $563,851 (December 31, 2016 - $116,469) as expensed through cost of sales.

(In Canadian dollars)

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 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.

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

	Three months ended December 31,	
	2017	2016
Interest paid	$ -	$ 126,582
Accretion of convertible debentures	-	76,024
Interest expense	$ -	$ 202,606

(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, 2017 and December 31, 2017	68,395,825	$	61,426,483

There are no preferred shares issued and outstanding.

(b) *Stock option plan:*

Stock options outstanding as at December 31, 2017:

	Number of options		Weighted average exercise price
Balance as at September 30, 2017 and December 31, 2017	2,040,000	$	1.35

The following table summarizes information pertaining to the Company's stock options outstanding as at December 31, 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 - $1.25	976,500	2.93	$	1.12	888,375	$	1.13
$1.26 - $1.65	1,063,500	2.18		1.56	985,125		1.57
	2,040,000	2.54	$	1.35	1,873,500	$	1.36

The exercise price of all stock options granted 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 month periods ended December 31, 2017 and 2016:

	Three months ended December 31, 2017	2016
Risk free interest rate	N/A	1.21%
Expected life	N/A	4.4
Vesting period	N/A	1.5 years
Expected volatility	N/A	46%
Expected dividends	N/A	Nil
Average fair value	N/A	$0.58
Forfeiture rate	N/A	11.4%

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 December 31, 2017	2016
Total compensation - stock options	$ 24,099	$ 135,343

(c) *Restricted share unit plan:*

Restricted share units ("RSUs") outstanding as at December 31, 2017:

	Number of RSUs
Balance as at September 30, 2017	529,560
Forfeited	(17,280)
Balance as at December 31, 2017	512,280

Using an estimated forfeiture rate of 10% for the three months ended December 31, 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 December 31, 2017	2016
Total compensation - RSUs	$ 64,006	$ 68,608

(In Canadian dollars)

7. Related party transactions:

(a) The remuneration of key management personnel:

	Three months ended December 31, 2017	2016
Salaries, accrued bonuses, and employee benefits	$ 301,415	$ 223,365
Share-based payments	73,821	147,787
	$ 375,236	$ 371,152

(b) As of December 31, 2017, amounts owing to a company controlled by an officer and director of the Company included in accounts payable and accrued liabilities were $286,188 (September 30, 2017 - $262,854).

(c) Legal and professional fees, taxes and disbursements totaling $20,038 for the three months ended December 31, 2017 (December 31, 2016 - $34,553) were incurred with a law firm of which a director of the Company is a partner. As of December 31, 2017, amounts owing to this company included in accounts payable and accrued liabilities were $39,485 (September 30, 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.

8. Supplementary cash flow information:

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

	Three months ended December 31, 2017	2016
Accounts receivable	$ 254,053	$ (60,072)
Inventory	19,424	(62,530)
Prepaid expenses and other assets	(525,567)	33,155
Accounts payable and accrued liabilities	(168,374)	(11,906)
	$ (420,464)	$ (101,353)

(b) *Interest and income taxes:*

During the three months ended December 31, 2017, the Company received $36,150 in interest income (December 31, 2016 - $3,551).

During the three months ended December 31, 2017, the Company paid $nil in interest (December 31, 2016 - $156,595). The Company did not pay any income taxes during the three months ended December 31, 2017 and 2016.

(c) *Cash and cash equivalents:*

Cash and cash equivalents are comprised of:

	December 31, 2017	September 30, 2017
Cash	$ 1,248,549	$ 914,378
Term deposit	9,650,364	9,969,541
	$ 10,898,913	$ 10,883,919

(In Canadian dollars)

8. Supplementary cash flow information (continued):

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

	Three months ended December 31, 2017	Three months ended December 31, 2016
Acquisition of property, plant and equipment in accounts payable	$ 70,073	$ -

9. Revenue:

During the three months ended December 31, 2017, the Company had one customer who represented greater than 10% of total revenues. This customer represented approximately 87% of total revenues (December 31, 2016 - one customer represented approximately 92% of total revenues).

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 December 31, 2017	Three months ended December 31, 2016
Salaries and benefits	$ 794,677	$ 658,391
Share-based compensation	88,105	203,951
Depreciation and amortization	356,763	726,504
Travel and entertainment	109,159	56,463
Professional fees and insurance	237,595	198,041
Public company costs	161,211	145,176
Rent and utilities	152,204	83,552
Maintenance and office expenses	58,030	72,868
Materials consumed	260,706	35,561
	$ 2,218,450	$ 2,180,507

(In Canadian dollars)

11. 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 Technologies Inc. ("TTI"), to a third party. The Company is actively pursuing potential purchasers and has engaged a business broker to pursue interested parties. At September 30, 2017, TTI was classified as a separate disposal group held for sale and as a discontinued operation.

The major classes of assets and liabilities of TTI classified as held for sale as at December 31, 2017 and September 30, 2017 are as follows:

	December 31, 2017	September 30, 2017
Cash	$ 109,466	$ 30,280
Accounts receivable	38,682	116,538
Inventory	111,083	54,525
Prepaid expenses	563	12,401
Property, plant and equipment	-	2,481
Assets held for sale	$ 259,794	$ 216,225
Accounts payable and accrued liabilities	$ 339,124	$ 200,226
Liabilities directly associated with assets held for sale	$ 339,124	$ 200,226
Cumulative loss in accumulated other comprehensive loss	$ (94,030)	$ (68,905)

(In Canadian dollars)

11. Discontinued operations (continued):

Net loss from discontinued operations, net of income taxes, is as follows:

	Three months ended December 31, 2017	Three months ended December 31, 2016
Revenue	$ 201,490	$ 212,542
Cost of sales	123,118	159,268
	78,372	53,274
Expenses		
Research and development	-	70,085
General and administration	73,127	113,876
Sales and marketing	3,119	47,399
Depreciation	-	3,197
	76,246	234,557
Gain (loss) before other expenses	2,126	(181,283)
Other expense		
Finance costs (income)	2,126	(764)
	2,126	(764)
Net loss from discontinued operations	$ -	$ (180,519)
Other comprehensive loss:		
Unrealized foreign exchange loss on translation of foreign operation	(25,125)	(24,969)
Net comprehensive loss from discontinued operations	$ (25,125)	$ (205,488)

Net cash flows from discontinued operations amounted to $95,329 (December 31, 2016 - $(213,820)).