



March 31, 2020

# QUARTERLY REPORT



# Nanotech Security Corp.

Management's Discussion and Analysis

For the three and six months ended March 31, 2020

---

For purposes of this management's discussion and analysis ("MD&A"), "Nanotech", the "Company", "we", or "us" refers to Nanotech Security Corp. This quarter or the current quarter means the quarter ended March 31, 2020. Year to date means the six months ended March 31, 2020.

## ADVISORY

This MD&A, dated May 7, 2020, should be read in conjunction with the cautionary statement regarding forward-looking statements below and the Company's condensed interim financial statements for the three and six months ended March 31, 2020 as well as with the Company's audited consolidated financial statements and MD&A for the year ended September 30, 2019. 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 this MD&A is unaudited.

Additional information relating to the Company is filed on SEDAR at [www.sedar.com](http://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, the Company's views that its optics-based technologies will continue to show promise for large scale production and the potential impacts of the COVID-19 pandemic on the Company's operations. 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 the loss of a key customer, 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, as well as risks related to the COVID-19 pandemic.*

*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 MD&A and the notes to the audited consolidated financial statements for the year ended September 30, 2019, 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](http://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.*

# Nanotech Security Corp.

Management's Discussion and Analysis

For the three and six months ended March 31, 2020

---

## 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. In addition, the Company owns and operates a manufacturing facility located in Thurso, Quebec. The Company's registered and records office is #1200 - 200 Burrard Street, Vancouver, BC, Canada V7X 1T2.

Nanotech researches, creates, and produces nano-optic structures and colour-shifting materials used in authentication and brand protection applications across a wide range of markets including banknotes, secure government documents, and commercial branding. The Company's technology platforms include:

- **KolourOptik®**, a patented technology that is exclusive to the government and banknote market and combines sub-wavelength nanostructures and microstructures to create modern overt security features with a unique and customizable visual effect. KolourOptik pure plasmonic colour pixels produce full colour, 3D depth, and movement used in security stripes and threads that are nearly impossible to replicate.
- **LiveOptik™**, a patented technology that utilizes innovative nano-optics one tenth the size of traditional holographic structures to create next generation overt security features customized to Nanotech's customers' unique requirements. LiveOptik delivers multi-colour, 3D depth, movement and image switches for secure brand protection stripes, threads and labels that are nearly impossible to replicate.
- **LumaChrome™** optical thin film 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 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.

# Nanotech Security Corp.

Management's Discussion and Analysis  
For the three and six months ended March 31, 2020

## RESULTS OF OPERATIONS

Select financial information for the three and six months ended March 31, 2020 and 2019:

Select Financial Information	Three months ended March 31		Six months ended March 31	
	2020	2019 <sup>(1)</sup>	2020	2019 <sup>(1)</sup>
Revenue	\$ 1,384,516	\$ 1,594,003	\$ 2,854,442	\$ 3,125,676
Cost of sales	251,410	317,351	557,219	678,899
	1,133,106	1,276,652	2,297,223	2,446,777
Expenses				
Research and development	556,096	402,539	958,028	738,650
General and administration	606,950	587,183	1,197,370	1,124,750
Sales and marketing	651,693	528,830	1,237,743	973,544
Depreciation and amortization	402,512	385,535	773,001	756,294
Restructuring costs	-	-	-	815,700
	2,217,251	1,904,087	4,166,142	4,408,938
Loss from operations before other income	(1,084,145)	(627,435)	(1,868,919)	(1,962,161)
Other income	(110,812)	(150,429)	(113,096)	(353,245)
Net loss	\$ (973,333)	\$ (477,006)	\$ (1,755,823)	\$ (1,608,916)
Adjusted EBITDA <sup>(2)</sup>	\$ (576,484)	\$ 45,027	\$ (836,947)	\$ 162,658

<sup>(1)</sup>Results for the three and six months ended March 31, 2019 have been adjusted to reflect the full retrospective application of IFRS 15-*Revenue from Contracts with Customers* ("IFRS 15"), which was adopted October 1, 2018. For further information, see note 2(a) of the condensed interim financial statements for the three and six months ended March 31, 2020.

<sup>(2)</sup>Adjusted EBITDA is a non-IFRS measure as described in the Non-IFRS Financial Measures section of this MD&A.

### Revenue

The Company currently derives a majority of its revenue from contract services with a G10 central bank. 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 contract services incorporate both nano-optic and optical thin film technologies and are focused on developing authentication features for future banknotes. While the Company is progressing toward the goal of incorporating a Nanotech security feature on this customer's banknote, there is inherent variability in the timing and scope of contract services. Revenues from this customer declined \$216,703 or 15% in the three months ended March 31, 2020 compared to the same period last year. For the six months ended March 31, 2020, revenues from this customer declined by \$468,376 or 16% compared to the same period last year.

Total revenue for the three months ended March 31, 2020 decreased by \$209,487 or 13% to \$1,384,516, compared to \$1,594,003 in the same period last year, due to lower contract services partially offset by a modest increase in product revenue in the current period.

Total revenue for the six months ended March 31, 2020 decreased by \$271,234 or 9% to \$2,854,442, compared to \$3,125,676 in the same period last year primarily due to reduced development contract revenue in the current period, partially offset by increased product revenue. Product revenue increased by \$197,142 or 116% as the Company delivered twelve product sales in the current period compared to five in the same period last year.

### Gross Margin

Gross margin for the three months ended March 31, 2020 decreased by \$143,546 or 11% to \$1,133,106, compared to \$1,276,652 in the same period last year as a result of the reduction in total revenue. The gross margin percentage was 82% for the three months ended March 31, 2020, up from 80% in the same period last year. This increase was primarily due to higher margins on contract services in the current quarter.

# Nanotech Security Corp.

Management's Discussion and Analysis

For the three and six months ended March 31, 2020

---

Gross margin for the six months ended March 31, 2020 decreased by \$149,554 or 6% to \$2,297,223, compared to \$2,446,777 in the same period last year as a result of the reduction in total revenue. The gross margin percentage was 80% for the six months ended March 31, 2020, up from 78% in the same period last year primarily due to higher margins on contract services in the current period.

## Research and Development

Research and development expenditures for the three months ended March 31, 2020 were \$556,096 an increase of \$153,557 or 38%, compared to \$402,539 in the same period last year. This increase was primarily due to increased equipment maintenance costs, including salary expenses for staff working on preventive maintenance, as well as increased professional fees in the current period.

Research and development expenditures for the six months ended March 31, 2020 were \$958,028 an increase of \$219,378 or 30%, compared with \$738,650 in the same period last year. This increase was primarily due to increased salary expense and equipment maintenance costs as well as increased professional fees in the current period, partially offset by a write-down of inventory in the prior period.

## General and Administration

General and administration expenditures for the three months ended March 31, 2020 were \$606,950, consistent with \$587,183 in the same period last year.

General and administration expenditures for the six months ended March 31, 2020 were \$1,197,370, an increase of \$72,620 or 7%, compared to \$1,124,750 in the same period last year. The increase was primarily related to increased salary expense and professional fees in the current period, partially offset by reduced rent expense as the Company transitioned to new lease accounting under IFRS16-Leases ("IFRS 16") as well as a decrease in share-based compensation expense in the current period.

## Sales and Marketing

Sales and marketing expenditures for the three and six months ended March 31, 2020 were \$651,693 and \$1,237,743 respectively, compared with \$528,830 and \$973,544 respectively in the same period last year. Sales and marketing expenditures for the current quarter were \$122,863 or 23% higher than the prior period, and \$264,199 or 27% higher for the year to date. These increases were related to higher salaries and benefits expenses as well as increased travel and marketing costs in the current period.

## Depreciation and Amortization

Depreciation and amortization expenditures for the three and six months ended March 31, 2020 were \$402,512 and \$773,001 respectively, compared to \$385,535 and \$756,294 respectively in the same period last year, which reflects the additional depreciation recorded for right-of-use leased assets, in combination with reduced depreciation under the Company's declining balance depreciation method.

## Restructuring Costs

On December 21, 2018, the Board implemented an executive transition plan, under which Mr. Doug Blakeway, the former CEO, transitioned his responsibilities to Mr. Troy Bullock. Under the terms of this transition plan, Mr. Blakeway's executive services consulting agreement was terminated, triggering termination benefits as laid out in the agreement: two years base salary, a pro-rated performance bonus, and vesting of all outstanding share-based awards. The Company incurred restructuring costs of \$815,700 for the six month period ended March 31, 2019, of which \$92,200 represented share-based compensation related to the accelerated vesting of Mr. Blakeway's restricted share units ("RSUs").

In January 2019, termination benefits were paid and 187,500 shares were issued to Mr. Blakeway upon vesting of his RSUs. Restructuring costs of \$nil remain accrued as at March 31, 2020 (September 30, 2019 - \$84,375).

## Other Income

Other income for the three months ended March 31, 2020 was \$110,812, a decrease of \$39,617 compared to other income of \$150,429 in the same period last year. Other income for the six months ended March 31, 2020 was \$113,096, a decrease of \$240,149 compared to other income \$353,245 in the same period last year.

# Nanotech Security Corp.

Management's Discussion and Analysis  
For the three and six months ended March 31, 2020

The decrease in both periods was primarily due to a reduction in tenant and steam income, as the tenant renting warehouse space in the Company's Thurso facility filed for CCAA protection, resulting in a write down of certain tenant and steam receivables. As of March 31, 2020, both the tenant and steam agreements have been terminated, and the Company may not recognize tenant or steam income moving forward. Interest expense recorded in the current periods also increased as a result of the transition to new lease accounting under IFRS 16. These decreases in other income were partially offset by increased foreign exchange gain in the current periods as a result of higher fluctuations in exchange rates compared to the same period last year.

## Adjusted EBITDA

Adjusted EBITDA for the three and six months ended March 31, 2020 was negative \$576,484 and negative \$836,947 respectively, compared to positive \$45,027 and positive \$162,658 respectively, during the same periods last year. The decrease was primarily due to reduced revenue in the current year in combination with increased research and development expenses and sales and marketing expenses and a reduction in other income.

## Net Loss

Net loss for the three months ended March 31, 2020 was \$973,333, compared to net loss of \$477,006 during the same period last year. The increase in net loss was primarily due to reduced revenue in combination with higher operating costs and a reduction in other income in the current period.

Net loss for the six months ended March 31, 2020 was \$1,755,823, compared to net loss of \$1,608,916 in the same period last year. The increase in net loss was primarily due to reduced revenue in current period in combination with higher operating costs and a reduction in other income, partially offset by the decrease in one time restructuring costs related to the executive transition in fiscal 2019.

## QUARTERLY RESULTS

	Q2 2020	Q1 2020	Q4 2019	Q3 2019	Q2 2019	Q1 2019	Q4 2018	Q3 2018
(\$ thousands, except per share data)								
Revenue <sup>(1)</sup>	\$1,385	\$1,470	\$1,450	\$1,827	\$1,594	\$1,532	\$3,000	\$1,769
Net income (loss) from continuing operations	(973)	(782)	(705)	(521)	(477)	(1,132)	770	(456)
Net income (loss)	(973)	(782)	(705)	(521)	(477)	(1,132)	770	(627)
Adjusted EBITDA <sup>(2)</sup>	(576)	(260)	(299)	17	45	118	1,306	100
Basic earnings (loss) per share:								
Continuing operations	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	0.01	(0.01)
Net income (loss)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	0.01	(0.01)
Diluted earnings (loss) per share:								
Continuing operations	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	0.01	(0.01)
Net income (loss)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	0.01	(0.01)

<sup>(1)</sup>Reflects the full retrospective application of IFRS 15, which was adopted October 1, 2018. For further information, see note 2(a) of the condensed interim financial statements for the three and six months ended March 31, 2020.

<sup>(2)</sup>Adjusted EBITDA is a non-IFRS measure as described in the Non-IFRS Financial Measures section of this MD&A.

Revenue and Adjusted EBITDA were impacted by the timing and scope of contract services and the timing of recurring LumaChrome orders in the quarters presented. There is inherent variability in contract revenue with government organizations and in the receipt of recurring LumaChrome orders. Net income (loss) from continuing operations and net income (loss) were further affected by restructuring costs in the first quarter of 2019. There are no seasonal effects in the Company's business over the quarters presented.

# Nanotech Security Corp.

Management's Discussion and Analysis  
For the three and six months ended March 31, 2020

## RELATED PARTY TRANSACTIONS

For the three and six months ended March 31, 2020 and 2019, 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 March 31		Six months ended March 31	
	2020	2019	2020	2019
Salaries, accrued bonuses, employee benefits and director fees	\$ 193,944	\$ 139,350	\$ 387,888	\$ 305,932
Share-based payments	59,436	59,738	140,126	162,591
Restructuring costs	-	-	-	815,700
	\$ 253,380	\$ 199,088	\$ 528,014	\$ 1,284,223

- (b) As at March 31, 2020, amounts owing to directors for director fees and expense reimbursements included in accounts payable and accrued liabilities were \$38,547 (September 30, 2019 - \$47,622).
- (c) As at March 31, 2020, amounts owing to a company controlled by a director of the Company included in accounts payable and accrued liabilities were \$nil (September 30, 2019 - \$84,375). The payables as at September 30, 2019 represent amounts owed upon the termination of an executive services consulting agreement.
- (d) Legal and professional fees, taxes and disbursements totaling \$nil for the three and six months ended March 31, 2020 (March 31, 2019 - \$24,908 and \$39,414 for the three and six months respectively) were incurred with a law firm of which a director of the Company was at the time a partner.

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 any potential shortfall from operations, working capital, and capital expenditures. Cash is also used to finance other long-term strategic business initiatives.

### Summary of Statements of Cash Flows

	Three months ended March 31		Six months ended March 31	
	2020	2019	2020	2019
Cash provided by (used in) continuing operations	\$ (26,968)	\$ (755,108)	\$ (586,531)	\$ 538,539
Cash used in discontinued operations	-	(4,925)	-	(4,977)
Cash provided by (used in) operating activities	(26,968)	(760,033)	(586,531)	533,562
Cash used in investing activities	(276,364)	(25,605)	(535,069)	(76,081)
Cash used in financing activities	(34,109)	-	(68,839)	-
Effect of foreign exchange on cash and cash equivalents	24,334	(49,461)	43,848	(21,870)
Cash and cash equivalents, beginning of period	1,918,518	3,285,474	2,752,002	2,014,764
Cash and cash equivalents, end of period	\$ 1,605,411	\$ 2,450,375	\$ 1,605,411	\$ 2,450,375

# Nanotech Security Corp.

Management's Discussion and Analysis  
For the three and six months ended March 31, 2020

---

## Operating Activities

Cash used in operating activities was \$26,968 for the three months ended March 31, 2020, compared to cash used in operating activities of \$760,033 for the same period last year. The decrease in cash used in operating activities was primarily due to the payment of certain restructuring costs in the prior period in combination with a decrease in accounts receivable in the current period.

Cash used in operating activities was \$586,531 for the six months ended March 31, 2020, compared to cash provided by operating activities of \$533,562 for the same period last year. The difference was a result of increased net loss during the current period, partially offset by a decrease in accounts receivable in the current period.

In 2017, the directors of the Company made the determination to pursue the sale of its subsidiary, Tactical Technologies Inc. ("Tactical"), to a third party. 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 cash flows for the three and six month periods ended March 31, 2019 includes the effects of extinguishment of remaining liabilities pursuant to the disposal.

## Investing Activities

Cash used in investing activities for the three and six months ended March 31, 2020 was \$276,364 and \$535,069, compared to \$25,605 and \$76,081 used in the same period last year. In 2020, the Company expanded its manufacturing footprint within the Thurso production facility, resulting in an increase in capital expenditures compared to the same periods in the prior year.

## Financing Activities

Cash used in financing activities for the three and six months ended March 31, 2020 was \$34,109 and \$68,839, which represents the payment of the lease liability recorded upon adoption of IFRS 16.

## 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 operations, and future significant capital investment opportunities. For the three and six months ended March 31, 2020, there were no changes in our approach to capital management. Management will continue to safeguard liquid assets in the short-term to weather the COVID-19 pandemic, while also making capital and other investments required for the long-term operation of the business. The Company is well-positioned with liquid assets of \$9.2 million at quarter end and no debt.

The Company's liquid assets were as follows:

	March 31, 2020	September 30, 2019
Cash	\$ 656,378	\$ 752,911
Cash equivalents	949,033	1,999,091
Short-term investments	7,612,483	7,537,262
	<u>\$ 9,217,894</u>	<u>\$ 10,289,264</u>

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

The Company had commitments of \$1,669,764 as at March 31, 2020, primarily for equipment purchases, operating costs in respect of leased office space and contracted equipment maintenance. Management has reviewed its projected funding requirements for the next twelve months and expects that, through the



# Nanotech Security Corp.

Management's Discussion and Analysis  
For the three and six months ended March 31, 2020

generation and collection of revenues, the Company will maintain sufficient liquidity to meet its requirements.

## 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), foreign exchange gain (loss), income taxes, depreciation and amortization, share-based compensation, and restructuring costs. The Company believes Adjusted EBITDA is a useful measure as 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, as well as 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, liquidity or cash flows. The Company's method of calculating these measures may differ from methods used by other entities and accordingly Nanotech's 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 March 31		Six months ended March 31	
	2020	2019	2020	2019
Net loss	\$ (973,333)	\$ (477,006)	\$(1,755,823)	\$(1,608,916)
Finance income	(28,161)	(48,592)	(61,606)	(100,965)
Foreign exchange (gain) loss	(92,102)	16,806	(69,459)	(30,338)
Depreciation and amortization	410,873	396,000	806,841	781,369
Share-based compensation	106,239	157,819	243,100	305,808
Restructuring costs	-	-	-	815,700
Adjusted EBITDA	\$ (576,484)	\$ 45,027	\$ (836,947)	\$ 162,658

## Financial Instruments

The Company considers the management of financial risk to be an important part of its overall corporate risk management policy. The nature and extent of risks arising from financial instruments and their related risk management are described in note 13 of the consolidated financial statements for the year ended September 30, 2019. In the three and six months ended March 31, 2020, there was no material change to the nature of the risks arising from our classification of financial instruments or related risk management objectives. Management is monitoring the impact of COVID-19 on credit risk and will mitigate any increased customer-specific risk with either credit insurance or prepayment, where appropriate.

# Nanotech Security Corp.

Management's Discussion and Analysis  
For the three and six months ended March 31, 2020

## CAPITAL STRUCTURE AND OUTSTANDING SHARE DATA

The Company maintains an equity incentive plan consisting of a stock option plan and an 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.

	March 31, 2020		September 30, 2019	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Common shares outstanding	69,200,125		69,200,125	
Options				
Outstanding	4,608,200	\$ 0.76	3,535,000	\$ 0.95
Exercisable	3,027,075	\$ 0.91	2,628,750	\$ 1.05
RSUs				
Outstanding	502,834	N/A	225,502	N/A

As at May 7, 2020, the Company has 69,200,125 common shares issued and outstanding. There are no preferred shares issued and outstanding.

## SIGNIFICANT ACCOUNTING POLICIES

### 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. The Company adopted the standard on October 1, 2019, using the modified retrospective approach. The modified retrospective approach applies the requirements of the standard retrospectively with the cumulative effects of initial application recorded in opening accumulated deficit as at October 1, 2019, and no restatement of the comparative period.

On October 1, 2019, the Company had two real estate leases which were impacted by the adoption of the standard. The Company recognized right-of-use assets of \$780,767, net of tenant inducements of \$35,001, and lease liabilities of \$815,768 related to these leases. The right-of-use assets are depreciated on a straight-line basis over the remaining lease term. The lease liability is carried at amortized cost with a finance charge recorded using the effective interest rate method. The depreciation expense of the right-of-use assets and the finance charge of the lease liability partially replaced the lease-related expenses recorded in general and administration expense. In relation to the leases under IFRS 16, the Company recognized depreciation expense of \$47,041 and \$92,060 and finance costs of \$11,671 and \$22,722 for the three and six months ended March 31, 2020 respectively, compared to general and administration expense of \$51,710 and \$103,421 for the three and six months ended March 31, 2019 respectively.

On November 6, 2019, the Company signed a lease extension and modification agreement to combine its two leases and extend the term to April 30, 2025. As required by the standard, the Company remeasured the lease liability by discounting the revised lease payments using an incremental borrowing rate of 4.5% and made a corresponding adjustment to the right-of-use asset of \$267,778.

Upon adoption of IFRS 16, the Company updated its lease accounting policy as follows:

The Company assesses whether a contract is or contains a lease at the inception of the contract. Leases are recognized as a right-of-use asset and corresponding lease liability at the lease commencement date. The lease liability is measured at the present value of the future fixed payments and variable lease payments that depend on an index or rate over the lease term, less any lease incentives receivable, discounted using the lessee's incremental borrowing rate, unless the implicit interest rate in the lease can be easily determined. Lease liabilities are subsequently measured at amortized cost using the effective

# Nanotech Security Corp.

Management's Discussion and Analysis

For the three and six months ended March 31, 2020

---

interest rate method. Lease terms applied are the contractual non-cancellable periods of the lease, plus periods covered by renewal or termination options, if the Company is reasonably certain to exercise those options. Lease liabilities are remeasured (with a corresponding adjustment to the right-of-use asset) when there is a change in the lease term, a change in the future lease payments resulting from a change in an index or rate used to determine those payments, or when the lease contract is modified and the lease modification is not accounted for as a separate lease.

The right-of-use assets include the initial measurement of the corresponding lease liabilities, lease payments at or before the commencement date, any initial direct costs, less any lease incentives received before the commencement date. The right-of-use assets are subsequently measured at cost and are depreciated on a straight-line basis from the date the underlying asset is available for use over the five year lease term.

The Company has elected not to recognise right-of-use assets and lease liabilities for leases of low value assets and short-term leases. The Company recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

## SUBSEQUENT EVENT

In March 2020, the COVID-19 outbreak was declared a pandemic by the World Health Organization. The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and Nanotech's business are not known at this time. This could include an impact on the Company's ability to obtain debt and equity financing, impairment in the value of long-lived assets, or potential future decrease in revenue or the profitability of Nanotech's operations.

As of the date of this MD&A, the Company's Thurso, Quebec production facility and Burnaby, BC office and laboratories are fully operational, with appropriate health and safety measures implemented. The Company's contract services are not currently expected to be impacted by COVID-19. Product revenue for the second half of fiscal 2020 may be impacted based on the timing of receipt of purchase orders.

## ADDITIONAL INFORMATION

### Strategic Update

The Company is pursuing future revenue growth by focusing on product sales opportunities in the government and banknote market and in the brand protection market. To achieve this, management previously established the following targets for fiscal 2020:

- **Revenue diversification.** Increase product revenue by generating sales of nano-optic products, expanding product lines and pursuing further growth opportunities for LumaChrome™ colour-shifting film.

In the first half of fiscal 2020, Nanotech recorded product revenue from twelve delivered customer orders, compared to fourteen for the full year 2019. These orders were predominantly for LumaChrome and included film for one new banknote and one new government ID application. In addition, the Company worked with several partners to qualify its LumaChrome product on four new banknote opportunities.

In the brand protection market, the Company delivered its first LiveOptik sale in the licensing vertical to the World Baseball Softball Confederation and worked with a partner to deliver film for a new commercial application. Although these initial orders are small, they have opportunities to become recurring orders and to grow in the future. During the second quarter of 2020, the Company also filled a LiveOptik product order for approximately 7.0 million labels in a confidential brand protection application.

- **Develop strategic sales relationships.** Expand the Company's sales reach by partnering with more established OEMs to promote Nanotech's products to their existing customer bases.

The Company has made significant progress in strengthening our sales partnerships. In the brand protection market, management partnered with two United States channel partners who are now marketing Nanotech's LiveOptik™ products. In the government and banknote market, management

# Nanotech Security Corp.

Management's Discussion and Analysis

For the three and six months ended March 31, 2020

---

is working with a key OEM partner to design a marketing housenote to enable this partner to begin marketing KolourOptik® products later this year.

- **Develop strategic manufacturing and product partnerships.** Partner with select manufacturers that have a proven track record of excellence to reduce the manufacturing risk associated with scaling product sales and to expand the Company's product lines.

The Company has partnered with a large OEM partner to produce LiveOptik products for the brand protection market. Nanotech's products have expanded to include foils, labels, QR codes, and track and trace capability as a result of its manufacturing partnerships. Outsourcing LiveOptik manufacturing also enables the Company to focus on its core capabilities in technology development.

In the government and banknote market, management is in the process of qualifying a world class OEM manufacturing partner for its KolourDepth products. Management expects to have this finalized within the next six months, enabling the Company to deliver on large volume banknote opportunities.

## Outlook

Management's commercialization strategy has shown great progress as the Company continues to expand its product lines for both the government and banknote and brand protection markets. In the government and banknote market there is serious interest in Nanotech's KolourOptik and LumaChrome OTF products, and the development contract is progressing well. The Company entered the brand protection market approximately one year ago and has already gained strong reference customer wins and built a solid pipeline of opportunities. The overall growth in product revenue demonstrates that although the commercialization strategy is in the early stages it is gaining traction.

Although the COVID-19 pandemic has not significantly impacted Nanotech's ability to deliver to customers, the sales team is seeing a general slowdown in access to customers and a tendency for customers to defer ordering decisions. As a result, management estimates approximately \$2.0 million in opportunities from the pipeline has been deferred to fiscal 2021. However, due to the success of Nanotech's commercialization strategy in the first half of 2020 and projected growth in contract services revenue in the second half of 2020, even during this unprecedented pandemic, management is still anticipating annual revenue growth in the 10% to 20% range.

The Company continues to make further investments in its sales and marketing team and initiatives to expand Nanotech's market reach. During the first half of fiscal 2020, these investments included rebranding the Company and its products, launching a new website, significantly increasing marketing materials, increasing lead generation activities, and increasing sales activity around several key customers. Management expects to add to the sales, marketing and research and development teams in the coming quarters to increase Nanotech's sales reach in the brand protection market and to enhance product development.

In the near-term, management expects that Adjusted EBITDA losses will continue as the Company continues to invest in marketing and product development activities to drive future revenue growth. Quarterly results may vary significantly depending on the timing of new product orders and recurring LumaChrome orders. With a strong balance sheet, including \$9.2 million in cash and short-term investments and no debt, the Company is well positioned to continue to pursue its product-based sales and marketing strategies in 2020.

## Public Securities Filings

Additional information about Nanotech can be found at the Company's website [www.nanosecurity.ca](http://www.nanosecurity.ca), the Canadian disclosure filings website [www.sedar.com](http://www.sedar.com) or the OTCMarkets disclosure filings website [www.otcmarkets.com](http://www.otcmarkets.com).

Condensed Interim Financial Statements of

**Nanotech Security Corp.**

Three and six months ended March 31, 2020 and 2019  
(Unaudited)

# Nanotech Security Corp.

Condensed Interim Statements of Operations and Comprehensive Loss  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

	Three months ended March 31		Six months ended March 31	
	2020	2019	2020	2019
Revenue (note 2(a) and note 10)	\$ 1,384,516	Adjusted note 2(a) \$ 1,594,003	\$ 2,854,442	Adjusted note 2(a) \$ 3,125,676
Cost of sales (note 11)	251,410	317,351	557,219	678,899
	1,133,106	1,276,652	2,297,223	2,446,777
Expenses (note 11)				
Research and development	556,096	402,539	958,028	738,650
General and administration	606,950	587,183	1,197,370	1,124,750
Sales and marketing	651,693	528,830	1,237,743	973,544
Depreciation and amortization	402,512	385,535	773,001	756,294
Restructuring costs (note 12)	-	-	-	815,700
	2,217,251	1,904,087	4,166,142	4,408,938
Loss from operations before other (income) expenses	(1,084,145)	(627,435)	(1,868,919)	(1,962,161)
Other (income) expenses				
Foreign exchange (gain) loss	(92,102)	16,806	(69,459)	(30,338)
Finance income (note 6)	(28,161)	(48,592)	(61,606)	(100,965)
Tenant income	(11,844)	(66,904)	(56,276)	(126,082)
Steam (income) expense (note 2(a))	21,295	(51,739)	74,245	(95,860)
	(110,812)	(150,429)	(113,096)	(353,245)
Net loss and total comprehensive loss	\$ (973,333)	\$ (477,006)	\$ (1,755,823)	\$ (1,608,916)
Basic and diluted loss per share:				
Net loss	\$ (0.01)	\$ (0.01)	\$ (0.03)	\$ (0.02)
Weighted average number of common shares				
Basic and diluted	69,200,125	68,898,584	69,200,125	68,834,344

See accompanying notes to the condensed interim financial statements.

# Nanotech Security Corp.

Condensed Interim Statements of Financial Position  
(Unaudited)

(In Canadian dollars)

	March 31, 2020	September 30, 2019
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents (note 9(c))	\$ 1,605,411	\$ 2,752,002
Short-term investments (note 4)	7,612,483	7,537,262
Accounts receivable	531,043	503,660
Inventory (note 5)	159,253	237,264
Prepaid expenses and other assets	333,391	419,753
	<u>10,241,581</u>	<u>11,449,941</u>
Property, plant and equipment	15,485,367	15,684,845
Goodwill	1,388,458	1,388,458
Right-of-use asset (note 3)	956,485	-
	<u>\$ 28,071,891</u>	<u>\$ 28,523,244</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities	\$ 1,142,905	\$ 1,232,159
Deposit	530,368	543,368
Deferred revenue	165,000	-
Current portion of lease liability (note 3)	164,827	-
	<u>2,003,100</u>	<u>1,775,527</u>
<b>Non-current liabilities:</b>		
Tenant inducement	-	16,083
Lease liability (note 3)	849,880	-
	<u>2,852,980</u>	<u>1,791,610</u>
<b>Shareholders' equity</b>		
Share capital (note 7(a))	62,355,479	62,355,479
Contributed surplus (note 7(b))	3,373,952	3,130,852
Deficit	(40,510,520)	(38,754,697)
	<u>25,218,911</u>	<u>26,731,634</u>
	<u>\$ 28,071,891</u>	<u>\$ 28,523,244</u>

Related party transactions (note 8)

Commitments (note 14)

See accompanying notes to the condensed interim financial statements.

Approved on behalf of the Board of Directors:

"Neil McDonnell"

Neil McDonnell, Director

"Ronan McGrath"

Ronan McGrath, Director

# Nanotech Security Corp.

Condensed Interim Statements of Changes in Shareholders' Equity  
(Unaudited)

Six months ended March 31, 2020 and 2019  
(In Canadian dollars)

	Number of shares	Share capital	Contributed surplus	Deficit	Total shareholders' equity
<b>Balance as at October 1, 2018</b>	68,771,501	\$ 61,892,395	\$ 2,930,964	\$ (35,919,443)	\$ 28,903,916
Net loss	-	-	-	(1,608,916)	(1,608,916)
RSUs vested (note 7(b)(ii))	187,500	188,070	(188,070)	-	-
Share-based compensation - options (note 7(b)(i))	-	-	197,908	-	197,908
Share-based compensation - RSUs (note 7(b)(ii) and note 12)	-	-	200,100	-	200,100
<b>Balance as at March 31, 2019</b>	68,959,001	\$ 62,080,465	\$ 3,140,902	\$ (37,528,359)	\$ 27,693,008
<b>Balance as at October 1, 2019</b>	69,200,125	\$ 62,355,479	\$ 3,130,852	\$ (38,754,697)	\$ 26,731,634
Net loss	-	-	-	(1,755,823)	(1,755,823)
Share-based compensation - options (note 7(b)(i))	-	-	189,225	-	189,225
Share-based compensation - RSUs (note 7(b)(ii))	-	-	53,875	-	53,875
<b>Balance as at March 31, 2020</b>	69,200,125	\$ 62,355,479	\$ 3,373,952	\$ (40,510,520)	\$ 25,218,911

See accompanying notes to the condensed interim financial statements.



# Nanotech Security Corp.

Condensed Interim Statements of Cash Flows  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

	Three months ended March 31		Six months ended March 31	
	2020	2019	2020	2019
Cash flows provided by (used in):				
Operating activities:				
Net loss	\$ (973,333)	\$ (477,006)	\$ (1,755,823)	\$ (1,608,916)
Items not involving cash:				
Depreciation and amortization (note 11)	410,873	396,000	806,841	781,369
Share-based compensation (note 11 and note 12)	106,239	250,019	243,100	398,008
Unrealized foreign exchange gain (loss)	(11,491)	50,285	(35,969)	17,224
Finance income (note 6)	(28,161)	(48,592)	(61,606)	(100,965)
Other	(5,520)	(11,651)	(6,101)	(17,365)
Non-cash working capital changes (note 9(a))	478,714	(930,166)	159,891	1,009,366
Interest paid on lease liability	(11,671)	-	(22,722)	-
Interest received	7,382	16,003	85,858	59,818
	(26,968)	(755,108)	(586,531)	538,539
Net cash used in discontinued operations (note 13)	-	(4,925)	-	(4,977)
Cash provided by (used in) operating activities	(26,968)	(760,033)	(586,531)	533,562
Investing activities:				
Purchase of property and equipment (note 9(d))	(276,364)	(22,366)	(464,419)	(47,906)
Net acquisition of short-term investments	-	(3,239)	(70,650)	(28,175)
Cash used in investing activities	(276,364)	(25,605)	(535,069)	(76,081)
Financing activities:				
Repayment of lease liability	(34,109)	-	(68,839)	-
Cash used in financing activities	(34,109)	-	(68,839)	-
Effect of foreign exchange on cash and cash equivalents	24,334	(49,461)	43,848	(21,870)
Increase (decrease) in cash and cash equivalents	(313,107)	(835,099)	(1,146,591)	435,611
Cash and cash equivalents, beginning of period	1,918,518	3,285,474	2,752,002	2,014,764
Cash and cash equivalents, end of period	\$ 1,605,411	\$ 2,450,375	\$ 1,605,411	\$ 2,450,375

See supplementary cash flow information (note 9)

See accompanying notes to the condensed interim financial statements.

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

---

## 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 protection applications across a wide range of markets including banknotes, secure government documents, and commercial branding.

## 2. Basis of preparation

### (a) *Statement of compliance*

These condensed 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 audited consolidated financial statements, with the exception of a new accounting policy that was adopted on October 1, 2019 as described in note 3.

These condensed 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 audited consolidated financial statements for the year ended September 30, 2019.

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

For the three and six months ended March 31, 2019, revenue and cost of sales were adjusted to reflect the reclassification of steam from revenue to other income under IFRS 15 – *Revenue from Contracts with Customers*. There was no impact on net loss and total comprehensive loss.

Revenue for the three months ended March 31, 2019 was previously reported as \$1,915,881 and adjusted to \$1,594,003, due to a reclassification of \$321,878 to other income. Cost of sales was previously reported as \$587,490 and adjusted to \$317,351, due to a reclassification of \$270,139 to other income.

Revenue for the six months ended March 31, 2019 was previously reported as \$3,639,758 and adjusted to \$3,125,676, due to a reclassification of \$514,082 to other income. Cost of sales was previously reported as \$1,097,121 and adjusted to \$678,899, due to a reclassification of \$418,222 to other income.

These condensed interim financial statements were approved and authorized for issue by the Company’s Board of Directors on May 6, 2020.

### (b) *Basis of measurement*

These condensed interim financial statements are presented in Canadian dollars and have been prepared on a historical cost basis.

## 3. Change in accounting policy

### *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. The Company adopted the standard on October 1, 2019, using the modified retrospective approach. The modified retrospective approach applies the requirements of the standard

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

## 3. Change in accounting policy (continued)

### *IFRS 16 – Leases (continued)*

retrospectively with the cumulative effects of initial application recorded in opening accumulated deficit as at October 1, 2019, and no restatement of the comparative period.

On October 1, 2019, the Company had two real estate leases for office space which were impacted by the adoption of the standard. The Company recognized right-of-use assets of \$780,767, net of tenant inducements of \$35,001, and lease liabilities of \$815,768 related to these leases. The right-of-use assets are depreciated on a straight-line basis over the remaining lease term. The lease liability is carried at amortized cost with a finance charge recorded using the effective interest rate method. The depreciation expense of the right-of-use assets and the finance charge of the lease liability partially replaced the lease-related expenses recorded in general and administration expense. In relation to the leases under IFRS 16, the Company recognized depreciation expense of \$47,041 and \$92,060 and finance costs of \$11,671 and \$22,722 for the three and six months ended March 31, 2020 respectively, compared to general and administration expense of \$51,710 and \$103,421 for the three and six months ended March 31, 2019 respectively.

The following table reconciles the operating lease commitments included in the September 30, 2019 commitments note to the lease liability recorded on transition as at October 1, 2019.

Operating lease commitments as at September 30, 2019	\$	281,029
Discounted using the incremental borrowing rate as at October 1, 2019		(17,990)
Lease liabilities recognized as at October 1, 2019		263,039
Extension options reasonably certain to be exercised		552,729
Lease liabilities recognized as at October 1, 2019	\$	815,768

On November 6, 2019, the Company signed a lease extension and modification agreement to combine its two leases and extend the term to April 30, 2025. As required by the standard, the Company remeasured the lease liability by discounting the revised lease payments using an incremental borrowing rate of 4.5% and made a corresponding adjustment to the right-of-use asset of \$267,778.

The following table reconciles the change in the right-of-use asset for the period ended March 31, 2020.

Balance on transition, October 1, 2019	\$	780,767
Lease modification		267,778
Depreciation		(92,060)
Balance as at March 31, 2020	\$	956,485

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

## 3. Change in accounting policy (continued)

### *IFRS 16 – Leases (continued)*

The following table reconciles the change in the lease liability and discloses a maturity analysis of the lease liability for the period ended March 31, 2020.

Balance on transition, October 1, 2019	\$	815,768
Lease modification		267,778
Accretion of lease liability (note 6)		22,722
Repayment of principal and interest		(91,561)
Balance as at March 31, 2020	\$	1,014,707
Minimum lease payments:		
Less than one year	\$	207,246
Between one and five years		934,409
		1,141,655
Less future finance charges		(126,948)
	\$	1,014,707
Current portion		
Non-current portion	\$	164,827
Balance as at March 31, 2020	\$	1,014,707

Upon adoption of IFRS 16, the Company updated its lease accounting policy as follows:

The Company assesses whether a contract is or contains a lease at the inception of the contract. Leases are recognized as a right-of-use asset and corresponding lease liability at the lease commencement date. The lease liability is measured at the present value of the future fixed payments and variable lease payments that depend on an index or rate over the lease term, less any lease incentives receivable, discounted using the lessee's incremental borrowing rate, unless the implicit interest rate in the lease can be easily determined. Lease liabilities are subsequently measured at amortized cost using the effective interest rate method. Lease terms applied are the contractual non-cancellable periods of the lease, plus periods covered by renewal or termination options, if the Company is reasonably certain to exercise those options. Lease liabilities are remeasured (with a corresponding adjustment to the right-of-use asset) when there is a change in the lease term, a change in the future lease payments resulting from a change in an index or rate used to determine those payments, or when the lease contract is modified and the lease modification is not accounted for as a separate lease.

The right-of-use assets include the initial measurement of the corresponding lease liabilities, lease payments at or before the commencement date, any initial direct costs, less any lease incentives received before the commencement date. The right-of-use assets are subsequently measured at cost and are depreciated on a straight-line basis from the date the underlying asset is available for use over the five year lease term.

The Company has elected not to recognise right-of-use assets and lease liabilities for leases of low value assets and short-term leases. The Company recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

## 4. Short-term investments

Short-term investments of \$7,612,483 (September 30, 2019 - \$7,537,262) consist of cashable term deposits held with a Canadian chartered bank. The term deposits have maturity dates between April 17, 2020 and December 22, 2020. Interest rates range between 2.01% and 2.02%.

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

## 5. Inventory

	March 31, 2020	September 30, 2019
Raw materials	\$ 132,176	\$ 134,435
Work in progress	25,362	100,087
Finished goods	1,715	2,742
	\$ 159,253	\$ 237,264

There were inventory write-downs of \$nil during the three and six months ended March 31, 2020 (March 31, 2019 - \$nil and \$47,513 for the three and six months respectively).

For the three months ended March 31, 2020, the Company recognized inventories of \$40,198 (March 31, 2019 - \$37,974) as expensed through cost of sales. For the six months ended March 31, 2020, the Company recognized inventories of \$183,313 (March 31, 2019 - \$83,667) as expensed through cost of sales.

## 6. Finance income

	Three months ended March 31		Six months ended March 31	
	2020	2019	2020	2019
Interest income from cash and cash equivalents and short-term investments	\$ (42,782)	\$ (50,661)	\$ (89,768)	\$ (105,107)
Interest paid on lease liability	11,671	-	22,722	-
Other interest expenses	2,950	2,069	5,440	4,142
	\$ (28,161)	\$ (48,592)	\$ (61,606)	\$ (100,965)

## 7. 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, 2019 and March 31, 2020	69,200,125	\$ 62,355,479

There are no preferred shares issued and outstanding.

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

## 7. 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% of the outstanding shares, less any shares reserved for issuance under the restricted share unit ("RSU") plan. The following stock options were outstanding as at March 31, 2020:

	Number of options	Weighted average exercise price
Balance as at September 30, 2019	3,535,000	\$ 0.95
Granted	1,479,000	0.40
Forfeited	(25,000)	0.45
Expired	(380,800)	1.12
Balance as at March 31, 2020	4,608,200	\$ 0.76

The following table summarizes information pertaining to the Company's stock options outstanding as at March 31, 2020.

Range of exercise prices	Options outstanding			Options exercisable	
	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
\$0.00 - \$0.50	1,454,000	4.71	\$ 0.40	363,500	\$ 0.40
\$0.51 - \$0.75	1,652,500	3.49	0.61	1,186,875	0.61
\$1.01 - \$1.25	786,700	1.42	1.13	761,700	1.13
\$1.26 - \$1.50	715,000	2.00	1.42	715,000	1.42
	4,608,200	3.29	\$ 0.76	3,027,075	\$ 0.91

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 three and six month periods ended March 31, 2020 and 2019.

	Three months ended March 31		Six months ended March 31	
	2020	2019	2020	2019
Risk free interest rate	-	1.9%	1.5%	2.2%
Expected life	-	4.3	5.0	4.9
Expected volatility	-	45.7%	51.4%	44.7%
Expected dividends	Nil	Nil	Nil	Nil
Average fair value	-	\$0.24	\$0.18	\$0.22

For the three and six months ended March 31, 2020 and 2019, the Company charged the following share-based payments to operating expenses in connection with the Company's stock option plan, with a corresponding increase in contributed surplus:

	Three months ended March 31		Six months ended March 31	
	2020	2019	2020	2019
Total compensation - stock options	\$ 73,327	\$ 102,024	\$ 189,225	\$ 197,908

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

## 7. Share capital (continued)

### (b) Share-based payment plans (continued)

#### (ii) Restricted share unit plan

RSUs outstanding as at March 31, 2020:

	Number of RSUs
Balance as at September 30, 2019	225,502
Forfeited	(14,147)
Granted	291,479
Balance as at March 31, 2020	502,834

For the three and six months ended March 31, 2020 and 2019, 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 March 31		Six months ended March 31	
	2020	2019	2020	2019
Total compensation - RSUs	\$ 32,912	\$ 147,995	\$ 53,875	\$ 200,100

## 8. Related party transactions

### (a) Remuneration of key management personnel

	Three months ended March 31		Six months ended March 31	
	2020	2019	2020	2019
Salaries, accrued bonuses, employee benefits and director fees	\$ 193,944	\$ 139,350	\$ 387,888	\$ 305,932
Share-based payments	59,436	59,738	140,126	162,591
Restructuring costs (note 12)	-	-	-	815,700
	\$ 253,380	\$ 199,088	\$ 528,014	\$ 1,284,223

(b) As at March 31, 2020, amounts owing to directors for director fees and expense reimbursements included in accounts payable and accrued liabilities were \$38,547 (September 30, 2019 - \$47,622).

(c) As at March 31, 2020, amounts owing to a company controlled by a director of the Company included in accounts payable and accrued liabilities were \$nil (September 30, 2019 - \$84,375). The payables as at September 30, 2019 represent amounts owing upon the termination of an executive services consulting agreement (note 12).

(d) Legal and professional fees, taxes and disbursements totaling \$nil for the three and six months ended March 31, 2020 (March 31, 2019 - \$24,908 and \$39,414 for the three and six months respectively) were incurred with a law firm of which a director of the Company was at the time a partner.

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.

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

## 9. Supplementary cash flow information

### (a) Change in non-cash working capital

	Three months ended March 31		Six months ended March 31	
	2020	2019	2020	2019
Accounts receivable	\$ 243,771	\$ (168,979)	\$ (24,176)	\$ 952,559
Inventory	24,517	(20,515)	71,074	(12,266)
Prepaid expenses and other assets	2,781	(39,282)	74,675	(8,266)
Accounts payable and accrued liabilities (note 9(d))	42,645	(701,390)	(113,682)	77,339
Deposit	-	-	(13,000)	-
Deferred revenue	165,000	-	165,000	-
	\$ 478,714	\$ (930,166)	\$ 159,891	\$ 1,009,366

### (b) Income taxes

The Company did not pay any income taxes during the three and six months ended March 31, 2020 and 2019.

### (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:

	March 31, 2020	September 30, 2019
Cash	\$ 656,378	\$ 752,911
Cash equivalents	949,033	1,999,091
	\$ 1,605,411	\$ 2,752,002

### (d) Supplemental disclosure of non-cash investing activities

As at March 31, 2020, property, plant and equipment included in accounts payable was \$105,796 (March 31, 2019 - \$28,460).

## 10. Revenue and segmented information

The Company's operations currently consist of one operating segment. Within this operating segment, revenue is disaggregated by type as follows:

	Three months ended March 31		Six months ended March 31	
	2020	2019 Adjusted note 2(a)	2020	2019 Adjusted note 2(a)
Contract services	\$ 1,261,507	\$ 1,478,210	\$ 2,488,044	\$ 2,956,420
Products and services	123,009	115,793	366,398	169,256
	\$ 1,384,516	\$ 1,594,003	\$ 2,854,442	\$ 3,125,676

For the three months ended March 31, 2020, sales within Canada were \$nil (March 31, 2019 - \$109,763) and sales outside Canada were \$1,384,516 (March 31, 2019 - \$1,484,240). For the six months ended March 31, 2020, sales within Canada were \$73,254 (March 31, 2019 - \$109,764) and sales outside Canada were \$2,781,188 (March 31, 2019 - \$3,015,912).

During the three months ended March 31, 2020, the Company had one customer who represented greater than 10% of total revenues. This customer represented approximately 91% of total revenues (March 31, 2019 - one



# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

## 10. Revenue and segmented information (continued)

customer represented approximately 93% of total revenues). During the six months ended March 31, 2020, the Company had one customer who represented greater than 10% of total revenues. This customer represented approximately 87% of total revenues (March 31, 2019 - one customer represented approximately 95% of total revenues).

## 11. Nature of expenses

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

	Three months ended March 31		Six months ended March 31	
	2020	2019 Adjusted note 2(a)	2020	2019 Adjusted note 2(a)
Salaries and benefits	\$ 964,132	\$ 886,959	\$ 1,895,538	\$ 1,616,242
Share-based compensation	106,239	157,819	243,100	305,808
Depreciation and amortization	410,873	396,000	806,841	781,369
Travel and entertainment	113,111	64,963	211,615	138,565
Professional fees and insurance	341,424	234,835	583,687	417,653
Public company costs	79,621	94,522	171,611	206,392
Rent and utilities	175,265	192,879	327,952	365,792
Maintenance and office expenses	123,213	72,310	241,284	153,872
Materials consumed	154,783	121,151	241,733	286,444
Restructuring costs (note 12)	-	-	-	815,700
	\$ 2,468,661	\$ 2,221,438	\$ 4,723,361	\$ 5,087,837

## 12. Restructuring costs

On December 21, 2018, the Board implemented an executive transition plan, under which Mr. Doug Blakeway, the former CEO, transitioned his responsibilities to Mr. Troy Bullock. Under the terms of this transition plan, Mr. Blakeway's executive services consulting agreement was terminated, triggering the following termination benefits as laid out in the agreement: two years base salary, a pro-rated performance bonus, and vesting of all outstanding share-based awards. The Company incurred restructuring costs of \$815,700 for the six month period ended March 31, 2019, of which \$92,200 represented share-based compensation related to the accelerated vesting of Mr. Blakeway's RSUs.

In January 2019, termination benefits were paid and 187,500 shares were issued to Mr. Blakeway upon vesting of his RSUs. Restructuring costs of \$nil remain accrued as at March 31, 2020 (September 30, 2019 - \$84,375).

## 13. Discontinued operations

On September 21, 2017, the directors of the Company made the determination to pursue the possible sale of the assets of its subsidiary, Tactical Technologies Inc. ("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 cash flows for the three and six month periods ended March 31, 2019 include the effects of extinguishment of remaining liabilities pursuant to the disposal.

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2020 and 2019  
(In Canadian dollars)

---

## 14. Commitments

As at March 31, 2020, the Company is committed to equipment purchases, operating costs in respect of leased office space, and contracted equipment maintenance for the following amounts:

2020	\$	790,640
2021		263,712
2022		257,208
2023		188,458
2024		107,208
2025		62,538
	\$	1,669,764

---

## 15. Subsequent event

In March 2020, the COVID-19 outbreak was declared a pandemic by the World Health Organization. The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and Nanotech's business are not known at this time. This could include an impact on the Company's ability to obtain debt and equity financing, impairment in the value of long-lived assets, or potential future decrease in revenue or the profitability of Nanotech's operations.