



March 31, 2021

# QUARTERLY REPORT



# Nanotech Security Corp.

Management's Discussion and Analysis

For the three and six months ended March 31, 2021

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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, 2021. Year to date means the six months ended March 31, 2021.

## ADVISORY

This MD&A, dated May 5, 2021, 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, 2021 as well as with the Company's audited financial statements and MD&A for the year ended September 30, 2020. 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 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 in 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 financial statements for the year ended September 30, 2020, 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.*

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## GENERAL OVERVIEW

Nanotech is incorporated under the laws of British Columbia, 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 develops and produces nano-optic structures and colour-shifting foils 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 visual 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 optical 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 visual 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.

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## RESULTS OF OPERATIONS

Select financial information for the three and six months ended March 31, 2021 and 2020:

Select Financial Information	Three months ended March 31		Six months ended March 31	
	2021	2020	2021	2020
Revenue	\$ 1,797,882	\$ 1,384,516	\$ 3,510,132	\$ 2,854,442
Cost of sales	521,381	251,410	844,554	557,219
	1,276,501	1,133,106	2,665,578	2,297,223
Expenses				
Research and development	569,367	556,096	1,210,346	958,028
General and administration	562,140	606,950	1,128,563	1,197,370
Sales and marketing	516,396	651,693	973,367	1,237,743
Depreciation and amortization	363,914	402,512	737,577	773,001
	2,011,817	2,217,251	4,049,853	4,166,142
Loss from operations before other (income) expenses	(735,316)	(1,084,145)	(1,384,275)	(1,868,919)
Other (income) expenses	27,721	(110,812)	83,861	(113,096)
Net loss	\$ (763,037)	\$ (973,333)	\$ (1,468,136)	\$ (1,755,823)
Adjusted EBITDA <sup>(1)</sup>	\$ (255,064)	\$ (567,033)	\$ (451,638)	\$ (818,978)

<sup>(1)</sup>Adjusted EBITDA is a non-IFRS measure as described in the Non-IFRS Financial Measures section of this MD&A. The calculation of Adjusted EBITDA for the three and six months ended March 31, 2020 was amended to exclude tenant and steam (income) expenses, which are no longer expected to be recurring in nature. See the Quarterly Results section of this MD&A for the revised historical figures on a quarterly basis.

### 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 increased \$375,523 or 30% in the three months ended March 31, 2021 compared to the same period last year. For the six months ended March 31, 2021, revenues from this customer increased by \$824,687 or 33% compared to the same period last year.

Total revenue for the three months ended March 31, 2021 increased by \$413,366 or 30% to \$1,797,882, compared to \$1,384,516 in the same period last year, due to higher contract services revenue in combination with an increase in product revenue in the current period.

Total revenue for the six months ended March 31, 2021 increased by \$655,690 or 23% to \$3,510,132, compared to \$2,854,442 in the same period last year primarily due to increased development contract revenue in the current period, partially offset by reduced product revenue.

### Gross Margin

Gross margin for the three months ended March 31, 2021 increased by \$143,395 or 13% to \$1,276,501, compared to \$1,133,106 in the same period last year as a result of the increase in total revenue. The gross margin percentage was 71% for the three months ended March 31, 2021, down from 82% in the same period last year. This decrease was primarily due to additional labour and other expenditures incurred to meet contract services deliverables in the current period.

Gross margin for the six months ended March 31, 2021 increased by \$368,355 or 16% to \$2,665,578, compared to \$2,297,223 in the same period last year as a result of the increase in contract services revenue. The gross margin percentage was 76% for the six months ended March 31, 2021, down from 80% in the same period last year primarily due to lower margins on contract services in the current period.

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## Research and Development

Research and development expenditures for the three months ended March 31, 2021 were \$569,367, compared to \$556,096 in the same period last year. This increase was primarily due to increased salary expense and patent expenditures in the current period, partially offset by an increase in salaries allocated to cost of goods sold.

Research and development expenditures for the six months ended March 31, 2021 were \$1,210,346, an increase of \$252,318 or 26%, compared with \$958,028 in the same period last year. This increase is in line with management's plan to make strategic investments in research and development to bring new products to market in fiscal 2021. The Company hired additional research and development staff and increased patent expenditures in the current period.

## General and Administration

General and administration expenditures for the three months ended March 31, 2021 were \$562,140, a decrease of \$44,810 or 7%, compared to \$606,950 in the same period last year. The decrease was primarily due to decreased utilities expense and professional fees in the current period, partially offset by higher IT expense.

General and administration expenditures for the six months ended March 31, 2021 were \$1,128,563, a decrease of \$68,807 or 6%, compared to \$1,197,370 in the same period last year. The decrease was primarily due to decreased share-based compensation and professional fees in the current period.

## Sales and Marketing

Sales and marketing expenditures for the three and six months ended March 31, 2021 were \$516,396 and \$973,367 respectively, compared with \$651,693 and \$1,237,743 respectively in the same periods last year. These decreases were primarily due to decreased share-based compensation, travel and conference expenses, and consulting fees in the current periods.

## Depreciation and Amortization

Depreciation and amortization expense included in operating expenditures for the three and six months ended March 31, 2021 were \$363,914 and \$737,577 respectively, compared to \$402,512 and \$773,001 respectively in the same periods last year, which reflects reduced depreciation under the Company's declining balance depreciation method.

## Other (Income) Expense

Other expense for the three months ended March 31, 2021 was \$27,721, an increase of \$138,533 compared to other income of \$110,812 in the same period last year. Other expense for the six months ended March 31, 2021 was \$83,861, an increase of \$196,957 compared to other income of \$113,096 in the same period last year. Finance income decreased in the current periods due to lower interest rates while foreign exchange loss increased compared to the same periods last year. In addition, there was no tenant and steam income or expense in the current periods as a result of the termination of tenant and steam agreements during the second quarter of 2020.

## Adjusted EBITDA

Adjusted EBITDA for the three and six months ended March 31, 2021 was negative \$255,064 and negative \$451,638 respectively, compared to negative \$567,033 and negative \$818,978 respectively during the same periods last year. The improvements were primarily due to increased revenue in the current periods in combination with decreased sales and marketing expenses in the COVID-19 environment and lower general and administration expenses, partially offset by increased research and development expenses as the Company continued to invest in its research and development team.

## Net Loss

Net loss for the three months ended March 31, 2021 was \$763,037, compared to net loss of \$973,333 during the same period last year. Net loss for the six months ended March 31, 2021 was \$1,468,136, compared to net loss of \$1,755,823 in the same period last year. The decreases in net loss were primarily due to increased revenue in combination with reduced sales and administrative expenses in the current

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periods, partially offset by increased research and development expenditures and a reduction in other income.

## QUARTERLY RESULTS

	Q2 2021	Q1 2021	Q4 2020	Q3 2020	Q2 2020	Q1 2020	Q4 2019	Q3 2019
(\$ thousands, except per share data)								
Revenue	\$1,798	\$1,712	\$2,913	\$1,947	\$1,385	\$1,470	\$1,450	\$1,827
Net income (loss)	(763)	(705)	293	(332)	(973)	(782)	(705)	(521)
Adjusted EBITDA <sup>(1)</sup>	(255)	(197)	953	198	(567)	(252)	(263)	(77)
Basic earnings (loss) per share:								
Net income (loss)	(0.01)	(0.01)	0.00	(0.00)	(0.01)	(0.01)	(0.01)	(0.01)
Diluted earnings (loss) per share:								
Net income (loss)	(0.01)	(0.01)	0.00	(0.00)	(0.01)	(0.01)	(0.01)	(0.01)

<sup>(1)</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. There are no seasonal effects in the Company's business over the quarters presented.

## RELATED PARTY TRANSACTIONS

For the three months ended March 31, 2021 and 2020, 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	
	2021	2020	2021	2020
Salaries, accrued bonuses, employee benefits and director fees	\$ 199,622	\$ 193,944	\$ 401,884	\$ 387,888
Share-based payments	52,755	59,436	81,991	140,126
	\$ 252,377	\$ 253,380	\$ 483,875	\$ 528,014

(b) As at March 31, 2021, amounts owing to directors for director fees and expense reimbursements included in accounts payable and accrued liabilities were \$43,905 (September 30, 2020 - \$58,619).

(c) On January 15, 2021, the Company purchased six patents from a company owned by a director of the Company for \$100,000 and agreed to share 10% of any product revenues related to the patents from a specific customer for a period of two years as well as ongoing royalties of 3% to 6% on other revenues derived from the patents for a period of five years.

The above transactions 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.

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## Summary of Statements of Cash Flows

	Three months ended March 31		Six months ended March 31	
	2021	2020	2021	2020
Cash used in operating operations	\$ (175,662)	\$ (26,968)	\$ (106,029)	\$ (586,531)
Cash used in investing activities	(89,496)	(276,364)	(368,314)	(535,069)
Cash used in financing activities	(43,958)	(34,109)	(87,425)	(68,839)
Effect of foreign exchange on cash and cash equivalents	3,430	24,334	30,159	43,848
Cash and cash equivalents, beginning of period	1,525,932	1,918,518	1,751,855	2,752,002
Cash and cash equivalents, end of period	\$ 1,220,246	\$ 1,605,411	\$ 1,220,246	\$ 1,605,411

### Operating Activities

Cash used in operating activities was \$175,662 for the three months ended March 31, 2021, compared to cash used in operating activities of \$26,968 for the same period last year. The increase in cash used in operating activities reflects changes in non-cash working capital, particularly related to the timing of accounts receivable and deferred revenue collected in the prior year, partially offset by the underlying improvement in revenue that improved operating results in the current period.

Cash used in operating activities was \$106,029 for the six months ended March 31, 2021, compared to cash used in operating activities of \$586,531 for the same period last year. The difference was a result of decreased net loss during the current period in combination with a decrease in accounts receivable in the current period.

### Investing Activities

Cash used in investing activities for the three and six months ended March 31, 2021 was \$89,496 and \$368,314 respectively, compared to \$276,364 and \$535,069 respectively during the same periods last year. The decrease was a result of the Company completing capital projects within the Thurso production facility in fiscal 2021, resulting in a decrease in capital expenditures compared to the same periods in the prior year. This decrease was partially offset by the acquisition of six patents, with a cash outlay of \$85,000 in the current quarter.

### Financing Activities

Cash used in financing activities for the three and six months ended March 31, 2021 was \$43,958 and \$87,425 respectively, compared to \$34,109 and \$68,839 respectively in the same periods last year, which represents payment of the lease liability.

### 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. Nanotech's 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, 2021, there were no changes in the Company's 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 \$8.1 million at quarter end and no debt.

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	March 31, 2021	September 30, 2020
Cash	\$ 844,350	\$ 1,026,845
Cash equivalents	375,896	725,010
Short-term investments	6,873,218	6,849,285
	<u>\$ 8,093,464</u>	<u>\$ 8,601,140</u>

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

The Company had commitments of \$811,144 as at March 31, 2021, primarily for operating costs in respect of leased office space, contracted equipment maintenance, and equipment purchases. Management has reviewed its projected funding requirements for the next 12 months and expects that, through the 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, tenant income, and steam (income) expense. 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	
	2021	2020 <sup>(1)</sup>	2021	2020 <sup>(1)</sup>
Net loss	\$ (763,037)	\$ (973,333)	\$ (1,468,136)	\$ (1,755,823)
Finance (income) expenses	3,184	(28,161)	202	(61,606)
Foreign exchange (gain) loss	24,537	(92,102)	83,659	(69,459)
Depreciation and amortization	373,603	410,873	753,456	806,841
Share-based compensation	106,649	106,239	179,181	243,100
Tenant income	-	(11,844)	-	(56,276)
Steam expense	-	21,295	-	74,245
Adjusted EBITDA	<u>\$ (255,064)</u>	<u>\$ (567,033)</u>	<u>\$ (451,638)</u>	<u>\$ (818,978)</u>

<sup>(1)</sup> The calculation of Adjusted EBITDA was amended to exclude tenant and steam (income) expenses, which are no longer expected to be recurring in nature. See the Quarterly Results section of this MD&A for the revised historical figures on a quarterly basis.

## 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 audited financial statements for the year ended September 30, 2020. In the three and six months ended March 31, 2021, there was no material change to the nature of the risks arising from Nanotech's classification of financial instruments or related risk management



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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.

## 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.

	March 31, 2021		September 30, 2020	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Common shares outstanding	69,399,861		69,399,861	
Options				
Outstanding	4,614,000	\$ 0.52	4,783,200	\$ 0.68
Exercisable	2,990,500	\$ 0.57	3,383,700	\$ 0.81
RSUs				
Outstanding	549,671	N/A	284,083	N/A

As at May 5, 2021, the Company has 69,399,861 common shares issued and outstanding. There are no preferred shares issued and outstanding.

## NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

### *Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)*

In January 2020, IASB issued *Classification of Liabilities as Current or Non-Current*, which amends IAS 1 – *Presentation of Financial Statements*. The narrow scope amendments affect only the presentation of liabilities in the statement of financial position and not the amount or timing of its recognition. It clarifies that the classification of liabilities as current or non-current is based on rights that are in existence at the end of a reporting period and specifies that classification is unaffected by expectations about whether an entity will exercise its right to defer settlement of a liability. It also introduces a definition of 'settlement' to make clear that settlement refers to the transfer to the counterparty of cash, equity instruments, other assets or services. The amendments are effective for annual reporting periods beginning on or after January 1, 2022. Earlier application is permitted. The Company is assessing the potential impact of these amendments.

## COVID-19 PANDEMIC

In March 2020, the World Health Organization declared the COVID-19 outbreak a pandemic. The ultimate duration of COVID-19, the magnitude of the impact on the economy, and the full extent to which COVID-19 may have direct and indirect impacts on Nanotech's business is 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. The Company has not yet experienced any material negative impacts to its business, results of operations, or its financial position as a result of COVID-19.

As of the date of this MD&A, Nanotech's Thurso, Quebec production facility has been designated an essential service by the Quebec Government and it continues at full operation. Burnaby, BC offices and laboratories also remain open and fully operational. The Company has enforced stringent guidelines to ensure employees in its offices, labs and production facilities are taking appropriate steps to maintain a safe working environment, including working from home where possible.

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## ADDITIONAL INFORMATION

### Strategic Update

The Company remains focused on commercializing its technology for long-term revenue growth, with efforts centered around the following pillars:

1. **Contract services** – The Company's development contract with a confidential G10 central bank remains a key strategic focus and significant resources are committed to this project. Developing a visual security feature that could be integrated into this country's banknotes would be a significant milestone in Nanotech's growth.

The Company is restricted from providing substantive information about this project, but management is pleased with the progress of this development contract. The Company has secured purchase orders of \$7.4 million for fiscal 2021, with potential for additional awards of \$720,000 for this fiscal year. Discussions are also underway for a second phase multi-year development contract that management expects to finalize in fiscal 2021.

2. **Product development** – Based on the positive market feedback of Nanotech's latest nano-optic product offerings, management believes there are extensive opportunities to offer these new visual products with exceptional differentiation in both banknote and brand protection markets. As a result, the Company plans to continue to increase its investment in additional development staff, product trials, and certifications, to drive technology advancement and enhanced product development to generate future revenue.

In the second quarter of 2021 the Company launched its LiveOptik PROTECT security foil for the brand protection market. This new product is currently being tested by several channel partners for inclusion in their product catalogue. Management plans to have additional product launches in the second half of fiscal 2021 for both brand protection and banknote applications.

3. **Strategic partnerships** – Nanotech has developed strategic relationships with established OEM manufacturers to enable scalable delivery for our customers. These relationships reduce the Company's manufacturing risk and extend the market reach of Nanotech's product offering. Management is also developing the Company's internal production capability to complement these OEM offerings, which is being optimized for the Company's proprietary KolourOptik technology platform. Nanotech is uniquely positioned as a leader in developing and mass-producing complex nanostructures, which could have applications beyond the Company's initial key markets in brand protection and banknote authentication.
4. **Expanded channels to market** – Nanotech will continue to market its products and pursue revenue through both direct sales and strategic channel partners who promote and offer Nanotech's products to their existing customers. Management expects to expand the Company's network of channel partners as new products are launched throughout fiscal 2021.

Product revenue increased to \$160,852 for the three months ended March 31, 2021, compared to \$123,009 during the same period last year. Nanotech delivered seven customer product orders in the quarter, compared to four in the same period last year. On a year-to-date basis, product revenue of \$197,401 from nine orders was lower than product revenue of \$366,398 from twelve orders in the same period of 2020. These variances were partially due to the timing of certain recurring orders, which can vary from year to year.

### 2021 Outlook

The Company has a solid base of 2021 revenue, with secure purchase orders for \$7.4 million dollars relating to contract services and anticipated recurring revenue. Management has reconfirmed its guidance for the year, with revenue growth for 2021 targeted at 15% to 25%, depending on the level of new and recurring LumaChrome sales, additional contract services and successful product launches. Given Nanotech's continued investment in technology, management expects modest Adjusted EBITDA losses in 2021.

With a strong balance sheet including no debt, an expanding IP portfolio, record contract services awards for 2021, and recurring LumaChrome business, the Company is well positioned for future product revenue

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growth and diversification. Looking beyond 2021, Nanotech is uniquely positioned as a leader in developing and mass-producing complex nanostructures, which could have applications far beyond the Company's initial key markets in brand protection and banknote authentication.

## **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, 2021 and 2020  
(Unaudited)

# Nanotech Security Corp.

Condensed Interim Statements of Operations and Comprehensive Loss  
(Unaudited)

Three and six months ended March 31, 2021 and 2020

(In Canadian dollars)

	Three months ended		Six months ended	
	March 31		March 31	
	2021	2020	2021	2020
Revenue (note 11)	\$ 1,797,882	\$ 1,384,516	\$ 3,510,132	\$ 2,854,442
Cost of sales (note 12)	521,381	251,410	844,554	557,219
	1,276,501	1,133,106	2,665,578	2,297,223
Expenses (note 12)				
Research and development	569,367	556,096	1,210,346	958,028
General and administration	562,140	606,950	1,128,563	1,197,370
Sales and marketing	516,396	651,693	973,367	1,237,743
Depreciation and amortization	363,914	402,512	737,577	773,001
	2,011,817	2,217,251	4,049,853	4,166,142
Loss from operations before other (income) expenses	(735,316)	(1,084,145)	(1,384,275)	(1,868,919)
Other (income) expenses				
Foreign exchange (gain) loss	24,537	(92,102)	83,659	(69,459)
Finance (income) expense (note 13)	3,184	(28,161)	202	(61,606)
Tenant income	-	(11,844)	-	(56,276)
Steam expense	-	21,295	-	74,245
	27,721	(110,812)	83,861	(113,096)
<b>Net loss and total comprehensive loss</b>	<b>\$ (763,037)</b>	<b>\$ (973,333)</b>	<b>\$ (1,468,136)</b>	<b>\$ (1,755,823)</b>
Basic and diluted loss per share:				
Net loss	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.03)
Weighted average number of common shares				
Basic and diluted	69,399,861	69,200,125	69,399,861	69,200,125

See accompanying notes to the condensed interim financial statements.

# Nanotech Security Corp.

Condensed Interim Statements of Financial Position  
(Unaudited)

(In Canadian dollars)

	March 31, 2021	September 30, 2020
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents (note 10(c))	\$ 1,220,246	\$ 1,751,855
Short-term investments (note 4)	6,873,218	6,849,285
Accounts receivable	710,834	1,505,391
Inventory (note 5)	250,467	210,715
Prepaid expenses and other assets	228,450	324,974
Asset held for sale (note 6)	125,000	-
	<u>9,408,215</u>	<u>10,642,220</u>
Property, plant and equipment	14,398,236	15,089,496
Intangible assets (note 7)	96,875	-
Goodwill	1,388,458	1,388,458
Right-of-use asset	768,324	862,405
	<u>\$ 26,060,108</u>	<u>\$ 27,982,579</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities (note 9)	\$ 1,098,385	\$ 1,630,754
Deposits	42,347	56,069
Current portion of lease liability	180,285	173,558
	<u>1,321,017</u>	<u>1,860,381</u>
<b>Non-current liabilities:</b>		
Lease liability	669,595	763,747
	<u>1,990,612</u>	<u>2,624,128</u>
<b>Shareholders' equity:</b>		
Share capital (note 8(a))	62,499,841	62,499,841
Contributed surplus (note 8(b))	3,587,834	3,408,653
Deficit	(42,018,179)	(40,550,043)
	<u>24,069,496</u>	<u>25,358,451</u>
	<u>\$ 26,060,108</u>	<u>\$ 27,982,579</u>

Related party transactions (note 9)

Commitments and contingencies (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)

Three and six months ended March 31, 2021 and 2020  
(In Canadian dollars)

	Number of shares	Share capital	Contributed surplus	Deficit	Total shareholders' equity
<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 8(b)(i))	-	-	189,225	-	189,225
Share-based compensation - RSUs (note 8(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
<b>Balance as at October 1, 2020</b>	69,399,861	\$ 62,499,841	\$ 3,408,653	\$ (40,550,043)	\$ 25,358,451
Net loss	-	-	-	(1,468,136)	(1,468,136)
Share-based compensation - options (note 8(b)(i))	-	-	129,079	-	129,079
Share-based compensation - RSUs (note 8(b)(ii))	-	-	50,102	-	50,102
<b>Balance as at March 31, 2021</b>	69,399,861	\$ 62,499,841	\$ 3,587,834	\$ (42,018,179)	\$ 24,069,496

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, 2021 and 2020

(In Canadian dollars)

	Three months ended		Six months ended	
	March 31		March 31	
	2021	2020	2021	2020
Cash flows provided by (used in):				
Operating activities:				
Net loss	\$ (763,037)	\$ (973,333)	\$(1,468,136)	\$(1,755,823)
Items not involving cash:				
Depreciation and amortization (note 12)	373,603	410,873	753,456	806,841
Share-based compensation (note 12)	106,649	106,239	179,181	243,100
Unrealized foreign exchange gain (loss)	2,423	(11,491)	(31,059)	(35,969)
Finance (income) expense (note 13)	3,184	(28,161)	202	(61,606)
Other	(2,874)	(5,520)	(5,363)	(6,101)
Non-cash working capital changes (note 10(a))	102,826	478,714	436,009	159,891
Interest paid on lease liability	(9,891)	(11,671)	(20,273)	(22,722)
Interest received	11,455	7,382	49,954	85,858
<b>Cash used in operating activities</b>	<b>(175,662)</b>	<b>(26,968)</b>	<b>(106,029)</b>	<b>(586,531)</b>
Investing activities:				
Purchase of property and equipment (note 10(d))	6,235	(276,364)	(234,862)	(464,419)
Purchase of intangible asset (note 10(d))	(85,000)	-	(85,000)	-
Net acquisition of short-term investments	(10,731)	-	(48,452)	(70,650)
<b>Cash used in investing activities</b>	<b>(89,496)</b>	<b>(276,364)</b>	<b>(368,314)</b>	<b>(535,069)</b>
Financing activities:				
Repayment of lease liability	(43,958)	(34,109)	(87,425)	(68,839)
<b>Cash used in financing activities</b>	<b>(43,958)</b>	<b>(34,109)</b>	<b>(87,425)</b>	<b>(68,839)</b>
Effect of foreign exchange on cash and cash equivalents	3,430	24,334	30,159	43,848
Decrease in cash and cash equivalents	(305,686)	(313,107)	(531,609)	(1,146,591)
Cash and cash equivalents, beginning of period	1,525,932	1,918,518	1,751,855	2,752,002
<b>Cash and cash equivalents, end of period</b>	<b>\$ 1,220,246</b>	<b>\$ 1,605,411</b>	<b>\$ 1,220,246</b>	<b>\$ 1,605,411</b>

See supplementary cash flow information (note 10)

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, 2021 and 2020  
(In Canadian dollars)

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## 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 develops and produces nano-optic structures and colour-shifting foils 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 financial statements.

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 financial statements for the year ended September 30, 2020.

These condensed interim financial statements were approved and authorized for issue by the Company’s Board of Directors on May 5, 2021.

### (b) *Basis of measurement*

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

## 3. New standards and interpretations not yet adopted

### *Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)*

In January 2020, IASB issued *Classification of Liabilities as Current or Non-Current*, which amends IAS 1 – *Presentation of Financial Statements*. The narrow scope amendments affect only the presentation of liabilities in the statement of financial position and not the amount or timing of its recognition. It clarifies that the classification of liabilities as current or non-current is based on rights that are in existence at the end of a reporting period and specifies that classification is unaffected by expectations about whether an entity will exercise its right to defer settlement of a liability. It also introduces a definition of ‘settlement’ to make clear that settlement refers to the transfer to the counterparty of cash, equity instruments, other assets or services. The amendments are effective for annual reporting periods beginning on or after January 1, 2022. Earlier application is permitted. The Company is assessing the potential impact of these amendments.

## 4. Short-term investments

Short-term investments of \$6,873,218 (September 30, 2020 - \$6,849,285) consist of cashable term deposits held with a Canadian chartered bank. The term deposits have maturity dates between April 20, 2021 and September 13, 2021. Interest rates range between 0.44% and 0.53%.

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2021 and 2020  
(In Canadian dollars)

## 5. Inventory

	March 31, 2021	September 30, 2020
Raw materials	\$ 141,608	\$ 179,034
Work in progress	43,276	30,281
Finished goods	65,583	1,400
	\$ 250,467	\$ 210,715

There were inventory write-downs of \$nil and \$17,648 expensed to materials consumed respectively during the three and six months ended March 31, 2021 (March 31, 2020 - \$nil).

For the three months ended March 31, 2021, the Company recognized inventories of \$93,126 (March 31, 2020 - \$40,198) as expensed through cost of sales. For the six months ended March 31, 2021, the Company recognized inventories of \$115,684 (March 31, 2020 - \$183,313) as expensed through cost of sales.

## 6. Asset held for sale

In October 2020, the Company completed a capital project to replace a propane heating system with an electric heating system and committed to a plan to sell the propane boiler. The Company previously recorded an impairment loss to reduce the carrying value of the boiler to the recoverable amount as at December 31, 2020, as measured by the expected net proceeds upon disposal. No further write-down was recorded and as at March 31, 2021, the propane boiler was reclassified from property, plant and equipment to a separate line on the balance sheet as asset held for sale.

## 7. Intangible assets

On January 15, 2021, the Company purchased six patents for \$100,000 and agreed to share 10% of any product revenues related to the patents from a specific customer for a period of two years as well as ongoing royalties of 3% to 6% on other revenues derived from the patents for a period of five years.

The intangible asset is capitalized at the cost of \$100,000 and is being amortized over four years according to the Company's depreciation policy.

Amortization for the three and six months ended March 31, 2021 of \$3,125 (March 31, 2020 - \$nil) is included in depreciation and amortization expense.

## 8. 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, 2020 and March 31, 2021	69,399,861	\$ 62,499,841

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, 2021 and 2020  
(In Canadian dollars)

## 8. 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, 2021:

	Number of options	Weighted average exercise price
Balance as at September 30, 2020	4,783,200	\$ 0.68
Granted	817,500	0.50
Forfeited	(191,700)	1.23
Cancelled	(795,000)	1.32
Balance as at March 31, 2021	4,614,000	\$ 0.52

The following table summarizes information pertaining to the Company's stock options outstanding as at March 31, 2021:

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	2,741,500	3.84	\$ 0.40	1,218,000	\$ 0.39
\$0.51 - \$0.75	1,587,500	2.88	0.61	1,487,500	0.61
\$1.01 - \$1.25	250,000	1.09	1.10	250,000	1.10
\$1.26 - \$1.50	35,000	1.39	1.43	35,000	1.43
	4,614,000	3.34	\$ 0.52	2,990,500	\$ 0.57

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, 2021 and 2020:

	Three months ended March 31		Six months ended March 31	
	2021	2020	2021	2020
Risk free interest rate	0.3%	-	0.4%	1.5%
Expected life	4.0 years	-	4.0 years	5.0 years
Expected volatility	71.6%	-	70.8%	51.4%
Expected dividends	Nil	Nil	Nil	Nil
Average fair value	\$0.36	-	\$0.26	\$0.18

For the three and six months ended March 31, 2021 and 2020, 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	
	2021	2020	2021	2020
Total compensation - stock options	\$ 73,019	\$ 73,327	\$ 129,079	\$ 189,225

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2021 and 2020  
(In Canadian dollars)

## 8. Share capital (continued)

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

#### (ii) Restricted share unit plan

RSUs outstanding as at March 31, 2021:

	Number of RSUs
Balance as at September 30, 2020	284,083
Granted	265,588
Balance as at March 31, 2021	549,671

For the three and six months ended March 31, 2021 and 2020, 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	
	2021	2020	2021	2020
Total compensation - RSUs	\$ 33,630	\$ 32,912	\$ 50,102	\$ 53,875

## 9. Related party transactions

For the three and six months ended March 31, 2021 and 2020, 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	
	2021	2020	2021	2020
Salaries, accrued bonuses, employee benefits and director fees	\$ 199,622	\$ 193,944	\$ 401,884	\$ 387,888
Share-based payments	52,755	59,436	81,991	140,126
	\$ 252,377	\$ 253,380	\$ 483,875	\$ 528,014

(b) As at March 31, 2021, amounts owing to directors for director fees and expense reimbursements included in accounts payable and accrued liabilities were \$43,905 (September 30, 2020 - \$58,619).

(c) The Company purchased six patents from a company owned by a director of the Company (note 7). Of the total purchase price, \$15,000 remains accrued as at March 31, 2021.

The above transactions 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, 2021 and 2020  
(In Canadian dollars)

## 10. Supplementary cash flow information

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

	Three months ended March 31		Six months ended March 31	
	2021	2020	2021	2020
Accounts receivable	\$ 47,718	\$ 243,771	\$ 692,673	\$ (24,176)
Inventory	(27,677)	24,517	(35,351)	71,074
Prepaid expenses and other assets	56,122	2,781	99,647	74,675
Accounts payable and accrued liabilities (note 10(d))	16,777	42,645	(319,972)	(113,682)
Deposits	9,886	-	(988)	(13,000)
Deferred revenue	-	165,000	-	165,000
	\$ 102,826	\$ 478,714	\$ 436,009	\$ 159,891

### (b) Income taxes

The Company did not pay any income taxes during the three and six months ended March 31, 2021 and 2020.

### (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, 2021	September 30, 2020
Cash	\$ 844,350	\$ 1,026,845
Cash equivalents	375,896	725,010
	\$ 1,220,246	\$ 1,751,855

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

As at March 31, 2021, property, plant and equipment included in accounts payable was \$40,043 (March 31, 2020 - \$105,796).

As at March 31, 2021, intangible assets included in accrued liabilities was \$15,000 (March 31, 2020 - \$nil).

During the three months ended March 31, 2021, deposits of \$2,566 (March 31, 2020 - \$nil) were applied to property, plant and equipment. During the six months ended March 31, 2021, deposits of \$12,734 (March 31, 2020 - \$nil) were applied to property, plant and equipment.

## 11. 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	
	2021	2020	2021	2020
Development contracts	\$ 1,637,030	\$ 1,261,507	\$ 3,312,731	\$ 2,488,044
Products and services	160,852	123,009	197,401	366,398
	\$ 1,797,882	\$ 1,384,516	\$ 3,510,132	\$ 2,854,442

For the three months ended March 31, 2021, sales within Canada were \$30,475 (March 31, 2020 - \$nil) and sales outside Canada were \$1,767,407 (March 31, 2020 - \$1,384,516). For the six months ended March 31,

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2021 and 2020  
(In Canadian dollars)

## 11. Revenue and segmented information (continued)

2021, sales within Canada were \$30,475 (March 31, 2020 - \$73,254) and sales outside Canada were \$3,479,657 (March 31, 2020 - \$2,781,188).

During the three months ended March 31, 2021, the Company had one customer who represented greater than 10% of total revenues. This customer represented approximately 91% of total revenues (March 31, 2020 - one customer represented approximately 91% of total revenues). During the six months ended March 31, 2021, the Company had one customer who represented greater than 10% of total revenues. This customer represented approximately 94% of total revenues (March 31, 2020 - one customer represented approximately 87% of total revenues).

## 12. Nature of expenses

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

	Three months ended		Six months ended	
	March 31		March 31	
	2021	2020	2021	2020
Salaries and benefits	\$ 1,200,442	\$ 964,132	\$ 2,305,564	\$ 1,895,538
Share-based compensation	106,649	106,239	179,181	243,100
Depreciation and amortization	373,603	410,873	753,456	806,841
Travel and entertainment	3,036	113,111	8,387	211,615
Professional fees and insurance	278,314	341,424	527,096	583,687
Public company costs	121,689	79,621	238,425	171,611
Rent and utilities	164,341	175,265	335,490	327,952
Maintenance and office expenses	120,237	123,213	241,834	241,284
Materials consumed	164,887	154,783	304,974	241,733
	\$ 2,533,198	\$ 2,468,661	\$ 4,894,407	\$ 4,723,361

## 13. Finance income

	Three months ended		Six months ended	
	March 31		March 31	
	2021	2020	2021	2020
Interest income from cash and cash equivalents and short-term investments	\$ (9,423)	\$ (42,782)	\$ (25,429)	\$ (89,768)
Interest paid on lease liability	9,891	11,671	20,273	22,722
Other interest expenses	2,716	2,950	5,358	5,440
	\$ 3,184	\$ (28,161)	\$ 202	\$ (61,606)

## 14. Commitments and contingencies

(a) As at March 31, 2021, the Company is committed to operating costs in respect of leased office space, contracted equipment maintenance, and equipment purchases for the following amounts:

2021	\$ 155,388
2022	273,761
2023	205,360
2024	114,097
2025	62,538
	\$ 811,144

# Nanotech Security Corp.

Notes to the Condensed Interim Financial Statements  
(Unaudited)

Three and six months ended March 31, 2021 and 2020  
(In Canadian dollars)

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## 14. Commitments and contingencies (continued)

- (b) Certain nano-optic products are subject to a 3% sales royalty in favour of Simon Fraser University (“SFU”) where certain elements of the nano-optic technology originated. There were royalties of \$296 during the three and six months ended March 31, 2021 (March 31, 2020 - \$2,504). In 2014, the Company prepaid royalties that would offset against future royalties owed as part of the transfer of the intellectual property from SFU, of which \$197,044 remains prepaid as at March 31, 2021 (September 30, 2020 - \$197,340).
- (c) Product revenue associated with the six patents acquired by the Company on January 15, 2021 is subject to royalties. The Company agreed to share 10% of any revenues related to the patents received from a specific customer for a period of two years and ongoing royalties of 3% to 6% on other revenues derived from the patents for a period of five years. There were no royalties during the three and six months ended March 31, 2021 and 2020 (notes 7 and 9).
- (d) In March 2020, the World Health Organization declared the COVID-19 outbreak a pandemic. The ultimate duration of COVID-19, the magnitude of the impact on the economy, and the full extent to which COVID-19 may have direct and indirect impacts on Nanotech’s business is 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. The Company has not yet experienced any material negative impacts to its business, results of operations, or its financial position as a result of COVID-19.