

SPECTRA INC.
CONSOLIDATED FINANCIAL STATEMENTS
NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016

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NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, Subsection 4.3 (3) (a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor. The accompanying unaudited financial statements of Spectra Inc. have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

STATEMENT OF COMPLIANCE

These condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting ("IAS 34") as issued by the International Accounting Standards Board ("IASB") and on a basis consistent with the accounting policies disclosed in the annual audited consolidated financial statements for the year ended December 31, 2016. These condensed interim consolidated financial statements were approved for issuance by the Board of Directors on November 3, 2017.

These condensed interim consolidated financial statements are not fully inclusive of all disclosures required by IFRS for annual financial statements, and should be read in conjunction with the annual audited consolidated financial statements, including accompanying notes, for the year ended December 31, 2016.

(The accompanying notes are an integral part of these consolidated financial statements.)

SPECTRA INC.Consolidated Statements of Financial Position
September 30, 2017 and December 31, 2016

	2017	2016
ASSETS		
Current		
Cash	\$ 145,467	\$ 79,746
Accounts receivable	200,840	163,153
Inventories (note 4)	162,585	162,572
Prepaid expenses	17,862	5,475
	<u>526,754</u>	410,946
Equipment (note 5)	<u>2,072</u>	6,447
Total Assets	<u>\$ 528,826</u>	<u>\$ 417,393</u>
LIABILITIES		
Current		
Accounts payable and accrued charges (notes 6, 12 and 13)	\$ 123,630	\$ 63,281
Loans payable – current portion (note 7)	<u>0</u>	100,000
	123,630	163,281
Loan Payable (note 7)	<u>0</u>	50,000
Royalty Debenture (note 8)	625,475	614,815
Convertible Preferred Shares (note 9)	<u>658,141</u>	658,141
	<u>1,407,246</u>	1,486,237
SHAREHOLDERS' DEFICIENCY		
Share Capital (note 10)	5,313,708	5,341,136
Contributed Surplus (note 10)	320,191	292,763
Accumulated Deficit	<u>(6,208,762)</u>	(6,323,357)
Deficiency Attributable to Shareholders of the Company	(574,863)	(689,458)
Non-controlling Interest (note 11)	<u>(303,557)</u>	(379,386)
Total Shareholders' Deficiency	<u>(878,420)</u>	(1,068,844)
Total liabilities and Shareholders' Deficiency	<u>\$ 528,826</u>	<u>\$ 417,393</u>

APPROVED ON BEHALF OF THE BOARD

"Glen Campbell"

"Andrew J. Malion"

Chairman

Director

(The accompanying notes are an integral part of these consolidated financial statements.)

SPECTRA INC.Consolidated Statements of Changes in Shareholders' Deficiency
Nine months ended September 30, 2017 and 2016

	Share Capital	Contributed surplus	Accumulated deficit	Deficiency attributable to shareholders of the Company	Non- controlling interest	Total deficiency
Balance,						
January 1, 2017	\$ 5,341,136	\$ 292,763	\$ (6,323,357)	\$ (689,458)	\$ (379,386)	\$ (1,068,844)
Net income			114,595	114,595	75,829	190,424
Cancellation of 4,866 common shares and 27,000 second preferred shares (note 10)	(27,428)	27,428				
Balance						
September 30, 2017	<u>\$ 5,313,708</u>	<u>\$ 320,191</u>	<u>\$ (6,208,762)</u>	<u>\$ (574,863)</u>	<u>\$ (303,557)</u>	<u>\$ (878,420)</u>

	Share Capital	Contributed surplus	Accumulated deficit	Deficiency attributable to shareholders of the Company	Non- controlling interest	Total deficiency
Balance,						
January 1, 2016	\$ 5,341,136	\$ 196,018	\$ (6,626,462)	\$ (1,089,308)	\$ (511,313)	\$ (1,600,621)
Net income			46,926	46,926	47,189	94,115
Gain on issuance of shares by subsidiary (notes 8 and 10)			56,250	56,250		56,250
Changes in ownership interest in subsidiary that does not result in a loss of control			2,767	2,767	(2,767)	-
Balance						
September 30, 2016	<u>\$ 5,341,136</u>	<u>\$ 196,018</u>	<u>\$ (6,520,519)</u>	<u>\$ (983,365)</u>	<u>\$ (466,891)</u>	<u>\$ (1,450,526)</u>

(The accompanying notes are an integral part of these consolidated financial statements.)

SPECTRA INC.Consolidated Statements of Comprehensive Loss
Three months ended September 30, 2017 and 2016

	2017	2016
Sales	\$ 432,186	\$ 342,034
Cost of Sales	207,496	129,166
Gross Profit	224,690	212,868
Selling costs	41,086	39,042
Administrative costs	120,775	126,021
Amortization	2,072	1,227
Reduction of impairment of loan receivable	-	-
Operating Income	60,757	46,578
Finance costs	3,948	30,218
Income Before Taxes	56,809	16,360
Provision for income taxes (note 14)	-	-
Net Income and Comprehensive Income	\$ 56,809	\$ 16,360
Net Income and Comprehensive Income Attributable to:		
Shareholders of the Company	\$ 34,655	\$ 7,205
Non-controlling interest	22,154	9,155
	\$ 56,809	\$ 16,360
Net Income per Share - Basic and Diluted	\$ 0.00	\$ 0.00
Weighted Average Number of Common Shares		
Outstanding During the Period – Basic	60,509,971	60,514,837
Outstanding During the Period – Diluted	60,509,971	60,514,837

(The accompanying notes are an integral part of these consolidated financial statements.)

SPECTRA INC.Consolidated Statements of Comprehensive Loss
Nine months ended September 30, 2017 and 2016

	2017	2016
Sales	\$ 1,332,592	\$ 1,206,651
Cost of Sales	583,295	491,943
Gross Profit	749,297	714,708
Selling costs	136,047	129,099
Administrative costs	400,927	413,347
Amortization	4,375	3,186
Reduction of impairment of loan receivable	-	(19,500)
Operating Income	207,948	188,576
Finance costs	17,524	94,461
Income Before Taxes	190,424	94,115
Provision for income taxes (note 14)	-	-
Net Income and Comprehensive Income	\$ 190,424	\$ 94,115
Net Income and Comprehensive Income Attributable to:		
Shareholders of the Company	\$ 114,595	\$ 46,926
Non-controlling interest	75,829	47,189
	\$ 190,424	\$ 94,115
Net Income per Share - Basic and Diluted	\$ 0.00	\$ 0.00
Weighted Average Number of Common Shares		
Outstanding During the Period – Basic	60,509,971	60,514,837
Outstanding During the Period – Diluted	60,509,971	60,514,837

(The accompanying notes are an integral part of these consolidated financial statements.)

SPECTRA INC.Consolidated Statements of Cash Flows
Nine months ended September 30, 2017 and 2016

	2017	2016
Cash Flows from Operating Activities		
Net income	\$ 190,424	\$ 94,115
Adjustments for:		
Finance costs	17,524	94,461
Amortization	4,375	3,186
	<u>212,323</u>	191,762
Changes in working capital:		
Accounts receivable	(37,687)	76,825
Inventories	(13)	(61,684)
Prepaid expenses	(12,387)	6,945
Accounts payable and accrued charges	60,349	(26,382)
	<u>222,585</u>	187,466
Cash used in operating activities:		
Interest paid	(6,864)	(22,085)
	<u>215,721</u>	165,381
Net Cash Provided by (Used in) Operating Activities	<u>215,721</u>	165,381
Cash Provided by (Used in) Financing Activities		
Repayment of loans payable	(150,000)	(100,000)
	<u>(150,000)</u>	(100,000)
Net Cash Provided by (Used in) Financing Activities	<u>(150,000)</u>	(100,000)
Net Increase (Decrease) in Cash	65,721	65,381
Cash - Beginning of Period	79,746	43,849
	<u>79,746</u>	43,849
Cash - End of Period	\$ 145,467	\$ 109,230
	<u>\$ 145,467</u>	<u>\$ 109,230</u>
Supplemental Information		
Non-monetary item:		
Issuance of shares in settlement of debts (note 8)	\$ -	\$ 56,250
	<u>\$ -</u>	<u>\$ 56,250</u>

(The accompanying notes are an integral part of these consolidated financial statements.)

1. Nature of Business and Basis of Presentation

Nature of Business

Spectra Inc. (“Spectra”), incorporated under the laws of the province of Alberta on October 4, 1994, and its subsidiary Spectra Products Inc. (“SPI”) (collectively the “Company”) are a manufacturing and marketing company operating in one market segment - bus and truck transportation safety equipment. The Company manufactures and markets brake and wheel-end monitoring equipment as an after-market product through transportation dealers, distributors and direct sales to fleet operators. The address of the Company is 41 Horner Avenue, Unit 2, Etobicoke, Ontario M8Z 4X4.

Basis of Presentation

These consolidated financial statements were prepared in accordance with International Financial Reporting Standards (IFRS).

The consolidated financial statements have been prepared on a historical cost basis, except for certain financial instruments that are measured at fair values as described in the accounting policies.

The consolidated financial statements were approved and authorized for issue by the Board of Directors on November 3, 2017.

Presentation and Functional Currency

The consolidated financial statements are presented in Canadian dollars, which is the Company’s functional currency.

Going Concern

These consolidated financial statements have been prepared on the assumption that the Company is a going concern which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. As at September 30, 2017, the Company had an accumulated shareholders’ deficiency of \$878,420 of which \$574,863 was attributable to the Company’s shareholders and \$303,557 was attributable to the non-controlling interest (2016 - \$1,068,844 of which \$689,458 was attributable to the Company’s shareholders and \$379,386 was attributable to the non-controlling interest). The Company’s ability to meet its obligations and continue as a going concern is dependent upon its ability to obtain additional financing and achievement of profitable operations. The Company may seek sufficient additional funds to provide working capital, inventory and capital equipment as needs arise, but at the moment, cash flow from operations is sufficient to support current needs.

The consolidated financial statements do not reflect any adjustments in the carrying values and classifications of the assets and liabilities or the reported expenses that would be necessary if the going concern assumption were not appropriate. Such adjustments could be material.

SPECTRA INC.

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

2. Summary of Significant Accounting Policies

a) Basis of Consolidation

These consolidated financial statements include the accounts of Spectra and SPI. As of September 30, 2017, Spectra held an interest of 67.73% (2016 – 67.73%) in SPI. All significant inter-company transactions and balances have been eliminated.

b) Non-controlling Interest

Non-controlling interest represents equity interest in a subsidiary owned by an outside party. The share of net assets of the subsidiary attributable to non-controlling interest is presented as a component of equity. Their share of net income and comprehensive income is recognized directly in equity. Changes in the parent company's ownership interest in subsidiary that do not result in loss of control are accounted for as an equity transaction.

c) Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Title and risk of loss generally pass to the customer at the time of delivery of the product to a common carrier.

d) Inventories

Inventories are valued, on a first-in, first-out basis at the lower of cost and net realizable value. The Company writes down estimated obsolete or excess inventory for the difference between the cost of inventory and estimated net realizable value based upon customer forecasts, shrinkage, the aging and future demand of the inventory, past experience with specific customers, and the ability to sell inventory to customers or back to suppliers. If these assumptions change, additional write-downs may be required.

e) Equipment

Equipment is recorded at cost less accumulated amortization and impairment losses recognized. Amortization is charged to earnings over the estimated useful lives of the assets, using the undernoted method:

Dies and molds – Brake Safe		
– Short Bracket molds	10 years	Straight line method
Dies and molds – Brake Safe		
– Other molds		Units of production method

f) Impairment of Tangible and Intangible Long-lived Assets

The Company reviews its long-lived assets for impairment at the end of each reporting period for events indicative of whether changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability is assessed based on the carrying amount of a long-lived asset compared to the sum of the future undiscounted cash flows expected to result from the use and the eventual disposal of the asset. An impairment loss is recognized when the carrying amount is not recoverable and exceeds fair value.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would be determined, net of depreciation or amortization, if no impairment loss had been recognized.

SPECTRA INC.

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

2. Summary of Significant Accounting Policies (cont'd)

g) Income Taxes

The Company uses the asset and liability method of accounting for deferred income taxes. Under the asset and liability method, deferred income tax assets and liabilities are determined based on temporary differences (difference between the accounting basis and the tax basis of the assets and liabilities), and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any deferred income tax asset if it is more likely than not that the asset will not be realized. Income tax expense or benefit is the sum of the Company's provision for current income taxes and the difference between the opening and ending balances of the deferred income tax assets and liabilities.

h) Stock-based Compensation

The Company uses the fair value-based method to account for stock-based compensation. The grant date fair value of stock options is estimated using the Black-Scholes option-pricing model. Compensation expense is recognized over the stock option vesting period with a corresponding charge to contributed surplus. When the stock options are exercised, the proceeds, together with the amount recorded in contributed surplus, are recorded in share capital.

i) Issuance of Shares by Subsidiary

When a subsidiary issues shares to new shareholders, the Company records an adjustment to reflect the increase or decrease in the carrying value of the investment and the resulting gain or loss in the consolidated statement of changes in equity.

j) Income per Share

Basic income per share is computed by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted income per share, using the treasury stock method, assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on income per share. As the exercise price of the warrants and options was higher than the average market share price of the shares during 2017 and 2016 the dilutive effect of outstanding options and warrants and their equivalents is not reflected in diluted income per share because their effect would be anti-dilutive.

k) Use of Estimates

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Examples of significant estimates include:

- Estimated useful life of assets;
- Allowance for doubtful accounts;
- Provision for inventories;
- Stock-based compensation; and
- Deferred income taxes

SPECTRA INC.

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

2. Summary of Significant Accounting Policies (cont'd)

l) Comprehensive Income

Certain gains and losses arising from changes in fair value are temporarily recorded outside the statement of income in accumulated other comprehensive income as a separate component of share capital. Comprehensive income is comprised of the Company's net income and other comprehensive income. Other comprehensive income may include any unrealized gains and losses on available-for-sale securities, foreign currency translation gains and losses on the net investment in self-sustaining foreign operations and changes in the fair value of derivative instruments designated as cash flow hedges, all net of income taxes. At September 30, 2017, the balance of other comprehensive income is \$nil (2016 – \$nil).

m) Financial Instruments

The Company classifies all its financial assets and liabilities into one of the following four categories: financial assets or financial liabilities at fair value through profit and loss, held-to-maturity investments, loan and receivables and available-for-sale financial assets. All financial instruments are measured on the balance sheet initially at fair value. Subsequent measurement and recognition of the changes in fair value of financial instruments depends upon their initial classifications:

Cash is classified as financial asset "*fair value through profit and loss*". Cash is measured at fair value with subsequent changes in fair value recognized in current period net income. Transaction costs are expensed in net income. Gains and losses arising from changes in fair value are presented in net income within other gains and losses in the period in which they arise.

Accounts receivable and loan receivable are classified as "*loans and receivables*". Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

Accounts payable and accrued charges, loan payable, royalty debenture and convertible preferred shares are classified as "*other financial liabilities*". Financial liabilities at amortized cost are recognized initially at fair value plus any directly attributable transaction costs. They are subsequently recorded at amortized cost. Subsequent measurements of the convertible preferred shares are recorded at amortized cost using the effective interest rate method. Debt issue and other transaction costs are netted against the carrying value of the long-term debt and are amortized over the life of the debt using the effective interest rate method.

The Company classifies fair value measurements using a fair value hierarchy that prioritizes the inputs used in measuring fair values as follows:

Level 1	valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2	valuation techniques based on inputs that are other than quoted prices included in Level 1 that are observable for the asset or liability either directly (prices) or indirectly (derived from prices); and
Level 3	valuation techniques with unobservable market inputs (involves assumptions and estimates by management).

The Company's only financial instrument that is at fair value is cash, which is categorized as Level 1.

n) Impairment of Financial Assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

SPECTRA INC.

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

2. Summary of Significant Accounting Policies (cont'd)

n) Impairment of Financial Assets (cont'd)

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss on a fair value through profit or loss financial asset is calculated by reference to its fair value. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in net income. Any cumulative loss in respect of a fair value through profit or loss financial asset recognized previously in equity is transferred to net income. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost, the reversal is recognized in profit or loss

o) Non-monetary Transactions

Transactions with no cash consideration are measured at the fair value of either the asset given up or the asset received, whichever is more reliably determinable.

p) Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing at the year-end. Revenues and expenses are translated from foreign currencies at the rate of exchange prevailing on the transaction date. Any resulting gains or losses are included in income for the year.

q) New Accounting Pronouncements

A number of new standards, and amendments to standards and interpretations, are not yet effective for the period ended September 30, 2017, and have not been applied in preparing these consolidated financial statements. The following standards and interpretations have been issued by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committees with effective dates relating to the annual accounting periods starting on or after the effective dates as follows:

IFRS 9 – Financial Instruments – Effective January 1, 2018

IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement, and applies to classification and measurement of financial assets and liabilities. This is a three-phase project with the objective of improving and simplifying the reporting for financial instruments. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will have an impact on the classification and measurement of financial assets, but will potentially have no impact on classification and measurement of financial liabilities. The Company will quantify the impact in conjunction with the other phases when issued.

IFRS 7 – Financial Instruments Disclosure – Effective January 1, 2018

IFRS 7 has been amended by the IASB to require additional disclosures on transition from IAS 39 to IFRS 9. The Company will evaluate the impact of adopting this standard on the consolidated financial statements.

IFRS 15 - Revenue from Contracts with Customers – Effective January 1, 2018

SPECTRA INC.

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

2. Summary of Significant Accounting Policies (cont'd)

q) New Accounting Pronouncements (cont'd)

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The Company is in the process of assessing the impact that the new and amended standards will have on its consolidated financial statements or whether to early adopt the new requirements.

3. Capital Structure

The capital structure of the Company consists principally of shareholders' deficiency comprised of deficit, contributed surplus and share capital. The Company's strategy is to effectively use debt financing to fund growth and manage its capital structure in light of economic conditions and the risk characteristics of the underlying assets. The Company's primary uses of capital are to finance non-cash working capital requirements and capital expenditures, which are currently funded from both its internally and externally generated cash flows. The Company is not subject to any externally imposed capital requirements and does not presently utilize any quantitative measures to monitor its capital. The Company's objectives in managing capital are to ensure sufficient liquidity to pursue its strategy of organic growth and to deploy capital to provide an appropriate return on investment to its shareholders.

The components of capital are as follows:

	2017	2016
Share capital	\$ 5,313,708	\$ 5,341,136
Contributed surplus	320,191	292,763
Accumulated deficit	<u>(6,512,319)</u>	<u>(6,702,743)</u>
	<u>\$ (878,420)</u>	<u>\$ (1,068,844)</u>

4. Inventories

	2017	2016
Finished goods	\$ 93,997	\$ 76,496
Raw materials	<u>68,588</u>	<u>86,076</u>
	<u>\$ 162,585</u>	<u>\$ 162,572</u>

As of September 30, 2017 inventories are reported net of a provision for decline in value of \$118,529 (2016 - \$118,529).

SPECTRA INC.

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

5. Equipment – Dies and Molds – Brake Safe

	2017			2016		
	Short Bracket Molds	Other Molds	Total	Short Bracket Molds	Other Molds	Total
Cost	\$ 9,210	\$ 123,244	\$ 132,454	\$ 9,210	\$ 120,244	\$ 129,454
Less: Accumulated amortization	7,138	123,244	130,382	2,763	120,244	123,007
	<u>\$ 2,072</u>	<u>\$ 0</u>	<u>\$ 2,072</u>	<u>\$ 6,447</u>	<u>\$ 0</u>	<u>\$ 6,447</u>

6. Accounts Payable and Accrued Charges

	2017	2016
Trade and other payables (note 13)	\$ 43,917	\$ 24,805
Accrued expenses	79,713	38,476
	<u>\$ 123,630</u>	<u>\$ 63,281</u>

7. Loan Payable

The loan payable to Dynamic Venture Opportunities Fund Ltd., (“DVOF”), one of the shareholders of the Company and an Ontario labour-sponsored venture capital fund, bore interest at 12% per annum payable monthly, interest only, and was unsecured. The loan was fully repaid during the nine months ended September 30, 2017. Included in finance costs are interest expense of \$6,864 (2016 - \$16,035) paid to DVOF

8. Royalty Debenture

On August 6, 2004 the Company closed a debenture financing arrangement with DVOF whereby DVOF advanced \$750,000 to Spectra's subsidiary, SPI. In consideration of the advance of these funds, DVOF is entitled to receive royalty payments equal to the greater of \$100,000 per annum or 10% of the total annual gross revenue generated by SPI. Twenty-five percent of each royalty payment shall be allocated against the principal amount of the debenture. The royalty payments shall continue until the earlier of (i) the date that the royalty debenture has been fully repaid and (ii) 15 years from issue date, at which time any remaining principal amount shall be due. As additional consideration, the Company issued 3,000,000 bonus shares to DVOF at a price of \$0.05 per share. The royalty debenture is secured by all the assets of SPI by way of a floating charge in favour of DVOF.

	2017	2016
Royalty debenture	\$ 652,065	\$ 652,065
Less: debt issuance costs	(218,388)	(218,388)
	<u>433,677</u>	<u>433,677</u>
Add : amortization of debt issuance cost	191,798	181,138
	<u>625,475</u>	<u>614,815</u>
Less : current portion	-	-
	<u>\$ 625,475</u>	<u>\$ 614,815</u>

SPECTRA INC.

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The minimum annual principal payments due in each of the next three years are as follows:

2017	\$	-
2018		-
2019		<u>652,065</u>
	\$	<u>652,065</u>

By agreement, the quarterly principal payments due by SPI in 2016 and 2017 totaling \$25,000 each year have been waived, and the royalty portion of payments for the year ended December 30, 2016, totaling \$75,000 was settled in 2016 by way of issuance of 100 common shares of SPI, and has been waived for 2017.

SPECTRA INC.

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

9. Convertible Preferred Shares

On June 1, 2007, SPI completed a \$750,000 private placement with DVOF where SPI issued 750 convertible preferred shares (the “Preferred Shares”) for proceeds of \$667,500 and Spectra issued 1,500,000 common shares at a market value of \$0.055 per share for proceeds of \$82,500.

The preferred shares are non-voting and are convertible into 1,000 common shares of SPI which would represent a 13.35% ownership interest, bringing their interest at that time to 45.62%. The Preferred Shares pay a 6% cumulative annual dividend, payable quarterly, commencing January 1, 2009; are redeemable; are retractable commencing May 31, 2018 (extended by mutual agreement previously from May 31, 2017 and originally from May 31, 2010). The amended agreement allows the 750 preferred shares to be retracted for \$1,000 per share (previously \$1,250 per share). The resulting gain of \$187,500 from the change in retraction price was recognized as a gain on extinguishment of debt in 2016. At September 30, 2017, the convertible preferred shares have accreted to \$658,141 (2016 - \$658,141) and accretion expense of \$0 (2016 - \$0) was included in finance costs. By agreement, the dividends due by SPI in 2013, 2014, 2015 and 2016 amounting to \$45,000 each year have been waived as have the dividends for 2017.

10. Share Capital

Authorized

Unlimited	common shares
Unlimited	first, second, third and fourth preferred shares to be issued in one or more series, redeemable, with rights, privileges, restrictions and conditions to be determined by the Board of Directors upon issuance
540,000	second preferred shares Series 1, non-cumulative dividends of 10% per annum, redeemable at the stated value, non-voting

Issued and outstanding

		2017	2016
60,509,971	(December 31, 2016 – 60,514,837) common shares	\$ 5,313,708	\$ 5,314,136
0	(December 31, 2016 - 90,000) second preferred shares Series 1	<u>0</u>	<u>27,000</u>
		\$ 5,313,708	\$ 5,341,136

On July 20, 2016, subsequent to shareholder approval on May 26, 2016, the Company received TSX Venture Exchange (the “Exchange”) consent to replace the existing escrow agreement (the “Prior Agreement”) with a new arrangement (the “Agreement”) for release of escrowed shares based on scheduled releases in 2016, 2017 and 2018. The first escrow release was completed on August 5, 2016 with the release of 1,552,165 common shares. 1,552,166 common shares were also released in May 2017 and a final release of 1,552,166 common shares in 2018 is scheduled. At September 30, 2017, 1,522,166 shares were held in escrow under the terms of the new “Agreement” (2016 – 3,104,332). On March 31, 2017, 4,866 common shares held under the terms of the “Prior Agreement” were cancelled and an amount of \$428 was transferred to Contributed Surplus.

Also on March 31, 2017, 90,000 second preferred shares Series 1 were cancelled and an amount of \$27,000 was transferred to Contributed Surplus.

10. Share Capital (cont'd)

Stock Options

The Company has a stock option plan for its directors, officers, employees and consultants. The maximum number of shares reserved for issuance under the plan is equal to 10% of the issued and outstanding common shares.

The following table represents all of the Company's stock options granted, exercised, forfeited and expired during the period ended September 30, 2017 and the year ended December 31, 2016:

	2017		2016	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Balance, beginning of period	-	\$ 0.10	300,000	\$ 0.10
Expired	-	0.10	(300,000)	0.10
Balance, end of period	-	\$ -	-	\$ -

No options were granted in the nine-months ended September 30, 2017 nor the year ended December 31, 2016.

For the nine-months ended September 30, 2017, stock-based compensation expense was \$nil (2016 - \$nil). Stock-based compensation expense is recorded in the statement of comprehensive income as a charge to contributed surplus.

As at September 30, 2017, the weighted average remaining contractual life of outstanding options was approximately 0 years (2016 - 0 years) and no options (2016 – no options) were exercisable.

Contributed Surplus

Contributed surplus consists of accumulated share-based compensation expense less the fair value of options at the grant date that were exercised and credited to common shares and share purchase warrants that expired. The current year addition of \$27,428 (2016 - \$96,745) to contributed surplus was derived from the cancellation of 4,866 common shares and 90,000 second preferred shares (2016 - was derived from the conversion feature embedded in the convertible preferred shares as described in note 8).

Issuance and Cancellation of Shares by Subsidiary

As discussed in note 8, SPI issued 0 (2016 – 75) common shares to DVOF. The Company recorded a \$nil royalty payment on the issuance of SPI's common shares in 2017 (2016 - \$56,250), recognized in equity.

These transactions resulted in no change of Spectra's ownership interest of 67.73% in SPI (2016 – reduced from 69.43% to 67.73%)

SPECTRA INC.Notes to Consolidated Financial Statements
September 30, 2017 and 2016**11. Non-controlling Interest**

The Company's subsidiary, Spectra Products Inc. has common shares issued to a shareholder other than its parent company, Spectra Inc. The interest of this shareholder is referred to as the non-controlling interest. The portion of the common share equity and deficit of Spectra Products Inc. attributed to the non-controlling interest is calculated based on their share ownership at the end of each reporting period. This attribution does not impact the Statement of Comprehensive Income, but is only a Statement of Financial Position reclassification. Details of this non-controlling interest are as follows:

	2017	2016
Common shares issued by Spectra Products Inc.		
Total issued	<u>4,075</u>	<u>4,075</u>
Total issued to non-controlling interest	<u>1,315</u>	<u>1,315</u>
Percentage ownership of non-controlling interest	<u>32.27</u>	<u>32.27</u>
Common share equity and deficit of Spectra Products Inc.		
Common share equity	\$ 4,239,950	\$ 4,239,950
Deficit	<u>(5,180,629)</u>	<u>(5,415,617)</u>
Combined common share equity and deficit	<u>\$ (940,679)</u>	<u>\$ (1,175,667)</u>
Allocation of combined common share equity and deficit to non-controlling interest based on percentage ownership at end of year		
Common share equity	\$ 1,368,230	\$ 1,368,230
Deficit	<u>(1,671,786)</u>	<u>(1,747,616)</u>
Combined common share equity and deficit	<u>\$ (303,557)</u>	<u>\$ (379,386)</u>

12. Financial Instruments

a) Fair Value

The carrying value of the Company's financial instruments consisting of cash, accounts receivable and accounts payable and accrued charges approximates their fair value due to their immediate or short-term maturity. The carrying value of the loan payable and royalty debentures approximates fair value as the loans bear interest at a rate which approximates market rate. The convertible preferred shares are adjusted to fair value using the effective interest rate method.

SPECTRA INC.

Notes to Consolidated Financial Statements
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12. Financial Instruments (cont'd)

b) Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of cash and accounts receivable.

Cash is maintained at a major financial institution. Deposits held with a bank may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with a financial institution of reputable credit and therefore bear minimal credit risk.

Credit risk from accounts receivable encompasses the default risk of customers. Credit risk on accounts receivable is minimized as a result of the constant review and evaluation of customer account balances. The Company does not believe that there is significant credit risk arising from customers, as it does not rely on any one major customer. The Company also maintains an allowance for doubtful accounts at an estimated amount, allocating sufficient protection against losses resulting from collecting less than full payments from its receivables.

The Company's maximum credit exposure is represented by the carrying amount of accounts receivable.

c) Foreign Currency Risk

The Company is exposed to currency risk due to a certain portion of the Company's sales and purchases being in U.S. currency, resulting in U.S. dollar denominated accounts receivable and certain U.S. dollar denominated cash balances. These activities result in exposure to fluctuations in foreign currency rates between the U.S. dollar and the Canadian dollar. The Company's sensitivity to these foreign currency fluctuations is such that a 10% strengthening or weakening of the U.S. dollar would result in a respective \$7,947 decrease or increase to the Company's income before taxes for the period ended September 30, 2017. At September 30, 2017, the Company had net assets denominated in U.S. currency of USD \$79,497 (2016 – USD \$62,151) translated into Canadian dollars as shown below, and a foreign exchange gain from operations in the nine months ended September 30, 2017 of \$120,785 (2016 – \$94,161). The Company does not utilize any financial instruments or cash management policies to mitigate the risks arising from changes in foreign currency rates.

	2017	2016
Cash	\$ 7,082	\$ 3,684
Accounts receivable	92,065	84,940
Accounts payable	-	(6,659)
	<u>\$ 99,147</u>	<u>\$ 81,965</u>

d) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company manages liquidity risk through regular monitoring of cash requirements by preparing short-term cash flow forecasts. The financing requirements are addressed through a combination of credit facilities and private placements. The Company's ability to meet its obligations and continue as a going concern is dependent upon achievement of profitable operations. The Company may seek sufficient additional funds to provide working capital, inventory and capital equipment as needs arise, but at the moment, cash flow from operations is sufficient to support current needs. (see note 1).

12. Financial Instruments (cont'd)

d) Liquidity Risk (cont'd)

The following are the contractual maturities of the Company's financial liabilities as at September 30, 2017:

	Due within 1 year	Due between				Total
		1 and 2 years	2 and 3 years	3 and 4 years	4 and 5 years	
Accounts payable and accrued charges	\$ 123,630	\$ -	\$ -	\$ -	\$ -	\$ 123,630
Royalty debenture	-		652,065	-	-	652,065
Convertible preferred shares*	-	750,000	-	-	-	750,000
Total	\$ 123,630	\$ 750,000	\$652,065	\$ -	\$ -	\$ 1,525,695

* Based on first possible retractable date (if not converted). See note 10.

e) Interest Rate Risk

The Company is not exposed to any interest rate risk.

13. Related Party Transactions

- a) During 2017, management fees of \$63,463 (2016 - \$61,390) were paid to a company of a key executive who is a shareholder of the Company.
- b) Included in accounts payable and accrued charges is \$7,172 (2016 - \$3,948) payable to directors.

These transactions were in the normal course of business and recorded at the exchange value established and agreed upon by the related parties.

SPECTRA INC.

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

14. Income Taxes

In assessing the realization of the Company's deferred income tax assets, management considers whether it is probable that some portion or all of the deferred income tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of deferred income tax assets considered realizable could change materially in the near term based on future taxable income generated during the carry-forward period.

Income tax expense varies from the amount that would be computed by applying the combined Federal and Provincial statutory income taxes rate as a result of the following:

	2016	2015 (Restated -note 2)
Expected income tax expense at the combined Federal and provincial rate of 26.50% (2015- 26.50%)	\$ 40,257	\$ 51,752
Increase (decrease) in income taxes resulting from:		
Non-deductible permanent differences	(47,493)	2,987
Temporary difference for which no deferred tax asset was recognized	13,721	(34,334)
Tax loss utilized	-	(20,438)
Other	(6,485)	-
	\$ -	\$ -
Provision for income taxes	\$ -	\$ -

No deferred tax asset has been recognized as the Company is reflecting uncertainties associated with realization of all deferred income tax assets. The significant components of the Company's deferred tax assets are as follows:

	2016	2015 (Restated -note 2)
Net operating losses carried forward	\$ 721,459	\$ 699,151
Equipment	58,027	80,765
Intangible assets	69,949	91,491
Investment and loan receivable	2,981	9,288
Royalty debenture	(9,871)	(13,647)
Convertible preferred shares	1,295	(36,929)
Deferred tax asset	\$ 843,840	\$ 830,119

As at December 31, 2016, the Company has non-capital tax losses available in the amount of approximately \$2,721,800 (2015 – \$2,638,000), which can be carried forward to be applied against future years' taxable income. These losses, if unused, will expire as follows:

2027	\$ 578,000
2028	638,100
2029	384,500
2030	362,600
2031	239,900
2032	281,700
2033	62,100
2034	51,500
2035	61,300
2036	62,100
	\$ 2,721,800

SPECTRA INC.

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

15. Commitments

- a) In 2015, the Company entered into a consulting services agreement with a company controlled by a key executive who is a shareholder of the Company. Under the terms of the consulting services agreement, that company is entitled to fees of \$75,000 per year until December 31, 2017. An annual participation fee, calculated as 5% of the annual net income of SPI, is also payable under the terms of the consulting services agreement. A participation fee of \$10,701 was payable for the year ended December 31, 2016, but was settled at \$7,895 and paid during the year. In December 2016, this consulting services agreement was extended for a further five years on the same terms and conditions and now expires on December 31, 2022.
- b) The Company entered into an extension of its operating lease for its premises. This extension commences on January 1, 2018 and continues for five years until December 31, 2022. Under this lease extension the Company is obligated for base rental payments as follows:

2018	\$	24,207
2019		27,665
2020		28,922
2021		30,180
2022		<u>30,180</u>
	\$	<u>141,154</u>

16. Segmented Information

Sales are attributed to countries based on location of customer.

	2017		2016	
Canada	\$	708,782	\$	793,476
China		28,894		0
United States		594,916		<u>413,175</u>
	\$	<u>1,332,592</u>	\$	<u>1,206,651</u>

In 2017, the Company derived 45% (2016 – 34%) of its revenue from sales to the United States and 2% of its sales from China (2016 – 0%). The Company's equipment is located in Canada.

In 2017, the Company derived sales from three customers amounting to 53% of the total sales revenue (2016 – three customers amounting to 38% of the total revenue).