



Q3 2023

Management's Discussion & Analysis

# Nanalysis Scientific Corp.

**nanalysis**

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## READER AND FORWARD-LOOKING STATEMENT ADVISORY

The Management's Discussion and Analysis ("MD&A") for the three- and nine-month period ended September 30, 2023, of the financial condition and results of operations of Nanalysis Scientific Corp. ("the Company"), is prepared as at November 29, 2023. This discussion should be read in conjunction with the Company's Interim Condensed Consolidated Financial Statements for the period ended September 30, 2023, and notes thereto. Other information on Nanalysis, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.nanalysis.com](http://www.nanalysis.com).

This MD&A and the interim condensed consolidated financial statements were reviewed by the Audit Committee of the Company's Board of Directors and approved by Nanalysis' Board of Directors on November 29, 2023. All dollar figures are in thousands of Canadian dollars, except per share amounts or unless otherwise stated. No requirement exists for these unaudited interim condensed consolidated financial statements to be reviewed by the Company's auditor and, as such, no review was performed.

This discussion should not be considered all-inclusive as it does not include all changes regarding general economic, political, governmental and environmental events.

### **Forward Looking Statements**

This Management's Discussion and Analysis ("MD&A") contains certain forward-looking statements and forward-looking information (collectively referred to herein as "forward-looking statements") within the meaning of applicable Canadian securities laws. All statements other than statements of present or historical fact are forward-looking statements. Forward-looking information is often, but not always, identified by the use of words such as "could", "should", "can", "anticipate", "expect", "believe", "will", "may", "projected", "sustain", "continues", "strategy", "potential", "projects", "grow", "take advantage", "estimate", "well positioned" or similar words suggesting future outcomes. In particular, this MD&A may contain forward-looking statements relating to future opportunities, business strategies, development and production plans and competitive advantages.

The forward-looking statements regarding the Company are based on certain key expectations and assumptions of the Company concerning anticipated financial performance, business prospects, strategies, regulatory developments, exchange rates, tax laws, the sufficiency of budgeted capital expenditures in carrying out planned activities, the availability and cost of labour and services and the ability to obtain financing on acceptable terms and future costs and expenses being based on historical costs and expenses, adjusted for inflation, all of which are subject to change based on market conditions and potential timing delays. Although management of the Company considers these assumptions to be reasonable based on information currently available to them, they may prove to be incorrect.

By their very nature, forward-looking statements involve inherent risks and uncertainties (both general and specific) that forward-looking statements will not be achieved. Undue reliance should not be placed on forward-looking statements, as a number of important factors could cause the actual results to differ materially from the beliefs, plans, objectives, expectations and anticipations, estimates and intentions expressed in the forward-looking statements, including, among other things: general economic and market factors, including business competition, changes in government regulations or in tax laws; component prices; technology development or operational activities; inability to scale manufacturing; changes in market demand; changes in international trade regulations, affecting the Company; timing and availability of external financing on acceptable terms; and lack of qualified, skilled labour or loss of key individuals; as well as those factors detailed from time to time in the Company's interim and annual financial statements and management's discussion and analysis of those statements. Readers are cautioned that the foregoing list is not exhaustive.

The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this MD&A are made as of the date of this MD&A and the Company does not undertake and is not obligated to publicly update such forward-looking statements to reflect new information, subsequent events or otherwise unless so required by applicable securities laws.



## BUSINESS OVERVIEW

### Overview

Nanalysis Scientific Corp. (the "Company") is the ultimate parent in the group. In June 2019, the Company completed a reverse takeover ("RTO") and obtained a listing on the TSX-V under the symbol "NSCI". The Company is headquartered in Calgary, Alberta, Canada and performs product development and manufacturing in its Calgary and Strasbourg facilities.

The Company's executive leadership is responsible for strategic decision making, resource allocation, and assessing financial performance and, as a group, is identified as our chief operating decision maker for the purposes of reporting segment information under International Financial Reporting Standards ("IFRS").

The Company has two primary business lines. Its first business line is the development and distribution of magnetic resonance ("MR") technology into industrial, research and teaching markets through the sale of accessible, affordable and automatable MR systems. By focusing on innovation in both method development and magnet and electronic design, the Company's product line addresses unmet needs of customers in a variety of applications, including pharmaceutical, academia, mining, oil and gas, and the cannabis industry among others. The Company has a focused, direct sales force in the United States, Germany, France, and Canada, and works through a channel of distributors and dealers in other geographical areas to ensure penetration in the current market. In 2022, the Company acquired K'(Prime) Technologies Inc. ("K'Prime"), a North American sales and service company, with a particular focus on scientific instrumentation for pharma, food, chemical and oil & gas customers, as well as imaging systems for security applications. Also in 2022, the Company acquired 43% of Quad Systems AG ("Quad"), a company based in Zurich, Switzerland that offers traditional MR technology with innovative solutions to address long standing limitations of MR technology, including accelerated data acquisition and improved sensitivity in biological samples.

Its second business line, through its expanding security services segment acquired with K'Prime, is to provide preventative and on-call maintenance services for technological detection equipment in a variety of security verticals. Prior to its acquisition by the Company, K'Prime had been providing such services for original equipment manufacturers and individual customers in service lines such as airport security equipment maintenance, secure facility detection equipment maintenance, and installation of such equipment. In May 2022, the Company, through its K'Prime subsidiary, was awarded a five-year, \$160 million contract to provide maintenance services for the Canadian Air Transport Security Authority ("CATSA"). This contract (the "Airport Security Project") allows the Company to materially expand its security services business by providing preventative maintenance, on-call maintenance, and ad-hoc services to CATSA through the second quarter of 2028, with two five-year renewal options thereafter.

The Company's two primary businesses are carried out through four reportable segments: Nanalysis, RS2D, K'Prime, and Corporate:

**Nanalysis:** This segment was founded in 2009 with the specific intent of developing the world's first portable MR spectrometer to address the three main limitations of this powerful magnetic resonance technique – affordability, accessibility and automatability. After approximately four years of development, Nanalysis began shipping its first commercial product in 2012. Since this time Nanalysis has expanded the functionality of this platform and launched the highest performing instrument available in the market to address the industrial market demands for increased performance metrics. Nanalysis is a provider of cutting edge, patent-protected magnetic resonance ("MR") technology to facilitate simple and rapid unknown chemical identification, quantification and diagnostics in a number of end markets including pharmaceutical, biotechnology, chemical, security, food, oil & gas and educational industries. Customers include Eli Lilly, Johnson & Johnson, Takeda Pharmaceutical, BASF, Hitachi Chemical, US Department of Agriculture, Lubrizol, Aramco Services, SABIC, Oxford University, Harvard University and many other Fortune 500 organizations. In 2023, the Company continues to develop its 60Mhz and 100Mhz platforms to further improve manufacturability and continue to

enhance end user experience. Nanalysis is expanding its presence in this market, starting with its 43% investment in QUAD Systems AG in 2022 ("Quad"). In April 2023, Quad launched its full high-field NMR system with a minimum resolution of 400MHz. Nanalysis supports Quad with the development and manufacturing of an NMR console capable of resolutions from 300MHz to 800MHz.

Until July 1, 2023, the Company had an option to acquire 100% of the issued and outstanding shares of Quad at a pre-set valuation formula in a combination of cash and common shares of the Company. The Company had assessed IFRS 10 and has determined that due to the Option and the level of integration between the Company and Quad, the Company had the power to govern the financial and operating policies of Quad. Therefore, the Company considered that it had control over Quad and fully consolidated the results of Quad into its interim condensed consolidated financial statements. Subsequent to June 30, 2023, the Company allowed its option to expire and will no longer consolidate the results of Quad after June 30, 2023, and now uses the equity method of accounting to account for its share of income/loss on associate.

*RS2D:* In March 2020, the Company acquired all outstanding shares of RS2D S.A.S., a complementary technology company based in Strasbourg, France, that specializes in the development of cutting-edge MR electronics. Based on a single electronic board, RS2D has developed MR product lines in high-field ("HF") Nuclear Magnetic Resonance ("NMR") and Magnetic Resonance Imaging ("MRI") that can further advance Nanalysis' existing product line, while rounding out the Company's magnetic resonance technology portfolio.

*K'Prime:* In January 2022, the Company acquired all outstanding shares of K'Prime Technologies Inc. Founded in 1997, K'Prime has two primary business focuses. Its sales and service business line consists of providing manufacturer representative services as an outsourced sales force for original equipment manufacturers of chemical analysis laboratory instrumentation. In addition, the Company provides ad hoc maintenance and other services on the same equipment. In the Company's security services division, the Company provides installation and maintenance services for both general commercial and airport security screening equipment. In May 2022, the Company was awarded a contract by CATSA to provide services for equipment in all of Canada's international airports. The Company is currently providing services in all customer locations required by this contract and expects to be EBITDA positive on the contract in Q4 2023, and fully servicing the contract in early 2024. In addition, K'Prime provides installation and maintenance for a complete spectrum of security equipment, including security cameras, access controls, and screening systems including millimeter wave and X-Ray technology.

*Corporate:* This segment is the corporate entity of the company; included in Corporate is executive, legal, and other administrative costs.

### **Critical Accounting Policies and Estimates**

The preparation of consolidated financial statements and this MD&A requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. The impacts of such estimates are pervasive throughout the consolidated financial statements and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and future periods if the revision affects both current and future periods. These estimates are based on historical experience, current and future economic conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Notes 2 and 3 to the Company's audited consolidated financial statements as at and for the year ended December 31, 2022, contain a description of the accounting policies, judgements, estimates and assumptions that are considered significant.

### **Non-IFRS Measures**

The Company prepares and reports its consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, as adopted by the Canadian Accounting Standards Board ("IFRS"). However, this MD&A may make reference to certain non-IFRS measures including key performance indicators used by management. These measures are not recognized measures under IFRS and do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement those IFRS measures by providing further understanding of the Company's results of operations from management's perspective. Accordingly, these measures should not be considered in isolation nor as a substitute for analysis of the Company's financial information reported under IFRS. The Company uses non-IFRS measures including "gross profits", "Loans and Leases", "EBITDA", and "Working Capital" which may be calculated differently by other companies. These non-IFRS measures and metrics are used to provide investors with supplemental measures of the Company's operating performance and liquidity and thus highlight trends in the Company's business that may not otherwise be apparent when relying solely on IFRS measures. The Company also believes that securities analysts, investors and other interested parties frequently use non-IFRS

measures in the evaluation of companies in similar industries. Management also uses non-IFRS measures and metrics in order to facilitate operating performance comparisons from period to period, to prepare annual operating budgets and forecasts and to determine components of executive compensation. Such terms are defined within this MD&A at the point in which they are introduced. The definitions provided within the MD&A allow for users to determine which IFRS amounts are included in these Non-IFRS Measures.

## PRODUCT SALES

### Product Overview

#### Magnetic Resonance Test, Measurement and Diagnostic Systems

The Company's line of magnetic resonance imaging and spectroscopy systems are designed to offer accessible and affordable options to proliferate the use of this powerful technique in underserved markets (e.g., academia, SME chemical production, etc.), industrial quality assurance and control assays (e.g., pharma/biotechnology, materials/polymers, cannabis, food, etc.), process control (e.g., crude refining, chemical production), and in the future, point-of-need diagnostics (e.g., ski hills, doctor's offices etc.).

By powering the entire range of magnetic resonance products on one electronic platform, the Cameleon 4 or Cam4™, and building tailored software layers from the ground up, Nanalysis can optimize data acquisition, processing, analysis, and integrity. Additionally, it provides the flexibility to provide automated software layers to ensure that these products can be placed with non-experts without compromising repeatability or reliability of the results.



#### Bridging the Gap in MR Accessibility

MRI and nuclear magnetic resonance ("NMR") spectroscopy have long been workhorses of medical diagnostics and chemical analysis. Given the capital and operating expenditures of these instruments, however, they are often limited by accessibility and other, often lesser techniques, are used to supplement the need. To address this issue, in 2009, Nanalysis Scientific Corp.'s first focus was on developing powerful, extremely uniform, permanent magnet-based systems that were more affordable and require little to no maintenance.

Launching its first platform, the 60 MHz in 2012, and the market-leading 100MHz in 2019, Nanalysis decided to expand its magnetic resonance portfolio to offer high-field NMR electronics and accessories and MRI for pre-clinical and OEM applications.

### Technology Portfolio

		Underserved Traditional MR Markets				
		Teaching	Research	Industrial QA/QC	Process	Diagnostics
Benchtop NMR	60 MHz	✓		✓	✓	
	100 MHz	✓	✓			
	Accessories		✓	✓	✓	
		Flow				
		AUTOSample		✓		
HF-NMR	QUAD NMR Console	✓	✓	✓		
	Gecho		✓			
MRI	Cam 4 Console	✓	✓			✓
Software	NMRGUI	✓	✓	✓		
	SPINit	✓	✓			✓
	OneMoon	✓	✓	✓	✓	✓

Benchtop NMR 60 MHz



60 MHz Platform

The initial flagship product of Nanalysis Scientific Corp., this 60 MHz is the most compact, high-performance model in its class. Shipping commercially since 2012, there are almost 1,000 instruments in the field in a variety of applications including academia and industrial QA/QC assay and process chemistry innovator and early adopter adopters.

To grow the market of the 60 MHz product line, Nanalysis is actively working with collaborators in method development to provide the necessary software layers to simplify and automate data analysis and maintain data integrity in several fields (e.g., cannabinoid detection, lithium quantification in brine).

Benchtop NMR 100MHz



100 MHz Platform

With market-leading, unparalleled resolution, the 100 MHz platform was announced to meet the high-end requirements of customers needing higher sensitivity and resolution than the 60 MHz platform can provide. It's easy-to-use, ergonomic touchscreen, and unparalleled data has been well received in the market since it began shipping in late 2020.

High-field NMR



QUAD NMR Console

Aimed as an OEM console for magnet manufacturers, this compact electronics platform can be incorporated on existing super conducting systems ranging from 300-800 MHz.

The Company manufactures the High Field NMR consoles for QUAD, in which the Company holds a 43% direct investment.

High-field NMR



Gecho

NMR is largely considered to be the most information rich analytical technique available to chemists. NMR, however, is limited in sensitivity when compared to ultra-sensitive characterization techniques such as Mass Spectrometry ("MS"). Gecho is aimed at improving industrial QA/QC by allowing higher sensitivity.

### MRI



### Cameleon 4 Console

The Cam 4 console provides a compact and affordable alternative to facilitate adoption of MRI in teaching and to springboard MRI innovations to provide safer high-resolution instruments and develop necessary software for earlier identification with key OEM partners.

## Software Portfolio

### NMRGui

The onboard Nanalysis user interface enables one-click data acquisition and processing for the Benchtop NMR product line. The interface was designed to simplify usage for non-experts while still providing more advanced users with the flexibility to modify acquisition parameters, or experiment sequences as required. This python-based software operates on a Linux operating system to allow users to write their own applications while also ensuring data integrity and automation.

### SPINit

SPINit is an all-in-one MR software platform to facilitate data acquisition, processing and high-level pulse programming for the Company's High-field NMR and MRI product lines. While competitive software packages require coding knowledge and expertise to develop experiments, the SPINit design philosophy is focused on transparency and usability to generate experiments directly from a graphical interface without requiring coding. There are several optional plug-ins to SPINit which allow for tailored workflow and automation to the user. These include SPINplanner (to control an autosampler) and Driver (to launch acquisition from any software).



### NMRFx

The newest component to Nanalysis' MR offerings, the NMRFx Platform offers a suite of premium software tools to streamline and automate MR data analysis and management. Originally developed in a leading pharmaceutical company, this advanced software platform was designed to be a powerful platform to provide routine, high-performance data processing and fill niches in MR data analysis including machine learning and database construction and search algorithms.

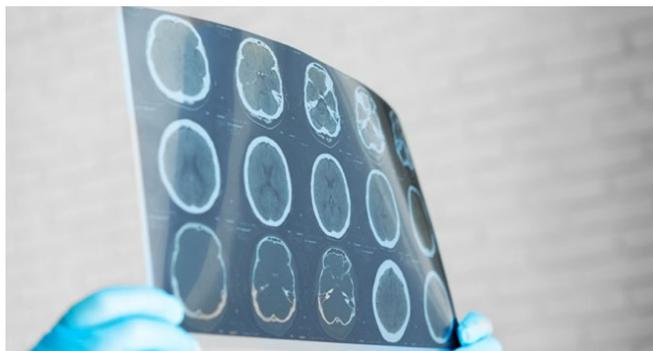
By combining these premium data analysis tools with the NMRGui software interface, Nanalysis offers analysis and application of MR solutions it has been validating.

## Third Party Sales and Service

### K'Prime Third Party Sales

K'Prime is a prominent science analytical instrumentation sale organization that places a top priority on customer satisfaction. With Third Party Sales headquarters in both the USA and Canada, K'Prime has a wide customer base and provides primary service lines in the sale and service of third-party chemical laboratory and analytical instruments for a wide variety of customers. Nanalysis and K'Prime have combined to integrate Nanalysis' existing product offerings with K'Prime's experience in equipment sales, leasing and service, bundling total laboratory solution packages. This includes offering premium training and servicing packages and better targeting specific market verticals where K'Prime has historically developed a significant user base.

## Technology Under Development



### Permanent Magnet Based MRI

By combining the Cam4™ console with Nanalysis' innovative core competencies of making unique, highly homogenous, permanent magnet arrays, the Company is working to make a series of portable MRIs that can be located at point of need to accelerate diagnostics of sprains and facilitate the early detection of tumors.

### Robust Industrial Detector

The unique magnet designs at Nanalysis enable the development of an industrial-hardened spectrometer capable of being incorporated directly into chemical production and refinery type applications. With high-pressure and high-temperature sampling as well as

explosion proof requirements, Nanalysis is working to use their existing benchtop NMR platforms to develop an online sensor that can improve safety, limit by-product formation, and improve yields in a completely automated manner.

### Full High-Field NMR Systems

To offer traditional NMR users improved performance and innovative MR components, as well as improved product scalability, Nanalysis acquired a 43% equity stake in QUAD Systems and their team of experienced MR specialists who have made significant contributions to the manufacture, integration, and development of NMR methods and components. In addition to using Nanalysis Cam4™ based consoles, QUAD Systems is entering the High-Field NMR market with full MR system upgrades and new installations in the academic, pharmaceutical, and chemical industry market. On April 18, 2023, QUAD Systems launched a full 400 MHz high-field NMR system in Monterrey, California, including the Company's High-Field NMR console.

## SECURITY SERVICES

### Airport Security Services

K'Prime offers a variety of security solutions, including specializing in the maintenance of large-scale and highly complex security systems, such as those used in airport security. In May 2022, K'Prime was awarded a six-year, \$160 million contract to service and maintain airport security equipment for CATSA, significantly expanding its presence in the airport security market. The Company began the ramp up of the contract in Q2 2022 and began providing services in Canadian airports in the fourth quarter of 2022. During Q2 2023, the Company expanded its presence into all 81 airport locations across Canada and has continued to expand its service capabilities in each airport through the third quarter. As of the reporting date, the Company has hired 130 employees to service the contract (99% of expected staff requirements). The Company continues to ramp up services in each airport and is expecting to be cash flow positive in the fourth quarter of 2023 and fully covering all airports in early 2024. The Company has invested \$6.5 million to the end of Q3 2023 and is close to completing the ramp-up period. The Company has reached 76% of its transition to full capacity on the CATSA project as at the approval date. Contracts such as this are commonly renewed for an additional five-year term, allowing for a potential 11-year recurring revenue opportunity with inflation-based contractual price increases.

Services provided by the security services group include scheduled preventative maintenance work, corrective maintenance work on both an on-call basis as well as on appointment request, installation and upgrade projects related to both detection and general security equipment, and other technical maintenance services, as requested by its customer, on a wide variety of air passenger screening equipment.

### Commercial Security Services

Through its security services business the Company also provides installation and maintenance services for commercial security equipment such as scanning devices, metal detectors, detection equipment, and other general security equipment in Canada and the United States.

The Company is continuing to pursue growth initiatives in its services business, including exploring expansion within the scientific instrumentation industry, including providing services to customers of the Benchtop NMR and MRI business.

## FINANCE AND OPERATIONS

(\$000's)	Three months ended September 30			Nine months ended September 30		
	2023	2022	(\$ Change)	2023	2022	(\$ Change)
Product sales	3,941	6,145	(2,204)	10,892	15,695	(4,803)
Service revenue	3,095	733	2,362	7,774	1,923	5,851
Total sales and revenue	7,036	6,878	158	18,666	17,618	1,048
Cost of products sold	2,233	3,476	(1,243)	6,774	7,049	(275)
Cost of services	3,177	589	2,588	9,640	1,311	8,329
Total cost of sales	5,410	4,065	1,345	16,414	8,360	8,054
Gross profit	1,626	2,813	(1,187)	2,252	9,258	(7,006)
Expenses						
Sales and marketing	909	1,218	(309)	3,323	3,662	(339)
General and administration	1,873	1,767	106	5,496	5,775	(279)
Research and development	198	446	(248)	733	1,224	(491)
Loss before other items	(1,354)	(618)	(736)	(7,300)	(1,403)	(5,897)
Other Items						
Business acquisition costs and contingent consideration (gain) loss	184	107	77	139	210	(71)
Depreciation and amortization expense	1,073	1,090	(17)	3,361	3,331	30
Finance expense	289	45	244	241	200	41
Stock-based compensation	281	425	(144)	861	1,102	(241)
Foreign exchange loss	79	84	(5)	249	159	90
Loss on loss of control of subsidiary	2,810	-	2,810	2,810	-	2,810
Loss from associate	256	-	256	256	-	256
Restructuring costs	82	-	82	437	-	437
Loss before tax	(6,408)	(2,369)	(4,039)	(15,654)	(6,405)	(9,249)
Current income tax expense (recovery)	13	(9)	22	16	197	(181)
Deferred income tax (recovery) expense	(134)	239	(373)	(1,009)	21	(1,030)
<b>Net loss</b>	<b>(6,287)</b>	<b>(2,599)</b>	<b>(3,688)</b>	<b>(14,661)</b>	<b>(6,623)</b>	<b>(8,038)</b>
Other comprehensive income	97	689	(592)	67	633	(566)
<b>Total comprehensive loss</b>	<b>(6,190)</b>	<b>(1,910)</b>	<b>(4,280)</b>	<b>(14,594)</b>	<b>(5,990)</b>	<b>(8,604)</b>
Share Information						
Loss per share (basic and diluted)	(0.06)	(0.03)	(0.03)	(0.14)	(0.07)	(0.07)
Share price (September 30, 2023)	0.48	0.85	(0.37)	0.48	0.85	(0.37)
Other Information						
Capitalized property plant and equipment	190	2,225	(2,035)	1,078	3,841	(2,763)
Capitalized intangible assets	598	1,718	(1,120)	3,118	4,444	(1,326)
(\$ 000's)	September 30, 2023	December 31, 2022	\$ Change			
Financial Position						
Total assets	52,579	69,902	(17,323)			
Total long-term debt/repayable contributions (includes current portion)	18,125	10,753	7,372			
Total liabilities	27,179	22,330	4,849			
Shareholders' equity	25,400	47,572	(22,172)			

See Footnote 1

<sup>1</sup> Total long-term debt/repayable contributions term bank loan, promissory note, lease liabilities, and long-term debt/repayable contributions.

## Overall Performance and Discussion of Operations

### Revenue

The Company derives revenue from three operating segments, Nanalysis, RS2D and K'Prime. Nanalysis has been involved in the development, manufacturing, and sale of MR spectrometers from inception in 2009. Within the Nanalysis segment, the Company does not engage in consulting services or any other revenue generating activity unrelated to product sales. RS2D is a technology company based in Strasbourg, France, which specializes in the manufacturing of cutting-edge electronics components for precision MR technologies. Its revenue is derived from product sales, licenses, consulting services and contracted installation services of these products. In the K'Prime segment, Nanalysis generates revenue as a sales and service company, located in Canada and the United States of America. As a sales organization, K'Prime sells scientific instrumentation for pharma, food, chemical and oil & gas customers and servicing imaging systems for security applications as a sales team for a major scientific equipment manufacturer. Revenue is generated by earning commissions on these sales. In addition, K'Prime provides maintenance services on these types of scientific instrumentation.

Through its security services team, K'Prime earns revenue by installing and servicing commercial and complex security equipment for a variety of industries, most notably within airport security. K'Prime, upon full launch of its Airport Security Project for CATSA, will be a leading provider of airport security equipment maintenance services in Canada.

### Product Sales

For the three-month period ended September 30, 2023, the Company reported consolidated product sales of \$3,941K, a 36% decrease from the comparable period ended September 30, 2022. Benchtop NMR revenue was down by \$1,336K versus the three months ended September 30, 2022. In 2022 there was a sales backlog against which units were shipped resulting in revenue recognized on sales made in previous quarters. In 2023, there is no existing sales backlog resulting in lower sales than the prior year quarter. Further, Nanalysis segment revenue decreased by \$322K due to Quad no longer being consolidated in Q3 2023. The Company has also seen downward pressure on average selling prices in 2023 due to weakening in the scientific instrumentation market. Compared to Q2 2023, however, Benchtop NMR revenue was up 61% in Q3 2023. Product sales for the RS2D segment were down by \$384K. The Company recognized an additional 10% of the project milestones and recognized a portion of the revenue accordingly related to a large pre-clinical MRI project. This work will continue into the fourth quarter of 2023. Third-party product sales within the K'Prime segment were down \$162K over the three months ended September 30, 2023, as a result of slowing market conditions related to the scientific equipment market.

For the nine months ended September 30, 2023, the Company reported consolidated product sales of \$10,892K, a decrease of \$4,803K or 31% from the comparative period in 2022. K'Prime third-party product sales were down \$987K year over year as a result of softness in the scientific equipment market, particularly in its US regions. The Nanalysis segment accounted for \$3,883K of the drop as a result both downward market pressure, because of continuing effects from the significant turnover in its Benchtop NMR sales organization, and the fact that Quad revenue is no longer consolidated effective July 1, 2023, as noted above. The Company believes that the effects of the sales organization turnover was felt most prominently during Q1 and Q2 of 2023, and in the third quarter has begun to overcome those challenges.

### Service Revenue

For the three-month period ended September 30, 2023, the Company reported \$3,095K in service revenue vs \$733K in Q3 2022. The majority of this increase in revenue was generated by the Airport Security Project as the Company increased its airport coverage significantly in 2023 versus Q3 2022, when the project roll-out had not started yet. This was partially offset by the expiry of a smaller, pre-existing, third-party maintenance contract in Q2 2023. The Company expects revenue from the Airport Security Project to continue to increase as it expands its available services through the remainder of 2023 and into 2024.

For the nine-month period ended September 30, 2023, the Company reported \$7,774K in service revenue as compared to \$1,923K in 2022. In Q3 2023, the Company was generating security services revenue from its legacy services business as well as the aforementioned third-party maintenance contract. In 2023, the Company was ramping up coverage and services provided on its Airport Security Project through to the end of September 30, 2023. Despite some delays faced in the roll-out of the project as a result of training availability and third-party processing times for security clearances, the Company expects to generate positive EBITDA<sup>2</sup> on the project in the fourth quarter of 2023.

### Cost of products sold

Cost of products sold for the Company includes the costs of manufacturing its products as well as the costs of servicing those products. Cost of sales for products is comprised of raw materials, direct costs, direct labor, an allocation of overhead, freight charges, warranty, and depreciation. The Company has consolidated manufacturing for both RS2D and Nanalysis in its facility in Calgary, Alberta.

<sup>2</sup> EBITDA is defined as earnings before Current income tax, Deferred income tax, and Other Items as per the Statement of Loss and Comprehensive Loss

Cost of products sold for the three months ended September 30, 2023, was \$2,233K or 57% of revenue as compared to \$3,476K or 57% of revenue for the same period of the prior year. For the nine months ended September 30, 2023, costs of products sold were \$6,774K or 62% of revenue as compared to \$7,049K or 45% of revenue for the same period of the prior year.

For the nine months ended September 30, 2023, the Company incurred additional warranty expense of \$702K related to replacement of a number of units that required greater than normal customer service intervention. In addition, cost of products sold has increased over the prior year as a result of inflationary pressure on parts prices as well as supply chain restrictions that have had a significant impact on the average cost of the Company's inventory. These supply chain constraints have largely eased, but inflation rates continue to impact parts costs. In addition, the Company had excess labour capacity due to lower sales in Q1 and Q2 of 2023, which resulted in lower utilization of manufacturing labour. These fixed labour costs increased costs of sales for the period. The Company has since implemented reductions in the manufacturing team to better align its human resources with anticipated sales activity as well as to account for significant manufacturing efficiencies which were realized in the second half of 2022. The Company continues to analyze a variety of options to manage parts cost increases and prevent further erosion of margins<sup>3</sup> due to high inventory costs.

See General and administrative expenses below for a discussion on reclassification of costs done during the year to cost of products sold.

#### **Cost of services**

Cost of services include the materials, direct labour, and direct overhead related to existing airport security services provided in the K'Prime segment. Direct labour on the project is deferred while employees are working for the Company and training to take over a particular customer service location. If an airport is being partially served, expenses are recognized in the statement of loss and other comprehensive loss on a pro-rata basis. Once the Company completes the transition process in that location and is fully servicing the respective airports covered by that location, deferred costs related to direct labour for the employees working in that location begin to be amortized into expense, and ongoing labour costs are no longer deferred under IFRS. Revenue generation from that project began in Q4 2022 and locations being serviced have since increased significantly, having a presence in all airports across Canada by the end of the second quarter of 2023. During the three months ended September 30, 2023, the Company continued to expand its rollout and by the approval date, has reached an estimated 76% of coverage on the entire project.

During the three months ended September 30, 2023, the Company deferred \$912K of wages related to the Airport Security Project within prepaid expenses (2022 - \$Nil). In addition, the Company also recorded a net of \$689K of up-front training and related costs for the Airport Security Project in Q3 2023. While the Company will continue to incur ongoing training costs related to employee turnover and recertification, it is expected that ongoing costs will be significantly lower than the initial training investment required to ramp up the Airport Security Project. Under IFRS, training costs cannot be deferred and must be included in the statement of loss and other comprehensive loss during the period in which they are incurred.

During the nine months ended September 30, 2023, the Company deferred \$2,595K of wages related to the Airport Security Project within prepaid expenses (2022 - \$Nil). In addition to regular wages, the Company amortized \$64K of previously deferred wages into cost of services relating to airports that were fully transitioned over to K'Prime. (2022 - \$Nil). As more airports reach full operations, the amount of labour being amortized into income each period will increase.

See General and administrative expenses below for a discussion on reclassification of costs done during the year to cost of services.

#### **Sales and marketing ("S&M")**

S&M expenses include the salaries, benefits, commissions, advertising, marketing expenses, and all related selling costs.

S&M for the three months ended September 30, 2023, was \$909K as compared to \$1,218K for the same period of the prior year. For the nine-months ended September 30, 2023, S&M expenses were \$3,323K as compared to \$3,662K for the same period of the prior year. S&M costs for the three-month period are lower mainly due to a reduction in commissions as a result of a decrease in sales. For the nine-month period, S&M were also down, due to reductions in commission expenses. These reductions were partially offset by inflationary increases related to travel, costs related to the larger rebuilt sales team, as well as new sales and marketing initiatives.

#### **General and administrative expenses ("G&A")**

G&A includes the cost of maintaining a corporate office, all publicly traded company-related expenses as well as administration costs incurred with respect to the day-to-day operations of each segment of the Company. For the three months ended September 30, 2023, G&A was \$1,873K as compared to \$1,767K for the same period of the prior year. For the nine-months ended September 30, 2023, G&A was \$5,496K as compared to \$5,775K for the same period of the prior year.

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<sup>3</sup> Gross margins are calculated as (Product Sales – Cost of Products Sold)/Product Sales

For the three months ended, G&A increased as a result of increased costs in the K'Prime segment related to the Airport Security Project. This was partially offset by decreases in G&A within Benchtop NMR as well as the Corporate segment. For the nine months ended, G&A was lower versus the prior year because of cost reduction initiatives implemented by the Company.

During the year, the Company reclassified certain costs from General and administrative expenses to better reflect the nature of the Costs. As the presentation was adjusted in the current period, no reclassifications were required for the three months ended September, 30, 2023. For the nine months ended September 30, 2023, \$527K was reclassified to Cost of product sold and \$463K to Cost of services relating to the period from January 1, 2023, to June 30, 2023.

For the three months ended September 30, 2022, the Company reclassified \$117K to Cost of product sold and \$42K to Cost of services. For the nine months ended September 30, 2022, the Company reclassified \$203K to Cost of product sold and \$42K to Cost of services.

#### **Research and development expenses ("R&D")**

R&D expenses are research costs that do not meet IFRS criteria to be capitalized to intangible assets and are therefore expensed in the period in which they are incurred. These costs currently stem from research activities from the Nanalysis and RS2D segments, which also included Quad until June 30, 2023. The activities support and are integral to the R&D strategy for the Company. For the three months ended September 30, 2023, R&D was \$198K as compared to \$446K for the same period of the prior year. The Company has reduced its headcount within the R&D group, slowed variable R&D spend in 2023, and the proportion of research and development activities capitalized increased as the Company has focused on more mature development projects in Q3 2023.

For the nine-months ended September 30, 2023, R&D was \$733K as compared to \$1,224K for the same period of the prior year. In 2023, variable spend on R&D activities has been reduced over 2022, and the Company has been focusing on development stage activities that meet the criteria for capitalization.

#### **Amortization of property, plant, equipment and intangibles**

For the three and nine months ended September 30, 2023, amortization was \$1,073K and \$3,361K as compared to \$1,090K and \$3,331K for the respective periods in the prior year. These costs for the three- and nine-month periods were largely flat since no major acquisitions of PPE were done that materially impacted the amortization of PPE, nor were any material new intangibles assets placed into service during these periods.

#### **Finance expense**

For the three and nine months ended September 30, 2023, finance expenses were \$289K and \$241K, respectively, as compared to expense of \$45K and \$200K from the comparable periods in 2022. During the three months ended September 30, 2023, interest on the new ATB \$10,000K loan resulted in higher net interest expense. In addition, the Company recognized accretion expense related to its interest free government loans for accounting purposes. During each period, the Company has also received interest-free government financing, which results in interest income for accounting purposes, which is netted against interest expense. During the three months ended September 30, 2023, this has partially offset interest expense.

#### **Foreign exchange**

Foreign exchange gains or losses typically occur when the exchange rate changes between the time revenue or expenses are recognized and when the resulting receivable is collected, or invoice is paid. Nanalysis conducts the vast majority of its business in US dollars and Euros resulting in exposure to foreign exchange gains and losses.

#### **Loss on loss of control of subsidiary**

On July 1, 2023, the Company allowed its unilateral option to acquire the remaining shares of Quad to expire. As a result, from the date of expiry the Company no longer has the power to govern the financial and operating policies of Quad under IFRS 10 and will cease to consolidate the results of Quad into its interim condensed consolidated financial statements. The expiry of the options resulted in a loss of control of Quad, and the Company derecognized the related assets, liabilities and non-controlling interest on July 1, 2023.

As a result of the deconsolidation process and subsequent required revaluation of Quad, the Company has recognized a loss of \$2,810K in Q3 2023.

#### **Loss from associate**

From July 1, 2023, onward, the Company is accounting for its investment in Quad as an investment in an associate and any income or loss from Quad is included within the income (loss) from associate account in the consolidated statement of loss and comprehensive loss at the Company's proportionate share of ownership.

From the acquisition date through June 30, 2023, the results of Quad were fully consolidated with the results of the Company.

### Restructuring costs

During the second quarter of 2023, the Company began a cost reduction plan, including layoffs, in certain of its segments to better align its resources and reduce its fixed costs. The Company expects to reduce its headcount by over 20% within those specific segments through a combination of both attrition and layoffs. This is expected to generate annualized fixed cost savings in excess of \$2.5 million. The Company is also pursuing other fixed cost reductions, not related to labour cuts, to further increase annualized cost savings. In conjunction with this initiative, the Company recognized restructuring expenses of \$437K for the nine months ended September 30, 2023.

### Net loss

The Company incurred a net loss of \$6,287K for the third quarter, up from a net loss of \$2,599K in Q3 2022. The increase in net loss was driven by the loss on loss of control of Quad, lower margins in Q3 2023, losses in the security services business as a result of one-time up-front training and other non-deferrable costs related to the ramp up of the Airport Security Project, and, to a lesser degree, higher G&A costs, also primarily related to the Airport Security Project.

### Investment in Capital Development Costs and Research and Development Expenditures

(\$000'S)	Three months ended September 30		Nine months ended September 30	
	2023	2022	2023	2022
Gross research and development costs	801	2,277	4,157	5,939
Less: research expenses	(198)	(446)	(733)	(1,224)
Development costs	603	1,831	3,424	4,715
Less: government grants and assistance	(54)	(122)	(406)	(404)
Development costs capitalized to intangibles	549	1,709	3,018	4,311
Less loss of control in subsidiary	-	-	(1,269)	-
Net development costs capitalized to intangibles	549	1,709	1,749	4,311

The Company is engaged in research and development ("R&D") activities and has internally generated intangible assets. Total development costs that meet the criteria for capitalization are reduced by government grants with the net difference being capitalized. Government grants consist of federal grants received under a variety of programs, provincial grants, as well as foreign grants related to work performed in RS2D.

Capitalized development costs are development costs that have met the criteria listed under IFRS for capitalization and represent capital expenditures that the Company believes hold future benefit. Capitalized development costs for three months ended September 30, 2023, were \$549K (2022 - \$1,709K). The primary cause of the drop for the three months ended September 30, 2023, results from the deconsolidation of Quad in Q3 2023. Quad, during 2022, was heavily engaged in R&D activities that drove up the Company's gross research and development costs. In Q3 2023, those costs are no longer included in the Company's results. For the nine months ended, in addition to the deconsolidation of Quad's results, the 2022 completion of certain development projects resulted in the Company scaling back its variable R&D expenditures and also redeployed certain team members off of high field NMR activities as Quad launched its product in Q2 2023.

The Company has continued to review its available R&D resources and has reduced its head count in Q3 2023 to manage fixed costs. This restructuring is included in the broader restructuring costs the Company recognized in Q2 and Q3 2023.

### Summary of Quarterly Results

The following table highlights revenue, cash (used in) provided by operating activities, net loss, and loss per share for the eight most recently completed quarters ended September 30, 2023.

(\$000's) (except per share information)	2023			2022				2021
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Revenue	7,036	6,956	4,674	7,203	6,877	5,187	5,554	5,077
Cash (used in) generated from operating activities	(1,550)	(3,441)	(3,861)	(5,235)	(1,465)	(696)	(959)	(1,511)
Net loss for the period	(6,287)	(4,054)	(4,320)	(3,292)	(2,599)	(2,532)	(1,492)	(658)
Loss per share, basic and diluted	(0.06)	(0.04)	(0.04)	(0.03)	(0.03)	(0.02)	(0.02)	(0.01)

- In Q3 2023, the Company increased its revenue slightly over Q2 2023. Benchtop NMR revenue was up 61% in Q3 over Q2, but this was offset by lower revenue recognition in the RS2D segment related to its large pre-clinical MRI project, and the fact that Quad revenues are no longer included in the Company's revenues as of Q3 2023. Service revenue was also flat, as the Company slowed down its roll-out of the Airport Security Project for most of Q3 due to the busy summer travel season. Cash used in operating activities decreased in Q3 2023 because of cost reduction initiatives, Quad cash used in operating activities no longer being consolidated in the Company's results, and increased margins in the services business over Q2 2023. Net losses were larger in Q3 versus Q2 despite better margins, primarily as a result of the loss on loss of control of Quad and higher interest expenses due to the new bank loan.
- In Q2 2023, the Company increased its revenue over Q2 2022 as the Company has rolled out its Airport Security Project, which was not generating revenue in Q2 2022. In addition, RS2D has made progress on a large MRI project, resulting in 40% of the project's revenue being recognized into income for IFRS purposes during the quarter. This was offset by lower Benchtop NMR sales in Q2 2023 versus Q2 2022. Net loss increased in Q2 2023 versus Q2 2022 because of significant investment in training for Airport Security Project staff, as well as lower Benchtop NMR sales and gross margins.
- In Q1 2023, the Company had lower revenue generated than in Q1 2022 due to reverberations from the disruption of the Company's direct sales force in Q2 2022 that resulted in poor lead generation through the middle of 2022. In addition, while Airport Security Project revenue increased, it was offset by lower revenue in RS2D due to the inability to recognize long-term project revenue under IFRS until later in 2023. Additionally, third-party equipment sales were slower in Q1 2023 than Q1 2022. Net loss increased because of lower sales in Q1 2023, lower margins than prior year, and significant costs related to the roll out of the Airport Security Project in Q1 2023.
- In Q4 2022, revenue grew significantly over Q4 2021 due to strong sales in the Nanalysis segment as well as the additions of sales from the Quad and K'Prime acquisitions. Cash used in operations was significantly higher than the prior year despite increased sales. This is primarily as a result of costs related to the ramp up of the Airport Security Project as well as the acquisition of Quad which is still investing in expanding its operations to bring a full high field NMR system to market. Net losses outpaced net losses in Q4 2021 due to increased cash and non-cash expenses related to new acquisitions, business expansion initiatives such as the Airport Security Project, increases in amortization of intangible assets, and increases in stock-based compensation expenses related to increased head count.
- In Q3 2022, net losses were higher than in Q3 2021, despite strong revenue growth. This is due primarily to increased expense in G&A, depreciation and amortization, and sales and marketing expenses. The increases were due in large part to the acquisitions of K'Prime and Quad. In addition, the Company began incurring non-deferrable training expense, recorded in cost of services, related to the phase in period of the Airport Security Project. During Q4 the Company began generating revenue on this project but will continue to incur expenses to train new employees as the phase in period of the contract continues. The project is expected to reach profitability during the first half of 2023.
- In Q2 2022, net losses increased despite revenue growth over prior year, as the Company continued to execute on its growth plans. Losses also increased due to increased stock-based compensation, increased depreciation and amortization and compressed margins in 2022. During the quarter, the Company also invested \$1,304K in property, plant and equipment, primarily related to expanding manufacturing capacity for MR product lines.
- Q1 2022 saw increased revenue quarter over quarter, net loss increased due to increased costs stemming from acquisitions, specifically increased stock-based compensation, increased depreciation and amortization and compressed margins.
- Q4 2021 continued to see a significant increase to revenue and led to a strong YTD revenue. Results were slightly hindered due to severance costs, increased stock-based compensation, increased depreciation and amortization and slightly reduced margins.

## LIQUIDITY & CAPITAL RESOURCES

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern and manage capital so that it can continue to provide returns for shareholders and benefits for other stakeholders through the development, maintenance, and expansion of its operating segments.

The Company defines its capital as share capital, debt and contributed surplus. The Company manages the capital structure and adjusts it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company's liquidity needs in the short and long term can be addressed in multiple ways including with funds from operations, available cash balances, new debt instruments, equity issuances and government funding. The Company monitors its financing requirements through regular forecasting of its cash position. Financing decisions are based on the timing and extent of expected operating and capital outlays. The Company has financed its capital requirements primarily through loans and share issuances since inception. The Company may issue new securities. The Company is not subject to any externally imposed capital requirements.

### Working Capital

(\$000's)	September 30, 2023	December 31, 2022	\$ Change
Cash	1,271	3,525	(2,254)
Loans and leases <sup>(b)</sup>	18,045	10,637	7,408
Working capital <sup>(a)</sup>	5,602	8,449	(2,847)

(a) Working capital is calculated as current assets less current liabilities.

(b) Loans and leases are calculated as the current and long-term portions of the line of credit, long-term debt/repayable contributions excluding promissory notes, and lease liabilities.

As at September 30, 2023, the Company had \$5,602K of working capital (December 31, 2022 – \$8,449K). This includes \$1,271K of cash (December 31, 2022 - \$3,525K). The decrease in working capital is mainly due to continued use of cash flows in operations as the Company continues its roll-out of the Airport Security Project and continues to rebuild sales in the Benchtop NMR portion of the Company. On June 29, 2023, the Company entered two new debt facilities with ATB Financial, being a term loan and an operating line of credit (the "ATB Facilities"). The Company used the proceeds from the ATB Facilities to repay its existing operating line of credit and had no balance on its new operating line as at end of September 30, 2023. The Company continues to closely manage its available liquidity and resources as at September 30, 2023, to ensure sufficient capital to support all research, development, and project initiatives including the Airport Security Project.

For further details, please see the Share Capital and Long-Term Debt sections of this MD&A.

### Loans and Borrowings

(\$000's)	Note	September 30, 2023	December 31, 2022
Western Economic Diversification Canada Interest-free loans	A	1,672	2,021
Prêt garanti par l'état Euro denominated loan	B	79	102
Procédure de sauvegarde interest free Euro denominated loan	B	286	538
Regional Recovery Relief Fund interest-free loan	A	700	913
Business Scale-up interest-free loan	A	2,885	1,121
Line of credit	C	-	2,541
Term Bank loan	D	10,000	-
Other		82	89
Loans and borrowings		15,704	7,325
Add: Promissory note on acquisition of One Moon Scientific	E	80	116
<b>Total loans and borrowings</b>		<b>15,784</b>	<b>7,441</b>
Less : Deferred finance fees	D	(230)	-
<b>Total loans and borrowings net of finance fees</b>		<b>15,554</b>	<b>7,441</b>
Less: current portion		2,953	3,655
<b>Non-current portion of loans and borrowings</b>		<b>12,601</b>	<b>3,786</b>

### Credit Facilities

#### Note A - Nanalysis

The Company has two interest free loans Western Economic Diversification Canada ("WINN") as per below:

- WINN #1: \$496K repayable in monthly installments of \$8K commencing June 30, 2017, which matured and was fully repaid on February 28, 2023.
- WINN #2: \$2,773K repayable in monthly installments of \$46K commencing February 1, 2022, and maturing January 31, 2027. The obligation is recorded at its present value using a 6.0% discount rate. Any amounts in default will incur interest at the Bank of Canada's interest rate plus 3% compounded monthly. This loan is unsecured.
- Regional Recovery Relief Fund: \$1,000K repayable in 35 monthly installments of \$28K commencing January 1, 2023. The obligation is recorded at its present value using a 6.0% discount rate. Any amounts in default will incur interest at the Bank of Canada's interest rate plus 3% compounded monthly. This loan is unsecured.
- Business Scale-up: In 2022, the Company received a funding contribution commitment of \$5.0 million from Prairies Economic Development Canada's Business Scale-up and Productivity program. The Company began drawing on the loan in 2022 and will continue to draw on the loan until the earlier of drawing the full available amount of the facility or the beginning of repayments on September 1, 2025. As at September 30, 2023, the Company had withdrawn 72% of the available funding (December 31, 2022 – 30%). The obligation is recorded at its present value using a 6.0%-7.6% discount rate depending on the timing of each drawdown on the facility. Any amounts in default will incur interest at the Bank of Canada's interest rate plus 3% compounded monthly. This loan is unsecured.

#### Note B – RS2D

RS2D has two Euro denominated loans as per below:

- Prêt garanti par l'état – (PGE) is an unsecured Euro denominated loan granted by the French state to RS2D. The loan bears interest at 0.7% and is repayable in monthly installments of \$2.5K commencing on July 20, 2021, maturing June 20, 2026. The obligation is recorded as its present value using a 2.5% discount rate.
- Procédure de sauvegarde is an unsecured interest free Euro denominated loan repayable in annual payments due each June, with the final payment maturing June 2024. The obligation is recorded as its present value using a 2.5% discount rate.

Note C – Line of Credit

On November 18, 2022, the Company consolidated its varied operating line facilities into one operating facility with a single Canadian financial institution. Under the consolidated facility, the Company could borrow up to the lesser of its borrowing base, which is based on its accounts receivable, inventory, and sales lease receivable balances, and \$9,000K, at an interest rate of prime plus 0.65%. The facility also bore a standby fee of 0.2% per annum on the unused portion of the facility. The facility is secured by a general security agreement over the property of Nanalysis Scientific Corp. and its significant subsidiaries.

On June 29, 2023, the Company repaid this facility and replaced it with a revolving operating facility from ATB Financial as well as a \$10,000K term loan (Note D). Under this revolving line of credit, the Company may borrow up to \$5,000K at an interest rate of prime plus 1%. This facility also bears a standby fee of 0.4% per annum on the unused portion of the facility. The borrowing base of the facility is based on the value of the Company's accounts receivables and inventory, less any amounts outstanding on its \$300K credit card facility, also advanced by ATB Financial. The available borrowing base for the Company at September 30, 2023, was \$4,504K.

Note D – Term Bank Loan

In conjunction with the advancement of a new revolving operating facility under Note C, the Company obtained a term loan of \$10,000K from ATB Financial. This term loan was advanced in one tranche on June 29, 2023, and bears interest at a rate of prime plus 2.50% until March 31, 2024, and thereafter, subject to the satisfactory review of the financial covenants, at a rate of prime plus 2%.

The loan amortizes over 48 months, with repayments beginning in January 2024.

Both facilities are secured by a general security agreement over the property of Nanalysis Scientific Corp. and its significant subsidiaries. As a condition of both the operating and term facilities, the Company must maintain a current ratio of 1.10:1.00. At September 30, 2023, the Company's applicable current ratio was 1.58:1.00.

Furthermore, beginning in the quarter ending March 31, 2024, the Company must maintain two additional covenants; funded debt to EBITDA must not exceed 3.50:1 and maintain a fixed charge coverage ratio of greater than or equal to 1.20:1.

Note E - Promissory note

The Company issued as part of its consideration for the acquisition of One Moon Scientific during the year ended December 31, 2021, four promissory notes for 82,472 common shares which, at the date of acquisition, were valued at a price of C\$1.34 per share resulting in a value assigned to each promissory note of \$87.5K USD. On the maturity date, the Company at its sole option, shall repay the total indebtedness of the note by: (i) the issuance of 82,472 common shares, (ii) a USD cash payment equal to the value of 82,472 common shares using the volume weighted average of the closing sales prices of common shares on the TSX Venture Exchange Inc. during the five (5) trading days immediately preceding the maturity date and using the average of the Bank of Canada U.S. dollar daily exchange rate during the five (5) trading days immediately preceding the maturity date. The promissory note is unsecured and bears no interest. The obligation is accounted for as a derivative financial liability as a result of its settlement in a foreign currency that differs from the Company's functional currency and its measurement being based on the share price of the Company at settlement date. It is revalued to fair value at each reporting period (Note 15).

The first and second promissory notes were settled in shares during the financial year ended December 31, 2022. The third and fourth promissory notes mature on December 31, 2023, and December 31, 2024, respectively.

Nanalysis Scientific Corporation  
Management's Discussion and Analysis

For the three- and nine-month period ended September 30, 2023



**Lease Liabilities**

(\$000's)	Nine months ended September 30, 2023	Twelve months ended December 31, 2022
Balance beginning of the period	3,312	1,304
Additions	414	1,874
Additions from K'Prime acquisition	-	306
Additions from Quad acquisition	-	638
Interest expense	148	159
Lease payments	(580)	(832)
Loss of control of subsidiary	(588)	-
Foreign exchange	13	22
<b>Balance, end of the period</b>	<b>2,571</b>	<b>3,312</b>
Current portion	650	785
Long-term portion	1,921	2,527

The Company and its subsidiaries have commitments under leases for buildings, office space and vehicles with varying terms that expire between 2023 and 2027.

The Company also has contractual commitments for leases that are short-term or low-value and accounts for them as operating leases. These operating leases relate to airport spaces and the leases are due as follows:

(\$000's)	2023
Within one year	55
1-3 years	60
4-5 years	26
<b>Total operating leases payable</b>	<b>141</b>

**Off-Balance Sheet Arrangements**

The Company does not have any off-balance sheet financing arrangements except for the short-term or low-value leases as disclosed above.

**Financial Management**

(\$000's)	Nine months ended September 30, 2023,		
	2023	2022	\$ Change
Cash generated provided by (used in):			
Operating activities	(8,852)	(3,120)	(5,732)
Investing activities	(4,697)	(11,078)	6,381
Financing activities	11,295	11,718	(423)
(Decrease) / Increase in cash	(2,254)	(2,480)	226

Cash used for operations was higher for the nine months ended September 30, 2023, from the same period in 2022 by \$5,732K. The increase is due to higher expenses related to the ramp up of the Airport Security Project related to training, travel, and deferred wages as the project continues to ramp up, as well as lower sales and margins in the Nanalysis segment.

Cash flows used in investing activities decreased significantly for the nine months ended September 30, 2023, from the same period in 2022 by \$6,381K. Higher investing cash flows in the prior year were due to the acquisitions of Quad and K'Prime.

Cash flows provided by financing activities for the nine months ended September 30, 2023, decreased by \$423K from the same period in 2022. In prior year comparative figures, cash flows were provided by a financing in Q1 generating \$13,886K in net proceeds. In 2023, cash flows were provided by a financing in Q2 of \$4,006K in net proceeds, a term loan of \$10,000K, and deferred finance fees of \$230K, and additional Government repayable funding of \$1,663K.

## SHARE CAPITAL

### [a] Authorized

Unlimited number of common shares, without nominal or par value  
 Unlimited number of Class A voting preferred shares without par value  
 Unlimited number of Class B non-voting preferred shares without par value

### [b] Issued

#### Common shares

Common Shares Issued	Number
<b>Balance, December 31, 2021</b>	<b>77,165,693</b>
Issuance of common shares	13,840,637
Acquisition of K'Prime	2,760,000
Exercise of stock options and RSUs	517,000
Settlement of promissory notes	164,944
<b>Balance, December 31, 2022</b>	<b>94,448,274</b>
Issuance of common shares	6,881,167
Exercise of stock options and RSUs	96,000
<b>Balance, September 30, 2023</b>	<b>101,425,441</b>

There are 690,000 shares under lock up issued for the acquisition of K'Prime. These common shares are scheduled for release on December 31, 2023. Shares issued in consideration for K'Prime are also subject to certain contractual obligations until December 31, 2023.

During the three months ended September 30, 2023, the Company completed a non-brokered private placement of 6,881,167 units of the Company at a price of \$0.60 per unit and aggregate gross proceeds of \$4,129K and net proceeds of \$4,006K. Each unit consisted of one common share of the Company and one full warrant exercisable at \$0.80 for a period of one year after the closing date of the offering. The Company closed the offering in two tranches on April 26, 2023, and May 3, 2023.

**[c] Loss per share**

(\$000's) except for number of shares	Three months ended September 30,		Nine months ended September 30,	
	2023	2022	2023	2022
<b>Numerator</b>				
Loss attributable to common shares (\$)	(6,287)	(2,465)	(14,073)	(6,211)
<b>Denominator</b>				
Weighted average number of shares for basic earning per share calculation (000's)	101,424	94,215	98,403	91,878
Weighted average number of shares for diluted earning per share calculation (000's)	101,424	94,215	98,403	91,878
Basic loss per common share (\$/share)	(0.06)	(0.03)	(0.14)	(0.07)
Diluted loss per common share (\$/share)	(0.06)	(0.03)	(0.14)	(0.07)

All potentially dilutive instruments were excluded from the diluted weighted-average share calculation as they were anti-dilutive to the loss for the period.

**[d] Stock options**

The Company has a stock option plan that provides for the issuance of options to eligible persons. The option price under each option granted must be no less than the discount market price defined by the TSX-V. The term of the options must be no longer than 5 years and the directors determine the vesting period, which is typically 3 years. The maximum number of outstanding options must be no more than 10% of the issued and outstanding common shares at any point in time, with the 10% including both stock options and restricted share units. The maximum number of outstanding options issued for investor relations must be no more than 2% of the issued and outstanding shares, and options issued for investor relations must vest in stages over a 12-month period with no more than one quarter of the options vesting in any three-month period.

Stock Options Outstanding	Number	Weighted Average Exercise Price (\$)
<b>Balance, December 31, 2021</b>	<b>4,893,334</b>	<b>0.62</b>
Granted	3,598,000	1.28
Exercised	(496,695)	0.54
Forfeitures	(304,000)	0.76
<b>Balance, December 31, 2022</b>	<b>7,690,639</b>	<b>1.04</b>
Granted	1,098,249	1.10
Exercised	(56,000)	0.45
Forfeitures	(832,478)	0.96
<b>Balance, June 30, 2023</b>	<b>7,900,410</b>	<b>1.12</b>

The fair values of stock options granted were estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2023	2022
Risk-free interest rate	2.9% - 4.09%	1.39% - 3.32%
Estimated annualized volatility based on historical performance	74% - 76%	73% - 75%
Expected life	5.0 years	5.0 years
Expected dividend yield	0%	0%
Exercise price	\$1.10	\$1.10 - \$1.50

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As at September 30, 2023, the Company had the following stock options outstanding and exercisable:

Exercise Price (\$)	Number of Options Outstanding	Weighted Average Life	Number of Options Exercisable
\$ 0.60	3,145,001	1.51	2,869,167
\$ 0.75	200,000	0.78	200,000
\$ 1.10	1,628,909	4.32	105,833
\$ 1.20	35,000	3.73	11,667
\$ 1.24	50,000	3.04	50,000
\$ 1.30	100,000	2.76	100,000
\$ 1.32	2,291,500	3.42	763,833
\$ 1.50	350,000	3.23	250,000
\$ 1.70	100,000	3.13	33,000
	<b>7,900,410</b>		<b>4,383,500</b>

**[e] Restricted Share Units ("RSUs")**

The Company maintains an RSU plan as compensation for certain directors of the Company. These RSUs vest over three years from the grant date and expire at the end of the third full calendar year subsequent to the grant date.

RSUs Outstanding	Number
<b>Balance, December 31, 2021</b>	<b>280,000</b>
Granted	60,000
Exercised	(20,000)
<b>Balance, December 31, 2022</b>	<b>320,000</b>
Granted	135,000
Exercised	(40,000)
<b>Balance, September 30, 2023</b>	<b>415,000</b>

**[f] Stock-based compensation expense**

(\$000's)	Three months ended September 30		Six months ended September 30	
	2023	2022	2023	2022
Stock-based compensation expenses related to stock options	259	406	794	1,044
Stock-based compensation expenses related to RSUs	22	19	67	58
<b>Total</b>	<b>281</b>	<b>425</b>	<b>861</b>	<b>1,102</b>

**[g] Warrants**

Warrants Outstanding	Number	Weighted Average Exercise Price (\$)
<b>Balance, December 31, 2021</b>	<b>5,119,038</b>	<b>1.70</b>
Issued	784,875	1.70
<b>Balance, December 31, 2022</b>	<b>5,903,913</b>	<b>1.70</b>
Issued	7,381,167	0.80
Expired	(5,119,038)	1.70
<b>Balance, September 30, 2023</b>	<b>8,166,042</b>	

Type of Warrant	Expiry Date	Exercise Price (\$)	Number of Warrants	
			Outstanding	Vested and Exercisable
Warrant	August 25, 2023	\$ 1.70	-	-
Broker warrant	August 25, 2023	\$ 1.70	-	-
Broker warrant	February 11, 2024	\$ 1.70	784,875	784,875
Warrant	April 26, 2024	\$ 0.80	3,738,667	3,738,667
Warrant	May 3, 2024	\$ 0.80	3,142,500	3,142,500
Warrant	June 29, 2025	\$ 0.80	500,000	500,000
			<b>8,166,042</b>	<b>8,166,042</b>

The warrants expiring on April 26 and May 3, 2024, were issued as part of each unit issued in the private placement discussed above in section [a].

On June 29, 2023, the Company issued 500,000 standalone warrants to its financial institution in connection with the closing of its revolving loan and term loan facilities. The fair value of the warrants was determined to be \$0.12 per warrant.

During the period ending September 30, 2023, 5,119,038 warrants have expired resulting in a movement in contributed surplus of \$549K.

**REVENUE AND SEGMENT INFORMATION**

**[a] Segment information**

The Company's activities are carried out through four reportable segments: Nanalysis, RS2D, K'Prime, and Corporate. The Company's executive leadership is responsible for strategic decision making, resource allocation, and assessing financial performance and, as a group, is identified as our chief operating decision maker for the purposes of reporting segment information under International Financial Reporting Standards ("IFRS").

Inter-segment transactions are recorded at values that approximate third-party selling prices and are eliminated for segmented reporting.

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(\$000's)

Three months ended September 30, 2023	Nanalysis	RS2D	K'Prime	Corporate	Total
Revenue	2,462	750	3,824	-	7,036
Loss before other items	(63)	(195)	(502)	(594)	(1,354)
Net loss	(496)	(673)	(563)	(4,555)	(6,287)
Depreciation and amortization expense	681	153	239	-	1,073
Capital expenditures	497	98	9	-	604
Total assets as at September 30, 2023	22,291	6,234	17,142	6,912	52,579

(\$000's)

Three months ended September 30, 2022	Nanalysis	RS2D	K'Prime	Corporate	Total
Revenue	4,120	1,135	1,623	-	6,878
Loss before other items	504	(474)	(104)	(544)	(618)
Net loss	(597)	(615)	(261)	(1,126)	(2,599)
Depreciation and amortization expense	772	147	171	-	1,090
Capital expenditures	2,121	42	232	-	2,395
Total assets as at September 30, 2022	50,362	6,191	15,228	1,105	72,886

(\$000's)

Nine months ended September 30, 2023	Nanalysis	RS2D	K'Prime	Corporate	Total
Revenue	6,189	2,482	9,995	-	18,666
Loss before other items	(2,349)	(314)	(2,806)	(1,831)	(7,300)
Net loss	(4,274)	(1,124)	(2,774)	(6,489)	(14,661)
Depreciation and amortization expense	2,215	445	701	-	3,361
Capital expenditures	3,237	423	75	-	3,735
Total assets as at September 30, 2023	22,291	6,234	17,142	6,912	52,579

(\$000's)

Nine months ended September 30, 2022	Nanalysis	RS2D	K'Prime	Corporate	Total
Revenue	10,072	2,416	5,130	-	17,618
Loss before other items	80	(351)	663	(1,795)	(1,403)
Net loss	(2,613)	(857)	8	(3,161)	(6,623)
Depreciation and amortization expense	2,374	462	495	-	3,331
Capital expenditures	6,405	78	253	-	6,736
Total assets as at September 30, 2022	50,362	6,191	15,228	1,105	72,886

**[b] Non-controlling interest**

Quad results from January 1, 2023, through June 30, 2023, were included within the Nanalysis segment. From July 1, 2023, onward, the result of Quad is accounted for using the equity method of accounting (Note 4).

The proportion of equity in Quad held by non-controlling interests is 57% at September 30, 2023 (September 30, 2022 - 57%). The non-controlling interest revenue portion for Quad is as follows:

	For the nine months ended September 30,	
	2023	2022
<b>Revenue</b>		
Attributable to:		
Equity holders of Nanalysis Scientific Corp.	517	457
Non-controlling interest	222	191
	295	265

**[c] Geographic segments**

The Company's revenues are allocated to geographic segments as follows:

(\$000's)	Three months ended September 30		Nine months ended September 30	
	2023	2022	2023	2022
Canada	3,635	3,307	9,690	9,479
United States of America	2,003	1,382	4,675	3,699
Europe	1,164	1,155	2,728	2,362
Asia	226	689	1,400	947
Other (Brazil, Chile, India, Mexico, Morocco, Nigeria)	8	345	173	1,131
	<b>7,036</b>	<b>6,878</b>	<b>18,666</b>	<b>17,618</b>

**FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

**[a] Fair value of financial instruments**

The carrying values of cash, accounts receivable, other receivables, accounts payable and accrued liabilities, and the line of credit approximate fair value due to the short-term nature of these instruments. The carrying value of sales lease receivables approximates fair value less costs to sell based on management's best estimate of costs to sell at the reporting date.

**[b] Fair value of promissory notes**

The Company accounts for its promissory note as a derivative financial liability and revalues the note using the Company's quoted market share price at the reporting period for unmatured portions of the liability, based on a specified formula within the note. During the three and nine months ended September 2023, the value of the promissory note decreased / increased resulting in an unrealized (loss) gain to the Company of (\$2K) and \$35K (three and nine months ended September 30, 2022 - \$43K and \$170K).

**[c] Fair value of contingent consideration**

Contingent consideration related to the K'Prime acquisition is based on K'Prime reaching certain performance goals related to overall segment performance to be settled in cash, as well as contingent consideration related to the performance on a specific contract to be settled in shares of the Company. The cash settled portion is based on revenue targets for K'Prime for 2023, which the Company believes are likely to be met. The contingent consideration has therefore been valued using an income approach, discounted using a risk-adjusted discount rate estimated to best reflect K'Prime's ongoing operations. The Company evaluates all inputs, including the

risk-adjusted discount rate at each reporting period. The share settled portion of contingent consideration is based on a set percentage of revenue from a specific contract within K'Prime.

The Company has determined, using internal forecasts, the estimated amount of share consideration and valued it using an income approach, discounted using a risk-adjusted discount rate specific to that contract. Forecast amounts of contingent consideration and the risk-adjusted discount rate are evaluated by the Company at each reporting period.

For the three and nine months ended September 30, 2023, the Company recognized an unrealized (loss) gain of (\$176K) and \$174K related to revaluation of contingent consideration related to the K'Prime acquisition within business acquisition costs (three and nine months ended September 30, 2022 – (\$279K) and (\$279K)).

Contingent consideration payable to One Moon Scientific ("OMS") is based on performance goals related to specific targets that OMS must meet over through the end of 2024. The Company has used internal forecasts to estimate the amount of each component of contingent consideration and valued it using an income approach, discounted using a risk-adjusted discount rate. The entity reassesses the forecast and estimated amount of contingent consideration and revises the risk-free discount rate based on available market data at each reporting period.

For the three and nine months ended September 30, 2023, the Company recognized an unrealized (loss) gain of (\$6K) and \$Nil related to revaluation of contingent consideration related to the OMS acquisition within business acquisition costs (three and nine months ended September 30, 2022 - \$130k and \$130K).

Significant assumptions used in valuation of contingent consideration include forecasted revenue and applicable discount rates.

#### [d] Fair value hierarchy

The three-level hierarchy reflects the significance of inputs used when determining fair value:

- **Level 1:** Fair value is determined using readily observable inputs from public or active markets.
- **Level 2:** Fair value is determined using inputs other than those quoted in public or active markets and may be both directly and indirectly observable.
- **Level 3:** Fair value is derived using unobservable inputs for which there is little to no available market data, and therefore the Company must develop its own assumptions for valuation.

#### September 30, 2023

(\$000's)	Level 1	Level 2	Level 3	Total
<b>Financial liabilities at fair value through profit or loss</b>				
Contingent consideration	-	-	1,622	<b>1,622</b>
<b>Derivative liabilities not designated as hedging instruments</b>				
Promissory note	80	-	-	<b>80</b>
<b>Total</b>	<b>80</b>	<b>-</b>	<b>1,622</b>	<b>1,702</b>
Current portion	40	-	814	<b>854</b>
Long-term portion	40	-	808	<b>848</b>

**December 31, 2022**

(\$000's)	Level 1	Level 2	Level 3	Total
<b>Financial liabilities at fair value through profit or loss</b>				
Contingent consideration	-	-	1,948	<b>1,948</b>
<b>Derivative liabilities not designated as hedging instruments</b>				
Promissory note	116	-	-	<b>116</b>
<b>Total</b>	<b>116</b>	<b>-</b>	<b>1,948</b>	<b>2,064</b>
Current portion	58	-	810	868
Long-term portion	58	-	1,138	1,196

The Company did not transfer any financial instruments between valuation hierarchy levels between December 31, 2022, and September 30, 2023.

**[e] Risk management**

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk,
- Liquidity risk,
- Market risk,
- Currency risk,
- Interest rate risk, and,
- Economic dependence.

The following presents information about the Company's exposure to each of the above risks and the Company's objectives, policies, and processes for measuring and managing risk.

**[i] Risk management framework**

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities.

**[ii] Credit risk**

Credit risk is the risk of a financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations. The Company is exposed to credit risk in the event of non-performance by counterparties in connection with its cash, accounts receivable, and other receivables. The Company's maximum exposure to credit risk at September 30, 2023, is the carrying amount of cash, accounts receivable, and other receivables on the consolidated statements of financial position. The Company mitigates this risk by holding its cash in major Canadian financial institutions and performing credit enquiries on its customers.

Management regularly assesses the Company's exposure to credit risk and provides allowances for potentially uncollectible accounts receivable as they become known. Although collection of these receivables could be influenced by economic factors, management considers the risk of significant loss to be mitigated by the number, reputation, and nature of the companies with which the Company does business. Trade accounts receivable are written off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of the counterparty to engage in a repayment plan with the Company and a failure to make contractual payments for a period of greater than 180 days past due. During the nine months ended September 30, 2023, \$55K of previously recognized bad debts were recovered (expense for the nine months ended September 30, 2022 - \$145K).

**[iii] Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its obligations as they come due. As of September 30, 2023, the Company had working capital of \$5,602K (December 31, 2022 - \$8,449K). The Company's exposure to liquidity risk is dependent on its ability to capitalize on its research and development, ability to manufacture and deploy new products, sale of inventory, collection of accounts receivable and other receivables, and the raising of funds to meet commitments, sustain operations, continue research and development, and service contracts. The Company manages liquidity risk by management of working capital, cash flows, availability of borrowing facilities and share issuances.

**[iv] Market risk**

Market risk is the risk of loss that results from changes in market prices. Market risk is comprised of foreign currency risk and interest rate risk. The level of market risk to which the Company is exposed to depends on market conditions, expectations of future price or market rate movements and the composition of the Company's financial assets and liabilities. The Company regularly monitors market risk exposure, tolerance and control processes in order to manage the exposure related to changes in market risk and to stay within acceptable market risk limits.

**[v] Currency risk**

The Company is exposed to the financial risk related to the fluctuation of foreign exchanges rates. The majority of the Company's sales are in U.S. dollars. The Company has not entered into foreign exchange derivative contracts.

The Company had the following assets and liabilities denominated in U.S. dollars at the end of period:

(\$000's)	September 30, 2023	December 31, 2022
	US\$	US\$
Cash	144	580
Accounts receivable	1,789	3,460
Prepayments	127	127
Lease receivables	-	1,182
Inventory	95	212
Accounts payable & accrued liabilities	(613)	(1,225)
Unearned revenue	(696)	(772)
Debt and lease liabilities	(496)	(574)
<b>Total</b>	<b>350</b>	<b>2,990</b>

The above assets and liabilities were translated using an exchange rate of 1.35 at September 30, 2023 (December 31, 2022 – 1.35). Based on the above net exposure, as at September 30, 2023, and December 31, 2022, assuming all other variables remain constant, a 10% appreciation or deterioration of the Canadian dollar against the U.S. dollar would result in a change of approximately \$47K (December 31, 2022 - \$405K) in the Company's other comprehensive income. Total sales in U.S. dollars for the nine months ended September 30, 2023, were \$5,886K (2022 - \$9,629K). A 10% appreciation or deterioration of the Canadian dollar against the U.S. dollar would result in a change of approximately \$792K (2022 - \$1,235K).

The Company had the following assets and liabilities denominated in Euros at the end of the period:

(\$000's)	September 30, 2023	December 31, 2022
	Euro (€)	Euro (€)
Cash	220	293
Accounts receivable	659	662
Prepayments and other receivables	505	49
Inventory	140	193
Accounts payable and accrued liabilities	(1,002)	(1,008)
Unearned revenue	(684)	(1,178)
Debt and lease liabilities	(347)	(574)
<b>Total</b>	<b>(509)</b>	<b>(1,563)</b>

The above assets and liabilities were translated at 1.43 at September 30, 2023 (December 31, 2022 – 1.45). Based on the above net exposure as at September 30, 2023, and December 31, 2022, assuming that all other variables remain constant, a 10% appreciation or deterioration of the Canadian dollar against the Euro would result in a change of approximately \$73K (December 31, 2022 - \$226K) in the Company's other comprehensive income. Total sales in Euros for the nine months ended September 30, 2023, were €1,895K (2022 - €2,761K). A 10% appreciation or deterioration of the Canadian dollar against the Euro would result in a change of approximately \$276K (2022 - \$377K).

**[vi] Interest rate risk**

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in the market interest rates. During the three and nine months ended September 30, 2023, and 2022, fluctuations in the market interest rates had an insignificant impact on the Company's interest expense. At September 30, 2023, the Company had \$10,000K of outstanding debt on its interest-bearing term loan. If the prime borrowing rate changed by 4%, it would have an impact of \$400K on interest expense on an annualized basis (December 31, 2022 - \$101K).

**[vii] Economic dependence**

During the nine months ended September 30, 2023, the Company was dependent on one customer for 34% of its revenue (2022 - None). There were no other customers who accounted for more than 10% of the Company's revenue during the period.

**Additional Risk Factors**

In addition to the Risk Factors discussed in the Company's Annual Information Form dated December 31, 2022, and filed on [www.sedar.com](http://www.sedar.com), the Company has identified the following additional risk factors:

**[a] Loans and Borrowings**

The Company has, and will continue to have, a substantial amount of outstanding loans and borrowings. This includes interest free loans from the Government of Canada, low interest loans from the Government of France, a revolving line of credit, leases, and the Company's term bank loan facility.

Some of these loans contain covenants and default provisions. Indebtedness could affect the Company in significant ways, including, but not limited to:

- a) Requiring the Company to dedicate significant portions of its cash flow from operations to the payments of principal and interest on its loans and borrowings;
- b) Make it more difficult for the Company to satisfy its obligations regarding loans and borrowings;
- c) Expose the Company to interest rate risk where the interest rates on loans and borrowings are not fixed;
- d) Require significant attention from the Company and key personnel in acquiring capital, limiting the ability to focus on the operations of the Company;
- e) Decrease the Company's flexibility in planning for and reacting to changes in the business or industry in which it operates;
- f) Obligations under loans and borrowings may restrict the Company's ability to make strategic acquisitions or cause the Company to make non-strategic divestitures;
- g) Limit the Company's ability to borrow additional funds; or,
- h) Place the Company at a competitive disadvantage to competitors with fewer or different loans and borrowings.

The Company's ability to service its loans and borrowings relies upon the Company's ability to generate operating cash flows. This, to a significant extent, is dependent on market and economic conditions, competition, and other factors that are beyond the Company's control. The Company cannot make assurances that its business will generate sufficient cash flow from operations or that sufficient borrowings will be available under its revolving line of credit to pay its servicing obligations under its loans and borrowings or manage its other liquidity needs. This may result in the Company being forced to refinance some or all of its loans and borrowings before maturity. The Company cannot guarantee that it will be able to refinance any of its loans and borrowings on commercially reasonable terms or at all. The Company may have to sell assets, seek additional financing such as equity financing, or take other actions to reduce near term cash expenditures in such a circumstance. If the Company is successful in obtaining more loans and borrowings, the Company's risk related to loans and borrowings may increase.

In a circumstance where the Company was unable to comply with the various covenants under its debt or generate sufficient cash flow or otherwise be unable to service its principal and interest obligations under its loans and borrowings, the Company could be in default with some, or all, of its lenders. In the event of such a default, some, or all, of the Company's loans and borrowings may be declared due and payable by its lenders, potentially including accrued and unpaid interest. In addition, an event of default may cause the Company to incur interest at higher rates or cause the lender under the Company's revolving line of credit and term loan to initiate foreclosure proceedings against the Company's assets, and the Company could be forced into bankruptcy or liquidation.

If the Company is unable to meet its debt covenants, it may need to obtain waivers from the lender under the revolving line of credit and term loan. If the Company is unable to obtain such waivers, it would be in default and the lender may exercise its rights as noted above.

### **[b] Inflation and Interest Rates**

The Company is subject to inflation risk related to its costs in all aspects of its operations. The Company may not be able to fully offset such costs with higher selling prices for its products or services. Inflation is also subject to change based on the actions of various governments and central banks, as well as the overall global economy, over which the Company has no control. Actions taken by such third parties could fail to mitigate inflation or otherwise have a negative impact on the results of the Company.

The Company's operating facility and term loan facility are based on variable interest rates. Increases in interest rates by a central bank would result in increased interest expense and debt servicing costs to the Company. Continuing inflation and increasing interest rates could have a material impact on the Company's results and cash flows.

### **[c] Contract Renegotiation**

The Company generates material amounts of revenue from contracts. Certain of these contracts have non-performance clauses that allow the customers to apply penalties, suspend, or cancel a contract based on the performance of the Company, which could result in a material adverse effect on the Company's revenues and profitability. In addition, as contracts expire, they must be extended, renewed, replaced, or renegotiated. The Company cannot make assurances that it will be able to successfully extend, renew, replace, or renegotiate a contract on terms favourable to the Company or at all, which may impact the financial position, results, and cash flows of the Company. In such cases, the Company may also incur substantial expenses to attract substitute customers.

## **RELATED PARTY DISCLOSURE**

Related party transactions are assessed for significance within the Company's normal process for transaction approval. Transactions determined to be significant by Management are approved by the Audit Committee of the Board of Directors.

The Company has approved several transactions with directors of the Company or parties related to directors:

- The Company has retained the lease of the building for K'Prime Canada. This facility is leased from a company related to a director of the Company. During the nine months ended September 30, 2023, the Company incurred \$88K for lease expenses (2022 - \$29K). These amounts have been recorded at the amounts that have been agreed upon by the two parties.
- Amounts paid to relatives of a director as employment compensation were \$284K for the nine months ended September 30, 2023 (2022 - \$93k).
- During the nine months ended September 30, 2023, the Company paid consulting fees to a director of the Company in the amount of \$101K (2022 - \$71K).

As at September 30, 2023, there were no balances in accounts payable due to related parties (December 31, 2022 - \$Nil). Total undiscounted payments remaining on the related party lease at September 30, 2023, are \$10K (December 31, 2022 - \$97K).

## **SUBSEQUENT EVENT**

On November 15, 2023, the Company paid out the second and final tranche of CHF 218K to Quad AG as per Shareholders loan agreement dated July 4, 2023. The loan is interest bearing at standard interest rates for this type of loan as established under Swiss law. As at the reporting date the interest rate is 3.75%.