

SPECTRA INC.
CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2017 AND 2016

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of **Spectra Inc.**
Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of **Spectra Inc.**, which comprise the consolidated statements of financial position at December 31, 2017 and 2016, and the consolidated statements of changes in shareholders' deficiency, comprehensive income and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparations and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of **Spectra Inc.** as at December 31, 2017 and 2016, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 of the consolidated financial statements, which indicates the existence of a material uncertainty that may cast substantial doubt about **Spectra Inc.**'s ability to continue as a going concern.

SF Partnership, LLP

Toronto, Canada
March 14, 2018

LICENSED PUBLIC ACCOUNTANTS

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

	2017	2016
ASSETS		
Current		
Cash	\$ 54,811	\$ 79,746
Accounts receivable	244,200	163,153
Inventories (note 4)	175,883	162,572
Prepaid expenses	4,737	5,475
	<u>479,631</u>	<u>410,946</u>
Equipment (note 5)	<u>-</u>	<u>6,447</u>
Total Assets	<u>\$ 479,631</u>	<u>\$ 417,393</u>
LIABILITIES		
Current		
Accounts payable and accrued charges (notes 7 and 14)	\$ 140,207	\$ 63,281
Loan payable – current portion (note 8)	<u>-</u>	<u>100,000</u>
	140,207	163,281
Loan Payable (note 8)	-	50,000
Royalty Debenture (note 9)	629,028	614,815
Preferred Shares (note 10)	<u>556,430</u>	<u>658,141</u>
	<u>1,325,665</u>	<u>1,486,237</u>
SHAREHOLDERS' DEFICIENCY		
Share Capital (note 11)	5,313,708	5,341,136
Contributed Surplus (note 11)	320,191	292,763
Accumulated Deficit	<u>(6,196,546)</u>	<u>(6,323,357)</u>
Deficiency Attributable to Shareholders of the Company	(562,647)	(689,458)
Non-controlling Interest (note 12)	<u>(283,387)</u>	<u>(379,386)</u>
Total Shareholders' Deficiency	<u>(846,034)</u>	<u>(1,068,844)</u>
Total liabilities and Shareholders' Deficiency	<u>\$ 479,631</u>	<u>\$ 417,393</u>

APPROVED ON BEHALF OF THE BOARD

"Glen Campbell"

"Andrew Malion"

Chairman

President

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

SPECTRA INC.

Consolidated Statements of Changes in Shareholders' Deficiency
 Years ended December 31, 2017 and 2016

	Share Capital	Contributed surplus	Accumulated deficit	Deficiency attributable to shareholders of the Company	Non- controlling interest	Total shareholders deficiency
Balance, January 1, 2017	\$ 5,341,136	\$ 292,763	\$ (6,323,357)	\$ (689,458)	\$ (379,386)	\$ (1,068,844)
Net income			126,811	126,811	95,999	222,810
Cancellation of 4,866 common shares and 27,000 second preferred shares (note 11)	(27,428)	27,428				
Balance, December 31, 2017	<u>\$ 5,313,708</u>	<u>\$ 320,191</u>	<u>\$ (6,196,546)</u>	<u>\$ (562,647)</u>	<u>\$ (283,387)</u>	<u>\$ (846,034)</u>

	Share Capital	Contributed surplus	Accumulated deficit	Deficiency attributable to shareholders of the Company	Non- controlling interest	Total shareholders deficiency
Balance, January 1, 2016	\$ 5,341,136	\$ 196,018	\$ (6,481,956)	\$ (944,802)	\$ (447,699)	\$ (1,392,501)
Net income			84,300	84,300	67,612	151,912
Equity component of convertible preferred shares		96,745		96,745		96,745
Changes in ownership interest in subsidiary that does not result in a loss of control			74,299	74,299	701	-
Balance , December 31, 2016	<u>\$ 5,341,136</u>	<u>\$ 292,763</u>	<u>\$ (6,323,357)</u>	<u>\$ (689,458)</u>	<u>\$ (379,386)</u>	<u>\$ (1,068,844)</u>

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

SPECTRA INC.Consolidated Statements of Comprehensive Income
Years ended December 31, 2017 and 2016

	2017	2016
Sales	\$ 1,780,609	\$ 1,549,112
Cost of Sales	<u>762,500</u>	<u>628,329</u>
Gross Profit	<u>1,018,109</u>	<u>920,783</u>
Gain on Extinguishment of Debt (note 10)	<u>30,423</u>	<u>187,500</u>
Expenses		
Selling costs	178,096	171,984
Administrative costs (note 14)	541,391	519,961
Amortization (note 5)	6,447	27,394
Finance costs (note 14)	99,788	260,832
Impairment of investment and loan receivable	<u>-</u>	<u>(23,800)</u>
	<u>825,722</u>	<u>956,371</u>
Income Before Taxes	222,810	151,912
Provision for income taxes (note 15)	<u>-</u>	<u>-</u>
Net Income and Comprehensive Income	<u>\$ 222,810</u>	<u>\$ 151,912</u>
Net Income and Comprehensive Income Attributable to:		
Shareholders of the Company	\$ 126,811	\$ 84,300
Non-controlling interest	<u>95,999</u>	<u>67,612</u>
	<u>\$ 222,810</u>	<u>\$ 151,912</u>
Net Income per Share - Basic and Diluted	<u>\$ -</u>	<u>\$ -</u>
Weighted Average Number of Common Shares		
Outstanding During the Year – Basic	<u>60,511,171</u>	<u>60,514,837</u>
Outstanding During the Year – Diluted	<u>60,511,171</u>	<u>60,514,837</u>

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

SPECTRA INC.Consolidated Statements of Cash Flows
Years ended December 31, 2017 and 2016

	2017	2016
Cash Flows from Operating Activities		
Net income	\$ 222,810	\$ 151,912
Adjustments for:		
Finance costs	99,788	260,832
Gain on extinguishment of debt	(30,423)	(187,500)
Amortization	6,447	27,394
	<u>298,622</u>	252,638
Changes in working capital:		
Accounts receivable	(81,047)	81,824
Inventories	(13,311)	(60,945)
Prepaid expenses	738	17,392
Accounts payable and accrued charges	76,927	(74,634)
	<u>281,929</u>	216,275
Cash used in operating activities:		
Interest paid	(6,864)	(27,378)
	<u>275,065</u>	188,897
Net Cash Provided by Operating Activities	<u>275,065</u>	188,897
Cash Flows from Investing Activities		
Purchase of equipment	-	(3,000)
	<u>-</u>	(3,000)
Net Cash Used in Investing Activities	<u>-</u>	(3,000)
Cash Flows from Financing Activities		
Redemption of preferred shares	(150,000)	-
Repayment of loan payable	(150,000)	(150,000)
	<u>(300,000)</u>	(150,000)
Net Cash Used in Financing Activities	<u>(300,000)</u>	(150,000)
Net (Decrease) Increase in Cash	(24,935)	35,897
Cash - Beginning of Year	79,746	43,849
Cash - End of Year	<u>\$ 54,811</u>	<u>\$ 79,746</u>
Supplemental Information		
Non-monetary item:		
Issuance of shares in settlement of debts (note 9)	\$ -	\$ 75,000

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

SPECTRA INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

1. Nature of Business and Basis of Presentation

Nature of Business

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

Basis of Presentation

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

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

Presentation and Functional Currency

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

Going Concern

These consolidated financial statements have been prepared on the assumption that the Company is a going concern which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. As at December 31, 2017, the Company had an accumulated shareholders' deficiency of \$846,034 of which \$562,647 was attributable to the Company's shareholders and \$283,387 was attributable to the non-controlling interest (2016 - \$1,068,844 of which \$689,458 was attributable to the Company's shareholders and \$379,386 was attributable to the non-controlling interest). The Company's ability to meet its obligations and continue as a going concern is dependent upon its ability to continue to achieve profitable operations and, if required, to refinance long-term debt as it matures. Management plans to achieve profitable operations and pursue refinancing of long-term debt as it matures, however, there can be no assurance that the Company will be able to negotiate such refinancing at maturity, nor to obtain alternative financing on terms satisfactory to the Company, if at all, should such debt not be satisfactorily refinanced.

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

SPECTRA INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

2. Summary of Significant Accounting Policies

a) Basis of Consolidation

These consolidated financial statements include the accounts of Spectra and SPI. As of December 31, 2017, Spectra held an interest of 67.73% (2016 – 67.73%) in SPI. All significant inter-company transactions and balances have been eliminated.

b) Non-controlling Interest

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

c) Revenue Recognition

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

d) Inventories

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

e) Equipment

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

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

f) Intangible Assets

Intangible assets consist of patents, trademarks, product rights and prototypes. They are recorded at cost and amortization is provided, over the estimated useful life of the assets, using the undernoted annual rate and method:

Product rights and prototypes	3-10 years	Straight line
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SPECTRA INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

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

g) Impairment of Tangible and Intangible Long-lived Assets

The Company reviews its long-lived assets for impairment at the end of each reporting period for events indicative of whether changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability is assessed based on the carrying amount of a long-lived asset compared to the sum of the future undiscounted cash flows expected to result from the use and the eventual disposal of the asset. An impairment loss is recognized when the carrying amount is not recoverable and exceeds fair value. Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would be determined, net of depreciation or amortization, if no impairment loss had been recognized.

h) Income Taxes

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

i) Stock-based Compensation

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

j) Issuance of Shares by Subsidiary

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

k) Income per Share

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

SPECTRA INC.

Notes to Consolidated Financial Statements
December 31, 2017 and 2016

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

l) Use of Estimates

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

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

Examples of significant estimates include:

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

m) Comprehensive Income

Certain gains and losses arising from changes in fair value are temporarily recorded outside the statement of income in accumulated other comprehensive income as a separate component of share capital. Comprehensive income is comprised of the Company's net income and other comprehensive income. Other comprehensive income may include any unrealized gains and losses on available-for-sale securities, foreign currency translation gains and losses on the net investment in self-sustaining foreign operations and changes in the fair value of derivative instruments designated as cash flow hedges, all net of income taxes. At December 31, 2017, the balance of other comprehensive income is \$nil (2016 – \$nil).

n) Financial Instruments

The Company has early adopted IFRS 9 – Financial Instruments. There were no changes to the carrying amount of the financial instruments from the adoption of the new standards.

The Company classifies all its financial assets and liabilities into one of the following categories: financial assets or financial liabilities at amortized cost, financial assets or financial liabilities at fair value through profit and loss and financial assets through other comprehensive income. All financial instruments are measured on the balance sheet initially at fair value. Subsequent measurement and recognition of the changes in fair value of financial instruments depends upon their initial classifications:

Cash is classified as financial asset measured at fair value through profit and loss. Cash is measured at fair value with subsequent changes in fair value recognized in current period net income. Transaction costs are expensed in net income. Gains and losses arising from changes in fair value are presented in net income within other gains and losses in the period in which they arise. Under IAS 39, cash was classified as "*financial asset at fair value through profit and loss*".

Accounts receivable is classified as financial asset measured at amortized cost. Accounts receivable is initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, accounts receivable is measured at amortized cost using the effective interest method less a provision for impairment. Under IAS 39, accounts receivable was classified as "*loans and receivables*".

SPECTRA INC.

Notes to Consolidated Financial Statements
December 31, 2017 and 2016

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

n) Financial Instruments (cont'd)

Accounts payable and accrued charges, loan payable, royalty debenture and preferred shares are classified as financial liabilities measured at amortized cost. Financial liabilities at amortized cost are recognized initially at fair value plus any directly attributable transaction costs and are subsequently recorded at amortized cost. Debt issue and other transaction costs are netted against the carrying value of the long-term debt and are amortized over the life of the debt using the effective interest rate method. Under IAS 39, these financial liabilities were classified as "*other financial liabilities*".

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

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

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

o) Impairment of Financial Assets

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

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

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

p) Non-monetary Transactions

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

SPECTRA INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

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

q) Foreign Currency Translation

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

r) Recent IFRS Standards Adopted

The Company adopted the following new accounting standards and amendments for its consolidated financial statements effective January 1, 2017.

The Company adopted IFRS 9 – Financial Instruments, which replaces IAS 39 – Financial Instruments. The standard sets out the classification and measurement of financial assets and liabilities. The adoption did not have a material impact on the consolidated financial statement.

The Company adopted the amendments to IFRS 7 – Financial Instruments Disclosure, which required additional disclosure on transition from IAS 39 to IFRS 9. The amended disclosure requirements have been applied to the consolidated financial statements.

s) New Accounting Pronouncements

A number of new standards, and amendments to standards and interpretations, are not yet effective for the year ended December 31, 2017, and have not been applied in preparing these consolidated financial statements. The following standards and interpretations have been issued by the International Accounting Standards Board (“IASB”) and the International Financial Reporting Interpretations Committees with effective dates relating to the annual accounting periods starting on or after the effective dates as follows:

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

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

IFRS 16 – Leases – Effective January 1, 2019

IFRS 16 replaces IAS 17 Leases and applies to the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract for all leases with a term of more than 12 months. The Company will evaluate the impact of adopting this standard on the consolidated financial statements.

SPECTRA INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

3. Capital Structure

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

The components of capital are as follows:

	2017	2016
Share capital	\$ 5,313,708	\$ 5,341,136
Contributed surplus	320,191	292,763
Accumulated deficit	<u>(6,479,933)</u>	<u>(6,702,743)</u>
	<u>\$ (846,034)</u>	<u>\$ (1,068,844)</u>

4. Inventories

	2017	2016
Finished goods	\$ 100,757	\$ 76,496
Raw materials	<u>75,126</u>	<u>86,076</u>
	<u>\$ 175,883</u>	<u>\$ 162,572</u>

5. Equipment – Dies and Molds – Brake Safe

	2017			2016		
	Short Bracket Molds	Other Molds	Total	Short Bracket Molds	Other Molds	Total
Cost	\$ 9,210	\$ 120,244	\$ 129,454	\$ 9,210	\$ 120,244	\$ 129,454
Less: Accumulated amortization	<u>9,210</u>	<u>120,244</u>	<u>129,454</u>	<u>2,763</u>	<u>120,244</u>	<u>123,007</u>
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,447</u>	<u>\$ -</u>	<u>\$ 6,447</u>

SPECTRA INC.
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

6. Intangible Assets – Product rights

	2017		2016
Cost	\$ 25,000	\$	25,000
Less: Accumulated amortization	<u>25,000</u>		<u>25,000</u>
	<u>\$ -</u>	\$	<u>-</u>

The product rights are still in use by the Company.

7. Accounts Payable and Accrued Charges

	2017		2016
Trade and other payables (note 14)	\$ 90,143	\$	24,805
Accrued expenses	<u>50,064</u>		<u>38,476</u>
	<u>\$ 140,207</u>	\$	<u>63,281</u>

8. Loan Payable

The loan payable to Dynamic Venture Opportunities Fund Ltd., (“DVOF”), one of the shareholders of the Company and an Ontario labour-sponsored venture capital fund, bore interest at 12% per annum payable monthly, interest only, and was unsecured. This loan was fully repaid on July 25, 2017. Included in finance costs are interest expense of \$6,864 (2016 - \$27,378) paid to DVOF.

9. Royalty Debenture

On August 6, 2004 the Company closed a debenture financing arrangement whereby \$750,000 was advanced to Spectra's subsidiary, SPI. In consideration of the advance of these funds, the holder is entitled to receive royalty payments equal to the greater of \$100,000 per annum or 10% of the total annual gross revenue generated by SPI. Twenty-five percent of each royalty payment shall be allocated against the principal amount of the debenture. The royalty payments shall continue until the earlier of (i) the date that the royalty debenture has been fully repaid and (ii) 15 years from issue date, at which time any remaining principal amount shall be due. As additional consideration, the Company issued 3,000,000 bonus shares at a price of \$0.05 per share. The royalty debenture is secured by all the assets of SPI by way of a floating charge in favour of the holder. During 2017, this debenture was acquired by a company in which a shareholder is a key executive and shareholder of the Company.

	2017	2016
Royalty debenture	\$ 652,065	\$ 652,065
Less: debt issuance costs	<u>(218,388)</u>	<u>(218,388)</u>
	433,677	433,677
Add : amortization of debt issuance cost	<u>195,351</u>	<u>181,138</u>
	629,028	614,815
Less : current portion	<u>-</u>	<u>-</u>
	<u>\$ 629,028</u>	<u>\$ 614,815</u>

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

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

By agreement, the quarterly principal payments due by SPI in 2016 and 2017 totaling \$25,000 each year have been waived, and the royalty portion of payments, totaling \$75,000 has been waived for 2017 and was settled in 2016 by way of issuance of 100 common shares of SPI valued at \$750 per share.

SPECTRA INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

10. Preferred Shares

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

The preferred shares are non-voting and were convertible into 1,000 common shares of SPI which would represent a 13.35% ownership interest, bringing their interest at that time to 45.62%. The Preferred Shares paid a 6% cumulative annual dividend, payable quarterly, commencing January 1, 2009; were redeemable; and were retractable commencing May 31, 2019 (extended by mutual agreement previously from May 31, 2018 and originally from May 31, 2010). The amended agreement allows the 750 preferred shares to be retracted for \$1,000 per share (previously \$1,250 per share). The resulting gain of \$187,500 from the change in retraction price is recognized as a gain on extinguishment of debt in the year ended December 31, 2016.

During 2017, these Preferred Shares were acquired by a company in which a shareholder is a key executive and shareholder of the Company. Following acquisition, the following changes were made to the terms of these shares:

150 of these shares were purchased for cancellation by SPI on December 20, 2017 for \$150,000.

- They are no longer convertible into common shares of SPI
- Commencing on January 1, 2018, dividends at 6% will be paid monthly
- The shares are now retractable in the following amounts and on the following dates:

○ June 30, 2018	125 shares	\$125,000
○ December 31, 2018	125 shares	\$125,000
○ June 30, 2019	100 shares	\$100,000
○ December 31, 2019	125 shares	\$125,000
○ June 30, 2020	125 shares	\$125,000

The preferred shares have accreted to \$556,430 (2016 - \$658,141), and accretion expense of \$48,489 (2016 - \$144,241) was included in finance costs.

Management has assessed the cumulative effect of these modifications to be a substantial modification under IFRS 9 – Financial Instruments. Consequently, the carrying value of the preferred shares has been recalculated as the present value of the modified contractual cash flows and a resulting gain on extinguishment of debt of \$30,423 has been recognized in the statement of comprehensive income.

11. Share Capital

Authorized			
Unlimited	common shares		
Unlimited	first, second, third and fourth preferred shares to be issued in one or more series, redeemable, with rights, privileges, restrictions and conditions to be determined by the Board of Directors upon issuance		
540,000	second preferred shares Series 1, non-cumulative dividends of 10% per annum, redeemable at the stated value, non-voting		
Issued and outstanding			
		2017	2016
60,509,971	(December 31, 2016 – 60,514,837) common shares	\$ 5,313,708	\$ 5,314,136
	(December 31, 2016 - 90,000) second preferred shares Series 1	<u>-</u>	<u>27,000</u>
		<u>\$ 5,313,708</u>	<u>\$ 5,341,136</u>

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

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

Contributed Surplus

Contributed surplus consists of accumulated share-based compensation expense less the fair value of options at the grant date that were exercised and credited to common shares, and share purchase warrants that expired and the equity portion of formerly convertible preferred shares. The current year addition of \$27,428 (2016 - \$96,745) to contributed surplus was derived from the cancellation of 4,866 common shares and 90,000 second preferred shares (2016 - was derived from the conversion feature embedded in the preferred shares as described in note 10).

Issuance and Cancellation of Shares by Subsidiary

As discussed in note 9, SPI issued nil (2016 – 100) common shares to DVOF. The Company recorded no royalty payment on the issuance of SPI’s common shares in 2017 (2016 - \$75,000), recognized in equity.

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

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12. Non-controlling Interest

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

	2017	2016
Common shares issued by Spectra Products Inc.		
Total issued	<u>4,075</u>	<u>4,075</u>
Total issued to non-controlling interest	<u>1,315</u>	<u>1,315</u>
Percentage ownership of non-controlling interest	<u>32.27</u>	<u>32.27</u>
Common share equity and deficit of Spectra Products Inc.		
Common share equity	\$ 4,239,950	\$ 4,239,950
Deficit	<u>(5,118,130)</u>	<u>(5,415,617)</u>
Combined common share equity and deficit	<u>\$ (878,180)</u>	<u>\$ (1,175,667)</u>
Allocation of combined common share equity and deficit to non-controlling interest based on percentage ownership at end of year		
Common share equity	\$ 1,368,230	\$ 1,368,230
Deficit	<u>(1,651,617)</u>	<u>(1,747,616)</u>
Combined common share equity and deficit	<u>\$ (283,387)</u>	<u>\$ (379,386)</u>

13. Financial Instruments

a) Fair Value

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

13. Financial Instruments (cont'd)

b) Credit Risk

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

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

Credit risk from accounts receivable encompasses the default risk of customers. Credit risk on accounts receivable is minimized as a result of the constant review and evaluation of customer account balances. The Company also maintains an allowance for doubtful accounts at an estimated amount, allocating sufficient protection against losses resulting from collecting less than full payments from its receivables.

As at December 31, 2017, two major customers accounted for 25% and 18% (2016 – two major customers accounted for 54% and 19%) of accounts receivable.

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

c) Foreign Currency Risk

The Company is exposed to currency risk due to a certain portion of the Company's sales and purchases being in U.S. currency, resulting in U.S. dollar denominated accounts receivable and certain U.S dollar denominated cash balances. These activities result in exposure to fluctuations in foreign currency rates between the U.S. dollar and the Canadian dollar. The Company's sensitivity to these foreign currency fluctuations is such that a 10% strengthening or weakening of the U.S. dollar would result in a respective \$8,988 decrease or increase to the Company's income before taxes for the year ended December 31, 2017. At December 31, 2017, the Company had net assets denominated in U.S. currency of USD 89,879 (2016 – USD 62,151) translated into Canadian dollars as shown below, and a foreign exchange gain from operations of \$159,776 (2016 – \$130,026). The Company does not utilize any financial instruments or cash management policies to mitigate the risks arising from changes in foreign currency rates.

	2017	2016
Cash	\$ 8,318	\$ 3,684
Accounts receivable	105,379	84,940
Accounts payable	-	(6,659)
	<u>\$ 113,697</u>	<u>\$ 81,965</u>

d) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company manages liquidity risk through regular monitoring of cash requirements by preparing short-term cash flow forecasts. The financing requirements are addressed through a combination of credit facilities and private placements. The Company's ability to meet its obligations and continue as a going concern is dependent upon its ability to continue to achieve profitable operations and if required, to refinance long-term debt as it matures. Management plans to achieve profitable operations and pursue refinancing of long-term debt as it matures, however, there can be no assurance that the Company will be able to negotiate such refinancing at maturity, nor to obtain alternative financing on terms satisfactory to the Company, if at all, should such debt not be satisfactorily refinanced (see note 1).

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13. Financial Instruments (cont'd)

d) Liquidity Risk (cont'd)

The following are the contractual maturities of the Company's financial liabilities as at December 31, 2017:

	Due	Due between				Total
	within 1 year	1 and 2 years	2 and 3 years	3 and 4 years	4 and 5 years	
Accounts payable and accrued charges	\$ 140,207	\$ -	\$ -	\$ -	\$ -	\$ 140,207
Royalty debenture	-	652,065	-	-	-	652,065
Preferred shares*	250,000	350,000	-	-	-	600,000
Total	\$ 390,207	\$ 1,002,065	\$ -	\$ -	\$ -	\$ 1,392,272

* Based on first possible retractable date. See note 10.

e) Interest Rate Risk

The Company is not exposed to any interest rate risk.

14. Related Party Transactions

- During 2017, management fees of \$84,010 (2016 - \$82,895) were paid to a company of a key executive who is a shareholder of the Company.
- During 2017, interest expense of \$6,864 (2016 - \$27,378) were paid to DVOF, a shareholder of the Company.

Included in accounts payable and accrued charges is \$4,297 (2016 - \$3,948) payable to directors.

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

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15. Income Taxes

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

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

	2017	2016
Expected income tax expense at the combined Federal and provincial rate of 26.50% (2016- 26.50%)	\$ 59,045	\$ 40,257
Increase (decrease) in income taxes resulting from:		
Non-deductible permanent differences	1,166	(47,493)
Temporary difference for which no deferred tax asset was recognized	8,127	13,721
Tax loss utilized	(68,338)	-
Other	-	(6,485)
	<u> -</u>	<u> -</u>
Provision for income taxes	\$ -	\$ -

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

	2017	2016
Net operating losses carried forward	\$ 653,121	\$ 721,459
Equipment	54,560	58,027
Intangible assets	64,981	69,949
Investment and loan receivable	2,981	2,981
Royalty debenture	(6,105)	(9,871)
Preferred shares	14,091	1,295
	<u>14,091</u>	<u>1,295</u>
Deferred tax asset	\$ 783,629	\$ 843,840

The Company has non-capital tax losses available in the amount of approximately \$2,463,900 (2016 - \$2,721,800), which can be carried forward to be applied against future years' taxable income. These losses, if unused, will expire as follows:

2027	\$ 245,400
2028	638,100
2029	384,500
2030	362,600
2031	239,900
2032	281,700
2033	62,100
2034	51,500
2035	61,300
2036	62,100
2037	74,700
	<u>74,700</u>
	<u>\$ 2,463,900</u>

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16. Commitments

- a) In 2015, the Company entered into a consulting services agreement with a company controlled by a key executive who is a shareholder of the Company. Under the terms of the consulting services agreement, that company is entitled to fees of \$75,000 per year until December 31, 2017. An annual participation fee, calculated as 5% of the annual net income of SPI, is also payable under the terms of the consulting services agreement. A participation fee of \$15,324 was payable for the year ended December 31, 2017, but was settled at \$9,000 and paid during the year. In December 2016, this consulting services agreement was extended for a further five years on the same terms and conditions and now expires on December 31, 2022.
- b) The Company entered into an extension of its operating lease for its premises. This extension commenced on January 1, 2018 and continues for five years until December 31, 2022. Under this lease extension the Company is obligated for base rental payments as follows:

2018	\$	24,207
2019		27,665
2020		28,923
2021		30,180
2022		<u>30,180</u>
	\$	<u>141,155</u>

17. Segmented Information

Sales are attributed to countries based on location of customer.

	2017	2016
Canada	\$ 961,247	\$ 879,944
China	28,894	-
United States	<u>790,468</u>	<u>669,168</u>
	<u>\$ 1,780,609</u>	<u>\$ 1,549,112</u>

In 2017, the Company derived 44% (2016 – 43%) of its revenue from sales to the United States and 2% (2016 – nil) of its revenue from sales to China. The Company's equipment is located in Canada.

In 2017, the Company derived sales from three customers amounting to 28%, 12% and 12% of the total sales revenue (2016 – three customers amounting to 25%, 14% and 14%).