Spectra Systems Corporation

Annual report and accounts 2013

A leading provider of advanced technology-based security solutions

Spectra Systems
CORPORATION

Spectra Systems Corporation is an established world leader in providing technology for secure transactions, from banknotes to gaming.

AERIS™

The world's first banknote cleaning system

Extending the life of paper banknotes

- Aeris™ extracts sebum and other contaminants that limit the useable of paper substrate banknotes through soiling.
- Dry process that does no compromise substrate, security features or print.
- Process over 1 million banknotes per day.
- Banknotes can remain strapped or bundled during processing for easy handling and high productivity.
- Lower environmental impact of shredded notes.

Highlights

Financial highlights (all figures in 000s):

- Revenue increased 23% to US$11,572 (2012: US$9,379)
- Adjusted EBITDA[1] before taxation of US$(657) (2012: US$(727))
- Adjusted earnings/(loss)[1] per share of US$(0.01) (2012: US$(0.02))
- Basic earnings/(loss) per share of US$(0.07) (2012: US$(0.04))
- Strong ungeared balance sheet, with cash and investments of US$13,435 (2012: US$16,167) at 31 December

1 Before stock compensation expense and exceptional items

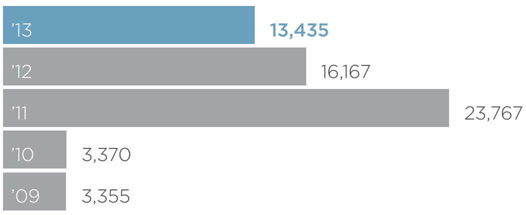
Operational highlights:

- Large machine-readable banknote authentication material orders were fully fulfilled
- Shipping of sensors for US$8 million contract commenced and continues through 2014
- New manufacturing facility cleared, and quality controls approved by corporate partner for shipping orders to all 18 central bank customers. Expected to be approved by a central bank customer in 2014
- Secure Transactions Group performed in line with expectations
- Inksure asset purchase executed and transaction closed in 2014. Integration of new products and customers on track
- Phosphor sales in Q4 2013 reverted to historical levels and continue to do so in Q1 2014

Cash and investments (US$'000)

13,435

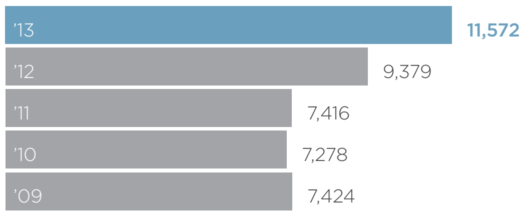
(2012: 16,167)



Revenue (US$'000)

11,572

(2012: 9,379)



Contents

Spectra at a glance

Spectra is a highly responsive organization that develops customized solutions for its customers.

Our new technology

The Aeris™ banknote cleaning system has dramatically increased the market potential of our product solutions.

Aeris™ extends the life of paper banknotes by cleaning them without affecting their mechanical properties and security features, potentially saving central banks over a billion dollars annually.

Find out more about Aeris™ at: www.spsy.com/aeris.html

Our solutions

Banknote and authentication processing

Spectra's sophisticated capabilities allow us to invent, develop and manufacture integrated solutions comprised of a system of taggant materials and sensor equipment to authenticate banknotes at high processing speeds.

Our solutions are used by:

- two G8 central banks;
- 17 other central banks for currency authentication; and
- a major G8 country for passport security.

Secure transactions

Spectra's secure transactions group is the leading supplier of real-time, fraud control and risk management systems to government sanctioned gaming operators. Currently deployed in North America, Europe, Asia, and Africa, Integrity systems monitor and audit more than US$20 billion in annual sales for online, internet, and mobile phone-based lotteries and pari-mutuel organizations.

Our products have been engineered to provide:

- fully automated independent real-time monitoring; and
- vendor independence – designed for any gaming system.

Our customers

Our customers include a G8 central bank organization and one of the world's largest commercial security printers and papermakers, which supplies the Company's technology to a second G8 central bank and numerous other central banks. Customers using our technology include:

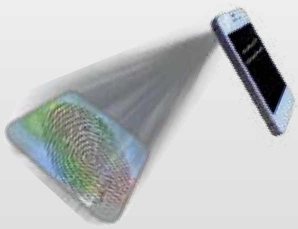
- 19 central banks
- Commercial security printers and papermakers
- Crane & Co
- National lotteries in nine countries
- Suppliers of security threads for world currencies
- Intralot SA
- Scientific Games International
- GTECH S.p.A.

32 Countries we operate in

30 Staff in our North American offices

23% Increase in revenue

Smartphone Authentication of Product Brands



TruBrand™
Spectra has completed the development of a new label technology and smartphone application which reliably confirms the authenticity of high value brands in the retail environment.

Customers can ensure they are buying a real product and brand owners can obtain valuable data on their customers who are using the TruBrand™ app connected to our secure servers and data mining operations supported by our secure transactions group.

Distributed Authentication Systems

Our product suite of low cost sensors and materials developed internally as well as through our acquisition of Inksure, can be used in applications from consumer products to tax stamps.

Our strategy

The Company's strategy for increasing revenue and earnings is based on:

Integrate advanced technologies into existing security products

Integrate new machine-readable technologies into public security features for banknotes, tax stamps and brand product packaging with a focus on Asia.

a. covert technologies; and

b. no redesign of banknotes or tax stamps required for faster adoption.

Enhance and upgrade our ICS product package

Increase our Secure Transactions Group revenues by:

a. providing higher value product upgrades to existing customers; and

b. bundling our software transaction capabilities with our machine-readable features to offer authorities complete track and trace solutions for tax stamps, IDs and other government documents.

Apply our expertise to consumer applications

Applying our expertise in lock and key, material/sensor technology for consumer and industrial applications where there is a need for protection against low cost, lower quality consumables by leveraging previous Inksure development efforts and relationships with such customers.

Advance smartphone authentication technology

Continuing to make advances on a smartphone-based physical authentication technology to allow consumers to authenticate brand products in real time using smartphone platforms.

Breakthrough disruptive technology for banknotes

Continuing the development efforts on products that can result in significant savings for central banks with regards to note processing, replacement volumes, and environmental impact.

Progress

- Covert machine-readable technology developed to scale up levels with central bank and available for sale worldwide.
- Agreement with a large Asian central bank under review.

Progress

- Upsold two existing customers with new premium platform offering.
- Won business from two new lotteries (AZ and MI).
- Penetrated internet and mobile phone lottery sector.

Progress

- Developed an FDA compatible and reliable technology.
- Interest from disposable coffee cup industry.

Progress

- Completed alpha version of software app for iPhone and Android platforms.
- Patents filed and pending.

Progress

- Aeris technology introduced in 2013; patents filed and expected to be issued in 2015.
- Trials underway with two major central banks and four more central banks in discussions.
- Technology introduced and very well received at major industry tradeshow, Banknote 2014.

Our market

Spectra Systems market opportunity has expanded dramatically with our introduction of the worlds first banknote cleaning system, Aeris™. With nearly 150 billion banknotes manufactured yearly at a cost approaching $10 billion annually along with the increasing demands that governments reduce costs, we are poised to capitalize on our banknote cleaning technology. Aeris machines have the potential for generating over $1 billion of hardware sales with ongoing service revenue.

Aeris has no competition, and once patents are granted, will be our market exclusively.

The combination of the banknote authentication market, where we are one of several competing companies, along with the Aeris banknote cleaning system, where will be the sole suppliers, dramatically expands the market potential of this sector of our business.

The use of our high-speed, machine-readable banknote authentication technology is utilized by many central banks to prevent sophisticated counterfeiting of their currency and will facilitate our ability to introduce and sell Aeris systems.

Spectra's secure internal control systems (ICS) software products have been augmented with new capabilities since the acquisitions and have resulted in revenue growth potential within existing customers as well as with new ones. Our ICS systems provide methods for fraud detection and statistical analysis and have recently been adopted in internet based lotteries, a growing sector of the gaming industry.

Spectra's suite of portable reader-based solutions including smartphone app-based products can be used for authenticating and tracking consumer and tax bearing products, both locally and through cloud-based internet connections. The fusion of our physical products along with internet-based operations has the potential for significantly expanding this segment of our business.

Chief Executive Officer's statement

The Company has achieved key commercial milestones lowering losses and increasing revenues well above 2012.

In brief

- The successful delivery of a very large order to a central bank customer has demonstrated our ability to deliver larger volumes of consumables on time and with high quality.
- The commencement of the delivery of sensors to a G8 central bank has added strong support to the continued longevity of our consumable sales to customers once they adopt our technologies.
- The early evidence that phosphor sales are returning to historical levels is a strong indication that 2014 expectations will be met.
- These expectations are further bolstered by the strong performance of the Secure Transactions Group formed around the acquisitions made in 2012, together with the Inksure products in the beginning of 2014.
- The qualification of our manufacturing facility by our partner, a major worldwide supplier of banknote printing services and paper, as well as subsequent orders, will set the stage for increased margins once the remaining customers served directly by us complete their evaluation of the facility's products and enter into a contract renewal.

In addition, the 2013 judgment reducing the lawsuit filed against the Company by 40% has reduced the exposure we have. We continue to vigorously defend our position while maintaining a channel of communication towards a satisfactory settlement.

The cancelation of the New Generation materials program by a central bank; although disappointing, has left us with a fully developed technology we are free to commercialize on either a nonexclusive or exclusive basis. We are highly optimistic that given the calibre of the technology and its level of validation, we will be able to commercialize this new covert machine-readable product.

Finally, the Company continues to develop and patent protect new products which can significantly expand our business opportunities. Of particular note is the demonstration of a new technology for cleaning soiled banknotes which could potentially save central banks over a billion dollars annually. The potential market has a large potential customer base which includes most of the world's central banks and is not limited to the more sophisticated customers with advanced counterfeiting threats prevented by our existing technologies.

Financial overview (000s)

Revenue exceeded prior year by 23% with US$11,572 (2012: US$9,379). The adjusted EBITDA before and after taxation for the year amounted to US$(657) (2012: US$(727)) – adjusted for stock compensation expense and exceptional items.

Cash and investments at the period end amounted to US$13,435 (2012: US$ 16,167). The Company has no debt and therefore has more than sufficient resources to execute on its manufacturing plans with its cash reserves and to pursue carefully selected complementary acquisitions.

Strategy

The Company's strategy for increasing revenue and earnings is based on:

- continuing efforts to integrate new machine-readable technologies into public security features for banknotes, tax stamps and brand product packaging with a focus on Asia;
- expanding our Secure Transactions Group contribution by:
  a. providing higher value product upgrades to existing customers; and
  b. bundling our software transaction capabilities with our machine readable features to offer authorities complete solutions for tax stamps, IDs and other government documents;
- applying our expertise in lock and key, material/sensor technology for consumer and industrial applications where there6is a need for protection against low cost, lower quality consumables by leveraging previous Inksure development efforts and relationships with such customers;
- continuing to make advances on a smartphone-based physical authentication technology to allow consumers to authenticate brand products in real time using smartphone platforms; and
- continuing the development efforts on products that can result in significant savings for central banks with regards to note processing and replacement volumes.

The five-pronged strategy summarized above will allow the Company to exploit largely developed expertise and technology along several parallel growth directions. The continued use and demonstration of embedding covert security within public features allows for implementation without banknote design mandates and is also the basis of current and future Inksure technology whereby the features have previously been primarily holograms. We believe we will be able to tap into the Asian market with this approach in both the banknote and product authentication sides of the technology.

The Secure Transactions Group has shown that our existing gaming customers have an appetite for upgraded product offerings. There is a parallel situation in the brand authentication and tax stamp arenas where track and trace capabilities proved a bundled higher value approach.

The area of lock and key technology linking the operation of a machine to a specific tagged consumable for the consumer product industries from plastic freezer bags to coffee cups is untapped and continues to present opportunities with large numbers of units. We have successfully developed such systems which yet to be adopted, but new opportunities continue to materialize with some already in development by Inksure.

The use of mobile phones to authenticate products has been regarded as the holy grail of the authentication industry for many years. Many have tried and produced products that are easily subverted or simply only work in highly controlled environments. Solving this problem will open a new internet-based market for us and further link our software database capabilities with our world-class physical authentication technology developments.

Chief Executive Officer's statement continued

The Company continues to have excellent prospects and will perform strongly in 2014.

Strategy continued

The area of banknote fitness and cleaning will allow us to have a commercial dialogue with a larger swathe of the banknote industry and will enable us to provide them with products which have an immediate return on investment. Cleaning banknotes will lower replacement costs for central banks and also open the door to partnerships with suppliers that may be affected. If the suppliers see that this is a viable technology, then some will adopt it as part of an expanded service to the central banks they currently serve.

Prospects

The Company's prospects have dramatically grown through the combination of the Inksure acquisition and the Company's organic banknote and product authentication development efforts, as well as our demonstration of a breakthrough technology for cleaning banknotes. Inksure customers include tax stamp authorities and brand owners who we feel will eventually be ready for upgraded, higher performance products built around our core technologies. Particularly important prospects for growth are:

- the mobile phone-based product authentication which will draw on both our expertise in optical materials and physics, as well as the database competence of the Secure Transactions Group; and
- the ongoing development effort initiated with Inksure by a large consumer brand supplier interested in a lock and key solution for its machines and consumables.

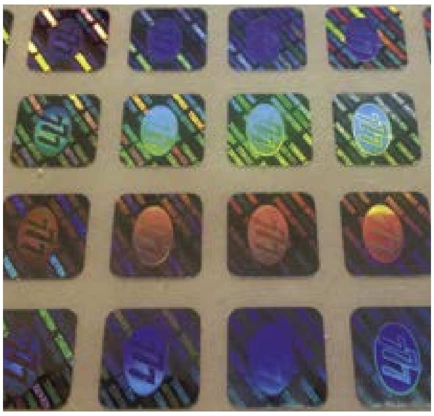
The combination of our new manufacturing facility shipping product for use by 18 central banks and the expected material qualification and contract renewal with a G8 central bank in 2014 will have a significant impact on our machine-readable materials margins. With the continued marketing efforts of our licensing partner, we will be able to increase earnings from this facility.

Our demonstration of a technology which can remove soiling substances (primarily human oils) without damaging the costly security features or compromising print has created a new paradigm in the banknote industry.

Based on the continued growth in banknote production to the level of nearly 150 billion banknotes per year at a cost approaching US$10 billion annually, we believe that we will have strong prospects for revenue growth in a segment of the industry where we expect to have controlling intellectual property.

The Board therefore believes that the Company continues to have excellent prospects and will perform strongly in 2014.

Nabil M. Lawandy
Chief Executive Officer
June 3, 2014



Inksure

In February 2014, Spectra acquired substantially all of Inksure's brand protection and tax stamp authentication assets, including importantly its long-standing customer relationships and authentication technology. Spectra will incorporate the Inksure assets within its existing business and is not making any incremental hires to support the increased revenue. Inksure's margins have historically been approximately 50%.

Inksure develops, markets and sells customised authentication solutions designed to enhance the security of documents and branded products, to meet the growing demand for protection from counterfeiting. Inksure has its technology applied to billions of consumer items and high-value documents every month using a proprietary verification system that is available on, among other things, most smart phones.

Commenting, Nabil Lawandy, CEO of Spectra Systems Corporation, said:

"We are pleased to have completed the acquisition of certain key assets of Inksure which will extend our reach into tax stamps and the authentication of commercial product brands. In time, we will be able to introduce existing Inksure customers to Spectra's already developed brand authentication technologies in a package which includes track and trace capabilities which leverage the database management capabilities in our Secure Transactions Group. Our reputation for providing banknote authentication to G 8 central banks will also allow us to directly, as well as through partnerships, upsell to governments looking for higher security tax stamp solutions. The integration of the Inksure technology, without the need for additional personnel, will increase the margins on the existing book of business immediately."

Board of Directors and senior management

Board of Directors

BJ Penn ◆ ▲

Non-executive Chairman

Mr. Penn was Acting Secretary of the US Navy from March to May 2009, having previously been Assistant Secretary of the Navy (Installations and Environment) from March 2005. He was also director, Industrial Base Assessments from October 2001 to March 2005, with responsibility for the overall health of the US defence industrial base. He commenced his career as a Naval Aviator, having received his BS from Purdue University, West Lafayette and his MS from the George Washington University, Washington DC. Mr. Penn has been a member of the Board since June 2010 and became Chairman of the Board on 7 June 2011.

Nabil M. Lawandy ◆

President and Chief Executive Officer

Dr. Lawandy is the founder, President and Chief Executive Officer of the Company. From 1981 to 1999, Dr. Lawandy was a tenured full professor of Engineering and Physics at Brown University in Providence, Rhode Island. He holds a BA in physics, and an MSc and PhD in chemistry, each from The Johns Hopkins University. He has authored over 170 reviewed scientific papers and is an inventor on 52 US and 27 foreign issued patents. He has also received a Presidential Young Investigator award, an Alfred P. Sloan Fellowship, a Rolex Award for Enterprise and a Samuel Slater Award for Innovation.

Donald Stanford ■ ▲

Non-executive Director

Mr. Stanford, who was until 2001 the Chief Technical Officer of GTECH Corporation, is an Adjunct Professor of Computer Science and Engineering at Brown University. He holds a BA in International Relations and an MS in Computer Science and Applied Mathematics, both from Brown University. Over 30 years, he has held every technical leadership position, including Vice President of Advanced Development and Chief Technology Officer. Mr. Stanford serves on several boards including Times Squared Academy Charter School, Spectra Systems and the Business Innovation Factory. Mr. Stanford is a member of the R.I. Science and Technology Advisory Council. He is also an Adjunct in the School of Engineering and is an instructor in the Program in Innovation, Management and Entrepreneurship (PRIME). He serves on the Brown advisory councils to the President and the School of Engineering. In 1999 Don received the Black Engineer of the Year Award for Professional Achievement. In 1999 he also received the Honorable Thurgood Marshall award for community service from the NAACP. In 2002 he received the Brown Graduate School's Distinguished Graduate award and the RI Professional Engineer's Award for Community Service.

Oussama Salam ■ ▲

Non-executive Director

Dr. Salam is the Chairman of the Hala Salaam Maksoud Foundation. He received a BSc in Civil Engineering from Loughborough University of Technology in 1968, a MS in Traffic and Transportation Engineering from the Department of Civil Engineering, Ohio State University in 1969, and a PhD in the Finite Elements Method from the Department of Civil Engineering, Ohio State University in 1974. He served as Director General of the construction department of International Center for Commerce & Contracting, a leading construction company in Saudi Arabia from September 1978 until December 2000. In 1990 he co-founded Pillar BV, a venture capital business-consulting firm based in Paris, and remained a partner until September of 1999. He also co-founded WorldCare Limited, a leading company in the emerging field of global eHealth, and served on its Board of Directors from 1993 until June 1998. Dr. Salam is currently a Board member of Spectra Systems Corporation, a company that specializes in optical solutions for document and currency authentication and tracking, marking and tracking in challenging applications such as optical media and postal documents. Dr. Salam is involved in the business development of these companies in Europe and the Middle East. Currently he lives in Beirut, Lebanon.

Senior management

Douglas A. Anderson

Chief Financial Officer, Company Secretary and Treasurer

Mr. Anderson joined the Company as Chief Financial Officer in December 2006 and was appointed Company Secretary in June 2011. Prior to joining the Company, Mr. Anderson was employed by Bluestreak Inc., a global marketing technology company, where he served as President. Mr. Anderson also held several financial positions including Director and Secretary of Bluestreak's wholly owned UK subsidiary, Bluestreak International Limited. Prior to Bluestreak, he was responsible for financial and account operations at Log On America, a publicly traded telecommunication company. He also spent three years at Ernst & Young advising clients on financial strategy, accounting and compliance needs. Mr. Anderson holds an MBA from Boston University and a BA from the University of Rhode Island.

William Goltsos ◆

Vice President, Engineering

Dr. Goltsos was appointed Vice President, Engineering, in April 2000. From September 1996 to April 2000, he served as Senior Systems Engineer. Prior to that, from 1992 to 1996, he served as a staff member of the MIT/Lincoln Laboratory's Optical Communications Group. Dr. Goltsos holds a BSc in physics from Rensselaer Polytechnic Institute and an MSc and PhD in physics from Brown University.

Committees

- ● Audit Committee
- ■ Compensation Committee
- ◆ Government Security Committee
- ▲ Nominating Committee

Read about the responsibilities of each committee in the Directors' report on page 12

Roland Puton ● ■

Non-executive Chairman

Mr. Puton has been a member of the Company's Board of Directors since 1997. He served as the president and Chief Executive Officer of Rolex Watch USA Inc from 1984 until his retirement in 2000. He holds a degree in business administration from the Swiss Business School. Mr. Puton is a member of the Board of Directors of the American Watch Association and the Fifth Avenue Association. He is a member of the Canadian twenty-four Karat Club and is an Honorary Director of the Explorers Club. Also, Mr. Puton is a member of the American Alpine Club, a Board member of the American Swiss Foundation, and a member of the Advisory Council of the Swiss Society of New York.

Jeffrey Donohue ●

Non-executive Chairman

Jeffrey Donohue is Corporate Counsel for Novartis Institutes for BioMedical Research, Inc. (NIBRI), the research arm of the global healthcare products company Novartis. Mr. Donohue has provided legal guidance on NIBRI's strategic acquisitions, licensing agreements, academic and government-backed consortia, and drug discovery collaborations. Mr. Donohue also is an Adjunct Professor at Boston University School of Law, where he teaches advanced courses on licensing and intellectual property transactions. Before joining NIBRI, Mr. Donohue served as Corporate Counsel at Vertex Pharmaceuticals Incorporated, a pharmaceutical company based in Cambridge, Massachusetts. Mr. Donohue started his legal career at Kirkpatrick & Lockhart LLP (now KLGates), where he spent seven years advising clients on corporate governance, mergers and acquisitions, and securities matters. Mr. Donohue obtained his JD from Boston University and a BA from Brandeis University.

Martin Jaskel ● ■ ▲

Non-executive Director

Martin Jaskel has over 40 years of involvement in the financial services industry. He began in the UK government bond market as a broker with leading firms, latterly as a Partner in W Greenwell & Co. In 1986 as an element of the deregulation of the UK markets, W Greenwell was sold to Midland Bank and became the leading Gilt Edged Market Maker, of which he was a Director. In 1988 he was appointed Director of Global Sales and Marketing of Midland Montagu Treasury (the Treasury division of Midland Bank) after chairing a committee to redesign the distribution of Treasury products. In 1990 he was appointed Director of Global Sales at NatWest Treasury and rebuilt the neglected franchise global distribution of Treasury and Capital Markets products. In 1994 he was promoted to Managing Director of Global Trade and Banking Services. He sat on the Advisory Board of ECGD, the UK export-import bank, and was responsible for several years for signing off all the UK exposure to BAE and Airbus and sat on several government and Bank of England advisory boards. In 1997 he left NatWest and founded a financial services consultancy, which included a consultancy at KPMG Corporate Finance and the corporate FX division of Travelex plc, and an interim appointment as the Managing Director of a private real estate company with a £500 million portfolio of commercial and residential property. In 2005 he joined European American Capital Limited, an FSA authorized and regulated specialized advisory bank as Senior Advisor. He has wide experience as a Non-executive Director of both publicly quoted and private companies.

James Cherry

Director of Authentication Systems

Mr. Cherry serves as Director of Authentication Systems. He joined the Company in 2002 from Auspex Systems, an enterprise network data storage system business, where he had been involved in marketing and product management for seven years. Prior to that, he had worked for five years at DuPont in product management.

Scott Tillotson

Director of Secure Transactions

Mr. Tillotson serves as Director of the Secure Transactions Group. Mr. Tillotson has held a variety of positions with Spectra for nine years and GTECH Corporation, a leader in the lottery industry, for eight years in product marketing and management. Prior to that, he worked for the IBM Corporation as an account executive and systems engineer. Scott holds a BSEE from Purdue University.

Andrei Smuk

Director of Research and Development

Dr. Smuk, who joined the Company in 2000, was appointed Director of Research and Development in 2006. He is responsible for the development of advanced materials and innovative sensor systems. He received a PhD in physics from Brown University in 2000 and an MS in applied physics from the Moscow Institute of Physics and Technology in 1994.

Directors' report
for the year ended December 31, 2013

The Directors present their report and the audited consolidated financial statements for the year ended December 31, 2013.

Domicile
Spectra Systems Corporation is a C corporation and is registered and domiciled in the United States.

Principal activity
The principal activity of the Company is to invent, develop, manufacture and market integrated materials and systems solutions to authenticate and process banknote and other high value documents.

Results and dividends
The Company's statement of comprehensive income is set out on page 18 and shows the result for the year.

The Directors do not recommend the payment of a dividend (2012: US$nil).

Review of business and future developments
A review of the operations of the Group is contained in the Group at a glance review on pages 2 and 3.

Principal risks and uncertainties and financial risk management
Complex products
Certain of the products produced by the Company are highly complex and are designed to be used in complex systems. Failure to correct errors or other problems identified after deployment could result in events that may have a negative effect on the Company's business and financial conditions.

The Company's markets may become impacted by technological change
Markets for the Company's products may become characterized by rapidly changing technology, evolving industry standards and increasingly sophisticated customer requirements. The introduction of products embodying new technology and the emergence of new industry standards could render the Company's existing products obsolete and unmarketable and may exert price pressures on exiting products. If the Company could not then develop products that remain competitive in terms of technology and price and that meet customer needs, this could have a negative impact on the business.

Expiry of patents
All patents have a limited duration of enforceability. US patents generally have a duration of 20 years from the filing date. Once a patent expires, the invention disclosed in the patent may be freely used by the public without accounting to the patent owner, as long as there are no other unexpired patents that embrace an aspect of the invention. There is no certainty that any improvement, new use or new formulation will be patented to extend the protection of the underlying invention, or provide additional coverage to adequately protect the invention. As a result, the public may have the right to freely use the invention described in and previously protected by an expired patent.

Dependence on key personnel
The success of the Company's revenues are dependent on a limited number of employees, and in particular the Chief Executive Officer and other managers with technological and development input. The Company has endeavored to ensure its key employees are incentivized but cannot guarantee the retention of these staff. It also has the benefit of keyman insurance.

Forward-looking statements
All statements other statements of historical fact contained in this document constitute "forward-looking statements". In some cases, forward-looking statements can be identified by terms such as "may", "intend", "might", "will", "should", "could", "would", "believe", or the negative of these terms and similar expressions. Such forward-looking statements are based on assumptions and estimates and involve risks, uncertainties and other factors which may cause the actual results, financial condition, performance or achievements of the Company, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. New factors may emerge from time to time that could cause the Company's business not to develop as it expects and it is not possible for the Company to predicts all such factors. Given these uncertainties, investors are cautioned not to place any undue reliance on such forward-looking statements. Except as required by law, the Company disclaims any obligation to update any such forward-looking statements in this document to reflect future events or developments.

Key performance indicators

- Revenue US$11,572 (2012: US$9,379)
- Adjusted profit (before stock compensation expense) before taxation of US$(657) (2012: US$727)
- Adjusted earnings per share (before stock compensation expense), in cents, of US$(0.01) (2012: US$0.02)
- Basic earnings/(loss) per share, in cents, of US$(0.07) (2012: US$0.04)

Post reporting date events

On February 28, 2014, Spectra acquired all of the assets of Inksure Technologies, Inc., including its long-standing customer relationships and authentication technology.

Financial instruments

Details of the use of financial instruments by the Company are contained in note B of the financial statements.

Directors' responsibilities

The Directors are responsible for preparing the Directors' report and the financial statements on the basis of preparation set out in note A of the financial statements and in accordance with United States Generally Accepted Accounting Principles (US GAAP). The Directors of the Company are responsible for the document in which the financial information is included.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent; and
- state whether they have been prepared in accordance with US GAAP, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with all legal requirements. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors' interests

The Directors' beneficial interests in the common stock of the Company were as follows:

	December 31,	
Ordinary shares	**2013**	2012
O. Salam	**3,594,464**	3,594,464
N. Lawandy	**1,833,570**	1,833,570
R. Puton	**314,514**	314,514
M. Jaskel	**9,960**	9,960
Total	**5,752,508**	5,752,508

Substantial shareholdings

The following shareholders held 3% or more of the issued common stock of the Company at December 31, 2013:

	Ordinary shares	% of issued
Blackrock	4,244,674	9.38
Artemis	4,196,047	9.27
O. Salam	3,594,464	7.94
Maunby	3,516,740	7.77
State Street Nominees	3,430,000	7.58
Albany International	3,160,526	6.98
N. Lawandy	1,883,570	4.16
Clearwater Capital Group	1,813,850	4.01
Total	**25,839,871**	57.10

Directors' report continued
for the year ended December 31, 2013

Directors' compensation

The following table details Directors' earned compensation for the year ended December 31, 2013:

	Salary and bonus	Benefits	Board fees	Total compensation
Executive Directors				
N. Lawandy	$ 544,662	$ 15,555	$ —	$ 560,217
Non-executive Directors				
B. Penn	—	—	12,000	12,000
O. Salam	—	—	12,000	12,000
M. Jaskel	—	—	12,000	12,000
R. Puton	—	—	12,000	12,000
D. Standord	—	—	12,000	12,000
J. Donohue	—	—	12,000	12,000
Total	**$ 544,662**	**$ 15,555**	**$ 72,000**	**$ 632,217**

Directors' share options

At December 31, 2013, Directors had options or warrants to purchase ordinary shares under the Company's stock option plan as follows:

	Options held at December 31, 2013	Weighted average exercise price	Options vested at December 31, 2013
N. Lawandy	2,686,729	$ 0.65	2,611,843
B. Penn	120,000	0.60	114,356
O. Salam	133,000	0.77	127,356
M. Jaskel	120,000	0.60	114,356
R. Puton	138,000	0.81	132,356
D. Standord	120,000	0.60	114,356
Total	**3,317,729**	**$ 0.65**	**3,214,623**

Corporate governance

The Board comprises one executive Director, Nabil M. Lawandy, and six independent non-executive Directors, BJ Penn, as Chairman, Jeffrey Donohue, Martin Jaskel, Roland Puton, Oussama Salam and Donald Stanford. The Board usually meets at least every three months to closely monitor the progress of the Company towards the achievement of budgets, targets, and strategic objectives.

The Board also operates four committees: the Audit Committee, the Compensation Committee, the Nominating Committee and the Government Security Committee.

The Audit Committee comprises Roland Puton, as Chairman, Jeffrey Donohue and Martin Jaskel. It has primary responsibility for monitoring the quality of internal controls and ensuring that the financial performance of the Company is properly measured and reported on. It will receive and review reports from the Company's management and auditors relating to the interim and annual accounts and the accounting and internal control systems in use throughout the Company. The Audit Committee intends to meet no less than three times each financial year and will have unrestricted access to the Company's auditors.

The Compensation Committee comprises Roland Puton, as Chairman, Martin Jaskel, Oussama Salam and Donald Stanford. It reviews the performance of executive Directors and makes recommendations to the Board on matters relating to their remuneration and terms of employment. The Committee also makes recommendations to the Board on proposals for the granting of shares options and other equity incentives pursuant to any share options scheme or equity incentive scheme in operation from time to time.

The Nominating Committee comprises Martin Jaskel, as Chairman, BJ Penn, Oussama Salam and Donald Stanford. The Committee seeks and nominates qualified candidates for election or appointment to Spectra's Board of Directors.

The Government Security Committee comprises BJ Penn, as Chairman, and Nabil M. Lawandy. It is responsible for ensuring the implementation within the Company of all procedures, organizational matters and other aspects pertaining to the security and safeguarding of information, including the exercise of appropriate oversight and monitoring of operations to ensure that protective measures are effectively maintained and implemented.

The Board intends to comply with Rule 21 of the AIM Rules relating to directors' dealings and will also take all reasonable steps to ensure compliance by the Company's applicable employees and the Company has adopted a share dealing code for this purpose on substantially the same terms as the Model Code.

Website publication

The Directors are responsible for ensuring the annual report and the financial statements are made available on a website. Financial statements are published on the Company's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the Company's website is the responsibility of the Directors. The Directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

Auditors

All of the current Directors have made themselves aware of any information needed by the Company's auditors for the purposes of their audit and to establish that the auditors are aware of that information. The Directors are not aware of any relevant information of which the auditors are unaware.

Miller Wachman LLP have expressed their willingness to continue as the Company's auditors and a resolution to re-appoint Miller Wachman LLP will be proposed at the Annual General Meeting.

By order of the Board

Douglas A. Anderson
Company Secretary
June 3, 2014

Independent auditors' report

To the Board of Directors and Stockholders
Spectra Systems Corporation
Providence, Rhode Island

We have audited the accompanying financial statements of Spectra Systems Corporation, which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of income and other comprehensive income, stockholder's equity and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 financial statements referred to above present fairly, in all material respects, the financial position of Spectra Systems Corporation as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note O to the financial statements, the 2012 financial statements have been restated to correct a misstatement. Our opinion is not modified with respect to this matter.

Miller Wachman LLP

Miller Wachman LLP
Certified Public Accountants
Boston, Massachusetts
June 11, 2014

Balance sheets
December 31, 2013 and 2012

		2013		2012 As restated See note O
Current assets				
Cash and cash equivalents	$	**13,434,737**	$	9,617,155
Investments		**—**		6,550,020
Accounts receivable		**2,284,111**		2,697,893
Other receivables		**4,947**		124,093
Unbilled revenue on contracts in progress		**—**		354,577
Due from Solaris (net of allowance of US$94,392 in 2013)		**—**		89,644
Deferred contract costs		**10,263**		343,820
Inventory		**2,968,718**		1,074,520
Prepaid expenses		**156,678**		129,026
Deferred tax assets		**344,000**		344,000
Total current assets		**19,203,454**		21,324,748
Property, plant and equipment, net		**2,903,144**		2,285,436
Other assets				
Intangible assets, net		**3,075,082**		3,122,732
Restricted cash and investments		**2,500,000**		1,050,000
Deferred tax assets		**902,000**		902,000
Other assets		**73,682**		96,644
Total other assets		**6,550,764**		5,171,376
Total assets	$	**28,657,362**	$	28,781,560
Liabilities and stockholders' equity				
Current liabilities				
Accounts payable	$	**1,633,323**	$	1,384,100
Accrued expenses and other liabilities		**926,424**		932,303
Deferred revenue		**3,040,203**		2,190,322
Total current liabilities		**5,599,950**		4,506,725
Non-current liabilities				
Deferred revenue		**103,087**		161,725
Contingent liability		**2,000,000**		270,764
Total non-current liabilities		**2,103,087**		432,489
Total liabilities		**7,703,037**		4,939,214
Stockholders' equity				
Common stock, $0.01 par value, 125,000,000 shares authorized 45,251,370 shares issued and outstanding		**452,514**		452,514
Additional paid in capital – common stock		**54,855,662**		54,739,423
Accumulated other comprehensive (loss)		**(4,897)**		(2,741)
Accumulated deficit		**(34,348,954)**		(31,346,850)
Total stockholders' equity		**20,954,325**		23,842,346
Total liabilities and stockholders' equity	$	**28,657,362**	$	28,781,560

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

Statements of income and other comprehensive income
for the years ended December 31, 2013 and 2012

		2013		2012 As restated See note O
Revenues				
Product	$	7,956,291	$	6,423,569
Service		3,154,532		2,470,426
Royalty		461,219		485,311
Total revenues		11,572,042		9,379,306
Cost of sales		6,006,729		4,814,305
Gross profit		5,565,313		4,565,001
Operating expenses				
Research and development		2,850,812		2,079,975
General and administrative		3,437,237		3,173,221
Sales and marketing		641,971		514,445
Total operating expenses		6,930,020		5,767,641
Loss from operations		(1,364,707)		(1,202,640)
Other income/(expense)				
Interest income		138,759		227,390
Other income		250		740
Contingent liability		(1,789,040)		(270,764)
Foreign currency gain/(loss)		12,634		(430,066)
Total other income/(expense)		(1,637,397)		(472,700)
Loss before provision for income taxes		(3,002,104)		(1,675,340)
Provision (benefit) for income taxes		—		—
Net loss	$	(3,002,104)	$	(1,675,340)
Loss per share				
Loss per share, basic and diluted	$	(0.07)	$	(0.04)
Weighted average number of common shares		45,251,370		45,251,370
Other comprehensive income/(loss)				
Unrealized gain/(loss) on currency exchange		10,478		424,848
Reclassification for realized (gain)/loss in net income		(12,634)		430,066
Total other comprehensive income/(loss)		(2,156)		854,914
Comprehensive income/(loss)	$	(3,004,260)	$	(820,426)

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

Statements of cash flows
for the years ended December 31, 2013 and 2012

	2013	2012 As restated See note O
Cash flows from operating activities		
Net loss	$ (3,002,104)	$ (1,675,340)
Adjustments to reconcile net loss to net cash from operating activities:		
Depreciation and amortization	428,589	351,156
Stock-based compensation expense	116,239	126,849
Allowance for Solaris note	94,392	—
Changes in operating assets and liabilities:		
Accounts receivable	416,362	(2,221,715)
Other receivable	117,791	(14,847)
Due from Solaris	(4,748)	(8,532)
Unbilled revenue on contracts in progress	354,577	(354,577)
Deferred contract costs	333,557	(279,540)
Inventory	(1,894,198)	(262,068)
Prepaid expenses	(28,725)	4,284
Other assets	22,106	(79,388)
Accounts payable	249,761	(80,426)
Accrued expenses and other liabilities	(4,916)	191,001
Deferred revenue	783,056	(190,907)
Contingent liability	1,729,236	270,764
Net cash used in operating activities	(289,025)	(4,222,686)
Cash flows from investing activities		
Increase in restricted cash and investments	(1,450,000)	—
Advance payments to suppliers	—	(36,704)
Payment of patent costs	(225,983)	(221,106)
Sales of investments	6,560,224	6,109,260
Purchase of investments	—	(6,473,726)
Asset acquisitions	—	(2,151,000)
Purchases of property, plant and equipment	(771,835)	(1,823,176)
Net cash provided by/(used in) investing activities	4,112,406	(4,596,452)
Effect of exchange rate changes on cash and cash equivalents	(5,799)	574,938
Net increase/(decrease) in cash and cash equivalents	3,823,381	(8,819,138)
Cash and cash equivalents at beginning of the year	9,617,155	17,861,355
Cash and cash equivalents at end of the year	$13,434,737	$ 9,617,155

Supplemental disclosure of cash flow information		
Income taxes paid	$ 500	$ 500

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

Statements of stockholders' equity
for the years ended December 31, 2013 and 2012

	Common stock					
	Shares	Amounts	Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss	Total stockholders' equity
Balance at December 31, 2011 – as restated	**45,251,370**	**$ 452,514**	**$ 54,612,574**	**$ (29,671,510)**	**$ (857,655)**	**$ 24,535,923**
Compensation cost related to amortization of stock options			126,849			126,849
Reclassification for realized loss in net income as restated					430,066	430,066
Change in currency translation adjustment as restated					424,848	424,848
Net loss – as restated				(1,675,340)		(1,675,340)
Balance at December 31, 2012 – as restated	**45,251,370**	**$ 452,514**	**$ 54,739,423**	**$ (31,346,850)**	**$ (2,741)**	**$ 23,842,346**
Compensation cost related to amortization of stock options			116,239			116,239
Reclassification for realized gain in net income					(12,634)	(12,634)
Change in currency translation adjustment					10,478	10,478
Net loss				(3,002,104)		(3,002,104)
Balance at December 31, 2013	**45,251,370**	**$ 452,514**	**$ 54,855,662**	**$ (34,348,954)**	**$ (4,897)**	**$ 20,954,325**

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

Notes to the financial information
for the years ended December 31, 2013 and 2012 (restated)

Note A – Corporate Information

Spectra Systems Corporation (the "Company") develops and sells integrated optical systems that provide customers with increased efficiency, security tracking and product life. The integrated systems combine consumables and engineered optical materials with software and hardware for use in applications. The Company develops and sells its integrated solutions across a spectrum of markets, including currency manufacturing, industrial logistics and other highly sensitive documents. The Company also provides software tools to the lottery and gaming industries for fraud detection, money laundering, match fixing and statistical analysis.

The Company was incorporated on July 3, 1996 in Delaware as Spectra Acquisition Corp. On August 26, 1996, the Company purchased substantially all of the assets of SSC Science Corporation (SSCSC) and changed its name to Spectra Science Corporation. The assets were purchased for $1,654,000 in cash plus common stock warrants. The acquisition was accounted for using the purchase method of accounting.

On June 8, 2001, the Company changed its name to Spectra Systems Corporation.

On July, 25 2011, the Company raised $20,241,179, net of offering costs, on the London Stock Exchange in a placing of 18,592,320 common shares at a placing price of £0.753 per new common share (the "Placing Price"), representing 41.09% of the enlarged common share capital of the Company. As a result of the offering, anti-dilution provisions found in the Company's Amended and Restated Certificate of Incorporation converted all of the issued and outstanding preferred shares into 17,185,052 common shares giving 26,659,050 common shares in issue at the time of the placing.

On June 6, 2012, the Company acquired, all of the assets of ESI Integrity, Inc., including its proprietary source codes, multi-year contracts, long-standing customer relationships, and assumed liabilities. $1,425,000 was paid consideration for the assets (see note P).

On September 14, 2012, the Company acquired certain assets of Lapis Software Associates including their proprietary source codes, multi-year and long-standing customer relationships, and assumed liabilities. $726,000 was paid in consideration for the assets (see note P).

Note B – Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. The accounting estimates that require the management's most difficult and subjective judgments include the assessment of recoverability of property, plant, and equipment; the valuation of inventory; and the recognition and measurement of income tax assets and liabilities. The actual results may differ materially from management's estimates.

Cash and Cash Equivalents

The Company considers highly liquid investment purchases with a maturity of 90 days or less at date of acquisition to be cash equivalents.

Restricted cash and investments represents money market investments held as collateral for certain performance agreements entered into by the Company in 2013 and 2012 as required in accordance with terms of a services contract. At December 31, 2013 and 2012, the agreement required $2,500,000 and $1,050,000, respectively, be maintained as collateral. The collateral will be released as the Company meets contractual milestones. Included in the $2,500,000 as of December 31, 2013 is a certificate of deposit of $1,036,867 which is considered an investment.

Concentration of Credit Risk and Significant Customers

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and cash equivalents and trade accounts receivable. The Company's cash management policies restrict investments to low-risk highly liquid securities, and the Company restricts its transactions to financial institutions with good credit standing. The Company has cash, including restricted, on deposit with three financial institutions which are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000 per institution. As of December 31, 2013, the amount in excess of the FDIC limit was $3,766,218. Also included in cash at December 31, 2013 is $10,972,807 of cash in bank accounts in the United Kingdom and Canada. Both accounts are not FDIC insured. The foreign bank account in Canada with a balance of $212,183 is subject to exchange rate changes.

Concentrations of credit risk with respect to trade accounts receivable are limited due to the concentration of business with government entities.

Notes to financial information continued

for the years ended December 31, 2013 and 2012 (restated)

Note B – Significant Accounting Policies continued

Concentration of Credit Risk and Significant Customers continued

The following table summarizes the number of customers that individually comprise greater than 10% of total revenues and their aggregate percentage of the Company's total revenues:

Year ended December 31,	Number of significant customers	Percentage of total revenues
2013	**3**	**82%**
2012	3	83%

The following table summarizes the number of customers that individually comprise greater than 10% of total accounts receivable and their aggregate percentage of the Company's total accounts receivable:

Year ended December 31,	Number of significant customers	Percentage of total receivables
2013	**2**	**58%**
2012	2	78%

During 2013 and 2012, the Company had purchases of approximately $2,606,000 and $1,747,000, respectively, with one vendor.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash and cash equivalents, accounts receivable and accounts payable, are carried in the financial statements at amounts that approximate their fair market values at December 31, 2013 and 2012.

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Inputs that are generally unobservable and typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability.

As of December 31, 2013, the Company has a certificate of deposit of $1,036,867 which is included in restricted cash and investments of $2,500,000. The company considers this certificate of deposit as a level 2 investment.

As of December 31, 2012, the Company's investments consist of foreign certificates of deposit of $6,550,020 in the United Kingdom that the Company considers a level 2 investment. One of the certificates of deposit was subject to exchange rate changes.

Foreign Currency Translation

The functional currency of the Company's foreign operations is the applicable local currency, the Canadian Dollar. The functional currency is translated into US Dollars for balance sheet accounts using currency exchange rates in effect as of the balance sheet date and for revenue and expense accounts using an average exchange in effect during the applicable period. The translation adjustments are deferred as a separate component of stockholders' equity in accumulated other comprehensive income.

Accounts Receivable

There is no allowance for doubtful accounts at December 31, 2013 and 2012. Management has evaluated the accounts receivable and believes that they are all collectable at December 31, 2013 and 2012.

Inventory

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. The Company regularly reviews inventory quantities on hand and records a provision to write down excess and obsolete inventory to its estimated net realizable value if less than cost.

Note B – Significant Accounting Policies continued

Intangible Assets

Intangible assets are recorded at the purchase price. Amortization is calculated using the straight-line method over the estimated useful lives of assets ranging from seven to 15 years. The Company evaluates the possible impairment of long-term assets annually, whenever events or circumstances indicate the carrying value of the asset may not be recoverable.

Property and Equipment

Property and equipment is stated on the basis of purchase price. Depreciation is calculated using the straight-line method over the following estimates useful lives:

Laboratory equipment	3–7 years
Computer and office equipment	3–5 years
Furniture and fixtures	7 years
Leasehold improvements	Shorter of lease term or estimated useful life
Software	3–5 years
Manufacturing equipment	5–7 years

Maintenance and repairs are charged to expense as incurred. When assets are retired or otherwise disposed of, the assets and related allowances for depreciation and amortization are eliminated from accounts and any resulting gain or loss is reflected in net income.

Computer Software

The Company capitalizes certain costs in connection with developing new internal software once certain criteria are met. Overhead, general and administrative and training costs are expensed as incurred.

Investment in Affiliates

The Company accounts for investments in affiliates under the cost method of accounting if the Company owns less than 20% of the affiliates' outstanding capital. As of December 31, 2013, the Company held a 19% ownership in an affiliate (SpectraMed) and a 10% ownership in an affiliate (Solaris). These affiliates have had significant losses in prior years and the Company had previously reduced its investments in these affiliates to $nil.

Accounting for Stock-Based Compensation

In accounting for the Employee Stock Option Plan, the Company uses the Black-Scholes option pricing model to calculate compensation costs associated with options granted to employees. Total compensation costs are recorded over the option vesting period, generally three years. The Company recorded compensation costs of $116,239 and $126,849 for 2013 and 2012, respectively, under the Plan.

Revenue Recognition

Product revenue includes sales of pigments and security taggants, delivery of prototypes, and contracts with multiple elements including nonrecurring engineering and follow-on manufacturing. Service revenue includes research and development services provided for a fixed price or provided for a specific period.

Revenues related to sales of pigments and security taggants and research and development services provided for a specific period are generally recognized when products are shipped or services are provided, the risk of loss has passed to the customer, the sales price is fixed or determinable and collectability is reasonably assured.

Revenue from multiple element arrangements is deferred until all elements of the contract are delivered unless all of the following criteria have been met: (1) the product or service has been delivered; (2) the fee for the delivered element is not subject to forfeiture, refund or concession based on performance or delivery of the undelivered element; and (3) the fair value of the delivered element is determined based upon the price charges by the Company or the price charged by competitors when similar services or products are sold separately; in which case the revenues for each element will be recognized independently in accordance with the Company's policy.

Revenue from fixed-price development contracts is recognized on the percentage-of-completion method, measured by the percentage of effort incurred to date to estimated total effort for each contract. That method is used because management considers total effort to be the best available measure of progress on the contracts. Because of inherent uncertainties in estimating effort, it is at least reasonably possible that the estimates used will change within the near term.

The asset "Unbilled revenue on contracts in progress" represents revenues recognized in excess of amounts billed.

Royalties are recognized when they are earned based on sales or use of technologies by third parties except where future income is not anticipated to cover non-refundable advances received, when the excess royalty is taken to income.

Notes to financial information continued

for the years ended December 31, 2013 and 2012 (restated)

Note B – Significant Accounting Policies continued

Research and Development

Internal research and development costs are expensed as incurred. Certain third party research and development costs are capitalized in connection with contracted work. These costs are expensed as certain milestones are achieved. Overhead, general and administrative and training costs are expensed as incurred. At December 31, 2012, the Company had an outstanding contract with a third party to adapt an existing capability to certain specific requirements. Such costs totaling $343,820 have been capitalized as deferred contract costs and are being expensed as certain milestones are met. The milestones were met in 2013 and these costs were expensed.

Advertising Costs

Advertising costs are charged to expense when incurred. No advertising expense was incurred in 2013 or 2012.

Income Tax

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income taxes. The benefits from net operating losses carried forward may be impaired or limited in certain circumstances. In addition, a valuation allowance can be provided for deferred tax assets when it is more likely than not that all or some portion of the deferred tax asset will not be realized. The Company has a deferred tax asset of $1,246,000 at December 31, 2013 and 2012.

Shipping and Handling

The Company reports the cost of shipping and handling as an operating expense. Shipping and handling expense was $105,184 and $65,230 for 2013 and 2012, respectively.

Subsequent Events

In preparing these financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through June 11, 2014, the date the financial statements were available to be issued (see note R).

Reclassification

Certain amounts in the 2012 financial statements have been reclassified to conform with the 2013 presentation.

Note C – Related Party Transactions

100% of the sales of the Company's phosphor products, which amounted to $463,000 and $595,000 for the years ended December 31, 2013 and 2012, respectively, are to a company owned by a shareholder.

Note D – Inventories

Inventories consist of the following:

	December 31, 2013	December 31, 2012
Raw materials	$ 2,621,159	$ 870,679
Finished goods	347,559	203,841
	$ 2,968,718	$ 1,074,520

Note E – Property and Equipment

Property and equipment consists of the following:

	December 31, 2013	December 31, 2012
Construction in progress	$ —	$ 2,036,107
Laboratory equipment	723,370	567,285
Computer and office equipment	565,425	510,941
Furniture and fixtures	116,961	106,694
Leasehold improvements	1,801,059	403,900
Software	349,711	331,616
Manufacturing equipment	2,121,167	979,916
Total	5,677,693	4,936,459
Less: accumulated depreciation	(2,774,549)	(2,651,023)
	$ 2,903,144	$ 2,285,436

Depreciation expense amounted to $154,590 and $171,786 for the years ended December 31, 2013 and 2012, respectively.

Note F – Intangible Assets

Intangible assets consist of the following:

	December 31, 2013	2012
Patents	$ 1,239,890	$ 1,013,906
Customer relationships	1,130,000	1,130,000
Non-compete agreements	110,000	110,000
Developed technology	390,000	390,000
Goodwill	1,276,946	1,276,946
Total	4,146,836	3,920,852
Less: accumulated amortization	(1,071,753)	(798,120)
	$ 3,075,083	$ 3,122,732

Amortization expense amounted to $273,998 and $179,370 for the years ended December 31, 2013 and 2012, respectively.

Estimated amortization expense for the next five years are as follows:

Year ending December 31,	
2014	$ 260,371
2015	250,753
2016	237,984
2017	237,171
2018	206,219
Thereafter	605,639
	$ 1,798,137

Note G – Other Assets

Other assets consist of the following:

	December 31, 2013	2012
Rental deposits	$ 19,836	$ 36,163
Other deposits	2,344	—
License agreements	4,477	6,467
Equipment deposits	47,025	54,014
	$ 73,682	$ 96,644

Notes to financial information continued
for the years ended December 31, 2013 and 2012 (restated)

Note H – Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities consist of the following:

	December 31, 2013	December 31, 2012
Royalties	$ 352,148	$ 404,433
Employee compensation	338,228	296,438
Professional fees	98,235	78,788
Property and sales taxes	82,245	71,909
Product warranty	25,000	25,000
Other	30,568	55,735
	$ 926,424	$ 932,303

Note I – Income Taxes

The approximate components of the income tax (benefit)/provision are as follows:

	December 31, 2013	December 31, 2012
Federal income tax provision/(benefit) computed at federal statutory rate	$ (300,000)	$ (524,000)
State income taxes provision/(benefit)	(53,000)	(96,000)
Federal deferred	(640,000)	(87,000)
State deferred	(113,000)	(14,000)
Change in valuation allowance	1,106,000	721,000
Income tax (benefit)	$ –	$ –

Approximate deferred income tax assets are as follows:

	December 31, 2013	December 31, 2012
Depreciation and amortization	$ 102,000	$ 137,000
Deferred revenue	344,000	(236,000)
Deferred rent	12,000	13,000
Federal and state tax credits	1,046,000	1,009,000
Inventory	178,000	52,000
Unbilled revenue on contracts	–	(142,000)
Deferred contract costs		(112,000)
Contingent liability	825,000	108,000
Net operating loss carryforward	8,002,000	8,574,000
Valuation allowance	(9,236,000)	(8,157,000)
Total deferred income tax assets	$ 1,246,000	$ 1,246,000

Note I – Income Taxes continued

The Company uses an effective tax rate of 40% consisting of a federal rate of 34% and a state rate of 6% net of federal effect.

As of December 31, 2013, the Company has net operating loss carryforwards expiring between 2018 and 2033 for US federal income tax purposes of approximately $24,449,000 and $1,756,000 expiring between 2014 and 2018 for state income tax purposes. A valuation allowance has been established for $8,151,000 and $8,157,000 as of December 31, 2013 and 2012, respectively, for the deferred tax benefit related to those loss carryforwards and other deferred tax assets.

At December 31, 2013, the Company also had approximately $738,000 and $308,000 of tax credit carryforwards that are available to offset federal and state liabilities, respectively. The credits will begin to expire between 2014 and 2029 for federal and between 2019 and 2021 for state.

In 2007, SpectraDisc Corporation merged with the Company. SpectraDisc Corporation has net operating loss carryforwards of approximately $1,400,000 and tax credit carryforwards of $8,300. Due to the restrictive nature of IRS code sections 382 and 383, management deems the future utilization of net operating losses and tax credits unlikely and has elected not to include them in the deferred tax calculations.

The utilization of the tax carryforwards described above are dependent upon future profitability prior to any expiration dates. Additionally, alternative minimum taxes, if any, and substantial changes in ownership and tax laws and regulations may substantially limit their realization.

Note J – Accounting for Uncertainty in Income Taxes

The Company accounts for the effect of any uncertain tax positions based on a “more likely than not” threshold to the recognition of the tax positions being sustained based on the technical merits of the position under scrutiny by the applicable taxing authority. If a tax position or positions are deemed to result in uncertainties of those positions, the unrecognized tax benefit is estimated based on a “cumulative probability assessment” that aggregates the estimated tax liability for all uncertain tax positions. The Company is not currently under examination by any taxing jurisdiction. The Company’s federal and state income tax returns are generally open for examination for three years following the date filed.

Note K – Commitments

Lease Commitments

The Company holds four real estate leases. The Company’s lease agreement for corporate office space expired September 30, 2012 and is now in a month-to-month arrangement. In 2011, the Company’s lease for laboratory space in East Providence was extended through May 31, 2014. The Company signed a five year lease agreement for a new space in East Providence beginning in November 2013 and expiring in October of 2017. To support our ICS business, the Company signed a two year lease ranging from February 2013 through January 2015. Rent expense was $423,376 and $373,973 for the years ended December 31, 2013 and 2012, respectively.

Future minimum lease payments are as follows:

Year ending December 31,		
2014	$	248,536
2015		157,573
2016		155,424
2017		129,520
	$	691,053

License and Supply Agreements

In 1996, and subsequently amended in 1999 and 2002, the Company entered into a license agreement under which the Company obtained a nonexclusive right to use certain technology through the term of the licensor’s patents on such technology. The license agreement contains provisions for royalties to be paid on sales of products developed under the agreement. For the years ended December 31, 2013 and 2012, the Company recorded $335,220 and $251,976, respectively in royalty expense (see note N).

On March 8, 1999, the Company entered into a license agreement with a shareholder who provides product consulting, technical services and technical know-how to facilitate incorporation of the Company’s technology into products the shareholder sells to US government agencies. In exchange for these services, the Company agreed to pay $200,000, of which $10,000 was due at December 31, 2000. The remaining $190,000 was paid in 2004. In addition, the shareholder is entitled to 30% of the profit of future sales. Royalties are expensed as incurred. The term of the agreement is 15 years from the date the US government agencies commenced use of the technology, but no longer than 20 years after the agreement’s effective date.

Notes to financial information continued
for the years ended December 31, 2013 and 2012 (restated)

Note K – Commitments continued

License and Supply Agreements continued

In 2002, the Company entered into a supply agreement whereby the Company agreed to purchase a certain quantity of laser materials at the established price. Under the terms of the agreement, the Company is required to purchase all materials from one vendor. The Company met its obligations under that agreement. The Company is also required to purchase all spare parts for the laser materials from that vendor until December 2013. During 2013 and 2012, the Company has purchased $79,581 and $232,223, respectively, of materials.

Note L – Stockholders' Equity

Common and Preferred Stock

The Company's Certificate of Incorporation, as amended in 2007, authorizes the Company to issue 125,000,000 shares of common stock (the "Common Stock"), $0.01 par value, and 17,882,179 shares of preferred stock (the "Preferred Stock"), $0.01 par value, of which 2,000,000 shares are undesignated. The Board designated 4,167,000 shares of preferred stock as Series A Convertible Preferred Stock ("Series A"), 1,700,000 as Series B Convertible Preferred Stock ("Series B"), 2,000,000 as Series B-1 Convertible Preferred Stock ("Series B-1"), 600,000 as Series B-2 Convertible Preferred Stock ("Series B-2"), 150,000 as Series B-3 Convertible Preferred Stock ("Series B-3"), 100,000 as Series B-4 Convertible Preferred Stock ("Series B-4"), 100,000 as Series B-5 Convertible Preferred Stock ("Series B-5"), 1,777,778 as Series C Convertible Preferred Stock ("Series C"), 2,362,400 as Series D convertible Preferred Stock ("Series D"), and 2,925,000 as Series E-1 Convertible Preferred Stock ("Series E-1").

On July, 25 2011, the Company raised $20,241,179, net of offering costs, on the London Stock Exchange in a placing of 18,592,320 common shares at a placing price of £0.753 per new common share (the "Placing Price"), representing 41.09% of the enlarged common share capital of the Company. As a result of the offering, anti-dilution provisions found in the Company's Amended and Restated Certificate of Incorporation converted all of the issued and outstanding preferred shares into 17,185,052 common shares giving 26,659,050 common shares in issue at the time of the placing. At December 31, 2013, there were 45,251,370 common shares issued and outstanding and no preferred shares in issue.

Warrants

- 2008 Common Stock warrants

  On April 7, 2008, the Company raised $600,000 in exchange for 1,000,000 common shares valued at $0.60 each. The Company paid a 10% commission and also provided the agent with warrants to purchase 275,000 common shares at an exercise price of $0.60 per share. The warrants expired on April 7, 2013.

- WH Ireland warrant agreement

  Pursuant to a warrant agreement dated July 19, 2011, the Company created and issued warrants to WH Ireland under Regulation D under the US Securities Act which entitles the holder to subscribe for up to 452,514 common shares at an exercise price of £0.753 per share. The warrants expire on July 25, 2014. Under the Black-Scholes pricing model, the Company estimated the fair value of the warrants to be $273,318. These costs have been included as part of the 2011 offering costs.

Stock Option Plan

In December 1996 the Company's Board of Directors, who control a majority of the shares of the Company, approved the 1997 Stock Option Plan (the "1997 Plan").

The 1997 Plan provided that key employees, non-employee Directors, and certain consultants and advisors may be granted either nonqualified or incentive stock options for the purchase of the Company's common stock at the fair market value, on the date of the grant. Stock options generally vest over three years. The options would be exercisable over a period up to ten years from the date of grant.

In February 2002, the Company adopted the 2002 Stock Plan (the "2002 Plan") which provided for the grant of incentive stock options and nonqualified stock options, stock awards and stock purchase rights for the purchase of up to 1,500,000 shares of the Company's common stock to officers, employees, consultants and Directors of the Company. The Board of Directors is responsible for administration of the 2002 Plan. The Board determines the term of each option, the option exercise price, and the number of shares for which each option is granted and the rate at which each option is exercisable. Incentive stock options may be granted to an officer or employee at an exercise price per share of not less than the fair value per common share on the date of the grant (not less than 110% of fair value in the case of holders of more than 10% of the Company's voting stock) and with a term not to exceed ten years from the date of the grant (five years for incentive stock options granted to holders of more than 10% of the Company's voting stock). Nonqualified stock options may be granted to consultants or Directors at an exercise price per share of not less than 85% of the fair value of the common stock.

Note L – Stockholders' Equity continued

Stock Option Plan continued

Upon the effective date of the 2002 Plan, the 1997 Plan was terminated. The termination did not affect the previously issued options.

In 2007, the number of shares available for grant under the 2002 Plan increased from 1,500,000 to 3,500,000.

In May 2007, the Company adopted the 2007 Stock Plan (the "2007 Plan") which provided for the grant of incentive stock options and nonqualified stock options, stock awards and stock purchase rights for the purchase of up to 14,100,000 shares of the Company's common stock to officers, employees, consultants and Directors of the Company. The Board of Directors is responsible for administration of the 2007 Plan. The Board determines the term of each option, the option exercise price, and the number of shares for which each option is granted and the rate at which each option is exercisable. Incentive stock options may be granted to an officer or employee at an exercise price per share of not less than the fair value per common share on the date of the grant (not less than 110% of fair value in the case of holders of more than 10% of the Company's voting stock) and with a term not to exceed ten years from the date of the grant (five years for incentive stock options granted to holders of more than 10% of the Company's voting stock). Nonqualified stock options may be granted to consultants or Directors at an exercise price per share of not less than 85% of the fair value of the common stock.

The 2007 Plan and the 2002 Plan existed at December 31, 2013.

At December 31, 2013, 70,187 options were issued under the 1997 plan, 2,269,864 options were issued under the 2002 Plan and 3,556,476 options were issued under the 2007 plan. 636,576 options were issued without a plan. 7,566,897 options were available for grant under the 2007 plan.

Information related to stock options granted by the Company is summarized as follows (including Certain options granted outside of the Plan):

	December 31, 2013			December 31, 2012		
	Number of shares under option		Weighted average exercise price	Number of shares under option		Weighted average exercise price
Outstanding at beginning of year	6,586,803	$	0.76	6,180,803	$	0.82
Granted	81,000	$	0.30	481,000	$	0.42
Exercised	—		—	—		—
Forfeited/canceled	(134,700)	$	1.54	(75,000)	$	3.97
Outstanding at end of year	6,533,103	$	0.74	6,586,803	$	0.76

The following table summarizes information about stock options outstanding at December 31, 2013:

	Options outstanding				Options exercisable		
Exercise price range	Number of outstanding shares	Weighted average contractual life (years)		Weighted average exercise price	Number of shares		Weighted average exercise price
$0.21–$0.99	4,901,550	4.87	$	0.62	4,544,963	$	0.63
$1.00–$5.50	1,631,553	3.42	$	1.09	1,547,520	$	1.09
	6,533,103				6,092,483		

Notes to financial information continued

for the years ended December 31, 2013 and 2012 (restated)

Note L – Stockholders' Equity continued

Stock Option Plan continued

The Company currently uses the Black-Scholes option pricing model to determine the fair value of our stock options. The valuations determined using this model are affected by assumptions regarding a number of complex and various subjective variables including stock price, volatility, expected life of options, risk free interest rates, and expected dividends if any. The assumptions used to value stock option grants for the year ended December 31, 2013 are as follows:

Risk free rate	0.09%–0.14%
Expected life	5 years
Assumed volatility	23.40%–67.23%
Expected dividends	None
Expected forfeitures	75%

Unrecognized Compensation Costs

As of December 31, 2013, there was approximately $85,000 of unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested stock-based payments granted to our employees, Directors and consultants. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures and recognized over the remaining vesting periods of the stock grants.

Note M – Employee Retirement Plan

During 1999, the Company adopted a defined contribution plan, established under the guidelines of section 401(k) of the Internal Revenue Code (IRC), which covers all employees. Employees are eligible to participate in the Plan at the beginning of the first month following the date of hire. Employees may contribute up to the maximum allowed by the IRC of eligible pay on a pre-tax basis. The Company made a matching contribution of 50% of employee contributions up to 4% of eligible salary. Company matching contributions vest at 25% after one year of service, 50% at the end of two years of service and 100% at the end of three years of service. For the years ended December 31, 2013 and 2012, the Company's matching contribution was $38,416 and $35,072, respectively.

Note N – Contingent Liability

In December 2011, the Company was notified by a corporate shareholder regarding a license agreement between the Company and the shareholder dated March 8, 1999. The shareholder has stated that the Company owes the shareholder approximately $2,100,000 in total for the years 2004 through 2010 based on their interpretation of the license agreement. The Company disagrees with the shareholder's interpretation of the license agreement.

In 2014, the Company and the shareholder entered into an agreement in principle. To settle the dispute for all past amounts due and all future amounts that may be due, the Company agreed to pay $2,000,000 plus the relief of a receivable owed the Company from the shareholder in the amount of approximately $129,000. Accordingly, the Company recorded a contingent liability expense of $1,789,040 in 2013.

Note O – Prior Year Restatement

During the year-end financial close process for 2013, the Company discovered an error related to accounting for foreign currency exchange transactions during 2012 and 2011. The Company had accounted for realized gain and losses on such transactions as a charge to other comprehensive income/(loss) which is a component of total stockholders' equity. These realized gains and losses should have been included as part of net income/(loss) on the statement of income. The result of this error had no effect on total stockholders' equity. The Company is restating its financial statements as of and for the year ended 31 December 2012 as follows:

As of December 31, 2011 accumulated deficit was increased by $63,959 and other comprehensive income/(loss) decreased by $63,959 resulting in no change to total stockholders' equity. For the year ended December 31, 2012, basic profit/(loss) for the period was increased by $430,066 with a corresponding decrease to other comprehensive income/(loss) of $430,066 resulting in no change to total stockholders' equity.

Note P – Business Combinations

Acquisition of assets of ESI Integrity

On June 6, 2012, the Company acquired all of the assets of ESI Integrity, Inc., a leader in the gaming software industry headquartered in Vancouver, Canada, with a 22% worldwide market share of the secure Internal Control Systems (ICS) segment. The acquisition was strategic for the Company, allowing us to expand beyond physical banknotes to secure software products for gaming. The total purchase price was $1,425,000 in cash and included its proprietary source codes, multi-year contracts, long-standing customer relationships and assumed liabilities. Our fiscal 2012 results of operations included revenue of approximately $891,000 associated with ESI Integrity customers for the seven-month period following the date of acquisition. We report ESI as part of our Secure Transactions group in our Canadian branch office.

Note P – Business Combinations continued

Acquisition of certain assets from Lapis Software Associates

On September 17, 2012, the Company acquired, certain assets from Lapis Software Associates, a leader in the gaming software industry headquartered in Parsippany, New Jersey, with a 15% worldwide market share of the secure Internal Control Systems (ICS) segment primarily with US state lotteries. The acquisition was strategic for the Company allowing us to expand our customer list with our secure software products for gaming. The Company will support the customers with the resources acquired from ESI Integrity. The total purchase price was $726,000 in cash and included its proprietary source codes, multi-year contracts and long-standing customer relationships. Our fiscal 2012 results of operations included revenue of approximately $89,000 associated with Lapis customers for the 105 day period following the date of acquisition. We report Lapis as part of Secure Transactions group.

Acquisition of certain assets from Inksure Technologies, Inc.

On February 28, 2014, the Company acquired, certain assets from Inksure Technologies, Inc., a leader in brand protection and tax stamp authentication headquartered in New York City, NY. The acquisition was strategic for the Company allowing us to extend our reach into tax stamps and the authentication of commercial product brands. The Company will support the customers with resources existing in its banknote authentication division. The total purchase price was $1,356,000 in cash with deferred consideration of $35,000, dependent upon achieving a commercial milestone. The purchase price included Inksure's long-standing customer relationships and authentication technology. We report Inksure as part of our Authentication Systems group.

The following tables provide further detail of these acquisitions:

Date of acquisition Reporting business segment		ESI Integrity June 6, 2012 Secure software transactions	Lapis September 17, 2012 Secure software transactions	Inksure February 28, 2014 Authentication aystems
Cash consideration paid to former owners		1,425,000	726,000	1,356,000
Allocation of purchase price:				
	Accounts receivable	—	—	136,000
	Inventories	—	—	249,000
	Property, plant and equipment	17,000	—	—
	Goodwill	1,087,000	190,000	574,000
	Identifiable intangible assets	1,070,000	560,000	500,000
Total assets acquired		**2,174,000**	**750,000**	**1,459,000**
	Deferred revenue	(749,000)	(24,000)	—
	Other liabilities	—	—	(103,000)
Total liabilities acquired		**(749,000)**	**(24,000)**	**(103,000)**
Net assets assumed		**1,425,000**	**726,000**	**1,356,000**

	Weighted average amortization period	Total	Weighted average amortization period	Total	Weighted average amortization period	Total
Identifiable intangible assets						
Customer relationships	8.00	790,000	15.00	340,000	8.00	300,000
Developed technology	6.00	280,000	9.00	110,000	5.00	135,000
Non-compete agreements	—	—	7.00	110,000	3.00	65,000
Weighted average amortization period and total	**7.48**	**1,070,000**	**12.25**	**560,000**	**6.54**	**500,000**

Notes to the financial information continued

for the years ended December 31, 2013 and 2012 (restated)

Note Q – Segment Reporting

In accordance with ASC 280, management has identified two operating segments. The first is its Authentication Systems group, which captures the hardware, software and materials related to banknote, tax stamp and other high value goods. The second segment is its Secure Transactions group. This group is characterized as providing an Internal Control System (ICS) software offering to the lottery and gaming industries. ICS provides tools for fraud detection, money laundering, match fixing and statistical analysis.

Information for each reportable segment as of December 31, 2013 and 2012 is as follows:

		Gross sales	Income (loss) from operations	Depreciation and amortization	Capital expense	Segment assets
2012	Secure Transactions	980,419	(137,713)	113,845	—	3,600,948
	Authentication Systems	8,398,887	(1,064,927)	237,311	1,823,176	25,126,612
	Total Segment	**9,379,306**	**(1,202,640)**	**351,156**	**1,823,176**	**28,727,560**
2013	Secure Transactions	1,590,299	192,887	181,228	17,099	3,800,729
	Authentication Systems	9,981,743	(1,557,594)	247,361	754,736	24,856,633
	Total Segment	**11,572,042**	**(1,364,707)**	**428,589**	**771,835**	**28,657,362**

Note R – Subsequent Events

On February 28, 2014, the Company acquired certain assets of Inksure Technologies. The final consideration amounted to $1,360,000 which was paid in cash on completion, together with deferred consideration of up to 35,000 dependent upon achieving a commercial milestone.

In December 2011, the Company was notified by a corporate shareholder regarding a license agreement between the Company and the shareholder dated March 8, 1999. The shareholder has stated that the Company owes the shareholder approximately $2,100,000 in total for the years 2004 through 2010 based on their interpretation of the license agreement. The Company disagrees with the shareholder's interpretation of the license agreement.

In 2014, the Company and the shareholder entered into an agreement in principle. To settle the dispute for all past amounts due and all future amounts that may be due, the Company agreed to pay $2,000,000 plus the relief of a receivable owed the Company from the shareholder in the amount of approximately $129,000. Accordingly, the Company recorded a contingent liability expense of $1,789,040 in 2013 (see note N).

Note S – Loss per share

The calculation of loss per share figures for the year ended December 31, 2013 and 2012 is based on the profit/(loss) attributable to ordinary shareholders of ($3,002,104) and ($1,675,340), respectively divided by the weighted average number of shares in issue, shown in the table below. Since the years ended December 31, 2013 and 2012 reflect losses, including the potential conversion of warrants and options in the diluted EPS calculation would decrease the loss per share. Accordingly, they are considered anti-dilutive and are not included in the calculation of loss per share.

	Year ended December 31, 2013		Year ended December 31, 2012	
	Number of shares	**Weighted average**	Number of shares	Weighted average
Basic – shares in issue	**45,251,370**	**45,251,370**	45,251,370	45,251,370

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