Spectra Systems Corporation
Interim results for the six months ended 30 June 2012

Spectra Systems Corporation, a leading provider of advanced technology solutions for banknote and product authentication, is pleased to announce its interim results for the six months ended 30 June 2012.

Financial highlights:

- Revenue in line with expectations at USD2,712,000 (2011: USD2,675,000)

- Loss before taxation of USD1,294,000 (2011: USD636,000)

- Loss per share of USD0.03 (2011: USD0.02)

- Strong ungeared balance sheet, with cash of USD18,426,000 (2010: USD1,248,000) at 30 June

Operational highlights:

- New generation technology development contract from a central bank has been executed, mirroring the sensor development contract with the same bank executed in 2011

- Large order from an existing central bank customer which is 70% larger than 2011 is being produced on schedule with the remaining $2.6 MM of a total $3.6MM to be recognized in the second half of this year

- New technology for the single note acceptor market ("SNA") (vending machines, change dispensers, ATMs, etc) has been developed including a low cost sensor and hand-held reader. G8 central bank testing of the new SNA feature scheduled for later this year

- Manufacturing facility scheduled to go on-line with test material qualification for G8 customers in November 2012

- Qualification of vendors for the Reserve Bank of India tender expired and is being re-issued, creating an uncertain delay in vendor selection

- Phosphour sales are down 70% relative to 2011 sales due to continued central bank focus on release of a new denomination; for which Spectra does not provide the phosphour. Management believes that orders will resume at a higher pace in the second half of 2012

- QC Reader order anticipated earlier this year has been postponed due to central bank 2012 funding constraints

- Acquisition of ESI Integrity has been completed with customers and partners continuing to support revenue and growth

- Acquisition of the Internal Control Systems (ICS) business of Lapis Software Associates completed and being transitioned to ESI team. No additional resources will be required making this small acquisition highly accretive in 2013

- The Company's marketing efforts in China are building traction with central banks and gaming

- Large scale polymer trials are on-going and are expected to be completed by the end of 2012

- Lock and Key product development for consumer appliance product is fully completed after additional customer requirements and we are awaiting a decision

Commenting on the interim results, Nabil Lawandy, Managing Director said:

“I am pleased to report that the Company’s first half of the year revenue results are in line with our expectations. As is typical for our business, our revenues for the full year will reflect a significant increase in the second half of the year, resulting in a satisfactory outcome for the whole year. However, it is unclear whether or not this will deliver a profit for the year.

The combination of the new generation consumable materials development contract, an expanded suite of banknote products, and the acquisition of software capabilities for secure gaming will, we believe, result in a strong and persistent income stream for years to come.

Enquiries:

Spectra Systems Corporation

Dr. Nabil Lawandy, Chief Executive Officer Tel: +1 (0) 401 274 4700

WH Ireland Limited

Chris Fielding (Head of Corporate Finance) Tel: +44 (0) 20 7220 1650

Chief Executive Officer's statement

The Company's first half of the year revenue results are in line with our expectations with a significant increase in revenue expected for the last two quarters of the year. As is typical for our business patterns, our revenues for the full year will be weighted towards the second half. In spite of timing delays, the execution of the new generation materials development contract with a central bank is a key milestone for securing the long-lived consumables component which complements the sensor development which has been underway since mid 2011. We continue to be optimistic of a similar positive decision with our Asian central bank initiatives in spite of similar bureaucratic delays.

We have followed through with our stated plans to actively market products to Asian central banks and particularly China. This sales effort has proven synergistic with marketing to other government channels, and in particular gaming, where we have acquired two new businesses this year. In addition, we have rapidly developed new products to address other banknote markets with significant potential beyond the high-level machine readable technologies we have successfully sold to central banks. These development expenditures, as well as one time legal fees for acquisitions in addition to some unexpected sensor development costs and a drop in phosphour sales, have contributed to the midyear loss for the period.

The Company has grown its staffing by adding three employees in the area of sensor development and two in manufacturing. In addition, the acquisition of two businesses in the secure gaming software area has added six additional employees, five of which operate in our Vancouver Canada office. Our initiative to develop a fully integrated manufacturing facility as well as the expansion into software security has met with a very positive response from our existing customers and our reputation in banknote security has opened new opportunities with the customers we now serve through the acquisitions made in 2012.

Financial overview

Revenue in the first half of the current year amounted to USD2,712,000 (2011: USD2,675,000), as expected, however, orders for the second half of the year already placed will significantly amplify our revenue for the full year. The loss before and after taxation for the first half amounted to USD1,294,000 (2011: USD636,000).

Gross margins through the first six months are in line with expectations, even though phosphour sales are down. Administrative costs are slightly higher due to expenses associated with legal fees connected to our acquisitions, new patents on single note bill acceptor technology, marketing and travel expenses to transition acquisition contracts and support Asia initiatives, and increased staffing from the acquisition of ESI Integrity.

The cash position at the period end amounted to USD18,462,000 (2011:USD1,248,000). The company has no long-term debt and is poised to execute on its plan with its cash reserves.

Strategy

We continue to target the use of public security products (optically variable inks, holograms, security threads and UV inks) as vehicles for the sale of our current and future products into new central banks along with leveraging our decade long reputation in banknote security to diversify the business into complementary and income accretive directions with long-term revenue streams.

Our efforts in product development have been refined in response to our customer's immediate needs to address opportunities for single note acceptor sensor-material combinations using covert machine readable material technologies which can be detected with low cost, robust readers. This draws on our existing customer base and complements our capabilities in sensor development and potentially opens up a very large market of bill acceptors in change machines, ATM's, and unmanned vending machines.

The development of sophisticated yet low cost technologies has resulted from the initiatives to expand our physical security to non-banknote applications such as heat sealable bags and the associated low cost devices used by consumers. We will continue to promote our mass market reader/material technologies outside of banknotes, and particularly within large organizations we have already penetrated with other products ~~[~~with similar profiles of use~~]~~.

Regarding acquisitions, while we continue to have dialogues with public security suppliers, we have targeted the area of Internal Control Systems for the gaming industry which has long-term contracts and government customers who value security at the highest levels.

Prospects

The Company's prospects continue to be very promising in spite of delays which have caused the timing of our revenues to slip out of phase with expectations. This is unfortunate but cannot be excluded when dealing with governments. The important facts to note are four-fold:

1) all of the contracts are intact and a critical materials development contract with a G8 central bank has been executed
2) the life of the consumable sales is extremely long, hence it is the timing of revenue and not the amount that is difficult to predict
3) several new and significant opportunities are active and maintaining or gaining traction
4) acquisitions have been made which have long-term contracts and high margins after consolidation

When revenue streams have a life of twenty to thirty years, as evidenced by our own experience, delays of months and even a year will not affect the ultimate value of revenues and income streams. The recent award of a new generation materials development contract underpins the solid prospects for a second multi-decade long materials sales revenue stream.

The development and successful large scale testing of a low cost, lock and key technology for a major consumer appliance company has led to a capability which is now under evaluation by a G8 central bank for single note acceptor applications. This has the prospect for both consumable and hardware sales which could spread to many cooperating countries if adopted.

The infusion of capital into the Company has allowed us to begin building a manufacturing facility which will increase margins, to develop new technology for different segments of the banknote market, to acquire businesses where we can leverage our reputation to grow revenues, and to increase our marketing efforts to win business in Asia, where over a third of the worldwide banknote revenue is still available to us in a consolidated set of customers.

In the more immediate future, we anticipate much stronger revenue in the second half; however, it is unclear if this will lead to a profit, primarily due to uncertainty as to the magnitude of high margin phosphour sales.

Nabil M. Lawandy
Chief Executive Officer
September 28, 2012

Statements of Income
for the half year ended 30 June 2012

	Note	Half Year to 30/6/12 Unaudited USD'000	Half Year to 30/6/11 Unaudited USD'000	Year to 31/12/11 Audited USD'000
Revenue		2,712	2,675	7,416
Cost of sales		(1,499)	(1,044)	(2,897)
Gross profit		1,213	1,631	4,519
Administrative expenses		(2,650)	(2,274)	(4,787)
Operating profit / (loss)		(1,437)	(643)	(268)
Investment income		143	7	129
Profit / (loss) before taxation		(1,294)	(636)	(139)
Taxation		-	-	-
Profit / (loss) for the period		(1,294)	(636)	(139)
Earnings per share:				
Basic earnings per share	2	(0.03)	(0.02)	(0.00)
Diluted earnings per share	2	(0.02)	(0.02)	(0.00)

All of the Group's operations are continuing.

Balance Sheets
as at 30 June 2012

	As at 30/6/12 Unaudited USD'000	As at 30/6/11 Unaudited USD'000	As at 31/12/11 Audited USD'000
Current assets			
Inventories	1,311	813	813
Trade and other receivables	2,119	1,259	667
Cash and cash equivalents	18,426	1,248	17,861
Investments	-	-	5,906
Deferred contract costs	72	-	64
Deferred tax asset	344	344	344
Prepaid expenses	67	20	80
Total current assets	22,339	3,684	25,735
Non-current assets			
Intangible assets	2,128	103	174
Property, plant and equipment	608	278	241
Restricted cash	1,050	1,000	1,050
Other assets	314	22	17
Deferred financing costs	-	414	-
Deferred tax asset	902	902	902
	5,002	2,719	2,384
Total assets	27,341	6,403	28,119
Current liabilities			
Trade and other payables	1,096	856	1,145
Accrued expenses and other	901	507	658
Deferred revenue	1,603	983	1,780
Total current liabilities	3,600	2,346	3,583
Non-current liabilities			
Deferred revenue	300	-	-
Total liabilities	3,900	2,346	3,583
Shareholders’ equity			
Convertible preferred stock	-	122	-
Additional paid in capital – Convertible preferred stock	-	26,041	-
Common stock	453	95	453
Additional paid in capital – Common stock	54,671	7,904	54,613
Accumulated other comprehensive (loss)	(781)	-	(922)
Accumulated deficit	(30,902)	(30,105)	(29,608)
Shareholders’ equity	23,441	4,057	24,536
Total liabilities & shareholders’ equity	27,341	6,403	28,119

Statements of Cash Flows
for the half year ended 30 June 2012

	Half Year to 30/6/12 Unaudited USD'000	Half Year to 30/6/11 Unaudited USD'000	Year to 31/12/11 Audited USD'000
Profit / (loss) before taxation	(1,294)	(636)	(139)
Depreciation and amortisation	128	105	210
Stock compensation expense	58	22	411
Trade and other receivables	(1,452)	(1,027)	(435)
Deferred contract costs	(8)	-	(64)
Inventories	(498)	26	27
Deposits	-	-	(2)
Other assets	-	(5)	2
Prepaid expenses	40	33	(32)
Refundable income taxes	-	-	5
Trade and other payables	(49)	456	744
Accrued expenses and other	16	(143)	8
Deferred revenue	(616)	(488)	309
Net cash provided by / (used in) operating activities	(3,675)	(1,657)	1,044
Investing activities			
Purchases of property, plant and equipment	(285)	(51)	(84)
Other long-term assets	(297)	-	-
Increase in restricted cash	-	-	(50)
Purchase of ESI Integrity	(1,225)	-	-
Payments of patent costs	-	-	(105)
(Purchases) / sales of investments	5,906	-	(5,906)
Net cash provided by / (used in) investing activities	4,099	(51)	(6,145)
Financing activities			
Proceeds from initial public offering - net	-	-	20,514
Deferred financing costs	-	(414)	-
Net cash provided by / (used in) financing activities	-	(414)	20,514
Effect of exchange rate changes on cash and cash equivalents	141	-	(922)
Net(decrease)/increase in cash and cash equivalents	565	(2,122)	14,491
Cash and cash equivalents at start of period	17,861	3,370	3,370
Cash and cash equivalents at end of period	18,426	1,248	17,861

Notes to financial information

1. Basis of preparation

This report was approved by the Directors on 26 September 2012.

The interim results for the half year ended 30 June 2012 have been prepared in accordance with the AIM Rules for Companies. The Group has not elected to apply IAS 34 Interim financial reporting. This financial information has been prepared using the recognition and measurement principles of US Generally Accepted Accounting Principles.

The principal accounting policies used in preparing the interim results are those the Company expects to apply in its financial statements for the year ending 31 December 2012 and are unchanged from those disclosed in the Company's Annual Report for the year ended 31 December 2011.

The results for the half year are unaudited. The financial information for the year ended 31 December 2011 does not constitute the full statutory accounts for that period. The Annual Report and financial statements for the year ended 31 December 2011 have been filed with the Registrar of Companies. The Independent Auditors' Report on the financial statements for the year ended 31 December 2011 was unqualified and did not draw attention to any matters by way of emphasis.

2. Earnings per share

The calculation of earnings per share figures for the half year ended 30 June 2012 is based on the profit / (loss) attributable to ordinary shareholders of USD(1,294,000) (2011 half year: USD(636,000); 2011 full year: USD(139,000) divided by the basic and diluted weighted average number of shares in issue, shown in the table below, which assumes that all preferred shares had converted to common shares prior to 1 January 2010.

	Half year to 30/6/12		Half year to 30/6/11		Year to 31/12/11	
	Number of shares	Weighted average	Number of shares	Weighted average	Number of shares	Weighted average
Basic- shares in issue	45,251,370	45,251,370	26,659,050	26,659,050	45,251,370	34,763,130
Share options	7,214,317	6,935,680	5,798,703	5,713,905	6,908,317	6,376,665
Diluted no. of shares		52,187,050		32,372,955		41,139,795

3. Acquisition

On 6 June 2012, the Company acquired, with effect from 1 June, all of the assets and certain liabilities of ESI Integrity, Inc., including importantly its proprietary source codes, multi-year contracts, and long-standing customer relationships. The consideration for the assets was USD1.425M in cash, USD1.25M payable upon closing and USD200k payable when certain milestones are met. The Company recorded USD2M of intangibles, USD190k of assets and assumed USD765k of liabilities, mainly deferred revenue, on the transaction.

4. Subsequent events

On 14 September, 2012, the Company acquired certain assets of Lapis Software Associates including, importantly their proprietary source codes, multi-year and long-standing customer relationships. Consideration for the acquisition is USD750k in cash payable upon completion

5. Copies of this statement will be sent to shareholders and are available to the public from the Registered Office at: 321 South Main Street, Suite 102, Providence, RI 02903 USA and are available on the Company's website.