

Spectra Systems Corporation
Interim results for the six months ended 30 June 2016

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 2016.

Financial highlights (\$000's):

- Spectra's financial performance is in line with expectations
- Revenue in the first half of \$4,822 (2015: \$6,720)
- Basic loss before taxation of (\$430) (2015: (\$758))
- Basic loss per share of (\$0.01) (2015: (\$0.02))
- Strong, debt-free balance sheet, with cash of \$8,705 (2015: \$9,773) at 30 June

Operational highlights:

- Negotiations substantially completed with G7 central bank for a new five year material supply agreement
- Increase of at least 35% in expected blended gross profit on all combined covert materials products once existing inventories used
- Record phosphor sales in the first half
- Brand Authentication and Secure Transactions Group performing in line with expectations

Commenting on the results, Nabil Lawandy, Chief Executive Officer, said:

“The Company’s revenues tracked to plan in the first half and are increasing in the second half of the year. The planned delivery of covert materials, the long projected increase in profit margins for these products through in house manufacture, robust brand authentication and specialty materials sales, and sustained gaming software profitability give us confidence in meeting the expected Group earnings targets for the year.

In addition, the new products based on smartphone authentication are steadily gaining traction with a number of successful potential customer trials bolstering our belief that these new products will produce sustainable new earnings streams in 2017 and going forward.

“The Board therefore believes that the Company, by achieving key business milestones, will continue to perform well for the remainder of 2016 with excellent prospects for ongoing growth thereafter.”

Enquiries:

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Chief Executive Officer's statement

Introduction

Through achieving key commercial milestones, as described in the Review of Operations below, Spectra Systems is on track to meet market expectations for the full 2016 financial year.

Revenue for the half year was USD 4,822k (2015: USD 6,720k) due to the absence of large hardware sales.

We expect an increase of at least 35% in blended gross profit on all combined covert materials products once existing inventories used.

Revenue this year will be heavily biased to the second half of 2016 with the scheduled delivery of 50% more covert materials orders in H2 than H1.

In the near future, the fulfilment of covert materials orders to our G7 central bank customer is expected to be under a new five year contract which will allow us to deliver materials manufactured in our facility.

Cash at the period end amounted to USD 8,705k (2015: USD 9,773k), notwithstanding the USD 3,118k asset acquisition consideration paid in January 2016. The Company has sufficient resources to execute on its growth plans with its existing cash reserves.

Review of operations

All three of the Company's major operating activities have performed to expectations and are on a positive slope to grow our revenues and profits going forward.

Authentication systems

The authentication systems revenues are driven by covert material sales through our licensing agreement with a major banknote supplier and printer to 18 central banks, including one G7 central bank, and directly to another G7 Central Bank. This sector of authentication has performed to expectations and orders have slightly exceeded plan although, due to contract negotiation delays, will mostly slip into H2 of this year.

We are pleased to report that we have achieved the projected margin increases from using our in-house manufacturing facility. Under the new contract terms and projected orders, we expect a blended margin uplift of 35% on the sale of covert materials in a typical year once non-G7 Central Bank inventories are exhausted.

The achievement of significantly higher margins for our covert materials has been complemented with continued strong sales and margins of brand authentication materials and phosphors. The brand authentication business is performing on track and continues to have significant prospects in Asia, while phosphor sales are expected to exceed the historical levels, before taking into account revenues from the specialty materials phosphor business acquired in January 2016.

Other achievements included:

- Negotiations with G7 central bank for a five year material supply contract substantially completed and expected to be executed in H2 2016;
- Positive evaluation results by our licensing partner of a new covert security feature for polymer banknotes;
- Acquisition of specialty phosphor assets completed and fully integrated;
- Record phosphor sales in the first half;

- Positive results from trials of the TruBrand™ smartphone based authentication technology for tobacco products in China; and
- Seven new patents, three USA and four international, issued to the Company.

Secure transactions group technologies

Secure Software Transactions ("SST") revenues and earnings are on track in the first half of 2016. The secure transactions group has recently introduced a new ICS system based on a full 64 bit architecture, with Norway's Norsk Tipping Lottery being the first customer and executing a new four year agreement beginning June of 2016. In addition, the secure transactions group has completed a rollout of mobile and internet wagering with its partner NeoGames, a division of Pollard Banknote, for the Virginia Lottery. Both of these developments are expected to lead to additional customers for these new products in H1 of 2017.

Banknote cleaning

With the completion of the development phase of this product line, the program costs associated with this new technology for 2016 have been limited to marketing purposes. On this front, we continue to receive strong interest from both G7 and G20 central banks, as well as smaller central banks whose banknotes are manufactured by an external supplier. The Banknote 2016 conference in May this year resulted in two additional trials, as well as a request by a G7 central bank for a proposal for a very large scale test, which is expected to take place in 2017.

The landscape of the banknote industry, with its risk averse nature, long sales cycles and the many special interests which would be negatively affected by the success of Aeris™ banknote cleaning technology, will impact the adoption cycle of the product. We therefore continue to look for a partner with a credible industry hardware supplier to advance the adoption of Aeris™.

Strategy

The Company's strategy for increasing revenue and earnings continues to be based on:

- Focusing on larger central banks with existing technology;
- Penetrating the polymer banknote authentication market with new materials-based solutions;
- Attracting additional customers for our phosphor product offerings which have been significantly increased with the acquisition of related specialty assets in January this year;
- Concentrating our marketing efforts for smartphone authentication on numerous sectors from linens to tobacco and electronics in Asia and on central banks for TruNote™.
- Expanding our Secure Transactions Group contributions by introducing new hardware options, as well as anticipating new opportunities in monitoring internet-based gaming and new betting formats such as daily fantasy sports enterprises;
- Controlling operating costs while maintaining strong capabilities for delivery of products with a reduced emphasis on research and development; and
- Renegotiating contract terms as they present themselves to increase our gross margins.

Prospects

The Company's prospects continue to increase in the authentication business, both within and outside of banknotes.

The near term opportunities include:

- The potential selection of our new covert technology for polymer notes by an existing G7 central bank customer which is introducing a new denomination in the next two years;
- The potential licensing of another covert technology for polymer banknotes by a major banknote printer;
- The potential adoption of our smartphone TruBrand™ technology by Asian brands in spirits, tobacco and linens; and
- The potential adoption of our brand authentication solutions for printer ink cartridges.

The longer term opportunities include:

- The potential adoption of our licensed covert technology by the Reserve Bank of India (RBI). This opportunity was again delayed as the RBI is believed to be going to design a new series while incorporating the existing features, as now an interim measure while they try to decide which new feature technologies they want to adopt; and
- The potential incorporation of our smartphone authentication materials into a series of banknotes to be released within the next three years.

We are pleased that we are able to supplement our sustained and growing profitability with a number of near-term and longer-term prospects as well as renegotiated terms for our covert materials, with in-house manufacturing leading to significantly increased margins. We are particularly delighted that the authentication business outside of banknotes is increasing ahead of expectations and that it can provide a smoothing of our less predictable but long term banknote business with its characteristically extended sales cycles and delays.

The Board is therefore optimistic about the future of the Company and its growth through increased sales, improved margins, and a full pipeline of opportunities.

Nabil M. Lawandy
Chief Executive Officer
September 19, 2016

**Statements of income and other comprehensive income
for the half year ended 30 June 2016**

	Note	Half Year to 30/6/16 Unaudited USD'000	Half Year to 30/6/15 Unaudited USD'000	Year to 31/12/15 Audited USD'000
Revenue		4,822	6,720	14,114
Cost of sales		(1,846)	(4,174)	(7,402)
Gross profit		2,976	2,546	6,712
Operating expenses		(3,438)	(3,344)	(6,730)
Operating profit / (loss)		(462)	(798)	(18)
Investment income		32	42	87
Foreign currency gain / (loss)		-	(2)	(34)
Profit / (loss) before taxation		(430)	(758)	35
Taxation		-	-	-
Profit / (loss) for the period		(430)	(758)	35
Loss per share:				
Basic earnings / (loss) per share	2	(0.01)	(0.02)	0.00
Other comprehensive income (loss):				
Unrealized gain (loss) on currency exchange		30	57	(60)
Reclassification for realized amounts included in basic profit (loss)		-	2	33
Total other comprehensive income (loss)		30	59	(27)
Comprehensive income (loss)		(400)	(699)	8

All of the Group's operations are continuing.

Balance sheets
as at 30 June 2016

	As at 30/6/16 Unaudited USD'000	As at 30/6/15 Unaudited USD'000	As at 31/12/15 Audited USD'000
Current assets			
Inventories	2,966	2,857	2,824
Trade and other receivables	1,052	2,040	4,251
Cash and cash equivalents	8,705	9,773	9,808
Deferred tax asset	170	215	170
Prepaid expenses	143	151	125
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Total current assets	13,036	15,036	17,178
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Non-current assets			
Intangible assets	7,640	4,218	4,627
Property, plant and equipment	2,719	2,637	2,868
Restricted cash	500	1,500	1,074
Other assets	19	287	19
Deferred tax asset	819	774	819
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Total non-current assets	11,697	9,416	9,407
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Total assets	24,733	24,452	26,585
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Current liabilities			
Trade and other payables	265	888	1,463
Accrued expenses and other	1,558	983	1,565
Deferred revenue	988	1,003	1,247
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Total current liabilities	2,811	2,874	4,275
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Non-current liabilities			
Deferred revenue	277	275	277
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Total non-current liabilities	277	275	277
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Total liabilities	3,088	3,149	4,552
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Shareholders' equity			
Common stock	453	453	453
Additional paid in capital	54,950	54,914	54,937
Accumulated other comprehensive (loss)	(57)	(1)	(87)
Accumulated deficit	(33,701)	(34,063)	(33,270)
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Shareholders' equity	21,645	21,303	22,033
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Total liabilities & shareholders' equity	24,733	24,452	26,585
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**Statements of cash flows
for the half year ended 30 June 2016**

	Half Year to 30/6/16 Unaudited USD'000	Half Year to 30/6/15 Unaudited USD'000	Year to 31/12/15 Audited USD'000
Profit / (loss) before taxation	(430)	(758)	35
Depreciation and amortisation	476	393	867
Stock compensation expense	13	-	23
Inventory obsolescence	-	-	76
Trade and other receivables	3,201	(289)	(2,502)
Inventories	(142)	1,338	1,295
Other assets	-	(103)	2
Prepaid expenses	(23)	(42)	(18)
Trade and other payables	(1,199)	149	454
Accrued expenses and other	(8)	(239)	161
Deferred revenue	(260)	(1,173)	(922)
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Net cash provided / (used) in operating activities	1,628	(724)	(529)
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Investing activities			
Increase in restricted cash / investments	574	1,000	1,426
Purchases of property, plant and equipment	(71)	(32)	(289)
Asset acquisitions	(3,118)	-	(214)
Payments of patent costs	(149)	(232)	(326)
Net cash provided by / (used in) investing activities	-----	-----	-----
	(2,764)	736	597
-----	-----	-----	-----
Effect of exchange rate changes on cash and cash equivalents	33	(12)	(33)
Net(decrease)/increase in cash and cash equivalents	(1,103)	-	35
Cash and cash equivalents at start of period	9,808	9,773	9,773
Cash and cash equivalents at end of period	-----	-----	-----
	8,705	9,773	9,808
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Notes to financial information

1. Basis of preparation

This report was approved by the Directors on 15 September 2016.

This financial information has been prepared using the recognition and measurement principles of US Generally Accepted Accounting Principles. The Group has not elected to apply IAS 34 Interim financial reporting.

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 2016 and are unchanged from those disclosed in the Company's Annual Report for the year ended 31 December 2015.

The results for the half year are unaudited. The financial information for the year ended 31 December 2015 does not constitute the full statutory accounts for that period. The Annual Report and financial statements for the year ended 31 December 2015 have been filed with the Registrar of Companies. The Independent Auditors' Report on the financial statements for the year ended 31 December 2015 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 2016 is based on the profit / (loss) attributable to ordinary shareholders of USD (\$430,000) (2015 half year: USD (\$758,000); 2015 full year: USD \$35,000) divided by the basic and weighted average number of shares in issue, shown in the table below.

	Half year to 30/6/16		Half year to 30/6/15		Year to 31/12/15	
	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	45,251,370	45,251,370	45,251,370	45,251,370
Weighted average no. of shares		45,251,370		45,251,370		45,251,370

The calculation of diluted earnings per share assumes conversion of all potentially dilutive ordinary shares, all of which arise from share options. A calculation is done to determine the number of shares that could have been acquired at fair value, based upon the monetary value of the subscription rights attached to outstanding share options.

3. Acquisition of certain specialty phosphor assets.

On January 28, 2016 Spectra completed the acquisition of certain specialty phosphor assets primarily used in the authentication of world banknotes. The total consideration amounted to \$3.118 million, of which \$2.805 million was paid in cash on closing with \$0.313 million held in escrow for 12 months.

4. On May 27, 2016, the Company granted options ("Options") over 3,306,689 shares of Common Stock ("Shares") to Directors and Senior Managers of the Company.

The Options, which expire on 27 May 2026, have an exercise price of 25 pence per Share.

Vesting of the Options is conditional on the satisfaction of performance conditions, determined by the Remuneration Committee, in respect of the three years ending 31 December 2018. The grant of the

Options is designed to align the interests of key Directors and senior managers of the Company with those of shareholders and to promote the retention of those individuals.

5. Copies of this statement are available to the public on the Company's website at <http://www.spsy.com>.