

**Spectra Systems Corporation**  
**Interim results for the six months ended 30 June 2018**

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 2018.

This announcement contains inside information for the purposes of Article 7 of Regulation 596/2014.

**Financial highlights:**

- Revenue up 11% in the first half at \$7,953k (2017: \$7,157k)
- Adjusted EBITDA<sup>1</sup> up 30% at \$3,930k (2017: \$3,022k)
- Adjusted PBTA<sup>2</sup> up 34% at \$3,802k (2017: \$2,834k),
- Adjusted earnings<sup>2</sup> per share up 30% at US \$7.8 cents (2017: US \$6.0 cents)
- Cash generated from operations of \$4,051k (2017: \$2,668k)
- Strong, debt-free balance sheet, with cash<sup>3</sup> of \$12,295k (2017: \$9,451k) at 30 June
- Annual dividend up 20% to US\$0.06 per share (\$2,728 in aggregate) paid in June

<sup>1</sup> Before stock compensation expense and foreign currency effects

<sup>2</sup> Before amortization and stock compensation expense

<sup>3</sup> Does not include \$1,099k (2017: \$1,097k) of restricted cash and investments

**Operational highlights:**

- Executed an exclusive, worldwide, licensing agreement and supply agreement for one of our existing products, which is in use by 18 central banks through an existing licensee, a major supplier of banknotes worldwide
- Delivered large G7 customer order on time
- Operational expenses reduced due to termination of royalty payments
- Brand Authentication and Secure Transactions Group performing in line with expectations
- QC readers for TruBrand delivered to customer in preparation for production
- Engaged by a G20 central bank to commence Phase I of a four-phase funded sensor development for use with polymer banknotes

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

"The Company's revenues for the first half of 2018 are 11 % higher than 2017 and were driven by delivery of a large G7 customer order and royalty and license revenue from our agreement with a major banknote supplier. As a result of our operating gearing adjusted EBITDA for the first half of the year is markedly higher, 30%, than last year resulting in strong midyear profitability. The continued in line performance of the Secure Transactions Group as well as Brand Authentication puts the company in a strong position to meet market expectations for the full year.

The delivery of two quality control devices to a tobacco manufacturer has increased our chances of introducing our TruBrand smartphone authentication technology in China. This is in addition to the recent allowance by the United States Patent Office of our patents on this technology.

The Board therefore believes that the Company, by achieving key business milestones, will continue to perform well for the remainder of 2018 with excellent prospects for ongoing earnings growth thereafter."

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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 deliver an excellent performance for the full 2018 financial year.

Revenue for the half year was up 11% at \$7,953k (2017: \$7,157k) due to higher royalties and sales of covert materials. Revenue this year will be heavily biased towards the first half of 2018 with continued positive earnings anticipated throughout H2.

As a result of the above factors, Adjusted EBITDA (before stock compensation expense) for the half year was up 30% at \$3,930k compared to the prior year of \$3,022k. The termination of royalty payments during the first half of 2018 has led to a significant reduction in operating expenses.

Having generated cash from operations of \$4,051k (2017: \$2,668k), cash at the period end amounted to \$12,295k (2017: \$9,451k), excluding \$1,099k of restricted cash and investments (2017: \$1,097k). This is notwithstanding \$2,728k paid to shareholders during June in the form of the Company's dividend of \$0.06 per share.

### **Review of Operations**

#### ***Authentication Systems***

The Authentication Systems business, which includes the security phosphor materials, generated revenue of \$7,326k (2017: \$6,548k) and Adjusted EBITDA of \$3,681k (2017: \$2,808k). Authentication Systems revenues, primarily in the form of royalty and license payments by our licensee and direct sales to another G7 central bank, underpin these results.

We have successfully completed the first phase of a sensor development program with a G20 central bank for use of one of our technologies for polymer notes. The program was reviewed by the G20 bank staff in May of this year.

The TruBrand authentication product introduction effort is performing on track with the delivery of two off-line quality control devices to a tobacco factory in China and the notice of allowance of the underlying patents by the United States Patent and Trademark Office.

#### ***Secure Transactions Group***

The Secure Transactions Group, formed around the various gaming technology acquisitions made in 2012, performed in line with management expectations, generating Adjusted EBITDA of \$249k (2017: \$214k) on revenue of \$627k (2017: \$609k).

The Secure Transactions Group has won new contracts with two US state lotteries and secured three new licenses as it continues to roll out the 64-bit Premier Integrity product package. The Secure Transaction Group will complete its ISO-27001 Certification in 2018 and continues to look for opportunities to sell its products in the emerging sports betting business in the USA.

## Strategy

The Company's strategy for increasing revenue and earnings continues to be focused on brand authentication and specialty optical materials for security applications while maintaining a robust effort to commercialize our covert security technologies with an emphasis on polymer banknotes. The brand authentication sector offers short term growth and some very large opportunities for smartphone based technology while the covert banknote security area provides long term, multi-decade revenues once new contracts are executed.

We have developed and introduced a covert material technology for the polymer notes of a G20 central bank. This technology is in a four phase externally funded development and testing program which has successfully met the first phase milestones. In addition to this polymer note security technology, we have formed a partnership with one of the largest suppliers of polymer substrates as those used for banknotes with the goal of eventually being a supplier of polymer substrates with unique covert properties, a capability which has not been possible to date. Our effort in security features for polymer banknotes is based on the use of polymer notes beginning to outpace paper banknote production.

The Secure Transactions Group continues to innovate within the lottery ICS industry, reducing cost and increasing efficiency with the introduction of Virtualized Machines and its Premier Integrity package. This focus on software innovation has resulted in the recent contract awards from two US state lotteries.

## Prospects

The important, near-term opportunities are:

- The manufacturing of market-trial product to be sold in China for use in conjunction with our TruBrand technology
- The continued polymer technology sensor development and testing phases with a G20 central bank
- The adoption of our phosphors for use by a supplier of products to a major Asian central bank
- The commencement of contracted, 36 month development of third generation sensors for direct sale to a G7 central bank customer

The longer term opportunities are:

- A licensing and supply agreement for polymer based technology developed through external funding with a major central bank
- The development and supply of further upgraded sensor capability to a G7 central bank following the contracted development phase
- The introduction of a secure polymer substrate to central banks, which combines high security and a durable substrate in one product

Nabil M. Lawandy  
Chief Executive Officer  
September 24, 2018

**Statements of income and other comprehensive income  
for the half year ended 30 June 2018**

	<b>Half Year to 30 Jun 2018 Unaudited USD '000</b>	<b>Half Year to 30 Jun 2017 Unaudited USD '000</b>	<b>Full Year to 31 Dec 2017 Audited USD '000</b>
<b>Note</b>			
Revenue	\$ 7,953	\$ 7,157	\$ 12,170
Cost of sales	<u>2,084</u>	<u>1,782</u>	<u>3,514</u>
Gross profit	5,869	5,375	8,656
Operating expenses	<u>2,521</u>	<u>2,912</u>	<u>5,625</u>
Operating profit (loss)	3,348	2,463	3,031
Interest and other income	85	18	60
Foreign currency gain (loss)	<u>(9)</u>	<u>(5)</u>	<u>2</u>
Profit (loss) before taxes	3,424	2,476	3,093
Benefit (provision) for income taxes	<u>(6)</u>	<u>(33)</u>	<u>187</u>
<b>Net income (loss)</b>	<u>\$ 3,418</u>	<u>\$ 2,443</u>	<u>\$ 3,280</u>
<b>Earnings per share</b>	2		
Basic	\$ 0.08	\$ 0.05	\$ 0.07
Diluted	\$ 0.07	\$ 0.05	\$ 0.07
<b>Other comprehensive income (loss)</b>			
Unrealized loss on currency exchange	(8)	-	10
Reclassification for realized loss in net income	<u>9</u>	<u>4</u>	<u>(2)</u>
<b>Total other comprehensive income (loss)</b>	1	4	8
<b>Comprehensive income (loss)</b>	<u>\$ 3,419</u>	<u>\$ 2,447</u>	<u>\$ 3,288</u>

All of the Group's operations are continuing

**Balance sheets  
as of 30 June 2018**

	<b>As of 30 Jun 2018 Unaudited USD '000</b>	<b>As of 30 Jun 2017 Unaudited USD '000</b>	<b>As of 31 Dec 2017 Audited USD '000</b>
<b>Current assets</b>			
Cash and cash equivalents	\$ 12,295	\$ 9,451	\$ 11,181
Trade and other receivables	1,088	2,277	1,425
Inventory	3,337	3,442	3,754
Prepaid expenses	171	388	116
Deferred tax assets	-	619	-
<b>Total current assets</b>	<u>16,891</u>	<u>16,177</u>	<u>16,476</u>
<b>Non-current assets</b>			
Property, plant and equipment, net	1,662	1,954	1,795
Intangible assets, net	6,802	7,170	6,967
Restricted cash and investments	1,099	1,097	1,099
Deferred tax assets	1,303	370	1,225
Other assets	147	156	151
<b>Total non-current assets</b>	<u>11,013</u>	<u>10,747</u>	<u>11,237</u>
<b>Total assets</b>	<u>\$ 27,904</u>	<u>\$ 26,924</u>	<u>\$ 27,713</u>
<b>Current liabilities</b>			
Accounts payable	\$ 263	\$ 79	\$ 200
Accrued expenses and other liabilities	978	1,670	1,521
Taxes payable	3	-	8
Deferred revenue	985	1,319	1,074
<b>Total current liabilities</b>	<u>2,229</u>	<u>3,068</u>	<u>2,803</u>
<b>Non-current liabilities</b>			
Deferred revenue	458	306	458
<b>Total non-current liabilities</b>	<u>458</u>	<u>306</u>	<u>458</u>
<b>Total liabilities</b>	<u>2,687</u>	<u>3,374</u>	<u>3,261</u>
<b>Stockholders' equity</b>			
Common stock	455	454	454
Additional paid in capital – common stock	55,298	55,164	55,224
Accumulated other comprehensive loss	(104)	(109)	(105)
Accumulated deficit	(30,432)	(31,959)	(31,121)
<b>Total stockholders' equity</b>	<u>25,217</u>	<u>23,550</u>	<u>24,452</u>
<b>Total liabilities and stockholders' equity</b>	<u>\$ 27,904</u>	<u>\$ 26,924</u>	<u>\$ 27,713</u>

**Statements of cash flows  
for the half year ended 30 June 2018**

	Half Year to 30 Jun 2018	Half Year to 30 Jun 2017	Full Year to 31 Dec 2017
	<u>Unaudited USD '000</u>	<u>Unaudited USD '000</u>	<u>Audited USD '000</u>
<b>Cash flows from operating activities</b>			
Net income	\$ 3,418	\$ 2,443	\$ 3,280
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	507	497	1,103
Stock based compensation expense	75	63	123
Allowance for doubtful accounts	-	-	36
Deferred Taxes	(78)	-	(236)
Provision for excess and obsolete inventory	51	-	92
Loss on disposal of assets	-	-	32
<i>Changes in operating assets and liabilities</i>			
Accounts and other receivables	334	429	1,246
Inventory	366	(528)	(932)
Prepaid expenses	(56)	(282)	(9)
Other assets	4	(1)	3
Accounts payable	62	(291)	(171)
Accrued expenses and other liabilities	(547)	231	89
Deferred revenue	(85)	107	13
<b>Net cash provided by operating activities</b>	<u>4,051</u>	<u>2,668</u>	<u>4,669</u>
<b>Cash flows from investing activities</b>			
Restricted cash and investments	-	(5)	(7)
Payment of patent and trademark costs	(139)	(161)	(396)
Payment of software costs	-	(9)	(8)
Asset acquisitions	-	-	-
Cash refund on property and equipment	-	405	405
Purchases of property, plant and equipment	(71)	(31)	(71)
<b>Net cash provided by (used in) investing activities</b>	<u>(210)</u>	<u>199</u>	<u>(77)</u>
<b>Cash flows from financing activities</b>			
Dividends paid	(2,728)	(2,270)	(2,270)
Proceeds from exercise of stock options	-	42	42
<b>Net cash used in financing activities</b>	<u>(2,728)</u>	<u>(2,228)</u>	<u>(2,228)</u>
Effect of exchange rate on cash and cash equivalents	<u>1</u>	<u>4</u>	<u>9</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	1,114	643	2,373
<b>Cash and cash equivalents, beginning of period</b>	11,181	8,808	8,808
<b>Cash and cash equivalents, end of period</b>	<u>\$ 12,295</u>	<u>\$ 9,451</u>	<u>\$ 11,181</u>

## Notes to financial information

### 1. Basis of preparation

This report was approved by the Directors on 20 September 2018.

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 2018 and are unchanged from those disclosed in the Company's Annual Report for the year ended 31 December 2017.

The results for the half year are unaudited. The financial information for the year ended 31 December 2017 does not constitute the full statutory accounts for that period. The Annual Report and financial statements for the year ended 31 December 2017 have been filed with the Registrar of Companies. The Independent Auditors' Report on the financial statements for the year ended 31 December 2017 was unmodified and did not draw attention to any matters by way of emphasis.

### 2. Earnings per share

The calculation of basic earnings per share is based on the net income divided by the weighted average number of common shares outstanding. Diluted earnings per share is calculated by considering the dilutive impact of common stock equivalents under the treasury stock method as if they were converted into common stock as of the beginning of the period or as of the date of grant, if later. The following table shows the calculation of basic and diluted earnings per common share.

	<b>Half Year to 30 Jun 2018</b>	<b>Half Year to 30 Jun 2017</b>	<b>Full Year to 31 Dec 2017</b>
Numerator:			
Net income	\$ 3,418,000	\$ 2,443,000	\$ 3,280,000
Denominator:			
Weighted average common shares	45,450,098	45,319,499	45,369,084
Effect of dilutive securities:			
Stock Options	3,509,747	1,486,897	2,512,699
Diluted weighted average common shares	<u>48,959,845</u>	<u>46,806,396</u>	<u>47,881,783</u>
Earnings per common share:			
Basic:	<u>\$ 0.08</u>	<u>\$ 0.05</u>	<u>\$ 0.07</u>
Diluted:	<u>\$ 0.07</u>	<u>\$ 0.05</u>	<u>\$ 0.07</u>

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