

Spectra Systems Corporation
Interim Results for the Six Months Ended 30 June 2023

Spectra Systems Corporation ("Spectra Systems" or the "Company"), a leader in machine-readable high speed banknote authentication, brand protection technologies and gaming security software, is pleased to announce its interim results for the six months ended 30 June 2023.

Financial highlights:

- Revenue of \$11,621k (2022: \$9,265k) up 25%
- Adjusted EBITDA¹ up 55% at \$5,903k (2022: \$3,818k)
- Adjusted PBTA¹ up 59% to \$5,837k (2022: \$3,669k)
- Adjusted earnings² per share up 74% to US \$10.8 cents (2022: US \$6.2 cents)
- Cash generated from operations of \$4,418k (2022: \$7,245k)
- Strong, debt-free balance sheet, with cash³ of \$16,582k (2022: \$17,961k) at 30 June 2023

¹ Before stock compensation expense and excludes non-controlling interest

² Before amortization and stock compensation expense, excludes noncontrolling interest and fewer remaining tax credits

³ Does not include \$500,000 (2022: \$500,000) of restricted cash and investments

Operational highlights:

- Achieved key development and payment milestones for sensor development program positioning Spectra Systems for preproduction units in 2024 and production units in 2025
- Completed fiscal year order at 22% higher pricing with in-house manufacturing for supply chain mitigation with a major central bank customer
- Ongoing large print trial of polymer substrate with Middle Eastern central bank

- Successful tests with new K-cup printer completed
- Successful installation and staff training for our first Banknote Disinfection System with an Asian central bank
- Hired new managing director for Canadian gaming software division

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

"The Company's first half revenues and earnings are up substantially from the six months ended June 30, 2022 with increases of 25% and 59% for revenue and PBTA, respectively. Our cash position remains strong at \$16,582k with a debt free balance sheet. The increased revenues in the first half are derived principally from pre-production development contracts as well as larger demand for our materials to meet increased banknote demands of one of our existing central bank customers.

We have achieved key milestones with our sensor development contract and are moving into the final phase of the program with the delivery of preproduction units in Q4 of 2024. The central bank customer expects to provide a first draft of the manufacturing contract in H2 of this year.

Our anticipation of potential supply chain issues and proactive implementation of a supply chain mitigation program with our largest central bank customer has resulted in significantly enhanced revenues in H1 as we have been able to complete that entire fiscal year order for 2022-2023 on time.

On the optical materials front, we have significantly grown revenue from K-cup printers and have received approval from a third customer in Canada which we expect to place a first order in Q1 of 2024.

With regards to our suite of smartphone-based authentication solutions, we have initiated a testing program with a UK passport company and are awaiting approval on the use of our combined smartphone and covert authentication holographic labels for protection of physical versions of non-fungible token ("NFT") artwork

Finally, our gaming software operation has gone live with the New York State lottery, and we have appointed a new managing director with a strong background in software management, development and sales.

"The Board therefore believes that the Company is on track to achieve record earnings and meet market expectations for the full year."

Spectra Systems Corporation
Dr. Nabil Lawandy, Chief Executive Officer

Tel: +1 (0)401 274 4700

WH Ireland Limited (Nominated Adviser and Joint Broker)
Chris Fielding/James Bavister (Corporate Finance)
Fraser Marshall (Corporate Broking)

Tel: +44 (0)20 7220 1650

Tel: +44 (0)20 3328 5665

Allenby Capital Limited (Joint Broker)
Nick Naylor/James Reeve (Corporate Finance)
Amrit Nahal/Guy McDougall (Sales and Corporate Broking)

The information contained within this announcement is deemed to constitute inside information as stipulated under the retained EU law version of the Market Abuse Regulation (EU) No. 596/2014 (the "UK MAR") which is part of UK law by virtue of the European Union (Withdrawal) Act 2018. The information is disclosed in accordance with the Company's obligations under

Article 17 of the UK MAR. Upon the publication of this announcement, this inside information is now considered to be in the public domain.

The person responsible for arranging the release of this announcement on behalf of the Company is Dr. Nabil Lawandy, Chief Executive of the Company.

Chief Executive Officer's statement

Introduction

In H1 2023, we have already achieved a PBTA level which is 73% of the market expectations for the year. We are therefore highly confident we will achieve market expectations for the full year.

Revenue was up 25% at \$11,621k (2022: \$9,265k) for the first half of the year. The increased revenues in the first half are derived principally from pre-production development contracts, as well as strong demand for our materials to meet the banknote requirements of one of our existing central bank customers.

As a result of the increased revenue, adjusted EBITDA (before stock compensation expense) for the half year increased 55% to \$5,903k compared to the prior year of \$3,818k.

Having generated cash from operations of \$4,418k (2022: \$7,245k), cash at the period end amounted to \$16,582k (2022: \$17,961k), excluding \$500,000 of restricted cash and investments (2022: \$500k). This is notwithstanding \$5,102k paid to shareholders during June in the form of the Company's annual dividend of \$0.115.

Review of Operations

Physical and Software Authentication Business

The Authentication Systems business generated revenue of \$10,589k (2022: \$8,565k) and Adjusted EBITDA of \$4,698k (2022: \$3,878k).

Authentication Systems revenues are driven by sales of covert materials and their associated equipment and service, optical and security phosphor materials, and the final license payments from our licensee. The increased revenue is due to a combination of sizable materials orders and meeting several key payment milestones relating to sensor development funding from our long-standing central bank customer. We continue to move forward with this central bank towards the delivery of the preproduction sensors in late 2024. In addition, we have executed a \$1.9mm contract with a central bank customer for Quality control equipment in H1 which will impact our revenue and PBTA primarily in 2024-2025.

Through our strong partnership with Cartor Security Printers in Wolverhampton we have further refined our abilities and yields of high quality conducting and opacified polymer substrates for evaluation by central banks, ink suppliers and printing organizations. We have produced custom designed sheets for a Middle Eastern central bank to be used in large scale print trials which continue. Final decisions have been delayed as the central bank has had to deal with local hyperinflation and has shifted temporarily to the printing of paper substrate notes in other denominations.

In addition, the Company has formed a close working relationship with the largest commercial printer of polymer banknotes and is near completion of a house note which will incorporate both our Fusion™ machine readable security as well as their newest public security feature. The Directors anticipate that the result of this joint development will be polymer banknotes of the highest quality for a joint marketing effort.

During H1 and going forward, we are utilizing our increased profitability to further support sales and marketing efforts. Since recruiting an experienced sales director for banknote technology in December of 2022, we have forged relationships with a number of central banks for our polymer product as well as other related authentication technology. With this additional recruitment, we have been able to free up time from our existing staff to further increase our sales efforts in brand authentication as well as document security, with a focus on passports.

The smartphone technology has been seeded in Asia for cigarettes and stationery for some time and while this continues to percolate, we have opened new opportunities in the NFT art and passport data page security areas. We now have a revised target of \$1mm of revenues for this technology by close of 2024.

Our K-cup materials business has grown significantly since a new customer began purchasing our products in H2 2021. We have recently successfully completed trials with a Canadian printer of K-cups and are currently working on assessing the additional revenue with this customer for 2024; we are hopeful we may begin filling orders in H2.

On the software security side of the Company's business, the Secure Transactions Group, formed around two gaming technology acquisitions made in 2012, generated an Adjusted EBITDA of \$40k (2022:(\$60k)) on revenue of \$840k (2022: \$700k). The H1 results are in line with expectations for this first half of the year and we expect an increase in H2 with several lottery wins from last year going live.

Banknote Cleaning and Disinfection Business

In 2022, we sold our first Banknote Disinfection System (BDS) for use by an Asian central bank. During H1 2023, we have successfully installed the BDS and trained the central bank staff. With this first unit now installed and operational, we are able to provide a full reference for other central banks.

Strategy

The Company's strategy for increasing revenue and earnings continues to be focused on selling more products to existing customers as well as opening new sales channels for the full spectrum of our product offerings.

We have had very good success in upselling existing central bank customers and commercially exploiting supply chain and pandemic related issues as part of our strategy. Examples of these successes are the expansion of sensor capabilities for exotic counterfeits, the development and first sale of a banknote disinfection machine, and the commencement of a program with our customer to deal with supply chain issues now and going forward.

Our strategy for growing our newest and potentially transformative technology for polymer banknotes is based on validation, followed by a commemorative banknote contract and then a full banknote denomination contract. The validation is focused on three major stakeholders in the polymer banknote industry: the ink manufacturers, the commercial printers, and the state printworks. Our primary targets are central banks which are currently using paper substrates and are contemplating a transition to polymer, as well as central banks who have decided not to use polymer for higher denominations due to security concerns.

With regards to our optical materials and brand authentication products, we continue to propose to both central banks and overt security suppliers the concept of upgrading security features to incorporate public and machine-readable security. The strategy behind this approach is based around partnering with suppliers who can benefit from our technology and materials to upsell their existing customers.

Finally, we continue to explore strategic as well as increased sales channel-based mergers and acquisitions. The active search for such opportunities is being accelerated as we expect to have significant cash resources through the successful delivery of the major central bank sensor contract.

Prospects

The Company has several new sales opportunities which mirror the broad-spectrum of products we have developed. The inventiveness which we have demonstrated repeatedly is a key component of our growth strategy and drives our profit generation process strategy. This approach has led to a high margin, intellectually driven, patent protected suite of products from products from smartphone authentication, to viral disinfection of banknotes to cutting-edge covert technologies.

Opportunities within the next 24 months or less include:

- Completion of sensor development and revenue recognition of the remaining sensor development payments
- Completion, delivery, and payment for a new online Quality Control system contract received this year
- First sensor shipments to a central bank commencing in Q2 2025
- Sale of additional Banknote Disinfection Systems
- Increased sales of our optical materials for K-cups and phosphor applications
- Expansion of our gaming software business in Canada and in the online lottery market

Opportunities within the next 3-5 years:

- TruBrand™ for use in art protection and passport data pages
- A commemorative note series using our Fusion polymer substrate
- Supply of upgraded sensors worth up to \$50mm in hardware to a central bank customer
- Supply of Fusion™ polymer substrate and sensors to a central bank for one or more banknote denominations
- Significantly increased adoption of covert authentication materials by a current or new central bank customer

The combination of these prospects, both short and long-term, has positioned the Company to continue its revenue and earnings growth over the coming years. We continue to develop cutting edge technologies to remain the technology leader in the authentication industry and to offer our shareholders growth through innovation for both new and existing customers.

Nabil M. Lawandy
Chief Executive Officer
September 25, 2023

**Consolidated statements of income
for the half year ended 30 June 2023**

	Half Year to 30 Jun 2023	Half Year to 30 Jun 2022	Full Year to 31 Dec 2022
	Unaudited USD '000	Unaudited USD '000	Audited USD '000
Revenues			
Product	\$ 7,242	\$ 5,488	\$ 11,208
Service	3,945	2,907	6,681
License and royalty	434	870	1,738
Total revenues	<u>11,621</u>	<u>9,265</u>	<u>19,627</u>
Cost of sales	<u>3,581</u>	<u>3,145</u>	<u>7,351</u>
Gross profit	8,040	6,120	12,276
Operating expenses			
Research and development	702	837	1,507
General and administrative	1,577	1,481	3,023
Sales and marketing	415	478	753
Total operating expenses	<u>2,694</u>	<u>2,796</u>	<u>5,283</u>
Operating profit	5,346	3,324	6,993
Interest and other income	172	8	17
Loss on sale of equipment	-	-	-
Foreign currency gain(loss)	<u>(35)</u>	<u>3</u>	<u>(8)</u>
Profit before taxes	5,483	3,335	7,002
Income tax expense	<u>784</u>	<u>707</u>	<u>901</u>
Net income	4,699	2,628	6,101
Net income (loss) attributable to noncontrolling interest	<u>14</u>	<u>22</u>	<u>46</u>
Net income attributable to Spectra Systems Corporation	<u><u>\$ 4,713</u></u>	<u><u>\$ 2,650</u></u>	<u><u>\$ 6,147</u></u>
Earnings per share			
Basic	\$ 0.10	\$ 0.06	\$ 0.14
Diluted	\$ 0.10	\$ 0.06	\$ 0.13

**Consolidated statements of comprehensive income
for the half year ended 30 June 2023**

	Half Year to 30 Jun 2023	Half Year to 30 Jun 2022	Full Year to 31 Dec 2022
	Unaudited USD '000	Unaudited USD '000	Audited USD '000
Net income	\$ 4,713	\$ 2,628	\$ 6,101
Other comprehensive income (loss)			
Unrealized gain (loss) on currency exchange	(45)	1	(45)
Reclassification for realized (gain) loss in net income	<u>35</u>	<u>(3)</u>	<u>8</u>
Total other comprehensive loss	<u>(10)</u>	<u>(2)</u>	<u>(37)</u>

Comprehensive income	4,703	2,626	6,064
Net gain (loss) attributable to noncontrolling interest	14	22	(46)
Comprehensive income attributable to Spectra Systems Corporation	\$ 4,717	\$ 2,648	\$ 6,018

**Consolidated balance sheets
as of 30 June 2023**

	As of 30 Jun 2023	As of 30 Jun 2022	As of 31 Dec 2022
	Unaudited USD '000	Unaudited USD '000	Audited USD '000
Current assets			
Cash and cash equivalents	\$ 16,582	\$ 17,961	\$ 17,496
Trade receivables, net of allowance	3,095	1,384	3,677
Unbilled and other receivables	1,002	527	1,133
Inventory	2,368	2,192	1,599
Prepaid expenses	795	1,272	760
Total current assets	23,842	23,336	24,665
Non-current assets			
Property, plant and equipment, net	1,910	1,617	2,102
Operating lease right of use assets, net	1,659	828	1,217
Intangible assets, net	6,970	7,057	7,055
Restricted cash and investments	500	500	500
Deferred tax assets	1,848	530	1,881
Other assets	595	105	597
Total non-current assets	13,482	10,637	13,352
Total assets	\$ 37,324	\$ 33,973	\$ 38,017
Current liabilities			
Accounts payable	\$ 796	\$ 664	\$ 929
Accrued expenses and other liabilities	476	465	504
Operating lease liabilities, short term	392	289	298
Taxes payable	194	49	684
Deferred revenue	4,601	1,898	4,626
Total current liabilities	6,459	3,365	7,041
Non-current liabilities			
Operating lease liabilities, long term	1,319	595	975
Deferred revenue	1,590	4,968	1,679

Total non-current liabilities	2,909	5,563	2,654
Total liabilities	9,368	8,928	9,695
Stockholders' equity			
Common stock	450	451	450
Additional paid in capital - common stock	53,270	53,336	53,178
Accumulated other comprehensive loss	(186)	(138)	(174)
Accumulated deficit	(26,319)	(29,224)	(25,727)
Total Spectra Systems Corporation stockholders' equity	27,215	24,425	27,727
Noncontrolling interest	741	620	595
Total stockholders' equity	27,956	25,045	27,921
Total liabilities and stockholders' equity	\$ 37,324	\$ 33,973	\$ 38,017

**Consolidated statements of cash flows
for the half year ended 30 June 2023**

	Half Year to 30 Jun 2023 Unaudited USD '000	Half Year to 30 Jun 2022 Unaudited USD '000	Full Year to 31 Dec 2022 Audited USD '000
Cash flows from operating activities			
Net income	\$ 4,699	\$ 2,628	\$ 6,101
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	459	418	917
Stock based compensation expense	92	65	142
Lease amortization expense	89	142	287
Deferred taxes	32	550	(801)
Allowance for doubtful accounts	-	-	(4)
Provision for excess and obsolete inventory	-	-	694
Loss on sale of equipment	-	-	-
<i>Changes in operating assets and liabilities</i>			
Accounts receivables	581	861	(1,428)
Unbilled and other receivables	131	102	(503)
Inventory	(770)	(248)	(349)
Prepaid expenses	(34)	(974)	(463)
Other assets	-	-	(500)
Accounts payable	(133)	175	441
Operating leases	(92)	(140)	(285)

Accrued expenses and other liabilities	(518)	(262)	417
Deferred revenue	(118)	3,928	3,374
Net cash provided by operating activities	4,418	7,245	8,040
Cash flows from investing activities			
Restricted cash and investments	(3)	-	-
Payment of patent and trademark costs	(129)	(147)	(476)
Proceeds from sale of equipment	-	-	-
Purchases of property, plant and equipment	(8)	(338)	(988)
Net cash provided by (used in) investing activities	(140)	(485)	(1,464)
Cash flows from financing activities			
Dividends paid	(5,182)	(5,004)	(5,004)
Repurchase of shares	-	(570)	(807)
Proceeds from exercise of stock options	-	6	6
Net cash used in financing activities	(5,182)	(5,568)	(5,805)
Effect of exchange rate on cash and cash equivalents	(10)	(6)	(50)
Net increase(decrease) in cash and cash equivalents	(914)	(1,186)	721
Cash and cash equivalents, beginning of period	17,496	16,775	16,775
Cash and cash equivalents, end of period	\$ 16,582	\$ 17,961	\$ 17,496

Notes to financial information

1. Basis of preparation

This report was approved by the Directors on the 18 September 2023.

This financial information has been prepared using the recognition and measurement principles of US Generally Accepted Accounting Principles (GAAP). 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 2023 and are unchanged from those disclosed in the Company's Annual Report for the year ended 31 December 2022.

The results for the half year are unaudited. The financial information for the year ended 31 December 2022 does not constitute the full statutory accounts for that period. The Annual Report and financial statements for the year ended 31 December 2022 have been filed with the Registrar of Companies. The Independent Auditors' Report on the financial statements for the year ended 31 December 2022 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. Excluded from the calculation of diluted earnings per common share for the six months ended June 30, 2023, and the year ended December 31, 2022, were 189,000 and 186,773 shares related to stock options, respectively, because their exercise prices would render them anti-

dilutive. For the six months ended June 30, 2022, 159,845 were excluded from the calculation of diluted earnings per common share. The following table shows the calculation of basic and diluted earnings per common share.

	Half Year to 30 Jun 2023	Half Year to 30 Jun 2022	Full Year to 31 Dec 2022
Numerator:			
Net income	\$ 4,712,975	\$ 2,650,000	\$ 6,147,374
Denominator:			
Weighted average common shares	45,143,754	45,569,258	45,189,208
Effect of dilutive securities:			
Stock Options	1,957,249	2,233,298	2,132,610
Diluted weighted average common shares	<u>47,101,003</u>	<u>47,802,556</u>	<u>47,321,818</u>
Earnings per common share:			
Basic:	<u>\$ 0.10</u>	<u>\$ 0.06</u>	<u>\$ 0.14</u>
Diluted:	<u>\$ 0.10</u>	<u>\$ 0.06</u>	<u>\$ 0.13</u>

3. Investment in affiliates and other entities

During the course of business, the Company enters into various types of investment arrangements. The Company determines whether such investments involve variable interest entities (VIEs). If the entity is determined to be a VIE, then management determines if the Company is the primary beneficiary of the entity and whether or not consolidation of the VIE is required. The primary beneficiary consolidating the VIE must normally have both (i) the power to direct the activities of a VIE that most significantly affect the VIE's economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE, in either case that could potentially be significant to the VIE. When the Company is deemed to be the primary beneficiary, the VIE is consolidated and the other party's equity interest in the VIE is accounted for as a noncontrolling interest.

On December 10, 2020, the Company invested \$702,000 in Solaris BioSciences ("Solaris") and increased its equity interest from 4.79% to 48.65% on an as converted basis. A noncontrolling interest is attributable to the 51.35% of Solaris not owned by the Company. Prior to the investment, the Chief Executive Officer of Spectra owned 84.54% of Solaris which declined to 46.01% after the transaction. As part of the transaction, the Company committed to provide \$100,000 of services at cost to Solaris, of which \$93,558 were provided during the six months ended June 30, 2021. In addition, the Company will provide nominal accounting support to Solaris and allow Solaris use of optical table space and facilities at Spectra. In accordance with Delaware law, the transaction was (a) unanimously approved by all three of Spectra's non-executive Directors and (b) specially approved by a majority-in-interest of the disinterested stockholders of Solaris. In addition, going forward Spectra's shares in Solaris will be voted as directed by Spectra's non-executive Directors. The Chief Executive Officer of Solaris is also the Chief Executive Officer of Spectra.

The Company has concluded that Solaris is a VIE and the Company is the primary beneficiary. The Company has consolidated the accounts of Solaris as of December 10, 2020. The aggregate carrying value of Solaris' assets and liabilities after elimination of any intercompany transactions and balances in the consolidated balance sheets were as follows:

	As of 30 Jun 2023	As of 30 Jun 2022	As of 31 Dec 2022
	Unaudited USD '000	Unaudited USD '000	Audited USD '000
Assets			
Cash	\$ 14	\$ 101	\$ 150
Property, plant and equipment, net	7	7	8
Intangible assets, net	110	56	40
Total Assets	<u>131</u>	<u>164</u>	<u>197</u>
Liabilities			
Accounts payable	22	-	21
Accrued expenses and other liabilities	-	-	-
Total liabilities	<u>\$ 22</u>	<u>\$ -</u>	<u>\$ 21</u>

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

Appendix - Reconciliation of Non-GAAP measures

The Company publishes certain additional information in a non-statutory format in order to provide readers with an increased insight into the underlying performance of the business. Reconciliations to the GAAP measures are shown in the following tables:

	Half Year to 30 Jun 2023 Unaudited USD '000	Half Year to 30 Jun 2022 Unaudited USD '000	Full Year to 31 Dec 2022 Unaudited USD '000
Adjusted earnings before interest, taxes, depreciation and amortization (EBITDA)			
Operating profit	\$ 5,346	\$ 3,324	\$ 6,993
Depreciation	203	159	321
Amortization	254	257	594
Stock compensation	92	65	142
Operating loss - noncontrolling interest	13	22	46
Stock compensation - noncontrolling interest	(5)	(10)	(19)
Adjusted EBITDA	\$ 5,903	\$ 3,817	\$ 8,077
Adjusted profit before taxes and amortization (PBTA)			
Profit before taxes	\$ 5,483	\$ 3,335	\$ 7,002
Amortization	254	257	594
Stock compensation	92	65	142
Operating loss - noncontrolling interest	13	22	46
Stock compensation - noncontrolling interest	(5)	(10)	(19)
Adjusted PBTA	\$ 5,837	\$ 3,669	\$ 7,765
Adjusted earnings per share			
Adjusted PBTA	\$ 5,837	\$ 3,669	\$ 7,765
Income tax expense	(784)	(707)	(901)
Adjusted earnings	\$ 5,053	\$ 2,962	\$ 6,864
Diluted weighted average common shares	47,101,003	47,802,556	47,321,818
Adjusted earnings per share	\$ 0.108	\$ 0.062	\$ 0.145

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