

Quarterly Report

December 31, 2015

NANO TECH
SECURITY CORP.

Nanotech Security Corp.

Management's Discussion and Analysis
For the three months ended December 31, 2015

For purposes of this discussion "Nanotech", the "Company", "we", or "us" refers to Nanotech Security Corp. and its subsidiaries. This quarter means the three months ended December 31, 2015.

ADVISORY

This management's discussion and analysis ("MD&A"), dated as of February 25, 2016 should be read in conjunction with the cautionary statement regarding forward-looking statements below and the Company's condensed consolidated interim financial statements for the three months ended December 31, 2015, as well as with the Company's consolidated financial statements and MD&A for the year ended September 30, 2015. The results reported herein have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are presented in Canadian dollars. All quarterly information disclosed in the MD&A is based on unaudited figures.

Unless otherwise indicated, the Company's significant accounting policies and estimates, contractual obligations, commitments, contingencies, and business risks and uncertainties, as described in its MD&A for the year ended September 30, 2015, are substantially unchanged. The MD&A and condensed consolidated interim financial statements were reviewed by the Company's Audit Committee and approved by the Company's Board of Directors.

Additional information relating to the Company is filed on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

The following discussion and analysis of the financial conditions and results of operations contains forward-looking statements concerning anticipated developments in our operations in future periods, the adequacy of our financial resources, and the events or conditions that may occur in the future. Forward-looking statements are frequently, but not always, identified by words such as "expects", "anticipates", "believes", "intends", "estimates", "predicts", "potential", "targeted", "plans", "possible" and similar expressions, or statements that events, conditions or results "will", "may", "could" or "should" occur or be achieved.

These forward-looking statements include, without limitation, statements about our market opportunities, strategies, competition, and the Company's views that its nano-optical and optical thin film technologies will continue to show promise for mass production and commercial application. Other forward-looking statements imply that the Company will remain capable of being financed and/or will be able to partner development until commercial sales are eventually realized. The principal risks related to these forward-looking statements are that the Company's intellectual property claims will not prove sufficiently broad or enforceable to provide the necessary commercial protection and to attract the necessary capital and/or that the Company's products will not be able to displace entrenched hologram, metalized strip tagging, and other conventional anti-counterfeiting technologies sufficiently to allow for profitability.

Our forward-looking statements are based on the beliefs, expectations and opinions of management on the date the statements are made. Consequently, all forward-looking statements made in this discussion and analysis of the financial conditions and results of operations or the documents incorporated by reference are qualified by this cautionary statement and there can be no assurance that actual results or developments we anticipate will be realized. For additional information with respect to certain of these risks or factors reference should be made to the "Business Risks and Uncertainties" section of this MD&A and notes to the consolidated financial statements for the year ended September 30, 2015, as well as with the Company's continuous disclosure materials filed from time-to-time with Canadian securities regulatory authorities, which are available online at www.sedar.com. Nanotech disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than as required by law, rule or regulation. You should not place undue reliance on forward-looking statements.

GENERAL OVERVIEW

Nanotech was incorporated under the laws of British Columbia, and is listed on the TSX Venture Exchange (trading symbol: NTS) and quoted in the United States on the OTCQX Market (trading symbol: NTSFF). The Company's head office is at #505 - 3292 Production Way, Burnaby, BC, Canada V5A 4R4. The Company's registered and records office is #1500 - 1055 West Georgia, Vancouver, BC, Canada V6E 4N7.

The Company operates its business through two business divisions – Security Features and Surveillance. The Company's reportable segments are strategic business divisions that offer different products and services. They are managed separately because each business is in a different stage in its life cycle and they require different sales and marketing strategies.

Security Features

Security Features provides nano-optics and optical thin film ("OTF") for use in anti-counterfeiting and authentication processes and products including currency, legal documents and commercial products. The Company conducts research at its Burnaby, BC head office, its research and production facility in Thurso, QC, and at 4D Labs nanofabrication facility, a federal government sponsored facility located at Simon Fraser University in Burnaby, BC.

The Security Features division is developing nanotechnology and OTF for use in anti-counterfeiting and commercial product authentication systems. The Company is developing specialized optical features for use in banknotes and other products. The nanotechnology employs arrays of billions of nano-holes that are impressed or embossed onto a substrate material such as polymer and metal. These arrays yield unique light signatures (visual images) that cannot be easily reproduced by a third party without access to the technology and equipment needed to create the arrays. These optical features can be directly applied to banknotes and other valuable documents and products creating unique optical signatures that are both overt (naked-eye-visible) and machine (only) readable. These features are being designed to be suitable for a variety of other commercial security applications and branding formats. Images of these features are available on the Company's website at: www.nanosecurity.ca

Surveillance

Surveillance designs and sells a wide range of sophisticated surveillance and intelligence gathering equipment and conducts surveillance training for the law enforcement and defense industries primarily in the United States and Canada. The Company conducts its research, production, and training at its facility in Holmes, PA, USA.

The Surveillance division has successfully developed the P-25 digital transmission system allowing federal, state and local law enforcement agencies to communicate with each other over a single frequency using both digital and analog frequencies, and the release of the Echo 8i that converts analog audio signals to digital, enabling secure, wireless smart-phone connectivity.

RESULTS OF OPERATIONS

The following table provides selected financial information for the three months ended December 31, 2015, and 2014:

Selected financial information

	Three months ended December 31,	
	2015	2014
Revenue	$ 1,509,240	$ 1,537,495
Cost of sales	760,820	1,009,658
	748,420	527,837
Expenses		
Research and development	1,316,656	1,083,510
General and administration	659,387	606,028
Sales and marketing	548,776	365,085
	2,524,819	2,054,623
Loss before other expenses	(1,776,399)	(1,526,786)
Other income	(30,064)	(595,515)
Net loss	$ (1,746,335)	$ (931,271)

Revenue
Revenues for the three months ended December 31, 2015 decreased by $28,255 to $1,509,240 compared to $1,537,495 in the same period last year. This included the Security Features division delivering revenue of $569,467 compared to $1,041,937 during the same period last year, primarily from development contracts. The OTF production continued to be negatively impacted as a large international customer reviewed its product specification and entered into discussions with the Company for increased colour-shifting OTF volumes. The customer requested Nanotech sub-contract volume production through a partner relationship. On November 17, 2015 the Company announced the signing of a Memorandum of Understanding ("MOU") which contemplates an operational agreement with Hueck Folien to collaborate in the production of volume colour-shifting OTF. These discussions have continued to consume internal resources in bringing the new collaboration on-line.

The Surveillance division achieved revenues of $939,773 compared to $495,558 during the same period last year. This increase reflected the delivery of a number of surveillance vans and product sales during the period.

Gross margin
Gross margin for the three months ended December 31, 2015 increased by $220,583 to $748,420 compared to $527,837 in the same period last year. The overall, gross margin percentage reached 50% for the three months ended December 31, 2015, an improvement from the 34% in the same period last year. This increase reflected higher margins on both the Security Features' research and development contracts and with the Surveillance division sales.

Research & development
Research and development expenditures for the three months ended December 31, 2015 increased by $233,146 to $1,316,656 compared to $1,083,510 in the same period last year. This is a result of an increase in depreciation and amortization of $229,866. Research and development activity for the three months

ended December 31, 2015 continues to be focused on new security features targeted for the bank note market.

General and administration
General and administration expenditures for the three months ended December 31, 2015 were $659,387, an increase of $53,359 compared to $606,028 in the same period last year which reflects higher office rent, and an increase in staffing.

Sales and marketing
Sales and marketing expenditures for the three months ended December 31, 2015 were $548,776, an increase of $183,691 compared to $365,085 in the same period last year due to increased sales and marketing activity relating to the Security Features division and includes increased salaries and international travel.

Net loss
The net loss for the three months ended December 31, 2015 was $1,746,335 compared to $931,271 during the same period last year. The increase in net loss reflects stronger gross margins offset by an increase in sales and marketing expenditures as the Company continues to pursue the bank note market, and a $600,000 prior period gain on the revaluation of contingent shares.

SEGMENT RESULTS
The Company analyzes financial performance by segments, which regroup related activities within the Company. The Company's two reportable operating segments are Security Features and Surveillance. Inter-segment transactions have been eliminated from the segmented financial information discussed below.

Security Features
Security Features provides light based recognition nanotechnology and OTF for use in anti-counterfeiting and authentication processes and products including currency, legal documents, and commercial products.

	Three months ended December 31,	
	2015	2014
Revenue	$ 569,467	$ 1,041,937
Net loss	(1,836,788)	(887,611)

Revenues from Security Features for the three months ended December 31, 2015 decreased to $569,467 from $1,041,937 for the same period last year. The decreased revenue was primarily due to decreased delivery of OTF as the Company focused on bringing Hueck Folien on-line.

The loss from Security Features for the three months ended December 31, 2015 increased by $949,177 to $1,836,788 from $887,611 for the same period last year. The increase in net loss reflects stronger gross margins offset by an increase in sales and marketing expenditures as the Company continues to pursue the bank note market, and a $600,000 prior period gain on the revaluation of contingent shares.

Surveillance
Surveillance designs and sells sophisticated surveillance and intelligence gathering equipment for the law enforcement and defense industries in the United States and Canada.

	2015	2014
Revenue	$939,773	$495,558
Net income (loss)	$90,453	$(43,660)

Revenues from Surveillance for the three months ended December 31, 2015 increased to $939,773 from $495,558 in the same period last year. The increased revenue for the three months ended December 31, 2015 was due to the fulfillment of a number of large surveillance van orders.

Net income from Surveillance for 2015 increased to $90,453 from a net loss of $43,660 in the same period last year. The net income was a result of increased sales and higher gross margins during the current quarter.

QUARTERLY RESULTS

	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014	Q2 2014
($ thousands, except common share amounts)								
Revenue	$1,509	$728	$1,359	$1,528	$1,537	$498	$600	$574
Net income (loss)	(1,746)	(1,565)	(1,280)	(895)	(931)	2,284	(1,115)	(859)
Net income (loss) per common share:								
Basic	(0.03)	(0.03)	(0.03)	(0.02)	(0.02)	0.06	(0.03)	(0.02)
Diluted	(0.03)	(0.03)	(0.03)	(0.02)	(0.02)	0.05	(0.03)	(0.02)

There are no seasonal effects or other trends in the Company's business over the quarters presented. The net income in Q4 2014 was the result of a non-recurring deferred income tax recovery of $3,892,000. The recovery was triggered by the application of previously unrecognized income tax assets of the Company being utilized to offset deferred tax liabilities which were created on the acquisitions of IDME Technologies Corp., IDIT Technologies Corp., and Fortress Optical Features Ltd.

RELATED PARTY TRANSACTIONS

For the three months ended December 31, 2015, the Company had no transactions with related parties as defined in IAS 24, *Related Party Disclosures,* except those pertaining to transactions with key management personnel in the ordinary course of their employment or as disclosed below.

(a) The remuneration of key management personnel is as follows:

	Three months ended December 31,	
	2015	2014
Salaries and employee benefits	$ 276,653	$ 225,091
Share based payments	56,070	63,829
	$ 332,723	$ 288,920

(b) Management fees totaling $97,500 (2014 - $64,060) charged by a company controlled by an officer and director of the Company, were included in salaries and benefits expense. As of December 31, 2015, amounts owing to this company included in accounts payable and accrued liabilities were $183,274 (2014 - $338,752).

(c) Legal and professional fees, taxes and disbursements totaling $22,351 (2014 - $27,197) were incurred with a law firm of which a director of the Company is a partner. As of December 31, 2015, amounts owing to this company included in accounts payable and accrued liabilities were $116,127 (September 30, 2015 - $171,895).

The above transactions are in the normal course of business and are measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of liquidity are cash provided by operations, including collection of accounts receivable, and access to equity capital resources. The Company's primary short term cash requirement is to fund operations, working capital, including supplier payables, capital expenditures, and fixed overhead costs. Cash is also used to finance other long term strategic business initiatives. As at December 31, 2015, cash and cash equivalents totaled $1,636,332, compared to $3,021,928 as at September 30, 2015.

Summary of Statement of Cash Flow

	Three months ended December 31,	
	2015	2014
Cash used in operating activities[1]	$ (904,312)	$ (813,588)
Changes in operating assets and liabilities	(283,264)	(305,488)
Cash used in operating activities	(1,187,576)	(1,119,076)
Cash used in investing activities	(168,434)	(206,292)
Cash provided by financing activities	-	74,250
Effect of foreign currency translation on cash and cash equivalents	(29,586)	(28,109)
Cash and cash equivalents, beginning of year	3,021,928	3,964,645
Cash and cash equivalents, end of year	$ 1,636,332	$ 2,685,418

[1] Before changes in operating assets and liabilities

Operating Activities
Cash used in operating activities was consistent at $1,187,576 for the three months ended December 31, 2015, compared to $1,119,076 for the same period last year.

Investing Activities
Cash used in investing activities was $168,434 for the three months ended December 31, 2015, compared to $206,292 for the same period last year. The decrease reflects the continuation of an upgrade to manufacturing equipment in the current quarter.

Financing Activities
Cash provided by financing activities was $NIL for the three months ended December 31, 2015, compared to $74,250 during the same period last year, as a result of the exercise of warrants in the previous quarter.

Capital Resources

	December 31, 2015	September 30, 2015
Cash and cash equivalents	$1,636,332	$3,021,928
Cash-based working capital	$1,913,421	$3,015,753
Long-term debt	$3,119,470	$3,126,363
Common shares outstanding	53,387,215	53,387,215

The Company's objectives when managing capital are to safeguard the ability to continue as a going concern, to provide adequate return to shareholders, to meet external capital requirements and preserve financial flexibility in order to benefit from potential opportunities that may arise. Our principal cash requirements are for operations, working capital, and capital expenditures. The Company has recurring operating losses and an accumulated deficit of $25,035,575 as of December 31, 2015 ($23,289,240 as of September 30, 2015). The Company also expects to continue to incur substantial expenses relating to its research and development efforts in light based recognition nanotechnology. As a result, the Company expects to incur significant losses in the next year unless it is able to realize revenue after commercialization of its products currently under development. The timing and amount of such revenues, if any, cannot be predicted with certainty. The Company's ability to continue as a going concern is dependent on its ability to obtain significant additional financing in order to meet its planned business objectives and to be able to commercialize products currently in development. The Company will need to raise funds and is pursuing additional funds through grants, strategic collaborations, public or private equity or debt financing or other funding sources. This funding may not be available on acceptable terms, or at all, and will most likely be dilutive to shareholder interests. However, there can be no assurance that the Company will be able to obtain additional financial resources. If the Company is unable to generate positive cash flows or obtain adequate financing, the Company will need to curtail operations and development activities. These factors cast significant doubt regarding the Company's ability to continue as a going concern. Should the Company be unable to realize its assets and discharge its liabilities in the normal course of business the net realizable value of its assets may be materially less than the amounts on the statement of financial position.

The Company's officers are responsible for managing the Company's capital and do so through quarterly meetings and regular review of financial information. The Board of Directors are responsible for overseeing this process. In managing its capital, the Company considers changes in economic conditions, risk that impact consolidated operations, and future significant capital investment opportunities. For the three months ended December 31, 2015, there were no other changes in our approach to capital management.

The capital of the Company consists of the items included in the Consolidated Balance Sheets in the shareholders' equity section and the secured note payable. As at December 31, 2015 shareholders' equity was $21,225,845 compared to $22,924,873 as at September 30, 2015.

As at December 31, 2015 cash and cash equivalents amounted to $1,636,332, compared to $3,021,928 as at September 30, 2015.

As at December 31, 2015, the Company had working capital of $1,913,421, as compared to $3,015,753 at September 30, 2015.

The Company has a note payable outstanding of $3,000,000 as at December 31, 2015 and September 30, 2015. The note bears interest at 4% per annum and the principal is due in September 2017. Monthly interest payments are required prior to the maturity date. The note payable was used to finance some of the real estate assets acquired on the acquisition of FOF. The note payable is secured by the assets of the Company.

The Company had 53,387,215 common shares issued and outstanding at December 31, 2015 and September 30, 2015.

The Company had 2,012,000 stock options outstanding at December 31, 2015 with a weighted average exercise price of $1.30 compared to 1,982,000 outstanding as at September 30, 2015 with a weighted average exercise price of $1.30.

The Company had 1,327,500 warrants outstanding as at December 31, 2015 and September 30, 2015 with a weighted average exercise price of $1.50.

The Company had no commitments for material capital expenditures as of December 31, 2015.

The Company had no lines of credit and no exposure to asset backed commercial paper.

Management has reviewed its projected funding requirements and expects that through the generation and collection of revenues and or being able to raise additional funds, that the Company will maintain sufficient liquidity to meet its requirements through December 31, 2016.

Financial Instruments
The Company considers the management of financial risk to be an important part of its overall corporate risk management policy. The nature and extent of risks arising from financial instruments, and their related risk management are described in note 13 of the Consolidated Financial Statements for the year ended September 30, 2015. In the three months ended December 31, 2015, there was no material change to the nature of the risks arising from our classification of financial instruments, or related risk management objectives.

ADDITIONAL INFORMATION

Outlook
Nanotech is presently developing and seeking to market its authentication feature under several trademarks including *KolourOptik*™, *NOtES*™ (*Nano-Optic Technology for Enhanced Security*) technology and *Plasmogram*™, as well as pursuing OTF opportunities. The Company anticipates that significant investment will be required to commercialize the technology. The Company may seek to involve third parties in joint venturing, partnering or otherwise funding such development activities failing which it will be required to seek to raise additional funds which will cause equity dilution to existing shareholders. The Company is currently presenting the technology to the bank note industry and other potential security authentication industry customers and is also working towards possible commercial licensing applications with third party specialists who supply security and brand recognition/protection features to the product marketplace. There can be no assurance that a successful product will be developed or that if developed any product will be commercially viable or competitive.

Outstanding Share Data
The Company's articles of incorporation authorize the issuance of an unlimited number of common shares and an unlimited number of preferred shares.

The Company's outstanding share data as at February 25, 2016 is as follows:

Issued common shares	53,387,215
Warrants	1,327,500
Stock options	2,326,000
Restricted Share Units	688,100

Public Securities Filings
Additional information about Nanotech, is available on the Company's website at www.nanosecurity.ca, or on SEDAR at www.sedar.com.

Condensed Consolidated Interim Financial Statements of

Nanotech Security Corp.

Three months ended December 31, 2015 and 2014
(Unaudited)

Nanotech Security Corp.
December 31, 2015 and 2014

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Nanotech Security Corp.

December 31, 2015

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the condensed consolidated interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed consolidated interim financial statements of the Company have been prepared by management and approved by the Audit Committee and Board of Directors of the Company. They include appropriate accounting principles, judgment and estimates in accordance with IFRS for interim financial statements.

The Company's independent auditors have not performed a review of these condensed consolidated interim financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of condensed consolidated interim financial statements by an entity's auditors.

Nanotech Security Corp.

Condensed Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

Three months ended December 31, 2015 and 2014
(In Canadian dollars)

	2015	2014
Revenue	$ 1,509,240	$ 1,537,495
Cost of sales (note 8)	760,820	1,009,658
Gross profit	748,420	527,837
Expenses (note 8)		
Research and development	1,316,656	1,083,510
General and administration	659,387	606,028
Sales and marketing	548,776	365,085
	2,524,819	2,054,623
Loss before other expenses	(1,776,399)	(1,526,786)
Other expenses (income)		
Foreign exchange gain	(66,483)	(26,810)
Finance expense	36,419	31,295
Gain on revaluation of contingent shares	-	(600,000)
	(30,064)	(595,515)
Net loss	(1,746,335)	(931,271)
Other comprehensive loss:		
Items that may be subsequently reclassified to earnings:		
Unrealized foreign exchange loss on translation of foreign operation	(28,114)	(23,388)
Total comprehensive loss for the year	$ (1,774,449)	$ (954,659)
Loss per share		
Basic and diluted	$ (0.03)	$ (0.02)
Weighted average number of common shares		
Basic and diluted	53,387,215	48,332,771

See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Financial Position
(Unaudited)

(In Canadian dollars)

	December 31, 2015	September 30, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 1,636,332	$ 3,021,928
Accounts receivable	955,116	879,266
Inventory	595,428	770,342
Prepaid expenses and other assets	85,911	76,840
	3,272,787	4,748,376
Property, plant and equipment	18,658,179	18,921,396
Intangible assets	2,385,257	2,725,629
Goodwill	1,388,458	1,388,458
	$ 25,704,681	$ 27,783,859
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,319,970	$ 1,732,623
Deferred revenue	39,396	-
	1,359,366	1,732,623
Long term liabilities:		
Note payable	3,000,000	3,000,000
Tenant inducement	119,470	126,363
	4,478,836	4,858,986
Shareholders’ equity		
Share capital (note 4)	44,666,497	44,666,497
Share based payment reserve	1,802,201	1,726,780
Deficit	(25,035,575)	(23,289,240)
Accumulated other comprehensive loss	(207,278)	(179,164)
	21,225,845	22,924,873
	$ 25,704,681	$ 27,783,859

Nature of operations and going concern (note 1(b))
Related party transactions (note 5)
See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Changes in Equity
(Unaudited)

Three months ended December 31, 2015 and 2014
(In Canadian dollars)

	Number of shares	Share capital	Share based payment reserve	Deficit	Accumulated other comprehensive loss	Total shareholders' equity
Balance as at September 30, 2014	48,307,934	$ 39,557,066	$ 1,143,570	$ (18,618,407)	$ (54,549)	$ 22,027,680
Net loss	-	-	-	(931,271)	-	(931,271)
Unrealized foreign exchange loss on translation	-	-	-	-	(23,388)	(23,388)
Share based payments	-	-	137,596	-	-	137,596
Warrants exercised	82,500	74,250	-	-	-	74,250
Balance as at December 31, 2014	48,390,434	$ 39,631,316	$ 1,281,166	$ (19,549,678)	$ (77,937)	$ 21,284,867
Balance as at September 30, 2015	53,387,215	$ 44,666,497	$ 1,726,780	$ (23,289,240)	$ (179,164)	$ 22,924,873
Net loss	-	-	-	(1,746,335)	-	(1,746,335)
Unrealized foreign exchange loss on translation	-	-	-	-	(28,114)	(28,114)
Share based payments (note 4)	-	-	75,421	-	-	75,421
Balance as at December 31, 2015	53,387,215	$ 44,666,497	$ 1,802,201	$ (25,035,575)	$ (207,278)	$ 21,225,845

See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

Three months ended September 30, 2015 and 2014
(In Canadian dollars)

	2015	2014
Operating activities:		
Net loss	$ (1,746,335)	$ (931,271)
Items not involving cash:		
Depreciation and amortization	773,495	580,087
Share based compensation	75,421	137,596
Amortization of tenant inducement	(6,893)	-
Gain on revaluation of contingent shares	-	(600,000)
Non-cash working capital changes (note 6(a))	(283,264)	(305,488)
Cash used in operating activities	(1,187,576)	(1,119,076)
Purchase of property and equipment	(168,434)	(206,292)
Cash used in investing activities	(168,434)	(206,292)
Financing activities:		
Issuance of shares for warrants exercised	-	74,250
Cash provided by financing activities	-	74,250
Effect of foreign exchange on cash and cash equivalents	(29,586)	(28,109)
Decrease in cash and cash equivalents	(1,385,596)	(1,279,227)
Cash and cash equivalents, beginning of period	3,021,928	3,964,645
Cash and cash equivalents, end of period	$ 1,636,332	$ 2,685,418

See accompanying notes to condensed consolidated interim financial statements.

1. Summary of business and nature of operations:

(a) Summary of business

Nanotech Security Corp. (the "Company" or "Nanotech") is incorporated under the laws of British Columbia with common shares listed on the TSX Venture Exchange (trading symbol: NTS) and quoted in the United States on the OTCQX Market (trading symbol: NTSFF). The Company's head office is located at #505 – 3292 Production Way, Burnaby, British Columbia, Canada V5A 4R4.

Nanotech is an identity company, providing light based nanotechnology and optical thin film ("OTF") for use in anti-counterfeiting, branding and authentication processes and products including currency, legal documents, and commercial products. Its wholly-owned subsidiary, Tactical Technologies Inc. ("TTI"), designs and sells sophisticated surveillance and intelligence gathering equipment for the law enforcement and defense industries in the United States and Canada.

(b) Nature of operations and going concern

These condensed consolidated interim financial statements have been prepared on the basis that the Company will continue as a going concern. The Company has recurring operating losses and an accumulated deficit of $25,035,575 as of December 31, 2015 ($23,289,240 as of September 30, 2015). The Company also expects to continue to incur substantial expenses relating to its research and development efforts in nano-optics and OTF. As a result, the Company expects to incur significant losses in the next few years until it is able to realize revenue following the recent commercialization of its products. The timing and amount of such revenues, if any, cannot be predicted with certainty.

The Company's ability to continue as a going concern is dependent on its ability to generate revenues or additional financing in order to meet its planned business objectives and to be able to commercialize future products currently in development. The Company may need to raise funds through grants, strategic collaborations, public or private equity, debt financing, or other funding sources. This funding may not be available on acceptable terms, or at all, and may be dilutive to shareholder interests. If the Company is unable to generate positive cash flows or obtain adequate financing, the Company may need to curtail operations and development activities. These factors cast significant doubt on the Company's ability to continue as a going concern. Should the Company be unable to realize its assets and discharge its liabilities in the normal course of business the net realizable value of its assets may be materially less than the amounts on the statement of financial position.

2. Basis of preparation:

These condensed consolidated interim financial statements were prepared using the same accounting policies and methods as those used in the Company's consolidated financial statements for the year ended September 30, 2015, except as described in note 3. These condensed consolidated interim financial statements have been prepared in compliance with IAS 34 – *Interim Financial Reporting*. Accordingly, certain disclosures normally included in annual financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") have been omitted or condensed. These condensed consolidated interim financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended September 30, 2015, which are included in the Company's 2015 annual report.

2. Basis of preparation (Continued):

These condensed consolidated interim financial statements include the accounts of the Company and its wholly-owned subsidiary, TTI. All intercompany balances and transactions are eliminated on consolidation.

These condensed consolidated interim financial statements were approved by the Company's Board of Directors and authorized for issue on February 25, 2016.

3. Significant accounting policy:

The Company reviews the estimated useful lives and the depreciation methods of its property, plant and equipment annually. At September 30, 2015, management revised its estimated useful life of manufacturing equipment from 5% to 10% declining balance. This change in estimate has been accounted for prospectively.

4. Share capital:

(a) Share capital:

Authorized:

Unlimited number of common shares with no par value
Unlimited number of preferred shares with no par value

Common shares issued and fully paid:

	Number of shares		Amount
Balance as at September 30, 2015 and December 31, 2015	53,387,215	$	44,666,497

(b) Share option plan:

Stock options outstanding as at December 31, 2015 are as follows:

	Number of options	Weighted average exercise price
Balance, September 30, 2015	1,982,000	$ 1.30
Granted	30,000	1.16
Balance, December 31, 2015	2,012,000	$ 1.30

4. Share capital (Continued):

(b) Share option plan (Continued):

The following table summarizes information pertaining to the Company's stock options outstanding at December 31, 2015:

	Options outstanding			Options exercisable	
Range of exercise prices	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
$0 - $0.80	482,000	0.47	$0.80	482,000	$0.80
$0.81 - $1.75	1,530,000	3.37	1.46	1,117,500	1.53
	2,012,000	2.68	$1.30	1,599,500	$1.35

The exercise price of all stock options granted during the period are equal to the closing market price at the grant date. The Company calculates share based payment from the vesting of stock options using the Black-Scholes option-pricing model with assumptions noted below.

The weighted average assumptions used to estimate the fair value of options granted during the period ended December 31, 2015 and 2014 are as follows:

	Three months ended December 31,	
	2015	2014
Risk free interest rate	0.42%	1.65%
Expected life	2.59	4.25
Vesting period	0.3 years	1.5 years
Expected volatility	56%	66%
Expected dividends	Nil	Nil
Average fair value	$0.13	$0.84
Forfeiture rate	10%	9.0%

The Company charged the following share based payments to operating expenses in connection with the Company's stock option plan, with a corresponding increase in the share based payment reserve:

	Three months ended December 31,	
	2015	2014
Total compensation – stock options	$ 43,453	$ 137,596

4. Share capital (Continued):

(c) Restricted Share Unit Plan:

RSUs outstanding as at December 31, 2015 are as follows:

	Number of RSUs	Weighted average exercise price
Balance as at September 30, 2015	319,598	$ 1.15
Granted	-	-
Forfeited	(19,398)	1.15
Balance as at December 31, 2015	300,200	$ 1.15

Using an estimated forfeiture rate of 10.0% for the three months ended December 31, 2015, the Company charged the following share based payments to operating expenses in connection with the Company's RSU plan, with a corresponding increase in the share based payment reserve:

	Three months ended December 31,	
	2015	2014
Total compensation - RSUs	$ 31,968	$ -

(d) Warrants:

Warrants outstanding as at December 31, 2015 are as follows:

	Number of warrants	Weighted average exercise price
Balance as at September 30, 2015 and December 31, 2015	1,327,500	$ 1.50

5. Related party transactions:

(a) The remuneration of key management personnel is as follows:

	Three months ended December 31,	
	2015	2014
Salaries and employee benefits	$ 276,653	$ 225,091
Share based payments	56,070	63,829
	$ 332,723	$ 288,920

(b) Management fees totaling $97,500 for the three months ended December 31, 2015 (December 31, 2014 – $64,060) charged by a company controlled by an officer and director of the Company, were included in salaries and benefits expense. As of December 31, 2015, amounts owing to this company included in accounts payable and accrued liabilities were $183,274 (September 30, 2015 - $338,752).

(c) Legal and professional fees, taxes and disbursements totaling $22,351 for the three months ended December 31, 2015 (December 31, 2014 - $27,197) were incurred with a law firm of which a director of the Company is a partner. As of December 31, 2015, amounts owing to this company

5. Related party transactions (Continued):

included in accounts payable and accrued liabilities were $116,127 (September 30, 2015 - $171,895).

The above transactions are in the normal course of business and are measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

6. Supplementary cash flow information:

(a) Change in non-cash operating working capital:

	Three months ended December 31,	
	2015	2014
Accounts receivable	$ (75,850)	$ (834,894)
Inventory	174,914	53,139
Prepaid expenses and other assets	(9,071)	51,272
Accounts payable and accrued liabilities	(412,653)	424,995
Deferred revenue	39,396	-
	$ (283,264)	$ (305,488)

(b) Interest and income taxes:

During the three months ended December 31, 2015, the Company paid $32,000 in interest (2015 - $33,384) and the Company did not pay any income taxes.

(c) Cash and cash equivalents:

Cash and cash equivalents are comprised of:

	December 31, 2015	September 30, 2015
Cash	$ 1,036,332	$ 1,521,928
Term deposit	600,000	1,500,000
	$ 1,636,332	$ 3,021,928

7. Segmented information:

Segmented information is prepared using the accounting policies described in note 17 of the Company's consolidated financial statements for the year ended September 30, 2015. The Company's business operates primarily through two business segments – Security Features and Surveillance. Security Features provides nano-optics and OTF for use in anti-counterfeiting and authentication processes and products including currency, legal documents, and commercial products. Surveillance designs and sells sophisticated surveillance and intelligence gathering equipment for the law enforcement and defense industries in the United States and Canada.

7. Segmented information (Continued):

During the three months ended December 31, 2015, the Company had three customers who represented greater than 10% each of total revenues. Those customers represented approximately 37% from our Surveillance segment and 17% and 10% from our Security Features segment respectively of total revenues (December 31, 2014 – two customers represented approximately 48% and 15% of total revenues and had sales from our Security Features segment).

December 31, 2015	Security Features	Surveillance	Total
Total current assets	$ 2,470,326	$ 802,461	$ 3,272,787
Property, plant and equipment	18,620,195	37,984	18,658,179
Intangible assets	2,382,167	3,090	2,385,257
Goodwill	1,388,458	-	1,388,458
Total current liabilities	1,241,820	117,546	1,359,366
Total liabilities	4,361,290	117,546	4,478,836

September 30, 2015	Security Features	Surveillance	Total
Total current assets	$ 3,889,907	$ 858,469	$ 4,748,376
Property, plant and equipment	18,881,278	40,118	18,921,396
Intangible assets	2,722,477	3,152	2,725,629
Goodwill	1,388,458	-	1,388,458
Total current liabilities	1,440,121	292,502	1,732,623
Total liabilities	4,566,484	292,502	4,858,986

Three months ended December 31, 2015	Security Features	Surveillance	Total
Revenue	$ 569,467	$ 939,773	$ 1,509,240
Cost of sales	146,762	614,058	760,820
Gross profit	422,705	325,715	748,420
Expenses	2,292,495	232,324	2,524,819
Other expenses (income)	(33,002)	2,938	(30,064)
Net income (loss)	$ (1,836,788)	$ 90,453	$ (1,746,335)

Three months ended December 31, 2014	Security Features	Surveillance	Total
Revenue	$ 1,041,937	$ 495,558	$ 1,537,495
Cost of sales	675,609	334,049	1,009,658
Gross profit	366,328	161,509	527,837
Expenses	1,864,394	190,229	2,054,623
Other expenses (income)	(610,455)	14,940	(595,515)
Net loss	$ (887,611)	$ (43,660)	$ (931,271)

8. Nature of expenses:

Cost of sales and expenses are comprised of the following:

	Three months ended December 31,	
	2015	2014
Cost of sales		
Direct cost of sales	757,482	958,731
Depreciation and amortization	3,338	50,927
	760,820	1,009,658
Research and development		
Direct expenses	581,812	593,917
Depreciation and amortization	758,459	528,593
Government grants	(23,615)	(39,000)
	1,316,656	1,083,510
General and administration		
Direct expenses	647,689	605,461
Depreciation and amortization	11,698	567
	659,387	606,028
Sales and marketing		
Direct expenses	548,776	365,085
	548,776	365,085
Supplementary information		
Salaries and benefits	1,251,180	1,228,979
Share based compensation	75,421	137,596

The Company reclassified certain items in the condensed consolidated interim statements of operations and comprehensive loss to conform to the current period's presentation. This reclassification had no impact on the net loss or total comprehensive loss.