Spectral Medical Inc.

Condensed Interim Consolidated Financial Statements

March 31, 2016
(Unaudited)

These unaudited condensed interim consolidated financial statements have been prepared by management of the Spectral Medical Inc. and have not been reviewed by the Company's auditor.

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Spectral Medical Inc.

Condensed Interim Consolidated Statements of Financial Position
(Unaudited)

(in thousands of Canadian dollars)

	Notes	March 31 2016 $	December 31 2015 $
Assets			
Current assets			
Cash		12,861	6,369
Trade and other receivables		886	630
Inventories		325	243
Prepayments and other assets		301	141
		14,373	7,383
Non-current assets			
Property and equipment		735	717
Intangible asset		353	359
		1,088	1,076
Total assets		15,461	8,459
Liabilities			
Current liabilities			
Trade and other payables		2,828	2,850
Deferred revenue		167	176
Total liabilities		2,995	3,026
Equity			
Share capital	9	62,918	53,058
Contributed surplus		7,849	7,849
Other equity reserves		3,890	3,723
Deficit		(62,191)	(59,197)
Total equity		12,466	5,433
Total liabilities and equity		15,461	8,459

Contingencies and commitments (Note 8)

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Spectral Medical Inc.

Condensed Interim Consolidated Statements of Loss and Comprehensive Loss
For the three months ended March 31, 2016 and 2015
(Unaudited)

(in thousands of Canadian dollars, except for share and per share data)

	Notes	2016 $	2015 $
Revenue		1,062	877
Expenses			
Changes in inventories of finished goods and work- in-process		25	24
Raw materials and consumables used		203	100
Employee benefits	9,12	1,241	1,004
Consulting and professional fees		2,055	1,572
Regulatory and investor relations		135	170
Travel and entertainment		209	203
Depreciation and amortization		42	43
Foreign exchange loss (gain)		15	(17)
Other expenses		144	124
		4,069	3,223
Operating loss		(3,007)	(2,346)
Finance income		13	24
Loss and comprehensive loss for the period		(2,994)	(2,322)
Basic and diluted loss per common share	10	(0.02)	(0.01)
Weighted average number of common shares outstanding	10	198,015,803	179,750,247

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Spectral Medical Inc.

Condensed Interim Consolidated Statements of Changes in Equity
For the three months ended March 31, 2016 and 2015
(Unaudited)

(in thousands of Canadian dollars)

	Notes	Issued capital Number	$	Contributed surplus $	Share-based compensation $	Warrants $	Deficit $	Total equity $
Balance, January 1, 2015		179,737,241	46,879	7,849	3,542	-	(49,450)	8,820
Shares repurchased under NCIB	9	(90,000)	(23)				(32)	(55)
Share options exercised	9	108,500	84	-	(41)	-	-	43
Loss and comprehensive loss for the period		-	-	-	-	-	(2,322)	(2,322)
Share-based compensation	9	-	-	-	162	-	-	162
Balance, March 31, 2015		179,755,741	46,940	7,849	3,663	-	(51,804)	6,648
Balance, January 1, 2016		190,771,405	53,058	7,849	3,723	-	(59,197)	5,433
Bought deal prospectus offering	13	15,106,804	9,402	-	-	-	-	9,402
Share options exercised	9	855,000	458	-	(192)	-	-	266
Loss and comprehensive loss for the period		-	-	-	-	-	(2,994)	(2,994)
Share-based compensation	9	-	-	-	359	-	-	359
Balance, March 31, 2016		206,733,209	62,918	7,849	3,890	-	(62,191)	12,466

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Spectral Medical Inc.

Condensed Interim Consolidated Statements of Cash Flows
For the three months ended March 31, 2016 and 2015
(Unaudited)

(in thousands of Canadian dollars)

	Notes	2016 $	2015 $
Cash flow provided by (used in)			
Operating activities			
Loss and comprehensive loss for the period		(2,994)	(2,322)
Adjustments for:			
Depreciation on property and equipment		35	37
Amortization of intangible asset		6	6
Share-based compensation	9	359	162
Changes in items of working capital :			
Trade and other receivables		(256)	(92)
Inventories		(82)	(52)
Prepayments and other assets		(160)	(49)
Trade and other payables		(22)	(482)
Deferred revenue		(9)	(64)
Net cash used in operating activities		(3,123)	(2,856)
Investing activities			
Property and equipment expenditures		(53)	(118)
Net cash used in investing activities		(53)	(118)
Financing activities			
Bought deal prospectus offering	13	9,402	-
Share options exercised	9	266	43
Shares repurchased under NCIB	9	-	(55)
Net cash provided by (used in) financing activities		9,668	(12)
Increase(decrease) in cash		6,492	(2,986)
Cash, beginning of period		6,369	10,054
Cash, end of period		12,861	7,068

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

(in thousands of Canadian dollars, except for share and per share data)

1. Nature of operations

Spectral Medical Inc. (Spectral or the Company) was incorporated on July 29, 1991 in Ontario, Canada as Spectral Diagnostics Inc. The address of the registered office is 135 The West Mall, Unit 2, Toronto, Ontario.

The Company is strategically focused on the development and commercialization of a treatment for septic shock utilizing its Endotoxin Activity Assay (EAA™) diagnostic and the Toraymyxin™ therapeutic. The Company also manufactures and sells certain proprietary reagents.

2. Basis of preparation

The condensed interim consolidated financial statements of Spectral for the three months ended March 31, 2016, have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS) as set out in the CPA Canada Handbook, applicable to the preparation of condensed interim consolidated financial statements, including IAS 34, "Interim Financial Reporting". The condensed interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2015, which have been prepared in accordance with IFRS. These condensed interim consolidated financial statements were approved by the Board of Directors for issue on May 11, 2016.

3. Significant accounting policies

The significant accounting polices used in the preparation of these condensed interim consolidated financial statements are consistent with those of the previous financial year.

4. Critical accounting estimates and judgments

The preparation of condensed interim consolidated financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying Spectral's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions are significant to the financials are the same as those that were applied to the financial statements for the year ended December 31, 2015.

5. Accounting standards adopted in the current period

The following amendment has been adopted by the Company for the financial year beginning on January 1, 2016:

Amendment to IAS 1, *Presentation of Financial Statements*: This standard was amended to clarify guidance on materiality and aggregation, the presentation of subtotals, the structure of

financial statements, and the disclosure of accounting policies. The amendment is required for years beginning on or after January 1, 2016. The adoption of the amendment to IAS 1 will not have any material impact on the Company's financial statements.

6. Accounting standards issued but not yet applied

There are no new IFRSs or IFRCs that are effective for the first time for this interim period that would be expected to materially affect the Company.

7. Risk management

i. Financial risk management

In the normal course of business, the Company is exposed to a number of financial risks that can affect its operating performance. These risks are: credit risk, liquidity risk and market risk. The Company's overall risk management program and prudent business practices seek to minimize any potential adverse effects on the Company's financial performance.

The condensed interim consolidated financial statements do not include all financial risk management information and disclosures required in the annual financial statements. They should be read in conjunction with the annual financial statements as at December 31, 2015. There have been no changes in the risk management or in any risk management policies since year end.

ii. Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with its financial liabilities as they become due. The Company is exposed to liquidity risk, as it continues to have net cash outflows to support its operations. The Company's objective for liquidity risk management is to maintain sufficient liquid financial resources to meet commitments and obligations in the most cost effective manner possible.

The Company achieves this by maintaining sufficient cash and managing working capital. The Company monitors its financial resources on a weekly basis and updates its expected use of cash resources on the latest available data. All of the Company's financial liabilities are classified as current liabilities. Trade and other payables were $2,828 as at March 31, 2016 with all of them having expected settlement dates within one year. There are uncertainties related to the timing and use of the Company's cash resources.

(in thousands of Canadian dollars, except for share and per share data)

8. Contingencies and commitments

i. The Company has committed to expenditures for its EUPHRATES trial as follows:

	2016 $	2017 $
Program management	2,663	810
Program oversight	234	36
Clinical site costs	724	32
Diagnostic supply and training	68	-
Employee benefits	416	264
Consultants	91	-
	4,196	**1,142**

Future commitments for the trial are based on enrolment of 446 evaluable patients in accordance with the approved clinical protocol at up to 60 clinical sites in the U.S. and Canada. The Company is only committed to the costs to the extent that evaluable patients are enrolled.

ii. Directors and officers are indemnified by the Company for various items including, but not limited to, costs to settle lawsuits or actions due to their association with the Company, subject to certain restrictions. The Company has purchased directors' and officers' liability insurance to mitigate the costs of any potential future lawsuits or actions. The term of the indemnification covers the period during which the indemnified party served as a director or officer of the Company.

In the normal course of business, the Company has entered into agreements that include indemnities in favour of third parties, such as purchase and sale agreements, confidentiality agreements, engagement letters with advisors and consultants, leasing contracts and license agreements. These indemnification arrangements may sometimes require such third parties to compensate counterparties for losses as a result of breaches in representations, covenants and warranties provided by the Company or as a result of litigation or other third party claims or statutory sanctions that may be suffered by the counterparties as a consequence of the relevant transaction. In some instances, the terms of these indemnities are not explicitly defined. No accruals have been required to be made as at March 31, 2016 with respect to these agreements.

9. Share capital and other equity reserves

i. The Company is authorized to issue an unlimited number of common shares ("Shares").

ii. On December 15, 2014 the Company announced that the Toronto Stock Exchange (the "TSX") approved its notice of intention to make a normal course issuer bid ("NCIB") for its outstanding Shares. Pursuant to the notice, the Company was able to purchase up to 3,594,745 of its Shares, representing approximately 2% of its issued and outstanding Shares,

(in thousands of Canadian dollars, except for share and per share data)

during the twelve month period commencing December 17, 2014 and ending December 16, 2015.

During the three month period ended March 31, 2015, the Company repurchased 90,000 Shares under this NCIB for $55. All Shares purchased were cancelled.

iii. Details of share options are as follows:

Under the Company's 2008 Amended Stock Option Plan, the total number of Shares that may be optioned to any director, officer, employee or consultant shall not exceed 5% of the total issued and outstanding shares at the date of the grant of the option. The aggregate number of shares issuable under the Plan shall not exceed 10% of the total number of Shares issued and outstanding.

During the year, the Company granted the following share options to directors, officers, employees and consultants at the discretion of the Board of Directors.

	2016			2015	
Date	Number of share options	Exercise price	Date	Number of share options	Exercise price
February 1, 2016	1,420,000	$0.73	January 22, 2015	1,250,000	$0.38
March 29, 2016	180,000	$0.76	March 24, 2015	100,000	$0.67

The exercise prices of the share options are equal to the closing market price of the Company's Shares on the TSX on the immediately preceding day of the grant of the option. Share options issued to the Company's directors vest 100% at the time of the grant. Share options issued to the Company's officers, employees, and consultants, generally vest at 25% of the grant amount at the time of the grant. The balance of these share options vest equally in each successive quarter and will be fully vested by the end of the third year following the grant date. Share options issued on February 1, 2016 will be fully vested by February 1, 2019. The share options issued March 29, 2016 were fully vested on the grant date. The contractual life of each share option is five years, except for the share options granted on March 29, 2016, which is two years. There is no cash settlement of the share options.

The volatility measured at the standard deviation of continuously compounded share returns is based on statistical analysis of weekly share prices over the last five and two years respectively.

Share options granted were valued using the Black-Scholes option pricing model, with the following assumptions:

(in thousands of Canadian dollars, except for share and per share data)

						2015
Grant date	**Risk-free interest rate**	**Expected life**	**Annualized volatility**	**Dividend rate**	**Grant date share price**	**Share option fair value**
January 22, 2015	0.84%	5 years	65.89%	0%	$0.365	$0.198
March 24, 2015	0.72%	5 years	75.12%	0%	$0.780	$0.496

						2016
Grant date	**Risk-free interest rate**	**Expected life**	**Annualized volatility**	**Dividend rate**	**Grant date share price**	**Share option fair value**
February 1, 2016	0.67%	5 years	74.04%	0%	$0.720	$0.429
March 29, 2016	0.51%	2 years	64.39%	0%	$0.760	$0.269

		2016			2015	
	Weighted average exercise price per share $	**Share options**		**Weighted average exercise price per share $**	**Share options**	
		All optionees	**Key management**		**All optionees**	**Key management**
January 1	0.37	5,086,500	4,143,500	0.37	5,566,000	4,513,500
Granted	0.73	1,600,000	950,000	0.40	1,350,000	950,000
Forfeited/cancelled	-	-	-	-	-	-
Exercised	0.31	(855,000)	(730,000)	0.40	(108,500)	(50,000)
Expired	0.32	(200,000)	(200,000)	0.42	(1,325,000)	(1,250,000)
Balance, March 31	**0.48**	**5,631,500**	**4,163,500**	**0.36**	**5,482,500**	**4,163,500**

Of the 5,631,500 outstanding share options (2015: 5,482,500), 3,986,173 share options (2015: 3,904,474) were exercisable.

(in thousands of Canadian dollars, except for share and per share data)

10. Loss per common share

The following table sets forth the computing of basic and diluted loss per share:

	2016 $	2015 $
Numerator for basic and diluted loss per common share available to common shareholders	(2,994)	(2,322)
Denominator for basic and diluted loss per common share	198,015,803	179,750,247
Basic and diluted loss per common share	(0.02)	(0.01)

For the periods noted above, the computation of diluted loss per common share is equal to the basic loss per common share due to the anti-dilutive effect of the outstanding share options and warrants.

Weighted average common shares outstanding

	2016		2015	
	Weighted average common shares-basic and diluted	**Number of Common Shares**	**Weighted average common shares-basic and diluted**	**Number of Common Shares**
Balance, January 1	190,771,405	190,771,405	179,737,241	179,737,241
Bought deal prospectus offering	15,106,804	6,919,175	-	-
Shares repurchased under NCIB	-	-	(90,000)	(20,111)
Share options exercised	855,000	325,223	108,500	33,117
Balance, March 31	**206,733,209**	**198,015,803**	**179,755,741**	**179,750,247**

(in thousands of Canadian dollars, except for share and per share data)

11. The EUPHRATES trial

The Company's current clinical development program is focused on obtaining U.S. FDA approval for Toraymyxin™, a therapeutic device for the treatment of septic shock that removes endotoxin from the bloodstream.

The Company has incurred the following costs associated with this clinical trial:

	2016 $	2015 $
Program management	1,017	823
Program oversight	48	43
Clinical site costs	916	624
Diagnostic supply and training	174	78
Employee benefits	111	114
Consultants	29	13
Total EUPHRATES	**2,295**	**1,695**

The trial costs have been included within operating loss in the statement of loss and comprehensive loss as required. Total trial costs since inception in 2010 are $35,154.

12. Employee benefits

Key management includes the Company's directors and officers. Compensation awarded to key management included:

	2016 $		2015 $	
	All employees	Key management	All employees	Key management
Salaries	632	315	603	324
Bonuses	90	90	90	90
Short term employee benefits	76	31	80	32
Directors' fees	79	79	63	63
Share-based compensation	359	223	162	117
Other	5	-	6	1
	1,241	**738**	**1,004**	**627**

Executive employment agreements allow for additional payments of approximately $1,752 if the individuals are terminated without cause and approximately $2,215 in the event of a change in control.

(in thousands of Canadian dollars, except for share and per share data)

13. Financings

i. Private placements

On June 10, 2014, the Company entered into agreements for a non-brokered private placement of up to $18,200 (the "Offering"), comprised of a Tranche "A" component and a Tranche "B" component.

The Tranche "A" component of the private placement, in the amount of $13,200, was completed on July 25, 2014. The Company received net proceeds of $12,816 which is being used to fund its EUPHRATES trial and for working capital and general corporate purposes.

The Tranche "B" component of the private placement was completed on April 1, 2015. Toray purchased 9,041,592 Shares at a subscription price of $0.553 per common share (representing the 20 day volume weighted average trading price of the Shares on the TSX for the 20 day period ended March 13, 2015) for aggregate gross proceeds of $5,000.

In connection with the Toray offering, Birch Hill exercised their anti-dilution rights and acquired 2,007,872 Shares at the subscription price of $0.553 per common share, for aggregate gross proceeds of $1,110.

In total, the Company issued 11,049,464 Shares for aggregate gross proceeds of $6,110. The Company received net proceeds of $6,021 which is being used to fund its EUPHRATES trial and for working capital and general corporate purposes.

ii. Bought deal prospectus offering

On February 18, 2016, the Company closed a bought deal prospectus offering ("the Offering") resulting in the issuance of 14,300,000 Shares for gross proceeds of $10,010.

On February 24, 2016, an additional 806,804 Shares were issued by the Company resulting in gross proceeds of $565 in connection with the underwriters' exercise of their over-allotment option.

In total, the Company issued 15,106,804 Shares for aggregate gross proceeds of $10,575. The Company received net proceeds of $9,402 which will be used to fund its EUPHRATES trial and for working capital and general corporate purposes.

The Company also issued 906,408 broker warrants to the underwriters representing 6% of the total number of shares sold pursuant to the bought deal financing. Each broker warrant entitles the holder thereof to acquire one Share at a price of $0.70 per Share for a period of 24 months from the closing date.

(in thousands of Canadian dollars, except for share and per share data)

14. Related party transactions

i. Toray Industries, Inc. ("Toray")

Toray holds 45,630,105 Shares of the Company as at March 31, 2016, representing approximately 22.1% (2015 – 22.4%) of Spectral's issued and outstanding capital, calculated on a non-diluted basis.

Toray is entitled to nominate one director (the "Toray Representative") to the Board of Directors as long as it owns in the aggregate not less than 10% of the Shares issued and outstanding calculated on a non-diluted basis.

The principal transactions with Toray which were carried out in the ordinary course of business are:

	2016 $	2015 $
Revenue		
Toray Medical Co., Ltd.	18	62
Toray International Italy S.r.l.	-	64
Purchases		
Toray Industries, Inc.	101	-
Toray International America Inc.	-	56
Reimbursement of expenses		
Toray Industries, Inc.	-	101
Due from (to)		
Toray Medical Co., Ltd.	18	
Toray Industries, Inc.	(95)	101
Toray International America Inc.	-	(58)

ii. Birch Hill Equity Partners Management Inc. ("Birch Hill")

Birch Hill, through a number of its funds and an investee company, holds 33,517,718 Shares of the Company as at March 31, 2016 representing approximately a 16.2% (2015 – 17.3%) ownership interest, calculated on a non-diluted basis.

Birch Hill is entitled to nominate one director to the Company's Board of Directors so long as it owns in aggregate not less than 5% of the issued and outstanding Shares of the Company calculated on a non-diluted basis.

iii. Key management consists of the Company's four executive officers and its' Board of Directors. Compensation of key management is disclosed in Note 12.

There are no other related party transactions.