

Quarterly Report

March 31, 2016

NANO TECH
SECURITY CORP.

Nanotech Security Corp.

Management's Discussion and Analysis
For the three and six months ended March 31, 2016

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 March 31, 2016.

ADVISORY

This management's discussion and analysis ("MD&A"), dated as of May 11, 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 and six months ended March 31, 2016, 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 located 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 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. They also customize and retrofit surveillance vans for various government authorities.

RESULTS OF OPERATIONS

The following table provides selected financial information for the three and six months ended March 31, 2016, and 2015:

Selected financial information

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Revenue	$ 948,220	$ 1,527,857	$ 2,457,460	$ 3,065,352
Cost of sales	455,218	809,424	1,216,038	1,819,082
	493,002	718,433	1,241,422	1,246,270
Expenses				
Research and development	1,426,563	1,192,623	2,743,219	2,276,133
General and administration	690,100	531,989	1,349,487	1,138,017
Sales and marketing	653,105	538,615	1,201,881	903,700
	2,769,768	2,263,227	5,294,587	4,317,850
Loss before other expenses	(2,276,766)	(1,544,794)	(4,053,165)	(3,071,580)
Other expenses (income)	173,244	(650,272)	143,180	(1,245,787)
Net loss	$ (2,450,010)	$ (894,522)	$ (4,196,345)	$ (1,825,793)

Revenue
Revenues for the three months ended March 31, 2016 decreased by $579,637 to $948,220 compared to $1,527,857 in the same period last year. This included the Security Features division delivering revenue of $644,949 compared to $868,029 during the same period last year, primarily from development contracts. The development contracts continue to progress well and are advancing both our KolourOptik and colour-shifting OTF technologies to be integrated into future banknotes.

OTF production continued to be negatively impacted as a large Asian issuing authority requested Nanotech sub-contract volume production through a partner relationship. On November 17, 2015 the Company announced the signing of a Memorandum of Understanding which contemplates an operational agreement with Hueck Folien to collaborate in the production of volume colour-shifting OTF. This integration has continued to consume internal resources in bringing the new manufacturing facility online. In May, subsequent to the quarter end, the Company completed the supplier acceptance process with the larger Asian issuing authority and commenced production and delivery of colour-shifting OTF through its licensed production partner Hueck Folien. Production is expected to ramp up volume through the summer and be positioned to supply this customer with significant colour-shifting OTF on a long term basis.

The Surveillance division achieved revenues of $303,271 for the three months ended March 31, 2016 compared to $659,828 during the same period last year. This decrease reflected the delay in the shipment of four surveillance vans valued at approximately $220,000 that were unable to be delivered prior to the quarter end, but were shipped in April 2016.

Revenues for the six months ended March 31, 2016 decreased by $607,892 to $2,457,460 compared to $3,065,352 in the same period last year. This included the Security Features division delivering revenue of $1,214,416 compared to $1,909,966 during the same period last year, primarily from development contracts. The OTF production continued to be negatively impacted as the team focused on bringing the new production facility online.

The Surveillance division achieved revenues of $1,243,044 for the six months ended March 31, 2016 compared to $1,155,386 during the same period last year. This modest increase reflected growth in the number of surveillance vans delivered during the period.

Gross margin
Gross margin for the three months ended March 31, 2016 decreased by $225,431 to $493,002 compared to $718,433 in the same period last year. Overall, the gross margin percentage reached 52% for the three months ended March 31, 2016, an improvement from the 47% in the same period last year. This increase is reflected in higher margins on the Security Features division's development contracts and Surveillance division sales.

Gross margin for the six months ended March 31, 2016 was $1,241,422, consistent with $1,246,270 in the same period last year. Overall, the gross margin percentage reached 51% for the six months ended March 31, 2016, an improvement from the 41% in the same period last year. This increase is again reflected in higher margins on the Security Features division's development contracts and Surveillance division sales.

Research & development
Research and development expenditures for the three months ended March 31, 2016 increased by $233,940 to $1,426,563 compared to $1,192,623 in the same period last year. This is primarily a result of an increase in depreciation of $253,312 reflecting a 2015 revision of the Company's depreciation policy. Research and development activity for the three months ended March 31, 2016 continued to focus on bringing the new Hueck Folien production facility online and new security features targeted for the banknote market.

Research and development expenditures for the six months ended March 31, 2016 increased by $467,086 to $2,743,219 compared to $2,276,133 in the same period last year. This is primarily a result of an increase in depreciation and amortization of $483,178 reflecting a 2015 revision of the Company's depreciation policy. Research and development activity for the six months ended March 31, 2016 also continued to focus on bringing the new Hueck Folien production facility online and new security features targeted for the banknote market.

General and administration
General and administration expenditures for the three months ended March 31, 2016 were $690,100, an increase of $158,111 compared to $531,989 in the same period last year which reflected higher office rent, overheads and an increase in stock based compensation.

General and administration expenditures for the six months ended March 31, 2016 were $1,349,487, an increase of $211,470 compared to $1,138,017 in the same period last year which again reflected higher office rent, overheads and an increase in stock based compensation.

Sales and marketing
Sales and marketing expenditures for the three months ended March 31, 2016 were $653,105, an increase of $114,490 compared to $538,615 in the same period last year due to increased sales and marketing activity related to the Security Features division, which includes increased salaries and international travel.

Sales and marketing expenditures for the six months ended March 31, 2016 were $1,201,881, an increase of $298,181 compared to $903,700 in the same period last year due to increased sales and marketing activity related to the Security Features division, which includes increased salaries and international travel.

Net loss
The net loss for the three months ended March 31, 2016 was $2,450,010 compared to $894,522 during the same period last year. The increase in net loss is reflected in lower sales, an increase in sales and marketing activities, and an increase in non-cash amortization and foreign exchange. The prior year figures also include a $560,000 gain on the revaluation of contingent shares.

The net loss for the six months ended March 31, 2016 was $4,196,345 compared to $1,825,793 during the same period last year. The increase in net loss is reflected in an increase in sales and marketing activities, and an increase in non-cash amortization and foreign exchange. The prior year figures also include a $1,160,000 gain on the revaluation of contingent shares.

SEGMENT RESULTS

The Company analyzes financial performance by segments, which group 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 March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Revenue	$ 644,949	$ 868,029	$ 1,214,416	$ 1,909,966
Net loss	(2,279,893)	(1,016,007)	(4,116,681)	(1,903,618)

Revenues from Security Features for the three months ended March 31, 2016 decreased to $644,949 from $868,029 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 online.

The loss from Security Features for the three months ended March 31, 2016 increased by $1,263,886 to $2,279,893 from $1,016,007 for the same period last year. The increase in net loss reflects lower sales, an increase in sales and marketing activities, and an increase in non-cash amortization and foreign exchange. The prior year figures also include a $560,000 gain on the revaluation of contingent shares.

Revenues from Security Features for the six months ended March 31, 2016 decreased to $1,214,416 from $1,909,966 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 online.

The loss from Security Features for the six months ended March 31, 2016 increased by $2,213,063 to $4,116,681 from $1,903,618 for the same period last year. The increase in net loss reflects, an increase in sales and marketing activities, and an increase in non-cash amortization and foreign exchange. The prior year figures also include a $1,160,000 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.

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Revenue	$ 303,271	$ 659,828	$ 1,243,044	$ 1,155,386
Net income (loss)	(170,117)	121,485	(79,664)	77,825

Revenues from Surveillance for the three months ended March 31, 2016 decreased to $303,271 from $659,828 in the same period last year. This decrease reflected the delay in the shipment of four surveillance vans valued at approximately $220,000 that were unable to be delivered prior to the quarter end, and were shipped in April 2016.

Net loss from Surveillance for the three months ended March 31, 2016 increased to $170,117 from net income of $121,485 in the same period last year. The net loss was as a result of lower sales during the quarter.

Revenues from Surveillance for the six months ended March 31, 2016 increased to $1,243,044 from $1,155,386 in the same period last year. This modest increase reflected growth in the number of surveillance vans delivered during the period.

Net loss from Surveillance for the six months ended March 31, 2016 increased to $79,664 from net income of $77,825 in the same period last year. The net loss was as a result of lower sales during the second quarter.

QUARTERLY RESULTS

	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014
($ thousands, except common share amounts)								
Revenue	$948	$1,509	$728	$1,359	$1,528	$1,537	$498	$600
Net income (loss)	(2,450)	(1,746)	(1,565)	(1,280)	(895)	(931)	2,284	(1,115)
Net income (loss) per common share:								
Basic	(0.05)	(0.03)	(0.03)	(0.03)	(0.02)	(0.02)	0.06	(0.03)
Diluted	(0.05)	(0.03)	(0.03)	(0.03)	(0.02)	(0.02)	0.05	(0.03)

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 and six months ended March 31, 2016, 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 March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Salaries, accrued bonuses, and employee benefits	$ 261,840	$ 222,665	$ 562,544	$ 447,756
Share based payments	185,243	97,086	241,369	160,915
	$ 447,083	$ 319,751	$ 803,913	$ 608,671

(b) Management fees and accrued bonuses totaling $103,500 for the three months ended March 31, 2016 (March 31, 2015 - $87,810) and $225,000 for the six months ended March 31, 2016 (March

31, 2015 - $151,870) by a company controlled by an officer and director of the Company, were included in salaries and employee benefits expense. As of March 31, 2016, amounts owing to this company included in accounts payable and accrued liabilities were $259,528 (September 30, 2015 - $338,752).

(c) Legal and professional fees, taxes and disbursements totaling $44,934 for the three months ended March 31, 2016 (March 31, 2015 - $61,685) and $67,285 for the six months ended March 31, 2016 (March 31, 2015 - $88,882) were incurred with a law firm of which a director of the Company is a partner. As of March 31, 2016, amounts owing to this company included in accounts payable and accrued liabilities were $161,061 (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 and 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 March 31, 2016, cash and cash equivalents totaled $1,141,740, compared to $3,021,928 as at September 30, 2015.

Summary of Statement of Cash Flow

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Cash used in operating activities[1]	$ (1,436,779)	$ (617,979)	$ (2,341,091)	$ (1,431,567)
Changes in operating assets and liabilities	738,939	(531,468)	455,675	(836,956)
Cash used in operating activities	(697,840)	(1,149,447)	(1,885,416)	(2,268,523)
Cash used in investing activities	(40,435)	(52,392)	(208,869)	(258,684)
Cash provided by financing activities	180,000	661,725	180,000	735,975
Effect of foreign currency translation on cash and cash equivalents	63,683	(61,281)	34,097	(89,390)
Cash and cash equivalents, beginning of period	1,636,332	2,685,418	3,021,928	3,964,645
Cash and cash equivalents, end of period	$ 1,141,740	$ 2,084,023	$ 1,141,740	$2,084,023

[1] Before changes in operating assets and liabilities

Operating Activities

Cash used in operating activities was $697,840 for the three months ended March 31, 2016, an improvement from the $1,149,447 for the same period last year. This improvement was as a result of an increase in cash collected from working capital partially offset by increased foreign exchange and losses in the Surveillance division.

Cash used in operating activities was at $1,885,416 for the six months ended March 31, 2016, compared to $2,268,523 for the same period last year. This improvement was as a result of an increase in cash collected from working capital partially offset by increased foreign exchange and losses in the Surveillance division.

Investing Activities
Cash used in investing activities was $40,435 for the three months ended March 31, 2016, consistent with the $52,392 for the same period last year.

Cash used in investing activities was $208,869 for the six months ended March 31, 2016, consistent with the $258,684 for the same period last year.

Financing Activities
Cash provided by financing activities was $180,000 for the three months ended March 31, 2016, compared to $661,725 during the same period last year. The current year reflects proceeds from the exercise of stock options and the prior period represents the proceeds from the exercise of warrants.

Cash provided by financing activities was $180,000 for the six months ended March 31, 2016, compared to $735,975 during the same period last year. The current year reflects proceeds from the exercise of stock options and the prior period represents proceeds from the exercise of warrants.

Capital Resources
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 $27,485,585 as of March 31, 2016 (September 30, 2015 - $23,289,240). 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 six months ended March 31, 2016, 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 Sheet in the shareholders' equity section and the secured note payable. As at March 31, 2016 shareholders' equity was $19,262,745 compared to $22,924,873 as at September 30, 2015.

As at March 31, 2016 cash and cash equivalents amounted to $1,141,740, compared to $3,021,928 as at September 30, 2015.

As at March 31, 2016, the Company had working capital of $679,890, as compared to $3,015,753 at September 30, 2015.

The Company has a note payable outstanding of $3,000,000 as at March 31, 2016 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 Fortress Optical Features Ltd. The note payable is secured by the assets of the Company.

The Company had 53,612,215 common shares issued and outstanding at March 31, 2016 and 53,387,215 at September 30, 2015.

The Company had 2,153,500 stock options outstanding at March 31, 2016 with a weighted average exercise price of $1.33 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 March 31, 2016 and September 30, 2015 with a weighted average exercise price of $1.50.

The Company had no commitments for material capital expenditures as of March 31, 2016.

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

Subsequent to the quarter end, the Company announced its intention to privately place approximately $2.5 million of unsecured senior debentures convertible into common shares at a price of $1.25 ("the Debentures"). The Debentures bear interest at 12% and come due May 31, 2018. The Debentures are subject to automatic conversion into common shares of the Company in the event that the common shares of the Company trade on the TSXV at or above $2.00 for ten consecutive days any time after the first four months from issuance. 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 March 31, 2017.

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 and six months ended March 31, 2016, 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

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 May 11, 2016 is as follows:

Issued common shares	53,612,215
Warrants	1,327,500
Stock options	2,153,500
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 and six months ended March 31, 2016 and 2015
(Unaudited)

Nanotech Security Corp.
March 31, 2016 and 2015

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Nanotech Security Corp.

Condensed Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

Three and six months ended March 31, 2016 and 2015
(In Canadian dollars)

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Revenue	$ 948,220	$ 1,527,857	$ 2,457,460	$ 3,065,352
Cost of sales (note 8)	455,218	809,424	1,216,038	1,819,082
Gross profit	493,002	718,433	1,241,422	1,246,270
Expenses (note 8)				
Research and development	1,426,563	1,192,623	2,743,219	2,276,133
General and administration	690,100	531,989	1,349,487	1,138,017
Sales and marketing	653,105	538,615	1,201,881	903,700
	2,769,768	2,263,227	5,294,587	4,317,850
Loss before other expenses	(2,276,766)	(1,544,794)	(4,053,165)	(3,071,580)
Other expenses (income)				
Foreign exchange (gain) loss	142,699	(125,061)	76,216	(151,871)
Finance expense	30,545	34,789	66,964	66,084
Gain on revaluation of contingent shares	-	(560,000)	-	(1,160,000)
	173,244	(650,272)	143,180	(1,245,787)
Net loss	(2,450,010)	(894,522)	(4,196,345)	(1,825,793)
Other comprehensive income (loss):				
Items that may be subsequently reclassified to earnings:				
Unrealized foreign exchange gain (loss) on translation of foreign operation	61,361	(60,375)	33,247	(83,763)
Total comprehensive loss for the period	$ (2,388,649)	$ (954,897)	$ (4,163,098)	$ (1,909,556)
Loss per share				
Basic and diluted	$ (0.05)	$ (0.02)	$ (0.08)	$ (0.04)
Weighted average number of common shares				
Basic and diluted	53,399,510	48,751,267	53,411,940	48,539,720

See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Financial Position
(Unaudited)

(In Canadian dollars)

	March 31, 2016	September 30, 2015
Assets		
Current assets:		
Cash and cash equivalents (note 6(c))	1,141,740	$ 3,021,928
Accounts receivable	405,025	879,266
Inventory	587,168	770,342
Prepaid expenses and other assets	88,495	76,840
	2,222,428	4,748,376
Property, plant and equipment	18,262,385	18,921,396
Intangible assets	2,044,590	2,725,629
Goodwill	1,388,458	1,388,458
	$ 23,917,861	$ 27,783,859
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	1,542,538	$ 1,732,623
	1,542,538	1,732,623
Long term liabilities:		
Note payable	3,000,000	3,000,000
Tenant inducement	112,578	126,363
	4,655,116	4,858,986
Shareholders’ equity		
Share capital (note 4)	44,930,433	44,666,497
Share based payment reserve	1,963,814	1,726,780
Deficit	(27,485,585)	(23,289,240)
Accumulated other comprehensive loss	(145,917)	(179,164)
	19,262,745	22,924,873
	$ 23,917,861	$ 27,783,859

Nature of operations and going concern (note 1(b))
Related party transactions (note 5)
Subsequent event (note 9)
See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Changes in Equity
(Unaudited)

Six months ended March 31, 2016 and 2015
(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	-	-	-	(1,825,793)	-	(1,825,793)
Unrealized foreign exchange loss on translation	-	-	-	-	(83,763)	(83,763)
Share based payments	-	-	392,668	-	-	392,668
Warrants exercised	817,750	735,975	-	-	-	735,975
Balance as at March 31, 2015	49,125,684	$ 40,293,041	$ 1,536,238	$ (20,444,200)	$ (138,312)	$ 21,246,767
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	-	-	-	(4,196,345)	-	(4,196,345)
Unrealized foreign exchange loss on translation	-	-	-	-	33,247	33,247
Share based payments (note 4)	-	-	320,970	-	-	320,970
Options exercised (note 4a)	225,000	263,936	(83,936)	-	-	180,000
Balance as at March 31, 2016	53,612,215	$ 44,930,433	$ 1,963,814	$ (27,485,585)	$ (145,917)	$ 19,262,745

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See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

Three and six months ended March 31, 2016 and 2015
(In Canadian dollars)

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Operating activities:				
Net loss	$ (2,450,010)	$ (894,522)	$ (4,196,345)	$ (1,825,793)
Items not involving cash:				
Depreciation and amortization	774,574	581,471	1,548,069	1,161,558
Share based compensation	245,549	255,072	320,970	392,668
Amortization of tenant inducement	(6,892)	-	(13,785)	-
Gain on revaluation of contingent shares	-	(560,000)	-	(1,160,000)
Non-cash working capital changes (note 6(a))	738,939	(531,468)	455,675	(836,956)
Cash used in operating activities	(697,840)	(1,149,447)	(1,885,416)	(2,268,523)
Purchase of property and equipment	(40,435)	(52,392)	(208,869)	(258,684)
Cash used in investing activities	(40,435)	(52,392)	(208,869)	(258,684)
Financing activities:				
Issuance of shares for options exercised	180,000	-	180,000	-
Issuance of shares for warrants exercised	-	661,725	-	735,975
Cash provided by financing activities	180,000	661,725	180,000	735,975
Effect of foreign exchange on cash and cash equivalents	63,683	(61,281)	34,097	(89,390)
Decrease in cash and cash equivalents	(494,592)	(601,395)	(1,880,188)	(1,880,622)
Cash and cash equivalents, beginning of period	1,636,332	2,685,418	3,021,928	3,964,645
Cash and cash equivalents, end of period	$ 1,141,740	$ 2,084,023	$ 1,141,740	$ 2,084,023

See accompanying notes to condensed consolidated interim financial statements.

1. Summary of business and nature of operations and going concern:

(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 $27,485,585 as of March 31, 2016 (September 30, 2015 - $23,289,240). 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 as filed with Canadian securities regulatory authorities.

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 May 26, 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	53,387,215	$	44,666,497
Options Exercised	225,000		263,936
Balance as at March 31, 2016	53,612,215	$	44,930,433

(b) Share option plan:

Stock options outstanding as at March 31, 2016 are as follows:

	Number of options	Weighted average exercise price
Balance, September 30, 2015	1,982,000	$ 1.30
Granted	446,500	1.23
Exercised	(225,000)	0.80
Forfeited	(50,000)	1.70
Balance, March 31, 2016	2,153,500	$ 1.33

4. Share capital (Continued):

(b) Share option plan (Continued):

The following table summarizes information pertaining to the Company's stock options outstanding at March 31, 2016:

	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	257,000	0.50	$0.80	257,000	$0.80
$0.81 - $1.75	1,896,500	3.58	1.40	1,433,500	1.47
	2,153,500	3.21	$1.33	1,690,500	$1.39

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 the fair value 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 periods ended March 31, 2016 and 2015 are as follows:

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Risk free interest rate	0.66%	0.70%	0.65%	0.70%
Expected life	4.4	4.4	4.1	4.4
Vesting period	1.6 years	1.5 years	1.5 years	1.5 years
Expected volatility	52%	54%	53%	54%
Expected dividends	Nil	Nil	Nil	Nil
Average fair value	$0.54	$0.49	$0.52	$0.49
Forfeiture rate	10.2%	8.4%	10.2%	8.4%

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

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Total compensation – stock options	$ 125,206	$ 196,240	$ 168,659	$ 333,836

4. Share capital (Continued):

(c) Restricted Share Unit Plan:

RSUs outstanding as at March 31, 2016 are as follows:

	Number of RSUs	Weighted average exercise price
Balance as at September 30, 2015	319,598	$ 1.15
Granted	387,900	1.26
Forfeited	(19,398)	1.15
Balance as at March 31, 2016	688,100	$ 1.21

Using an estimated forfeiture rate of 10.0% for the six months ended March 31, 2016 and 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 March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Total compensation – RSUs	$ 120,343	$ 58,832	$ 152,311	$ 58,832

(d) Warrants:

Warrants outstanding as at March 31, 2016 are as follows:

	Number of warrants	Weighted average exercise price
Balance as at September 30, 2015 and March 31, 2016	1,327,500	$ 1.50

5. Related party transactions:

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

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Salaries, accrued bonuses, and employee benefits	$ 261,840	$ 222,665	$ 562,544	$ 447,756
Share based payments	185,243	97,086	241,369	160,915
	$ 447,083	$ 319,751	$ 803,913	$ 608,671

(b) Management fees and accrued bonuses totaling $103,500 for the three months ended March 31, 2016 (March 31, 2015 - $87,810) by a company controlled by an officer and director of the Company, were included in salaries and benefits expense. Management fees totaling $225,000 for the six months ended March 31, 2016 (March 31, 2015 - $151,870) by a company controlled by an officer and director of the Company, were included in salaries and employee benefits expense. As of March 31, 2016, amounts owing to this company included in accounts payable and accrued liabilities were $259,528 (September 30, 2015 - $338,752).

5. Related party transactions (Continued):

(c) Legal and professional fees, taxes and disbursements totaling $44,934 for the three months ended March 31, 2016 (March 31, 2015 - $61,685) and $67,285 for the six months ended March 31, 2016 (March 31, 2015 - $88,882) were incurred with a law firm of which a director of the Company is a partner. As of March 31, 2016, amounts owing to this company included in accounts payable and accrued liabilities were $161,061 (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 March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Accounts receivable	$ 550,090	$ 841	$ 474,241	$ (834,053)
Inventory	8,260	(178,615)	183,174	(125,476)
Prepaid expenses and other assets	(2,583)	(89,708)	(11,655)	(38,436)
Accounts payable and accrued liabilities	222,568	(238,986)	(190,085)	186,009
Deferred revenue	(39,396)	(25,000)	-	(25,000)
	$ 738,939	$ (531,468)	$ 455,675	$ (836,956)

(b) Interest and income taxes:

During the six months ended March 31, 2016, the Company paid $62,658 in interest (2015 - $65,000) and the Company did not pay any income taxes.

(c) Cash and cash equivalents:

Cash and cash equivalents are comprised of:

	March 31, 2016	September 30, 2015
Cash	$ 492,390	$ 1,521,928
Term deposit	649,350	1,500,000
	$ 1,141,740	$ 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 March 31, 2016, the Company had two customers who represented greater than 10% each of total revenues. Those customers represented approximately 46% from our Security Features segment and 12% from our Surveillance segment respectively of total revenues (March 31, 2015 - three customers represented approximately 16% and 29% from our Security Features segment and 18% from our Surveillance segment respectively).

During the six months ended March 31, 2016, the Company had two customers who represented greater than 10% each of total revenues. Those customers represented approximately 35% from our Security Features segment and 23% from our Surveillance segment respectively of total revenues (March 31, 2015 - three customers represented approximately 14%, 15% and 24% of total revenues from our Security Features segment).

March 31, 2016	Security Features	Surveillance	Total
Total current assets	$ 1,597,123	$ 625,305	$ 2,222,428
Property, plant and equipment	18,226,333	36,052	18,262,385
Intangible assets	2,041,858	2,732	2,044,590
Goodwill	1,388,458	-	1,388,458
Total current liabilities	1,401,916	140,622	1,542,538
Total liabilities	4,514,494	140,622	4,655,116

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 March 31, 2016	Security Features	Surveillance	Total
Revenue	$ 644,949	$ 303,271	$ 948,220
Cost of sales	264,471	190,747	455,218
Gross profit	380,478	112,524	493,002
Expenses	2,488,046	281,722	2,769,768
Other expenses (income)	172,325	919	173,244
Net income (loss)	$ (2,279,893)	$ (170,117)	$ (2,450,010)

Three months ended March 31, 2015	Security Features	Surveillance	Total
Revenue	$ 868,029	$ 659,828	$ 1,527,857
Cost of sales	352,714	456,710	809,424
Gross profit	515,315	203,118	718,433
Expenses	2,040,082	223,145	2,263,227
Other expenses (income)	(508,760)	(141,512)	(650,272)
Net income (loss)	$ (1,016,007)	$ 121,485	$ (894,522)

7. Segmented information (Continued):

Six months ended March 31, 2016	Security Features	Surveillance	Total
Revenue	$ 1,214,416	$ 1,243,044	$ 2,457,460
Cost of sales	411,233	804,805	1,216,038
Gross profit	803,183	438,239	1,241,422
Expenses	4,780,541	514,046	5,294,587
Other expenses (income)	139,323	3,857	143,180
Net income (loss)	$ (4,116,681)	$ (79,664)	$ (4,196,345)

Six months ended March 31, 2015	Security Features	Surveillance	Total
Revenue	$ 1,909,966	$ 1,155,386	$ 3,065,352
Cost of sales	1,028,323	790,759	1,819,082
Gross profit	881,643	364,627	1,246,270
Expenses	3,904,476	413,374	4,317,850
Other expenses (income)	(1,119,215)	(126,572)	(1,245,787)
Net income (loss)	$ (1,903,618)	$ 77,825	$ (1,825,793)

8. Nature of expenses:

Cost of sales and expenses are comprised of the following:

	Three months ended March 31,		Six months ended March 31,	
	2016	2015	2016	2015
Cost of sales				
Direct cost of sales	451,725	734,491	1,209,207	1,693,222
Depreciation and amortization	3,493	74,933	6,831	125,860
	455,218	809,424	1,216,038	1,819,082
Research and development				
Direct expenses	667,189	729,923	1,249,001	1,323,840
Depreciation and amortization	759,374	506,062	1,517,833	1,034,655
Government grants	-	(43,362)	(23,615)	(82,362)
	1,426,563	1,192,623	2,743,219	2,276,133
General and administration				
Direct expenses	678,393	531,513	1,326,082	1,136,974
Depreciation and amortization	11,707	476	23,405	1,043
	690,100	531,989	1,349,487	1,138,017
Sales and marketing				
Direct expenses	653,105	538,615	1,201,881	903,700
	653,105	538,615	1,201,881	903,700
Supplementary information				
Salaries and benefits	1,281,859	1,054,824	2,533,039	2,283,803
Share based compensation	245,549	255,072	320,970	392,668

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.

9. Subsequent Events:

Subsequent to the quarter end, the Company announced its intention to privately place approximately $2.5 million of unsecured senior debentures convertible into common shares at a price of $1.25 ("the Debentures"). The Debentures bear interest at 12% and come due May 31, 2018. The Debentures are subject to automatic conversion into common shares of the Company in the event that the common shares of the Company trade on the TSXV at or above $2.00 for ten consecutive days any time after the first four months from issuance.