Nanotech Security Corp.

Three Months Ended December 31, 2014

Management Discussion & Analysis and
Unaudited Consolidated Financial Statements

NANOTECH
SECURITY CORP.

Nanotech Security Corp.

Management's Discussion and Analysis
For the three months ended December 31, 2014

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, 2014.

ADVISORY

This management's discussion and analysis ("MD&A"), dated as of February 26, 2015 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, 2014, as well as with the Company's consolidated financial statements and MD&A for the year ended September 30, 2014. 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, 2014, 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 condition 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 technology 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" section of the MD&A and notes to the consolidated financial statements for the year ended September 30, 2014, 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 #308 - 2999 Underhill Avenue, Burnaby, BC, Canada V5A 3C2 and the registered and records office is Suite 1500 - 1055 West Georgia, Vancouver, BC, Canada V6E 4N7.

The Company operates its business through two business segments – Security Features and Surveillance. The Company's reportable segments are strategic business units 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.

<u>Security Features</u>

Security Features provides light based recognition nanotechnology 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 each of its Burnaby head office, its research and production facility in Thurso, QC, Canada and at 4D Labs nanofabrication facility which is a Canadian federal government sponsored facility located at Simon Fraser University ("SFU") in Burnaby, BC.

The Security Features segment 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 nano-technology employ 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. During the spring of 2014 the Company successfully demonstrated the commercialization of its nanotechnology product at the TED conference held in Vancouver, B.C. Images of these features are available on the Company's website at: <u>www.nanosecurity.ca</u>

<u>Surveillance</u>

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 in the United States and Canada. The Company conducts its research, production and training at its facility in Holmes, PA, USA

The Surveillance segment continues to build and outfit surveillance vans for undercover operations and delivered accredited classes in electronic surveillance. In the second half of 2014 the Company successfully launched the newly developed P-25 digital transmission system allowing federal, state and local law enforcement agencies to correspond to 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 smart-phone connectivity over the wireless.

RESULTS OF OPERATIONS

The following table provides selected financial information for the three months ended December 31, 2014 and 2013:

Selected Financial Information

	2014	2013
Revenue	$ 1,541,008	$ 557,319
Cost of sales	1,009,658	369,270
	531,350	188,049
Expenses		
Research and development	847,696	409,985
General and administration	933,905	343,134
Sales and marketing	273,022	127,303
	2,054,623	880,422
Loss before other expenses (income)	(1,523,273)	(692,373)
Other expenses (income)	(592,002)	903
Net loss	$ (931,271)	$ (693,276)

Revenue

Revenues for the three months ended December 31, 2014 increased by $983,689 or 177% to $1,541,008 compared to $557,319 in the same period last year. The increased revenues was a result of revenue generated by the new Security Features business unit which delivered revenues in excess of $1 million primarily from the delivery of Optical Thin Film ("OTF") and development contracts. The newly acquired Thurso production facility achieved its largest quarterly revenues since the business was founded three years ago. This growth was partially offset by a decline in Surveillance revenues of approximately $61,000 as a number of surveillance vans were delivered in January 2015 after the December 31, 2014 quarter end.

Gross Margin

Gross margin for the three months ended December 31, 2014 increased by $343,301 or 183% to $531,350 compared to $188,049 in the same period last year. The increased gross margin was a result of the revenues generated by the Security Features sales. Overall gross margin percentage was 34% for the three months ended December 31, 2014 compared to 34% in the same period last year.

Research & Development

Research and development expenditures for the three months ended December 31, 2014 were $847,696, an increase of $437,711 compared to $409,985 in the same period last year. These costs included approximately $340,000 of amortization of intangible assets in both periods. The overall increase reflected the acquisition on Fortress Optical Features Ltd. ("FOF") and their development activity focused on new OTF security features.

General and Administration

General and administration expenditures for the three months ended December 31, 2014 were $933,905, an increase of $590,711 compared to $343,134 in the same period last year. The overall increase reflects the recent acquisition of FOF and includes depreciation of $188,850 compared to $3,509 in the same period last year and overheads for the Thurso, QC facility.

Sales and Marketing

Sales and marketing expenditures for the three months ended December 31, 2014 were $273,022, an increase of $145,719 compared to $127,303 in the same period last year due to increased marketing activities including new customer visits.

Net loss

The Net loss increased from $693,276 to $931,271 and reflected the increase in cost related to the recent FOF acquisition. This largely represented an increase in depreciation and amortization of $233,336 related to the machinery and building, an increase in share based compensation of $109,650, and general overheads including salaries and administrative costs offset by a gain on revaluation of contingent shares of $600,000.

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	
	2014	2013
Revenue	$1,045,450	$518
Net income (loss)	$(887,611)	$(704,756)

Revenues from Security Features for the three months ended December 31, 2014 increased to $1,045,450 from $518 for the same period last year. The increased revenue was primarily from the delivery of OTF and development contracts. The newly acquired Thurso production facility achieved its largest quarterly revenues since the business was founded three years ago.

Net loss from Security Features for the three months ended December 31, 2014 increased by $182,855 to $887,611 from $704,756 for the same period last year as a result of increased depreciation related to the machinery and building used by the OTF business, an increase in general and administrative costs including office salaries and administrative costs offset by a gain on revaluation of contingent shares of $600,000.

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 December 31	
	2014	2013
Revenue	$495,558	$556,801
Net income (loss)	$(43,660)	$11,480

Revenues from Surveillance for the three months ended December 31, 2014 decreased to $495,558 from $556,801 for the same period last year. The decreased revenue was a result a number of surveillance vans being delivered in January 2015 after the December 31, 2014 quarter end.

Net loss from Surveillance for the three months ended December 31, 2014 was $43,660 compared to net income of $11,480 for the same period last year. The increased net loss reflects the lower sales levels.

QUARTERLY RESULTS

	Q1 2015	Q4 2014	Q3 2014	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013
($ thousands, except common share amounts)								
Revenue	$1,541	$488	$603	$578	$557	$459	$403	$410
Net income (loss)	(931)	2,285	(1,116)	(859)	(693)	(727)	(525)	(477)
Net income (loss) per common share –								
Basic	(0.02)	0.05	(0.03)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
Diluted	(0.02)	0.04	(0.03)	(0.02)	(0.02)	(0.02)	(0.02)	(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 $3,892. 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 FOF.

RELATED PARTY TRANSACTIONS

For the three months ended December 31, 2014, 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:

	2014	2013
Salaries and employee benefits	$ 223,501	$ 72,990
Share based payments	63,829	-
	$ 287,360	$ 72,990

(b) Management fees totaling $26,560 (2013 - $62,490) charged by a company controlled by an officer and director of the Company, were included in salaries and benefits expense. As of December 31, 2014, amounts owing to this company included in accounts payable and accrued liabilities were $312,066 (September 30, 2014 - $286,490).

(c) Legal and professional fees, taxes and disbursements totaling $23,681 (2013 - $19,764) were incurred with a law firm of which a director of the Company is a partner. As of December 31, 2014, amounts owing to this company included in accounts payable and accrued liabilities were $415,824 (September 30, 2014 - $425,370).

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, 2014, cash and cash equivalents totaled $2,685,418, compared to $3,964,645 as at September 30, 2014. Subsequent to December 31, 2014, the Company received proceeds of $540,225 as a result of the exercising of 600,250 share purchase warrants at a price of $0.90.

Summary of Statement of Cash Flow

	Three months ended December 31	
	2014	2013
Cash used in operating activities[1]	$ (813,588)	$ (327,424)
Changes in operating assets and liabilities	(305,488)	(256,617)
Cash used in operating activities	(1,119,076)	(584,041)
Cash used in investing activities	(206,292)	9,491
Cash provided by financing activities	74,250	-
Effect of foreign currency translation on cash and cash equivalents	(28,109)	26,027
Decrease in cash and cash and cash equivalents	(1,279,227)	(548,523)
Cash and cash equivalents, beginning of period	3,964,645	4,155,811
Cash and cash equivalents, end of period	$2,685,418	$3,607,288

[1] Before changes in operating assets and liabilities

Operating Activities
Cash used in operating activities was $1,119,076 for the three months ended December 31, 2014, compared to $584,041 for the same period last year. The cash used reflects $305,488 that was required for increased working capital with the remaining $813,588 representing the cash used in operations.

Investing Activities
For the three months ended December 31, 2014, $206,292 was used in investing activities, compared to $9,491 generated in the same period in 2013. The increase in investing activities is due to increased capital investments made to upgrade the OTF production equipment to improve efficiencies.

Financing Activities
For the three months ended December 31, 2014, $74,250 was provided by financing activities, compared to $nil cash received in the same periods in 2013. For the three months ended December 31, 2014, 82,500 share purchase warrants were exercised for proceeds of $74,250.

Capital Resources

	December 31, 2014	September 30, 2014
Cash and cash equivalents	$2,685,418	$3,964,645
Working capital	$2,682,528	$3,656,267
Long-term debt	$5,500,000	$6,100,000
Common Shares Outstanding	48,390,434	48,307,934

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 $19,549,678 as of December 31, 2014 and $18,618,407 as of September 30, 2014. 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 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 may 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 may 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, 2014, there were no other changes in our approach to capital management.

The Company had no commitments for material capital expenditures as of December 31, 2014.

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 financing, that the Company will maintain sufficient liquidity to meet its requirements through September 30, 2015.

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 the Company's MD&A and consolidated financial statements for the year ended September 30, 2014. In the three months ended December 31, 2014, 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*™. 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.

Risks & Uncertainties

For a complete list of risks and uncertainties related to the Company, please refer to the Company's MD&A for the year ended September 30, 2014, which is available on SEDAR at www.sedar.com.

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 26, 2015 is as follows:

Issued shares	48,990,684
Warrants	5,330,426
Stock options outstanding	1,567,000

Public Securities Filings

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

Condensed Consolidated Interim Financial Statements of

Nanotech Security Corp.

Three months ended December 31, 2014 and 2013
(Unaudited)

Nanotech Security Corp.
December 31, 2014 and 2013

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Nanotech Security Corp.

December 31, 2014

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.

Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

Three months ended December 31, 2014 and 2013
(In Canadian dollars)

	2014	2013
Revenue	$ 1,541,008	$ 557,319
Cost of sales (Note 12)	1,009,658	369,270
	531,350	188,049
Expenses (Note 12)		
Research and development	847,696	409,985
General and administration	933,905	343,134
Sales and marketing	273,022	127,303
	2,054,623	880,422
Loss before other expenses (income)	(1,523,273)	(692,373)
Other expenses (income)		
Foreign exchange (gain) loss	(26,810)	10,775
Finance expense	34,808	(1,027)
Gain on revaluation of contingent shares	(600,000)	-
Gain on sale of fixed asset	-	(8,845)
	(592,002)	903
Net loss	(931,271)	(693,276)
Unrealized foreign exchange gain (loss) on translation of foreign operation	(23,388)	27,467
Total comprehensive loss for the period	$ (954,659)	$ (665,809)
Loss per share		
Basic and diluted	$ (0.02)	$ (0.02)
Weighted average number of common shares		
Basic and diluted	48,332,771	38,756,136

See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Consolidated Statements of Changes in Equity
(Unaudited)

Three months ended December 31, 2014 and 2013
(In Canadian dollars)

	Number of shares	Share capital	Share based payment reserve	Deficit	Accumulated other comprehensive income	Total shareholders' equity	Non-controlling interest	Total equity
Balance as at September 30, 2013	38,756,136	$ 26,409,880	$ 755,138	$ (18,124,376)	$ (11,629)	$ 9,029,013	$ (14,924)	$ 9,014,089
Net earnings (loss)	-	-	-	(695,092)	-	(695,092)	1,816	(693,276)
Unrealized foreign exchange gain (loss) on translation	-	-	-	-	27,467	27,467	-	27,467
Share based payments			27,946			961,851	-	961,851
Warrants exercised	-	-	-	-	-	273,022	-	273,022
Options exercised	-	-	-	-	-	-	-	-
Balance as at December 31, 2013	38,756,136	26,409,880	783,084	(18,819,468)	15,838	9,596,261	(13,108)	9,583,153

	Number of shares	Share capital	Share based payment reserve	Deficit	Accumulated other comprehensive income	Total shareholders' equity	Non-controlling interest	Total equity
Balance as at September 30, 2014	48,307,934	39,557,066	1,143,570	(18,618,407)	(54,549)	22,027,680	-	22,027,680
Net earnings (loss)	-	-	-	(931,271)	-	(931,271)	-	(931,271)
Unrealized foreign exchange gain (loss) on translation	-	-	-	-	(23,388)	(23,388)	-	(23,388)
Warrants exercised	82,500	74,250				74,250	-	74,250
Options exercised (Note 9)				-	-	-	-	-
Share based payments (Note 9)			137,596	-	-	137,596	-	137,596
Balance as at December 31, 2014	48,390,434	$ 39,631,316	$ 1,281,166	$ (19,549,678)	$ (77,937)	$ 21,284,867	$ -	$ 21,284,867

See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Consolidated Statements of Financial Position
(Unaudited)

(In Canadian dollars)

	December 31, 2014	September 30, 2014
Assets		
Current assets:		
Cash and cash equivalents	$ 2,685,418	$ 3,964,645
Accounts receivable	1,361,304	526,410
Inventory	545,387	598,526
Prepaid expenses and other assets	137,586	188,858
	4,729,695	5,278,439
Property, plant and equipment	18,966,747	18,995,321
Intangible assets	3,747,134	4,087,634
Goodwill (Note 6)	1,388,458	1,388,458
	$ 28,832,034	$ 29,749,852
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 2,022,167	$ 1,597,172
Deferred revenue	25,000	25,000
	2,047,167	1,622,172
Long term liabilities:		
Note payable	3,000,000	3,000,000
Contingent consideration shares	2,500,000	3,100,000
	7,547,167	7,722,172
Shareholders' equity		
Share capital (Note 9)	39,631,316	39,557,066
Share based payment reserve	1,281,166	1,143,570
Deficit	(19,549,678)	(18,618,407)
Accumulated other comprehensive income	(77,937)	(54,549)
	21,284,867	22,027,680
	$ 28,832,034	$ 29,749,852

Nature of operations and going concern (Note 1)
Subsequent Event (Note 13
See accompanying notes to condensed consolidated interim financial statements.

Nanotech Security Corp.

Consolidated Statements of Cash Flows
(Unaudited)

Three months ended December 31, 2014 and 2013
(In Canadian dollars)

	2014	2013
Operating activities:		
Net loss	$ (931,271)	$ (693,276)
Items not involving cash:		
Depreciation and amortization	580,087	346,751
Share based compensation	137,596	27,946
Gain on revaluation of contingent shares	(600,000)	-
Gain on sale of asset	-	(8,845)
Non-cash working capital changes (Note 10)	(305,488)	(256,617)
Cash used in operating activities	(1,119,076)	(584,041)
Investing activities:		
Purchase of property and equipment, net of disposals	(206,292)	9,491
Cash used in investing activities	(206,292)	9,491
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	(28,109)	26,027
Decrease in cash and cash equivalents	(1,279,227)	(548,523)
Cash and cash equivalents, beginning of period	3,964,645	4,155,811
Cash and cash equivalents, end of period	$ 2,685,418	$ 3,607,288

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 #308 - 2999 Underhill Avenue, Burnaby, British Columbia, Canada.

Nanotech is a global security features company, providing light based recognition nanotechnology and Optical Thin Film ("OTF") for use in anti-counterfeiting 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

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 $19,549,678 as of December 31, 2014 ($18,618,407) as of September 30, 2014). 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 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 or 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, 2014, 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, 2014, which are included in the Company's 2014 annual report.

2. Basis of preparation: (continued)

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, TTI. All intercompany balances and transactions are eliminated on consolidation. The financial statements of the subsidiary is included in the consolidated financial statements from the date that control commences.

The Company acquired 100% of IDIT Technologies Corp. ("IDIT") and 95% of IDME Technologies Corp. ("IDME") on September 27, 2013 and the remaining 5% of IDME on May 5, 2014. On September 29, 2014, the Company underwent a reorganization whereby 100% of the assets and liabilities of IDIT and IDME were wound up into the Company and IDME and IDIT were dissolved.

The Company acquired 100% of FOF on September 16, 2014. Subsequently on October 1, 2014, FOF was amalgamated into the Company.

Intercompany balances, transactions, revenues and expenses have been eliminated on consolidation.

These condensed consolidated interim financial statements were approved by the Company's Board of Directors and authorized for issue on February 26, 2015.

3. Changes in accounting policies:

The International Accounting Standards Board ("IASB") has issued the following amendments and new standards, which had not been previously adopted by the Company. Each of the amendments and new standards is effective for the annual period beginning on or after October 1, 2014, unless otherwise indicated, with early adoption permitted. The following is a description of the new or amended standards:

Amendments to IAS 32 - *Offsetting Financial Assets and Liabilities*

The amendments to IAS 32 - *Offsetting Financial Assets and Liabilities* clarify when an entity has a right to offset financial assets and liabilities. The adoption of these amendments during the period did not have any material impact on the condensed consolidated interim financial statements and notes to the financial statements.

Amendments to IAS 36 - *Recoverable Amount of Disclosures For Non-Financial Assets*

The amendments to IAS 36 - *Recoverable Amount of Disclosures For Non-Financial Assets cl*arify the disclosure requirements regarding the measurement of recoverable amounts related to goodwill and indefinite life intangible assets. The adoption of these amendments during the period did not have any material impact on the condensed consolidates interim financial statements and notes to the financial statements.

4. New standards and interpretations not yet adopted:

IFRS 9 - *Financial Instruments*

In November 2013, the IASB issued IFRS 9 - *Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)*. IFRS 9 (2009) establishes the measurement and classification of financial assets. Financial assets are measured either at fair value through earnings or at amortized cost if certain conditions are met. IFRS 9 (2010) includes guidance on the classification and measurement of financial liabilities. The most recent amendment, IFRS 9 (2013) includes a new general hedge accounting model which will align hedge accounting more closely with risk management. The effective date of this standard is January 1, 2018. The Company is currently evaluating the impact of IFRS 9 on its financial statements and expects to apply the standard to its financial statements beginning October 1, 2018.

IFRS 15 – *Revenue from contracts with customers:*

In May 2014, the IASB issued IFRS 15 – *Revenue from contracts with customers* which sets out the principles for when revenue should be recognized and how it should be measured, together with related disclosures. The new standard replaces all current revenue standards and interpretations in IFRS and is effective for fiscal periods beginning on or after January 1, 2017. The new standard is to be applied retrospectively. The Company is currently evaluating the impact of IFRS 15 on its financial statements and expects to apply this new standard to its financial statements beginning on October 1, 2017.

5. Use of estimates, assumptions and judgments:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are accounted for prospectively. The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities are discussed below:

(a) *Allocation of purchase consideration to acquired assets and assumed liabilities*

The Company determined and allocated the purchase price of an acquired company to the tangible and intangible assets acquired and liabilities assumed as of the business combination date in accordance with IFRS 3 – *Business Combinations*. The purchase price allocation process requires us to use significant estimates and assumptions, including fair value estimates, as of the acquisition date.

While management uses their best estimates and assumptions as a part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the business combination date, the estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the purchase price allocation period, which is generally one year from the acquisition date, management records adjustments to the assets acquired and liabilities assumed with the corresponding offset to goodwill.

5. Use of estimates, assumptions and judgments (continued):

(b) Valuation of goodwill

Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business less impaired losses if any. For purposes of impairment testing, goodwill is allocated to each of the Company's cash-generating units (or groups of cash-generating units) that is expected to benefit from the synergies of the combination. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. Management evaluates goodwill for impairment annually as of September 30th. While management uses their best estimate and assumptions to assess goodwill impairment, there are inherent uncertainties in projecting future cash flows.

(c) Judgments:

Management uses judgment when applying accounting policies and when making estimates and assumptions as described above. The most significant areas that require judgment include determination of functional currency, determination of cash generating units and segments, and assessing the Company's ability to continue as a going concern.

6. Acquisitions of IDME and IDIT:

(a) On September 27, 2013, pursuant to a share exchange agreement for a combined transaction, the Company completed the acquisition of controlling interests in two privately held British Columbia corporations, IDIT and IDME, from whom the Company had sublicensed its anti-counterfeiting technology. As consideration the Company agreed to issue a total of 3,940,000 common shares in exchange for 100% of the issued and outstanding common shares of IDIT and 95% of the issued and outstanding common shares of IDME. The fair value of the equity shares issued was based on the market value of Nanotech's traded shares on September 27, 2013, the acquisition date.

The fair value of the net assets acquired does not include certain common shares of the Company still registered in the name of IDME as of September 30, 2013 because these shares had been reserved for distribution to the former shareholders of IDME prior to the date of acquisition.

Two of the Company's directors and a Vice President were among the vendors of the IDIT and IDME common shares for total of 3,740,000 shares. Included in the 3,940,000 common shares issuable are 234,897 common shares issuable subject to prior approval of the Company's disinterested shareholders (the "Contingent shares") as the Company did not have sufficient authorized shares at the acquisition date. At the Annual General Meeting held on April 16, 2014, the disinterested shareholders voted to approve the issuance of the shares. These shares were issued in June 2014. All common shares issued by the Company in connection with the acquisition will be escrowed and the escrow will allow for 25% semi-annual releases over two years from closing starting six months from closing.

The acquisition eliminates a 6% gross revenue royalty on product sales and also results in the Company acquiring direct ownership of the principal nanotechnology patents, as well as ownership of additional intellectual property in related fields. The Company's products and services will now be subject to a 3% sales royalty in favour of Simon Fraser University where elements of the nanotechnology originated.

The acquisition of IDIT and IDME in a combined transaction, have been accounted for using the purchase method with the provisional fair values of the assets acquired, and liabilities assumed.

(In Canadian dollars)

6. Acquisitions of IDME and IDIT (continued):

(b) On May 5, 2014, the Company acquired, by exercising a compulsory acquisition right, the remaining 5% of IDME shares from Simon Fraser University. The Company now owns 100% of IDME. As consideration the Company agreed to issue a total of 60,000 common shares in exchange for the remaining 5% of the issued and outstanding common shares of IDME. The fair value of the equity shares issued was based on the market value of Nanotech's traded shares on May 5, 2014, the acquisition date, and was accounted for as a separate transaction with the charge going directly against retained earnings.

(c) On September 27, 2013, the Company recognized the major classes of assets acquired and liabilities assumed at the acquisition date based on estimated fair values. During the year ended September 30, 2014, the Company finalized the provisional amounts in the initial purchase price allocation and finalized the estimated fair value of intellectual property acquired that resulted in an increase to intangible assets of $5,444,954, an increase to deferred tax liability of $1,388,458, and a corresponding decrease to goodwill of $4,056,496.

As prescribed by IFRS 3, these adjustments were applied retrospectively to the acquisition date of September 27, 2013 and as a result of the amortization of the intangible assets, research and development expense for the three month period ended December 31, 2013 increased by $340,310 from the amount previously reported.

The following table summarizes the fair value of the consideration transferred and the final purchase price allocation based on estimated fair values of the major classes of assets acquired and liabilities assumed at the acquisition date:

3,705,103 Common shares at $1.31 per share	$ 4,853,685
234,897 Contingent common shares at $1.31 per share	307,715
Fair value of equity consideration	$ 5,161,400
Non-controlling interest - proportionate share of net assets	$ 14,924
Recognized amounts of identifiable net assets:	
Accounts receivable	487,406
Property and equipment	2,550
Intangible assets	5,444,954
Goodwill	1,388,458
Accounts payable and accrued liabilities	(788,434)
Deferred income tax	(1,388,458)
Fair value of net identifiable assets acquired	$ 5,161,400

The Company incurred acquisition related costs of $49,852 related to professional fees which have been expensed as incurred.

7. Acquisition of FOF:

On September 16, 2014 pursuant to a share and loan purchase agreement ("Purchase Agreement") with an arms-length vendor, the Company completed a transaction to acquire 100% of the issued and outstanding shares of FOF, a producer of OTF used as security threads in banknotes in several countries. Under the terms of the Purchase Agreement, the Company paid $7,179,822 cash, issued 5 million common shares of Nanotech and a secured note of $3,000,000 with an interest rate of 4% per annum. Of this consideration 3 million common shares are escrowed and shall be released based on certain specific performance milestones based on sales of product to new customers over up to five years and thus represent contingent consideration as defined in IFRS 3. Shares may be released early in the event of a sale of the business or change of control of the Company and any unearned shares will be returned to the Company.

The Purchase Agreement included a post-completion requirement for FOF to enter into a lease agreement whereby a majority of its building will be leased to an affiliate of the vendor for up to 10 years, to enter into a shared services agreement whereby FOF and an affiliate of the vendor will share certain utility and security services and a supply agreement whereby another affiliate of the vendor will have the right to purchase product from FOF on most favoured basis subject to certain minimum purchase commitments.

Concurrent with the FOF acquisition, the Company also completed a private placement of 6,772,151 subscription receipts of the Company (the "Subscription Receipts") at a price of $1.50 per Subscription Receipt, for gross proceeds to the Company of $10,158,227. The Subscription Receipts automatically converted, without additional payment, into one Common share and one-half of a Common share purchase warrant of the Company for each Subscription Receipt concurrently with completion of the FOF acquisition. Each whole purchase warrant entitles the holder to purchase one common share of the Company at a price of $1.90 for a period of one year from issuance. The warrants are subject to accelerated expiry in the event that the common shares of the Company trade in excess of $2.25 for a ten day period after the four month resale restricted period expires.

(In Canadian dollars)

7. Acquisition of FOF: (continued)

On September 30, 2014, the Company recognized the major classes of assets acquired and liabilities assumed at the acquisition date based on estimated fair values. The following table summarizes the preliminary fair value of the consideration transferred and the purchase price allocation based on estimated fair values of the major classes of assets acquired and liabilities assumed at the acquisition date.

Cash	$ 7,179,822
Secured note	3,000,000
2,000,000 Common shares at $1.59 per share	3,180,000
3,000,000 Contingent consideration common shares	3,180,000
Fair value of consideration	$ 16,539,822
Cash	$ 118,822
Inventory	274,721
Accounts receivable	87,973
Manufacturing equipment	15,144,236
Building	3,619,100
Land	141,700
Accounts payable and accrued liabilities	(342,738)
Deferred income tax	(2,503,992)
Fair value of net identifiable assets acquired	$ 16,539,822

The Company incurred acquisition related costs of $258,376 related to professional fees which have been expensed as incurred.

8. Related party transactions:

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

	Three months ended December 31	
	2014	2013
Salaries and employee benefits	$223,501	$72,990
Share based payments	63,829	-
	$287,360	$72,990

(b) Management fees totaling $26,560 (2013 - 62,490) charged by a company controlled by an officer and director of the Company, were included in salaries and benefits expense. As of December 31, 2014, amounts owing to this company included in accounts payable and accrued liabilities were $312,066 (September 30, 2014 - $286,490).

(In Canadian dollars)

8. Related party transactions (continued):

(c) Legal and professional fees, disbursements and taxes totaling $23,681 (2013 - $19,764) were incurred with a law firm of which a director of the Company is a partner. As of December 31, 2014, amounts owing to this company included in accounts payable and accrued liabilities were $415,824 (September 30, 2014 - $425,370).

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.

9. 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, 2014	48,307,934	$ 39,557,066
Warrants exercised	82,500	74,250
Balance as at December 31, 2014	48,390,434	$ 39,631,316

(b) Stock option plan

Stock options outstanding as at December 31, 2014 are as follows:

	Number of options	Weighted average exercise price
Balance, September 30, 2014	1,567,000	$ 1.38
Granted	-	-
Exercised	-	-
Forfeited	-	-
Balance, December 31, 2014	1,567,000	$ 1.38

(In Canadian dollars)

9. Share capital: (continued)

(c) Stock option plan (continued)

The following table summarizes information pertaining to the Company's stock options outstanding at December 31, 2014:

	Options outstanding			Options exercisable	
Range of exercise prices Cdn$	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	1.47	$0.80	482,000	$0.80
$0.81 - $1.75	1,085,000	4.09	1.62	430,000	1.64
	1,567,000	3.29	$1.38	912,000	$1.20

(d) Warrants

	Number of shares	Weighted average exercise price
Balance as at September 30, 2014	6,013,176	$ 1.49
Exercised	82,500	0.90
Balance as at December 31, 2014	5,930,676	$ 1.50

The following table summarizes information pertaining to the Company's warrants outstanding at December 31, 2014:

Number of warrants	Exercise price	Warrant expiry date
2,130,250	$ 0.90	February 20, 2015
155,000	0.90	March 3, 2015
259,350	1.50	September 12, 2015
3,386,076	1.90	September 12, 2015
5,930,676		

(In Canadian dollars)

10. Supplementary cash flow information:

(a) Change in non-cash operating working capital

	Three months ended December 31 2014	Three months ended December 31 2013
Accounts receivable	$ (834,894)	$ 107,138
Inventory	53,139	49,878
Prepaid expenses and other assets	51,272	(25,673)
Accounts payable and accrued liabilities	424,995	(387,960)
	$ (305,488)	$ (256,617)

(b) Interest and income taxes

During the three months ended December 31, 2014 the Company paid $35,000 interest (2013 - $nil) and the Company did not pay income taxes in the three months ended December 31, 2014 or 2013.

(c) Cash and cash equivalents

Cash and cash equivalents are comprised of:

	December 31, 2014	September 30, 2014
Cash	$ 475,160	$ 1,456,148
Money market funds	2,210,258	8,497
Term deposit	-	2,500,000
	$ 2,685,418	$ 3,964,645

11. Segmented information:

Segmented information is prepared using the accounting policies described in note 11 of the Company's consolidated financial statements for the year ended September 30, 2014. The Company's business operates primarily through two business segments – Security Features and Surveillance. 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. Surveillance designs and sells sophisticated surveillance and intelligence gathering equipment for the law enforcement and defense industries in the United States and Canada.

No customer represents in excess of 10% of total revenue in the three ended December 31, 2014 and 2013.

(In Canadian dollars)

11. Segmented information: (continued)

December 31, 2014	Security Features	Surveillance	Total
Total current assets	$ 4,003,804	$ 725,891	$ 4,729,695
Property, plant and equipment	18,926,934	39,813	18,966,747
Intangible assets	3,743,405	3,729	3,747,134
Goodwill	1,388,458	-	1,388,458
Total current liabilities	1,886,332	160,835	2,047,167
Total liabilities	7,386,332	160,835	7,547,167

September 30, 2014	Security Features	Surveillance	Total
Total current assets	$ 4,669,919	$ 608,520	$ 5,278,439
Property, plant and equipment	18,956,599	38,722	18,995,321
Intangible assets	4,083,716	3,918	4,087,634
Goodwill	1,388,458	-	1,388,458
Total current liabilities	1,465,888	156,284	1,622,172
Total liabilities	7,565,888	156,284	7,722,172

Three months ended December 31, 2014	Security Features	Surveillance	Total
Revenue	$ 1,045,450	$495,558	$1,541,008
Cost of sales	675,609	334,049	1,009,658
Gross profit (loss)	369,841	161,509	531,350
Expenses	1,864,394	190,229	2,054,623
Other expenses (income)	(606,942)	14,940	(592,002)
Net loss	$ (887,611)	$ (43,660)	$ (931,271)

Three months ended December 31, 2013	Security Features	Surveillance	Total
Revenue	$ 518	$ 556,801	$ 557,319
Cost of sales	463	368,807	369,270
Gross profit (loss)	55	187,994	188,049
Expenses	706,772	173,650	880,422
Other expenses (income)	(1,961)	2,864	903
Net loss	$ (704,756)	$ 11,480	$ (693,276)

(In Canadian dollars)

12. Nature of expenses:

Cost of sales and expenses are comprised of the following:

	Three months ended December 31	
	2014	2013
Cost of Sales		
Direct cost of sales	$958,731	$366,338
Depreciation and amortization	50,927	2,932
	$1,009,658	$369,270
Research and development		
Direct expenses	$546,386	$125,211
Depreciation and amortization	340,310	340,310
Government grants	(39,000)	(55,536)
	$847,696	$409,985
General and administration		
Direct expenses	$745,055	$339,625
Depreciation and amortization	188,850	3,509
	$933,905	$343,134
Sales and marketing		
Direct expenses	$273,022	$127,303
Depreciation and amortization	-	-
	$273,022	$127,303
Supplementary information		
Salaries and benefits	$1,228,979	$310,337
Share based compensation	$137,596	$27,946

13. Subsequent Event:

Subsequent to December 31, 2014, the Company received proceeds of $540,225 as a result of the exercising of 600,250 share purchase warrants at a price of $0.90.