

Spectra Systems Corporation

Audited results for the twelve months ended 31 December 2022

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Spectra Systems Corporation (the “Company”), a leader in machine-readable high speed banknote authentication, brand protection technologies, and gaming security software, is pleased to announce its results for the twelve months ended 31 December 2022.

Financial highlights:

- Revenue of \$19,627k (2021: \$16,592k) up 18%
- Adjusted EBITDA¹ up 17% at \$8,077k (2021: \$6,896k)
- Adjusted PBTA¹ up 17% to \$7,765k (2021: 6,622k)
- Adjusted earnings² per share up 21% to US 14.5 cents (2021: US 12.0 cents)
- Cash generated from operations of \$8,040k (2021: \$8,084k)
- The Board are declaring an increased annual dividend of US\$0.115 per share to be paid in June 2023
- Strong, debt-free balance sheet, with cash³ of \$17,496k (2021: \$16,775k) at 31 December
- Buy-back of 500,000 shares during 2022 at a total cost of US\$807k

¹ Before stock compensation expense and excludes noncontrolling interest

² Before amortization and stock compensation expense, excludes noncontrolling interest

³ Does not include \$500,000 (2021: \$1,099k) of restricted cash and investments

Operational highlights:

- Continued momentum towards customer acceptance of latest pre-production sensor units.
- Completed supply chain mitigation program with central bank worth \$1.3mm for preparation and given go ahead for production in 2022 at 21% price increase.
- Increased sales efforts for polymer substrates with appointment of Global Sales Director for Banknote Technology and launch of enhanced website.
- Central bank request to provide large quantities of Fusion substrate for a large print trial ongoing in 2023.

- Continued strong sales of K-cup optical materials through a second large customer.
- Increased operational efficiency in software security group by launching a new tool to significantly improve our ability to manage customer support.

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

Company's earnings and revenues are up substantially over 2021 both due to strong sales which would in themselves had enabled the company to exceed market expectations and which were further increased due to over-manufacturing of covert materials for a Central Bank. Improved financial planning has been put in place for 2023. Our cash position remains strong due to sensor development milestones and prepayments as well as additional sales in optical and covert materials. In addition, information from one of our major licensees as well as improved visibility on current sensor life have allowed us to write-off inventory which we anticipate will not contribute to future sales.

Spectra Systems, with our proven track record of developing solutions for our customers in record time, has capitalized on the environment that was created by the Covid-19 pandemic. We have successfully completed a supply chain mitigation program with a central bank customer by manufacturing in-house a previously commercially sourced chemical. This effort has resulted in payment for the development as well as an approval to manufacture material starting in Q4 of 2022 at a higher price.

On the materials front, our revenue from K-cup printers continues to be strong and we began testing with a third printer in Canada in 2022. Taggant material orders from a central bank customer were again at high levels, further bolstering consumable revenue.

"The Board therefore believes that the Company is on track to achieve record earnings and meet market expectations for 2023."

Spectra Systems Corporation

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

Chief Executive Officer's statement

Introduction

We are delighted to report that we significantly outperformed the 2021 results while our year end cash position is the highest in the Company's history.

Revenue for the year was up 18% at \$19,627k (2021: \$16,592k), primarily driven by pre-production development contracts as well as ongoing demand for our materials to meet production for our long-standing central bank customer.

The adjusted EBITDA (before stock compensation expense) for the year increased 17%, to \$8,077k compared to the prior year of \$6,896k.

Having generated cash from operations of \$8,040k (2021: \$8,084k), cash at the period end was \$17,496k (2021: \$16,775k), excluding \$500,000 of restricted cash and investments (2021: \$1,099k). This is notwithstanding \$5,004k paid to shareholders during June in the form of the Company's dividend of \$0.11 per share and \$807k used for buying back 500,000 shares.

Review of Operations

Physical and Software Authentication Business

The Authentication Systems business generated revenue of \$18,164k (2021: \$14,718k) and Adjusted EBITDA of \$8,005k (2021: \$6,556k). Authentication Systems revenues were driven by sales of covert materials and the funding of a new in-house capability and facility to combat supply chain issues relating to one of our central bank customers. Authentication Systems revenue was further increased by milestone payments which are part of the sensor development program with one of our long-standing central bank customers. We continue to advance through the acceptance process with this central bank with the delivery of preproduction units of our latest sensor in late 2024. In addition, revenue from optical and security phosphour materials remained strong while licence payments from our licensee continued with on time payments and at the contracted value.

Through our vertically integrated manufacturing we have been able to produce high quality conducting and opacified polymer substrate for evaluation by central banks, ink suppliers and printing organizations. We have produced a large number of print ready sheets for a Middle Eastern central bank print trial which has resulted in an additional large scale print trial scheduled for Q2 2023. The Company has formed a close working relationship with the largest commercial printer of polymer banknotes and is developing a house note which will incorporate both our Fusion™ machine readable security as well as their newest public security feature. The objective of this joint development will produce polymer banknotes of the highest quality for a joint marketing effort.

We are increasing our sales and marketing efforts for Fusion™ as well as our full suite of banknote products having introduced Fusion at the Banknote Conference and appointed a UK based Global Director of Sales for Banknote Technology.

With the TruBrand™ authentication product having been successfully introduced into the Chinese tobacco market in 2019 annually and for use in stationary products in 2021, we have completed two successful gravure tests with another large supplier of cigarettes in China and plan to additional print tests in Q1 of 2023 with two additional tobacco companies in China. We continue to expand our search for new TruBrand™ customers outside of China, including with a major Japanese printer and a partnership with a company in India bidding on authentication of both dairy products, as well as transit certificates, and with our multinational Fusion polymer partner for labels. We have also developed smartphone readable security threads to further expand the palette of target applications and potential partners. In addition, we continue to work with a printer for a well-respected French luxury brand to help protect their products sold in China using authentication technology we acquired several years ago.

Our K-cup materials business has grown significantly after a new customer began purchasing our products during 2021. In 2022, we began a new testing program with a Canada based K-cup lid printer which we expect will produce revenues in Q2 2023.

On the software security side of the Company's business, the Secure Transactions Group generated an Adjusted EBITDA of \$72k (2021: \$340k) on revenue of \$1,463k (2021: \$1,874k). The 2022 results are in line with expectations as we continue development of a new software platform. While this development continues, we are focusing on the online lottery sector which grew during the pandemic through a partnership with NextGen Lotteries.

Finally, the Company has received several additional patents on authentication technology in Africa, China, and EU which protects our position in covert authentication as well as polymer substrates technology and machine readability

Banknote Cleaning and Disinfection Business

We have sold our first Banknote Disinfection System (BDS) for use by an Asian central bank. The unit will be installed in the Q1 2023 and the terms included a 30% up-front payment as well as a follow-on service agreement. As this system is scalable from 250,000 notes to over five million notes in a single cycle of one hour, we have the ability to accommodate a large spread of potential customer requirements. With this first unit sold, we are ramping up our sales and marketing process to other central banks as well as the casino industry. We do not expect this product to significantly contribute to revenue until another Covid outbreak or the emergence of another rapidly spreading pathogen.

Solaris BioSciences Investment Asset

In December 2020, the Company made an investment in Solaris BioSciences, whose results are consolidated by the Company. The technology is entirely optical and has evolved rapidly over the last months of 2022 and Q1 2023. The technology is now capable of point of care measurement of plasma viscosity, cancer markers, lipid content, and LDL in microliters of blood. During H1 2022, Solaris BioSciences Holdings was formed as a UK company and has obtained EIS status with HMRC to expand the base of investment opportunities to the UK.

Corporate Governance

Spectra Systems is an AIM listed company and has always worked to abide by best practices as advised by both our bankers as well as our shareholders. Recently ISS has issued certain recommendations regarding board composition, committee assignments, and option grants.

Our board has comprised the same Directors since our listing except for the addition of Mr. Jeremy Fry (UK based) who replaced Mr. Martin Jaskel after his untimely passing away. In order to add a new dimension to the board, Dr. Barbara Paldus joined the board in H2 2022 as an Independent Non-Executive Director. She has extensive entrepreneurial experience, particularly in technology solutions, which will be of immense value to Spectra.

With the addition of this new board member, Dr. Nabil Lawandy exited the Audit Committee assignment as there is now a suitable replacement to share the burden of committee assignments.

With regards to Director option grants, the Company has adopted a new policy which will allow new Directors to receive a one-time option grant upon joining the board of directors. Going forward, no Directors will be issued new options beyond the ones received at joining the board. This is a compromise position relative to USA standards and UK guidance that Non-Executive Directors hold no options.

Strategy

The Company's strategy for increasing revenue and earnings continues to be focused on selling more products to existing customers as well as opening new sales channels for the full spectrum of our product offering. We have had very good success in upselling existing central bank customers and commercially exploiting supply chain and pandemic related issues as part of our strategy. Examples of these successes are the expansion of sensor capabilities for exotic counterfeits, the development and first sale of a banknote disinfection machine, and the commencement of a program with our customer to deal with supply chain issues now and going forward.

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

With regards to our optical materials and brand authentication products, we continue to propose to both central banks and overt security suppliers the concept of upgrading such features to incorporate public and machine-readable security. Our recent development of smartphone readable security threads will expand the opportunities of the technology to passports and secure documents. The strategy behind this approach is based around partnering with current contract holders who can benefit from our technology and materials to upsell their existing customers.

Finally, with our strong cash position, we do explore possible mergers and acquisitions which can immediately open doors to implement our upselling strategy, expand our customer base or strengthen our supply chain for Fusion polymer substrate. The exploration of such opportunities is now becoming more viable at larger scales as we expect to have even more significant cash resources through the successful delivery of the major central bank sensor contract.

Prospects

The Company continues to have a multitude of new short-term and long-term prospects. The short-term opportunities are expected in the 2023-2025 period and the long-term opportunities are expected in the 2025–2030-time frame.

The near-term opportunities are:

- Completion of sensor development and revenue recognition of development payments
- New online Quality Control system contract
- First sensor shipments to a central bank
- TruBrand™ revenue reaching \$1m per annum levels
- Increased sales of our newest phosphor products
- Expansion of our gaming software business in Canada and other non-USA customers and in the online lottery market
- Opportunity to bid in a polymer banknote tender
- A commemorative note series using our Fusion polymer substrate

The longer-term opportunities are:

- Supply of upgraded sensors worth up to \$50MM in hardware to a central bank customer
- Supply of Fusion™ polymer substrate and sensors to a central bank for one or more banknote denominations
- Further increase of covert authentication materials by a current or new central bank customer

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

Dividend

With the Company having an eighth year of sustainable profits, reaching their highest levels since its admission to trading on AIM, and having sufficient resources to execute on its growth plans with its existing cash reserves, the Board is delighted to again issue an increased dividend. Our dividend policy takes account of the Group's profitability, underlying growth, and maintenance of sufficient cash reserves. The Board therefore intends to pay an annual dividend of US\$0.115 per share on or about June 23, 2023 to shareholders of record as of June 5, 2023.

Nabil M. Lawandy
Chief Executive Officer
March 21, 2023

**Consolidated statements of income
for the years ended 31 December:**

	2022 Audited USD '000	2021 Audited USD '000
Revenue		
Product	\$ 11,208	\$ 9,281
Service	6,681	5,524
Licence and royalty	1,738	1,787
Total revenues	<u>19,627</u>	<u>16,592</u>
Cost of sales	<u>7,351</u>	<u>6,069</u>
Gross profit	12,276	10,523
Operating expenses		
Research and development	1,507	1,399
General and administrative	3,023	2,743
Sales and marketing	753	471
Total operating expenses	<u>5,283</u>	<u>4,613</u>
Operating profit	6,993	5,910
Interest income	17	40
Loss on sale of equipment	--	(19)
Foreign currency income (loss)	<u>(8)</u>	<u>12</u>
Profit before taxes	7,002	5,943
Income tax expense	<u>901</u>	<u>878</u>
Net income	6,101	5,065
Net loss attributable to noncontrolling interest	<u>(46)</u>	<u>(98)</u>
Net income attributable to Spectra Systems Corporation	<u><u>\$ 6,147</u></u>	<u><u>\$ 5,163</u></u>
Earnings per share		
Basic	\$ 0.14	\$ 0.11
Diluted	\$ 0.13	\$ 0.11

All of the Group's operations are continuing

**Consolidated statements of comprehensive income
for the years ended 31 December:**

	2022 Audited USD '000	2021 Audited USD '000
Net income	\$ 6,101	\$ 5,065
Other comprehensive income (loss)		
Unrealized gain(loss) on currency exchange	(45)	10
Reclassification for realized (gain)loss in net income	8	(12)
Total other comprehensive loss	<u>(37)</u>	<u>(2)</u>
Comprehensive income	<u>6,064</u>	<u>5,063</u>
Net loss attributable to noncontrolling interest	<u>(46)</u>	<u>(98)</u>
Comprehensive income attributable to Spectra Systems Corporation	<u><u>\$ 6,110</u></u>	<u><u>\$ 5,161</u></u>

**Consolidated balance sheets
as of 31 December:**

	2022 Audited USD '000	2021 Audited USD '000
Current assets		
Cash and cash equivalents	\$ 17,496	\$ 16,775
Trade receivables, net of allowance	3,677	2,242
Unbilled and other receivables	1,133	630
Inventory	1,599	1,944
Prepaid expenses	760	298
Total current assets	<u>24,665</u>	<u>21,889</u>
Non-current assets		
Property, plant and equipment, net	2,102	1,439
Operating lease right of use assets, net	1,217	972
Intangible assets, net	7,055	7,161
Restricted cash and investments	500	500
Deferred tax assets	1,881	1,080
Other assets	597	111
Total non-current assets	<u>13,352</u>	<u>11,263</u>
Total assets	<u><u>\$ 38,017</u></u>	<u><u>\$ 33,152</u></u>
Current liabilities		
Accounts payable	\$ 929	\$ 490
Accrued expenses and other liabilities	504	512
Operating lease liabilities, short term	298	286
Taxes payable	684	262
Deferred revenue	4,626	2,184
Total current liabilities	<u>7,041</u>	<u>3,734</u>
Non-current liabilities		
Operating lease liabilities, long term	975	739
Deferred revenue	1,679	758
Total non-current liabilities	<u>2,654</u>	<u>1,497</u>
Total liabilities	<u>9,695</u>	<u>5,231</u>
Stockholders' equity		
Common stock	450	453
Additional paid in capital – common stock	53,178	53,833
Accumulated other comprehensive loss	(174)	(137)
Accumulated deficit	(25,727)	(26,870)
Total Spectra Systems stockholders' equity	<u>27,727</u>	<u>27,279</u>
Noncontrolling interest	595	642
Total liabilities and stockholders' equity	<u><u>\$ 38,017</u></u>	<u><u>\$ 33,152</u></u>

Statements of cash flows
for the year ended 31 December:

	2022 Audited USD '000	2021 Audited USD '000
Cash flows from operating activities		
Net income	\$ 6,101	\$ 5,065
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	917	831
Stock based compensation expense	142	71
Lease amortization expense	287	274
Deferred taxes	(801)	320
Allowance for doubtful accounts	(4)	-
Provision for excess and obsolete inventory	694	494
Loss on sale of equipment	-	19
<i>Changes in operating assets and liabilities</i>		
Accounts receivables	(1,428)	346
Unbilled and other receivables	(503)	(153)
Inventory	(349)	356
Prepaid expenses	(463)	(25)
Other assets	(500)	-
Accounts payable	441	(44)
Operating leases	(285)	(265)
Accrued expenses and other liabilities	417	71
Deferred revenue	3,374	724
Net cash provided by operating activities	<u>8,040</u>	<u>8,084</u>
Cash flows from investing activities		
Restricted cash and investments	-	599
Payment of patent and trademark costs	(476)	(471)
Proceeds from sale of equipment	-	36
Purchases of property, plant and equipment	(988)	(76)
Net cash provided (used) in investing activities	<u>(1,464)</u>	<u>88</u>
Cash flows from financing activities		
Dividends paid	(5,004)	(4,302)
Repurchase of shares	(807)	(1,170)
Proceeds from exercise of stock options	6	38
Net cash used in financing activities	<u>(5,805)</u>	<u>(5,434)</u>
Effect of exchange rate on cash and cash equivalents	<u>(50)</u>	<u>(1)</u>
Net increase in cash and cash equivalents	721	2,737
Cash and cash equivalents, beginning of year	16,775	14,038
Cash and cash equivalents, end of year	<u><u>\$ 17,496</u></u>	<u><u>\$ 16,775</u></u>

Notes to financial information

1. Basis of preparation

This report was approved by the Directors on the 16th day of March 2023.

This financial information has been prepared using the recognition and measurement principles of US Generally Accepted Accounting Principles. The Group has not elected to apply IAS 34 Interim Financial Reporting.

The principal accounting policies used in preparing the interim results are those the Company expects to apply in its financial statements for the year ending 31 December 2022 and are unchanged from those disclosed in the Company's Annual Report for the year ended 31 December 2021.

2. Earnings per share

The calculation of basic earnings per share is based on the net income divided by the weighted average number of common shares outstanding. Diluted earnings per share is calculated by considering the dilutive impact of common stock equivalents under the treasury stock method as if they were converted into common stock as of the beginning of the period or as of the date of grant, if later. Excluded from the calculation of diluted earnings per common share for the years ended 31 December 2022 and 2021 were 186,773 and 125,425 shares, respectively, related to stock options because their exercise prices would render them anti-dilutive. The following table shows the calculation of basic and diluted earnings per common share.

	Full Year to 31 Dec 2022	Full Year to 31 Dec 2021
Numerator:		
Net income	\$ 6,147,374	\$ 5,162,830
Denominator:		
Weighted average common shares	45,189,208	45,353,550
Effect of dilutive securities:		
Stock Options	2,132,610	2,385,480
Diluted weighted average common shares	<u>47,321,818</u>	<u>47,739,030</u>
Earnings per common share:		
Basic:	<u>\$ 0.14</u>	<u>\$ 0.11</u>
Diluted:	<u>\$ 0.13</u>	<u>\$ 0.11</u>

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

4. Nature of financial information

The Preliminary Announcement set out above is an extract from the forthcoming Annual Report and Accounts and does not represent statutory accounts for Spectra Systems Corporation. The statutory accounts of Spectra Systems Corporation in respect of the period ended 31 December 2022 will be delivered to the Registrars of Companies before the Company's Annual General Meeting.

It is anticipated that the Annual Report and Accounts will be circulated to shareholders of Spectra Systems Corporation by April 2023.

Appendix – Reconciliation of Non-GAAP measures

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

	2022 USD '000	2021 USD '000
Adjusted earnings before interest, taxes, depreciation and amortization (EBITDA):		
Operating profit	\$ 6,993	\$ 5,910
Depreciation	321	307
Amortization	594	524
Stock compensation	142	71
Operating loss - noncontrolling interest	46	101
Stock compensation - noncontrolling interest	(19)	(17)
Adjusted EBITDA	\$ 8,077	\$ 6,896
Adjusted profit before taxes and amortization (PBTA):		
Profit before taxes	\$ 7,002	\$ 5,943
Amortization	594	524
Stock compensation	142	71
Operating loss - noncontrolling interest	46	101
Stock compensation - noncontrolling interest	(19)	(17)
Adjusted PBTA	\$ 7,765	\$ 6,622
Adjusted earnings per share:		
Adjusted PBTA	\$ 7,765	\$ 6,622
Income tax expense	(901)	(878)
Adjusted earnings	\$ 6,864	\$ 5,744
Diluted weighted average common shares	47,321,818	47,739,030
Adjusted earnings per share	\$ 0.145	\$ 0.120