

Unaudited Condensed Interim Consolidated Financial Statements of

SPECTRA7 MICROSYSTEMS INC.

For the Three and Nine Months Ended September 30, 2020 and 2019

(Expressed in United States Dollars)

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 interim financial statements, they must be accompanied by a notice indicating that the interim financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed interim consolidated financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these unaudited condensed interim consolidated financial statements in accordance with standards established by the Chartered Professional Accountants of Canada for a review of the interim financial statements by an entity's auditor.

SPECTRA7 MICROSYSTEMS INC.
(Unaudited)

For the Three and Nine Months Ended September 30, 2020 and 2019

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SPECTRA7 MICROSYSTEMS INC.

Condensed Interim Consolidated Statements of Loss and Comprehensive Loss
Three and Nine Months Ended September 30, 2020 and 2019
(Unaudited, expressed in United States Dollars)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	\$	\$	\$	\$
Revenue	281,982	1,369,517	655,009	3,716,883
Cost of sales	126,122	554,906	293,327	1,615,145
Gross margin	155,860	814,611	361,682	2,101,738
Research and development, net of investment tax credits including amortization of licenses	573,551	1,453,047	2,331,006	4,011,458
Sales and marketing	63,579	347,250	309,928	1,355,799
General and administrative	293,502	883,889	1,020,438	2,239,089
Depreciation of right-of-use assets	74,373	79,503	234,083	238,509
Depreciation of property and equipment	68,740	96,019	227,925	309,893
Share-based compensation	(11,849)	236,725	252,539	891,958
Interest on lease obligation of right-of-use asset	5,342	25,309	25,875	82,906
Accretion expense (Note 5)	548,463	471,803	1,587,986	1,353,050
Government grant (Note 11)	(206,546)	-	(776,085)	-
Change in derivative liability	-	-	-	(35)
Foreign exchange gain	(4,842)	(32,262)	(46,807)	(45,836)
	1,404,313	3,561,283	5,166,888	10,436,791
Net Loss	(1,248,453)	(2,746,672)	(4,805,206)	(8,335,053)
Other comprehensive (loss) gain:				
Unrealized foreign currency translation	(187,939)	143,217	374,734	(82,520)
Total comprehensive loss	(1,436,392)	(2,603,455)	(4,430,472)	(8,417,573)
Basic and diluted	(0.00)	(0.01)	(0.01)	(0.03)
Basic and diluted	571,713,886	311,677,445	509,077,429	262,517,042

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

SPECTRA7 MICROSYSTEMS INC.

Condensed Interim Consolidated Statements of Changes in Deficiency
 Nine Months Ended September 30, 2020 and 2019
 (Unaudited, expressed in United States Dollars)

	Common shares	Share-based payment reserve	Convertible debentures - share conversion option	Warrants	Subscription received for shares not issued	Deficit	Accumulated other comprehensive loss	Total Shareholders' Deficiency
	\$	\$	\$	\$	\$	\$	\$	\$
Balance, December 31, 2018	136,129,926	3,946,639	1,574,971	895,435	-	(149,841,563)	315,887	(6,978,705)
Impact of adopting IFRS 16	-	-	-	-	-	52,526	-	52,526
Adjusted balance, January 1, 2019	136,129,926	3,946,639	1,574,971	895,435	-	(149,789,037)	315,887	(6,926,179)
Shares issued under Restricted Share Unit plan	158,828	(158,828)	-	-	-	-	-	-
Restricted share units granted to directors to settle unpaid directors' fees	-	95,846	-	-	-	-	-	95,846
Units issued pursuant August Private Placement (Note 6(a)(ii))	3,504,607	-	-	-	-	-	-	3,504,607
Units issued pursuant to August Prospectus Offering	2,454,437	-	-	-	-	-	-	2,454,437
Allocation of warrants portion of August Units (Note 6(a)(ii))	(397,601)	-	-	397,601	-	-	-	-
Cash paid for issuance costs (Note 6(a)(ii))	(640,561)	-	-	(45,795)	-	-	-	(686,356)
Shares issued as commission on August Private Placement (Note 6(a)(ii))	60,864	-	-	-	-	-	-	60,864
Shares issued as commission on August Prospectus (Note 6(a)(ii))	81,941	-	-	-	-	-	-	81,941
Allocating commission shares to warrants (Note 6(a)(iii))	(133,277)	-	-	(9,528)	-	-	-	(142,805)
Compensation options issued to brokers (Note 6(a)(ii))	(112,919)	-	-	112,919	-	-	-	-
Share-based compensation expense	-	891,958	-	-	-	-	-	891,958
Total comprehensive loss	-	-	-	-	-	(8,335,053)	(82,520)	(8,417,573)
Balance, September 30, 2019	141,106,245	4,775,615	1,574,971	1,350,632	-	(158,124,090)	233,367	(9,083,260)

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SPECTRA7 MICROSYSTEMS INC.

Condensed Interim Consolidated Statements of Changes in Deficiency

Nine Months Ended September 30, 2020 and 2019

(Unaudited, expressed in United States Dollars)

	Common shares	Share-based payment reserve	Convertible debentures - share conversion option	Warrants	Subscription received for shares not issued	Deficit	Accumulated other comprehensive loss	Total Shareholders' Deficiency
	\$	\$	\$	\$	\$	\$	\$	\$
Balance, December 31, 2019	142,428,107	3,663,400	1,574,971	1,282,929	(4,104)	(160,831,092)	62,362	(11,823,427)
Shares issued under Restricted Share Unit plan (Note 6(b)(i))	281,789	(281,789)	-	-	-	-	-	-
Subscription received for common shares	-	-	-	-	4,104	-	-	4,104
Units issued on March Private Placement, net of issuance costs (Note 6(a)(i))	1,102,344	-	-	-	-	-	-	1,102,344
Units issued on July Private Placement, net of issuance costs (Note 6(a)(i))	604,447	-	-	-	-	-	-	604,447
Allocation of warrants portion of July Units, net of issuance costs (Note 6(a)(i))	-	-	-	10,826	-	-	-	10,826
Share-based compensation expense (Note 6(b)(iii))	-	252,539	-	-	-	-	-	252,539
Settlement of Promissory Notes (Note 10)	753,583	-	-	-	-	-	-	753,583
Total comprehensive loss	-	-	-	-	-	(4,805,206)	374,734	(4,430,472)
Balance, September 30, 2020	145,170,270	3,634,150	1,574,971	1,293,755	-	(165,636,298)	437,096	(13,526,056)

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

SPECTRA7 MICROSYSTEMS INC.

Condensed Interim Consolidated Statements of Financial Position

September 30, 2020 and December 31, 2019

(Unaudited, expressed in United States Dollars)

	September 30, 2020	December 31, 2019
	\$	\$
Assets		
Current assets:		
Cash	84,349	71,121
Trade and other receivables	6,723	650,573
Investment tax credits	8,867	11,884
Inventories	214,345	482,925
Prepaid expenses and other assets	299,745	216,524
	614,029	1,433,027
Non-current investment tax credits	23,406	24,245
Property and equipment	351,347	613,330
Right-of-use assets (Note 3)	173,537	608,604
Intangible assets	2	312,546
	1,162,321	2,991,752
Liabilities		
Current liabilities:		
Trade and other payables	4,638,695	3,830,582
License liabilities	1,837	269,908
Obligation under finance lease	-	4,482
Promissory notes to related parties (Note 10)	-	1,040,000
Deferred revenue	298,897	17,533
Convertible debentures (Note 5)	9,557,598	9,008,693
Lease obligation on right-of-use assets (Note 4)	191,350	345,874
	14,688,377	14,517,072
Non-current lease obligation on right-of-use assets (Note 4)	-	298,107
	14,688,377	14,815,179
Shareholders' Equity		
Common shares (Note 6(a))	145,170,270	142,428,107
Share-based payment reserve	3,634,150	3,663,400
Convertible debentures - share conversion option	1,574,971	1,574,971
Warrants	1,293,755	1,282,929
Subscription received for shares not issued	-	(4,104)
Deficit	(165,636,298)	(160,831,092)
Accumulated other comprehensive loss	437,096	62,362
	(13,526,056)	(11,823,427)
	1,162,321	2,991,752

Going concern (Note 1)

Subsequent events (Note 13)

Signed on behalf of the Board:

"Ron Pasek"

Director

"Raouf Halim"

Director

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

SPECTRA7 MICROSYSTEMS INC.

Condensed Interim Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2020 and 2019

(Unaudited, expressed in United States Dollars)

	Nine Months Ended September 30,	
	2020	2019
	\$	\$
Operating activities:		
Net Loss	(4,805,206)	(8,335,053)
Items not involving cash:		
Amortization of licenses	312,544	451,110
Depreciation of property and equipment	270,025	354,716
Depreciation of right-of-use assets	234,082	238,509
Termination of right-of-use assets	(14,132)	-
Share-based compensation	252,539	891,958
Accretion expense	1,587,986	1,353,050
Government grant (Note 11)	(776,085)	-
Change in value of derivative liability	-	(35)
	(2,938,247)	(5,045,745)
Net change in non-cash working capital items		
Trade and other receivables	643,850	(405,729)
Investment tax credits	3,856	35,463
Inventories	268,580	362,353
Prepaid expenses and other assets	(83,221)	(71,798)
Trade and other payables	848,666	1,625,384
Deferred revenue	281,364	(731,267)
	(975,152)	(4,231,339)
Grant funds received (Note 11)	776,085	-
Interest paid	(745,980)	(368,913)
	(945,046)	(4,600,252)
Financing activities:		
Proceeds from promissory notes to related parties (Note 10)	-	1,025,000
Repayment of promissory notes (Note 10)	-	(150,000)
Repayment of obligation under finance lease	(4,482)	(32,190)
Repayment of license liabilities	(268,071)	(280,406)
Repayment of lease obligation on right-of-use assets (Note 4)	(237,514)	(198,916)
Proceeds from issuance of warrants	-	404,234
Proceeds from issuance of shares, net of issuance costs (Note 6(a)(i))	1,397,711	4,104,642
	887,644	4,872,364
Investing activities:		
Acquisition of property and equipment	(8,042)	(56,861)
Acquisition of licenses	-	(143,392)
	(8,042)	(200,253)
Effect of foreign exchange rate changes on cash	78,672	90,917
Increase in cash	13,228	162,776
Cash, beginning of period	71,121	932,203
Cash, end of period	84,349	1,094,979

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

SPECTRA7 MICROSYSTEMS INC.

Notes to the Condensed Interim Consolidated Financial Statements

Three and Nine Months Ended September 30, 2020 and 2019

(Unaudited, expressed in United States Dollars)

1. Nature of operations, going concern and continuation of the business

Spectra7 Microsystems Inc. (the "Company" or "Spectra7"), is a publicly traded company listed on the TSX Venture Exchange (the "TSXV"). The Company is a high performance analog semiconductor company delivering unprecedented bandwidth, speed and resolution to enable disruptive industrial design for leading electronics manufacturers in Virtual Reality ("VR"), Augmented Reality ("AR"), Mixed Reality ("MR"), data centers and other connectivity markets.

The Company is domiciled in Canada and its registered office is located at 181 Bay Street, Suite 1800, Toronto, Canada M5J 2T9.

The Company's condensed interim consolidated financial statements have been prepared on a going concern basis. The going concern basis of presentation assumes that the Company will continue its operations for the foreseeable future and be able to realize the carrying value of its assets and discharge its liabilities in the normal course of operations. The Company incurred a comprehensive loss of \$1,436,392 (three months ended September 30, 2019 - \$2,603,455 and \$4,430,472 (nine months ended September 30, 2019 - \$8,417,573) during the three and nine month periods ended September 30, 2020, respectively and as of that date has an accumulated deficit of \$165,636,298 (December 31, 2019 - \$160,831,092). To date, the Company has funded operations through debt financings and through private and public equity offerings. These factors represent material uncertainties that may cast significant doubt upon the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is dependent upon its ability to obtain additional financing and/or achieve profitable operations in the future. The condensed interim consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate.

The COVID-19 pandemic has negatively impacted the Company and its impact on the data center programs is uncertain. While demand for the Company's new data center products remains strong, Spectra7 is currently experiencing significant staffing issues, customer disruptions, and supply chain challenges caused by the spread of COVID-19 and associated shut downs that are expected to continue to impact overall revenues in the near term. Revenue for the three and nine months ended September 30, 2020 was significantly reduced as a result of the COVID-19 pandemic. In response to the material near-term revenue impact, the Company has significantly reduced operating expenses, including employee furloughs. The Company continues to pursue the best available paths to manage operational risk and preserve capital during this time.

On April 24, 2020, the Company applied for enrollment in the Paycheck Protection Program ("PPP") formed under the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). The PPP provides funding by the U.S. Small Business Administration ("SBA"), an Agency of the United States of America, to incentivize small businesses to maintain employees on the payroll during the Coronavirus (COVID-19) pandemic. On June 5, 2020, the Paycheck Protection Program Flexibility Act ("PPFPA") was approved by the United States Congress to provide greater flexibility in order for recipients to be eligible for forgiveness of funds received under the PPP. On October 9, 2020, the Company applied for forgiveness of the funds received under the PPP.

2. Basis of presentation

a) Statement of compliance

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), using International Accounting Standard 34, Interim Financial Reporting ("IAS 34").

These condensed interim consolidated financial statements do not include all of the information required for full annual consolidated financial statements and should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2019 and 2018.

Except as noted below per Note 2(d), the Company has followed the same basis of presentation, accounting policies and method of computation for these condensed interim consolidated financial statements as were disclosed in the audited consolidated financial statements for the years ended December 31, 2019 and 2018.

These condensed interim consolidated financial statements were approved and authorized for issuance by the Board of Directors on November 16, 2020.

SPECTRA7 MICROSYSTEMS INC.

Notes to the Condensed Interim Consolidated Financial Statements

Three and Nine Months Ended September 30, 2020 and 2019

(Unaudited, expressed in United States Dollars)

b) Basis of measurement

The condensed interim consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments measured at fair value through profit or loss. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

These condensed interim consolidated financial statements are presented in United States dollars. The Company's functional currency is Canadian dollars.

c) Basis of consolidation

The condensed interim consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiaries:

- Spectra7 Microsystems Corp., a company incorporated under the laws of Ontario;
- Spectra7 Microsystems Ltd., a company incorporated under the laws of Delaware;
- Spectra7 Microsystems (Ireland) Limited, a company incorporated under the laws of Ireland; and
- Si Bai Ke Te (Dongguan) Electronics Trading Co. Ltd., a China wholly foreign-owned enterprise (WFOE).

All intercompany balances and transactions are eliminated in full on consolidation.

d) New Accounting Policies and Accounting Standards

(i) New Accounting Policies

During the nine months ended September 30, 2020, the Company adopted the following accounting policy related to government grants due to the receipt of funds under the PPP (see Note 1):

Government grants are recognized where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognized as income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed.

The Company has presented the government grant in the statement of financial position as Government grants and in the statement of loss and comprehensive loss as other income.

(ii) New Accounting Standards

The Company adopted the following amendments to accounting standards as of January 1, 2020:

IFRS 3: Business Combinations

In October 2018, the IASB issued amendments to IFRS 3, Business Combinations ("IFRS 3"). The amendments are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2020 and apply prospectively. The amendments clarify the definition of a business, with the objective of assisting entities in determining whether a transaction should be accounted for as a business combination or as an asset acquisition. Adoption of the amendments to IFRS 3 did not have any impact on the Company's condensed interim consolidated financial statements. They may affect whether future acquisitions are accounted for as business combinations or asset acquisitions, along with the resulting allocation of the purchase price between the net identifiable assets acquired and goodwill.

The following are future accounting standards issued as at January 1, 2020, but not yet effective:

IAS 1: Presentation of Financial Statements

In January 2020, the IASB issued amendments to IAS 1, Presentation of Financial Statements ("IAS 1") to clarify the requirements for classifying liabilities as current or non-current. The amendments are effective for annual periods beginning on or after January 1, 2022. The Company is currently assessing the impact of the amendment to IAS 1 to the Company's consolidated financial statements.

SPECTRA7 MICROSYSTEMS INC.

Notes to the Condensed Interim Consolidated Financial Statements
Three and Nine Months Ended September 30, 2020 and 2019
(Unaudited, expressed in United States Dollars)

3. Right-of-use assets

The following table sets forth the right-of-use assets as at September 30, 2020:

	\$
Balance, January 1, 2019	875,336
Depreciation	(159,006)
Balance September 30, 2019	716,330
Depreciation	(107,726)
Balance December 31, 2019	608,604
Depreciation	(234,082)
Derecognition of right-of-use asset	(200,985)
Balance September 30, 2020	173,537

The Company did not renew its Little Rock, Arkansas office lease ("Little Rock lease") as of April 1, 2020. The carrying amount of the right-of-use asset related to the Little Rock Lease of \$200,985 was derecognized along with the corresponding lease obligation of \$215,117 (see note 4). The difference of \$14,132 was recognized in net loss for the period.

4. Lease obligations on right-of-use assets

The present value of the remaining minimum lease payments on the obligations for right-of-use assets as at September 30, 2020 are as follows:

	\$
Balance, January 1, 2020	643,981
Principal repayments	(237,514)
Derecognition of lease obligation (Note 3)	(215,117)
Balance, September 30, 2020	191,350
Current	191,350
Non-Current	-

5. Convertible debentures

	\$
Balance, January 1, 2019	7,238,396
Accretion expense	1,863,945
Repayments of interest	(368,913)
Foreign exchange translation adjustment	275,265
Balance, December 31, 2019	9,008,693
Accretion expense	1,587,986
Repayments of interest	(745,980)
Foreign exchange translation adjustment	(293,101)
Balance, September 30, 2020	9,557,598

SPECTRA7 MICROSYSTEMS INC.

Notes to the Condensed Interim Consolidated Financial Statements

Three and Nine Months Ended September 30, 2020 and 2019

(Unaudited, expressed in United States Dollars)

The Company's convertible debentures are subject to certain covenants including restrictions against incurring certain additional indebtedness. The Company entered into promissory notes with certain directors of the Company during the year ended December 31, 2019 (see Notes 8 and 10), which put the Company offside such covenants. On May 21, 2020 the Company settled all outstanding amounts under the promissory notes and therefore brought the Company into compliance with such restrictive covenants. As of September 30, 2020, the Company is in compliance with all covenants.

6. Shareholders' equity

(a) Common shares

- Authorized share capital consists of an unlimited number of common shares.

The following table summarizes the changes to the issued and outstanding common shares during the nine months ended September 30, 2020:

	Common Shares	
	#	\$
Balance, December 31, 2019	409,557,177	142,428,107
Shares issued under Restricted Share Unit plan	2,717,091	281,789
Units issued on March Private Placement (i)	99,999,998	1,102,344
Units issued on July Private Placement (i)	37,724,824	616,623
Allocation of warrant portion of compensation shares (i)	-	(12,176)
Settlement of Promissory Notes (Note 10)	42,000,000	753,583
Balance, September 30, 2020	591,999,090	145,170,270

The following table summarizes the changes to the issued and outstanding common shares during the nine months ended September 30, 2019:

	#	\$
Balance, December 31, 2018	237,738,585	136,129,926
Shares issued under Restricted Share Unit plan	1,452,126	158,828
August Units issued - August Private Placement (ii)	93,176,081	3,504,607
August Units issued - August Prospectus Offering (ii)	65,255,480	2,454,437
Allocation of warrants portion of August Units (ii)	-	(397,601)
Cash paid for issuance costs - shares portion (ii)	-	(640,561)
Shares issued as commission - August Private Placement (ii)	1,797,984	60,864
Shares issued as commission - August Prospectus Offering (ii)	2,420,600	81,941
Allocation of warrant portion of compensation shares	-	(133,277)
Compensation Options issued to brokers - shares portion	-	-
August Private Placement and August Prospectus Offering (ii)	-	(112,919)
Balance, September 30, 2019	401,840,856	141,106,245

SPECTRA7 MICROSYSTEMS INC.

Notes to the Condensed Interim Consolidated Financial Statements

Three and Nine Months Ended September 30, 2020 and 2019

(Unaudited, expressed in United States Dollars)

(i) Private Placement

On March 10, 2020, the Company announced a non-brokered private placement of up to 100,000,000 common shares in the capital of the Company ("Common Shares") at a price of CDN \$0.015 per Common Share for gross proceeds of up to \$1,087,132 (CDN \$1,500,000), (the "March Private Placement"). The first tranche of the March Private Placement closed on March 10, 2020 and consisted of the issuance of 80,798,400 Common Shares for aggregate gross proceeds of (CDN \$1,211,976) \$882,657 (net of issuance costs).

On April 20, 2020, the Company completed a second tranche of the March Private Placement, which consisted of the issuance of 19,201,598 Common Shares for aggregate gross proceeds of (CDN \$288,024) \$219,687 (net of issuance costs).

On June 18, 2020, the Company announced a non-brokered private placement of up to 40,000,000 units of the Company ("Units") at a price of CDN \$0.025 per Unit for gross proceeds of up to \$759,071 (CDN \$1,000,000), (the "July Private Placement"). Each Unit consists of one Common Share and one-half of one common share purchase warrant (each whole warrant, a "July Warrant") with each July Warrant being exercisable into one Common Share at an exercise price of \$0.05 for a period of five years from the date of issuance, subject to adjustment upon certain customary events. The expiry date of the July Warrants can be accelerated by the Company at any time following the date that is 4 month and one day after closing of the July Private Placement and prior to the expiry date of the July Warrants if the closing price of the Common Shares on the TSX Venture Exchange is greater than \$0.08 for any 10 non-consecutive trading days.

On July 15, 2020, the Company completed a first tranche of the July Private Placement, which consisted of the issuance of 21,046,904 Units at a price of \$0.025 per Unit for gross proceeds of (CDN \$526,173) \$343,917 (net of issuance costs).

On September 25, 2020, the Company completed a second tranche of the July Private Placement, which consisted of the issuance of 16,677,920 Units at a price of \$0.025 per Unit for gross proceeds of (CDN \$416,948) \$260,530 (net of issuance costs).

Gross proceeds from the March Private Placement and the July Private Placement were allocated to the Common Shares and July Warrants based on their relative fair values. The fair value of the July Warrants was determined using the Black Scholes option pricing model with the following assumptions: risk free interest rate of 0.33%, expected life of 5 years and expected volatility of 25.6%. \$700,026 was attributed to the Common Shares and \$12,176 to July Warrants, with the July Warrants classified as equity in shareholders' equity.

(ii) Private Placement and Prospectus Offering

On August 21, 2019, the Company closed its best efforts prospectus offering of 65,255,480 units ("August Units") at a price of CDN \$0.05 per Unit for aggregate gross proceeds to the Company of \$2,454,437 (CDN \$3,262,774) (the "August Prospectus Offering"). Each August Unit consists of one Common Share and one-half of one common share purchase warrant (each whole warrant, a "2019 Warrant"). Each 2019 Warrant entitles the holder thereof to acquire one common share at an exercise price of CDN \$0.08 until August 21, 2024 (the "Expiry Date").

Concurrently with the August Prospectus Offering, the Company closed a non-brokered private placement of 93,176,081 August Units, for gross proceeds of \$3,504,607 (CDN \$4,658,804) (the "August Private Placement" and, together with the August Prospectus Offering, the "Offerings"), bringing the aggregate gross proceeds to the Company from the Offerings to \$5,959,044 (CDN \$7,921,578).

Gross proceeds from the Offerings were allocated to the common shares and 2019 Warrants based on their relative fair values. The fair value of the 2019 Warrants was determined using the Black Scholes option pricing model with the following assumptions: risk free interest rate of 1.49%, expected life of 5 years and expected volatility of 33.9%. \$5,561,443 and \$397,601 were attributed to the common shares and 2019 Warrants, respectively with the 2019 Warrants classified as equity in shareholders' equity.

In consideration for the services provided by the agents under the August Prospectus Offering, the Company paid commissions (the "Agents' Commission") equal to 6.0% of the proceeds of the August Prospectus Offering of which \$71,078 (CDN \$94,736) was payable in cash and a total of \$81,941 (CDN \$101,030) was payable by the issuance of 2,020,600 common shares at a fair value of CDN \$0.45 per share (the "Commission Shares"). In addition, the Company issued 400,000 common shares to Haywood Securities Inc. ("Corporate Finance Fee Shares") at a fair value of \$0.045 per share.

SPECTRA7 MICROSYSTEMS INC.

Notes to the Condensed Interim Consolidated Financial Statements

Three and Nine Months Ended September 30, 2020 and 2019

(Unaudited, expressed in United States Dollars)

The Company also issued to the agents an aggregate of 4,567,883 non-transferable compensation options (the "Compensation Options") equal to 7.0% of the total number of August Units sold under the August Prospectus Offering. Each Compensation Option is exercisable into one Common Share at an exercise price equal of CDN \$0.05 at any time prior to the Expiry Date. The fair value of the Compensation Options was determined at \$76,474 using the Black Scholes option pricing model with the following assumptions: risk free interest rate of 1.49%, expected life of 5 years and expected volatility of 33.9%.

In connection with the provision of certain financial advisory services, the Company also paid Haywood Securities Inc. a cash advisory fee and issued an aggregate of 5,900,000 non-transferable advisory options on the same terms as the Compensation Options.

In consideration for the services provided by certain finders in connection with the August Private Placement the Company issued an aggregate of 1,797,984 common shares at a fair value of \$0.045 per share. The Company also issued 2,097,648 Compensation Options to the finders, each Compensation Option is exercisable into one common share at an exercise price equal of CDN \$0.05 at any time from 5 years of the grant date. The fair value of the Compensation Options was determined at \$20,198 using the Black Scholes option pricing model with the following assumptions: risk free interest rate of 1.49%, expected life of 5 years and expected volatility of 33.9%. \$18,850 and \$1,348 were allocated to the common shares and warrants respectively based on their relative fair values. The Company paid \$686,356 of transaction costs related to the Offerings, with \$640,561 and \$45,795 being allocated to the common shares and warrants, respectively.

Of the 65,255,480 August Units issued pursuant to the August Prospectus Offering, 13,290,000 August Units were issued for settlement of accounts payable and cash transaction costs of \$327,653 and there was no gain or loss recognized from these settlements. Also, of the 93,176,081 August Units issued pursuant to the August Private Placement, 15,728,452 August units were issued in settlement of promissory notes of \$475,000 and accounts payable of \$116,590 and there was no gain or loss recognized from these settlements.

(b) Share-based compensation

The Company has established a stock option plan ("Option Plan") and a restricted share unit plan ("RSU Plan") with the intention of attracting, retaining and motivating employees, officers and directors.

The Company's Board of Directors determines, among other things, the eligibility of individuals to participate in the RSU Plan and the Option Plan and the term, vesting periods, and the exercise price of options granted under the Option Plan.

At the annual and special meeting of shareholders in June 2019, shareholders approved amendments to both the Option Plan and the RSU Plan to provide that the combined maximum number of common shares reserved for issuance under both the Option Plan and the RSU Plan, inclusive of existing stock options and RSUs, shall not exceed 47,838,517. The combined aggregate number of common shares reserved under the Option Plan and the RSU Plan at September 30, 2020 was 44,748,087 common shares (December 31, 2019 - 39,332,300 common shares).

(i) *Restricted Share Units (RSU)*

Vesting is determined by the Company's Board of Directors at the time of grant. Vesting is contingent upon continuous service/employment through the specific vesting date. The fair value as of the grant date is used to determine the value.

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The following table summarizes information about the Company's outstanding RSUs as at September 30, 2020 and 2019:

	September 30, 2020	September 30, 2019
	#	#
Balance, opening	37,105,661	17,135,257
Granted	1,300,000	6,150,000
Forfeited	(8,572,609)	(27,263)
Vested and common shares issued	(2,717,091)	(1,452,126)
Balance, ending	27,115,961	21,805,868

During the nine months ended September 30, 2020, 2,717,091 RSUs were delivered for \$281,789, which was transferred to common shares from share-based payment reserve (nine month period ended September 30, 2019 - 1,452,126 RSUs were delivered for \$158,828).

(ii) Stock options

Vesting is determined by the Company's Board of Directors at the time of grant. Vesting is contingent upon continuous service/employment through the specific vesting date as set forth in the option certificate issued in respect of such option and in any event shall not be less than market price of the common shares as of the award date.

The expiry date of an option is fixed by the Board of Directors at the time the particular option is awarded, provided that the expiry date shall be no later than the date that is 10 years following the award date of such option, subject to earlier termination upon the option holder ceasing to be a director, officer, employee or consultant of the Company.

The following table summarizes information about the Company's outstanding stock options as at September 30, 2020 and 2019:

	September 30, 2020		September 30, 2019	
	Number of Options	Weighted Average Price	Number of Options	Weighted Average Price
	#	CDN \$	#	CDN \$
Options outstanding, opening	2,226,639	0.56	6,428,453	0.43
Granted	17,821,129	0.02	-	-
Forfeited	(2,415,642)	0.19	(4,061,361)	0.34
Options outstanding, ending	17,632,126	0.07	2,367,092	0.58

During the three month and 9 month periods ended September 30, 2020, the Company reversed share-based compensation expenses of \$4,014 and \$2,593 respectively (three and nine month periods ended September 30, 2019 - \$1,533 and \$118,920 respectively) as a result of forfeitures.

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The following table is a summary of the Company's stock options outstanding as at September 30, 2020:

Exercise price range	Number outstanding	Options Outstanding		Options Exercisable	
		Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
CDN \$	#	#	CDN \$	#	CDN \$
0.00 - 0.20	16,058,629	6.12	0.03	7,208,629	0.03
0.21 - 0.40	279,358	3.69	0.22	234,577	0.22
0.41 - 0.60	717,524	2.42	0.48	661,239	0.48
0.61 - 0.80	501,615	1.47	0.68	501,600	0.68
0.81 - 1.00	75,000	1.14	0.92	75,000	0.92
Balance, Sept 30, 2020	17,632,126	5.78	0.07	8,681,045	0.11

The following table is a summary of the Company's stock options outstanding as at September 30, 2019:

Exercise price range	Number outstanding	Options Outstanding		Options Exercisable	
		Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
CDN \$	#	#	CDN \$	#	CDN \$
0.00 - 0.20	100,000	5.86	0.19	27,083	0.19
0.21 - 0.40	389,164	4.90	0.22	213,116	0.22
0.41 - 0.60	758,804	3.41	0.48	586,713	0.47
0.61 - 0.80	629,124	2.36	0.70	595,956	0.70
0.81 - 1.00	490,000	0.68	0.93	490,000	0.93
Balance, Sept 30, 2019	2,367,092	2.91	0.58	1,912,868	0.63

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(iii) Share based compensation expense

For its RSU Plan and Option Plan, the Company recognized share-based compensation expense of a negative \$11,850 and \$252,539 for the three and nine months ended September 30, 2020 (September 30, 2019 - \$236,725 and \$891,958) with a corresponding amount recognized as share-based payment reserve. The negative \$11,850 for the three month period is due to terminated employees.

The fair value of the RSUs is determined based upon the Company's stock price on the date of grant. There were 17,821,129 stock options granted during the nine months ended September 30, 2020 (nine months ended September 30, 2019: NIL stock options granted). The fair value of stock options granted during the nine months ended September 30, 2020 was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Nine Months Ended September 30,	
	2020	2019
Dividend yield	0%	N/A
Expected volatility	36%	N/A
Risk free rate of return	0.84%	N/A
Forfeiture rate	10%	N/A
Expected life	6.5 years	N/A

Expected volatility is based on comparable companies listed on various exchanges.

(c) Warrants

The following table summarizes information about the Company's outstanding warrants as at September 30, 2020 and 2019:

	September 30, 2020		September 30, 2019	
	Number of Warrants	Weighted Average Price	Number of Warrants	Weighted Average Price
	#	CDN \$	#	CDN \$
Balance, opening	151,550,744	0.17	68,138,557	0.35
Warrants component of July Private Placement (Note 6(i))	18,862,412	0.05	-	-
Prospectus Offering/ August Private Placement (Note 6(ii))	-	-	12,565,531	0.05
Warrants component of August Prospectus Offering (Note 6(ii))	-	-	32,627,740	0.08
Warrants component of August Private Placement (Note 6(ii))	-	-	46,588,041	0.08
Non-broker warrants expired	-	-	(7,679,125)	0.55
Broker warrants expired	(3,063,000)	0.35	(690,000)	0.40
Balance, ending	167,350,156	0.16	151,550,744	0.17

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The following is a summary of the warrants outstanding as at September 30, 2020:

Number of warrants outstanding	Exercise Price	Expiry Date
Non-broker Warrants		
22,182,975	CDN \$0.50	January 9, 2021
14,168,145	CDN \$0.1575	July 6, 2023
16,206,114	CDN \$0.225	October 30, 2023
79,215,781	CDN \$0.08	August 21, 2024
10,523,452	CDN \$0.05	July 15, 2025
8,338,960	CDN \$0.05	September 25, 2025
Broker Warrants (Compensation Options)		
497,137	CDN \$0.1575	July 6, 2023
1,447,051	CDN \$0.225	October 30, 2023
12,565,531	CDN \$0.05	August 21, 2024
Waiver Warrants		
2,205,010	CDN \$0.30	February 24, 2022

The following is a summary of the warrants outstanding as at September 30, 2019:

Number of warrants outstanding	Exercise Price	Expiry Date
Non-broker Warrants		
22,182,975	CDN \$0.50	January 9, 2021
14,168,145	CDN \$0.1575	July 6, 2023
16,206,114	CDN \$0.225	October 30, 2023
79,215,781	CDN \$0.08	August 21, 2024
Broker Warrants (Compensation Options)		
3,063,000	CDN \$0.35	January 9, 2020
497,137	CDN \$0.1575	July 6, 2023
1,447,051	CDN \$0.225	October 30, 2023
12,565,531	CDN \$0.05	August 21, 2024
Waiver Warrants		
2,205,010	CDN \$0.30	February 24, 2022

7. Other Comprehensive Loss

The operating results of Spectra7 Microsystems Corp., and Si Bai Ke Te (Dongguan) Electronics Trading Co. Ltd, both wholly-owned subsidiaries of the Company, are translated from their functional currencies of Canadian Dollars (CDN) and Chinese Yuan Renminbi (CNY), respectively, into the Company's presentation currency of USD at the end of each reporting period, with the difference being recorded in other comprehensive income. During the nine month period ended September 30, 2020, the Company recorded an other comprehensive gain of \$374,734 (September 30, 2019: other comprehensive loss of \$82,520 related to unrealized foreign currency translation, which arose to the significant change in the USD exchange rate to CDN and CNY).

8. Related party transactions

The Company transacts with key individuals from management and with its directors who have authority and

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responsibility to plan, direct and control the activities of the Company. The nature of these dealings was in the form of payments for services rendered in their capacity as employees and as directors of the Company.

The Company's key management personnel are comprised of the Board of Directors and current and former members of the executive team of the Company.

Key management personnel compensation is comprised of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
	\$	\$	\$	\$
Salaries, fees and short-term benefits	80,249	545,002	1,383,792	1,489,378
Share-based benefits	98,154	204,130	349,281	708,201
Total	178,403	749,132	1,733,073	2,197,579

At June 30, 2020, the Company settled the non-interest bearing promissory notes payable to certain directors of the Company in the amount of \$750,000, net of the effect of foreign exchange rate (December 31, 2019 - \$1,040,000). The promissory notes were non-interest bearing and repayable within one year. See Note 10.

9. Economic dependence

During the three and nine month periods ended September 30, 2020, the Company derived approximately 98% and 94% of its revenue from two customers, respectively (three and nine months ended September 30, 2019 - 99% and 95% from three customers), respectively.

10. Promissory Notes

As at December 31, 2019, the Company had \$1,040,000 owing to certain directors of the Company pursuant to outstanding promissory notes (the "Promissory Notes"). During the nine month period ended September 30, 2020, the Company settled \$290,000 of the Promissory Notes with funds from the issuance of Common Shares pursuant to the March Private Placement as described in Note 6(a)(i). On May 22, 2020, the Company issued an aggregate of 42,000,000 Common Shares to directors of the Company at a deemed issuance price of CDN \$0.025 per Common Share to settle the remaining \$750,000 Promissory Notes, net of the effect of foreign exchange rate.

11. Government Grant

	\$
Balance, January 1, 2020	-
Received during the period	776,085
Released to the statement of loss and comprehensive loss	(776,085)
Balance September 30, 2020	-

Under the terms of the PPP, the Company received approval and grant from a US based bank and the SBA for \$776,085 at an interest rate of 1.0% per annum and maturing in 24 months. Payments will not be due by the Company during the initial six-month period and, commencing one month after such six-month period, the Company shall be responsible for monthly payments of principal and interest in equal amounts until the maturity date.

Under the CARES Act, the Company is eligible for forgiveness of both the principal and accrued interest to the extent that the Funds are used to cover eligible payroll, mortgage interest, rent and utility costs over a 24-week period following receipt of the grant and so long as the Company retains its employees and maintains their levels

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of compensation. No more than 40% of the funds may be allocated to non-payroll costs.

The Company intends to use the funds for the purposes set out in the CARES Act and the PPPFA and apply for forgiveness of the grant either on the maturity date or prior to the maturity date if all the Funds have been used by the Company. As at September 30, 2020, the Company reasonably expects that it will meet the terms of forgiveness under the CARES Act and on this basis, the Company considers the funds to be in the form of a government grant (see Note 2(d)). On October 9, 2020, the Company submitted the application for forgiveness to the SBA following an initial review by our bank.

12. Trade and Other Payables

Trade and other payables are comprised of the following:

	September 30, 2020	December 31, 2019
	\$	\$
Trade payables	3,096,255	2,363,662
Other payables	1,542,440	1,466,920
Total	4,638,695	3,830,582

As at September 30, 2020 the amount of other payables is \$1,542,440 (December 31, 2019 - \$1,466,920), and includes \$1,281,745 (December 31, 2019 - \$1,198,454) related to accrued executive payroll and bonus.

13. Subsequent Events

Subsequent to period end, the Company has agreed to issue to the Chief Executive Officer 22,448,912 restricted share units (the "RSUs") under the Company's RSU Plan, on the basis of a price per common share of CAD \$0.025 and a CAD to USD exchange rate of 0.757275 to 1. Prior to issuance of the RSUs, and in accordance with the Company's RSU Plan, the Directors of the Company will need to approve a further increase in the number of common shares reserved for issuance under the RSU plan.

The Company announced on October 30, 2020 that it has entered into a term sheet with a requisite percentage of debenture holders setting out the Company's intention to amend certain terms of its existing \$9.685 million (CDN \$12.898 million) 7% unsecured convertible debentures (the "Debentures") due to mature in January 2021. Pursuant to the term sheet, the maturity date of the Debentures is to be extended 18 months from January 9, 2021 to July 9, 2022, subject to adjustment, and the conversion price of the principal amount of the Debentures is to be reduced from \$0.35 per common share to \$0.05 per common share. In consideration for the amendments, the Company has agreed to increase the outstanding principal obligations of the Debentures by 10%. The amendments to the Debentures are subject to approval by the TSX Venture Exchange and formal approval of holders of greater than 66 2/3% of the outstanding Debentures.