

SPECTRA INC.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS
THREE AND SIX MONTHS ENDED JUNE 30, 2009 AND 2008

Canadian dollars

(Unaudited – See notice of no auditor review)

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 financial statements have not been reviewed by an auditor. The accompanying unaudited financial statements of Spectra Inc. 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 financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

SPECTRA INC.
Consolidated Balance Sheets
June 30, 2009 and December 31, 2008

	June 30 2009	December 31 2008
ASSETS		
Current		
Cash	\$ 15,208	\$ 29,458
Accounts receivable	88,988	77,136
Inventories (note 3)	286,681	343,786
Prepaid expenses	9,621	19,493
	<u>400,498</u>	469,873
Equipment (note 4)	55,230	60,510
Intangible Assets (note 5)	52,000	62,578
	<u>\$ 507,728</u>	<u>\$ 592,961</u>
LIABILITIES		
Current		
Bank loan payable (note 6)	\$ 0	\$ 29,500
Related party loan payable (note 6)	20,000	0
Accounts payable and accrued charges	430,356	464,136
Dividend payable (note 10)	22,500	0
Loan payable (note 7)	904,990	756,193
Royalty debenture – current portion (note 9)	50,000	37,500
	<u>1,427,846</u>	1,287,329
Related Party Loan (note 8)	0	14,848
Royalty Debenture (note 9)	471,184	498,505
Convertible Preferred Shares (note 10)	860,784	826,130
	<u>2,759,814</u>	<u>2,626,812</u>
SHAREHOLDERS' DEFICIENCY		
Share Capital (note 11)	4,809,486	4,809,486
Warrants (note 11)	0	100,897
Contributed Surplus (note 11)	196,018	95,121
Deficit	(7,257,590)	(7,039,355)
	<u>(2,252,086)</u>	<u>(2,033,851)</u>
	<u>\$ 507,728</u>	<u>\$ 592,961</u>

APPROVED ON BEHALF OF THE BOARD

“Andrew Malion”

“Michael Faye”

Director

Director

(The accompanying notes are an integral part of these consolidated financial statements.)

SPECTRA INC.Consolidated Statements of (Loss) Earnings and Comprehensive (Loss) Income and Deficit
Six months ended June 30, 2009 and 2008

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
		(note 17)		(note 17)
Sales	\$ 194,703	\$239,886	\$ 383,350	\$ 500,575
Cost of Sales	<u>77,437</u>	104,501	<u>168,392</u>	227,646
Gross Profit	<u>117,266</u>	135,385	<u>214,958</u>	272,929
Expenses				
Management fees and salaries	63,543	118,303	101,502	228,202
Consulting	6,000	30,000	12,000	58,000
Commissions	14,465	14,756	26,274	32,978
Product royalty	1,457	1,477	2,754	3,781
Travel and courier	2,133	10,166	7,757	22,262
Trade shows	3,990	2,461	7,347	6,259
Advertising and promotion	8,696	21,896	11,238	35,456
Professional fees	14,970	29,319	31,449	59,547
Insurance	6,968	6,771	13,810	14,112
Premises cost	12,794	14,599	22,855	30,398
Bad debt recovery	(1,389)	-	(27,185)	-
Bank interest and charges	952	2,965	2,203	4,204
Office and general	8,559	11,593	17,423	22,884
Debenture royalty	18,750	18,749	37,500	38,301
Interest on long-term debt	28,422	14,810	55,118	23,785
Accretion of discount on debt	41,465	31,652	68,630	55,892
Amortization	11,168	12,042	20,018	23,549
	<u>242,943</u>	341,559	<u>410,693</u>	659,610
Loss Before Other Income (Expenses)	(125,677)	(206,174)	(195,735)	(386,681)
Debt settlement	<u>-</u>	-	<u>-</u>	11,610
(Loss) Earnings Before Income Taxes	<u>(125,677)</u>	(206,174)	<u>(195,735)</u>	(375,071)
Provision for income tax (note 14)	<u>-</u>	-	<u>-</u>	-
Net (Loss) Earnings and Comprehensive (Loss) Income	(125,677)	(206,174)	(195,735)	(375,071)
Deficit – Beginning of Period	(7,120,663)	(6,450,350)	(7,039,355)	(6,281,453)
Dividend payment (note 10)	<u>(11,250)</u>	-	<u>(22,500)</u>	-
Deficit - End of Period	<u>\$ (7,257,590)</u>	\$ (6,656,524)	<u>\$ (7,257,590)</u>	\$ (6,656,524)
Loss per Share – Basic and diluted	<u>\$ (0.003)</u>	\$ (0.004)	<u>\$ (0.004)</u>	\$ (0.008)
Weighted Average Number of Common Shares Outstanding During the Period - Basis	<u>49,881,837</u>	46,881,837	<u>49,881,837</u>	46,881,837
- Diluted	<u>56,678,158</u>	56,201,807	<u>56,678,158</u>	55,922,285

(The accompanying notes are an integral part of these consolidated financial statements.)

SPECTRA INC.Consolidated Statements of Cash Flows
Six months ended June 30, 2009 and 2008

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
		(note 17)		(note 17)
Cash Flows from Operating Activities				
Net (loss) earnings	(125,677)	(206,174)	\$ (195,735)	\$ (375,071)
Adjustments for non-cash items:				
Accretion of discount on debt	41,465	31,652	68,630	55,893
Amortization	11,168	12,041	20,018	23,548
Debt settlement	-	-	-	(11,610)
	(73,044)	(162,481)	(107,087)	(307,240)
Changes in working capital:				
Accounts receivable	16,518	20,661	(11,852)	44,687
Inventories	56,199	(68,778)	57,105	(122,268)
Prepaid expenses	3,030	(6,729)	9,872	(1,801)
Accounts payable and accruals	(11,400)	21,662	(33,780)	91,789
Net Cash Used in Operating Activities	(8,697)	(195,665)	(85,742)	(294,833)
Cash Flows from Investing Activities				
Equipment additions	-	-	-	-
Intangible assets additions	(1,600)	(9,126)	(4,160)	(15,526)
Net Cash Used in Investing Activities	(1,600)	(9,126)	(4,160)	(15,526)
Cash Flows from Financing Activities				
Proceeds from (repayment of) loan payable	10,000	305,420	90,500	300,000
Related party repayment	(4,172)	(18,188)	(14,848)	(18,188)
Royalty debenture payments	-	6,517	-	-
Net Cash Provided by Financing Activities	5,828	293,749	75,652	281,812
Net (Decrease) Increase in Cash	(4,469)	88,958	(14,250)	(28,547)
Cash - Beginning of Period	19,677	(33,503)	29,458	84,002
Cash - End of Period	\$ 15,208	55,455	\$ 15,208	\$ 55,455
Supplemental Information				
Interest paid	\$ 28,422	14,810	\$ 55,118	\$ 23,785
Income taxes	\$ -	-	\$ -	\$ -
Non-cash item				
Debt carrying value adjustment	\$ 41,465	31,650	\$ 68,630	\$ 55,891

(The accompanying notes are an integral part of these consolidated financial statements)

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

1. Nature of Business and Basis of Presentation

Nature of Business

Spectra Inc. (“Spectra”) and its wholly-owned subsidiary Spectra Products Inc. (“SPI”) (collectively the “Company”) is a manufacturing and marketing company incorporated under the laws of the province of Alberta on October 4, 1994. The Company operates in one market segment - bus and truck transportation safety equipment. The Company manufactures and markets brake monitoring equipment as an after market product through transportation dealers, distributors and direct sales to fleet operators.

Going Concern

These consolidated financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. As at June 30, 2009, the Company had a deficit of \$7,257,590 (2008 - \$7,039,355). The Company's ability to meet its obligations and continue as a going concern is dependent upon its ability to obtain additional financing and achievement of profitable operations. Management plans to achieve profitable operations and pursue additional financing, however, there can be no assurance that the Company will be able to secure financing when needed or to obtain such financing on terms satisfactory to the Company, if at all. The Company is seeking additional financing to provide working capital, inventory and capital equipment necessary to implement its five year business plan. The Company will continue to seek new financing, joint venture or strategic financial relationships that will permit ongoing operation of the Company.

The consolidated financial statements do not reflect any adjustments in the carrying values of the assets and liabilities, the reported expenses, and the balance sheet classifications used that would be necessary if the going concern assumption were not appropriate. Such adjustments could be material.

Basis of Presentation

The management of the Company has prepared these interim consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”). Disclosure of the interim financial statements does not conform in all respects to the requirements of GAAP for annual statements. The notes presented in these interim financial statements include only significant events and transactions and do not include all matters normally disclosed in the Company’s audited annual financial statements. These interim financial statements have not been audited or reviewed by the Company’s independent auditors. These statements follow the same accounting policies and methods as the most recent annual audited financial statements and should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2008.

In the opinion of management, all adjustments considered necessary for fair presentation have been included in these interim consolidated financial statements. Operating results for the six months ended June 30, 2009, are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

2. Summary of Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Outlined below are those policies considered particularly significant:

a) Principles of Consolidation

These consolidated financial statements include the accounts of Spectra and SPI. All significant inter-company transactions and balances have been eliminated.

b) Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Title and risk of loss generally pass to the customer at the time of delivery of the product to a common carrier.

c) Inventories

Inventories are valued, on a first-in, first-out basis at the lower of cost and net realizable value. The Company writes down estimated obsolete or excess inventory for the difference between the cost of inventory and estimated net realizable value based upon customer forecasts, shrinkage, the aging and future demand of the inventory, past experience with specific customers, and the ability to sell inventory back to customers or suppliers. If these assumptions change, additional write-downs may be required.

d) Equipment

Equipment is recorded at cost and amortization is provided, over the estimated useful life of the asset, using the undernoted annual rates and methods:

Dies and molds – other		Units of production method
Dies and molds – Brake Inspector	5 years	Straight line
Furniture and fixtures	20%	Declining balance
Computer equipment	30%	Declining balance
Machinery and equipment	20%	Declining balance

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

2. Summary of Significant Accounting Policies (cont'd)

e) Intangible Assets

Intangible assets consist of patents, trademarks, product rights and prototypes. They are recorded at cost and amortization is provided, over the estimated useful life of the asset, using the undernoted annual rates and methods:

Patents and trademarks	4-10 years	Straight line
Product rights	3-10 years	Straight line
Prototypes	3-10 years	Straight line

f) Impairment of Long-lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability is assessed based on the carrying amount of a long-lived asset compared to the sum of the future undiscounted cash flows expected to result from the use and the eventual disposal of the asset. An impairment loss is recognized when the carrying amount is not recoverable and exceeds fair value.

g) Deferred Charges

Deferred financing fees are deferred and amortized using the effective interest rate method over the term of the royalty agreement and the related amortization is included within amortization expense. In accordance with the CICA's Handbook Section 3855 "Financial Instruments", these deferred financing fees have been reclassified to offset against the royalty debenture.

h) Income Taxes

The Company uses the asset and liability method of accounting for future income taxes. Under the asset and liability method, future income tax assets and liabilities are determined based on temporary differences (difference between the accounting basis and the tax basis of the assets and liabilities), and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized. Income tax expense or benefit is the sum of the Company's provision for current income taxes and the difference between the opening and ending balances of the future income tax assets and liabilities.

i) Stock-based Compensation

The Company uses the fair value-based method to account for stock-based compensation. The grant date fair value of stock options is estimated using the Black-Scholes option-pricing model. Compensation expense is recognized over the stock option vesting period with a corresponding charge to contributed surplus. When the stock options are exercised, the proceeds, together with the amount recorded in contributed surplus, are recorded in share capital.

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

2. Summary of Significant Accounting Policies (cont'd)

j) (Loss) Earnings per Share

Basic (loss) earnings per share is computed by dividing the net (loss) earnings available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted (loss) earnings per share, using the treasury stock method, assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on (loss) earnings per share. As the exercise price of the warrants and options was higher than the average market share price of the shares during 2009 and 2008 the dilutive effect of outstanding options and warrants and their equivalents is not reflected in diluted (loss) earnings per share because their effect would be anti-dilutive.

k) Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles 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 dates of the financial statements and the reported amounts of expenses during the reporting periods. Significant estimates include the carrying value of certain accrued liabilities and the value of future income taxes. Actual results could differ from those estimates.

l) Capital Structure

The capital structure of the Company consists principally of shareholders' deficiency comprised of deficit and share capital. The Company's strategy is to effectively use debt financing to fund growth and manage its capital structure in light of economic conditions and the risk characteristics of the underlying assets. The Company's primary uses of capital are to finance non-cash working capital requirements and capital expenditures, which are currently funded from both its internally and externally generated cash flows. The Company is not subject to any externally imposed capital requirements and does not presently utilize any quantitative measures to monitor its capital. The Company's objectives in managing capital are to ensure sufficient liquidity to pursue its strategy of organic growth and to deploy capital to provide an appropriate return on investment to its shareholders.

m) Comprehensive (Loss) Income

Certain gains and losses arising from changes in fair value are temporarily recorded outside the statement of loss in accumulated other comprehensive income as a separate component of share capital.

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

2. Summary of Significant Accounting Policies (cont'd)

m) Comprehensive (Loss) Income (cont'd)

Comprehensive (loss) income is comprised of the Company's net (loss) income and other comprehensive (loss) income. Other comprehensive (loss) income may include any unrealized gains and losses on available-for-sale securities, foreign currency translation gains and losses on the net investment in self-sustaining foreign operations and changes in the fair value of derivative instruments designated as cash flow hedges, all net of income taxes. At June 30, 2009, the balance of other comprehensive (loss) income is \$nil (2008 – \$nil).

n) Accounting Policy Developments

(i) *Financial Instruments - Disclosure and Presentation*: In December 2006, the CICA issued Section 3862, "Financial Instruments Disclosures", and Section 3863, "Financial Instruments, Presentation". These standards provide additional guidance on disclosing risks related to recognized and unrecognized financial instruments and how those risks are managed. This Section applies to annual consolidated financial statements of the Company commencing the 2008 fiscal year.

(ii) *Capital Disclosures*: CICA issued Section 1535, "Capital Disclosures", which provides standards for disclosures regarding an entity's capital and how it is managed. Enhanced disclosure with respect to the objectives, policies and processes for managing capital and quantitative disclosures about what an entity regards as capital is required. These recommendations are effective for fiscal years beginning on or after January 1, 2008 therefore, apply to the Company. See note 2(l) regarding additional disclosure.

(iii) *General Standards on Financial Statements Presentation*: In June 2007, the CICA Handbook Section 1400, "General Standards on Financial Statements Presentation", has been amended to include requirements to assess and disclose an entity's ability to continue as going concern. The changes are effective for annual financial statements beginning on or after January 1, 2008 therefore, apply to the Company. See note 1 regarding additional disclosure.

(iv) *Goodwill and Intangible Assets*: In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets". The new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The new section will be applicable to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2009. There is no impact of these new sections on the Company's consolidated financial statements.

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

2. Summary of Significant Accounting Policies (cont'd)

o) Future Accounting Pronouncements

(i) *International Financing Reporting Standards (IFRS)*: In 2006, the CICA adopted a strategy of converging Canadian generally accepted accounting principles for publicly accountable enterprises with International Financial Reporting Standards ("IFRS"). The Company is required to report using these converged standards for interim and annual financial statements for fiscal years commencing on or after January 1, 2011. The Company is currently in the process of evaluating the impact of this convergence on the consolidated financial statements.

(ii) *Business Combinations and Consolidated Financial Statements*: In December 2008, the CICA issued Handbook Section 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements" and Section 1602, "Non-Controlling Interests". Section 1582 establishes standards for accounting for business combinations and is equivalent to the IFRS standard, IFRS 3 (Revised). The new standards apply to business combinations with an acquisition date on or after January 1, 2011, however earlier adoption is permitted. The Company is currently evaluating the impact of this new standard on its consolidated financial statements.

Sections 1601 and 1602, together, replace Section 1600, "Consolidated Financial Statements". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for non-controlling interest in a subsidiary subsequent to a business combination. It is equivalent to the provisions in IFRS standard, IAS 27 (Revised), "Consolidated and Separate Financial Statements". The new standards apply to interim and annual consolidated financial statements with fiscal years beginning on or after January 1, 2011. Early adoption is permitted as of the beginning of the fiscal year. The Company is currently evaluating the impact of this new standard on its consolidated financial statements.

3. Inventories

	2009	2008
Finished goods	\$ 72,892	\$ 113,152
Raw materials	213,789	230,634
	<u>\$ 286,681</u>	<u>\$ 343,786</u>

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

4. Equipment

	2009		2008	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Dies and molds - other	\$ 98,692	\$ 63,328	\$ 98,692	\$ 61,277
Dies and molds - Brake Inspector	21,045	10,523	21,045	8,418
Furniture and fixtures	24,731	22,540	24,731	22,296
Computer equipment	12,704	11,391	12,704	11,159
Machinery and equipment	33,144	27,304	33,144	26,656
	\$ 190,316	\$ 135,086	\$ 190,316	\$ 129,806
Net carrying amount		<u>\$ 55,230</u>		<u>\$ 60,510</u>

5. Intangible Assets

	2009		2008	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Patents and trademarks	\$ 41,341	\$ 41,341	\$ 41,341	\$ 41,341
Product rights	43,000	23,257	43,000	22,007
Prototypes	211,328	179,071	207,168	165,583
	\$ 295,669	\$ 243,669	\$ 291,509	\$ 228,931
Net carrying amount		<u>\$ 52,000</u>		<u>\$ 62,578</u>

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

6. Bank Loan and Related Party Loan Payable

The related party loan payable is due to a company controlled by a key executive, who is also a shareholder and a director of Spectra. The loan is unsecured, payable on demand and accrues interest at 12% payable upon repayment of the loan. The bank loan was fully repaid by June 30, 2009.

7. Loan Payable

The loan payable is due to Dynamic Venture Opportunities Fund Ltd. ("DVOF"), an Ontario labour-sponsored venture capital fund. The loan accrues interest at 12% per annum payable at maturity, is unsecured and matures on November 30, 2009.

	2009	2008
Loan payable	\$ 950,000	\$ 850,000
Less: debt issuance cost (net of accumulated amortization of \$104,990 (2008 - \$56,193))	<u>(45,010)</u>	<u>(93,807)</u>
	<u>\$ 904,990</u>	<u>\$ 756,193</u>

8. Related Party Loan

Related party loan payable is due to a key executive, who is also a shareholder and a director of Spectra. This loan is interest-free and is repayable 366 days after demand. The loan is secured by a first charge general security agreement over the assets of Spectra and a fixed charge on the Schandelmeier patent which is fully amortized as at June 30, 2009 (see note 5). The loan was fully discharged by June 30, 2009.

9. Royalty Debenture

On August 6, 2004 the Company closed a debenture financing arrangement with DVOF whereby DVOF advanced \$ 750,000 to Spectra's wholly-owned subsidiary, SPI. In consideration of the advance of these funds, DVOF is entitled to receive royalty payments equal to the greater of \$100,000 per annum or 10% of the total annual gross revenue generated by SPI. Twenty-five percent of each royalty payment shall be allocated against the principal amount of the debenture. The royalty payments shall continue until the earlier of (i) the date that the royalty debenture has been fully repaid and (ii) 15 years from issue date, at which time any remaining principal amount shall be due. As additional consideration, the Company issued 3,000,000 bonus shares to DVOF at a deemed price of \$0.05 per share. The royalty debenture is secured by all the assets of SPI by way of a floating charge in favour of DVOF.

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

9. Royalty Debenture (cont'd)

	2009	2008
Royalty debenture payable	\$ 652,065	\$ 652,065
Less: debt issuance costs	<u>(168,263)</u>	<u>(168,263)</u>
	483,802	483,802
Add: accretion of discount on debt	<u>37,382</u>	<u>52,203</u>
	521,184	536,005
Less: current portion	<u>(50,000)</u>	<u>(37,500)</u>
Long-term portion	<u>\$ 471,184</u>	<u>\$ 498,505</u>

The minimum annual principal payments due in each of the next five years and thereafter are as follows:

2009	\$ 50,000
2010	25,000
2011	25,000
2012	25,000
2013	25,000
Thereafter	<u>502,065</u>
	<u>\$ 652,065</u>

10. Convertible Preferred Shares

On June 1, 2007, SPI completed a \$750,000 private placement with DVOF where SPI issued 750 convertible preferred shares (the "Preferred Shares") for proceeds of \$667,500 and the Company issued 1,500,000 common shares at a market value of \$0.055 per share for proceeds of \$82,500.

The Preferred Shares will pay a 6 percent cumulative annual dividend, payable quarterly, commencing January 1, 2009; are redeemable; are retractable commencing May 31, 2010 for \$1,250 per share; are non-voting and are convertible into 1,000 common shares of SPI which would represent a 25% ownership interest. DVOF has received 750 warrants to subscribe to an additional 750 preferred shares of SPI at a price of \$1,000 each, exercisable until December 31, 2009 (extended by mutual agreement from June 30, 2009). At the period ended June 30, 2009, the convertible preferred shares have accreted to \$860,784 (2008 - \$826,130). By exercising all of the warrants and converting the Preferred Shares, DVOF could increase its ownership of common shares of SPI by an additional 15% to 40% of the total outstanding shares.

Dividends, due January 1, 2009 and April 1, 2009, each in the amount of \$11,250, were accrued in these statements (see note 16).

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

11. Share Capital

Authorized

Unlimited common shares

Unlimited first, second, third and fourth preferred shares to be issued in one or more series, redeemable, with rights, privileges, restrictions and conditions to be determined by the Board of Directors upon issuance

540,000 second preferred shares Series 1, non-cumulative dividends of 10% per annum, redeemable at the stated value, non-voting

Issued and outstanding

	2009	2008
49,881,837 (2008 – 49,881,837) common shares	\$ 4,782,486	\$ 4,782,486
90,000 (2008 - 90,000) second preferred shares Series 1	<u>27,000</u>	<u>27,000</u>
	\$ 4,809,486	\$ 4,809,486

**Number of
Shares****Amount**

Common Shares

Balance January 1, 2009 and June 30, 2009

49,881,837 \$ 4,782,486

On May 15, 1995, the Company entered into an escrow agreement. Pursuant to the agreement, escrowed shares totaled 7,142,780 and one common share is released for each \$0.20 of net income, adjusted for amortization, depletion and deferred taxes. As at June 30, 2009, 5,596,260 (2008 - 5,596,260) shares were held in escrow.

- a) On July 17, 2008 the Company issued 3,000,000 common shares at a deemed price of \$0.05 per share to Dynamic Venture Opportunities Fund Ltd (“DVOF”) pursuant to a \$750,000 loan arrangement with DVOF, a labour-sponsored venture capital fund.

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

11. Share Capital (cont'd)

Stock Options

The Company has a stock option plan for its directors, officers, employees and consultants. The maximum number of shares reserved for issuance under the plan is equal to 10% of the issued and outstanding common shares.

The following table represents all of the Company's stock options granted, exercised, forfeited and expired during the periods ended June 30, 2009 and December 31, 2008:

	2009		2008	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Balance, beginning of period	2,550,000	\$ 0.10	3,025,000	\$ 0.10
Issued (Expired)	(350,000)	0.10	(475,000)	0.10
Balance, end of period	<u>2,200,000</u>	<u>\$ 0.10</u>	<u>2,550,000</u>	<u>\$ 0.10</u>

As at June 30, 2009, the weighted average remaining contractual life of outstanding options was approximately 1.8 years (2008 – 2 years) and a total of 2,200,000 options (2008 – 2,550,000) were exercisable at a weighted average exercise price of \$0.10 (2008 - \$0.10).

The weighted average estimated fair value at the date of grant for options granted during the period was \$nil (2008 – \$nil). The estimated fair value of options is amortized over the vesting period on a straight-line basis determined on the date of grant using the Black-Scholes option pricing model, based on the following assumptions:

Risk-free interest rate	4.22 %
Expected life	5 years
Expected volatility	89 %
Expected dividends	-

For the period ended June 30, 2009, stock-based compensation expense was \$nil (2008 - \$nil). Stock-based compensation expense is recorded in the statement of earnings and as a charge to contributed surplus.

SPECTRA INC.

Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

11. Share Capital (cont'd)

Warrants

The movement in share purchase warrants was as follows:

	Number of Warrants	Weighted Average Exercise Price	Fair Value
Balance, January 1, 2008	6,413,910	\$ 0.10	\$ 110,846
Expired	(1,668,910)	0.10	(9,949)
Exercised	-	-	-
Balance, December 31, 2008	4,745,000	0.10	100,897
Expired	(4,745,000)	0.10	(100,897)
Exercised	-	-	-
Balance, June 30, 2009	0	-	0

The fair value of each warrant was determined on the date of grant using the Black-Scholes option pricing model, based on the following assumptions:

Risk-free interest rate	4.10 %
Expected life	2 years
Expected volatility	88 %
Expected dividends	-

At June 30, 2009, no share purchase warrants were outstanding.

Contributed Surplus

The movement in contributed surplus was as follows:

	2009	2008
Balance, beginning of period	\$ 95,121	\$ 85,172
Warrants expired	100,897	9,949
Balance, end of period	\$ 196,018	\$ 95,121

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Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

12. Financial Instruments

Section 3855 requires all financial assets and liabilities to be classified into one of the following five categories: held for trading; held-to-maturity; loans and receivables; available-for-sale financial assets; and other financial liabilities. All financial instruments are measured on the balance sheet at fair value. Subsequent measurement and recognition of the changes in fair value of financial instruments depends upon their initial classifications:

Held-for-trading financial assets - are measured at fair value with subsequent changes in fair value recognized in current period net income:

Held-to-maturity assets, loans and receivables and other financial liabilities - are measured at amortized cost with changes recognized in current period net income: and

Available-for-sale financial assets - are measured at fair value with subsequent gains and losses included in other comprehensive income until the asset is removed from the balance sheet.

The Company's financial instruments consist of cash, accounts receivable, bank loan payable, accounts payable and accrued charges, dividend payable, loan payable, related party loan, royalty debenture, and convertible preferred shares. The Company measures its accounts receivable, royalty debenture, and convertible preferred shares as loans and receivables, and its bank loan payable, accounts payable and accrued charges, dividend payable, loan payable and related party loan payable as other financial liabilities.

The carrying value and fair value of these financial instruments at June 30, 2009 and December 31, 2008 is disclosed below by financial instrument category:

Financial Instruments

	2009 Carrying Amount	Fair Value	2008 Carrying Amount	Fair Value
Financial Assets				
<i>Held for trading</i>				
Cash	\$ 15,208	\$ 15,208	\$ 29,458	\$ 29,458
<i>Loans and receivables</i>				
Accounts receivable	\$ 88,988	\$ 88,988	\$ 77,136	\$ 77,136
<i>Loans and receivables</i>				
Royalty debenture	\$521,184	\$732,382	\$536,005	\$ 863,712
Convertible preferred shares	\$860,784	\$834,326	\$826,130	\$ 787,344
<i>Other financial liabilities</i>				
Bank loan payable	\$ 0	\$ 0	\$ 29,500	\$ 29,500
Related party demand loan payable	\$ 20,000	\$ 20,000	\$ 0	\$ 0
Accounts payable and accrued charges	\$443,356	\$443,356	\$464,136	\$ 464,136
Dividend payable	\$ 22,500	\$ 22,500	\$ 0	\$ 0
Loan payable	\$904,990	\$904,990	\$756,193	\$ 756,193
Related party loan	\$ 0	\$ 0	\$ 14,848	\$ 13,257

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Notes to Consolidated Financial Statements

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12. Financial Instruments (cont'd)

a) Fair value

The carrying value of the Company's financial instruments consisting of cash, accounts receivable, bank loan payable, related party loan payable, accounts payable and accrued charges, dividend payable and loan payable, approximates fair value due to their immediate or short-term maturity. The carrying value of related party loan, royalty debenture, and convertible preferred shares is reflected on the balance sheet at amortized cost using the effective interest method of measurement.

b) Credit risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of cash and accounts receivable.

Cash is maintained at major financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions of reputable credit and therefore bear minimal credit risk.

Credit risk from accounts receivable encompasses the default risk of customers. Credit risk on accounts receivable is minimized as a result of the constant review and evaluation of customer account balances. The Company does not believe that there is significant credit risk arising from customers, as it does not rely on any one major customer. The Company also maintains an allowance for doubtful accounts at an estimated amount, allocating sufficient protection against losses resulting from collecting less than full payments from its receivables.

c) Foreign currency risk

The Company is exposed to currency risk due to a certain portion of the Company's sales being in U.S. currency, resulting in U.S. dollar denominated accounts receivable. These activities result in exposure to fluctuations in foreign currency rates between the U.S. dollar and the Canadian dollar. The Company's sensitivity to these foreign currency fluctuations is such that a 10% strengthening or weakening of the U.S. dollar would result in a respective \$374 decrease or increase to the Company's income before taxes for the period ended June 30, 2009. At June 30, 2009, the Company had net assets denominated in U.S. currency of approximately \$3,738 (2008 - \$9,240) as shown below, and a foreign exchange gain from operations of \$4,637. The Company does not utilize any financial instruments or cash management policies to mitigate the risks arising from changes in foreign currency rates.

	2009		2008
Cash	\$ 61	\$	3,350
Accounts receivable	3,677		5,890
	<u>\$ 3,738</u>	\$	<u>9,240</u>

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Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

13. Related Party Transactions

- a) In 2007, the Company entered into a management agreement with a company controlled by a key executive who is a shareholder and director of the Company. Under the terms of the management agreement, that company is entitled to fees of \$180,000 per year until December 31, 2012. In 2009, the management agreement was amended to \$67,500 for the year ended December 31, 2009. An annual participation fee, calculated as 5% of the annual net income of SPI, is also payable under the terms of the management agreement. No participation fee was payable for the period ended June 30, 2009.
- b) In the first six months of 2009, management fees of \$22,500 (2008 - \$90,000) were paid to companies of key executives who are shareholders and directors of the Company.
- c) In the first six months of 2009, royalties of \$2,754 (2008 - \$3,781) were paid to a company owned by a director.
- d) In the first six months of 2009, consulting fees of \$12,000 (2008 - \$24,000) were paid to a company owned by a director.

Included in accounts payable and accrued charges is \$1,910 (2008 - \$6,070) payable to directors and \$37,630 (2008 - \$24,108) payable to companies controlled by directors.

These transactions were in the normal course of business.

14. Income Taxes

The provision for income taxes has been computed as follows:

	2008	2007
Expected income tax provision (recovery) at the combined Federal and provincial rate of 33.50% (2007- 36.12%)	\$ (253,897)	\$ 72,471
Tax effect of expenses not deductible (taxable) for income tax purposes:		
Expired tax losses	106,082	-
Accretion of discount on debt	53,866	23,990
Change in enacted tax rate	30,184	-
Other	442	-
Deferred charges	(24,673)	(21,344)
Loss on disposition of equipment	-	9,423
Stock-based compensation	-	24,889
Excess of amortization over capital cost allowance	-	21,858
Debt settlement	-	(433,445)
Change in valuation allowance	<u>87,996</u>	<u>302,158</u>
Provision for income taxes	<u>\$ -</u>	<u>\$ -</u>

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Notes to Consolidated Financial Statements

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14. Income Taxes (cont'd)

The tax effects of temporary differences that give rise to the future tax assets at December 31, 2008 and December 31, 2007 are as follows:

	2008	2007
Net operating losses carried forward	\$ 896,332	\$ 817,365
Equipment	69,846	66,688
Intangible assets	80,425	74,554
Deferred financing costs	4,628	4,628
	<hr/>	<hr/>
Gross future income tax asset	1,051,231	963,235
Less: valuation allowance	(1,051,231)	(963,235)
	<hr/>	<hr/>
Future income tax asset	\$ -	\$ -

In order to record a future income tax benefit, it must be more likely than not that the future tax asset resulting from the net operating losses carried forward and the difference in the carrying value of the equipment and intangible assets for accounting purposes versus tax purposes will be realized. Given the Company's history of losses, deficit and future uncertainty regarding profitability, it is appropriate to set up a 100% valuation allowance in respect of the future income tax asset.

The Company has non capital tax losses available in the amount of approximately \$3,090,800 which can be carried forward to be applied against future years' taxable income. These losses, if unused, will expire as follows:

2009	\$ 401,600
2010	519,900
2014	278,500
2015	338,800
2026	77,400
2027	836,500
2028	<hr/> 638,100
	<hr/>
	\$ 3,090,800

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Notes to Consolidated Financial Statements

June 30, 2009 and December 31, 2008

15. Commitments

- a) The Company entered into a management agreement with a company controlled by a key executive who is a shareholder and director of the Company. The management agreement is effective until December 31, 2012 and results in a commitment of \$180,000 per year for management services and an annual participation fee of 5% of the annual net income of SPI.
- b) The Company is obligated under an operating lease for premises until December 31, 2012 as follows:

2009	\$	11,694
2010		25,988
2011		29,627
2012		<u>31,186</u>
	\$	<u>98,495</u>

16. Subsequent Event

On July 7, 2009, the company's subsidiary, Spectra Products Inc., issued 45 common shares to Dynamic Venture Opportunities Fund. A value of \$33,750 was attributed to this issue. These shares were issued in settlement of dividend payments of \$11,250 due on January 1, 2009 and April 1, 2009 on the Convertible Preferred Shares issued by Spectra products Inc. and accrued in these financial statements and also the dividend payment of \$11,250 due on July 1, 2009. (See note 10)

17. Comparative Figures

Certain of the prior year's comparative figures have been reclassified to conform to the current year's presentation.