

**Spectra Inc.**

**Management Discussion and Analysis**

**Second Quarter Ending June 30, 2006**

**August 29, 2006**

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The following Management Discussion and Analysis is supplementary to, and should be read in conjunction with the interim financial statements for the period ended June 30, 2006. The consolidated financial statements are unaudited and 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. Management has prepared the interim financial statements in accordance with generally accepted accounting principles ("GAAP") in Canada and all amounts, unless otherwise indicated, are expressed in Canadian dollars.

**Description of Business**

Spectra Inc., through its wholly owned subsidiary, Spectra Products Inc., supplies products to the transportation industry. The current product line includes a visual brake stroke indicator, Brake Safe<sup>®</sup>, that permits vehicle drivers and maintenance personnel to visually determine the brake adjustment condition of a truck, trailer or bus equipped with an air activated brake system. The Company's electronic version of Brake Safe<sup>®</sup>, is an air brake diagnostic system called Brake Inspector<sup>®</sup>. This product provides an in-cab display of air brake status and permits diagnosis of various existing and potential brake problems with the foundation brakes of trucks, trailers and buses. The Company also supplies an anti-corrosion lubricant called Termin-8r<sup>™</sup> to the transportation industry.

Spectra Inc. contracts the manufacture of Brake Safe<sup>®</sup> and Brake Inspector<sup>®</sup> products to third parties and receives the product components for select subassembly and packaging. The Termin-8r<sup>™</sup> product line is blended, packaged and shipped to the Company ready for shipping to end users.

Spectra's products are sold to the transportation industry directly to "house account" fleets; through traditional transportation distributors and truck/trailer dealerships; and to several trailer manufacturers.

**Financial Results**

Selected Financial Information

**Quarterly Data**

The table below sets forth certain un-audited information for each of the eight most recent quarters, the most recent quarter being June 30, 2005.

**QUARTERLY DATA**

| Canadian Dollars | Three month period ending: |                |                   |                    |               |                |                   |                    |
|------------------|----------------------------|----------------|-------------------|--------------------|---------------|----------------|-------------------|--------------------|
|                  | June 30, 2006              | March 31, 2006 | December 31, 2005 | September 30, 2005 | June 30, 2005 | March 31, 2005 | December 31, 2004 | September 30, 2004 |
| Revenue          | 271,982                    | 144,339        | 185,997           | 146,344            | 216,313       | 164,355        | 212,584           | 210,944            |
| Gross Profit     | 128,654                    | 84,017         | 80,543            | 93,404             | 133,061       | 87,925         | 148,519           | 119,352            |
| SG&A Expenses    | 271,299                    | 157,006        | 340,467           | 158,718            | 251,697       | 155,973        | 389,459           | 151,490            |

|                                  |           |          |           |          |           |          |           |          |
|----------------------------------|-----------|----------|-----------|----------|-----------|----------|-----------|----------|
| Loss for the period              | (142,645) | (72,989) | (259,924) | (65,314) | (118,636) | (68,048) | (240,940) | (32,139) |
| Loss per share (basic & diluted) | (.004)    | (.002)   | (.007)    | (.002)   | (.003)    | (.002)   | (.007)    | (.001)   |

### **Seasonality:**

The Company's sales reflect a marginal sales trend with the weakest sales quarter occurring in the January through March period, representing on average about 20 percent of annual sales. The strongest sales quarter, March through June accounts for approximately 29 percent of total sales.

## **Results of Operations**

### **Revenues:**

#### **Three months ended June 30, 2006**

Revenue for the three months ended June 30, 2006 increased by 26% to \$271,982 compared to revenue of \$216,313 for the three month period ended June 30, 2005. The increase in revenue is attributable to increased sales of the Brake Safe<sup>®</sup> product, up 15 percent over sales in 2005, increased Brake Inspector<sup>®</sup> sales, up 45 percent over 2005 and sales of Termin-8r, up 39 percent compared to 2005.

During the three month period ended June 30, 2006, Brake Safe<sup>®</sup> revenues were \$23,893 higher than the same period in 2005. The increase resulted from a unit sales increase of 6.9 percent and higher distributor margins.

Brake Inspector<sup>®</sup> sales during the three month period ending June 30, 2006 exceeded the same period in 2005 by \$21,068 or 45 percent. This increase was the result of unit sales 44 percent higher than the previous year with 70 percent of the quarter's sales to a U.S. based customer generating added revenue of \$4,319 from conversion of U.S. currency to Canadian dollars.

Termin-8r<sup>™</sup> sales in the three month period ending June 30, 2006 exceeded the equivalent period in 2005 by \$4,698 or 39 percent. Termin-8r<sup>™</sup> has a small customer base. For this reason quarterly sales will fluctuate depending on the timing of existing and new customer orders.

#### **Six months ended June 30, 2006**

Revenue for the six months ended June 30, 2006 increased by 9% to \$416,321 compared to revenue of \$380,668 for the six month period ended June 30, 2005. The increase in revenue is attributable to increased Brake Inspector<sup>®</sup> sales and sales of Termin-8r<sup>™</sup>, offset by decreased sales of Brake Safe<sup>®</sup> product that occurred in the first quarter of 2006.

The Canadian market accounts for most of the Brake Safe<sup>®</sup> sales. As roadside enforcement and fines are increased in the United States, management believes sales of the Brake Safe<sup>®</sup> product will show significant growth.

Brake Inspector<sup>®</sup> is in the early stage of product introduction and has a small customer base. For this reason quarterly sales will fluctuate depending on the timing of existing and new customer orders and the scheduling of vehicle production/deliveries.

The Company expects to experience considerable variances quarter to quarter as new fleets proceed from a trial of the product to equipping all fleet vehicles. Product sales are currently limited to standalone vehicles, i.e. trucks and buses. The Company has completed beta trials of the stand-alone digital truck system and the stand-alone trailer system and is scheduling production of this system for the fall of 2006. The Company is currently in beta trials on its truck-trailer system utilizing a digital, PLC based transmission of brake data. These two additional product lines are expected to generate sales growth commencing in the fourth quarter of 2006.

The company is currently selling its anti-corrosion line of Termin-8r<sup>™</sup> products to the transportation industry directly to several fleet users and through its dealer/distributor network. Sales in the six month period ending June 30, 2006 were 37 percent higher than the equivalent period in 2005. The Company plans to maintain its current customer base and slowly expand sales distribution after the Brake Inspector<sup>®</sup> product is fully launched into the North American marketplace.

## **Gross Profit**

### **Three months ended June 30, 2005**

Gross profit decreased by \$4,404 for the three months ended June 30, 2006 to \$128,654 or 47 percent of revenue from \$133,061 or 62 percent of revenue for the three months ended June 30, 2005. The decrease in gross profit as a percent of revenues is attributable to the lower margin Brake Inspector<sup>®</sup> sales capturing a higher percentage of total sales for the period.

### **Six months ended June 30, 2006**

Gross profit decreased by \$8,315 for the six months ended June 30, 2006 to \$212,671 or 51 percent of revenue from \$220,986 or 58 percent of revenue for the six months ended June 30, 2005. The decrease in gross profit is attributable to increased sales of the lower margin Brake Inspector<sup>®</sup> product offsetting higher margin sales of Brake Safe<sup>®</sup> and Termin-8r<sup>™</sup> product lines. The Brake Inspector<sup>®</sup> product is currently being produced at higher per unit costs due to the lower quantity production runs and the resultant higher cost of components. Gross profit margins will vary depending on the mix of product sales within the Brake Safe<sup>®</sup> and Brake Inspector<sup>®</sup> product lines. In addition the mix of distribution channels may affect margins when sales are generated through distributors, dealers and direct sales to fleets. The Company's most profitable sale rests with the fleet customer, followed by dealers and distributors.

## **Expenses:**

### **Operating Expenses**

**Three months ended June 30, 2006**

Total operating expenses before interest expense and amortization charges increased by \$18,488 to \$225,083 for the three months ending June 30, 2006 compared to \$206,595 for the three months ended June 30, 2005.

Selling expenses for the three months ending June 30, 2006 were \$23,763 or \$3,633 higher than the same period in 2005. Increased costs resulted from costs incurred in training customer technical staff in installation of Brake Inspector<sup>®</sup> systems.

Royalty fees for the three month period ended June 30, 2006 were \$25,099 exceeding the equivalent period in 2005 by \$5,886. Royalty expenses in the quarter exceeded the minimum quarterly payment due to increased revenues relative to the same period in 2005.

Professional fees for the three month period ended June 30, 2006 were \$25,311, an increase in fees from the equivalent period in 2005 of \$5,983. Increased audit expenses and private placement filing fees accounted for the increased expenses.

Annual audit fees related to the ISO9001-2000 quality control system were \$1700 during the three month period ended June 30, 2006. No audit fees occurred during the same period in 2005.

Consultant fees for the three month period ended June 30, 2006 were \$9,000, a decrease of \$4,060 from the equivalent period in 2005. Fee decreases resulted from termination of services provided by Mentorinc Financial Services in managing the Company's advisory board.

Commissions on product sales for the three month period ended June 30, 2006 were \$5,747, a decrease of \$2,849 compared to the equivalent period in 2005. Decreased commissions reflect increased sales to non-commission accounts for the Brake Safe<sup>®</sup> and Brake Inspector<sup>®</sup> product lines.

**Six months ended June 30, 2006**

Total operating expenses before interest expense and amortization charges increased by \$22,117 to \$337,894 for the six months ending June 30, 2006 from \$315,777 for the six months ended June 30, 2005.

Selling expenses for the six months ending June 30, 2006 were \$40,231 or \$5,696 higher than the same period in 2005. Increases resulted from costs incurred in training customer technical staff in installation of Brake Inspector<sup>®</sup>.

Royalty fees for the six month period ended June 30, 2006 were \$43,849 exceeding the equivalent period in 2005 by \$3,837. Royalty expenses in the second quarter exceeded the minimum quarterly payment due to increased revenues relative to the same period in 2005.

Professional fees for the six month period ended June 30, 2006 were \$40,498, an increase in fees from the equivalent period in 2005 of \$12,487. Increased legal fees, audit expenses and private placement filing fees accounted for the increased expenses.

Consultant fees for the six month period ended June 30, 2006 were \$18,974, a decrease of \$9,321 from the equivalent period in 2005. Fee decreases resulted from termination of services provided by Mentorinc Financial Services in managing the Company's advisory board.

Commissions on product sales for the six month period ended June 30, 2006 were \$10,557, a decrease of \$3,047 compared to the equivalent period in 2005. Decreased commissions reflect increased sales to non-commission accounts for the Brake Safe<sup>®</sup> and Brake Inspector<sup>®</sup> product lines.

### **Interest Expense**

Interest expense for the three months ended June 30, 2006 was \$14,924 compared to \$10,295 during the same period in 2005. Year to date Interest charges for the six months ended June 30, 2006 were \$29,780 compared to \$20,744 during the same period in 2005. Declining interest charges will continue on the long term debt as principal repayment reduces charges payable. The Company owes TD Canada Trust at June 30, 2006 long term debt of \$6,091. Long term debt with the Business Development Bank of Canada at June 30, 2006 was \$6,600. Declining interest payment on bank loans is offset by compounding interest charges on outstanding supplier balances and loans from management.

### **Amortization**

Amortization of capital assets and other assets totaled \$31,975 for the three month period ending June 30, 2006 compared to \$34,807 for the same period in 2005. For the six months ended June 30, 2006 amortization of capital assets and other assets were \$62,736 compared to \$71,149 during the same period in 2005.

### **Brake Safe Royalty and Financing Fee Amortization**

Royalty and financing amortization during the three month period ending June 30, 2006 was \$18,766 compared to \$18,575 expense in the same period of 2005. For the six months ended June 30, 2006 royalty and financing amortization costs were \$37,532 compared to \$36,844 during the same period in 2005.

The Company terminated its royalty agreement for the Brake Safe<sup>®</sup> product effective August 6, 2004 for a lump sum payment of \$149,862. This cost is being amortized over the remaining 26 month term of the royalty agreement at August 6, 2004.

The Company incurred closing costs of \$68,388 for the debenture royalty financing arrangement concluded August 6, 2004 with Dynamic Venture Opportunities Fund. The costs are being amortized over the 15 year term of the financing agreement.

### **Net Loss**

#### **Three months ended June 30, 2006**

Net Loss for the three months ended June 30, 2006 was \$142,645 or \$0.004 per share basic and fully diluted compared to \$118,636 or \$0.003 per share basic and fully diluted for the three months ending June 30, 2005.

#### **Six months ended June 30, 2006**

Net Loss for the six months ended June 30, 2006 was \$215,634 or \$0.006 per share basic and \$0.005 per share fully diluted compared to \$186,684 or \$0.005 per share basic and fully diluted for the six months ending June 30, 2005.

The Company anticipates that it will incur losses during the final six months of its fiscal year ending December 31, 2006. A return to profitability is expected in the fiscal period commencing January 2007 as the Company expands its distribution network for its Brake Inspector<sup>®</sup> product line and introduces its systems for standalone trailers and tractor-trailer combinations. Brake Inspector<sup>®</sup> is anticipated to become the leading revenue generator in 2007 and product margins should increase as production costs are decreased from volume purchasing of system components and lower cost production methods.

### **Balance Sheet:**

#### **Total Assets**

Total assets ending June 30, 2006 were \$528,938, an increase of 14.1 percent from \$463,608 for the period ending December 31, 2005. This increase in asset value is the result of the closing of a private placement on January 29, 2006, offset by normal depreciation charges.

#### **Total Liabilities**

Total liabilities ending June 30, 2006 were \$2,527,937, an increase of 8.5 percent from \$2,329,887 for the period ending December 31, 2005. This increase in liabilities resulted from an increase in trade payables and accrued liabilities of \$205,286 offset by a decrease in loans payable.

### **Liquidity and Cash Flow**

#### **Three months ended June 30, 2006**

During the three month period ending June 30, 2006, the Company used \$110,671 of working capital to fund its operations, compared to \$82,944 during the same period in 2005. Non-cash working capital during the three months ending June 30, 2005 contributed \$99,180 compared to additional working capital requirements of \$35,539 in

the period ending June 30, 2006. Non cash working capital was primarily comprised of an increase in accounts payable of \$189,161. Increases in financing activities included increases in loans totaling \$1,499, stock based compensation of \$9,359 and share capital of \$73,555. The Company used \$11,260 of cash proceeds to increase non current assets resulting in a net reduction in cash resources of \$1,979 and total cash resources available at the end of the period of \$10,322. During the equivalent three month period in 2005, the Company showed a net reduction in cash resources of \$1,554 and net cash resources balance of \$15,644.

### **Six months ended June 30, 2006**

For the six month period ending June 30, 2006, the Company utilized \$152,258 of working capital compared to \$115,534 in 2005. Non-cash working capital during the six months ending June 30, 2005 contributed \$156,638 compared to additional working capital requirements of \$85,609 in the period ending June 30, 2006. Non cash working capital was primarily comprised of an increase in accounts payable of \$195,386. Increases in financing activities included increases in loans totaling \$2,664, stock based compensation of \$9,359 and share capital of \$73,555. For the six month period ending June 30, 2006, the Company used \$13,050 to increase non current assets, resulting in a net cash increase of \$5,879. Cash resources at the end of the six month period totaled \$10,322. During the corresponding six month period in 2005 the Company showed a net increase in cash resources of \$7,729 and cash resources balance at the end of the period of \$15,644.

The financial statements have been prepared on a going concern basis which presumes the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. The Company has experienced significant losses from operations during the past several years and has an accumulated deficit at June 30, 2006 of \$6,159,446 compared to an accumulated deficit of \$5,943,812 at December 31, 2005. The Company has a working capital deficiency of \$1,115,898 at June 30, 2006. The Company's current cash and cash equivalents will be insufficient to meet the anticipated need for ongoing expenses, working capital and capital expenditures. The Company received \$78,500 of gross proceeds from a private placement during the three month period ending June 30, 2006 and is seeking \$2,500,000 of additional funds to provide working capital, inventory and capital equipment necessary to implement its five year business plan.

The Company's ability to continue operations is dependent upon its ability to achieve profitability, maintain current financing and obtain new sources of financing. The outcome of these matters cannot be predicted at this time. The financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue operations.

The Company is currently pursuing financing opportunities that may take the form of additional equity or debt securities. In the event the Company raises funds through the sale of equity or convertible debt instruments, additional dilution to existing shareholders may result. Terms of debt instruments may limit the Company's operations or ability to

pursue market opportunities. Management cannot be certain that this additional financing will be available in the amounts required or on acceptable terms.

The Company will continue to seek new financing, joint venture or strategic financial relationships that will permit ongoing operation of the Company and its subsidiary. Management believes that the strong functional and competitive capabilities of its Brake Safe<sup>®</sup>, Brake Inspector<sup>®</sup> and Termin-8r<sup>™</sup> product lines will improve the Company's profitability. Funding the Company's current operations and addressing its future growth opportunities are dependent on revenue growth and future financing arrangements.

### **Related Party Transactions**

As at June 30, 2006, The Company has no related party transactions.

### **Off Balance Sheet Arrangements**

As at June 30, 2006, the Company does not have any material off balance sheet arrangements.

### **Outstanding Share Data**

The Company's authorized share capital consists of an unlimited number of common shares. As at June 30, 2006, there were 37,536,837 outstanding common shares including 5,596,260 remaining in escrow with release dependent on the Company attaining certain cash flow levels.

### **Share Options**

The Company has a stock option plan that permits the grant of options to directors, officers, employees and consultants. The plan provides for the grant of a maximum number of options equal to ten percent of issued and outstanding common shares issued, with a maximum term of five years, fully vesting at the date of grant. The Company values options based on the trading price of the Company's common shares on the date of the grant, (CICA Handbook section 3870, "Stock-based compensation and other stock-based payments"), and the pricing requirements of the TSX Venture Exchange.

As at June 30, 2006, there were 1,550,000 outstanding options to acquire common shares. These options were held by directors, employees and consultants.

### **Warrants**

On June 29, 2006, the Company closed a private placement of 1,570,000 units consisting of one common share at a deemed price of \$0.05 per share and one warrant redeemable until June 29, 2008 for one common share of the Company at a price of \$0.10 per share. The Company has 1,570,000 warrants outstanding as at June 30, 2006.

## **OUTLOOK:**

The Company continues to focus its efforts on completion of its Brake Inspector<sup>®</sup> product development program. With its standalone truck system receiving initial sales success in the waste management and redi-mix industries, the opportunity to expand in these market segments throughout North America is significant. With the completion of the digital version of the current standalone truck system and standalone trailer system, the Company is positioned to launch Brake Inspector<sup>®</sup> into additional market segments experiencing similar needs, most notably fire and emergency vehicles, hydro electric utilities, construction vehicles and trailer fleets. The development and testing of the PLC version of Brake Inspector<sup>®</sup> for tethered truck-trailer combinations will complete our product offering and provide the transportation industry with solutions that meet the needs of safety, operating efficiency and maintenance cost reductions. The Company's Brake Safe<sup>®</sup> product has gained market acceptance in the Canadian marketplace. As roadside enforcement and fines are increased in the United States, management believes sales of the Brake Safe<sup>®</sup> product will show significant growth.

The Company is seeking \$2,500,000 of additional funds to provide working capital, inventory and capital equipment necessary to implement its five year business plan. Upon successful completion of a financing, the Company will proceed to accelerate its sales through expansion of the sales force, introduction of marketing and advertising programs, and initiation of product cost reducing measures. As a result of these activities, the Company anticipates a return to profitability in the fiscal period commencing January 2007.

## **FORWARD LOOKING STATEMENTS**

Except for the historical information contained herein, this discussion contains forward looking statements that involve risks and uncertainties, including the impact of competitive products and pricing and general economic conditions as they affect the Company's customers. Actual results and developments may therefore differ materially from those described in this release.