

**Spectra Inc.**

**Management Discussion and Analysis**

**First Quarter Ending March 31, 2006**

**May 30, 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 March 31, 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 March 31, 2006.

**QUARTERLY DATA**

Canadian Dollars	Three month period ending:							
	March 31, 2006	December 31, 2005	September 30, 2005	June 30, 2005	March 31, 2005	December 31, 2004	September 30, 2004	June 30, 2004
Revenue	144,339	185,997	146,344	216,313	164,355	212,584	210,944	163,813
Gross Profit	84,017	80,543	93,404	133,061	87,925	148,519	119,352	86,811
SG&A Expenses	157,006	340,467	158,718	251,697	155,973	389,459	151,490	226,226

Loss for the period	(72,989)	(259,924)	(65,314)	(118,636)	(68,048)	(240,940)	(32,139)	(139,415)
Loss per share (basic & diluted)	(.002)	(.007)	(.002)	(.003)	(.002)	(.007)	(.001)	(.005)

### 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 March 31, 2006

Revenue for the three months ended March 31, 2006 decreased by 12% to \$144,339 compared to revenue of \$164,355 for the three month period ended March 31, 2005. This decrease in revenue is attributable to decreased sales of the Brake Safe<sup>®</sup> product, down 22% from sales in 2005, offset by increased sales Brake Inspector<sup>®</sup>, 16% ahead of the same period in 2005 and increased Termin-8r sales, up 36 percent over 2005.

During the three month period ended March 31, 2006, Brake Safe<sup>®</sup> revenues were \$28,530 lower than the same period in 2005.

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> sales during the three month period ending March 31, 2006 exceeded the same period in 2005 by \$3,491 or 16 percent.

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 is completing beta trials of the stand-alone digital truck system and the stand-alone trailer system. 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 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 three month period ending March 31, 2006 exceeded the equivalent period in 2005 by \$5,022 or 36 percent. Termin-8r<sup>TM</sup> has a small customer base. For this reason quarterly sales will fluctuate depending on the timing of existing and new customer orders. 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 March 31, 2006**

Gross profit decreased by \$3,908 for the three months ended March 31, 2006 to \$84,017 or 58 percent of revenue from \$87,925 or 53 percent of revenue for the three months ended March 31, 2005. The decrease in gross profit margin is attributable to decreased unit sales of Brake Safe<sup>®</sup> compared to unit sales in 2005.

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 March 31, 2006**

Total operating expenses before interest expense and amortization charges increased by \$907 to 110,731 for the three months ending March 31, 2006 from \$109,814 for the three months ended March 31, 2005.

Subcontract Labour for the 2006 period increased by \$1,440 compared to the same period in 2005. Higher labour costs in 2006 included subcontracted installation of Brake Inspector<sup>®</sup> systems.

Selling expenses for the three months ending March 31, 2006 were \$16,468 or \$2,063 higher than the same period in 2005. Increased costs resulted from additional staff attending the Mid-America Truck Show in Louisville, Kentucky, needed for installation of Brake Inspector<sup>®</sup> systems, resulting in higher travel and related costs.

Office and General costs for the three month period ended March 31, 2006 were \$12,945, a decrease of \$2,895 from the equivalent period in 2005 by. Higher costs in 2005 were the result of registration costs for the Company's ISO 9001-2000 quality management system.

Consultant fees for the three month period ended March 31, 2006 were \$9,974, a decrease of \$5,261 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.

Professional fees for the three month period ended March 31, 2006, were \$15,187, an increase in fees from the equivalent period in 2005 of \$6,504. Increased legal fees, accounting expenses and trustee filing fees accounted for the increased expenses.

### **Interest Expense**

Interest expense for the three months ended March 31, 2006 was \$15,514 compared to \$10,913 during the same period in 2005. The Company owes TD Canada Trust at March 31, 2006 long term debt of \$8,600. Long term debt with the Business Development Bank of Canada at March 31, 2006 was \$11,550. The Company owes \$708,696 to Dynamic Venture Opportunities Fund and Management loans owed at March 31, 2006 totaled \$457,134.

### **Amortization**

Amortization of capital assets and other assets totaled \$30,761 for the three month period ending March 31, 2006 compared to \$35,246 for the same period in 2005.

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

Royalty and financing amortization costs during the three month period ending March 31, 2006 was \$18,786 compared to \$18,269 in the same period of 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 effective 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 March 31, 2006**

Net Loss for the three months ended March 31, 2006 was \$ 72,989 or \$0.002 per share basic and fully diluted compared to \$ 68,048 or \$0.002 per share basic and fully diluted for the three months ending March 31, 2005.

The Company anticipates that a return to profitability will occur in the fiscal period ending December 31, 2006 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 a leading revenue generator in 2006 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 March 31, 2006 were \$398,010, a decrease of 14.0 percent from \$463,608 for the period ending December 31, 2005. This decrease in asset value is the result of normal depreciation charges.

### **Total Liabilities**

Total liabilities ending March 31, 2006 were \$2,337,278, an increase of \$7,391 from \$2,329,887 for the period ending December 31, 2005. This increase in liabilities resulted primarily from an increase in trade payables.

## **Liquidity and Cash Flow**

### **Three months ended March 31, 2006**

During the three month period ending March 31, 2006, the Company used \$42,228 of working capital to fund its operations, compared to \$32,591 during the same period in 2005. Non cash working capital generated \$55,021 of cash for the period compared to \$57,458 for the three months ended March 31, 2005. Non cash working capital was primarily comprised of an decrease in receivables of \$21,442 and inventory of \$19,472. The Company used \$1,150 of cash proceeds to decrease non current assets and \$3,785 in loan repayments resulting in a net increase in cash resources of \$7,858 and total cash resources available at the end of the period of \$12,301. During the equivalent three month period in 2005, the Company showed a net increase in cash resources of \$9,283 and net cash resources balance of \$17,198.

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 March 31, 2006 of \$6,016,801 compared to an accumulated deficit of \$5,943,812 for the same period in 2005. The Company has a working capital deficiency of \$1,082,326 at March 31, 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. Therefore 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.

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 March 31, 2006, The Company has no related party transactions.

### **Off Balance Sheet Arrangements**

As at March 31, 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 March 31, 2005, there were 35,966,837 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 March 31, 2006, there were 2,500,000 outstanding options to acquire common shares. These options were held by directors, employees and consultants.

### **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 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 and construction vehicles. The development and testing of the Brake Inspector<sup>®</sup> digital standalone trailer system and 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 ending December 31, 2006.

#### **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.