

**Spectra Inc.**

**Management Discussion and Analysis**

**Second Quarter Ending June 30, 2005**

**Revised January 31, 2006**

**Spectra Inc.**  
**Management Discussion and Analysis**  
**Second Quarter Ending June 30, 2005**

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, 2005. The consolidated financial statements have been prepared 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, 2005	March 31, 2005	December 31, 2004	September 30, 2004	June 30, 2004	March 31, 2004	December 31, 2003	September 30, 2003
Revenue	216,313	164,355	212,584	210,944	163,813	112,299	106,702	110,389
Gross Profit	133,061	87,925	148,519	119,352	86,811	55,912	65,912	36,864

SG&A Expenses	251,697	155,973	389,459	151,490	226,226	155,699	362,590	165,392
Loss for the period	(118,636)	(68,048)	(249,940)	(32,475)	(139,415)	(99,787)	(296,686)	(128,528)
Loss per share (basic & diluted)	(.003)	(.002)	(.007)	(.001)	(.005)	(.003)	(.010)	(.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 June 30, 2005**

Revenue for the three months ended June 30, 2005 increased by 32% to \$216,313 compared to revenue of \$163,813 for the three month period ended June 30, 2004. The increase in revenue is attributable to increased sales of the Brake Safe<sup>®</sup> product, up 38% over sales in 2004 and increased Brake Inspector<sup>®</sup> sales, up 23 percent over 2004.

During the three month period ended June 30, 2005, Brake Safe<sup>®</sup> revenues were \$43,199 higher than the same period in 2004. The increase resulted from a price increase of \$1.00 per unit implemented in January 2005 to all customers and a unit sales increase of 31 percent.

Brake Safe<sup>®</sup> sales reflect the general transportation aftermarket parts growth resulting from the improved economy in North America and increased business for the trucking industry. 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 June 30, 2005 exceeded the same period in 2004 by \$9,082 or 23 percent. While unit sales of Brake Inspector<sup>®</sup> were the same for the three month period of 2005 and 2004, dollar sales were higher due to a product mix of higher priced, four axle Brake Inspector<sup>®</sup> systems.

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

Revenue for the six months ended June 30, 2005 increased by 38% to \$380,668 compared to revenue of \$276,112 for the six month period ended June 30, 2004. The increase in revenue is attributable to increased sales of the Brake Safe<sup>®</sup> product and increased Brake Inspector<sup>®</sup> sales.

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 currently in beta trials on its truck-trailer system and plans to launch the product in the first quarter of 2006. A stand-alone trailer system is under development with beta testing scheduled for the third quarter of 2005 and product introduction in early 2006. 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 June 30, 2005 were five percent higher than the equivalent period in 2004. 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 increased by \$46,250 for the three months ended June 30, 2005 to \$133,061 or 62 percent of revenue from \$86,811 or 53 percent of revenue for the three months ended June 30, 2004. The increase in gross profit is attributable to increased margins for Brake Safe<sup>®</sup> sales resulting from January 2005 price increases and higher margin Brake Inspector<sup>®</sup> sales due to the sale higher value 4 axle systems.

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

Gross profit increased by \$76,263 for the six months ended June 30, 2005 to \$220,986 or 58 percent of revenue from \$142,723 or 52 percent of revenue for the six months ended June 30, 2004. The increase in gross profit is attributable to increased margins for Brake Safe<sup>®</sup> sales resulting from a January 2005 price increases.

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, 2005**

Total operating expenses before interest expense and amortization charges increased by \$20,733 to \$206,595 for the three months ending June 30, 2005 from \$185,862 for the three months ended June 30, 2004.

Subcontract Labour for the 2005 period exceeded 2004 by \$9,281. Higher labour costs resulted from the contracting of one full time production staff. Production in the 2004 period was absorbed by existing employees.

Royalty fees for the three month period ended June 30, 2005 exceeded the equivalent period in 2004 by \$10,756. Royalty expenses in 2005 reflect the Dynamic Venture Opportunity Fund royalty debenture expenses that became effective August 6, 2004. These fees are based on total revenues of the Company. In addition, a royalty fee was payable on Brake Inspector<sup>®</sup> sales during the 2005 period. The 2004 royalty expense payable to Brake Safe Inc. was based solely on Brake Safe<sup>®</sup> product sales and excluded Brake Inspector<sup>®</sup> product sales.

**Six months ended June 30, 2005**

Total operating expenses before interest expense and amortization charges increased by \$25,938 to \$315,237 for the six months ending June 30, 2005 from \$289,299 for the six months ended June 30, 2004.

Office and General costs for the six month period ended June 30, 2005 were \$29,160 exceeding the equivalent period in 2004 by \$5,365. Fee increases resulted from increases in insurance premiums due to increases in the level of commercial liability coverage from \$1million to \$3 million and registration costs for the Company's ISO 9001-2000 quality management system.

Consultant fees for the six month period ended June 30, 2005 were \$28,295 exceeding the equivalent period in 2004 by \$8,718. Fee increases resulted from services provided by Mentorinc Financial Services in creating and managing the Company's newly created advisory board.

Royalty fees for the six month period ended June 30, 2005 exceeded the equivalent period in 2004 by \$22,460. Royalty expenses in 2005 reflect the Dynamic Venture Opportunity Fund royalty debenture expenses that became effective August 6, 2004. These fees are based on total revenues of the Company. In addition, a royalty fee was payable on Brake Inspector<sup>®</sup> sales during the 2005 period. The 2004 royalty expense payable to Brake Safe Inc. was based solely on Brake Safe<sup>®</sup> product sales and excluded Brake Inspector<sup>®</sup> product sales.

**Interest Expense**

Interest expense for the three months ended June 30, 2005 was \$10,295 compared to \$12,940 during the same period in 2004. Year to date Interest charges for the six months ended June 30, 2005 were \$20,744 compared to \$26,668 during the same period in 2004.

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, 2005 long term debt of \$16,127. Long term debt with the Business Development Bank of Canada at June 30, 2005 was \$36,300.

### **Amortization**

Amortization of capital assets and other assets totaled \$17,227 for the three month period ending June 30, 2005 compared to \$27,424 for the same period in 2004. For the six months ended June 30, 2005 amortization of capital assets and other assets were \$34,304 compared to \$65,939 during the same period in 2004.

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

Royalty and financing amortization during the three month period ending June 30, 2005 was \$17,690 compared to NIL expense in the same period of 2004. For the six months ended June 30, 2005 royalty and financing amortization costs were \$37,385 compared to no cost during the same period in 2004.

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, 2005**

Net Loss for the three months ended June 30, 2005 was \$118,636 or \$0.003 per share basic and fully diluted compared to \$ 139,415 or \$0.005 per share basic and fully diluted for the three months ending June 30, 2004.

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

Net Loss for the six months ended June 30, 2005 was \$186,684 or \$0.005 per share basic and fully diluted compared to \$239,203 or \$0.008 per share basic and fully diluted for the six months ending June 30, 2004.

The Company anticipates that it will incur losses during the final six months of its fiscal year ending December 31, 2005. A return to profitability is expected 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 the 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 June 30, 2005 were \$598,881, a decrease of 8.7 percent from \$656,243 for the period ending December 31, 2004. This decrease in asset value is the result of normal depreciation charges.

### **Total Liabilities**

Total liabilities ending June 30, 2005 were \$2,164,318, an increase of 6.4 percent from \$2,035,036 for the period ending December 31, 2004. This increase in liabilities resulted from an increase in trade payables of \$145,494 offset by a decrease in loans payable.

### **Liquidity and Cash Flow**

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

During the three month period ending June 30, 2005, the Company used \$82,944 of working capital to fund its operations, compared to \$99,646 during the same period in 2004. Non cash working capital generated \$99,180 of cash for the period compared to \$93,940 for the three months ended June 30, 2004. Non cash working capital was primarily comprised of an increase in accounts payable of \$128,667. The Company used \$9,141 of cash proceeds to increase non current assets and \$8,649 in loan repayments resulting in a net reduction in cash resources of \$1,554 and total cash resources available at the end of the period of \$15,644. During the equivalent three month period in 2004, the Company showed a net reduction in cash resources of \$4,264 and net cash resources balance of \$4,892.

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

For the six month period ending June 30, 2005, the Company utilized \$115,534 of working capital compared to \$173,264 in 2004. Non-cash working capital during the six months contributed \$156,658 compared to \$169,735 in 2004. For the six month period ending June 30, 2005, the Company used \$17,326 to increase non current assets and \$16,048 for repayment of loans, resulting in a net cash increase of \$7,729. Cash resources at the end of the six month period totaled \$15,644. During the corresponding six month period in 2004, increases in capital assets of \$4,735 and contribution of \$7,226 from loans and share capital resulted in a net reduction in cash resources of \$1,038 and cash resources balance at the end of the period of \$4,892.

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, 2005 of \$5,618,575 compared to an accumulated deficit of \$5,431,891 for the same period in 2004. The Company has a working capital deficiency of \$794,774 at June 30, 2005. 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 June 30, 2005, The Company has no related party transactions.

### **Off Balance Sheet Arrangements**

As at June 30, 2005, 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, 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 June 30, 2005, there were 1,550,000 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.