SPECTRAL INC
Diagnostics

2014
First Quarter Report

Dear Shareholders:

During the first quarter of 2014, we continued to make progress in our Phase III EUPHRATES trial. As of May 14, 2014, 275 patients had been randomized into the study, which is designed to measure the safety and efficacy of our theranostics approach for the treatment of septic shock.

At the end of January 2014, the results of the planned second interim analysis were reported to Spectral. The Data Safety Monitoring Board (DSMB) evaluated the safety, futility and efficacy of the trial, with stopping rules in place, using actual data for 184 randomized patients followed for 28 days. The DSMB recommended that the trial continue, but asked that the contract research organization (CRO) managing the trial perform additional statistical analysis.

In April 2014, the DSMB completed its review of the detailed analysis it had previously requested. It suggested an additional exclusion criteria and an increase in the sample size. Based on the DSMB's recommendations, we have increased the trial's sample size from 360 to 650 patients and have submitted an amended protocol to the FDA outlining the new exclusion criteria. We believe this increase in the number of enrolled patients enhances the likelihood of demonstrating, with sufficient power, a statistically and clinically significant effect.

Septic shock remains a very large unmet medical need. The incidence of sepsis continues to increase and no new therapeutic interventions have become available in North America. Our targeted approach to identifying patients most likely to respond to our therapy remains the only phase III trial in progress in the North America.

I would like to thank our shareholders for your continuing support and I look forward to updating you on the progress of the EUPHRATES trial.

Sincerely,

Dr. Paul Walker
President & CEO

May 14, 2014

MANAGEMENT'S DISCUSSION & ANALYSIS
(All figures are expressed in thousands of Canadian dollars)

This Management's Discussion & Analysis ("MD&A") for the three months ended March 31, 2014 has been prepared to help investors understand the financial performance of the Company in the broader context of the Company's strategic direction, the risks and opportunities as understood by management, and the key success factors that are relevant to the Company's performance. Management has prepared this document in conjunction with its broader responsibilities for the accuracy and reliability of the financial statements, as well as the development and maintenance of appropriate information systems and internal controls to ensure that the financial information is complete and reliable. The Finance and Audit Committee of the Board of Directors has reviewed this document and all other publicly reported financial information for integrity, usefulness, reliability and consistency.

This discussion should be read in conjunction with the Condensed Interim Financial Statements of the Company, and the notes thereto, for the three months ended March 31, 2014 (the "Condensed Interim Financial Statements") and the Audited Annual Financial Statements of the Company, and the notes thereto for the years ended December 31, 2013 and 2012 (the "Annual Financial Statements"), as well as management's discussion and analysis for the year ended December 31, 2013.

FORWARD LOOKING STATEMENTS

Certain statements contained in this MD&A constitute forward-looking information within the meaning of securities law. Forward-looking information may relate to our future outlook and anticipated events or results and may include statements regarding our future financial position, business strategy, budgets, litigation, projected costs, capital expenditures, financial results, taxes and plans and objectives. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. These statements are based on certain factors and assumptions regarding, among other things, expected growth, results of operations, performance and business prospects and opportunities. While we consider these assumptions to be reasonable based on information currently available to us, they may prove to be incorrect. Forward looking-information is also subject to certain factors, including risks and uncertainties that could cause actual results to differ materially from what we currently expect. These factors include, among other things, the availability of funds and resources to pursue development projects, the successful and timely completion of clinical studies, the ability of Spectral Diagnostics Inc. to take advantage of business opportunities, the granting of necessary approvals by regulatory authorities as well as general economic, market and business conditions. For more exhaustive information on these risks and uncertainties you should refer to our most recently filed annual information form which is available at www.sedar.com. Forward-looking information contained in this MD&A is based on our current estimates, expectations and projections, which we believe are reasonable as of the current date. You should not place undue importance on forward-looking information and should not rely upon this information as of any other date. While we may elect to, we are under no obligation and do not undertake to update this information at any particular time.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS

The Company's management maintains a system of disclosure controls and procedures to provide reasonable assurance that material information is made known, and has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards ("IFRS"), applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting". There has been no change during the Company's most recent interim period in the internal controls over financial reporting.

The accounting policies applied in these Condensed Interim Financial Statements are based on IFRS effective for the three months ended March 31, 2014, as issued and outstanding as of May 14, 2014, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's Condensed Interim Financial Statements for the three months ended March 31, 2014 could result in restatement of these financial statements, including the transition adjustments recognized on the change-over to IFRS.

Dr. Paul M. Walker, Chief Executive Officer, and Mr. Anthony Businskas, Chief Financial Officer, in accordance with Multilateral Instrument NI 52-109, have also both certified that:

- They have reviewed the Condensed Interim Financial Statements and this MD&A ("the Filings");
- Based on their knowledge, these Filings do not contain any untrue fact or omit a material fact;
- The Filings present fairly the financial position, loss and comprehensive loss, and cash flows of the Company;
- They have designed such disclosure controls and procedures, or caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Company is made known to them by others within the Company, particularly during the period in which the annual filings are being prepared;
- They have designed such internal controls over financial reporting, or caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

This document and the related financial statements can also be viewed on the Company's website at www.spectraldx.com and at www.sedar.com. The Company's Annual Information Form and Management Information Circular are also available on these websites.

INTRODUCTION

Spectral Diagnostics Inc. ("Spectral" or the "Company") is strategically focused on the development and commercialization of a treatment for severe sepsis utilizing its Endotoxin Activity Assay (EAA™) and the Toraymyxin therapeutic ("PMX"). If approved, this will be the first theranostics product, a targeted therapy guided by a specific diagnostic, in the area of sepsis. The Company also manufactures and sells certain proprietary reagents.

EAA™

Spectral has pioneered the development of biochemical markers for the clinical syndrome known as "severe sepsis". In 2003, the Company achieved U.S. Federal Drug Administration ("FDA"), Health Canada and European CE clearance of the Endotoxin Activity Assay ("EAA™") for the first recognized rapid test for the risk of developing sepsis in the Intensive Care Unit ("ICU"). In North America alone, over 1,000,000* patients are diagnosed with the clinical syndrome of sepsis annually. Between 30% and 50% of patients with severe sepsis die in the ICU. Earlier identification and treatment of patients at risk for sepsis reduces mortality and saves significant cost by reducing the length of stay in the ICU and helping to guide therapeutic interventions. Spectral's EAA™ endotoxin measurement is the only FDA cleared diagnostic for this indication currently on the market.

PMX

PMX is a therapeutic hemoperfusion device that removes endotoxin from the bloodstream. PMX has been used in more than 100,000 patients globally and has demonstrated in clinical trials that it safely and effectively removes endotoxin and reduces mortality in patients with severe sepsis.

Results of a randomized controlled trial (the EUPHAS trial) were published in the *Journal of the American Medical Association* (JAMA, 2009; Vol. 301 No. 23, 2445-2452). The results demonstrated that when PMX is added to conventional therapy, there is significantly improved hemodynamics and organ function, and reduced 28-day mortality in patients with severe sepsis and septic shock in comparison to those patients in the conventional therapy group.

PROPRIETARY REAGENTS

Spectral develops, produces and markets recombinant proteins, antibodies and calibrators. These materials are sold for use in research and development as well as in products manufactured by other diagnostic companies through non-exclusive license and supply agreements. Royalty revenues are earned from these license arrangements based on a percentage of end user sales of Troponin I.

CLINICAL DEVELOPMENT

The Company's only clinical development program is focused on obtaining U.S. FDA approval for PMX.

On March 6, 2009, Spectral signed a license agreement with Toray Industries, Inc. of Japan granting Spectral the exclusive development and commercial rights in the U.S. for PMX, a therapeutic device for the treatment of sepsis that removes endotoxin from the bloodstream. Under the terms of the agreement, Spectral is seeking U.S. FDA approval for PMX and intends to commercialize the product, together with its Endotoxin Activity Assay (EAA™), the only FDA cleared diagnostic for the measurement of endotoxin.

On February 26, 2010, the Company received final approval of its Investigation Device Exemption ("IDE") from the U.S. FDA, which permits the Company to conduct a pivotal trial for PMX (the EUPHRATES trial) in the United States.

** Ref: Martin. G., Expert Rev Anti Infect Ther.2012 June; 10(6): 701-706*

In October, 2010, the Company announced the initiation of its EUPHRATES trial (Evaluating the Use of Polymyxin B Hemoperfusion in a Randomized controlled trial of Adults Treated for Endotoxemia and Septic shock) in the United States comparing standard of care versus PMX plus standard of care.

In November, 2010, the Company signed a long-term, exclusive distribution agreement with Toray Industries, Inc. and Toray Medical Co., Ltd. of Japan (collectively "Toray") to market and sell PMX in Canada. Both the PMX product and Spectral's EAA™ diagnostic are already approved for sale by Health Canada. The Company is developing commercial plans for the Canadian market. The first step in the Canadian commercialization process is the inclusion of Canadian sites in the EUPHRATES trial. There are currently 9 operational Canadian sites with 11 hospitals.

In the fourth quarter of 2011, "Xigris", an Eli Lilly product, was withdrawn from the market globally, following results of a European clinical study which showed that the trial did not meet the primary endpoint of a statistically significant reduction in 28-day all cause mortality in patients with septic shock. In February, 2012, the first of two anticipated pivotal phase III sepsis studies for Tolactoferrin alfa ("Aggenix AG") was halted for safety reasons. While unfortunate for sepsis patients and clinicians, the opportunity to find an effective treatment remains.

On June 20, 2012, the FDA approved the Company's request to add up to an additional 30 clinical trial sites. This provides the Company with the capability to expand the trial to a total of 60 clinical sites in North America and internationally.

On September 26, 2012, the FDA approved an amended protocol for the EUPHRATES trial, which included two planned interim analyses instead of one.

In January, 2013, the first interim analysis was conducted on the 76 randomized patients who were followed for 28 days. The Data Safety and Monitoring Board ("DSMB"), consisting of experts in the fields of critical care medicine, infectious disease, nephrology, biostatistics and regulatory affairs, reviewed the totality of the data set for evidence of safety concerns, such as adverse events and/or adverse device effects, related to the use of the PMX cartridge. The results from the first interim safety analysis by the DSMB stated that there are no safety issues concerning the application of the PMX cartridge to patients in the EUPHRATES trial. In addition, the results stated that the EUPHRATES clinical protocol appears to be defining the correct target patient population for this study.

On May 1, 2013, the Company announced the appointment of Dr. Gualtiero Guadagni as the Company's Vice President, Sales and Marketing. Dr. Guadagni will primarily be responsible for the development of sales and marketing programs, the expansion of commercial opportunities and the execution of sales and marketing initiatives for PMX and EAA™ in Canada, the United States and Europe.

On September 26, 2013, the Company announced that the 184 patients required for the planned, second interim analysis had been randomized into its EUPHRATES trial.

On January 27, 2014, the DSMB met to review the results of the second interim analysis after 184 patients had been randomized and followed for 28 days in accordance with the Statistical Analysis Plan agreed to with the FDA. On that date, the DSMB reported that stopping rules for safety, efficacy and futility were not met and that the trial should continue. The DSMB did not, however, provide the planned sample size recalculation at that time. The DSMB requested that additional analysis be performed by the Contract Research Organization on the original 184 patients prior to the recalculation.

The Company received the recommendations of the DSMB pursuant to its analysis on April 11, 2014 Based on the current recommendations, the trial's sample size was recalculated and increased from 360 to 650 patients. This increase in the number of enrolled patients enhances the likelihood of demonstrating, with sufficient power, a statistically and clinically significant effect. The revised sample size falls within the statistical plan already agreed to by the U.S. FDA. The DSMB was also recommended that the Company submit a protocol amendment to the FDA for an additional exclusion criterion, which request was submitted on May 1, 2014.

There are currently 39 operational sites in the clinical trial, of which 6 have enlisted an additional institution, bringing the total number of operational hospitals to 45. As of May 14, 2014, the trial has enrolled 276 patients.

The EUPHRATES trial is currently the only active Phase III study in the area of septic shock.

PMX is marketed in Japan and Europe and has been used to treat more than 100,000 sepsis patients safely and effectively. Spectral's EAA™ can identify patients that will benefit from PMX and monitor the effects of the treatment. This combination of the EAA™ diagnostic and the PMX therapeutic has been utilized by clinicians in Europe since November 2007 and has demonstrated a significant reduction in mortality. The market opportunity for Spectral is large, as the combined diagnostic and therapeutic product is expected to fulfill a major unmet need for the approximately 350,000 patients who develop severe sepsis or septic shock in the U.S. each year. Over half of these patients potentially have highly elevated levels of endotoxin. The U.S. market potential for this treatment is estimated at over $ 1 billion.

OPERATIONS

During the first three months of 2014 the Company's activities focused on implementation of the EUPHRATES trial.

The Company also continued to sell its EAA™ diagnostic and its proprietary reagents under the terms of existing commercial arrangements.

OPERATING RESULTS

SELECTED FINANCIAL INFORMATION

(In thousands of Canadian dollars)

REVENUE

Revenue for the three months ended March 31, 2014 was $844, compared to $708 for the same period in the preceding year. The $136 increase is attributable primarily to the timing of orders under existing distribution agreements. Revenue levels in 2014 are expected to be consistent with those achieved in 2013.

EXPENSES

Operating costs for the three months ended March 31, 2014 were $4,033, compared to $2,807 for the same period in the preceding year, an increase of $1,226.

Of this increase, $590 is directly attributable to the EUPHRATES trial activities due to additional clinical sites and higher patient enrolment. In the first quarter of 2014, 47 patients were enrolled compared to 24 patients enrolled in the first quarter of 2013. In addition, $393 of consulting fees related to various corporate initiatives were incurred in the first quarter. Most of these costs are reflected in consulting and professional fees category

Employee benefit costs increased from $740 in the first three months of 2013 to $1,034 for the same period in 2014. This increase is attributed primarily to the financial impact this year of staff additions in 2013 and the higher fair value of share options granted in the first quarter of 2014 as compared to those granted in the first quarter last year.

Apart from the activities of the EUPHRATES trial, the Company continues to maintain a low cost operating structure for its base business operations.

The $100 of management service fees in the three months ended March 31, 2013 was paid to Medwell for the provision of various consulting services related to the operation and management of the EUPHRATES trial and the Company's investor relations program.

OTHER INCOME

Other income for the three months ended March 31, 2014 was $14 compared to $5 in the first quarter of 2013. Other income represents interest earned on the Company's premium rate savings account on balances in excess of $5,000. The balance of the account fluctuated above and below this threshold during the three months ended March 2014 and 2013 which impacted the amount of interest earned.

FINANCE INCOME

Finance income represented interest earned on the company's short-term investment and is $17 lower than in the prior period. The last short-term investment matured on November 25, 2013 and was not reinvested. The investment amount, including accrued interest, was deposited to the Company's premium rate savings account to allow access to funds for the ongoing costs of the EUPHRATES trial.

LOSS

For the three months ended March 31, 2014, the Company reported a loss of $3,175 compared to a loss of $2,077 for the three months ended March 31, 2013. The higher loss is attributable to the cost increases explained above.

SHARES OUSTANDING

The total number of shares outstanding as of the date of this Management's Discussion & Analysis is 134,462,607.

BALANCE SHEET, FINACIAL CONDITION AND LIQUIDITY

(in thousands of Canadian dollars)

Cash and cash equivalents of $3,730 at March 31, 2014; decreased by $3,499, from $7,229 at December 31, 2013. This decrease was attributable to the following:

Cash operating losses	$(2,816)
Working capital	(681)
Property, plant and equipment additions	(2)
	$(3,499)

SUBSEQUENT EVENTS

On May 5, 2014, shareholders approved a name change for the company from Spectral Diagnostics Inc. to "Spectral Medical Inc." to take effect at a date to be determined by its Board of Directors.

In addition, shareholders approved the extension of the Company's $0.60 warrants to insiders from March 2, 2014 to September 2, 2014. At March 31, 2014, there are a total of 25,106,204 share purchase warrants outstanding.

RELATED PARTIES

All related parties and the respective transactions have been disclosed in Note 11 to the Condensed Interim Financial Statements for the three months ended March 31, 2014 and 2013.

i. Medwell Captial Corp ("Medwell") has significant influence on the Company. Medwell is entitled to nominate two directors to the Company's Board of Directors for so long as Medwell and its affiliates own in the aggregate not less than 10% of the outstanding Common shares (on a non-diluted basis). Mr. Kevin Giese and Mr. Laine Woollard are the Medwell representatives. Mr Giese is Chief Executive Officer of Medwell.

   Medwell holds 15,287,500 Spectral shares, representing approximately 11.4% of Spectral's issued and outstanding capital (calculated on a non-diluted basis). Medwell also held 15,200,000 Spectral warrants. On December 6, 2013, Medwell effected payment to its shareholders of record as of November 12, 2013 a dividend of two share purchase warrants of Spectral for every one common share of Medwell held. The dividend resulted in a payout of 14,208,672 Spectral warrants, following which Medwell continues to hold 991,328 warrants.

   The Company entered into a services agreement with Medwell for the provision of various consulting services related to the operation and management of the EUPHRATES trial and the Company's investor relations program as described earlier. The agreement was terminated effective May 14, 2013 and a termination fee of $125 was paid on that date.

ii. Toray has significant influence on the Company. Toray's investment represents approximately 12.4% of the issued and outstanding Common Shares, calculated on a non-diluted basis. As long as Toray owns in the aggregate not less than 10% of the Common Shares issued and outstanding calculated on a non-diluted basis, Toray shall be entitled to nominate one director to the Company's Board of Director's. Mr Koichiro Takeshita is the Toray representative on the Board.

iii. Key management consists of the Company's four executive officers and its Board of Directors.

OUTLOOK

The Company expects to generate sales in 2014 pursuant to its existing commercial arrangements for EAA™ and its proprietary biological reagents. The strategic focus continues to be on the successful implementation and completion of the EUPHRATES trial.

The DSMB completed its review of the second interim analysis early in April 2014 and provided clearer direction to the Company on the future pathway for the EUPHRATES trial. Pursuant to the DSMB recommendations, the EUPHRATES trial continues with a total anticipated patient enrolment of 650 patients.

The Company will need to raise additional funds in 2014 to continue operations and pursue its clinical development activities and anticipates that a financing should be completed by the end of the third quarter of 2014. As at March 31, 2014 the Company had $3,730 available to fund its clinical development activities and operations.

BUSINESS RISKS

The Company's operations are exposed to a variety of risk factors inherent in new product development. The Company's short operating history in its new endeavours makes prediction of future operating results difficult. Actual future results may differ significantly from those projected in any forward-looking statements. Key business risks for the Company are detailed in its most recent Annual Information Form which is available at www.sedar.com.

RISK MANAGEMENT

1. FINANCIAL RISK MANAGEMENT

In the normal course of business, the Company is exposed to a number of financial risks that can affect its operating performance. These risks are: credit risk, liquidity risk and market risk. The

Company's overall risk management program and prudent business practices seek to minimize any potential adverse affects on the Company's financial performance.

a. Credit Risk

i. Cash: The Company places its cash with Canadian Schedule I banks.

ii. Cash equivalent: Cash equivalent consist of a premium money market saving account placed with a Canadian Schedule I bank. The premium money market saving account can be converted to cash on demand.

iii. Trade and other receivables: The Company sells its products to distribution partners in major markets. The credit risk associated with the accounts receivable pursuant to these agreements is evaluated during initial negotiations and on an ongoing basis. There have been no events of default under these agreements. As at March 31, 2014 and 2013, no material accounts receivable balances were considered impaired or past due.

b. Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with its financial liabilities. The Company is exposed to liquidity risk, as it continues to have net cash outflows to support its operations. The company's objective for liquidity risk management is to maintain sufficient liquid financial resources to fund the statement of financial position and to meet commitments and obligations in the most cost-effective manner possible.

The Company achieves this by maintaining sufficient cash and cash equivalents and managing working capital. The Company monitors its financial resources on a weekly basis and updates its expected use of cash resources on the latest available data. All of the Company's financial liabilities are classified as current liabilities. Current liabilities were $3,093 as at March 31, 2014 with all of it having expected settlement dates within one year. There are uncertainties related to the timing and use of the Company's cash resources. The risks surrounding the timing and the use of the Company's cash resources are disclosed in Note 1 to the Condensed Interim Financial Statements.

c. Market Risk

i. Currency risk: The majority of the Company's revenue is denominated in U.S. dollars and Euros. At March 31, 2014, cash and cash equivalents included US$92. Trade and other receivables included a total of US$423 and €71. Trade and other payables included a total of US$1,905 and €1. There is no active hedging program currently in place due to the relatively short time frame for settlement of these balances. A 10% change in the U.S. dollar /Canadian dollar, Euro/Canadian or exchange rates on the March 31, 2014 amounts would impact on losses by $143.

ii. Interest rate risk: The Company has no material exposure to fluctuations in interest rates.

2. CAPITAL RISK MANAGEMENT

The Company's primary objective, when managing capital, is to maintain appropriate levels of cash and cash equivalents for working capital and operating purposes, as well as funding commercialization of its core products. Capital consists of share capital, contributed surplus, other equity reserves, and deficit.

Spectral Diagnostics Inc.

Condensed Interim Financial Statements

March 31, 2014
(Unaudited)

These unaudited condensed interim financial statements have been prepared by management of Spectral Diagnostics Inc. and have not been reviewed by the Company's auditor.

Spectral Diagnostics Inc.

Condensed Interim Statement of Financial Position

(in thousands of Canadian dollars)

	Note	March 31 2014 $	December 31 2013 $
		Unaudited	Audited
Assets			
Current assets			
Cash and cash equivalents		3,730	7,229
Trade and other receivables		673	569
Inventories		189	315
Prepayments		343	289
		4,935	8,402
Non-current assets			
Property, plant and equipment		571	627
Intangible asset		403	409
		974	1,036
Total assets		5,909	9,438
Liabilities			
Current liabilities			
Trade and other payables		3,103	3,636
Deferred revenue		80	106
Total liabilities		3,183	3,742
Equity			
Share capital		33,957	33,957
Contributed surplus		3,864	3,864
Other equity reserves	8	8,038	7,833
Deficit		(43,133)	(39,958)
Total equity		2,726	5,696
Total liabilities and equity		5,909	9,438

Approved by the Board of Directors

(signed) Anthony Bihl III Director **(signed) Guillermo Herrera** Director

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

Spectral Diagnostics Inc.

Condensed Interim Statement of Loss and Comprehensive Loss
For the three months ended March 31, 2014 and 2013
(Unaudited)

(in thousands of Canadian dollars, except for share and per share data)

	Note	2014 $	2013 $
Revenue		844	708
Other income		14	5
Expenses			
Changes in inventories of finished goods and work-in-process		173	83
Raw materials and consumables used		77	111
Employee benefits	8,10	1,034	740
Consulting and professional fees		2,287	1,304
Management services	11	-	100
Regulatory and investor relations		76	48
Travel and entertainment		179	219
Depreciation and amortization		64	55
Foreign exchange loss		27	9
Other expenses		116	138
		4,033	2,807
Operating loss		(3,175)	(2,094)
Finance income		-	17
Loss and comprehensive loss for the year		(3,175)	(2,077)
Basic and diluted loss per common share		(0.02)	(0.02)
Weighted average number of common shares outstanding		134,462,580	113,883,394

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

Spectral Diagnostics Inc.

Condensed Interim Statement of Changes in Equity
For the three months ended March 31, 2014 and 2013
(Unaudited)

(in thousands of Canadian dollars, except for number of shares)

	Note	Issued capital Number	$	Contributed surplus $	Share-based compensation $	Warrants $	Deficit $	Total Equity $
Balance, January 1, 2013		113,883,394	27,101	3,864	3,117	5,143	(28,651)	10,574
Loss and comprehensive loss for the period		-	-	-	-	-	(2,077)	(2,077)
Share-based compensation	8, 10	-	-	-	77	-	-	77
Balance, March 31, 2013		113,883,394	27,101	3,864	3,194	5,143	(30,728)	8,574
Balance, January 1, 2014		134,462,561	33,957	3,864	3,239	4,594	(39,958)	5,696
Warrants exercised		46	-	-	-	-	-	-
Loss and comprehensive loss for the period		-	-	-	-	-	(3,175)	(3,175)
Share-based compensation	8, 10	-	-	-	205	-	-	205
Balance, March 31, 2014		134,462,607	33,957	3,864	3,444	4,594	(43,133)	2,726

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

Spectral Diagnostics Inc.

Condensed Interim Statement of Cash Flows
For the three months ended March 31, 2014 and 2013
(Unaudited)

(in thousands of Canadian dollars)

	Note	2014 $	2013 $
Cash flow provided by (used in)			
Operating activities			
Loss and comprehensive loss for the year		(3,175)	(2,077)
Adjustments for:			
Depreciation on property, plant, and equipment		58	48
Amortization of intangible asset		6	6
Share-based compensation	8,10	205	77
Changes in items of working capital :			
Trade and other receivables		(104)	(83)
Inventories		126	(141)
Prepayments		(54)	(421)
Trade and other payables		(533)	(241)
Deferred revenue		(26)	(25)
Net cash used in operating activities		(3,497)	(2,857)
Investing activities			
Property, plant and equipment expenditures		(2)	(129)
Redemption of short-term investment		-	5,137
Purchase of short-term investment		-	(5,173)
Net cash used in investing activities		(2)	(165)
Decrease in cash and cash equivalents		(3,499)	(3,022)
Cash and cash equivalents, beginning of period		7,229	5,425
Cash and cash equivalents, end of period		3,730	2,403

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

(in thousands of Canadian dollars, except for share and per share data)

1. Nature of operations and going concern

Spectral Diagnostics Inc. (Spectral or the Company) was incorporated on July 29, 1991 in Ontario, Canada. The Company is strategically focused on the development and commercialization of a treatment for severe sepsis utilizing its Endotoxin Activity Assay (EAA™) diagnostic and the Toraymyxin therapeutic. The address of the registered office is 135-2 The West Mall, Toronto, Ontario.

While the condensed interim financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities during the normal course of operations for the foreseeable future, certain adverse conditions and events may cast substantial doubt on the validity of this assumption and, hence, the ultimate appropriateness of the use of accounting principles applicable to a going concern. For the three months ended March 31, 2014, the Company recorded a loss from operations of $3,085 and a deficit of $43,043 as at that date. The Company's ability to continue as a going concern is dependent on the successful execution of management's operating and strategic plan, which includes, among other things, the implementation of a viable regulatory strategy, the securing of additional forms of equity financing, the potential commercialization of the technology, the continued financial support of its shareholders and, ultimately, the attainment of profitable operations. The success of these initiatives cannot be assured at this time. These condensed interim financial statements do not reflect the adjustments to the carrying amounts of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary if the Company were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.

2. Basis of preparation

These condensed interim financial statements of Spectral Diagnostics Inc. for the three months ended March 31, 2014 have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"), defined as International Financial Reporting Standards ("IFRS") as set out in the Handbook of the Canadian Institute of Chartered Accountants applicable to the preparation of interim financial statements, including IAS 34, "Interim Financial Reporting". The condensed interim financial statements should be read in conjunction with the annual financial statements for the year ended December 31, 2013, which have been prepared in accordance with Canadian GAAP. These condensed interim financial statements were approved by the Board of Directors for issue on May 14, 2014.

(in thousands of Canadian dollars, except for share and per share data)

3. Significant accounting policies

The significant accounting polices used in the preparation of these condensed interim financial statements are consistent with those of the previous financial year.

4. Critical accounting estimates and judgments

The preparation of condensed interim financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying Spectral's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions are significant to the financials are the same as those that were applied to the financial statements for the year ended December 31, 2013.

5. Accounting standards issued but not yet applied

There are no new IFRSs or IFRICs that are effective for the first time for this interim period that would be expected to materially affect the Company.

6. Risk management

i. Financial risk management

In the normal course of business, the Company is exposed to a number of financial risks that can affect its operating performance. These risks are: credit risk, liquidity risk and market risk. The Company's overall risk management program and prudent business practices seek to minimize any potential adverse effects on the Company's financial performance.

The condensed interim financial statements do not include all financial risk management information and disclosures required in the annual financial statements. They should be read in conjunction with the annual financial statement as at December 31, 2013. There have been no changes in the risk management since year end or in any risk management policies.

ii. Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with its financial liabilities. The Company is exposed to liquidity risk, as it continues to have net cash outflows to support its operations. The company's objective for liquidity risk management is to maintain sufficient liquid financial resources to fund the statement of financial position and to meet commitments and obligations in the most cost effective manner possible.

The Company achieves this by maintaining sufficient cash and cash equivalents and managing working capital. The Company monitors its financial resources on a weekly basis

(in thousands of Canadian dollars, except for share and per share data)

and updates its expected use of cash resources on the latest available data. All of the Company's financial liabilities are classified as current liabilities. Current liabilities were $3,093 as at March 31, 2014 with all of it having expected settlement dates within one year. There are uncertainties related to the timing and use of the Company's cash resources.

7. Commitments

The Company has committed to expenditures for its EUPHRATES trial as follows:

	2014 $	2015 $	2016 $
Program management	2,486	3,115	1,741
Program oversight	133	221	57
Clinical site costs	2,264	3,425	1,988
Diagnostic supply and training	180	361	105
Employee benefits	446	225	225
Consultants	106	108	108
	5,615	**7,455**	**4,224**

Future commitments for the trial are based on enrolment of 650 patients at up to 60 clinical sites in the U.S. and Canada. The company is only committed to the costs to the extent that patients are enrolled in the trial.

8. Share capital

The Company granted the following share options to its directors and officers, at the discretion of the Board of Directors.

	March 31, 2014			March 31, 2013	
Date	Number of share options	Exercise price	Date	Number of share options	Exercise price
January 3, 2014	916,000	$0.60	February 7, 2013	950,000	$0.21

The exercise prices of the share options are equal to the closing market price of the Company's shares on the Toronto Stock Exchange on the immediately preceding day of the grant of the option. Share options issued to the Company's directors vest 100% at the time of the grant. Share options issued to the Company's officers vest at 25% of the grant amount at the time of the grant. The balance of these share options vest equally in each successive quarter and will be fully vested by the end of the third year following the grant date. Share options issued in 2014 vest January 3, 2017. Share options issued in 2013 will be fully vested by February 7, 2016. The contractual life of each share option is five years. There is no cash settlement of the share options.

The volatility measured at the standard deviation of continuously compounded share returns is based on statistical analysis of weekly share prices over the last five years.

(in thousands of Canadian dollars, except for share and per share data)

Share options granted were valued using the Black-Scholes option pricing model, with the following assumptions:

	2014	2013
Grant date	January 3 2014	February 7 2013
Risk-free interest rate	1.95%	1.48%
Expected life	5 years	5 years
Annualized volatility	74.89%	85.99%
Dividend rate	0%	0%
Grant date share price	$0.580	$0.215
Share option fair value	$0.354	$0.146

9. The EUPHRATES trial

The Company's current clinical development program is focused on obtaining U.S. FDA approval for Toraymyxin, a therapeutic device for the treatment of sepsis that removes endotoxin from the bloodstream.

The Company has incurred the following costs associated with this clinical trial:

	For the three months ended March 31 2014 $	March 31 2013 $
Program management	896	696
Program oversight	58	81
Clinical site costs	932	406
Diagnostic supply and training	30	120
Employee benefits	108	93
Consultants	54	92
Total EUPHRATES	**2,078**	**1,488**

The trial costs have been included within operating loss in the statement of loss and comprehensive loss as required. Total trial costs since inception in 2010 are $20,913.

10. Employee benefits

Key management includes the Company's directors and officers. Compensation awarded to key management included:

(in thousands of Canadian dollars, except for share and per share data)

	For the three months ended March 31 2014 $		For the three months ended March 31 2013 $	
	All employees	**Key management**	**All employees**	**Key management**
Salaries	536	274	490	267
Bonuses	90	90	-	-
Short term employee benefits	88	28	71	29
Directors fees	70	70	60	60
Post-employment benefits	42	42	42	42
Share- based compensation	205	191	77	73
Other	3	-	-	-
	1,034	**695**	**740**	**471**

11. Related party transactions

i. Medwell Captial Corp ("Medwell") has significant influence on the Company. Medwell is entitled to nominate two directors to the Company's Board of Directors for so long as Medwell and its affiliates own in the aggregate not less than 10% of the outstanding Common shares (on a non-diluted basis). Mr. Kevin Giese and Mr. Laine Woollard are the Medwell representatives. Mr Giese is Chief Executive Officer of Medwell.

Medwell holds 15,287,500 Spectral shares, representing approximately 11.4% of Spectral's issued and outstanding capital (calculated on a non-diluted basis). Medwell also holds 991,328 Spectral warrants, which are exercisable at $0.60 and expire on September 2, 2014.

The Company entered into a services agreement with Medwell for the provision of various consulting services related to the operation and management of the EUPHRATES trial and the Company's investor relations program. The agreement was effective January 1, 2010, and was later amended January 1, 2011. Under the terms of the agreement, Medwell was paid $1,500 per annum plus applicable expenses from January 1, 2012 through July 31, 2012.

Effective August 1, 2012, pursuant to a restructuring of the services agreement, Medwell was paid $400 per annum plus up to $50 of applicable expenses to December 31 2013.

The Company provided notice of termination effective May 14, 2013. A termination fee of $125 was paid on that date, representing 50% of remaining amounts due under the contract to December 31, 2013.

As at March 31, 2014, the amount owing to Medwell was $nil (2013: $nil).

ii. Toray has significant influence on the Company. Toray became a related party as part of the Private Placement that occurred on April 2, 2013. Toray acquired 16, 666,667 Common Shares of the Company at a price of $0.30 per Common share, for $5,000. At March 31, 2014, Toray's

(in thousands of Canadian dollars, except for share and per share data)

investment represents 12.4% of the issued and outstanding Common Shares, calculated on a non diluted basis. As part of this transaction and as long as Toray owns in the aggregate not less than 10% of the Common Shares issued and outstanding calculated on a non-diluted basis, Toray shall be entitled to nominate one director (the "Toray Representative") to the Board of Director's. Mr. Koichiro Takeshita is the Toray representative.

The principal transactions with Toray which were carried out in the ordinary course of business are:

	For the three months ended	
	March 31, 2014	March 31, 2013
	$	$
Revenue		
Toray Medical Co., Ltd.	54	33
Toray International Italy S.r.l.	-	22
Due from related party		
Toray Medical Co., Ltd.	-	33
Toray International Italy S.r.l.	-	-

iii. Key management consists of the Company's four executive officers and its Board of Directors. Compensation of key management is disclosed in Note 10.

There are no other related party transactions.

12. Subsequent events

On May 5, 2014, shareholders approved a name change for the company from Spectral Diagnostics Inc. to "Spectral Medical Inc." to take effect at a date to be determined by its Board of Directors.

In addition, shareholders approved the extension of the Company's $0.60 share purchase warrants to insiders from March 2, 2014 to September 2, 2014. At March 31, 2014, there are a total of 25,106,204 share purchase warrants outstanding.

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Diagnostics

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