Spectral Medical Inc.

Condensed Interim Consolidated Financial Statements

September 30, 2018
(Unaudited)

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

Spectral Medical Inc.

Condensed Interim Consolidated Financial Statements

September 30, 2018

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Spectral Medical Inc.

Condensed Interim Consolidated Statements of Financial Position
(Unaudited)

(in thousands of Canadian dollars)

	Notes	September 30 2018 $	December 31 2017 Restated (Note 7) $	January 01 2017 Restated (Note 7) $
Assets				
Current assets				
Cash		4,567	1,449	5,080
Trade and other receivables		504	881	642
Inventories		289	191	244
Prepayments and other assets		193	73	166
Contract asset	7	126	-	-
		5,679	2,594	6,132
Non-current assets				
Property and equipment		454	570	634
Intangible asset		290	309	334
Total assets		6,423	3,473	7,100
Liabilities				
Current liabilities				
Trade and other payables		441	612	1,112
Contract liability	7	29	3	6
Total liabilities		470	615	1,118
Equity				
Share capital		66,646	63,225	63,084
Contributed surplus		7,981	7,849	7,849
Share-based compensation		5,591	4,914	4,103
Warrants		1,930	132	132
Deficit	7	(76,195)	(73,262)	(69,186)
Total equity	7	5,953	2,858	5,982
Total liabilities and equity	7	6,423	3,473	7,100

Going concern (Note 1)
Contingencies and commitments (Note 9)

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

Spectral Medical Inc.

Condensed Interim Consolidated Statements of Loss and Comprehensive Loss
For the nine-months ended September 30, 2018 and 2017
(Unaudited)

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

	Notes	Three-months ended 2018	2017 Restated (Note 7) $	Nine-months ended 2018	2017 Restated (Note 7) $
Revenue	7	579	820	1,976	2,785
Expenses					
Changes in inventories of finished goods and work- in-process		13	78	69	204
Inventory write-down		-	-	38	-
Raw materials and consumables used		82	56	207	167
Salaries and benefits	10,13	619	748	2,523	2,632
Consulting and professional fees	13	266	406	962	1,610
Product development		-	-	66	50
Regulatory and investor relations		80	59	360	220
Travel and entertainment		16	81	78	226
Depreciation and amortization		57	56	176	168
Foreign exchange (gain) loss		12	39	(10)	73
Other expenses		143	154	440	435
		1,288	1,677	4,909	5,785
Loss and comprehensive loss for the period	7	(709)	(857)	(2,933)	(3,000)
Basic and diluted loss per Share	11	(0.003)	(0.004)	(0.013)	(0.014)
Weighted average number of Shares outstanding	11	225,591,183	207,446,674	218,346,659	207,288,352

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

Spectral Medical Inc.

Condensed Interim Consolidated Statements of Changes in Equity
For the nine-months ended September 30, 2018 and 2017
(Unaudited)

(in thousands of Canadian dollars)

	Notes	Issued capital Number	$	Contributed surplus $	Share-based compensation $	Warrants $	Deficit $	Total equity $
Balance, January 1, 2017		207,165,587	63,084	7,849	4,103	132	(69,346)	5,822
Change in accounting policies	7	-	-	-	-	-	160	160
Restated equity, January 1, 2017		207,165,587	63,084	7,849	4,103	132	(69,186)	5,982
Share options exercised		283,750	137	-	(56)	-	-	81
Loss and comprehensive loss for the period, restated	7	-	-	-	-	-	(3,000)	(3,000)
Share-based compensation	10	-	-	-	433	-	-	433
Balance, September 30, 2017		207,449,337	63,221	7,849	4,480	132	(72,186)	3,496
Share options exercised		9,685	4	-	(1)	-	-	3
Loss and comprehensive loss for the period, restated	7	-	-	-	-	-	(1,076)	(1,076)
Share-based compensation		-	-		435		-	435
Balance, December 31, 2017		207,459,022	63,225	7,849	4,914	132	(73,262)	2,858
Balance, January 1, 2018		207,459,022	63,225	7,849	4,914	132	(73,262)	2,858
Private placement	14	17,694,661	3,267	-	-	1,930	-	5,197
Share options exercised		437,500	154	-	(63)	-	-	91
Warrant expiry		-	-	132	-	(132)	-	-
Loss and comprehensive loss for the period	7	-	-	-	-	-	(2,933)	(2,933)
Share-based compensation	10	-	-	-	740	-	-	740
Balance, September 30, 2018		225,591,183	66,646	7,981	5,591	1,930	(76,195)	5,953

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

Spectral Medical Inc.

Condensed Interim Consolidated Statements of Cash Flows
For the nine-months ended September 30, 2018 and 2017
(Unaudited)

(in thousands of Canadian dollars)

	Notes	2018	2017 Restated (Note 7)
		$	$
Cash flow provided by (used in)			
Operating activities			
Loss and comprehensive loss for the period	7	(2,933)	(3,000)
Adjustments for:			
Depreciation on property and equipment		157	149
Amortization of intangible asset		19	19
Share-based compensation	10	740	433
Gain on disposal of property and equipment		-	(4)
Changes in items of working capital :			
Trade and other receivables		377	(97)
Inventories		(98)	22
Prepayments and other assets		(120)	(7)
Contract asset	7	(126)	-
Trade and other payables		(171)	(328)
Contract liability	7	26	(2)
Net cash used in operating activities		(2,129)	(2,815)
Investing activities			
Purchase of property and equipment		(41)	(90)
Proceeds on disposal of property and equipment		-	15
Net cash used in investing activities		(41)	(75)
Financing activities			
Proceeds from private placement	14	5,308	-
Transaction costs paid	14	(111)	-
Proceeds from Share options exercised	10	91	81
Net cash provided by financing activities		5,288	81
Increase (decrease) in cash		3,118	(2,809)
Cash, beginning of period		1,449	5,080
Cash, end of period		4,567	2,271

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

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

1. Nature of operations and going concern

Spectral Medical Inc. (Spectral or the Company) was incorporated on July 29, 1991 in Ontario, Canada as Spectral Diagnostics Inc. Effective December 31, 2014, the Company's name was changed to "Spectral Medical Inc.". The address of the registered office is 135 The West Mall, Unit 2, Toronto, Ontario.

The Company is strategically focused on the development and commercialization of a treatment for septic shock utilizing its Endotoxin Activity Assay ("EAA™") diagnostic and the Toraymyxin™ therapeutic ("PMX"). The Company also manufactures and sells certain proprietary reagents.

These condensed interim consolidated financial statements have been prepared using International Financial Reporting Standards ("IFRS") applicable to a going concern, which contemplates the realization of assets and the settlement of liabilities during the normal course of operations for the foreseeable future.

The ability of the Company, to realize its assets and meet its obligations as they come due is dependent on obtaining regulatory approval from the United States Food and Drug Administration ("FDA") of the Company's primary product (PMX), successful commercialization of the Company's products (including the PMX product) and achieving future profitable operations, the outcome of which cannot be predicted at this time. Furthermore, the Company will require additional funding from commercial transactions or investors to continue the development and commercialization of products. These circumstances, lend significant doubt as to the ability of the Company to meet its obligations as they come due and, accordingly, the ultimate appropriateness of the use of accounting principles applicable to a going concern.

Management has assessed the Company's ability to continue as a going concern and concluded that it is dependent on the successful execution of management's operating and strategic plan, which includes among other things, securing additional financing, the commercialization of its products, the continued financial support of its shareholders and ultimately, the attainment of future profitable operations. There are no assurances that any of these initiatives will be successful. Factors within and outside the Company's control could have a significant bearing on its ability to obtain additional financing.

These condensed interim consolidated financial statements do not reflect the adjustments to the carrying amounts of assets and liabilities and the reported expenses and statement of financial position 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.

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

2. Basis of preparation

The condensed interim consolidated financial statements of Spectral for the nine-months ended September 30, 2018, have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS) as set out in the CPA Canada Handbook, applicable to the preparation of condensed interim consolidated financial statements, including IAS 34, "Interim Financial Reporting". The condensed interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2017, which have been prepared in accordance with IFRS. These condensed interim consolidated financial statements were approved by the Board of Directors for issue on November 13, 2018.

3. Significant accounting policies

The significant accounting polices used in the preparation of these condensed interim consolidated financial statements are consistent with those of the previous financial year and corresponding interim reporting period, except for the adoption of new and amended standards as set out in Note 5.

4. Critical accounting estimates and judgments

The preparation of condensed interim consolidated 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 except for those estimates required for the revised accounting policies as a result of adoption of IFRS 15 and 9 as described in Note 5.

5. Accounting standards adopted in the current period

A number of new standards and amendments to standards and interpretations have been applied in preparing these condensed interim consolidated financial statements as described below. The Company has elected to use the full retrospective method upon adoption of these standards which requires retrospective adjustments to the condensed interim consolidated financial statements for the earliest year presented. The impact on adoption of the new standards are described within Note 7.

a. IFRS 15, *Revenue from Contracts with Customers*

The Company implemented the new standard, IFRS 15, *Revenue from Contracts with Customers* as of January 1, 2018. The new standard amends revenue recognition requirements and establishes principles for recording information about the nature, timing and uncertainty of revenue and cash flows arising from contracts with customers. The standard replaces IAS 18, *Revenue* and IAS 11, *Construction Contracts* and related interpretations.

The new standard also introduces expanded disclosure requirements.

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

The following revenue recognition policies have been adopted:

i. Royalty revenue

The Company grants licenses to use certain proprietary biochemical and patented process applications or intellectual property ("IP"). Where the license is offered on a standalone basis or it is determined that the license is distinct from other goods and services offered in the contract, the Company assesses whether the license is a right to use or right to access the IP. The Company has determined that all licenses meet the definition of a right to use IP as they grant the licensee the right to use the IP as it exists at a point in time. Therefore, revenue is recognized at a point in time when control transfers to the licensee and the license period begins. Where the Company has recognized revenue ahead of invoicing the customer, the amount is recognized as a contract asset.

The Company may offer its licenses of IP in combination with contracts for the sale of certain proprietary biochemicals. Where it is determined that the license is not distinct from the sale of the product and the product is the predominant component in the bundle, the performance obligation is satisfied with delivery of the product (product sales revenue is described below). The Company allocates the cost of the license to the product revenue based on its estimated expected sales for the period to which the license fee relates based on historical trends with that customer.

Revenue also includes royalty income which is earned on certain proprietary biochemical and patented process application. When the license of IP is the predominant item to which the royalty relates, royalty revenue is recognized at the later of when the subsequent sale or usage occurs and the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied). When the license of IP is not the predominant item to which the royalty relates, royalty revenue is recognized in accordance with variable consideration guidance and the amount of consideration to which the Company will be entitled to in exchange for transferring the promised goods or services is estimated based on the expected value.

Where licensing agreements contain minimum royalty guarantees, minimum royalties for right to use licenses are recognized as fixed consideration when the Company transfers control of the license. Royalties earned above the minimum guarantee are recognized in accordance with the paragraph above.

Licensing arrangements may contain payment terms that include upfront payments and minimum guaranteed royalties as noted above. Where there is a difference in timing of receiving the consideration from the customer and the timing of the Company's performance (beyond one year), these payments are accounted for as a financing component and interest is imputed and recognized separately from revenue. The Company did not have any of these arrangements as of September 30, 2018.

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

ii. Product revenue

The Company recognizes revenue when a contractual promise to a customer has been fulfilled by transferring control over the promised goods to the customer at the point in time of shipment. The amount of revenue to be recognized is based on the consideration that the Company expects to receive in exchange for the product. If the contract contains more than one performance obligation, the consideration is allocated based on the standalone selling price of each performance obligation. Where consideration is received ahead of the Company fulfilling its performance obligations as per the contract, the amount is recorded as a contract liability.

The Company may offer discounts on purchases above certain purchase quantity thresholds. Such arrangements represent an option that the customer receives in connection with a current revenue transaction. Where this option is considered a material right, a portion of revenue is deferred and recognized in conjunction with discounted sales in the future.

b. IFRS 9, *Financial Instruments*

The Company implemented the new standard, IFRS 9, *Financial Instruments* as of January 1, 2018. The new standard replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments.

IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through other comprehensive income (OCI) and fair value through profit or loss. The basis of classification depends on the Company's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI without recycling to profit and loss. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 32.

For financial liabilities, there were no changes to classification and comprehensive income for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness test. It requires an economic relationship between the hedged item and the hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 32.

In addition, IFRS 7, *Financial Instruments: Disclosures* was amended to include additional disclosure requirements on transition to IFRS 9. As a result of the adoption of IFRS 9, management has not changed its accounting policy for financial assets except for the adoption of the simplified approach to determining expected credit losses for trade receivables which had no impact on the carrying value of any financial assets or financial liabilities as of the date of adoption of this standard.

The Company's updated accounting policy under IFRS 9 is as follows:

i. Trade and other receivables

Trade and other receivables are initially recognized at their invoiced amounts, including any related sales taxes less adjustments for estimated revenue deductions such as rebates, chargebacks and cash discounts. For trade and other receivables, the Company applies the simplified approach to providing for expected credit losses at inception as prescribed by IFRS 9, which requires the use of the lifetime expected loss provision matrix for all trade and other receivables based on the Company's historical default rates over the expected life of the trade and other receivables and is adjusted for forward looking estimates.

Significant financial difficulties of a customer, such as probability of bankruptcy, financial reorganization, default or delinquency in payments are considered indicators that recovery of the trade receivable is doubtful. These provisions represent the difference between the trade receivable's carrying amount in the interim consolidated statement of financial position and the estimated net collectible amount. Charges for doubtful trade receivables are recorded as bad debt expense recognized in the condensed interim consolidated income statement within "Other expenses".

6. Accounting standards issued but not yet applied

a. IFRS 16, *Leases*

On January 13, 2016, the International Accounting Standards Board published a new standard, IFRS 16, *Leases*. The new standard will eliminate the distinction between operating and finance leases and will bring most leases on the consolidated balance sheets for lessees.

This standard is effective for annual reporting periods beginning on or after January 1, 2019. The impact of the adoption of the standard is expected to result in the recognition of all leases with the corresponding assets and liabilities recorded in the consolidated financial statements. The Company will recognize assets and liabilities for its leased premises on the consolidated balance sheet upon adoption.

7. Impacts of adoption of new IFRS standards

Note 5 explains the changes and new accounting policies introduced on January 1, 2018, resulting from the adoption of the new accounting standards IFRS 15, *Revenue from Contracts with Customers* and IFRS 9, *Financial Instruments*.

a. IFRS 15, *Revenue from Contracts with Customers*

The most significant impact from the adoption of IFRS 15, *Revenue from Contracts with Customers* relates to the timing of the recognition of income from upfront payments and from contracts with customers that give them the right to use the Company's IP as it exists at a point in time. Where the Company has met its performance obligation with respect to these right to use license agreements, revenue is recognized at a point in time. Under IAS 18, these

payments were deferred and amortized over the term of the agreements. Therefore, upon adoption of IFRS 15, the deferred revenue in relation to these payments have been derecognized and the impact accordingly recognized to deficit in the amount of $166 as of January 1, 2017, and $26 as of December 31, 2017.

Where the Company has recognized revenue ahead of invoicing the customer, the amount is recognized as a contract asset. As a result, the Company has recorded revenue of $251 in the nine-months ended September 30, 2018, with corresponding contract asset of $126 as at September 30, 2018.

The adoption of IFRS 15 did not significantly change the timing or amount of revenue recognized with respect to the change in accounting policy for product revenue. The only change relates to a contract, which entitles the customer to receive one EAA™ diagnostic for each unit of instrumentation sold. Under IFRS 15, this is considered to be a contract with multiple performance obligations where the consideration is allocated based on the standalone selling price of each performance obligation. Under IAS 18, these payments were recognized on one performance obligation, the sale of instrumentation, and the purchase price was not allocated to the EAA™ diagnostic. To reflect this change in policy, the Company reclassified $6 from deficit to contract liability as of January 1, 2017, and $3 as of December 31, 2017.

b.* IFRS 9, *Financial Instruments

The adoption of IFRS 9, *Financial Instruments* from January 1, 2018 did not result in any adjustments to the amounts recognized in the condensed interim consolidated financial statements.

The following tables show the IFRS 15 adjustments recognized for each individual financial statement line item. Line items that were not affected by the changes have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided.

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

Statement of Financial Position (extract)	January 1 2017 As reported	Adjustment IFRS 15	January 1 2017 Restated	December 31 2017 As reported	Adjustment IFRS 15	December 31 2017 Restated
	$	$	$	$	$	$
Liabilities						
Current liabilities						
Contract liability	166	(160)	6	26	(23)	3
Total liabilities	1,278	(160)	1,118	638	(23)	615
Equity						
Deficit	(69,346)	160	(69,186)	(73,285)	23	(73,262)
Total equity	5,822	160	5,982	2,835	23	2,858
Total liabilities and equity	7,100	-	7,100	3,473	-	3,473

Statement of Loss and Comprehensive Loss (extract)	Three-months ended			Nine-months ended		
	September 30 2017 As reported	Adjustment IFRS 15	September 30 2017 Restated	September 30 2017 As reported	Adjustment IFRS 15	September 30 2017 Restated
	$	$	$			
Revenue	857	(37)	820	2,888	(103)	2,785
Loss and comprehensive loss for the period	(820)	(37)	(857)	(2,897)	(103)	(3,000)

8. 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 consolidated financial statements do not include all financial risk management information and disclosures required in the annual financial statements.

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

They should be read in conjunction with the annual financial statements as at December 31, 2017. There have been no changes in the risk management or in any risk management policies since year end.

ii. ***Liquidity risk***

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with its financial liabilities as they become due. 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 meet commitments and obligations in the most cost effective manner possible.

The Company achieves this by maintaining sufficient cash 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.

The Company will need additional capital to fund its clinical and regulatory programs and commercialization of the Toraymyxin™ therapeutic. Potential sources of capital could include equity and/or debt financings, the collection of revenues resulting from commercialization activities and/or new strategic partnerships.

There can be no assurance that the Company will be able to obtain sufficient capital to meet any or all of the Company's needs. The availability of equity or debt financing will be affected by, among other things, the ability to obtain regulatory approvals, the market acceptance of its products, the state of the capital market generally, strategic alliance agreements and other relevant commercial considerations. In addition, if the Company raised additional funds by issuing equity securities, its existing security holders will likely experience dilution, and any incurrence of additional debt would result in debt service obligations and could require the Company to agree to operating and financial covenants that would restrict its operations. Any failure on the Company's part to raise additional funds on terms favourable to it, or at all, may require it to significantly change or curtail its current or planned operations in order to conserve cash until such time, if ever, that sufficient proceeds from operations are generated, and could result in the Company not taking advantage of business opportunities, the curtailment of its product development programs, the sale or assignment of rights to its technologies and/or products and the inability to file market approval applications at all or in time to competitively market its products.

All of the Company's financial liabilities are classified as current liabilities. Trade and other payables were $441 as at September 30, 2018 with all of them having expected settlement dates within one year. There are uncertainties related to the timing and use of the Company's cash resources.

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

9. Contingencies and commitments

i. The FDA has determined that the Company is required to continue its clinical and regulatory program to collect more evidence in order to make a final determination to approve the PMX cartridge. As at September 30, 2018, the Company has made a commitment to its clinical research organization for US$877 in anticipation of its determination of the regulatory path forward with the FDA.

ii. Directors and officers are indemnified by the Company for various items including, but not limited to, costs to settle lawsuits or actions due to their association with the Company, subject to certain restrictions. The Company has purchased directors' and officers' liability insurance to mitigate the costs of any potential future lawsuits or actions. The term of the indemnification covers the period during which the indemnified party served as a director or officer of the Company.

In the normal course of business, the Company has entered into agreements that include indemnities in favour of third parties, such as purchase and sale agreements, confidentiality agreements, engagement letters with advisors and consultants, leasing contracts and license agreements. These indemnification arrangements may sometimes require such third parties to compensate counterparties for losses as a result of breaches in representations, covenants and warranties provided by the Company or as a result of litigation or other third party claims or statutory sanctions that may be suffered by the counterparties as a consequence of the relevant transaction. In some instances, the terms of these indemnities are not explicitly defined. No accruals have been required to be made as at September 30, 2018 with respect to these agreements.

iii. The Company has further commitments related to its exclusive license agreement for PMX with Toray. As part of this agreement, on obtaining market approval from the FDA for PMX, the Company would be required to pay an additional US$1,000 in cash and issue 500,000 Shares to Toray.

In addition, on obtaining market approval and commercial sale of Toraymyxin™, the Company would be required to pay royalties to Toray at 8% for net sales of Toraymyxin™ up to US$25,000 per annum and 6% for net sales of Toraymyxin™ in excess of US$25,000.

10. Share capital and other equity reserves

i. The Company is authorized to issue an unlimited number of common shares ("Shares").

ii. Details of share options are as follows:

Under the Company's 2008 Amended Stock Option Plan, the total number of Shares that may be optioned to any director, officer, employee or consultant shall not exceed 5% of the total issued and outstanding shares at the date of the grant of the option. The aggregate number of shares issuable under the Plan shall not exceed 10% of the total number of Shares issued and outstanding.

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

During the nine-month period ended September 30, the Company granted the following share options to directors, officers, employees and consultants at the discretion of the Board of Directors.

	2018			2017	
Date	Number of share options	Exercise price	Date	Number of share options	Exercise price
February 13, 2018	2,333,500	$0.395	February 28, 2017	1,637,505	$0.30
March 28, 2018	100,000	$0.395	June 1, 2017	785,305	$0.53

The exercise prices of the share options are not less than the closing market price of the Company's Shares on the TSX 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, except for 253,500 share options that will vest equally on each of April 1st, July 1st, and October 1st, 2018 respectively.

Share options issued to the Company's officers and employees, generally vest at 25% of the grant amount at the time of the grant, except for 765,000 share options issued to the Company's officers that will vest 75% upon receipt of FDA approval for Toraymyxin™ and 25% upon a value derived from a business development transaction. 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 to the Company's consultants vest 100% at the time of the grant.

The contractual life of each share option is five years, except for 265,000 share options granted on February 13, 2018, which is two years.

There is no cash settlement of the share options.

Share options issued on February 28, 2017 vested 25% at the time of the grant and will be fully vested by February 28, 2020. Share options issued on June 1st, 2017 will vest upon receipt of FDA approval for Toraymyxin™.

For purposes of the share option expense calculation, the Company had estimated that FDA approval could possibly occur on March 18, 2018, the date the 180-day review period ended.

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 and two years respectively.

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

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

						2018
Grant date	**Risk-free interest rate**	**Expected life**	**Annualized volatility**	**Dividend rate**	**Grant date share price**	**Share option fair value**
February 13, 2018	1.97%-2.04%	4-5 years	109.65%-121.95%	0%	$0.395	$0.290-$0.330
March 28, 2018	1.99%	5 years	116.42%	0%	$0.300	$0.237

						2017
Grant date	**Risk-free interest rate**	**Expected life**	**Annualized volatility**	**Dividend rate**	**Grant date share price**	**Share option fair value**
February 28, 2017	1.09%	5 years	123.09%	0%	$0.290	$0.242
June 1, 2017	1.05%	5 years	105.08%	0%	$.0495	$0.375

Share compensation expense is allocated as follows:

	Three-months ended September 30 $		Nine-months ended September 30 $	
	2018	**2017**	**2018**	**2017**
Key management and employees	47	55	603	401
Consultants and others	-	3	137	32
	47	**58**	**740**	**433**

		September 30, 2018			September 30, 2017	
	Weighted average exercise price per share $	**Share options**		**Weighted average exercise price per share $**	**Share options**	
		All participants	**Key management**		**All participants**	**Key management**
Balance, January 1	0.46	7,664,997	5,795,060	0.48	5,591,872	4,163,500
Granted	0.40	2,433,500	1,893,500	0.37	2,422,810	2,272,810
Change in key management	0.44	-	(975,870)	-	-	-
Exercised	0.21	(437,500)	(287,500)	0.28	(283,750)	-
Expired	0.39	(767,500)	(350,000)	0.29	(585,000)	(585,000)
Forfeited/cancelled	0.54	(198,125)	-	0.69	(11,250)	-
Balance, September 30	**0.46**	**8,695,372**	**6,075,190**	**0.47**	**7,134,682**	**5,851,310**

Of the 8,695,372 outstanding share options (2017: 7,134,682), 6,398,702 share options (2017: 5,342,645) were exercisable.

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

iii. The Company estimated the fair value of the warrants issued as part of the private placement financing using the Black-Scholes option pricing model with the following assumptions:

Grant date	Risk-free interest rate	Expected life	Annualized volatility	Dividend rate	Grant date share price	Warrant fair value
April 20, 2018	2.02%	3 years	138.33%	0%	$0.30	$0.218

11. Loss per Share

The following table sets forth the computing of basic and diluted loss per Share:

	Three-months ended September 30		Nine-months ended September 30	
	2018	2017 Restated (note 7)	2018	2017 Restated (note 7)
		$		$
Numerator for basic and diluted loss per Share available to shareholders	(709)	(857)	(2,933)	(3,000)
Denominator for basic and diluted loss per Share	225,591,183	207,446,674	218,346,659	207,288,352
Basic and diluted loss per Share	(0.003)	(0.004)	(0.013)	(0.014)

For the periods noted above, the computation of diluted loss per Share is equal to the basic loss per Share due to the anti-dilutive effect of the outstanding share options and warrants.

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

Weighted average Shares outstanding

	September 30, 2018		September 30, 2017	
	Weighted average Shares-basic and diluted	Number of Shares	Weighted average Shares-basic and diluted	Number of Shares
Balance, January 1	207,459,022	207,459,022	207,165,587	207,165,587
Private placement	10,564,944	17,694,661	-	-
Share options exercised	322,693	437,500	122,765	283,750
Balance, September 30	**218,346,659**	**225,591,183**	**207,288,352**	**207,449,337**

12. Clinical development and regulatory program

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

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

	Three-months ended September 30		Nine-months ended September 30	
	2018	2017	2018	2017
		$		$
Program management	120	77	366	469
Program oversight	2	105	73	627
Clinical site costs	2	23	2	55
Diagnostic supply and training	4	11	14	44
Employee benefits	71	97	255	292
Consultants	-	12	-	36
	199	**325**	**710**	**1,523**

The clinical trial costs have been included within operating loss in the statement of loss and comprehensive loss. Total trial costs since inception in 2010 are $42,246.

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

13. Salaries and benefits

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

	Three-months ended September 30, 2018 $		Nine-months ended September 30, 2018 $	
	All employees	**Key management**	**All employees**	**Key management**
Salaries	480	212	1,564	719
Short term employee benefits	74	33	239	82
Directors' fees	15	15	109	109
Share-based compensation	47	48	603	565
Other	3	2	8	5
	619	**310**	**2,523**	**1,480**
Consulting fees	16	16	79	79
	635	**326**	**2,602**	**1,559**

	Three-months ended September 30, 2017 $		Nine-months ended September 30, 2017 $	
	All employees	**Key management**	**All employees**	**Key management**
Salaries	571	293	1,798	921
Bonuses	-	-	5	-
Short term employee benefits	71	22	248	81
Directors' fees	48	48	171	171
Share-based compensation	54	50	400	379
Other	4	2	10	4
	748	**415**	**2,632**	**1,556**

Executive employment agreements allow for additional payments of approximately $1,405 if the individuals are terminated without cause and approximately $1,473 in the event of a change in control.

14. Private placement

On April 20, 2018, the Company closed a private placement financing resulting in the issuance of 17,694,661 units ("Units") for gross proceeds of $5,308. Each Unit is comprised of one Share priced at $0.30 per Share and one-half of a share purchase warrant ("Warrant"). Each whole Warrant entitles the holder to acquire one additional Share at an exercise price of $0.45 per Share for a three-year period expiring April 20, 2021.

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

In total, the Company issued 17,694,661 Shares and 8,847,331 Warrants for aggregate gross proceeds of $5,308. The Company received net proceeds of $5,197 which will be used for further clinical study of the PMX cartridge and the accompanying regulatory pursuit for FDA approval and for working capital and general corporate purposes.

The estimated fair value of the warrants issued as part of the private placement financing was $1,930 or $0.218 per warrant (Note 10).

15. Related party transactions

i. Toray Industries, Inc. ("Toray")

Toray holds 45,630,105 Shares of the Company as at September 30, 2018, representing approximately 20.2% (2017 – 22.0%) of Spectral's issued and outstanding capital, calculated on a non-diluted basis.

Toray is entitled to nominate one director (the "Toray Representative") to the Board of Directors as long as it owns in the aggregate not less than 10% of the Shares issued and outstanding calculated on a non-diluted basis.

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

	Three-months ended September 30		Nine-months ended September 30	
	2018	2017 Restated (note 7) $	2018	2017 Restated (note 7) $
Revenue				
Toray Medical Co., Ltd.	71	95	214	252
Purchases				
Toray International America Inc.	-	-	134	99
Due from (to)				
Toray Medical Co., Ltd.			71	97

ii. Birch Hill Equity Partners Management Inc. ("Birch Hill")

Birch Hill, through a number of its funds and an investee company, holds 36,017,718 Shares of the Company as at September 30, 2018 representing approximately a 16.0% (2017– 16.2%) ownership interest, calculated on a non-diluted basis.

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

Birch Hill is entitled to nominate one director to the Company's Board of Directors so long as it owns in aggregate not less than 5% of the issued and outstanding Shares of the Company calculated on a non-diluted basis.

iii. Key management consists of the Company's four executive officers and its' Board of Directors. Compensation of key management is disclosed in Note 13.

There are no other related party transactions.