



Consolidated Financial Statements of

**PHOTON CONTROL INC.**

For the three months ended March 31, 2015 and 2014

## **NOTICE OF NO-AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, “Continuous Disclosure Obligations”, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The Company’s external auditors, MNP LLP, have not performed a review of these financial statements.

# PHOTON CONTROL INC.

## Consolidated Statements of Financial Position

(Expressed in Canadian dollars)

As at March 31, 2015 and December 31, 2014

	March 31, 2015	December 31, 2014
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 16,708,128	\$ 14,061,381
Trade accounts receivable and other	5,055,120	4,011,075
Note receivable - related (note 9(a))	20,422	20,422
Due from related party (note 9(a))	421,782	415,083
Inventory (note 4)	3,030,593	1,791,334
Prepaid expenses and deposits	58,025	198,259
	<b>25,294,070</b>	20,497,554
Property and equipment (note 5)	282,971	266,530
Intangible assets (note 6)	132,974	143,924
Internally generated intangible assets (note 8)	-	-
Long term rental deposits	34,695	34,695
Note receivable - related (note 9(a))	88,763	93,975
Restricted cash (note 14)	53,743	53,743
Deferred taxes	1,137,211	2,138,211
<b>Total Assets</b>	<b>\$ 27,024,427</b>	<b>\$ 23,228,632</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Deferred revenue	\$ 98,285	\$ 94,014
Accounts payable and accrued liabilities (note 16)	1,867,819	1,234,107
Due to related party (note 9(a))	232,853	223,519
Provisions (note 10(b))	28,037	28,037
	<b>2,226,994</b>	1,579,677
Shareholders' equity (note 7):		
Share capital	27,965,299	27,911,549
Contributed surplus	3,590,832	3,216,511
Deficit	(6,758,698)	(9,479,105)
	<b>24,797,433</b>	21,648,955
Commitments and contingencies (note 10)		
Bank indebtedness (note 14)		
Subsequent events (note 19)		
<b>Total liabilities and Shareholders' Equity</b>	<b>\$ 27,024,427</b>	<b>\$ 23,228,632</b>

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board

"Christopher Weston", Director

"David C. Dueck", Director

# PHOTON CONTROL INC.

## Consolidated Statement of Comprehensive Income

(Expressed in Canadian dollars)

For the three months ended March 31, 2015 and 2014

	Three Months Ended March 31 2015	Three Months Ended March 31 2014
Revenue	\$ 6,847,152	\$ 5,761,837
Cost of sales	3,177,542	3,044,556
Gross Margin	3,669,610	2,717,281
Operating expenses (notes 9 and 11):		
General and administrative	733,004	370,457
Engineering	182,022	243,707
Business development	142,369	109,377
Operating expenses	1,057,395	723,541
Net earnings before other earnings and tax	2,612,215	1,993,740
Other earnings (expenses):		
Interest and other earnings	19,065	9,560
Interest expense	-	(35)
Foreign exchange	1,090,127	68,846
	1,109,192	78,371
Net earnings before income tax	3,721,407	2,072,111
Deferred income tax (expense) recovery	(1,001,000)	-
Net earnings and total comprehensive income	\$ 2,720,407	\$ 2,072,111
Basic and diluted earnings (loss) per share		
Weighted average common shares used in computing		
	102,456,796	101,702,112
Diluted average common shares used in computing		
	112,309,407	109,948,335
Basic earnings per share	\$0.03	\$0.02
Diluted earnings per share	\$0.02	\$0.02

See accompanying notes to consolidated financial statements.

**PHOTON CONTROL INC.****Consolidated Statements of Changes in Equity  
(Expressed in Canadian dollars)  
As at March 31, 2015 and 2014****For the three months ending March 31, 2014**

	Share Capital		Contributed Surplus and Deficit		
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
<b>Balance at December 31, 2013</b>	<b>101,918,518</b>	<b>\$ 27,944,283</b>	<b>\$ 2,480,492</b>	<b>\$(14,518,122)</b>	<b>\$ 15,906,653</b>
Stock based compensation to employees	-	-	49,410	-	49,410
Share issues	-	-	-	-	-
NCIB share buy backs	(850,000)	(261,058)	-	-	(261,058)
Total comprehensive income (loss)	-	-	-	2,072,111	2,072,111
<b>Balance at March 31, 2014</b>	<b>101,068,518</b>	<b>\$ 27,683,225</b>	<b>\$ 2,529,902</b>	<b>\$(12,446,011)</b>	<b>\$ 17,767,116</b>

**For the three months ending March 31, 2015**

	Share Capital		Contributed Surplus and Deficit		
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
<b>Balance at December 31, 2014</b>	<b>102,185,518</b>	<b>\$ 27,911,549</b>	<b>\$ 3,216,511</b>	<b>\$(9,479,105)</b>	<b>\$ 21,648,955</b>
Stock based compensation to employees	-	-	-	-	-
Share issues	535,000	53,750	374,321	-	428,071
NCIB share buy backs	-	-	-	-	-
Total comprehensive income (loss)	-	-	-	2,720,407	2,720,407
<b>Balance at March 31, 2015</b>	<b>102,720,518</b>	<b>\$ 27,965,299</b>	<b>\$ 3,590,832</b>	<b>\$(6,758,698)</b>	<b>\$ 24,797,433</b>

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

# PHOTON CONTROL INC.

## Consolidated Statement of Cash Flows (Expressed in Canadian dollars) For the years ended March 31, 2015 and 2014

As at March 31	2015	2014
Cash provided by (used in):		
Operations:		
Net earnings	\$ 2,720,407	\$ 2,072,111
Non-cash items:		
Depreciation of property, plant and equipment	16,857	13,047
Amortization expenses of intangibles	10,950	9,816
Stock-based compensation	374,321	49,410
Amortization of deferred development costs	-	3,007
Accretion income	(2,688)	(671)
Amortization on gain on sale to R&D	-	-
Inventory reserve provision	76,000	26,000
Allowance for doubtful accounts reversal	-	-
Deferred tax	1,001,000	-
Changes in non-cash operating working capital:		
Trade accounts receivable and other	(1,044,045)	(390,658)
Inventory	(1,315,259)	(697,317)
Prepaid expenses and deposits	140,234	93,660
Accounts payable and accrued liabilities	633,712	212,471
Due to/from related party	2,635	(33,600)
Contingent liabilities	-	-
Deferred revenue	4,271	2,889
	<b>2,618,395</b>	1,360,165
Financing:		
Shares buy-back (Normal Course Issuer Bid)	-	(257,553)
Shares issue expenses (Normal Course Issue Bid)	-	(3,505)
Shares issue proceeds (exercise of options)	53,750	-
Restricted cash (irrevocable letter of credit: lawsuit)	-	-
Proceeds from note receivable	7,900	7,620
	<b>61,650</b>	(253,438)
Investments:		
Purchase of equipment	(33,298)	-
Purchase of intangible assets	-	-
Deferred development costs	-	-
	<b>(33,298)</b>	-
Increase (decrease) in cash and cash equivalents	<b>2,646,747</b>	1,106,727
Cash and cash equivalents, beginning of year	<b>14,061,381</b>	6,068,133
Cash and cash equivalents, end of period	<b>16,708,128</b>	7,174,860
Supplementary information:		
Cash received for interest	14,318	2,975
Cash paid for interest	-	(35)

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

(Expressed in Canadian dollars, unless specifically indicated otherwise)

For the three months ended March 31, 2015 and 2014

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## 1. Nature of business and continuing operations:

**Photon Control Inc. (“Photon Control” or the “Company”)** is a publicly-traded company listed on the TSX Venture Exchange (the “TSX-V”) and is incorporated under the laws of British Columbia, Canada. The Company’s head office is 200-8363 Lougheed Highway, Burnaby, British Columbia, Canada, V5A 1X3. The address of the registered office and records office is 19<sup>th</sup> Floor, 885 West Georgia Street, Vancouver, British Columbia, Canada, V6C 3H4.

The consolidated financial statements of the Company for the three months ended March 31, 2015 comprise the Company and its (inactive) subsidiaries. The financial statements were authorized for issue by the Board of Directors on May 27, 2015.

Photon Control designs, manufactures and distributes a wide range of optical sensors and instruments to measure temperature, pressure, position, and flow. These products are used by original equipment manufacturers (OEM) as well as end-users in the Semiconductor, Oil and Gas, Power, Life Science, and Manufacturing industries. The Company’s common shares are listed on the TSX-V under the trading symbol PHO. In 2002, the Company changed its name from Coldswitch Technologies Inc. to Photon Control Inc.

## 2. Significant accounting policies:

### (a) Basis of presentation and statement of compliance:

These condensed consolidated interim financial statements of the Company were prepared in compliance with International Accounting Standard (AIS) 34 Interim Financial Reporting as issued by the International Accounting Standards Board (IASB). The condensed consolidated interim financial statements do not include all of the information for full annual financial statements.

These consolidated financial statements have been prepared on the historical cost basis except for certain financial assets and financial liabilities which are measured at fair market value. The consolidated financial statements are presented in Canadian (CAD) dollars which is the Company’s functional currency.

### (b) Basis of consolidation:

The Company consolidates subsidiaries controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
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## 2. Significant accounting policies (continued):

Inter-company balances and transactions, including any income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

These consolidated financial statements include the accounts of the Company's wholly owned subsidiaries LAI Lightwave Aerospace Industries Ltd., CST Coldswitch Holdings Inc., The Lightswitch Company Inc., and Photon Control (Alberta) Inc., all of which are inactive.

(c) Cash and cash equivalents:

Cash and cash equivalents consist of highly liquid investments that are readily convertible to known amounts of cash. Short-term investments have maturity dates of six months or less from the date of purchase, or they are redeemable prior to maturity.

(d) Inventory:

Inventory consists of optical, mechanical and electronic components and finished goods and is valued at the lower of cost or net realizable value. Cost is determined on a first in first out basis, and includes the cost of direct material, direct labour and other overhead costs. Labour costs are allocated to items based on actual labour rates. Fixed and variable overhead are allocated to production activities in converting materials to finished goods.

(e) Property and equipment:

Property and equipment are stated at cost. Depreciation is provided on the declining balance basis at the following annual rates:

Asset	Rate
Lab equipment	20%
Computers, office furniture and equipment	20%
Production equipment	30%
Leasehold improvements	Over the lesser of the initial term of the lease and the useful life of assets

(f) Intangible assets:

The costs of acquiring intangible assets, consisting of licenses, patents and trademarks, and software are capitalized. Costs are amortized over the lesser of the estimated useful life of the intangible asset or the license term.

(g) Revenue recognition:

Revenue from sales of products is recognized when goods are shipped and title passes, there is persuasive evidence of an arrangement, collection is probable and fees are fixed and determinable. Cash collected prior to revenue recognition criteria being met is recorded as deferred revenue on the consolidated statement of financial position.



# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
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## 2. Significant accounting policies (continued):

### (h) Research and development costs:

Research costs are expensed as incurred. Development costs are expensed as incurred unless all of the following can be demonstrated:

- The technical feasibility of completing the intangible asset so that it will be available for use or sale;
- The intention to complete the intangible asset and use or sell it;
- The ability to use or sell the intangible asset;
- How the intangible asset will generate probable future economic benefits;
- The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- The ability to measure reliably the expenditure attributable to the intangible asset during its development.

### (i) Government assistance:

The Company makes periodic applications for financial assistance under available government incentive programs. Government assistance relating to capital expenditures is reflected as a reduction of the cost of such assets, while government assistance relating to current expenses is recorded as a reduction of such expenses.

The benefits of government assistance are recognized when there is reasonable assurance that they will be realized. Reasonable assurance is considered to have occurred when the relevant authorities have indicated that the Company's research and development activities qualify for government assistance. The Company did not receive any government assistance during the three months ended March 31, 2015 nor for the three months ended March 31, 2014.

### (j) Earnings (loss) per share:

Basic earnings (loss) per share amounts are calculated by dividing net earnings (loss) by the weighted average number of common shares outstanding during the year. Diluted earnings per share amounts are computed similarly to basic earnings per share except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of additional options and warrants, if dilutive. The number of additional shares are calculated by assuming that outstanding stock options and warrants were exercised and that the proceeds from such exercises were used to acquire shares of common stock at the average market price during the year.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
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## 2. Significant accounting policies (continued):

### (k) Income taxes:

Tax expense comprises current and deferred tax. Tax is recognized in the consolidated statements of comprehensive income except to the extent it relates to items recognized in other comprehensive income or directly in equity.

#### *Current income tax*

Current tax expense is based on the results for the period as adjusted for items that are not taxable or not deductible. Current tax is calculated using tax rates and laws that were substantively enacted at the end of the reporting period. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. Provisions are established where appropriate on the basis of amounts expected to be paid to the tax authorities.

#### *Deferred tax*

Deferred taxes are the taxes expected to be payable or recoverable on differences between the carrying amounts of assets in the consolidated statements of financial position and their corresponding tax bases used in the computation of taxable profit, and are accounted for using the balance sheet asset and liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences between the carrying amounts of assets and their corresponding tax bases. Deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets in a transaction that affects neither the taxable profit nor the accounting profit.

### (l) Share issue costs:

The costs of issuing common shares are applied to reduce the stated value of such shares.

### (m) Translation of foreign currencies:

Monetary items denominated in foreign currencies are translated to Canadian dollars at exchange rates in effect at the Statement of Financial Position dates and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenue and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in earnings.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
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## 2. Significant accounting policies (continued):

### (n) Stock-based compensation plans:

The Company has a stock-based compensation plan, which is described in Note 7(c). The fair value of the services rendered is determined indirectly by reference to the fair value of the equity instruments granted. Compensation cost attributable to options granted to employees and directors is measured at the fair value at the grant date using the Black-Scholes option pricing model. Compensation expense is recognized over the vesting period of the underlying option. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to share capital. No compensation cost is recognized for options that employees forfeit if they fail to satisfy the service requirement for vesting. Compensation expense is recognized for stock-based payments to non-employees using the fair value of the goods or services received, unless the fair value of the equity instruments granted is more reliably determinable.

### (o) Warranty provision:

The Company accrues for the estimated obligations under warranty provisions at the time sales are recognized and any changes in estimates are recognized prospectively. The Company provides its customers with a limited right of return for defective products. All warranty returns must be authorized by the Company prior to acceptance.

### (p) Financial instruments:

The Company has classified its financial instruments as follows:

- Cash and cash equivalents and bank indebtedness, if any, as “held-for-trading”.
- Derivatives, if any, as “held-for-trading”.
- Trade accounts receivable, the note receivable and amounts due from related parties are classified as “loans and receivables”.
- Accounts payable and accrued liabilities, amounts due to related parties are classified as “other financial liabilities”.

All financial instruments are initially recognized at fair value and are subsequently accounted for based on their classification. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
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## 2. Significant accounting policies (continued):

Subsequent to initial recognition, financial assets and liabilities classified as held-for-trading are measured at fair value with changes in fair value recorded in the consolidated statements of comprehensive income. Financial assets classified as "loans and receivables" and "other financial liabilities" are carried at amortized cost using the effective interest rate method. The fair values are based on quoted market bid process if available; otherwise fair value is obtained using discounted cash flow analysis. Transaction costs that are directly attributable to the issuance of financial assets or liabilities are accounted for as part of the carrying value at inception, and are recognized over the term of the assets or liabilities using the effective interest method.

The Company assesses at the end of each reporting period whether there is objective evidence that financial assets are impaired. A financial asset is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset that has a negative impact on the estimated future cash flows of the financial asset that can be reliably measured. When there is objective evidence that an impairment loss on a financial asset measured at amortized cost has been incurred, an impairment loss is recognized in net earnings for the period measured as the difference between the financial asset's (a) fair value less costs to sell, and (b) value in use.

### (q) Impairment of property, equipment, intangibles and internally generated intangible assets:

At each date of the consolidated statement of financial position, the Company's carrying amounts of its assets are reviewed to determine whether there are any indications of impairment. If such indication exists, the recoverable amount of the assets is estimated using the higher of (a) fair value less costs to sell, and (b) value in use.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount is less than its carrying amount, the carrying amount is reduced to its recoverable amount and the impairment loss is recognized in profit or loss for the period. When there are indicators that the conditions giving rise to the impairment previously recognized have reversed, then the reversal of the impairment loss is reversed in that period.

### (r) Use of estimates

The preparation of these consolidated financial statements in conformity with IFRS requires management to make sufficient judgements, estimates and assumptions that affect the reported amounts of assets and liabilities, application of accounting policies and the reporting of assets and liabilities at the dates of the consolidated financial statements and the reported revenue and expenses during the years.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
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## 2. Significant accounting policies (continued):

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which estimates are revised and any future periods affected. There have been no changes made to the methodology to determine critical accounting estimates during the last two fiscal years.

Significant items subject to such assumptions and estimation uncertainties that have a significant risk of a material adjustment are as follows:

- i) Stock based compensation comprises compensation expense related to the granting of stock options. The Company values stock options using a fair value-based method of accounting. The fair value of stock options is estimated at the grant or issue date using the Black-Scholes option pricing model. The Black-Scholes option pricing model requires the input of a number of assumptions, including expected dividend yield, expected stock price volatility, life of the options, forfeiture rate, and risk-free interest rates.

These assumptions are determined using management's best estimates and involve inherent uncertainties relating to market conditions, forfeitures and exercise which are outside of the control of the Company. Such assumptions are reviewed quarterly and have a significant impact on the estimates of fair value produced by the Black-Scholes option pricing model.

- ii) The Company makes estimates related to the recovery of deferred development costs based on the expectation and assumption of realizing revenues from future commercial agreements that it anticipates will develop with companies for whom these projects have been untaken. Changes in these expectations and assumptions could result in a change in the recoverable amount calculated.
- iii) The Company makes estimates related to the useful lives of property and equipment, patents, and intangible assets and related amortization. The Company also periodically assesses the recoverability of long lived assets. The recoverability analysis requires the Company to make assumptions about future operations. Changes to one or more assumptions would result in a change in the recoverable amount calculated and/or depreciation expensed.
- iv) The Company maintains an allowance for doubtful accounts for estimated losses that may occur if parties are unable to pay balances owing to the Company. This allowance is determined based on a review of specific parties' historical experience and economic circumstances. Non-Canadian export trade customers are covered by Export Development Canada (EDC) receivables insurance up to a maximum of USD \$1,500,000. Consequently, the estimates of allowance are primarily based on Canadian customers, none of whom are not covered by EDC insurance, but also include estimates for any EDC receivables insurance deductible amounts.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
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## 2. Significant accounting policies (continued):

- v) Valuation adjustments for inventory are comprised of the impairments or recoveries recorded against inventories. The Company records valuation adjustments for inventory by comparing the inventory cost to its net realizable value. This process requires the use of estimates and assumptions related to future market demand, costs and prices. Such assumptions are reviewed quarterly and have a significant impact on the valuation adjustments for inventory.
  - vi) The Company makes estimates related to warranty provision. This provision is based on a periodic review of historical experience of warranty claims.
  - vii) Deferred income tax assets are recognized for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that probable that future taxable profit will be available against which the deductible temporary differences and carry-forward of unused tax assets and unused tax losses can be utilized. In addition, the valuation of tax credits receivable requires management to make judgements on the amount and timing of recovery.
- (s) Accounting Judgments:

In applying the Company's accounting policies, management has made certain judgments that may have a significant effect on the amounts recognized in the consolidated financial statements. Such judgments include the determination of the functional currency.

In determining the Company's functional currency, it periodically reviews its primary and secondary indicators as stipulated under IAS 21, "The Effects of Changes in Foreign Exchange Rates" to assess the Company's primary economic environment in which the Company operates. The Company analyzes the currency that mainly influences revenues, labour, material and other costs of providing goods or services which is often the currency in which such costs are denominated and settled. The Company also analyzes secondary indicators such as the currency in which funds from financing activities such as debt and equity issuances are generated and the currency in which receipts from operating activities are retained. Determining the Company's predominant economic environment requires significant judgment.

These consolidated financial statements, in management's opinion, have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized above.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
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### 3. Recently adopted and future accounting pronouncements:

The following accounting pronouncements became effective for the Company for the current fiscal year ending December 31, 2015 and were adopted as at January 1, 2015:

(a) IFRS 2, Share Based Payments (amendment):

The amendments to IFRS 2, issued by the International Accounting Standards Board (IASB) in December 2013, incorporated into Part I of the CPA Canada Handbook – Accounting by the Accounting Standards Board (AcSB) in March 2014, clarify the definition of “vesting conditions” and “market conditions”, and separately define a “performance condition” and a “service condition”. A performance condition requires the counterparty to complete a specified period of service and to meet a specified performance target during the service period. A service condition solely requires the counterparty to complete a specified period of service. Adoption of this standard had no impact on the Company’s consolidated financial statements.

(b) IFRS 10, Consolidated Financial Statements (amendment):

In October 2012, the IASB issued amendments to this Section, incorporated into the Handbook by the AcSB in January 2013 that introduce an exception for investment entities to the principle that all subsidiaries are consolidated. The amendments define an investment entity and require an investment entity to measure subsidiaries at fair value through profit or loss in accordance with IFRS 9 Financial Instruments or IAS 39 Financial Instruments: Recognition and Measurement. Consequential amendments were also made to IFRS 1 First-time Adoption of International Financial Reporting Standards, IFRS 3 Business Combinations and IAS 7 Statement of Cash Flows. Adoption of this standard had no impact on the Company’s consolidated financial statements.

(c) IFRS 12, Disclosure of Interests in Other Entities (amendment):

In October 2012, the IASB issued amendments to this Section, incorporated into the Handbook by the AcSB in January 2013, to add disclosure requirements for investment entities. The amendments require an entity to disclose that it meets the definition of an investment entity, if applicable, including significant judgments and assumptions it has made in determining that it is an investment entity. Specific disclosure requirements for information about an investment entity’s non-consolidated subsidiaries have also been included. Adoption of this standard had no impact on the Company’s consolidated financial statements.

(d) IAS 32, Financial Instruments: Presentation (amendment):

This Section was amended by the International Accounting Standards Board (IASB) in December 2011, incorporated into Part I of the CPA Canada Handbook – Accounting (the Handbook) by the Accounting Standards Board (AcSB) in May 2012, to address inconsistencies in applying criteria for offsetting financial assets and financial liabilities. The meaning of the offsetting criterion “currently has a legally enforceable right to set off” has been clarified, to state that the right must not be contingent on future events and must be enforceable in the normal course of business, in event of default and in the event of

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
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### 3. Recently adopted and future account pronouncements (continued):

insolvency or bankruptcy. Additional guidance has been included to clarify the principle behind net settlement, including identifying when some gross settlement systems may be considered equivalent to net settlement. Adoption of this standard had no impact on the Company's consolidated financial statements.

(e) IAS 32, Impairment of Assets (amendment):

In May 2013, the International Accounting Standards Board (IASB) issued an amendment, incorporated into Part I of the CPA Canada Handbook – Accounting by the Accounting Standards Board (AcSB) in September 2013, to IAS 36. These narrow-scope amendments address the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal. Adoption of this standard had no impact on the Company's consolidated financial statements.

(f) IAS 39, Financial Instruments: Recognition and Measurement (amendment):

In June 2013, the International Accounting Standards Board (IASB) issued an amendment, incorporated into Part I of the CPA Canada Handbook – Accounting by the Accounting Standards Board (AcSB) in September 2013, to IAS 39. The amendments clarify that novation of a hedging derivative to a clearing counterparty as a consequence of laws or regulations or the introduction of laws or regulations does not terminate hedge accounting. Adoption of this standard had no impact on the Company's consolidated financial statements.

(g) IFRIC 21, Levies:

In May 2013, the International Accounting Standards Board (IASB) issued IFRIC 21, incorporated into Part I of the CPA Canada Handbook – Accounting by the Accounting Standards Board (AcSB) in September 2013, which provides guidance on the accounting for levies within the scope of IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

The main features of IFRIC 21 are as follows:

- i) The obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation; and
- ii) The liability to pay a levy is recognized progressively if the obligating event occurs over a period of time.

Adoption of this standard had no impact on the Company's consolidated financial statements.



# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
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### 3. Recently adopted and future account pronouncements (continued):

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and is assessing the impact of these new standards and amendments but they are not expected to have a material impact on the Company:

(a) The IASB intends to make amendments to IFRS 8, Operating segments:

The amendments to IFRS 8, issued by the International Accounting Standards Board (IASB) in December 2013, incorporated into Part I of the CPA Canada Handbook - Accounting by the Accounting Standards Board (AcSB) in March 2014, require an entity to disclose the judgments made by management in applying the aggregation criteria for reportable segments. The amendments will only affect disclosure and are effective for annual periods beginning on or after July 1, 2014. The Company is currently evaluating the impact the final standard is expected to have on its consolidated financial statements.

(b) The IASB intends to implement IFRS 9, Financial Instruments:

Recognition and Measurement in its entirety with IFRS 9, Financial Instruments ("IFRS 9") which is intended to reduce the complexity in the classification and measurement of financial instruments. At present, the current version of IFRS 9 does not include a mandatory effective date. However, IFRS 9 is available for early application. An effective date will be added when all phases of the project are completed. The Company is currently evaluating the impact the final standard is expected to have on its consolidated financial statements.

(c) The IASB intends to make amendments to IFRS 11, Joint Arrangements:

In May 2014, the IASB issued amendments to this Standard, incorporated into the Handbook by the AcSB in July 2014, to clarify that the acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3 Business Combinations, is required to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs with the exception of those principles that conflict with the guidance in IFRS 11. The amendments apply to the acquisition of an interest in a joint operation on its formation, unless the formation of the joint operation coincides with the formation of the business, and the acquisition of additional interests in the same joint operation. The Company is currently evaluating the impact the final standard is expected to have on its consolidated financial statements.

(d) The IASB intends to implement IFRS 15, Revenue from Contracts with Customers:

In May 2014, the International Accounting Standard Board (IASB) issued a new International Financial Reporting Standard (IFRS) on the recognition of revenue from contracts with customers. IFRS 15 specifies how and when entities recognize revenue, as well as requires more detailed and relevant disclosures. IFRS 15 supersedes IAS 11 Construction Contracts,

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
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### 3. Recently adopted and future account pronouncements (continued):

IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers and SIC-31.

Revenue – Barter Transactions Involving Advertising Services. The Section provides a single, principles based five-step model to be applied to all contracts with customers, with certain exceptions. The five steps are:

- i) Identify the contract(s) with the customer.
- ii) Identify the performance obligation(s) in the contract.
- iii) Determine the transaction price.
- iv) Allocate the transaction price to each performance obligation in the contract.
- v) Recognize revenue when (or as) the entity satisfies a performance obligation.

The standard is effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. The Company is currently evaluating the impact the final standard is expected to have on its consolidated financial statements.

(e) The IASB intends to make amendments to IAS 24, Related Party Disclosures:

The amendments to IAS 24, issued by the International Accounting Standards Board (IASB) in December 2013, incorporated into Part I of the CPA Canada Handbook – Accounting by the Accounting Standards Board (AcSB) in March 2014, clarify that a management entity, or any member of a group of which it is a part, that provides key management services to a reporting entity, or its parent, is a related party of the reporting entity. The amendments also require an entity to disclose amounts incurred for key management personnel services provided by a separate management entity. This replaces the more detailed disclosure by category required for other key management personnel compensation. The amendments will only affect disclosure and are effective for annual periods beginning on or after July 1, 2014. The Company is currently evaluating the impact the final standard is expected to have on its consolidated financial statements.

# PHOTON CONTROL INC.

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## 4. Inventory:

As at March 31	2015	2014
Raw materials	\$ 1,416,462	\$ 802,549
Work in process	810,496	331,415
Finished goods	803,635	629,766
	<hr/>	
	\$ 3,030,593	\$ 1,763,730

For the three months ended March 31, 2015, inventory recognized as an expense in cost of sales amounted to \$1,945,370 (March 31, 2014 - \$2,002,103). Included in the above amount for the three months ending March 31, 2015 were inventory write downs of \$17,000 (three months ending March 31, 2014 – \$26,000). There were no reversals of previously recorded inventory write downs for 2015 (March 31, 2014 - Nil).

As of March 31, 2015, the Company anticipates the net inventory will be realized within one year.

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## 5. Property and equipment:

		Laboratory equipment	Computers, office furniture and equipment	Production equipment	Leasehold improvements	Total
<b>Asset Cost</b>						
Balance January 1, 2014	\$	346,446	313,584	378,054	387,495	1,425,579
Additions		-	9,466	76,588	3,380	89,434
<b>Balance December 31, 2014</b>		<b>346,446</b>	<b>323,050</b>	<b>454,642</b>	<b>390,875</b>	<b>1,515,013</b>
Additions		-	1,766	31,532	-	33,298
Disposals		-	-	-	-	-
<b>Balance March 31, 2015</b>	\$	<b>346,446</b>	<b>324,816</b>	<b>486,174</b>	<b>390,875</b>	<b>1,548,311</b>

### Accumulated Depreciation

Balance January 1, 2014	\$	264,791	243,316	307,787	376,488	1,192,382
Depreciation for period		14,856	14,439	24,108	2,698	56,101
<b>Balance December 31, 2014</b>		<b>279,647</b>	<b>257,755</b>	<b>331,895</b>	<b>379,186</b>	<b>1,248,483</b>
Depreciation for period		3,714	12,432	-	711	16,857
Disposals		-	-	-	-	-
<b>Balance March 31, 2015</b>	\$	<b>283,361</b>	<b>270,187</b>	<b>331,895</b>	<b>379,897</b>	<b>1,265,340</b>

### Carrying Amounts

At January 1, 2014	\$	81,655	70,268	70,267	11,007	233,197
At December 31, 2014	\$	66,799	65,295	122,747	11,689	266,530
At March 31, 2015	\$	63,085	54,629	154,279	10,978	282,971

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## 6. Intangible assets:

	Patents	Trademarks	Computer software	Computer system (SW)	Total
<b>Asset Cost</b>					
<b>Balance January 1, 2014</b>	\$ 378,053	28,602	94,683	145,152	<b>646,490</b>
Additions	-	-	-	46,210	<b>46,210</b>
<b>Balance December 31, 2014</b>	<b>378,053</b>	<b>28,602</b>	<b>94,683</b>	<b>191,362</b>	<b>692,700</b>
Additions	-	-	-	-	-
<b>Balance March 31, 2015</b>	<b>\$ 378,053</b>	<b>28,602</b>	<b>94,683</b>	<b>191,362</b>	<b>692,700</b>
<b>Accumulated Amortization</b>					
<b>Balance January 1, 2014</b>	297,681	26,377	92,283	91,109	<b>507,450</b>
Amortization for period	19,452	1,200	2,400	18,274	<b>41,326</b>
<b>Balance December 31, 2014</b>	<b>\$ 317,133</b>	<b>27,577</b>	<b>94,683</b>	<b>109,383</b>	<b>548,776</b>
Amortization for period	4,863	300	-	5,787	<b>10,950</b>
<b>Balance March 31, 2015</b>	<b>\$ 321,996</b>	<b>27,877</b>	<b>94,683</b>	<b>115,170</b>	<b>559,726</b>
<b>Carrying Amounts</b>					
At January 1, 2014	\$ 80,372	2,225	2,400	54,043	<b>139,040</b>
At December 31, 2014	\$ 60,920	1,025	-	81,979	<b>143,924</b>
At March 31, 2015	\$ 56,057	725	-	76,192	<b>132,974</b>

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## 7. Share capital:

### (a) Authorized:

Unlimited number of common shares without par value

### (b) Issued and outstanding:

#### Common shares:

	Number of shares	Stated values
Issued and outstanding as at December 31, 2013	101,819,518	\$ 27,944,283
Shares issued in 2014	1,216,000	204,052
Share buy-back (Normal Course Issuer Bid)	(850,000)	(236,786)
Issued and outstanding as at December 31, 2014	102,185,518	\$ 27,911,549
Shares issued in 2015 (exercise of options)	535,000	53,750
Issued and outstanding as at March 31, 2015	102,720,518	\$ 27,965,299

Note: The Normal Course Issuer Bid (NCIB) period terminated May 7, 2014 during which a total of 1,950,000 common shares of the Company were repurchased and cancelled in 2013 and 2014.

#### Contributed Surplus:

	Amount
Balance, December 31, 2013	\$ 2,480,492
Stock-based compensation to employees in 2014	842,872
Shares issued in 2014 (exercise of options)	(82,452)
NCIB share buy back in 2014	(24,401)
Balance, December 31, 2014	\$ 3,216,511
Stock-based compensation to employees in 2015	374,321
Shares issued in 2015 (exercise of options)	Nil
Balance, March 31, 2015	\$ 3,590,832

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## 7. Share capital (continued):

### (c) Stock options:

The number of options reserved for issuance under the Company's stock option plan is equal to 10% of the issued and outstanding shares in the Company. Accordingly, as at March 31, 2014, the Company had reserved 10,096,952 options for issuance under the Company's stock option plan. As at March 31, 2015, there was a change in the number of outstanding shares and consequently a change in the reserved options to 10,272,052 options. The stock option plan provides that options may be granted with an exercise price of not less than the market price of the Company's shares on the grant date less applicable discounts permitted by the TSX-V. The stock option plan also provides that the term of the options shall not exceed five years.

Stock option transactions are summarized as follows:

	Number of Share Options	Weighted average exercise price
Outstanding, December 31, 2013	8,240,000	\$ 0.120
Granted	10,000	\$ 0.290
Granted	30,000	\$ 0.300
Granted	10,000	\$ 0.310
Granted	10,000	\$ 0.320
Granted	30,000	\$ 0.430
Granted	3,110,000	\$ 0.500
Forfeited	(30,000)	\$ 0.100
Forfeited	(10,000)	\$ 0.150
Expired	-	\$ -
Exercised	(1,216,000)	\$ 0.100
Outstanding, December 31, 2014	10,184,000	\$ 0.240
Granted	30,000	\$ 0.490
Forfeited	-	\$ -
Expired	(125,000)	\$ 0.100
Exercised	(10,000)	\$ 0.110
Exercised	(10,000)	\$ 0.115
Exercised	(515,000)	\$ 0.100
Outstanding, March 31, 2015	9,554,000	\$ 0.251

30,000 stock options were granted during the three months ended March 31, 2015 (60,000 granted for the three months ended March 31, 2014).

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## 7. Share capital (continued):

### (c) Stock options (continued):

The following table summarizes the stock options outstanding at March 31, 2015:

Exercise price	Options outstanding			Options exercisable	
	Number of options	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
\$0.100	3,544,000	2.00	\$ 0.100	3,526,500	\$ 0.100
\$0.105	10,000	0.50	\$ 0.105	10,000	\$ 0.105
\$0.110	20,000	1.26	\$ 0.110	7,500	\$ 0.110
\$0.150	2,750,000	3.50	\$ 0.150	2,750,500	\$ 0.150
\$0.165	10,000	3.52	\$ 0.165	2,500	\$ 0.165
\$0.200	10,000	3.62	\$ 0.200	2,500	\$ 0.200
\$0.285	10,000	3.90	\$ 0.285	2,500	\$ 0.285
\$0.295	10,000	3.77	\$ 0.295	2,500	\$ 0.295
\$0.300	20,000	3.88	\$ 0.300	5,000	\$ 0.300
\$0.310	10,000	3.83	\$ 0.310	2,500	\$ 0.310
\$0.320	10,000	4.00	\$ 0.320	2,500	\$ 0.320
\$0.425	20,000	4.44	\$ 0.425	-	\$ 0.425
\$0.490	30,000	4.87	\$ 0.490	-	\$ 0.490
\$0.500	3,110,000	4.48	\$ 0.500	1,555,500	\$ 0.500
	9,554,000	3.27	\$ 0.248	7,869,000	\$ 0.197

The options outstanding as at March 31, 2015 expire between September 28, 2015 and February 11, 2020.

The fair value of options granted was estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2015	2014
Expected option lives	5 years	5 years
Risk-free interest rate	1.10% to 3.09%	1.16% to 3.09%
Dividend yield	0%	0%
Volatility	116% to 309%	123% to 380%

During the three months ended March 31, 2015, the Company recorded \$468,552 (2014 - \$49,410) of compensation expense representing the fair value of the options and shares vesting during the three months with a corresponding increase to contributed surplus.

### (d) Net earnings (loss) per share:

The weighted average number of shares outstanding as at March 31, 2015 of 102,456,796 (March 31, 2014 - 101,702,112) were used in the calculation of basic earnings per share for the three months ended March 31, 2015. 112,309,407 shares were used in the calculation of diluted earnings per share as at March 31, 2015 (March 31, 2014 - 109,948,335).



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## 8. Internally generated assets:

		Internally Generated R&D Assets
<b>Asset Cost</b>		
Balance January 1, 2014	\$	219,071
Additions		-
<b>Balance December 31, 2014</b>		<b>219,071</b>
Additions		-
<b>Balance March 31, 2015</b>	<b>\$</b>	<b>219,071</b>

### Accumulated Amortization

Balance January 1, 2014	\$	76,571
Amortization for period		142,500
<b>Balance December 31, 2014</b>		<b>219,071</b>
Amortization for period		-
Disposals		-
<b>Balance March 31, 2015</b>	<b>\$</b>	<b>219,071</b>

### Carrying Amounts

At January 1, 2014	\$	142,500
At December 31, 2014	\$	-
At March 31, 2015	\$	-

The Company amortizes internally generated research and development costs, commencing with commercial production, over the expected future benefit period based upon quantities delivered compared to expected levels contracted to be delivered. In 2014, there were indicators that gave rise to the impairment of these assets, consequently, the assets were progressively and completely written down to zero value by December 31, 2014. Since these assets were impaired, the amount amortized or considered impaired and discounted for the three months ending March 31, 2015 was \$ nil (March 31, 2014 – \$3,007). The Company has a balance of internally generated intangible assets as at March 31, 2015 of \$ nil (March 31, 2014 - \$139,493).

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## 9. Related party balances and transactions:

### (a) Related company balances and transactions:

All transactions with related parties have been translated in the normal course of operations and have been measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Related party transactions include transactions with Photon Control R&D Ltd. and DCD Management Ltd. Photon Control R&D Ltd. commenced providing engineering consulting and research and development services to the Company on October 1, 2008 and, as a result, the Company has reduced its internal research and development operations. DCD Management Ltd. provides financial, payroll and IT services. The Company subleases space to Photon Control R&D Ltd. and DCD Management Ltd. at the same facility and charges both for premises and related expenses to recover the Company's costs. Amounts outstanding with DCD Management Ltd. are non-interest bearing, unsecured and due on demand. Amounts outstanding with Photon Control R&D Ltd. are unsecured and due on demand but, as of Q3 2014, outstanding balances were changed to interest bearing at prime plus 1%. These accounts are active and payments are received on a monthly basis, and the balance is paid out at least twice during the year.

Effective 2013, the Company signed a new engineering support standby fee with Photon Control R&D Ltd. of \$45,000 per month to ensure prompt technical responses to customer requests, support for OEM and other customers, development of new products and engineering design, and to maintain technical competitiveness while exploring new markets.

As at March 31	2015	2014
<b>Statement of Financial Position</b>		
Accounts receivable	\$ 421,782	\$ 822,876
Note receivable	109,185	135,514
Accounts payable and accrued liabilities	232,853	174,623
<b>Statement of Comprehensive Income</b>		
<b>Charges to:</b>		
Revenue from sales of products and services to Photon R&D	\$ 25,989	\$ 57,944
Payroll reimbursement re: Photon Control R&D Ltd.	399,450	387,476
Recovery of premises and related expenses (Re: DCD Management Ltd. and Photon Control R&D Ltd.)	74,298	84,551
<b>Charges from:</b>		
Products & services charged by Photon Control R&D Ltd.	\$ 31,881	\$ 68,529
Engineering & R&D services charged by Photon Control R&D	175,010	234,655
Royalty expenses charged by Photon Control R&D Ltd.	429,751	289,063
Management services expenses charged by DCD Mgmt. Ltd.	\$ 55,960	\$ 46,553

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## 9. Related party balances and transactions (continued):

During 2009, the Company finalized and amended the terms of its agreement to transfer its R&D workforce to Photon Control R&D Ltd. Under the finalized terms, Photon Control R&D Ltd. issued a \$315,000 promissory note to the Company as consideration for the transfer. The promissory note bears a coupon rate of 3% per annum, is repayable in equal monthly instalments of \$3,089 beginning April 1, 2010 and matures March 1, 2020. For accounting purposes, the transaction was recognized at the exchange amount and the promissory note was discounted at an estimated market rate of 10% resulting in a carrying value of the note receivable at issuance of \$217,487 and a deferred gain as at June 30, 2010.

The promissory note receivable is being accreted up to its face value of \$315,000 by the effective interest method and as at March 31, 2015, \$31,436 (2014 - \$29,420) to date in accretion was recognized in interest income.

As at March 31	2015	2014
Promissory note receivable – face value	\$ 315,000	\$315,000
Less: discount	(97,513)	(97,513)
	217,487	217,487
Accretion	34,124	29,420
Principal repayment	(142,426)	(111,393)
Carrying amount	109,185	135,514
Current portion	(20,422)	(22,464)
Long-term portion	\$ 88,763	\$ 113,050

### (b) Compensation of key management personnel:

The Company's key management personnel have authority and responsibility for overseeing, planning, directing and controlling the activities of the Company and consist of the Company's Board of Directors and the Company's Executive Leadership Team. The Executive Leadership Team consists of the CEO and President, and the Chairman.

Total compensation expense for key management personnel and the composition thereof, for the three months ended March 31 is:

	2015	2014
Short term benefits	\$ 60,577	\$ 41,596
Share-based compensation	85,022	20,690
Carrying Amount	\$ 145,599	\$ 62,286

A portion of the short term benefits relates to expected bonuses (if applicable) that are to be paid subsequent to year end and subject to final determination by Board of Directors.

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## 10. Commitments and contingencies:

### (a) Leases:

As at March 31, 2015, the Company has entered into premises leases requiring the following future minimum lease payments and related costs (applicable sales taxes extra) as follows:

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2015	\$	589,031
2016		830,452
		<hr/>
	\$	1,419,483

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For the three months ended March 31, 2015, lease payments and related costs recognized as an expense amounted to \$196,344 (2014 - \$185,105).

The above amounts do not include any offset payments for subleases to Photon Control R&D Ltd. and DCD Management Ltd. which sublease portions of Photon Control Inc.'s facility. Future minimum sublease payments expected to be received by Photon Control Inc. under non-cancellable subleases are as follows:

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2015	\$	152,649
2016		266,388
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	\$	386,337

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### (b) Litigation:

The Company had a debt obligation of \$ 992,096 owing to its former President arising out of a judgement rendered by the BC Supreme Court in 2011 in favour of the former President (appeal to the BC Court of Appeal dismissed in 2012). Of the total provision of \$992,096 taken by the Company, payments were made in 2013 to settle the judgment in full. A provision of \$28,037 remains for potential interest and costs.

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## 11. Supplementary information:

As at March 31	2015	2014
General and administrative:		
Salaries and fees	\$ 178,552	\$ 145,242
Stock option compensation expense (non-directors)	133,348	19,764
Office premises expenses and rent	47,134	47,490
Travel	7,490	10,353
Supplies and postage	10,506	15,171
Audit	21,000	15,000
Insurance	39,468	46,420
Legal	24,211	19,675
Legal judgements	-	-
Communications	7,219	5,252
Dues and subscriptions	22	109
Directors fees (including applicable stock options expense)	240,973	29,646
Depreciation and amortization	10,278	8,715
Bad debt expense	3,000	1,000
Other expenses	9,803	6,620
	<u>\$ 733,004</u>	<u>\$ 370,457</u>
Engineering expenses:		
Engineering support fees	\$ 135,000	135,000
Consulting fees	40,011	99,656
Certification and testing	2,149	4,188
Travel and entertainment	-	-
Depreciation and amortization	4,862	4,863
Other expenses	-	-
	<u>\$ 182,022</u>	<u>\$ 243,707</u>
Business development and marketing:		
Salaries and consulting fees	\$ 67,240	56,115
Travel expenses	779	-
Commissions	-	-
Trade shows	31,239	45,950
Promotion	4,667	7,012
Consulting fees	38,144	-
Depreciation and amortization	300	300
Other expenses	-	-
	<u>\$ 142,369</u>	<u>\$ 109,377</u>

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## 12. Financial instruments:

Fair Value of Financial Assets and Liabilities:

The categories of the fair value hierarchy that reflect the significance of inputs used in making fair value measurements are as follows:

Level 1 – quoted prices in active markets for identical assets or liabilities;

Level 2 – inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3 – inputs for the asset or liability that are not based on observable market data.

At March 31, 2015, the levels in the fair value hierarchy into which the Company's financial assets and liabilities are measured and recognized on the Consolidated Statement of Financial Position at fair value on a recurring basis are categorized as follows:

	Category	At March 31, 2015	At March 31, 2014	At March 31, 2013
Cash and cash equivalents	Level 1	\$16,708,128	\$ 2,752,860	\$ 3,581,628
Derivatives: Cash subject to USD futures contracts	Level 2	-	4,422,000	-
Total		\$16,708,128	\$ 7,174,860	\$ 3,581,628

The Company's policy for determining when a transfer occurs between levels in the fair value hierarchy is to assess the impact at the date of the event or the change in circumstances that could result in a transfer. As of March 31, 2015, there were \$ nil transfers between Level 1 and Level 2 cash and cash equivalents. There were \$4,422,000 transfers between Level 1, Level 2 and Level 3 during the three months ended March 31, 2014.

Cash and cash equivalents are classified as held for trading and are recorded at fair value in the consolidated statement of financial position. The Company had no other financial instruments recorded at fair value as at March 31, 2015, nor as at March 31, 2014.

Derivative financial instruments are mainly used to manage the Company's exposure to foreign exchange market risks, generally through forward foreign exchange contracts. The fair values of forward contracts are calculated using discounted contractual cash flows based on quoted forward curves and discount rates incorporating US and Canadian interest rates.

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## 12. Financial instruments (continued):

The note receivable from related party is measured at amortized cost. Its market value was determined at inception based upon discounting contractual cash flows at estimated market discount rates considering the credit risk of the counterparty. The estimated market value as at March 31, 2015 is estimated to approximate its carrying value.

The fair value of the Company's cash and cash equivalents, trade accounts receivable and other amounts due under credit facility, amounts due to and from related parties, accounts payable and accrued liabilities approximate their respective carrying amounts due to their short maturities or are discounted at market interest rates.

### Risk Management:

The Company manages its exposure to financial risk, including credit and interest rate risk, liquidity risk, and foreign exchange risk. The Company's Board of Directors oversees management's risk management practices. The following describes the types of risks that the Company is exposed to and its objectives and policies for managing those risk exposures.

#### (a) Credit and interest rate risk:

The Company is exposed to credit risk associated with its trade accounts receivable and related party receivables. Credit risk is minimized substantially by ensuring the credit worthiness of the entities with which it carries on business. In November 2009, the Company entered into an agreement with Export Development Canada to insure its non-Canadian accounts receivable up to a maximum of USD \$1,500,000. As at March 31, 2015 the maximum credit risk, which is the total of its uninsured trade receivables (primarily Canadian based customers and intercompany), was \$635,867 or 15% (March 31, 2014 - \$971,342 or 18%) of the total outstanding accounts receivable balances.

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## 12. Financial instruments (continued):

The following table provides information regarding the aged trade receivables as at March 31, 2015:

Current	31-60 days	61-90 days	91 days +
54%	40%	3%	3%

The following table provides information regarding the aged trade receivables as at March 31, 2014:

Current	31-60 days	61-90 days	91 days +
42%	41%	7%	10%

The Company holds its cash and cash equivalents at a major Canadian banking institution. As at March 31, 2015, the Company was not exposed to significant credit or interest rate risk.

### Allowance for Doubtful Accounts

At each period end, the Company reviews the collectability of outstanding receivables. The specific accounts are only written off once all the collection avenues have been explored or when legal bankruptcy has occurred. The following is a reconciliation of the allowance account.

Reconciliation of the allowance for doubtful accounts March 31	2015	2014
Balance, beginning of the year	\$ 51,774	\$ 50,281
Write-offs of specific accounts	-	(1,028)
Change in provision	3,000	(1,000)
Balance as at March 31	\$ 54,774	\$ 50,253



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## 12. Financial instruments (continued):

The following table identifies the percentage of trade accounts receivable from individual customers comprising 10% or more of the Company's trade receivables:

March 31	2015	2014
Customer A	56%	25%
Customer B	11%	32%
Customer C	15%	18%

### (b) Market, interest and foreign exchange risk:

Market risk is the risk that changes in market prices such as foreign exchange rates and interest rates will affect the Company's net earnings or the values of financial instruments. The Company is exposed to interest rate risk with regard to the cash, cash equivalents and amounts due under credit facility and its related party note receivable. The majority of the Company's sales revenues and trade receivables are denominated in United States dollars. As such, the Company may be subject to material, realized and unrealized exchange gains or losses resulting from above average changes in exchange rates between the Canadian and the United States dollar. Beginning in the fourth quarter 2013, the Company started to utilize forward exchange contracts to mitigate any of the risks as mentioned above. As of September 19, 2014, all of the remaining forward exchange contracts have expired thus there are no forward exchange contracts in effect as at March 31, 2015

The contracts required the sale of an agreed upon amount of US dollars at specified future dates at forward exchange rates. These financial instruments were entered into solely to mitigate foreign exchange risk and were not used for speculation. These derivatives were not designated as a hedge for accounting purposes. The Company does not expect any credit losses in the event of non-performance by the counterparty as the counterparty is a well-established brokerage firm. As at March 31, 2015, the impact of any additional foreign exchange expenses of these contracts has been recognized.

The following table lists the United States dollar balances of monetary items denominated in United States dollars as at March 31:

Amounts denominated in U.S. dollars as at March 31	2015	2014
Cash	\$ 2,961,157	\$5,847,352
Trade accounts receivable	3,775,567	3,891,400
Trade accounts payable	183,841	147,803

The estimated impact on net earnings at March 31, 2015 with a +/- 10% change in foreign exchange rates is CAD \$829,988 (March 31, 2014 – CAD \$1,060,279).

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## 12. Financial instruments (continued):

The above sensitivity demonstrates the effect of a change in foreign exchange rates in isolation. In reality, there may be other contributing factors that will materially alter the estimated outcome. Furthermore, the financial position of the Company may vary at the time that a change in foreign currency exchange rates occurs, again, causing the impact on the Company's results to differ materially from the estimated outcome shown above.

### (c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The ability to do this relies on the Company being able to successfully rely on external financing as well as the timely collection of its outstanding trade accounts receivable. As at March 31, 2015, the Company's accounts trade payable and accrued liabilities were \$1,867,819 (March 31, 2014 - \$1,196,876) which fall due for payment within twelve months of the balance sheet date. As at March 31, 2015, the Company had access to a credit facility of \$1,000,000. This credit facility currently remains unutilized (unutilized as at March 31, 2015). The Company has recorded a provision for the remainder of a lawsuit of \$28,037 (March 31, 2014 - \$28,037) which is classified as due in 2015.

Significant cash commitments in years subsequent to March 31, 2015 are as follows:

	1 year	2 years	3 years	4 years	5 years	Total
Accounts trade payable and accrued liabilities	\$ 1,867,819	\$ -	\$ -	\$ -	\$ -	\$ 1,867,819
Due to related party	232,853	-	-	-	-	232,853
Provision (unguaranteed)	28,037	-	-	-	-	28,037
Standby engineering	540,000	-	-	-	-	540,000
Lease obligation	589,031	830,452	-	-	-	1,419,483

The standby engineering charge is subject to review (annually) and possible change in the future.

In addition, there is a significant cash commitment with regard to royalties which is based on a variable percentage of revenue for applicable products. Although no specific amounts can be determined for the future, royalties were \$429,751 for the three months ended March 31, 2015 (2014 - \$289,063).

## 13. Capital disclosure:

The Company's objectives when managing capital are:

- To maintain its ability to continue as a going concern.
- To provide adequate working capital.
- To maintain cash on hand in highly liquid and highly rated financial instruments.
- Meet the debt covenants imposed by the Company's banking institution.

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## 13. Capital disclosure (continued):

The Company includes the following items in the management of capital: cash, cash equivalents, credit facility and shareholders' equity comprised of issued capital, contributed surplus and deficit. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions. The Company may adjust its capital structure in the future, by issuing shares and adjusting debt utilization. As at March 31, 2015 the Company's capital is as follows:

As at March 31	2015	2014
Cash and cash equivalents	\$ 16,708,128	\$ 7,174,860
Credit facility (debt)	-	-
Shareholders' equity	24,797,433	17,767,116
	<u>\$ 41,505,561</u>	<u>\$ 24,941,976</u>

The Company is subject to the following capital requirements relating to the covenants and conditions of its bank line of credit:

- The working capital ratio shall not be less than 1.1:1.
- The debt to tangible net worth ratio shall not at any time exceed 2.75:1.
- There will be no dividends, reduction in loans from shareholders, subsidiaries or related parties, or other withdrawals of similar nature without the prior consent of the bank.
- The bank reserves the right to require foreign receivables to be insured by the EDC with direction by the Company to pay all insurance proceeds to the bank.

The Company was in compliance with the above noted covenants as at March 31, 2015 and as at March 31, 2014.

## 14. Bank credit facility and restricted cash:

Since November 2007, the Company has had a bank operating line of credit with a major Canadian chartered bank. This credit facility was secured by a general security agreement based on trade accounts receivable and applicable inventory. In September 2012, this bank operating line of credit facility was further increased from \$500,000 up to maximum of \$1,000,000. This facility bears interest at the bank's prime plus 1.50% per annum. Formerly, this credit facility was additionally secured by a cash deposit of \$50,000 but this is no longer required and the deposit was returned plus interest earned thereon during Q2 2012. The line of credit was unused at March 31, 2015 and 2014.

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## 14. Bank credit facility and restricted cash (continued):

The Company also obtained a corporate credit card in September 2007. The credit card is secured by a \$51,750 cash deposit. The deposit earns interest at prime minus 2.35%. The facility is subject to periodic review by the bank not less frequently than annually. All amounts outstanding under the credit facility are due on demand.

Prior to Q3 2014, restricted cash included an Irrevocable Letter of Credit (ILOC) of \$850,000 as a guarantee against a lawsuit. In Q3 2014, this ILOC was completely paid to the Plaintiff.

As at March 31	2015	2014
Credit card cash deposit	\$ 53,743	\$ 53,743
Balance as at March 31	\$ 53,743	\$ 53,743

## 15. Segmented information:

Photon Control designs, manufactures and distributes a wide range of optical sensors and instruments to measure temperature, pressure, position, and flow. These products are used by Original Equipment Manufacturers (OEM) as well as end-users in the Semiconductor, Oil and Gas, Power, Life Science, and Manufacturing industries. Photon Control's products have competitive advantages in both performance and cost. Photon Control's approach to creating shareholder value has been to pursue OEM sales whether directly or through a distributor and to investigate the market potential of products by working directly with customers in select industries to foresee their sectors' requirements. These collaborations often include commitments to conduct trials of the new products on industrial sites.

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## 15. Segmented information (continued):

### (a) Geographic information:

Information regarding revenue earned from major customers by geographic segments, based on the location of the customer, is as follows:

	For the three months ended	
	Mar. 31, 2015	Mar. 31, 2014
Revenue:		
Canada	\$ 63,432	\$ 165,138
United States	5,917,929	4,302,897
China	662,080	1,216,512
Europe	17,846	15,468
Singapore	99,720	-
Japan	66,172	24,329
Taiwan	-	904
Indonesia	-	-
Malaysia	2,447	35,925
Other	17,526	664
	<u>\$ 6,847,152</u>	<u>\$ 5,761,837</u>

### (b) Assets and liabilities.

The Company has only one operation in Burnaby, British Columbia, Canada. All of the Company's assets (including cash, inventory, property plant and equipment, intangible assets) and liabilities are located in Canada.

### (c) Major customers:

The following table identifies the percentage of revenue generated from individual customers comprising 10% or more of the Company's revenue:

As at March 31	2015	2014
Entity A	52%	33%
Entity B	20%	22%
Entity C	10%	21%
Entity D	8%	7%
	<u>90%</u>	<u>83%</u>

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## 16. Trade payables and accrued liabilities

As at March 31	2015	2014
Trade payables	\$ 1,075,933	\$ 635,010
Accrued liabilities	567,131	344,423
Warranty provision	224,755	217,443
Balance as at March 31	\$ 1,867,819	\$ 1,196,876

The following is a reconciliation of the warranty provision during the three months.

Reconciliation of warranty provision as at March 31	2015	2014
Provision as at December 31, beginning of the year	\$ 217,880	\$ 195,000
Warranty costs incurred	(29,125)	(34,557)
Warranty provision - additions or changes	36,000	57,000
Balance as at March 31	\$ 224,755	\$ 217,443

Due to the uncertainty surrounding the timing of warranty returns, the entire provision has been classified as current.

## 17. Subsequent Events:

As at March 31, 2015, the Company had 102,720,518 common shares issued and outstanding. As at the day of this report, the Company had 102,797,518 common shares issued and outstanding due to the subsequent exercise of 77,000 stock options in Q2 2015.

There were 9,554,000 outstanding stock options to purchase common shares of the Company as at March 31, 2015 and 9,527,000 outstanding stock options as at the day of this report due to the subsequent exercise of stock options and the employment option grant in Q2 2015.