

PHOTON CONTROL INC.

Financial Statements

For the nine months ended September 30, 2009

(Unaudited)

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, KPMG LLP, have not performed a review of these financial statements.

PHOTON CONTROL INC.

Consolidated Balance Sheets

September 30, 2009 and December 31, 2008

	2009	2008
	(Unaudited)	(Audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ -	\$ 108,582
Trade accounts receivable and other	926,815	968,248
Due from related party	620,792	468,470
Inventory (note 2(d))	968,835	688,394
Prepaid expenses and deposits	42,015	238,522
	<u>2,558,457</u>	<u>2,472,216</u>
Property and equipment	580,091	712,514
Intangible assets	182,806	190,566
Deferred development costs	201,545	190,905
Long-term rental deposits	48,544	48,544
Restricted cash (note 8)	102,890	101,750
	<u>\$ 3,674,333</u>	<u>\$ 3,716,495</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 984,609	\$ 1,056,414
Due to related party	179,132	366,792
Credit facility (note 8)	481,120	287,539
Deferred revenue	101,728	96,340
	<u>1,746,589</u>	<u>1,807,085</u>
Other liabilities	310,499	310,499
Deferred rent and sublease deposits	160,184	206,467
Shareholders' equity		
Share capital	28,148,968	28,148,968
Contributed surplus	1,912,686	1,839,751
Deficit	(28,604,592)	(28,596,274)
	<u>1,457,062</u>	<u>1,392,445</u>
Continuing operations (note 1)		
	<u>\$ 3,674,334</u>	<u>\$ 3,716,496</u>

See accompanying notes to financial statements

Approved on behalf of the Board

"Christopher Weston"

Director "David C. Dueck"

Director

PHOTON CONTROL INC.

Consolidated Statements of Operations, Comprehensive Loss and Deficit

For the Periods Ended September 30, 2009 and 2008

	Nine Months Ended September 30, 2009		Three Months Ended September 30, 2009	
	2009	2008	2009	2008
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue	\$ 2,809,774	\$ 3,930,145	\$ 1,489,914	\$ 1,058,453
Cost of sales	1,518,503	2,413,009	809,255	629,228
	1,291,271	1,517,136	680,659	429,225
Operating expenses (note 5)				
General and administrative	643,548	955,868	236,592	229,771
Engineering Services	342,220	1,368,046	(21,352)	75,116
Business development and marketing	105,250	203,941	34,058	40,024
Amortization	166,010	187,346	56,721	61,947
	1,257,028	2,715,202	306,019	406,859
	34,243	(1,198,066)	374,640	22,366
Other earnings (expenses):				
Interest and other earnings	17,035	8,677	17,035	670
Interest expense	(16,661)	(2,529)	(5,607)	(765)
Foreign exchange	(42,935)	31,182	(42,728)	15,522
	(42,561)	37,330	(31,300)	15,427
Profit and comprehensive loss for the period	(8,318)	(1,160,736)	343,340	37,793
Deficit, beginning of period	(28,596,274)	(27,472,870)	(28,756,866)	(28,150,846)
Deficit, end of period	\$ (28,604,592)	\$ (28,633,606)	\$ (28,413,526)	\$ (28,113,053)
Basic and diluted loss per share	\$ (0.00)	\$ (0.01)	\$ 0.00	\$ 0.00
Weighted average common shares, used in computing loss per share basic and diluted	101,352,018	101,352,018	101,352,018	101,352,018

See accompanying notes to financial statements

PHOTON CONTROL INC.

Consolidated Statements of Cash Flows

For the Periods Ended September 30, 2009 and 2008

	Nine months ended September 30,		Three months ended September 30,	
	2009	2008	2009	2008
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Cash provided by (used in):				
Operations:				
Loss for the year	\$ (8,318)	\$ (1,160,736)	\$ 343,339	\$ 37,793
Non-cash items:				
Amortization of property, equipment and intangibles	166,010	187,346	56,721	61,947
Amortization of stock-based compensation	72,935	148,973	22,613	47,478
Loss on disposal and impairment of assets	-	-	-	-
Amortization of deferred development costs	-	(400,814)	-	(400,814)
Deferred rent and sublease deposits	(46,283)	(11,886)	(15,428)	(10,048)
Changes in non-cash operating working capital:				
Trade accounts receivable and other	41,433	84,164	(417,970)	29,207
Inventory	(280,441)	81,318	(199,977)	15,505
Prepaid expenses and deposits	196,507	83,340	209,196	32,970
Accounts payable and accrued liabilities	(71,805)	179,154	162,644	69,924
Net due from related party	(339,983)	-	(96,271)	-
Deferred revenue	5,388	28,298	-	549
	(264,556)	(780,843)	64,867	(115,489)
Investments:				
Restricted cash	(1,140)	(50,561)	(1,140)	(561)
Purchase of equipment	(6,412)	(155,327)	(3,247)	(3,716)
Proceeds from disposal of equipment	-	-	-	-
Purchase of intangible assets	(18,448)	(16,802)	(6,841)	(9,938)
Deferred development costs	(11,607)	-	(967)	-
	(37,607)	(222,690)	(12,195)	(14,215)
Financing:				
Advances under credit facility	193,581	-	(52,671)	-
Proceeds from issue of common shares	-	-	-	-
Share issue costs	-	(914)	-	-
	193,581	(914)	(52,671)	-
Decrease in cash and cash equivalents	(108,582)	(1,004,447)	1	(129,704)
Cash and cash equivalents, beginning of year	(372,538)	1,004,447	2,053	129,704
Cash and cash equivalents, end of year	\$ (481,120)	\$ -	\$ 2,054	\$ -
Supplementary information:				
Cash received for interest	\$ 17,035	\$ 8,677	\$ -	\$ 669
Cash paid for interest	(16,661)	(2,529)	(5,251)	(4,293)
Income taxes paid	-	-	-	-
Non-cash financing and investing activities:				
Fair value of agent's warrants granted on share issuance	-	-	-	-

See accompanying notes to financial statements

PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

For the nine months ended September 30, 2009

1. Nature of and continuing operations:

Photon Control Inc. (the "Company") is incorporated under the laws of British Columbia. The Company's operations are focused on developing and commercializing new optical switching and sensing technologies and new optical meters and analyzers for various industries. On August 17, 2000, the Company completed an initial public offering of its common shares, which are listed on the TSX Venture Stock Exchange under the trading symbol PHO. In 2002, the Company changed its name from Coldswitch Technologies Inc. to Photon Control Inc.

These financial statements have been prepared by management on a going-concern basis, which assumes the Company will continue in operation for the foreseeable future and will be able to realize its assets and settle its liabilities and commitments in the normal course of business. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary should the going concern assumption become inappropriate.

The Company has made efforts to diversify the industries that it serves in an attempt to reduce the impact of a downturn on any one segment. The continued commercialization of products in 2009, form the basis of management's opinion that the Company will meet its liabilities and commitments as they become due. The Company is currently monitoring all expenditures and implementing cash management strategies to ensure that it has adequate cash reserves to fund identified expenditure requirements. If the Company is unable to obtain adequate financing or maintain profitable operations the Company will be required to reduce or curtail operations.

2. Significant accounting policies:

(a) Basis of presentation:

The accompanying unaudited financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles for interim financial information and, accordingly, do not include all information and note disclosures required for an annual set of financial statements. In the opinion of management, all adjustments (consisting solely of normal recurring adjustments) considered necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented, have been made. Results for the interim periods presented are not necessarily indicative of the results that may be expected for the year or for any other period. These financial statements have been prepared using the same accounting policies used in the preparation of the Company's audited financial statements for the year ended December 31, 2008, and should be read in conjunction with those financial statements and notes thereto. The Company's auditors have not reviewed these financial statements.

(b) 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 weighted average cost 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.

PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

For the nine months ended September 30, 2009

2. Significant accounting policies (continued):

(c) 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 the fee is fixed and determinable. Cash collected prior to revenue recognition criteria being met is recorded as deferred revenue on the consolidated balance sheet.

(d) Engineering costs:

Engineering costs are expensed as incurred.

(e) Comparative figures:

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.

3. Changes in accounting policies

(a) CICA Handbook Section 3064, Goodwill and Intangible Assets

In February 2008, the CICA issued the new CICA 3064, Goodwill and Intangible Assets, replacing CICA 3062, Goodwill and Other Intangible Assets, and CICA 3450, Research and Development Costs. Collectively, these changes bring Canadian practice closer to International Financial Reporting Standards ("IFRS") and U.S. GAAP. The effective date of adopting this standard for the Company is January 1, 2009.

4. Share capital:

(a) Authorized:

Unlimited number of Common Shares without par value

(b) Issued and outstanding:

As at September 30, 2009 there were 101,352,018 common shares issued and outstanding, excluding 1,400,000 common shares held in treasury.

(c) Treasury shares:

Pursuant to Purchase and Sale Agreements dated April 5, 2000 between the Company and certain individuals, the Company acquired all of the issued and outstanding shares of CST Coldswitch Holdings Inc. in exchange for the issuance of 1,400,000 of the Company's common shares. The sole asset of CST Coldswitch Holdings Inc. is 1,400,000 of the Company's common shares which have been assigned a value of \$700,000. These shares have been recorded as treasury shares, and accordingly, the cost of the shares has been deducted from share capital.

PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

For the nine months ended September 30, 2009

4. Share capital (continued):

(d) 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 September 30, 2009, the Company's board of directors had reserved 10,135,202 options for issuance under the Company's stock option plan. The plan provides that options may be granted with an exercise price of no less than the greater of 75% of the market price of the Company's stock on the date of the grant and \$0.10. The plan also provides that the term of the options shall not exceed five years and that the minimum option vesting period shall be 18 months with a maximum vesting of 25% per six month period.

Stock option transactions for the nine months ended September 30, 2009 are summarized as follows:

	Number of shares	Weighted average exercise price
Outstanding, December 31, 2008	5,713,750	\$ 0.34
Granted	50,000	0.10
Exercised	-	
Forfeited	(1,218,750)	0.38
Outstanding, September 30, 2009 (Unaudited)	4,545,000	\$ 0.21

The following table summarizes the stock options outstanding at September 30, 2009:

Exercise price	Options outstanding			Options exercisable	
	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
\$0.10 to \$0.20	3,210,000	2.93	\$ 0.11	1,775,000	\$ 0.11
\$0.22 to \$0.50	730,000	0.95	0.33	640,000	0.34
\$0.52 to \$1.00	605,000	1.08	0.55	501,250	0.54
	4,545,000	2.36	\$ 0.21	2,946,250	\$ 0.24

The options outstanding at September 30, 2009 expire between October 1, 2009 and September 21, 2014. 50,000 stock options were granted during the three months ended September 30, 2009.

PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

For the nine months ended September 30, 2009

(d) Stock options (continued):

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:

Expected option lives	5 years
Risk-free interest rate	2.094%
Dividend yield	0%
Volatility	344%

During the three months ended September 30, 2009, the Company recorded \$22,613 of compensation expense representing the fair value of the options vesting during the year with a corresponding increase to contributed surplus.

(e) Warrants:

As at September 30, 2009 the Company had no warrants outstanding.

PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

For the nine months ended September 30, 2009

5. Supplementary statement of operations information:

The following information for the nine months ended September 30, 2009 is provided pursuant to the requirements of the British Columbia Securities Commission:

General and administrative:	
Salaries and fees	\$ 150,113
Office premises expenses	269,706
Legal and accounting	145,146
Insurance	35,364
Investor relations	15,608
Directors fees	2,131
Other	25,480
	<hr/>
	\$ 643,548
Engineering Services:	
Salaries and fees	\$ 183,119
Materials	115,526
Certification and testing	7,050
Consulting fees	202,244
Government grants received	
Amortization of deferred development costs	-
Other	(165,719)
	<hr/>
	\$ 342,220
Business development and marketing:	
Salaries and fees	\$ 36,556
Office and Travel expenses	11,387
Consulting fees	19,715
Promotion	19,715
Other	16,802
	<hr/>
	\$ 105,250

(1) Directors' fees and expenses include stock based compensation expense of \$ 2,131.

PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

For the nine months ended September 30, 2009

6. Financial instruments – risk management objectives and policies:

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.

Risk Management

(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. The Companies maximum credit risk is the total of its uninsured trade receivables which were \$ 925,815 as at September 30, 2009.

The Company is exposed to interest rate risk with regard to the cash, cash equivalents and amounts due under credit facility. The Company holds its cash and cash equivalents at a major Canadian banking institution. As at September 30, 2009, the Company was not exposed to significant credit or interest rate risk.

(b) Market 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 majority of the Company's sales revenues and trade receivables are denominated in United States dollars. As such the Company's may be subject to, material, realized and unrealized exchange gains or losses resulting from above average changes in exchange rates between the Canadian and United States dollar. As at September 30, 2009, the Company did not utilize any forward exchange contracts to mitigate any of the risks as mentioned 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 September 30, 2009, the Company's accounts payable and accrued liabilities were \$ 984,609 of which fall due for payment within twelve months of the balance sheet date. As at September 30, 2009, the Company was using \$481,120 of it's credit facility.

7. 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.

PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

For the nine months ended September 30, 2009

7. 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 September 30, 2009 the Company's capital is as follows:

Credit facility	\$	481,120`
Cash		-
Net debt (cash)		481,120
Shareholders' equity		1,457,062
	\$	1,938,182

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.

8. Bank credit facility and restricted cash:

In November 2007, the Company secured a bank operating line credit facility of up to \$500,000 under the Export Development Canada's Master Accounts Receivable Guarantee (MARG) program. This credit facility is secured by a cash deposit of \$50,000 which was paid in January 2008, a general security agreement, a general assignment of book debts and a \$450,000 MARG program with Export Development Canada and assignment of all risk insurance coverage. This facility bears interest at the bank's prime plus 1.25% per annum. The Company also obtained a corporate credit card in June 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.