Consolidated Financial Statements of

PHOTON CONTROL INC.

For the nine months ended September 30, 2014 and 2013

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 September 30, 2014 and December 31, 2013

		September 30, 2014		December 31, 2013
Assets				
Current assets:				
Cash and cash equivalents	$	11,811,807	$	6,068,133
Trade accounts receivable and other		3,209,451		4,075,086
Note receivable - related (note 9(a))		22,464		22,464
Due from related party (note 9(a))		709,286		802,089
Inventory (note 4)		1,774,623		1,092,413
Prepaid expenses and deposits		81,187		250,597
		17,608,818		12,310,782
Property and equipment (note 5)		227,703		233,197
Intangible assets (note 6)		138,513		139,040
Internally generated intangible assets (note 8)		46,500		142,500
Long term rental deposits		34,695		34,695
Note receivable - related (note 9(a))		98,949		119,999
Restricted cash (note 14)		53,743		53,743
Deferred taxes		3,489,887		4,201,886
Total Assets	$	21,698,808	$	17,235,842
Liabilities and Shareholders' Equity				
Current liabilities:				
Deferred revenue	$	111,027	$	129,311
Accounts payable and accrued liabilities (note 16)		943,835		984,405
Due to related party (note 9(a))		180,267		187,436
Provisions (note 10(b))		28,037		28,037
		1,263,166		1,329,189
Shareholders' equity (note 7):				
Share capital		27,801,696		27,944,283
Contributed surplus		2,949,044		2,480,492
Deficit		(10,315,098)		(14,518,122)
		20,435,642		15,906,653
Commitments and contingencies (note 10)				
Bank indebtedness (note 14)				
Subsequent events (note 18)				
Total liabilities and Shareholders' Equity	$	21,698,808	$	17,235,842

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 nine months ended September 30, 2014 and 2013

	Three Months Ended September 30 2014	Three Months Ended September 30 2013	Nine months Ended September 30 2014	Nine months Ended September 30 2013
Revenue (note 17)	$ 5,144,161	$ 4,609,445	$ 15,022,502	$ 11,127,329
Cost of sales (note 17)	2,636,621	2,626,774	7,875,422	6,720,222
Gross Margin	2,507,540	1,982,671	7,147,080	4,407,107
Operating expenses (notes 9 and 11):				
General and administrative	982,318	491,043	1,771,577	1,348,134
Engineering	236,934	220,547	750,311	676,964
Business development	84,197	69,834	295,127	274,855
Operating expenses	1,303,449	781,424	2,817,015	2,299,953
Net earnings before other earnings and tax	1,204,091	1,201,247	4,330,065	2,107,154
Other earnings (expenses):				
Interest and other earnings	9,425	25,294	23,730	45,713
Interest expense	-	(202)	(39)	(230)
Foreign exchange	668,794	(104,389)	561,268	104,057
	678,219	(79,297)	584,959	149,540
Net earnings before income tax	1,882,310	1,121,950	4,915,024	2,256,694
Deferred income tax (expense) recovery	(472,000)	-	(712,000)	-
Net earnings and total comprehensive income	$ 1,410,310	$ 1,121,950	$ 4,203,024	$ 2,256,694
Basic and diluted earnings (loss) per share				
Weighted average common shares used in computing	101,755,615	102,905,555	101,755,615	102,905,555
Diluted average common shares used in computing	109,566,505	108,425,555	109,566,505	108,425,555
Basic earnings per share	$0.01	$0.01	$0.04	$0.02
Diluted earnings per share	$0.01	$0.01	$0.04	$0.02

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Equity
(Expressed in Canadian dollars)
As at September 30, 2014 and 2013

For the nine months ending September 30, 2013

	Share Capital		Contributed Surplus and Deficit		
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
Balance at December 31, 2012	**102,909,518**	**$ 28,246,173**	**$ 2,099,797**	**$(18,011,217)**	**$ 12,334,753**
Stock based compensation to employees	-	-	16,200	-	16,200
Share issues	-	-	-	-	-
NCIB share buy backs	-	-	-	-	-
Total comprehensive income (loss)	-	-	-	391,227	391,227
Balance at March 31, 2013	**102,909,518**	**$ 28,246,173**	**$ 2,115,997**	**$(17,619,990)**	**$ 12,742,180**
Stock based compensation to employees	-	-	16,350	-	16,350
Share issues	-	-	-	-	-
NCIB share buy backs	-	-	-	-	-
Total comprehensive income (loss)	-	-	-	743,515	743,515
Balance at June 30, 2013	**102,909,518**	**$ 28,246,173**	**$ 2,132,347**	**$(16,876,475)**	**$ 13,502,045**
Stock based compensation to employees	-	-	60,551	(1)	60,550
Share issues (Exercise of share options)	**10,000**	1,000	-	-	1,000
NCIB share buy backs	**(100,000)**	(15,330)	-	-	(15,330)
Total comprehensive income (loss)	-	-	-	1,121,950	1,121,950
Balance at September 30, 2013	**102,819,518**	**$ 28,231,843**	**$ 2,192,898**	**$(15,754,526)**	**$ 14,670,215**

For the nine months ending September 30, 2014

	Share Capital		Contributed Surplus and Deficit		
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
Balance at December 31, 2013	**101,819,518**	**$ 27,944,283**	**$ 2,480,492**	**$(14,518,122)**	**$ 15,906,653**
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
Balance at March 31, 2014	**100,969,518**	**$ 27,683,225**	**$ 2,529,902**	**$(12,446,011)**	**$ 17,767,116**
Stock based compensation to employees	-	-	44,621	-	44,621
Share issues (exercise of options)	**785,000**	78,500	-	-	78,500
NCIB share buy backs	-	-	-	-	-
Total comprehensive income (loss)	-	-	-	720,603	720,603
Balance at June 30, 2014	**101,754,518**	**$ 27,761,725**	**$ 2,574,523**	**$(11,725,408)**	**$ 18,610,840**
Stock based compensation to employees	-	-	374,521	-	374,521
Share issues (Exercise of share options)	**401,000**	39,971	-	-	39,971
NCIB share buy backs	-	-	-	-	-
Total comprehensive income (loss)	-	-	-	1,410,310	1,410,310
Balance at September 30, 2014	**102,155,518 $-**	**$ 27,801,696**	**$ 2,949,044**	**$(10,315,098)**	**$ 20,435,642**

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 nine months ended September 30, 2014 and 2013

As at September 30	2014	2013
Cash provided by (used in):		
Operations:		
Net earnings	$ 4,203,024	$ 2,256,694
Non-cash items:		
Depreciation of property, plant and equipment	40,950	78,183
Amortization expenses of intangibles	30,190	-
Stock-based compensation	468,552	93,100
Amortization of deferred development costs	96,000	-
Accretion income	(2,015)	-
Amortization on gain on sale to R&D	-	-
Inventory reserve provision	76,000	-
Allowance for doubtful accounts reversal	-	-
Deferred tax	711,999	-
Changes in non-cash operating working capital:		
Trade accounts receivable and other	865,635	(2,018,424)
Inventory	(758,210)	193,623
Prepaid expenses and deposits	169,410	(6,926)
Accounts payable and accrued liabilities	(40,570)	(275,743)
Due to/from related party	85,634	(173,646)
Received from related party	-	-
Contingent liabilities	-	-
Deferred revenue	(18,284)	1,096
	5,928,315	147,957
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)	118,471	(14,330)
Restricted cash (irrevocable letter of credit: lawsuit)	-	-
Proceeds from note receivable	23,065	-
	(119,522)	(14,330)
Investments:		
Restricted cash	-	850,000
Purchase of equipment	(35,456)	(36,284)
Purchase of intangible assets	(29,663)	-
Deferred development costs	-	-
	(65,119)	813,716
Increase (decrease) in cash and cash equivalents	5,743,674	947,343
Cash and cash equivalents, beginning of year	6,068,133	3,607,507
Cash and cash equivalents, end of period	11,811,807	4,554,850
Supplementary information:		
Cash received for interest	15,801	22,212
Cash paid for interest	(39)	(230)

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

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 19th Floor, 885 West Georgia Street, Vancouver, British Columbia, Canada, V6C 3H4.

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 (ISA) 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.

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.

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 nine months ended September 30, 2014 nor for the nine months ended September 30, 2013.

(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.

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.

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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.

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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.

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 deductable amounts.

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 deductable 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 deductable 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.

3. Recently adopted and future accounting pronouncements:

The following accounting pronouncements became effective for the Company for the current fiscal year ending December 31, 2014 and were adopted as at January 1, 2014:

(a) IFRS 7, Financial Instruments, Disclosures:

The amendments to disclosure requirements in IFRS 7 emphasize the interaction between quantitative and qualitative disclosures and the nature and extent of risks and amends credit risk disclosures. Adoption of this standard had no impact on the Company's consolidated financial statements.

(b) IFRS 10, Consolidated Financial Statements:

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation-Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements. Adoption of this standard had no impact on the Company's consolidated financial statements.

(c) IAS 19, Employee Benefits:

In June 2011, the IASB issued an amended IAS 19. The Standard requires recognition of changes in the net defined benefit liability (asset) including immediate recognition of defined benefit cost, disaggregation of defined benefit cost into components, recognition of re-measurements in other comprehensive income, plan amendments, curtailments and settlements. In addition there are modifications in accounting for termination benefits, including distinguishing benefits provided in exchange for service and benefits provided in exchange for the termination of employment and affect the recognition and measurement of termination benefits. The Company does not anticipate a significant impact on its financial statements Adoption of this standard had no impact on the Company's consolidated financial statements.

(d) IAS 28, Investments in Associates:

IAS 28 was amended to include joint ventures in its scope and to address the changes in IFRS 10 to IFRS 12. This amendment is effective for annual periods beginning on or after January 1, 2013. Earlier adoption is permitted. The Company does not anticipate the application of IAS 28 to have a significant impact on its financial statements.

3. Recently adopted and future account pronouncements (continued):

(e) IFRS 11, Joint Arrangements:

In May 2011, the IASB issued IFRS 11, Joint Arrangements, which supersedes IAS 31, Interests in Joint Ventures and SIC 13, Jointly Controlled Entities – Non-Monetary Contributions by Venturers. The standard requires the Company to classify its interest in a joint arrangement as a joint venture or joint operation. This standard will eliminate the use of proportionate consolidation when accounting for joint ventures, as they will be accounted for using the equity method, whereas joint operations will be accounted for by recognizing the venturer's share of the assets, liabilities, revenue and expenses. Management has adopted this standard in the Company's financial statements for the period beginning January 1, 2013. The Company does not anticipate the application of IFRS 11 to have a significant impact on its financial statements.

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

The IASB has issued IFRS 12 Disclosure of Interest in Other Entities, which includes disclosure requirements about subsidiaries, joint ventures, and associates, as well as unconsolidated structured entities and replaces existing disclosure requirements. This standard became effective for annual periods beginning on or after July 1, 2013 with earlier adoption being permitted. Management adopted this standard in the Company's financial statements for the periods beginning January 1, 2013 and for all subsequent periods. The Company does not anticipate the application of IFRS 12 to have a significant impact on its financial statements

(g) IFRS 13, Fair Value Measurement:

IFRS 13, Fair Value Measurement: effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, sets out in a single IFRS a framework for measuring fair value and new required disclosures about fair value measurements. Management has adopted this standard in the Company's financial statements for the period beginning January 1, 2013. The Company does not anticipate the application of IFRS 13 to have a significant impact on its financial statements.

(h) IAS 32, Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities:

In December 2011, the IASB issued an amendment to IAS 32. The amendment clarifies the meaning of "currently has a legally enforceable right to set-off". The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The Company does not anticipate a significant impact to its consolidated financial statements.

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 replace IAS 39, 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.

4. Inventory:

As at September 30	2014	2013
Raw materials	$ 646,494	$ 421,653
Work in process	432,789	445,708
Finished goods	695,340	381,614
	$ 1,774,623	$ 1,248,975

For the nine months ended September 30, 2014, inventory recognized as an expense in cost of sales amounted to $4,933,813 (September 30, 2013 - $4,366,589). Included in the above amounts were inventory write downs of $76,000 (September 30, 2013 – $95,000). There were no reversals of previously recorded inventory write downs for 2014 (September 30, 2013 - Nil). As of September 30, 2014, the Company anticipates the net inventory will be realized within one year.

5. Property and equipment:

		Laboratory equipment	Computers, office furniture and equipment	Production equipment	Leasehold improvements	Total
Asset Cost						
Balance January 1, 2013	$	346,446	313,584	338,250	386,395	**1,384,675**
Additions		-	-	39,804	1,100	**40,904**
Balance December 31, 2013		**346,446**	**313,584**	**378,054**	**387,495**	**1,425,579**
Additions		-	6,868	25,208	3,380	**35,456**
Disposals		-	-	-	-	-
Balance September 30, 2014	**$**	**346,446**	**320,452**	**403,262**	**390,875**	**1,461,035**
Accumulated Depreciation						
Balance January 1, 2013	$	246,538	225,749	292,764	373,940	**1,138,991**
Depreciation for period		18,253	17,567	15,023	2,548	**53,391**
Balance December 31, 2013		**264,791**	**243,316**	**307,787**	**376,488**	**1,192,382**
Depreciation for period		9,099	10,711	19,157	1,983	**40,950**
Disposals		-	-	-	-	-
Balance September 30, 2014	**$**	**273,890**	**254,027**	**326,944**	**378,471**	**1,233,332**
Carrying Amounts						
At January 1, 2013	$	99,908	87,835	45,486	12,455	**245,684**
At December 31, 2013	$	81,655	70,268	70,267	11,007	**233,197**
At September 30, 2014	$	72,556	66,425	76,318	12,404	**227,703**

PHOTON CONTROL INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars, unless specifically indicated otherwise)
For the nine months ended September 30, 2014 and 2013

6. Intangible assets:

		Patents	Trademarks	Computer software	Computer system (SW)	Total
Asset Cost						
Balance January 1, 2013	$	378,053	28,602	90,573	145,152	**642,380**
Additions		-	-	4,110	-	**4,110**
Balance December 31, 2013		**378,053**	**28,602**	**94,683**	**145,152**	**646,490**
Additions		-	-	-	29,663	**29,663**
Balance September 30, 2014	**$**	**378,053**	**28,602**	**94,683**	**174,815**	**676,153**
Accumulated Amortization						
Balance January 1, 2013		271,353	25,177	90,573	67,949	**455,052**
Amortization for period		26,328	1,200	1,710	23,160	**52,398**
Balance December 31, 2013	**$**	**297,681**	**26,377**	**92,283**	**91,109**	**507,450**
Amortization for period		14,589	900	1,800	12,901	**30,190**
Balance September 30, 2014	**$**	**312,270**	**27,277**	**94,083**	**104,010**	**537,640**
Carrying Amounts						
At January 1, 2013	$	106,700	3,425	-	77,203	**187,328**
At December 31, 2013	$	80,372	2,225	2,400	54,043	**139,040**
At September 30, 2014	$	65,783	1,325	600	70,805	**138,513**

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, 2012	102,909,518	$ 28,246,173
Shares issued in 2013	10,000	1,000
Share buy back (Normal Course Issuer Bid)	(1,100,000)	(302,890)
Issued and outstanding as at December 31, 2013	101,819,518	$ 27,944,283
Shares issued in 2014 (exercise of options)	1,186,000	118,471
Share buy-back (Normal Course Issuer Bid)	(850,000)	(261,058)
Issued and outstanding as at September 30, 2014	102,155,518	$ 27,801,696

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, 2012	$ 2,099,797
Stock-based compensation to employees in 2013	292,556
NCIB share buy back in 2013	88,139
Balance, December 31, 2013	$ 2,480,492
Stock-based compensation to employees	468,552
	-
Balance, September 30, 2014	**$ 2,949,044**

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 December 31, 2013, the Company had reserved 10,181,952 options for issuance under the Company's stock option plan. As at September 30, 2014, there was a change in the number of outstanding shares and consequently a change in the reserved options to 10,215,552 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, 2012	5,510,000	$	0.10
Granted	2,780,000		0.15
Forfeited	(40,000)		0.10
Expired	-		0.00
Exercised	(10,000)		0.10
Outstanding, December 31, 2013	8,240,000	$	0.12
Granted	10,000		0.29
Granted	30,000		0.30
Granted	10,000		0.31
Granted	10,000		0.32
Forfeited	(30,000)		0.10
Forfeited	(10,000)		0.15
Outstanding, March 31, 2014	8,260,000	$	0.12
Exercised	(785,000)		0.10
Outstanding, June 30, 2014	7,475,000	$	0.12
Granted	30,000		0.43
Granted	3,110,000		0.50
Exercised	(401,000)		0.10
Outstanding, September 30, 2014	10,214,000	$	0.24

3,140,000 stock options were granted during the three months ended September 30, 2014 (2,760,000 granted for the three months ended September 30, 2013).

7. Share capital (continued):

(c) Stock options (continued):
The following table summarizes the stock options outstanding at September 30, 2014:

	Options outstanding			Options exercisable	
Exercise price	Number of options	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
$0.100	4,214,000	2.21	$ 0.100	4,186,500	$ 0.100
$0.105	10,000	1.00	$ 0.105	7,500	$ 0.105
$0.110	20,000	1.35	$ 0.110	15,000	$ 0.110
$0.115	10,000	1.20	$ 0.115	7,500	$ 0.115
$0.150	2,750,000	4.00	$ 0.150	1,862,500	$ 0.150
$0.165	10,000	4.02	$ 0.165	-	$ 0.165
$0.200	10,000	4.12	$ 0.200	-	$ 0.200
$0.285	10,000	4.40	$ 0.285	-	$ 0.285
$0.295	10,000	4.27	$ 0.295	-	$ 0.295
$0.300	20,000	4.38	$ 0.300	-	$ 0.300
$0.310	10,000	4.33	$ 0.310	-	$ 0.310
$0.320	10,000	4.50	$ 0.320	-	$ 0.320
$0.425	20,000	4.94	$ 0.425	-	$ 0.425
$0.500	3,110,000	4.98	$ 0.500	777,500	$ 0.500
	10,214,000	3.55	$ 0.237	6,856,500	$ 0.159

The options outstanding as at September 30, 2014 expire between October 26, 2014 and September 23, 2019**.**

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:

	2014	2013
Expected option lives	5 years	5 years
Risk-free interest rate	1.37% to 2.59%	1.28% to 2.59%
Dividend yield	0%	0%
Volatility	147% to 209%	123% to 380%

During the nine months ended September 30, 2014, the Company recorded $468,552 (2013 - $93,100) of compensation expense representing the fair value of the options and shares vesting during the year with a corresponding increase to contributed surplus.

(d) Net earnings (loss) per share:

The weighted average number of shares outstanding as at September 30, 2014 of 101,755,615 (September 30, 2013 - 102,905,555) were used in the calculation of basic earnings per share for the nine months ended September 30, 2014. 109,566,505 shares were used in the calculation of diluted earnings per share as at September 30, 2014 (September 30, 2013 - 108,425,555).

8. Internally generated assets:

		Internally Generated R&D Assets
Asset Cost		
Balance January 1, 2013	$	219,071
Additions		-
Balance December 31, 2013		**219,071**
Additions		-
Balance September 30, 2014	**$**	**219,071**
Accumulated Amortization		
Balance January 1, 2013	$	70,246
Amortization for period		6,325
Balance December 31, 2013		**76,571**
Amortization for period		96,000
Disposals		-
Balance September 30, 2014	**$**	**172,571**
Carrying Amounts		
At January 1, 2013	$	148,825
At December 31, 2013	$	142,500
At September 30, 2014	$	46,500

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 Q3, 2014, there were indicators that gave rise to the possibility of impairment of these assets. Amount amortized or considered impaired and discounted for the nine months ending September 30, 2014 was $93,000 (September 30, 2013 – nil). The Company has a balance of internally generated intangible assets as at September 30, 2014 of $46,500 (September 30, 2013 - $148,824).

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 2013, 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**.**

As at September 30	2014	2013
Statement of Financial Position		
Accounts receivable	$ 709,286	$ 1,243,976
Note receivable	121,413	155,214
Accounts payable and accrued liabilities	180,267	306,208
Statement of Comprehensive Income		
Charges to:		
Revenue from sales of products and services to Photon R&D	$ 96,756	$ 234,350
Payroll reimbursement re: Photon Control R&D Ltd.	1,046,732	1,131,346
Recovery of premises and related expenses (Re: DCD Management Ltd. and Photon Control R&D Ltd).	303,149	224,649
Charges from:		
Products & services charged by Photon Control R&D Ltd.	$ 166,747	$ 396,193
Engineering & R&D services charged by Photon Control R&D	690,910	604,929
Royalty expenses charged by Photon Control R&D Ltd.	863,863	551,910
Management services expenses charged by DCD Mgmt Ltd.	$ 147,254	$ 142,167

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 product and engineering design, and to maintain technical competitiveness while exploring new markets.

9. Related party balances and transactions (continued):

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for directors and officers of the Company.

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 September 30, 2014, $30,764 (2013 - $31,525) to date in accretion was recognized in interest income.

As at September 30	2014	2013
Promissory note receivable – face value	$ 315,000	$315,000
Less: discount	(97,513)	(97,513)
	217,487	217,487
Accretion	30,764	31,525
Principal repayment	(126,838)	(93,798)
Carrying amount	121,413	155,214
Current portion	(22,464)	(24,711)
Long-term portion	$ 98,949	$ 130,503

9. Related party balances and transactions (continued):

(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, is:

As at September 30	2014	2013
Short term benefits	$ 390,912	$ 200,106
Share-based compensation	181,183	23,465
Carrying Amount	$ 572,095	$ 233,571

10. Commitments and contingencies:

(a) Leases:

As at September 30, 2014, the Company has entered into premises leases requiring the following future minimum lease payments and related costs (applicable sales taxes extra) as follows:

2014	$ 185,106
2015	785,374
2016	830,452
	$ 1,800,932

For the nine months ended September 30, 2014, lease payments and related costs recognized as an expense amounted to $555,317 (2013 - $494,195)

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:

2014	$ 47,445
2015	203,832
2016	217,896
	$ 469,173

10. Commitments and contingencies (continued):

(b) Litigation:

In October 2001, a former member of management and President of the Company (the “Claimant”) initiated an arbitration proceeding asserting that certain amounts were owing to him by the Company. The Company had commenced an action against the Claimant for a declaration that it had properly rescinded a loan agreement between the Company and the Claimant dated March 5, 2001 (the "Loan Agreement") and that the debt owed to the Claimant (the "Claimant Debt"), being $340,887 as at the date of the Loan Agreement, was repayable in shares of the Company at a rate of one share per dollar of debt. In addition, the Claimant has filed a claim against the Company seeking unspecified damages for wrongful dismissal. The Company con considered the allegations in the lawsuit to be without merit and subsequently proceeded to defend the action.

The Company’s application to dismiss the claim was denied in September 2009. The trial commenced on May 9, 2011 but did not complete on May 20, 2011 as scheduled. The trial resumed on June 13 and was completed on June 17, 2011.

As announced in the Company’s News Release dated August 2, 2011, the Supreme Court of British Columbia decided that the Company did not have the right to rescind the Loan Agreement and that this debt is repayable in accordance with the Loan Agreement. The amount of the Claimant Debt payable is $374,562 including interest as at September 30, 2010 plus interest thereafter. The Court also ruled that the Claimant was dismissed without cause in 2001 and awarded 18 months notice at $130,000 per year in salary plus the value of the benefits payable to him. As announced in the Company’s News Release dated September 12, 2011, Photon Control filed a Notice of Appeal from the decision of the Supreme Court of British Columbia in respect of the Court's decision on both rescission of the loan agreement and the dismissal of the Claimant from the Company.

Subsequently, the Company's appeal of both the loan agreement decision and the wrongful dismissal decision was heard by the British Columbia Court of Appeal on March 15 and 16, 2012. As announced in the Company’s News Release dated August 16, 2012, the Court of Appeal dismissed the Company’s appeal and upheld the trial decision.

As announced in the Company’s News Release dated June 12, 2013, the Supreme Court of Canada has denied the Company’s application for leave to appeal the decision of the British Columbia Court of Appeal.

10. Commitments and contingencies (continued):

A charge for the Claimant Debt in the amount of $310,499 was previously taken by the Company as a long term liability and was reported on the Company's previous financial statements. Also, the Company recorded an additional $539,501 in Q1 2012 to reflect the decision of the Court and the current estimate of this claim. Both of these amounts, totalling $850,000, were classified in Q1 2012 as a contingent liability. Related to this issue, the Company has provided an $850,000 standby irrevocable letter of credit as a guarantee against this lawsuit (included in restricted cash). An additional $142,096 was added to the provision in Q2 2013 resulting in a total provision of $992,096 as at June 30, 2013.

In Q3 2013, the Company proceeded with payments to Claimant which have impacted provisions as follows:

Provision as at December 31, 2012	$	850,000
Increase to provision Q2 2013		142,095
July 2013 - irrevocable letter of credit released to Claimant		(850,000)
August 2013 - related tax withholding deposited to Canada Revenue Agency		(114,058)
Remaining provision (for potential interest and costs) as of December 31, 2013	$	28,037

Provision in the amount of $28,037 remains unchanged as at September 30, 2014.

Appropriate adjustments will be made in the Company's future 2014 financial statements to reflect the any subsequent payments or decisions of the Court.

11. Supplementary information:

As at September 30		2014		2013
General and administrative:				
Salaries and fees	$	708,895	$	549,226
Stock option compensation expense (non-directors)		171,061		36,875
Office premises expenses and rent		185,099		154,683
Travel		30,002		21,761
Supplies and postage		37,398		44,011
Audit		61,150		52,515
Insurance		146,300		102,336
Legal		57,204		63,461
Legal judgements		-		174,726
Communications		16,980		18,815
Dues and subscriptions		146		142
Directors fees (including applicable stock options expense)		297,491		53,975
Depreciation and amortization		27,395		33,615
Bad debt expense		6,000		12,000
Other expenses		26,456		29,993
	$	1,771,577	$	1,348,134
Engineering expenses:				
Engineering support fees	$	405,000		405,000
Consulting fees		285,910		199,929
Certification and testing		36,271		36,059
Travel and entertainment		8,541		16,070
Depreciation and amortization		14,589		19,746
Other expenses		-		160
	$	750,311	$	676,964
Business development and marketing:				
Salaries and consulting fees	$	161,303		182,827
Travel expenses		4,126		7,310
Commissions		138		-
Trade shows		90,288		68,886
Promotion		26,872		14,932
Consuting		11,500		-
Depreciation and amortization		900		900
Other expenses		-		-
	$	295,127	$	274,855

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 September 30, 2014, 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 September 30, 2014	At December 31, 2013	At December 31, 2012
Cash and cash equivalents	Level 1	$11,811,807	$ 6,068,133	$ 3,607,507
Derivatives: Cash subject to USD futures contracts	Level 2	-	-	-
Total		$11,811,807	$6,068,133	$ 3,607,507

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 September 30, 2014, there are $nil remaining transfers between Level 1 and Level 2 cash and cash equivalents. There were no transfers between Level 1, Level 2 and Level 3 during the year ended December 31, 2013.

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 September 30, 2014, nor as at September 30, 2013.

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.

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 September 30, 2014 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 September 30, 2014 the maximum credit risk, which is the total of its uninsured trade receivables (primarily Canadian based customers and intercompany), was $769,829 or 19% (September 30, 2013 - $1,406,151 or 30%) of the total outstanding accounts receivable balances.

12. Financial instruments (continued):

The following table provides information regarding the aged trade receivables as at September 30, 2014:

Current	31-60 days	61-90 days	91 days +
57%	35%	4%	4%

The following table provides information regarding the aged trade receivables as at September 30, 2013:

Current	31-60 days	61-90 days	91 days +
54%	33%	4%	9%

The Company holds its cash and cash equivalents at a major Canadian banking institution. As at September 30, 2014, 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 September 30	2014	2013
Balance, beginning of the year	$ 50,281	$ 157,126
Write-offs of specific accounts	(1,228)	(22,845)
Change in provision	6,000	12,000
Balance as at September 30	$ 55,053	$ 146,281

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:

September 30	2014	2013
Customer A	43%	36%
Customer B	19%	16%
Customer C	23%	29%

(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 30, 2014, all of the remaining forward exchange contracts have expired.

The contracts required the sale of an agreed upon amount of US dollars at specified future dates at forward exchange rates. As at September 30, 2014, the remaining contract expired. These financial instruments were entered into solely to mitigate foreign exchange risk and are 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 September 30, 2014, 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 September 30:

Amounts denominated in U.S. dollars as at September 30	2014	2013
Cash	$10,444,726	$3,710,018
Trade accounts receivable	2,819,144	3,140,958
Trade accounts payable	57,857	311,346

The estimated impact on net earnings at September 30, 2014 with a +/- 10% change in foreign exchange rates is $1,479,074 (September 30, 2013 - $653,020).

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 September 30, 2014, the Company's accounts trade payable and accrued liabilities were $943,835 (September 30, 2013 - $1,265,096) which fall due for payment within twelve months of the balance sheet date. As at September 30, 2014, the Company had access to a credit facility of $1,000,000. This credit facility currently remains unutilized (unutilized as at September 30, 2013). The Company has recorded a provision for the remainder of a lawsuit of $28,037 (September 30, 2013 - $28,037) which is due in 2014.

Significant cash commitments in years subsequent to September 30, 2014 are as follows:

	1 year	2 years	3 years	4 years	5 years	Total
Accounts trade payable and accrued liabilities	$ 943,835	$ -	$ -	$ -	$ -	$ 943,835
Due to related party	180,267	-	-	-	-	180,267
Provision (unguaranteed)	28,037	-	-	-	-	28,037
Standby Engineering	135,000	-	-	-	-	135,000
Lease obligation	185,106	785,374	830,452	-	-	1,800,932

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 $863,862 for the nine months ended September 30, 2014 (2013 - $551,910).

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.

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 September 30, 2014 the Company's capital is as follows:

As at September 30	2014	2013
Cash and cash equivalents	$ 11,811,807	$ 4,564,850
Credit Facility (debt)	-	-
Shareholders' equity	20,435,642	14,670,216
	$ 32,247,449	$ 19,235,066

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 September 30, 2014 and as at September 30, 2013.

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 September 30, 2014 and 2013.

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 2013, restricted cash included an Irrevocable Letter of Credit (ILOC) of $850,000 as a guarantee against a lawsuit. In Q3 2013, this ILOC was completely paid to the Plaintiff.

As at September 30		2014		2013
Bank operating line of credit cash deposit	$	-	$	-
Credit card cash deposit		53,743		53,743
ILOC provisions for lawsuit (guarantee)		-		-
Balance as at September 30	$	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.

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		For the nine months ended	
	Sept 30, 2014	Sept 30, 2013	Sept 30, 2014	Sept 30, 2013
Revenue:				
Canada	$ 44,707	$ 183,971	$ 275,472	$ 401,999
United States	4,173,644	3,753,735	12,018,236	8,654,692
Europe	27,755	7,751	72,307	29,291
Malaysia	-	21,184	138,627	197,594
China	774,795	610,167	2,325,720	1,644,818
Russia	12,431	15,023	12,431	115,067
Other	110,829	17,614	179,709	83,868
	$ 5,144,161	$ 4,609,445	$ 15,022,502	$ 11,127,329

(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 September 30	2014	2013
Entity A	39%	43%
Entity B	25%	22%
Entity C	15%	15%
Entity D	5%	6%
	84%	86%

16. Trade payables and accrued liabilities

As at September 30	2014	2013
Trade payables	$ 392,457	$ 836,971
Accrued liabilities	332,958	235,393
Warranty provision	218,420	192,729
Balance as at September 30	$ 943,835	$ 1,265,093

The following is a reconciliation of the warranty provision during the year.

Reconciliation of warranty provision as at September 30	2014	2013
Provision as at December 31, beginning of the year	$ 195,000	$ 130,131
Warranty costs incurred	(123,580)	(55,402)
Warranty provision - additions or changes	147,000	118,000
Balance as at September 30	$ 218,420	$ 192,729

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

17. Reclassification of revenue and cost of sales:

Warranty provisions have been reclassified from revenue to cost of sales for both FY2014 and comparative FY2013. The reason for such reclassification is to conform to IAS 18 definition of revenue which is the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates that the entity allows. Thus warranty provisions previously included in revenue should be re-classed to cost of sales.

Gross margin remains unchanged.

Impact of this change on both current and prior fiscal period is:

Reclassification of revenue:

For the nine months ended September 30	2014	2013
Revenue prior to reclassification	$ 14,875,502	$ 11,011,329
Reclassification of warranty	147,000	116,000
Revenue	$ 15,022,502	$ 11,127,329

Reclassification of cost of sales

For the nine months ended September 30	2014	2013
Cost of sales prior to reclassification	$ 7,728,422	$ 6,604,222
Reclassification of warranty	147,000	116,000
Cost of sales	$ 7,875,422	$ 6,720,222

18. Subsequent Events:

As at September 30, 2014, the Company had 102,155,518 common shares issued and outstanding. As at the day of this report, the Company had 102,175,518 common shares issued and outstanding due to the subsequent exercise of 20,000 stock options in Q4 2014.

There were 10,214,000 outstanding stock options to purchase common shares of the Company as at September 30, 2014 and 10,194,000 outstanding stock options as at the day of this report due to the subsequent exercise of stock options in Q4 2014.