Consolidated Financial Statements of

PHOTON CONTROL INC.

Years ended December 31, 2008 and 2007

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Photon Control Inc. as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Vancouver, Canada
February 25, 2009

PHOTON CONTROL INC.

Consolidated Balance Sheets

December 31, 2008 and 2007

	2008	2007
Assets		
Current assets:		
Cash and cash equivalents	$ 108,582	$ 1,004,447
Trade accounts receivable and other	968,248	762,307
Due from related party (note 8)	468,470	-
Inventory (note 2(d))	688,394	635,082
Prepaid expenses and deposits	238,522	274,455
	2,472,216	2,676,291
Property and equipment (note 4)	712,514	753,476
Intangible assets (note 5)	190,566	199,853
Deferred development costs (note 2 (h))	190,905	-
Long-term rental deposits	48,544	48,544
Restricted cash (note 13)	101,750	51,750
	$ 3,716,495	$ 3,729,914
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,056,414	$ 762,502
Due to related party (note 8)	366,792	-
Credit facility (note 13)	287,539	-
Deferred revenue (note 2(g))	96,340	75,000
	1,807,085	837,502
Other liabilities (note 9 (b))	310,499	310,499
Deferred rent and sublease deposits (note 9)	206,466	212,260
Shareholders' equity (note 6)		
Share capital	28,148,968	28,149,882
Contributed surplus	1,839,751	1,692,641
Deficit	(28,596,274)	(27,472,870)
	1,392,445	2,369,653
Continuing operations (note 1)		
Commitments and contingencies (note 9)		
	$ 3,716,495	$ 3,729,914

See accompanying notes to financial statements

Approved on behalf of the Board

"Michael Weston" Director *"David C. Dueck"* Director

PHOTON CONTROL INC.

Consolidated Statements of Operations, Comprehensive Loss and Deficit

Years ended December 31, 2008 and 2007

	Year 2008	Year 2007
Revenue	$ 5,350,378	$ 6,065,851
Cost of sales	3,346,718	3,593,261
	2,003,660	2,472,590
Operating expenses (note 10)		
General and administrative	1,106,443	1,279,791
Research and development	1,701,658	2,589,741
Business development and marketing	191,213	435,651
Amortization	252,094	258,945
	3,251,408	4,564,128
	(1,247,748)	(2,091,538)
Other earnings (expenses):		
Interest and other earnings	9,715	52,231
Interest expense	(4,534)	(9,328)
Foreign exchange	119,163	(289,198)
Loss on disposal and impairment of assets	-	(73,116)
	124,344	(319,411)
Loss and comprehensive loss for the year	(1,123,404)	(2,410,949)
Deficit, beginning of year	(27,472,870)	(25,061,921)
Deficit, end of year	$ (28,596,274)	$ (27,472,870)
Basic and diluted loss per share (note 6(f))	$ (0.01)	$ (0.03)
Weighted average common shares, used in computing loss per share basic and diluted	101,352,018	92,218,319

See accompanying notes to financial statements

PHOTON CONTROL INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2008 and 2007

		2008		2007
Cash provided by (used in):				
Operations:				
Loss for the year	$	(1,123,404)	$	(2,410,949)
Non-cash items:				
Amortization of property, equipment and intangibles		252,094		258,945
Amortization of stock-based compensation		147,110		220,914
Loss on disposal and impairment of assets		-		75,734
Amortization of deferred development costs		28,166		-
Deferred rent and sublease deposits		(5,794)		125,508
Changes in non-cash operating working capital:				
Trade accounts receivable and other		(205,941)		188,596
Inventory		(53,312)		41,163
Prepaid expenses and deposits		35,933		36,442
Accounts payable and accrued liabilities		293,912		(643,718)
Net due from related party		(101,678)		-
Deferred revenue		21,340		-
		(711,574)		(2,107,365)
Investments:				
Restricted cash		(50,000)		(51,750)
Purchase of equipment		(168,911)		(297,465)
Proceeds from disposal of equipment		-		2,418
Purchase of intangible assets		(32,934)		(77,937)
Deferred development costs		(219,071)		-
		(470,916)		(424,734)
Financing:				
Advances under credit facility		287,539		-
Proceeds from issue of common shares		-		1,186,305
Share issue costs		(914)		(84,765)
		286,625		1,101,540
Decrease in cash and cash equivalents		(895,865)		(1,430,559)
Cash and cash equivalents, beginning of year		1,004,447		2,435,006
Cash and cash equivalents, end of year	$	108,582	$	1,004,447
Supplementary information:				
Cash received for interest	$	9,715	$	52,231
Cash paid for interest		(4,534)	$	(9,328)
Income taxes paid		-		-
Non-cash financing and investing activities:				
Fair value of agent's warrants granted on share issuance (note 6 (b))		-		20,942

See accompanying notes to financial statements

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.

During the years ended December 31, 2008 and 2007, the Company incurred losses of $1,123,404 and $2,410,949 respectively. As at December 31, 2008, the Company had an accumulated deficit of $28,596,274 (2007 - $27,472,870).

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. Certain factors discussed below raise substantial doubt about the ability of the Company to continue as a going concern.

The Company's ability to continue as a going concern is dependant upon the market's acceptance of its products, its ability to fund working capital and its ability to generate positive cash flows from operations. There can be no assurance that the Company's new products will be able to secure market acceptance.

The Company undertook restructuring activities beginning in the third quarter of 2007 and ending in the third quarter of 2008. Subsequently, customers in the Company's semi-conductor market have postponed orders as a consequence of a reduction of demand in their markets. It is unforeseeable to what extent this postponement of sales orders will translate into a longer term reduction of revenue from this segment. 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:

These financial statements consolidate the accounts of the Company and its subsidiary companies. These subsidiary companies are inactive and all material intercompany balances and transactions have been eliminated.

2. Significant accounting policies (continued):

(b) 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 three months or less from the date of purchase, or they are redeemable prior to maturity.

(c) Use of estimates:

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported revenue and expenses during the years. Significant items subject to such estimates and assumptions include the recoverable amount of equipment, deferred development costs and intangible assets, and valuation allowances for receivables and inventory and assumptions used in determining the fair value of options and warrants.

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

(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 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. Comparative inventory values for the Company are outlined in the table below.

	2008	2007
Raw materials	$ 450,137	$ 383,224
Finished goods	238,257	251,858
	$ 688,394	$ 635,082

2. Significant accounting policies (continued):

(e) Property and equipment:

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

Asset	Rate 2008	Rate 2007
Lab equipment	20%	20%
Computers, office furniture and equipment	20%	20%
Computer software	100%	100%
Production equipment	30%	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 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 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.

(h) Research and development costs:

Research costs are expensed as incurred. Development costs are expensed as incurred unless they meet the required criteria for deferral and amortization. The Company deferred $219,071 of development costs in 2008, (2007-Nil) relating to development of a portable sulphur analyzer product. The Company amortizes previously deferred development costs, commencing with commercial production, over the expected future benefit period based upon quantities delivered compared to expected levels contracted to be delivered. The amount amortized in fiscal 2008 totalled $28,166, (2007-Nil). The Company has a balance of $190,905, (2007-Nil) of deferred development expenses as at December 31, 2008.

(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

(i) Government assistance (continued):

assistance. The Company received no government assistance during the year ended December 31, 2008, (2007 – $4,500).

(j) Loss per share:

Basic loss per share amounts are calculated by dividing the net loss by the weighted average number of common shares outstanding during the year. Diluted loss 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 is 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.

(k) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases (temporary differences), and losses carried forward. The resulting future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change in tax rate is enacted or substantively enacted. Future income tax assets are evaluated and, if realization is not considered “more likely than not”, a valuation allowance is provided.

(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 balance sheet 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.

2. Significant accounting policies (continued):

(n) Stock-based compensation plans:

The Company has a stock-based compensation plan, which is described in note 6(d). The Company accounts for employee stock options using the fair value based method. Under the fair value based method, 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 based method.

(o) Warranty provision estimate:

The company accrues for the estimated obligation under warranty provisions at the time sales are recognized and any changes in estimates are recognized prospectively.

(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”.
- Trade accounts receivable and other and amounts due from related parties are classified as ”loans and receivables”.
- Accounts payable and accrued liabilities, amounts due to related parties and advances under credit facility 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. 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 Operations. 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 adoption of these standards did not have an impact on the classification and valuation of financial instruments.

(q) Impairment of property, equipment, intangibles and deferred development costs:

The Company determines if any impairment exists when events or changes in circumstances indicate that the carrying amount of an asset may not be recovered. An impairment loss is then required if the carrying amount of a long-lived asset exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. The

(q) Impairment of property, equipment, intangibles and deferred development costs (continued):

amount of loss is measured as the amount by which the long-lived asset's carrying value exceeds its fair value.

(r) 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) Inventory:

Effective January 1, 2008, the Company adopted the new Canadian CICA Handbook Section 3031 "Inventories". This section requires that inventories are measured at the lower of cost and net realizable value and that the write-downs of inventories to its net realizable value should be reversed if such value subsequently recovers. It also provides further guidance on the determination of cost. There were no material effects on the financial statements caused by the adoption of this standard. Disclosure relating to this standard is included in (note 2(d)).

(d) Capital Disclosure:

Effective January 1, 2008, the Company adopted the new CICA Handbook Section 1535 "Capital Disclosures". The objective of this new standard is to disclose information concerning the Company's capital and how it is managed as well as any externally imposed capital requirements. The adoption of this standard had no effect on the Company's financial position, operations or cash flows. Disclosure relating to this standard is included in note 12.

(c) Financial Instruments:

On January 1, 2008 the Company adopted the new CICA Handbook Section 3862 "Financial Instruments - Disclosures" and 3863 "Financial Instruments – Presentation". The objective of these disclosure standards is to provide information about the significance of financial instruments to the Company's financial position and performance, the nature and extent of risks arising from financial instruments to which the Company is exposed and how the Company manages those risks. Disclosures relating to these standards are included in note 11.

(d) Recent accounting pronouncements:

i) CICA Handbook Section 3064, Goodwill and Intangible Assets

In February 2008, the CICA issued 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. This standard is not expected to impact the Company's financial statements.

(d) Recent accounting pronouncements (continued):

ii) Adoption of International Financial Reporting Standards

The CICA's Accounting Standards Board has announced that Canadian publicly accountable enterprises will adopt IFRS as issued by the International Accounting Standards Board effective January 1, 2011. The Company is in the process of developing a plan for the implementation of IFRS and will assess the impact of the differences in accounting standards on the Company's consolidated financial statements. The Company expects to make changes to processes and system before the 2011 fiscal year, in time to enable the Company to record transactions under IFRS for comparative purposes in the 2011 financial year reporting.

4. Property and equipment:

	2008			2007		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Lab equipment	$ 317,153	$ 145,095	$ 172,058	$ 315,937	$ 106,981	$ 208,956
Computers, office furniture and equipment	304,655	106,002	198,653	162,696	66,861	95,835
Computer software	90,572	90,572	-	90,572	86,885	3,687
Production equipment	311,105	166,995	144,110	287,637	108,111	179,526
Leasehold improvements	369,030	171,337	197,693	366,762	101,290	265,472
	$ 1,392,515	$ 680,001	$ 712,514	$1,223,604	$ 470,128	$ 753,476

5. Intangible assets:

	2008			2007		
	Cost	Accumulated amortization	Net book Value	Cost	Accumulated amortization	Net book Value
Licenses	$ 373,172	$ 373,172	-	$ 373,172	$ 373,172	-
Patents	300,171	119,239	180,932	267,237	79,426	187,811
Trademarks	28,602	18,968	9,634	28,602	16,560	12,042
	$ 701,945	$ 511,379	$ 190,566	$ 669,011	$ 469,158	$ 199,853

6. 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, 2006	88,443,318	27,069,284
Issued for cash pursuant to private placement *(i)*	2,908,700	436,305
Issued for cash pursuant to private placement (ii)	10,000,000	750,000
Share issue costs	-	(105,707)
Issued and outstanding as at December 31, 2007	101,352,018	$ 28,149,882
Share issue costs	-	(914)
Issued and outstanding as at December 31, 2008	101,352,018	$ 28,148,968

Contributed surplus	Amount
Balance, December 31, 2006	1,450,785
Issue of warrants for financing proceeds and services	20,942
Stock-based compensation to employees	204,513
Stock-based compensation to non-employees	16,401
Balance, December 31, 2007	$ 1,692,641
Stock-based compensation to employees	143,187
Stock-based compensation to non-employees	3,923
Balance, December 31, 2008	$ 1,839,751

Private placements:

(i) On February 15, 2007, the Company completed the third tranche of a private placement of 2,908,700 units at a price of $0.15 per unit. Each unit consists of one common share of the Company and one-half of a non-transferable warrant. Each whole warrant is exercisable to purchase one common share of the Company at $0.21 until August 15, 2009. A total of 2,908,700 common shares were issued for gross proceeds of $436,305 and $64,879 was paid in issue costs. In addition 232,695 non-transferable warrants, which entitle the broker to purchase one unit of the Company until February 15, 2009 at a price of $0.15, were issued to the broker as compensation with a fair value of $20,942. The one-half of a non-transferable warrant issued to the broker upon the purchase of a unit entitles the broker to purchase one-half of a common share of the Company until August 15, 2008 at a price of $0.21.

(b) Issued and outstanding (continued):

(ii) On November 19, 2007, the Company completed a non-brokered private placement resulting in 10,000,000 common shares being issued for gross proceeds of $750,000 and $19,886 was paid in issue costs.

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.

(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 December 31, 2008, the Company's board of directors had reserved 10,135,202 (December 31, 2007 - 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 are summarized as follows:

	Number of shares	Weighted average exercise price
Outstanding, December 31, 2006	5,456,250	$ 0.34
Granted	3,090,000	0.10
Cancelled	(693,750)	0.33
Expired	(1,067,500)	0.23
Outstanding, December 31, 2007	6,785,000	$ 0.25
Granted	40,000	0.10
Cancelled	(520,000)	0.25
Expired	(591,250)	0.28
Outstanding, December 31, 2008	5,713,750	$ 0.25

(d) Stock options (continued):

The following table summarizes the stock options outstanding at December 31, 2008:

	Options outstanding			Options exercisable	
Exercise price	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	3,330,000	3.63	$ 0.11	1,822,500	$ 0.11
$0.22 to $0.50	1,478,750	1.37	0.36	1,358,750	0.36
$0.52 to $1.00	905,000	1.76	0.58	785,000	0.59
	5,713,750	2.75	$ 0.25	3,966,250	$ 0.29

The options outstanding at December 31, 2008 expire between January 22, 2009 and November 24, 2013. The per share weighted average fair value of stock options granted during 2008 was $0.10 (2007 - $0.10).

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:

	2008	2007
Expected option lives	5 years	5 years
Risk-free interest rate	2.81%	4.20%
Dividend yield	0%	0%
Volatility	134%	132%

During the year ended December 31, 2008, the Company recorded $147,109 of compensation expense representing the fair value of the options vesting during the year with a corresponding increase to contributed surplus.

(e) Warrants:

Information related to the Company's share purchase warrant activity for the year ended December 31, 2007 and 2008 is as follows:

Expiry dates	Exercise price	Balance, December 31, 2007	Issued	Exercised	Expired	Balance, December 31, 2008
May 17, 2008	$0.21	7,437,099	-	-	7,437,099	-
November 17, 2008	$0.15 (i)	1,123,269	-	-	1,123,269	-
June 13, 2008	$0.21	1,108,549	-	-	1,108,549	-
December 13, 2008	$0.15 (i)	123,800	-	-	123,800	-
August 15, 2009	$0.21	1,454,350	-	-	-	1,454,350
February 15, 2009	$0.15 (i)	232,695	-	-	-	232,695
		11,479,762	-	-	9,792,717	1,687,045

Information related to the Company's share purchase warrant activity for the year ended December 31, 2006 and 2007 is as follows:

Expiry dates	Exercise price	Balance, December 31, 2006	Issued	Exercised	Expired	Balance, December 31, 2007
June 16, 2007	$0.55	5,625,000	-		5,625,000	-
June 16, 2007	$0.40 (i)	900,000	-		900,000	-
July 18, 2007	$0.55	625,000	-		625,000	-
May 17, 2008	$0.21	7,437,099	-		-	7,437,099
November 17, 2008	$0.15 (i)	1,123,269	-		-	1,123,269
June 13, 2008	$0.21	1,108,549	-		-	1,108,549
December 13, 2008	$0.15 (i)	123,800	-		-	123,800
August 15, 2009	$0.21	-	1,454,350		-	1,454,350
February 15, 2009	$0.15 (i)	-	232,695		-	232,695
		16,942,717	1,687,045		7,150,000	11,479,762

(i) These are agents' options to purchase units, which are issued as commissions with respect to private placements. Each unit consists of one common share and one half of one common share purchase warrant.

(f) Loss per share:

The weighted average number of shares outstanding during the year ended December 31, 2008 of 101,352,018 (year ended December 31, 2007 - 92,218,319) was used in the calculation of basic loss per share. Exercise of all of the stock options and share purchase warrants referred to in note 6(d) and 6(e) are anti-dilutive for all years presented.

7. Income taxes:

(a) Effective tax rate:

The effective income tax rates differ from the Canadian statutory rates for the following reasons:

	2008	2007
Combined federal and provincial taxes at the expected rate of 31% (2007 - 34.12%)	$ (348,255)	$ (822,615)
Non-capital losses expiring	486,087	198,774
Future income tax expense resulting from reduction in statutory tax rate	271,150	1,627,663
Change in valuation allowance	(532,317)	(1,064,450)
Permanent differences	42,768	77,774
Other	80,567	(17,146)
Provision for recovery of income taxes	$ -	$ -

(b) Future tax assets:

Future tax assets arise from difference between tax and accounting values related to the following:

	2008	2007
Property and equipment	$ 369,665	$ 327,216
Intangible assets	3,650	151,933
Non-capital loss carryforwards	3,133,878	3,996,378
Reserves	77,545	67,769
Scientific research and development expenses	1,791,011	1,293,186
Share issue costs	82,627	154,211
Total gross future tax assets	5,458,376	5,990,693
Valuation allowance	(5,458,376)	(5,990,693)
Net future tax assets	$ -	$ -

7. Income taxes (continued):

(b) Future tax assets (continued):

As at December 31, 2008, the Company has non-capital loss carryforwards for income tax purposes of approximately $12,053,377 available to reduce taxable income of future years. These losses expire as follows:

2009	$ 1,472,372
2010	1,563,365
2014	2,217,479
2015	2,287,702
2026	947,016
2027	2,434,172
2028	1,131,271
	$ 12,053,377

The Company has research and development expenditures of $6,888,504 which are available to reduce taxable income of future years. These amounts can be carried forward indefinitely.

The Company has unamortized share issue costs for tax purposes of $317,796 which are available to reduce taxable income of future years as follows:

2009	$ 211,162
2010	89,315
2011	17,136
2012	183
	$ 317,796

The Company has federal and provincial Scientific Research and Experimental Development (SR&ED) investment tax credits in the amount of $2,466,465 as a result of incurring research and development costs in prior years. The Company can utilize these investment tax credits to offset future corporate income taxes. They expire over ten to twenty years from the year in which the investment tax credits are earned.

8. Related party transactions:

All transactions with related parties have been provided 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 a private company, owned or controlled by officers or directors of the Company. The related entity commenced providing engineering consulting and research and development services to the Company on October 1, 2008 as the Company has substantially reduced its internal research and development operations. The engineering, research and development expenses are provided from shared space provided by the Company. The Company charges the related party premises and related expenses to recover its costs. Amounts outstanding with the private entity are non-interest bearing, unsecured and due on demand.

Years ended December 31,	2008	2007
Balance Sheet :		
Accounts Receivable	$ 468,470	-
Accounts payable	367,792	-
Statement of operations:		
Recovery of premises and related expenses	468,470	-
Engineering, research and development services	367,792	-

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.

No stock options were granted to directors of the Company during the year ended December 31, 2008. In the year ended December 13, 2007 465,000 stock options with a weighted average exercise price of $0.10 per share were granted to directors as consideration for services provided to the Company. Directors and officers participated in private placements acquiring 1,414,366 common shares for proceeds of $141,437 in 2007.

9. Commitments and contingencies:

(a) Leases:

The Company has entered into premises leases requiring the following minimum lease payments as follows:

2009	$ 803,282
2010	844,294
2011	666,714
2012	216,443
	$ 2,530,733

The above lease commitment amounts are prior to rental expense recoveries of $208,637 per annum for 2009 and 2010 plus $17,386 in 2011 in relation to sub-lease agreements executed in 2006 and 2007.

The Company entered into a lease agreement in June 2006 and in 2008 has recorded $194,910 (2007 – 200,704) in deferred rent to account for reduced rent benefits received.

(b) Litigation:

In October 2001, a former member of management and director of the Company (the Claimant) initiated arbitration asserting that certain amounts were owing to him by the Company. The Company denies that it owes these amounts.

In addition, the Claimant has filed a claim against the Company seeking unquantified damages for wrongful dismissal. The Company considers the allegations in the lawsuit to be without merit and intends to defend the action. The Company has also filed a counterclaim.

It is not possible to determine the likely outcome of these litigation matters, nor is it possible to determine the nature and amount of consideration, if any, which the Company may have to pay or which it may collect as a result of these proceedings. Provision has been made in the accounts of the Company for these actions.

10. Supplementary statement of operations information:

	2008	2007
General and administrative:		
Salaries and fees	$ 619,199	$ 522,826
Office premises expenses	201,675	298,606
Legal and accounting	142,885	177,985
Insurance	92,996	138,053
Investor relations	15,193	22,541
Directors fees	13,730	58,684
Other	20,765	61,096
	$ 1,106,443	$ 1,279,791
Research and development:		
Salaries and fees	$ 976,710	$ 1,629,957
Materials	255,775	333,024
Certification and testing	30,564	43,444
Consulting fees	365,270	328,384
Government grants received	-	(4,500)
Amortization of deferred development costs	28,166	-
Other	45,173	259,432
	$ 1,701,658	$ 2,589,741
Business development and marketing:		
Salaries and fees	$ 76,839	$ 244,146
Travel expenses	27,646	60,070
Consulting fees	40,887	27,073
Promotion	44,516	102,142
Other	1,325	2,220
	$ 191,213	$ 435,651

11. 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 $ 1,069,926 as at Dec 31, 2008.

The following table provides information regarding the aging of trade receivables as at December 31, 2008:

Current	31-60 days	61-90 days	91 days +
50%	35%	14%	1%

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 December 31, 2008, 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 December 31, 2008, the Company did not utilize any forward exchange contracts to mitigate any of the risks as mentioned above. The following table lists the Canadian dollar balances of monetary items denominated in US dollars as at December 31, 2008:

Amounts denominated in: US Dollars		2008
Cash	$	108,582
Trade Accounts Receivable	$	896,726
Trade Accounts Payable	$	234,423

11. Financial instruments – risk management objectives and policies (continued):

The Company has completed a sensitivity analysis to estimate the impact on net loss for the period with a +/- 10% change in foreign exchange rates.

Estimated impact (net gain/loss)	
Change of +/- 10 % in US $ foreign exchange rate	+/- $ 77,089

The above table 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 December 31, 2008, the Company's accounts payable and accrued liabilities were $1,056,414 of which fall due for payment within twelve months of the balance sheet date. As at December 31, 2008, the Company was utilizing $287,539 of its $500,000 credit facility as outlined in note 13.

12. 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.

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 December 31, 2008 the Company's capital is as follows:

	2008	2007
Credit facility	$ 287,539	$ -
Cash	(108,582)	(1,004,447)
Net debt (cash)	178,957	(1,004,447)
Shareholders' equity	1,392,445	2,369,653
	$ 1,571,402	$ 1,365,206

12. Capital Disclosure (continued):

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 December 31, 2008, and for the year then ended.

13. 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.

14. Segmented information:

The Company is developing and commercializing optical switching and sensing technologies and primarily operates in one industry segment: however, the Company's recent and future commercialization of new products involves potential future diversification into two or three additional industry segments.

a) Geographic information:

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

	2008	2007
Revenue:		
Canada	$ 195,144	$ 58,311
United States	4,008,933	4,279,349
Europe	155,897	88,238
Taiwan	15,164	430,004
China	782,979	1,170,498
Other	192,261	39,451
	$ 5,350,378	$ 6,065,851

All of the Company's equipment and intangible assets are located in Canada.

(b) Major customers:

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

	2008	2007
Entity A	12%	28%
Entity B	11%	19%
Entity C	8%	15%
Entity D	4%	15%
	35%	77%