



Consolidated Financial Statements of

**PHOTON CONTROL INC.**

For the years ended December 31, 2015 and 2014

## **Management's Responsibility**

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To the Shareholders of Photon Control Inc.:

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of consolidated financial statements.

The Board of Directors and Audit Committee are composed primarily of Directors who are neither management nor employees of the Company. The Board is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Board fulfils these responsibilities by reviewing the financial information prepared by management and discussing relevant matters with management and external auditors. The Audit Committee has the responsibility of meeting with management and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Board is also responsible for recommending the appointment of the Company's external auditors.

MNP LLP, an independent firm of Chartered Professional Accountants, is appointed by the shareholders to audit the consolidated financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, the Board of Directors, Audit Committee and management to discuss their audit findings.

March 29, 2016

"Christopher Weston"  
CEO

"Gerald Adams"  
CFO

## Independent Auditors' Report

To the Shareholders of Photon Control Inc.:

We have audited the accompanying consolidated financial statements of Photon Control Inc., which comprise the consolidated statements of financial position as at December 31, 2015 and 2014, and the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Photon Control Inc. as at December 31, 2015 and 2014, and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

Vancouver, BC  
March 29, 2016



MNP LLP

Chartered Professional Accountants

# PHOTON CONTROL INC.

## Consolidated Statements of Financial Position

(Expressed in Canadian dollars)

As at December 31, 2015 and December 31, 2014

	December 31, 2015	December 31, 2014
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 26,227,017	\$ 14,061,381
Trade accounts receivable and other	3,566,245	4,011,075
Note receivable - related (note 8(a))	18,566	20,422
Due from related party (note 8(a))	178,336	415,083
Inventory (note 4)	2,634,010	1,791,334
Prepaid expenses and deposits	36,832	198,259
	<b>32,661,006</b>	20,497,554
Property and equipment (note 5)	479,491	266,530
Intangible assets (note 6)	122,556	143,924
Long term rental deposits	34,695	34,695
Note receivable - related (note 8(a))	74,985	93,975
Restricted cash (note 13)	53,743	53,743
Deferred taxes	318,350	2,138,211
<b>Total Assets</b>	<b>\$ 33,744,826</b>	<b>\$ 23,228,632</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Deferred revenue	\$ 68,325	\$ 94,014
Accounts payable and accrued liabilities (note 15)	1,216,086	1,234,107
Corporate tax payable (Note 16)	610,462	-
Due to related party (note 8(a))	184,858	223,519
Provisions (note 9(b))	28,037	28,037
	<b>2,107,768</b>	1,579,677
Shareholders' equity (note 7):		
Share capital	28,217,623	27,911,549
Contributed surplus	3,694,121	3,216,511
Deficit	(274,686)	(9,479,105)
	<b>31,637,058</b>	21,648,955
Subsequent events (note 17)		
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 33,744,826</b>	<b>\$ 23,228,632</b>

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board

"Christopher Weston", Director

"David C. Dueck", Director

# PHOTON CONTROL INC.

## Consolidated Statements of Comprehensive Income (Expressed in Canadian dollars)

For the years ended December 31, 2015 and 2014

	Year Ended December 31 2015	Year Ended December 31 2014
Revenue	\$ 27,574,653	\$ 21,035,160
Cost of sales	12,994,182	10,892,544
Gross Margin	14,580,471	10,142,616
Operating expenses (notes 8 and 10):		
General and administrative	2,748,780	2,792,790
Engineering	835,485	987,693
Business development	564,373	434,695
Operating expenses	4,148,638	4,215,178
Net earnings before other earnings and tax	10,431,833	5,927,438
Other earnings (expenses):		
Interest and other earnings	90,426	34,168
Interest expense	(1,960)	(39)
Foreign exchange	1,694,804	1,141,125
	1,783,270	1,175,254
Net earnings before income tax	12,215,103	7,102,692
Income tax expense	(1,190,823)	-
Deferred income tax expense	(1,819,861)	(2,063,675)
Net earnings and total comprehensive income	\$ 9,204,419	5,039,017
Basic and diluted earnings (loss) per share		
Weighted average common shares used in computing		
	103,172,777	101,860,823
Diluted average common shares used in computing		
	112,342,419	110,272,936
Basic earnings per share	\$0.09	\$0.05
Diluted earnings per share	\$0.08	\$0.05

See accompanying notes to consolidated financial statements.

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

	Share Capital		Contributed Surplus and Deficit		
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
<b>Balance at December 31, 2013</b>	101,819,518	\$ 27,944,283	\$ 2,480,492	\$ (14,518,122)	\$ 15,906,653
Stock based compensation to employees	-	-	842,872	-	842,872
Share issues	1,216,000	204,052	(82,452)	-	121,600
NCIB share buy backs	(850,000)	(236,786)	(24,401)	-	(261,187)
Total comprehensive income (loss)	-	-	-	5,039,017	5,039,017
<b>Balance at December 31, 2014</b>	<b>102,185,518</b>	<b>\$ 27,911,549</b>	<b>\$ 3,216,511</b>	<b>\$ (9,479,105)</b>	<b>\$ 21,648,955</b>

**For the year ending December 31, 2015**

	Share Capital		Contributed Surplus and Deficit		
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
<b>Balance at December 31, 2014</b>	<b>102,185,518</b>	<b>\$ 27,911,549</b>	<b>\$ 3,216,511</b>	<b>\$ (9,479,105)</b>	<b>\$ 21,648,955</b>
Stock based compensation to employees	-	-	604,833	-	604,833
Share issues	1,786,000	306,074	(127,223)	-	178,851
Total comprehensive income (loss)	-	-	-	9,204,419	9,204,419
<b>Balance at December 31, 2015</b>	<b>103,971,518</b>	<b>\$ 28,217,623</b>	<b>\$ 3,694,121</b>	<b>\$ (274,686)</b>	<b>\$ 31,637,058</b>

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

# PHOTON CONTROL INC.

## Consolidated Statement of Cash Flows

(Expressed in Canadian dollars)

For the year ended December 31, 2015 and 2014

As at December 31	2015	2014
Cash provided by (used in):		
Operations:		
Net earnings	\$ 9,204,419	\$ 5,039,017
Non-cash items:		
Depreciation of property, plant and equipment	82,141	56,102
Amortization expenses of intangibles	47,451	41,326
Stock-based compensation	604,833	842,872
Amortization of deferred development costs	-	142,500
Accretion income	(10,755)	(2,687)
Amortization on gain on sale to R&D	20,422	(22,484)
Inventory reserve provision	99,000	76,000
Allowance for doubtful accounts	98,937	-
Deferred tax	1,819,861	2,063,675
Changes in non-cash operating working capital:		
Trade accounts receivable and other	345,893	64,011
Inventory	(941,676)	(774,921)
Prepaid expenses and deposits	161,427	52,338
Accounts payable and accrued liabilities	(18,021)	249,702
Corporate tax payable	610,462	-
Due to/from related party	198,086	423,089
Deferred revenue	(46,111)	(12,813)
	<b>12,276,369</b>	8,237,727
Financing:		
Shares buy-back (Normal Course Issuer Bid)	-	(257,553)
Shares issue expenses (Normal Course Issue Bid)	-	(3,634)
Shares issue proceeds (exercise of options)	178,851	121,600
Proceeds from note receivable	31,601	30,753
	<b>210,452</b>	(108,834)
Investments:		
Purchase of equipment	(295,102)	(89,435)
Purchase of intangible assets	(26,083)	(46,210)
	<b>(321,185)</b>	(135,645)
Increase (decrease) in cash and cash equivalents	<b>12,165,636</b>	7,993,248
Cash and cash equivalents, beginning of year	<b>14,061,381</b>	6,068,133
Cash and cash equivalents, end of year	<b>26,227,017</b>	14,061,381

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

(Expressed in Canadian dollars, unless specifically indicated otherwise)

For the years ended December 31, 2015 and 2014

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## 1. Nature of business and continuing operations:

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

The consolidated financial statements of the Company for the year ended December 31, 2015 comprise the Company and its (inactive) subsidiaries. The consolidated financial statements were authorized for issue by the Board of Directors on March 29, 2016.

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 consolidated financial statements of the Company and its subsidiaries were prepared in compliance with the International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”).

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

### (b) Basis of consolidation:

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



# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 2. Significant accounting policies (continued):

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

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

(c) Cash and cash equivalents:

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

(d) Inventory:

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

(e) Property and equipment:

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

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

(f) Intangible assets:

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

(g) Revenue recognition:

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 2. Significant accounting policies (continued):

### (h) Research and development costs:

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

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

### (i) Government assistance:

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

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

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

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 2. Significant accounting policies (continued):

### (k) Income taxes:

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

#### *Current income tax*

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

#### *Deferred tax*

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

### (l) Share issue costs:

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

### (m) Translation of foreign currencies:

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 2. Significant accounting policies (continued):

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

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

### (o) Warranty provision:

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

### (p) Financial instruments:

The Company has classified its financial instruments as follows:

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

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 2. Significant accounting policies (continued):

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

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

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

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

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

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

### (r) Use of estimates

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 2. Significant accounting policies (continued):

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

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

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

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

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 2. Significant accounting policies (continued):

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

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

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

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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### 3. Recently adopted and future accounting pronouncements:

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

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

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

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

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

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

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



# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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

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

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

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

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

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

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

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

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

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 4. Inventory:

As at December 31	2015	2014
Raw materials	\$ 1,282,005	\$ 603,934
Work in process	272,854	321,857
Finished goods	1,079,151	865,543
	<hr/>	
	\$ 2,634,010	\$ 1,791,334

For the year ended December 31, 2015, inventory recognized as an expense in cost of sales amounted to \$7,780,338 (December 31, 2014 - \$6,691,184). Included in the above amount for the year ending December 31, 2015 were inventory write downs of \$99,000 (year ending December 31, 2014 – \$76,000). There were no reversals of previously recorded inventory write downs for 2015 (December 31, 2014 - Nil).

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
 (Expressed in Canadian dollars, unless specifically indicated otherwise)  
 For the years ended December 31, 2015 and 2014

## 5. Property and equipment:

		Laboratory equipment	Computers, office furniture and equipment	Production equipment	Leasehold improvements	Total
<b>Asset Cost</b>						
Balance January 1, 2014	\$	346,446	313,584	378,054	387,495	<b>1,425,579</b>
Additions		-	9,466	76,588	3,380	<b>89,434</b>
<b>Balance December 31, 2014</b>		<b>346,446</b>	<b>323,050</b>	<b>454,642</b>	<b>390,875</b>	<b>1,515,013</b>
Additions		-	45,447	242,908	6,747	<b>295,102</b>
Disposals		-	-	-	-	-
<b>Balance December 31, 2015</b>	<b>\$</b>	<b>346,446</b>	<b>368,497</b>	<b>697,550</b>	<b>397,622</b>	<b>1,810,115</b>

<b>Accumulated Depreciation</b>						
Balance January 1, 2014	\$	264,791	243,316	307,787	376,488	<b>1,192,382</b>
Depreciation for year		14,856	14,439	24,108	2,698	<b>56,101</b>
<b>Balance December 31, 2014</b>		<b>279,647</b>	<b>257,755</b>	<b>331,895</b>	<b>379,186</b>	<b>1,248,483</b>
Depreciation for year		14,856	16,724	47,553	3,008	<b>82,141</b>
Disposals		-	-	-	-	-
<b>Balance December 31, 2015</b>	<b>\$</b>	<b>294,503</b>	<b>274,479</b>	<b>379,448</b>	<b>382,194</b>	<b>1,330,624</b>

<b>Carrying Amounts</b>						
At December 31, 2014	\$	66,799	65,295	122,747	11,689	<b>266,530</b>
At December 31, 2015	\$	51,943	94,018	318,102	15,428	<b>479,491</b>

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
 (Expressed in Canadian dollars, unless specifically indicated otherwise)  
 For the years ended December 31, 2015 and 2014

## 6. Intangible assets:

	Patents	Trademarks	Computer software	Computer system (SW)	Total
<b>Asset Cost</b>					
<b>Balance January 1, 2014</b>	\$ 378,053	28,602	94,683	145,152	<b>646,490</b>
Additions	-	-	-	46,210	<b>46,210</b>
<b>Balance December 31, 2014</b>	<b>378,053</b>	<b>28,602</b>	<b>94,683</b>	<b>191,362</b>	<b>692,700</b>
Additions	-	-	26,083	-	<b>26,083</b>
<b>Balance December 31, 2015</b>	<b>\$ 378,053</b>	<b>28,602</b>	<b>120,766</b>	<b>191,362</b>	<b>718,783</b>
<b>Accumulated Amortization</b>					
<b>Balance January 1, 2014</b>	297,681	26,377	92,283	91,109	<b>507,450</b>
Amortization for year	19,452	1,200	2,400	18,274	<b>41,326</b>
<b>Balance December 31, 2014</b>	<b>\$ 317,133</b>	<b>27,577</b>	<b>94,683</b>	<b>109,383</b>	<b>548,776</b>
Amortization for year	19,627	1,025	3,650	23,149	<b>47,451</b>
<b>Balance December 31, 2015</b>	<b>\$ 336,760</b>	<b>28,602</b>	<b>98,333</b>	<b>132,532</b>	<b>596,227</b>
<b>Carrying Amounts</b>					
At December 31, 2014	\$ 60,920	1,025	-	81,979	<b>143,924</b>
At December 31, 2015	\$ 41,293	-	22,433	58,830	<b>122,556</b>

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 7. Share capital:

### (a) Authorized:

Unlimited number of common shares without par value

### (b) Issued and outstanding:

#### Common shares:

	Number of shares	Stated values
Issued and outstanding as at December 31, 2013	101,819,518	\$ 27,944,283
Shares issued in 2014	1,216,000	204,052
Share buy-back (Normal Course Issuer Bid)	(850,000)	(236,786)
Issued and outstanding as at December 31, 2014	102,185,518	\$ 27,911,549
Shares issued in 2015 (exercise of options)	1,786,000	306,074
Issued and outstanding as at December 31, 2015	103,971,518	\$ 28,217,623

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

#### Contributed Surplus:

	Amount
Balance, December 31, 2013	\$ 2,480,492
Stock-based compensation to employees in 2014	842,872
Shares issued in 2014 (exercise of options)	(82,452)
NCIB share buy back in 2014	(24,401)
Balance, December 31, 2014	\$ 3,216,511
Stock-based compensation to employees in 2015	477,610
Shares issued in 2015 (exercise of options)	Nil
Balance, December 31, 2015	\$ 3,694,121

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
 (Expressed in Canadian dollars, unless specifically indicated otherwise)  
 For the years ended December 31, 2015 and 2014

## 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, 2014, the Company had reserved 10,218,552 options for issuance under the Company's stock option plan. As at December 31, 2015, there was a change in the number of outstanding shares and consequently a change in the reserved options to 10,397,152 options. The stock option plan provides that options may be granted with an exercise price of not less than the market price of the Company's shares on the grant date less applicable discounts permitted by the TSX-V. The stock option plan also provides that the term of the options shall not exceed five years.

Stock option transactions are summarized as follows:

	Number of Share Options	Weighted average exercise price
Outstanding, December 31, 2013	8,240,000	\$ 0.120
Granted	10,000	\$ 0.290
Granted	30,000	\$ 0.300
Granted	10,000	\$ 0.310
Granted	10,000	\$ 0.320
Granted	30,000	\$ 0.430
Granted	3,110,000	\$ 0.500
Forfeited	(30,000)	\$ 0.100
Forfeited	(10,000)	\$ 0.150
Expired	-	\$ -
Exercised	(1,216,000)	\$ 0.100
Outstanding, December 31, 2014	10,184,000	\$ 0.240
Granted	30,000	\$ 0.490
Granted	20,000	\$ 0.620
Granted	140,000	\$ 0.690
Granted	10,000	\$ 0.660
Granted	30,000	\$ 0.700
Forfeited	(25,000)	\$ 0.100
Expired	(125,000)	\$ 0.100
Exercised	(1,756,000)	\$ 0.100
Exercised	(10,000)	\$ 0.105
Exercised	(10,000)	\$ 0.110
Exercised	(10,000)	\$ 0.115
Outstanding, December 31 2015	8,478,000	\$ 0.284

230,000 stock options were granted during the year ended December 31, 2015 (3,200,000 options granted for the year ended December 31, 2014).

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 7. Share capital (continued):

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

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

Exercise price	Options outstanding			Options exercisable	
	Number of options	Weighted average contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
\$0.100	2,298,000	1.72	\$ 0.100	2,292,375	\$ 0.100
\$0.110	10,000	0.50	\$ 0.110	10,000	\$ 0.110
\$0.150	2,750,000	2.75	\$ 0.150	2,750,000	\$ 0.150
\$0.165	10,000	2.77	\$ 0.165	5,000	\$ 0.165
\$0.200	10,000	2.87	\$ 0.200	5,000	\$ 0.200
\$0.285	10,000	3.15	\$ 0.285	2,500	\$ 0.285
\$0.295	10,000	3.02	\$ 0.295	2,500	\$ 0.295
\$0.300	20,000	3.13	\$ 0.300	5,000	\$ 0.300
\$0.310	10,000	3.07	\$ 0.310	2,500	\$ 0.310
\$0.320	10,000	3.25	\$ 0.320	5,000	\$ 0.320
\$0.425	20,000	3.69	\$ 0.425	-	\$ 0.425
\$0.490	20,000	4.12	\$ 0.490	-	\$ 0.490
\$0.500	3,110,000	3.73	\$ 0.500	2,332,500	\$ 0.500
\$0.620	10,000	4.38	\$ 0.620	-	\$ 0.620
\$0.660	10,000	4.90	\$ 0.660	-	\$ 0.660
\$0.690	140,000	4.64	\$ 0.690	-	\$ 0.690
\$0.700	30,000	4.92	\$ 0.700	-	\$ 0.700
	8,478,000	2.88	\$ 0.279	7,412,375	\$ 0.245

The options outstanding as at December 31, 2015 expire between July 4, 2016 and November 30, 2020.

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

	2015	2014
Expected option lives	5 years	5 years
Risk-free interest rate	0.69% to 2.71%	1.10% to 3.09%
Dividend yield	0%	0%
Volatility	96% to 309%	116% to 309%

During the year ended December 31, 2015, the Company recorded \$604,833 (2014 - \$842,872) 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 December 31, 2015 of 103,172,777 (December 31, 2014 - 101,860,823) were used in the calculation of basic earnings per share for the year ended December 31, 2015. 112,342,419 shares were used in the calculation of diluted earnings per share as at December 31, 2015 (December 31, 2014 - 110,272,936).

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 8. Related party balances and transactions:

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

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

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

As at December 31	2015	2014
<b>Statement of Financial Position</b>		
Accounts receivable	\$ 178,336	\$ 415,083
Note receivable	93,551	114,397
Accounts payable and accrued liabilities	184,858	223,519
<b>Statement of Comprehensive Income</b>		
<b>Charges to:</b>		
Revenue from sales of products and services to Photon R&D	\$ 164,518	\$ 125,929
Payroll reimbursement re: Photon Control R&D Ltd.	1,424,389	1,330,306
Recovery of premises and other related expenses (Re: DCD Management Ltd. and Photon Control R&D Ltd.)	326,239	398,500
Intercompany interest	2,058	17,646
<b>Charges from:</b>		
Products & services charged by Photon Control R&D Ltd.	\$ 304,795	\$ 212,497
Engineering & R&D services charged by Photon Control R&D	751,646	916,550
Royalty expenses charged by Photon Control R&D Ltd.	1,779,059	1,262,509
Intercompany interest	1,078	-
Management services expenses charged by DCD Mgmt. Ltd.	\$ 225,993	\$ 203,164



# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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

During 2009, the Company finalized and amended the terms of its agreement to transfer its R&D workforce to Photon Control R&D Ltd. Under the finalized terms, Photon Control R&D Ltd. issued a \$315,000 promissory note to the Company as consideration for the transfer. The promissory note bears a coupon rate of 3% per annum, is repayable in equal monthly instalments of \$3,089 beginning April 1, 2010 and matures March 1, 2020.

The promissory note receivable is being accreted up to its face value of \$315,000 by the effective interest method and as at December 31, 2015, \$42,191 (2014 - \$31,436) to date in accretion was recognized in interest income.

As at December 31	2015	2014
Promissory note receivable – face value	\$ 315,000	\$315,000
Less: discount	(97,513)	(97,513)
	217,487	217,487
Accretion	42,191	31,436
Principal repayment	(166,127)	(134,526)
Carrying amount	93,551	114,397
Current portion	(18,566)	(20,422)
Long-term portion	\$ 74,985	\$ 93,975

### (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 President and CEO, and the Chairman.

Total compensation expense for key management personnel and the composition thereof, for the year ended December 31 is:

	2015	2014
Short term benefits	\$ 684,472	\$ 648,748
Share-based compensation	224,576	330,304
Carrying Amount	\$ 909,048	\$ 979,052

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 9. Commitments and contingencies:

### (a) Leases:

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

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2016	\$ 830,452
	<hr/> \$ 830,452 <hr/>

For the year ended December 31, 2015, lease payments and related costs recognized as an expense amounted to \$589,031 (2014 - \$740,422).

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

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2016	\$ 248,028
	<hr/> \$ 248,028 <hr/>

### (b) Litigation:

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 10. Supplementary information:

As at December 31	2015	2014
General and administrative:		
Salaries and fees	\$ 1,197,491	\$ 1,113,488
Stock option compensation expense	585,382	842,873
Professional fees	369,884	366,016
Depreciation and amortization	46,530	37,811
Other expenses	549,493	432,602
	<u>\$ 2,748,780</u>	<u>\$ 2,792,790</u>
Engineering expenses:		
Engineering support and consulting fees	\$ 751,646	\$ 916,550
Depreciation and amortization	19,627	19,452
Other expenses	64,212	51,691
	<u>\$ 835,485</u>	<u>\$ 987,693</u>
Business development and marketing:		
Salaries and consulting fees	\$ 287,093	\$ 225,995
Depreciation and amortization	1,025	1,200
Other expenses	276,255	207,500
	<u>\$ 564,373</u>	<u>\$ 434,695</u>

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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

	Category	At December 31, 2015	At December 31, 2014
Cash and cash equivalents	Level 1	\$26,227,017	\$ 14,061,381
Total		\$26,227,017	\$ 14,061,381

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.

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 December 31, 2015, nor as at December 31, 2014.

Periodically, derivative financial instruments are 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. Forward foreign exchange contracts were not utilized during 2015.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 11. 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 December 31, 2015 is estimated to approximate its carrying value.

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

Risk Management:

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

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

The Company is exposed to credit risk associated with its trade accounts receivable and related party receivables. Credit risk is minimized substantially by ensuring the credit worthiness of the entities with which it carries on business. In November 2009, the Company entered into an agreement with Export Development Canada to insure its non-Canadian accounts receivable up to a maximum of USD \$1,500,000. As at December 31, 2015 the maximum credit risk, which is the total of its uninsured trade receivables (primarily Canadian based customers and intercompany), was \$331,190 or 9% (December 31, 2014 - \$635,867 or 15%) of the total outstanding accounts receivable balances.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 11. Financial instruments (continued):

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

Current	31-60 days	61-90 days	91 days +
57%	37%	2%	4%

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

Current	31-60 days	61-90 days	91 days +
62%	35%	1%	2%

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

### Allowance for Doubtful Accounts

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

Reconciliation of the allowance for doubtful accounts as of December 31	2015	2014
Balance, beginning of the year	\$ 51,774	\$ 50,281
Write-offs of specific accounts	4,538	(6,507)
Change in provision	98,688	8,000
Balance as at December 31	\$ 155,000	\$ 51,774

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 11. 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:

December 31	2015	2014
Customer A	40%	53%
Customer B	18%	7%
Customer C	10%	17%

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

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

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

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

Amounts denominated in U.S. dollars as at December 31	2015	2014
Cash	\$ 2,425,187	\$10,980,862
Trade accounts receivable	3,473,617	3,181,599
Trade accounts payable	74,749	81,438

The estimated impact on net earnings at December 31, 2015 with a +/- 10% change in foreign exchange rates is CAD \$597,365 (December 31, 2014 – CAD \$1,633,539).

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 11. 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 December 31, 2015, the Company's accounts trade payable and accrued liabilities were \$1,216,086 (December 31, 2014 - \$1,234,107) which fall due for payment within twelve months of the balance sheet date. As at December 31, 2015, the Company had access to a credit facility of \$1,000,000. This credit facility currently remains unutilized (also unutilized as at December 31, 2014). The Company has recorded a provision for the remainder of a lawsuit of \$28,037 (December 31, 2014 - \$28,037) which is classified as due in 2016.

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

	1 year	2 year	3 year	4 year	5 year	Total
Accounts trade payable and accrued liabilities	\$ 1,216,086	-	-	-	-	\$ 1,216,086
Corporate tax payable	601,462	-	-	-	-	601,462
Due to related company	184,858	-	-	-	-	184,858
Provision (unguaranteed)	28,037	-	-	-	-	28,037
Standby engineering	540,000	-	-	-	-	540,000
Lease obligation	830,452	-	-	-	-	830,452

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 \$1,779,059 for the year ended December 31, 2015 (2014 - \$1,262,509).

## 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.



# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 12. 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 December 31, 2015 the Company's capital is as follows:

As at December 31	2015	2014
Cash and cash equivalents	\$ 26,227,017	\$ 14,061,381
Shareholders' equity	31,728,170	22,004,630
	<u>\$ 57,955,187</u>	<u>\$ 35,710,336</u>

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

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

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

## 13. 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 December 31, 2015 and 2014.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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

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

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

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

## 14. 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.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 14. 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 year ended:	
	December 31, 2015	December 31, 2014
Revenue		
Canada	\$ 429,864	608,005
United States	21,454,126	16,410,964
China	3,464,372	2,876,889
Singapore	767,190	50,157
Malaysia	261,239	222,237
Europe	116,513	87,321
Other Asia	1,081,349	779,587
Total	\$ 27,574,653	\$ 21,035,160

### (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 December 31	2015	2014
Entity A	47%	41%
Entity B	19%	24%
Entity C	13%	14%
	79%	79%

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 15. Trade payables and accrued liabilities

As at December 31	2015	2014
Trade payables	\$ 352,067	\$ 267,242
Accrued liabilities	549,915	748,985
Warranty provision	259,292	217,880
Balance as at December 31	\$ 1,161,274	\$ 1,234,107

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

Reconciliation of warranty provision as at December 31	2015	2014
Balance, beginning of the year	\$ 217,880	\$ 195,000
Warranty costs incurred	(192,616)	(148,120)
Warranty provision - additions or changes	234,028	171,000
Balance as at end of year	\$ 259,292	\$ 217,880

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

## 16. Income Tax:

We confirm that we believe our deferred tax assets to be realized and, as such, have given full recognition to these assets. Furthermore, the Company's net income taxes are fairly summarized as follows:

The following table reconciles the expected income tax expense (recovery) at the Canadian statutory income tax rates to the amounts recognized in the consolidated statements of operations for the years ended December 31, 2015 and 2014:

For the year ended December 31	2015	2014
Income before income tax	\$ 12,215,103	\$ 7,102,692
Canadian statutory tax rate	26.00%	26.00%
Expected income tax	\$ 3,175,927	\$ 1,846,700
Non-deductible items	158,521	220,143
Changes in estimates	(323,764)	(3,168)
Total income tax expense	\$ 3,010,684	\$ 2,063,675
Current tax expense	1,190,823	-
Deferred tax expense	1,819,861	2,063,675
Total income tax expense	\$ 3,010,684	\$ 2,063,675

Deferred taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for the financial reporting purposes and their tax values. Deferred tax assets (liabilities) at December 31, 2015 and 2014 are comprised of the following:

For the year ended December 31	2015	2014
Intangible assets	\$ 3,679	\$ 3,956
Scientific research and development expense	-	1,791,011
Investment tax credit	-	(13,492)
Reserves	127,119	94,828
Property and equipment	173,937	245,411
Notes receivable	13,615	16,498
Deferred tax asset	\$ 318,350	\$ 2,138,212

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements  
(Expressed in Canadian dollars, unless specifically indicated otherwise)  
For the years ended December 31, 2015 and 2014

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## 17. Subsequent Events:

As at December 31, 2015, the Company had 103,971,518 common shares issued and outstanding due to the exercise of 1,786,000 stock options in 2015.

Subsequent to December 31, 2015 year end, as at the day of this report, the Company had 104,400,018 common shares issued and outstanding due to a) subsequent exercise of 558,500 stock options, and b) NCIB 130,000 common shares repurchase and cancellation in Q1 2016.

As at December 31, 2015, the Company had 8,478,000 outstanding stock options to purchase common shares of the Company. 31, 2015 and 7,929,500 outstanding stock options

Subsequent to December 31, 2015 year end, as at the date of this report, the Company had 7,929,500 outstanding stock options due to a) employment option grant, and b) subsequent exercise of stock options in Q1 2016.