Photon Control Inc.

Management's Discussion and Analysis

For the three months ended March 31, 2017

(in Canadian dollars, amounts in thousands except number of shares and per share amounts)

DATED May 30, 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

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MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") of Photon Control Inc. ("Photon Control" or the "Company") is dated May 30, 2017. We have prepared this MD&A with reference to National Instrument 51-102 "Continuous Disclosure Obligations" of the Canadian Securities Administrators, and it should be read in conjunction with the condensed interim consolidated financial statements and accompanying notes for the three months ended March 31, 2017, and the consolidated financial statements and accompanying notes for the year ended December 31, 2016. The financial data contained in this report and in the condensed interim consolidated financial statements for the three months ended March 31, 2017 have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are stated in Canadian dollars, unless otherwise noted.

In addition to the results reported in accordance with IFRS, the Company uses various non-GAAP financial measures, which are not recognized under IFRS, as supplemental indicators of the Company's operating performance and financial position. These non-GAAP financial measures are provided to enhance the user's understanding of the Company's historical and current financial performance and its prospects for the future. Management believes that these measures provide useful information in that they exclude amounts that are not indicative of the Company's core operating results and ongoing operations and provide a more consistent basis for comparison between quarters and years. Details of such non-GAAP financial measures and how they are derived are provided in conjunction with the discussion of the financial information reported.

The Company has reclassified certain balances to conform to the presentation adopted in the current year. In addition, there may be minor differences due to rounding of numbers.

Certain statements in this MD&A constitute forward-looking statements or forward-looking information within the meaning of applicable securities laws. You should carefully read "Cautionary Note Regarding Forward-looking Statements" in this MD&A and should not place undue reliance on any such forward-looking statements.

In this MD&A, unless the context otherwise requires, references to "the Company", "Photon Control", "we", "us" and "our" refer to Photon Control Inc. and its subsidiaries.

Additional information about the Company, including our most recent consolidated financial statements is available on SEDAR *at www.sedar.com.*

BUSINESS OVERVIEW

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 ("OEMs") as well as end users in the semiconductor, energy, and manufacturing industries. Photon Control's products provide high levels of accuracy and reliability in extreme conditions and are supported by a team of experts that offers on-site installation, training, and support. Photon Control also provides engineering services for customized optical measurement systems. Headquartered in an ISO 9001:2008 manufacturing facility in Richmond, British Columbia, Canada, Photon Control is listed on the TSX Venture Exchange (the "TSX-V"), trading under the symbol "PHO".

Company highlights for the first quarter ended March 31, 2017

- reported revenues for the three months ended March 31, 2017 of $11.9 million, showing growth of approximately 65% over the 2016 comparable period;
- added Scott Edmonds and Chuck Cargile to the Company's Board of Directors (the "Board"), and Scott Edmonds, Paul Hellebrekers and Yuri Sikorski to the Company's management team;
- reached a tentative agreement to settle our disputes with Photon Control R&D Ltd. ("Photon R&D"), including a draft Settlement Agreement with Photon R&D to confirm our ownership of intellectual property, and to clarify our agreement with respect to royalty rates, and taking over the employment of Photon R&D personnel (concluded April 14, 2017); and,
- leased a new facility to allow increased production capacity. The Company successfully moved into the new facility in May 2017.

PRODUCTS, DISTRIBUTION AND INDUSTRIES

Photon Control is a leader in fiber optic temperature, position and gas flow measurement technology.

Semiconductor Industry: Temperature and Position Sensors

The semiconductor capital equipment industry represents a number of significant and growing applications for our technology and has become the primary source of revenue and growth for our business. The Company designs and produces precision positioning and temperature sensors used by semiconductor capital equipment manufacturers. The manufacturing of silicon wafers for microchips involves a multitude of complex processes in harsh environments; monitoring and maintaining correct position and temperature is critical. Such sensors must be both electromagnetic and radio frequency signal immune to operate in the chip making environment. Photon Control's precision positioning and temperature sensors meet all these customer requirements and are manufactured according to "copy exact" standards.

Our optical sensor technology with its immunity to electromagnetic and radio frequency disturbances is unique when it comes to measuring temperature in semiconductor manufacturing environments such as wafer etching, atomic layer deposition ("ALD"), chemical vapour deposition ("CVD") and physical vapour deposition ("PVD"). Temperature control with increasing geometric granularity drives the number of measurement points and as semiconductor capital equipment has gone from 28nm to 10nm linewidth for leading edge applications over the course of the last 10 years, the number of desirable measurement points has increased more than four-fold. Similarly, 3D chip designs are becoming more and more mainstream taking significant market share in many applications and we see the need for our products increasing. These factors have driven and are expected to continue to drive demand for our products.

Oil and Gas Industry: Flow Rate Sensors

Based on the "laser-two-focus" method, our optical gas flow meter technology is the leading laser technology used in industrial gas flow metering applications. Laser-2-Focus Velocimetry uses laser beams to measure the gas flow by sensing the velocity of microscopic particulates naturally occurring in gas. Being indifferent to gas composition, our solution has less sensitivity than competing alternatives in gas velocity and volumetric flow rate measurements for flare and vent gas applications.

Other Products
We offer a comprehensive range of spectrometer accessories and software to make OEM integrations and complex experiments easier. We also provide stable ultraviolet ("UV") and broadband light sources, reflectance probes, transmission stages, and collimating lenses.

SALES, MARKETING AND DISTRIBUTION

Photon Control sells its products globally with sales to OEMs primarily in the United States who in turn sell their products to end users in the United States, Asia and Europe. We also have a network of distributors in Asia who sell our products to OEMs in their home markets.

MARKET LANDSCAPE

Semiconductor Industry (Optical Sensors)

Semiconductors have revolutionized the way we work, communicate, travel, entertain, and live. As a building block of technology, semiconductor chips will continue to enable innovation and transform industries. With the accelerating pace of new chip capabilities and more applications, chip makers will need to increase production to meet this growing market. Simultaneously, semiconductor companies are transitioning to new design and production technologies, specifically multi-patterning, 3D NAND and FinFET. Many of these technologies increase the number of process steps requiring more overall production capacity. According to Gartner Inc., a leading information technology research company, the wafer-level manufacturing equipment market is expected to grow 15% from $33 billion to $38 billion between 2016 and 2018 (Gartner Inc. May 2016). The combination of overall semiconductor growth and increased demand for equipment will in turn drive growth for the Company. Photon Control's strength in this market is in "etch" one of many manufacturing steps in the process of creating semiconductors. The Company works in and is developing business plans to meet demand in several other process steps including deposition.

Oil and Gas Industry – Emissions Regulations (Optical Flow Meters)

Recent oil and gas regulations require measurement and reporting of gas emissions on flare stacks and we anticipate that the regulation of emissions will continue to become more stringent. In addition to meeting regulatory standards, energy companies will require detailed breakouts of the composition of emissions in order to participate in carbon capture revenue incentive programs. The Company's Focus® 2.0 Optical Gas Flow Meter has applications for flare gas monitoring, natural gas monitoring, biogas and digester gas output.

Other

The Company sells spectrometers and fiber optic temperature sensors to universities, research labs and others. As well, the Company has provided a limited number of fiber optic temperature sensors to be used in medical devices such as magnetic resonance imaging machines and in power industry for hot-spot monitoring in switch gears and dry-transformers.

SELECTED QUARTERLY INFORMATION

The following table highlights key financial information for the quarter ended March 31, 2017 as compared to the prior comparable period.

	For the three months ended March 31, 2017	For the three months ended March 31, 2016	Variance ($)	Variance (%)
Revenue	$ 11,879	$ 7,191	$ 4,688	65%
Cost of sales	4,763	3,388	1,375	41%
Gross profit	7,116	3,803	3,313	87%
Gross profit %	*59.9%*	*52.9%*	*7.0%*	*13%*
Operating expenses	4,644	1,027	3,617	352%
Operating income	2,472	2,776	(304)	-11%
Other expenses	(110)	(635)	525	-83%
Net income before tax	2,362	2,141	221	10%
Income tax expenses	664	554	110	20%
Net earnings and total comprehensive income	1,698	1,587	111	7%
Basic earnings per share	$ 0.02	$ 0.02	$ -	0%
Diluted earnings per share	$ 0.02	$ 0.01	$ 0.01	100%
Financial Position	**March 31, 2017**	**December 31, 2016**	**Variance ($)**	**Variance (%)**
Cash	$ 32,112	$ 32,508	$ (396)	-1%
Total assets	50,543	43,191	7,352	17%
Total liabilities	10,073	4,319	5,754	133%
Total shareholders' equity	40,470	38,872	1,598	4%

The following table provides a detailing of our Adjusted EBITDA for the three months ended March 31, 2017 and 2016.

	For the three months ended March 31, 2017	For the three months ended March 31, 2016
Net income for the period	$ 1,698	$ 1,587
Add (deduct)		
Finance income	(30)	(21)
Income taxes	664	554
Depreciation of property and equipment	66	33
Amortization of intangible assets	7	13
Foreign exchange loss	140	656
Legal and advisory fees on Photon R&D litigation and Corporate Changes	2,365	-
Adjusted EBITDA(1) for the period	**$ 4,910**	**$ 2,822**

(1) Adjusted EBITDA is a non-GAAP measure and is therefore not universally defined. The Company defines Adjusted EBITDA as earnings before finance income, income taxes, depreciation, amortization, foreign exchange loss and non-recurring items.

OVERALL PERFORMANCE AND DISCUSSION OF OPERATIONS

Revenue

Revenue for the three months ended March 31, 2017 was $11.9 million representing an increase of $4.7 million or 65% compared to $7.2 million reported in 2016. The improvements in reported revenue for the quarter were due to pre-orders of products by certain of our customers in planning for a potential disruption in services as a result of the move to a new facility on May 1, 2017, as well as pent-up demand for next generation product introductions and continued robust market conditions persisting in the semiconductor industry. The increase in revenue as a result of the move is not expected to reoccur.

The following tables provide a summary of our revenues by territory, and by segment:

	For the three months ended March 31,				Variance	
Country		**2017**		**2016**	**($)**	**(%)**
United States	$	7,246	$	5,257	$ 1,989	38%
Asia, excluding China		3,125		887	2,238	252%
China		1,474		832	642	77%
Canada		25		141	(116)	-82%
Europe		9		74	(65)	-88%
Total	**$**	**11,879**	**$**	**7,191**	**$ 4,688**	**65%**

	For the three months ended March 31,				Variance	
Product Segment		**2017**		**2016**	**($)**	**(%)**
Semi-conductor	$	11,821	$	6,898	$ 4,923	71%
Other		52		222	(170)	-77%
Oil & Gas		6		71	(65)	-92%
Total	**$**	**11,879**	**$**	**7,191**	**$ 4,688**	**65%**

Gross Profit

Gross profit for the three months ended March 31, 2017 increased over the prior comparable period as a result of higher overall revenues. Margin percentage for Q1 2017 improved to 59.9% from 52.9% reported in Q1 2016 due to a favourable product mix and the impact of lower royalty rates which had retroactive effects to January 1, 2017, as a result of the settlement with Photon R&D. Additionally, the Company achieved production efficiencies gained from producing higher volumes of certain product lines relative to the prior comparable period.

Operating Expenses

Total operating expenses for the three months ended March 31, 2017 were $4.6 million, an increase of 352% over the same period in 2016. When adjusted for non-recurring, one time charges as described below, operating expenses totaled $2.3 million, an increase of 122% over Q1 2016.

In addition to spending on new product and technology development and increased staff to facilitate growth, the Company incurred large one-time expenses on legal and advisory fees related to actions taken following the unauthorized transfer of $4.5 million to Photon R&D on June 3, 2016 (the "Unauthorized Transfer"), as more particularly described under the heading "*Litigation with Photon R&D*".

General and Administrative

General and administrative expenses totaled $3.6 million for the quarter compared to $0.6 million in Q1 2016, representing an increase of $3.0 million or 506%. When adjusted for non-recurring legal and advisory fees, expenses for the period increased by $0.7 million and 110% to $1.3 million. The adjusted increases in general and administrative expenses for the quarter resulted from the use of contract consultants, compensation costs for the former Interim CEO and an overlap of rent for both the former Burnaby and new Richmond facilities.

Engineering

Engineering expenses totaled $0.8 million for the quarter compared to $0.2 million in Q1 2016. The increase was primarily driven by engineering consulting fees paid to Photon R&D in connection with increases in revenue, production volumes, and new product and technology development as well as the appointment of a contract consultant in the latter half of 2016 whose contract ended in April 2017.

Sales and Marketing

Sales and marketing expenses were $0.2 million for the quarter and which is comparable to the same period in 2016.

Foreign Exchange Loss

The Company is subject to foreign exchange risk as its products are globally priced in United States dollars (“US dollars”), while the majority of its expenses and assets are denominated in Canadian dollars. The Company does have a partial “natural hedge” against foreign exchange risk, as some of its component parts and accounts payable are priced and or valued in US dollars. The foreign exchange loss for the three months ended March 31, 2017 is due to the strengthening of the Canadian dollar relative to the US dollar throughout the period as a majority of the Company’s revenues are denominated in US dollars.

Net Income Before Tax

Net income before tax for the quarter were $2.4 million compared to $2.1 million in Q1 2016, an increase of $0.3 million or 10%. This 10% increase in earnings is primarily attributable to higher revenues, gross profit and margin percentage achieved from increased sales of high margin products, partially offset by non-recurring, one-time legal and advisory fees as describe above.

Income Taxes

Income taxes for the quarter were $0.7 million compared to $0.6 million in Q1 2016.

Adjusted EBITDA

Adjusted EBITDA is defined as earnings before finance income, income taxes, depreciation, amortization, foreign exchange loss and legal and advisory fees on Photon R&D litigation and Corporate Changes. Adjusted EBITDA for the three months ended March 31, 2017 amounted to $4,910 compared to $2,822 in the same period in 2016.

Order Backlog

Order backlog was approximately $11.0 million on March 31, 2017, an increase of 25% compared to December 31, 2016. Order backlog represents the unfulfilled value of sales orders received and scheduled for fulfillment in the remaining rolling 12-month period.

SUMMARY OF QUARTERLY RESULTS

The global semiconductor industry is fast paced, competitive and constantly innovating to increase processing speed and power. The ability to anticipate these technology changes and innovate to meet them without compromising quality, is a key competitive advantage in this market. As a supplier of componentry to semiconductor capital equipment manufacturers, Photon's key strengths include our ISO certified production facility and CE methods, and our ability to manufacture to our customer's exacting standards with our highly trained workforce. In the addition to our high quality manufacturing strengths, our products include unique proprietary characteristics which both differentiate our products and allow us to outperform competitive offerings.

The following table provides a summary of the Company's financial results for the eight most recently completed quarters.

	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017
Revenue	$ 8,958	$ 5,966	$ 5,803	$ 7,191	$ 7,237	$ 8,733	$ 9,011	$11,879
Gross profit	$ 4,788	$ 3,218	$ 2,905	$ 3,803	$ 3,563	$ 4,569	$ 4,285	$ 7,116
Gross margin %	53%	54%	50%	53%	49%	52%	48%	60%
Net income	$ 2,810	$ 1,964	$ 1,710	$ 1,587	$ 1,397	$ 2,181	$ 1,351	$ 1,698
EPS (Basic)	$ 0.03	$ 0.02	$ 0.02	$ 0.01	$ 0.01	$ 0.02	$ 0.01	$ 0.02
EPS (Diluted)	$ 0.03	$ 0.02	$ 0.01	$ 0.01	$ 0.01	$ 0.02	$ 0.01	$ 0.02
Cash	$20,524	$25,001	$26,227	$27,300	$23,538	$31,139	$32,508	$32,112

Our financial results vary quarter to quarter less due to seasonality than to overall industry growth as we respond to our OEM customer orders, which in turn are driven by orders from their end user customers. While our most recent profitability results were positively impacted by increased revenue as a result of customer purchases made in anticipation of the Company's move to a new facility, net income reflects the negative effect of the litigation and corporate changes described elsewhere.

The Company has achieved generally consistent growth in its revenue over the past eight quarters as its primary segment, the semiconductor industry, has grown. The Company's net income for the most recently completed four quarters were negatively affected by the litigation and related costs incurred following the Unauthorized Transfer.

LIQUIDITY AND CAPITAL RESOURCES

Cash at March 31, 2017 was $32.1 million, compared to $32.5 million at December 31, 2016. Despite the strong cash generated from operations, the decrease in cash levels was primarily due to the increase in raw materials inventory in anticipation of the move to the new facility, an increase in capital expenditures on the new manufacturing facility in Richmond, BC, and one-time, non-recurring legal and advisory fees incurred in connection with the Photon R&D litigation and changes to the Board and management team ("Corporate Changes").

The Company had working capital of $35.7 million as at March 31, 2017, compared to working capital of $37.0 million as at December 31, 2016.

The Company follows a "copy exact" standard in providing its products to its customers, and is required to maintain adequate inventory on hand to fill purchase orders from its customers. As a result, and due to the fact that the timing and quantum of such purchases orders cannot be forecasted with complete accuracy, the Company must also have available a large quantity of finished goods and parts. In addition, it may have to add contract staff to its production team to meet large orders. These variances in demand and revenue can have a short-term effect on the Company's liquidity from time to time.

Cash provided by operations was $3.1 million for Q1 2017, compared to $1.2 million in Q1 2016, with the increase attributable to strong revenue performance and favourable product mix in the current period; this was partially offset by one-time costs related to the Photon R&D litigation and other increases in expenses described above. Cash used for financing activities was $0.4 million for Q1 2017 primarily due to re-purchasing common shares from the normal course issuer bid ("NCIB"). Investing activities used cash of

$3.1 million in Q1 2017, compared to cash used of $0.1 million in Q1 2016, for capital expenditures made toward the new manufacturing facility.

As at March 31, 2017, the Company's accounts payable and accrued liabilities, which fall due for payment within 12 months of the balance sheet date, were $9.8 million, compared to $2.0 million as at December 31, 2016; the increase is attributable to capital expenditures relating to the new Richmond facility ($2.4 million), and one-time costs incurred for the Photon R&D litigation and Corporate Changes ($1.6 million).

Management believes the Company will be able to continue to meet its liabilities and commitments as they become due and will generate sufficient amounts of cash from the continued manufacturing and distribution of existing products and the commercialization of new products. This cash will be used to maintain capacity, meet planned growth and development activities. The Company continues to monitor all expenditures and implement cash management strategies to ensure that it has adequate cash reserves to fund identified expenditure requirements.

The Company has a line of credit of $1.0 million available to it. The line of credit was unused as at March 31, 2017 and at December 31, 2016.

Premises and Lease

In September 2016, the Company signed a premises lease for a new office and production facility requiring minimum lease payments from January 1, 2017 to December 31, 2024 of approximately $0.3 million per annum or $2.4 million over the life of the new lease.

The Company moved in to the new facility on May 1, 2017 and anticipates the facility will be fully operational no later than June 30, 2017.

Litigation with Photon R&D

As described in the "Litigation" note to the interim condensed consolidated financial statements for the three months ended March 31, 2017, the Company was engaged in litigation with Photon R&D in the latter half of 2016.

In June 2016, the Company became aware of the Unauthorized Transfer, and the Company's then CEO and Director, Christopher Weston resigned. He was and continues to be a shareholder of Photon R&D. David Dueck, who was Chair of the Company's Board at that time and a shareholder and director of Photon R&D also resigned in connection with the Unauthorized Transfer. On July 25, 2016, the $4.5 million plus interest was paid back to the Company by Photon R&D.

Following the resignations of Michael Weston and David Dueck, the Board consisted of three independent members. These directors, all of whom were directors prior to and at the time of the Unauthorized Transfer, appointed Board member, Michael Goldstein to Chair of the Board and soon afterwards, interim CEO.

In August 2016, the Company commenced litigation proceedings against Photon R&D in order to clarify ownership of certain intellectual property ("IP") and as a result of an alleged breach of the terms of royalty arrangements related to that IP. The Company also began the process of building its own in-house engineering capabilities and terminating certain other non-arm's-length arrangements including agreements with DCD Management Ltd. ("DCD"), a company controlled by former Board Chair David Dueck, and its subsidiaries. DCD provided financial, payroll and IT services according to a services agreement, the costs of which were reported as an operating expense.

Following the Unauthorized Transaction, the Company added three new independent directors to the Board: Ronan McGrath on July 21, 2016, and Michael Torok and Neil McDonnell on November 3, 2016. At the earliest meeting of the expanded Board it was determined to be in the best interests of the Company to attempt to resolve the litigation issues with Photon R&D through settlement in order to avoid long term negative effects on the Company's staff, customers and financial results. It was also determined that a search for a permanent CEO should be commenced, with the new independent directors tasked with this responsibility.

In April 2017, following a period of negotiation, all disputes with Photon R&D and its directors and officers were resolved with the Company clarifying the ownership of 100% of the IP, and acquiring the assets, inventory and engineering personnel of Photon R&D. All transferred personnel are now employed by the Company under new employment agreements.

Just prior to the settlement of the dispute with Photon R&D, the Company underwent the following Corporate Changes to its Board and management team: (i) on March 31, 2017, two of the members of the Board at the time of the Unauthorized Transfer resigned from the Board; (ii) the Interim CEO who was also a director at the time of the Unauthorized Transfer resigned from both positions effective April 1, 2017; and (iii) on March 31, 2017, the Company appointed Chuck Cargile as a director, and Scott Edmonds a director as well as President and CEO.

For the three months ended March 31, 2017, expenses relating to the Photon R&D Litigation and Corporate Changes as described above totaled $2.4 million.

Liquidity

The Company held $32.1 million in cash as at March 31, 2017, compared to $32.5 million at December 31, 2016.

For the three months ended March 31, 2017, the Company incurred significant one-time expenses and cash outlays related to the Photon R&D litigation, the Corporate Changes and moving to the new facility. These non-recurring events are expected to continue requiring cash throughout Q2 2017. Offsetting these uses of cash, the Company currently generates cash from operations.

The following table describes the cash impact of the foregoing events on the Company's cash flow and liquidity included in the condensed interim consolidated financial statements for the three months ended March 31, 2017.

	Cash Outflow	
Cash used for one-time events	**Q1 2017**	**Remainder of 2017**
Corporate Changes and R&D Settlement (including litigation)	$ 280	$ 1,602
Fitout costs of new facility	268	2,425
Total cash used for one-time events	**$ 548**	**$ 4,027**

The Company's practice is to prudently manage its cash while looking for opportunities to invest in additional revenue opportunities. The second half of fiscal 2016 was a period of high non-recurring expenses related to the Photon R&D litigation (resolved April 2017), the Corporate Changes (resolved March 2017), and the outfitting of the new facility (to be completed by June 2017), the latter two of which commenced in Q1 2017. The Company expects to return to normalized cash flows now that the Photon R&D litigation and the Corporate Changes are completed and once it has taken occupancy and completed certification of its new facility, all of which have combined to reduce liquidity in the last two quarters.

The Company commenced an NCIB on January 4, 2016 allowing for the purchase of up to 5 million of its shares, representing 4.8% of the Company's then-issued and outstanding equity. During the period, the former Board authorized management to use at least 20% of the Company's annual free cash flow to repurchase the Company's outstanding shares. The NCIB was renewed on January 3, 2017 and remains open.

During Q1 2017, Photon Control purchased 579,800 common shares at a total cost of $0.6 million or an average price per share of $1.05 under the NCIB share buyback. All purchased shares have been cancelled.

OFF BALANCE SHEET ARRANGEMENTS

The Company had no off-balance sheet arrangements in the first quarters of 2017 and 2016.

TRANSACTIONS BETWEEN RELATED PARTIES

(a) Related company balances and transactions

Up to and including Q3 2016, related party transactions included transactions with Photon Control R&D Ltd. and DCD Management Ltd. During Q3 2016, the Company terminated all non-arm's length relationships with Photon Control R&D Ltd. and DCD Management Ltd. and all subsequent transactions were considered at arm's length. As at March 31, 2017, all balances with Photon R&D and DCD were included in trade and other receivables and accounts payable and accrued liabilities.

On June 3, 2016, the sum of $4.5 million was transferred from the Company to Photon Control R&D Ltd. However, the transaction had not been approved by the Board of Directors prior to the transfer of funds and therefore involved a breach of corporate governance as well as regulatory requirements. The $4.5 million plus $56 in interest was returned to Photon Control Inc. in full on July 25, 2016.

The events following the above transaction as described in Note 13 to the condensed interim consolidated financial statements for the three months ended March 31, 2017 led to the termination of contracts with Photon Control R&D Ltd. and DCD Management Ltd. and thus their status as related parties.

In 2009, Photon Control R&D Ltd. issued a $315 promissory note to the Company. As at March 31, 2017, the promissory note bore a coupon rate of 3% per annum, was repayable in equal monthly instalments of $3 which began on April 1, 2010 and was to mature on March 1, 2020.

The promissory note receivable was being accreted up to its face value of $315 by the effective interest method. As at March 31, 2017, $57 (2016 - $45) to date in accretion was recognized in interest income.

		March 31, 2017		**March 31, 2016**
Promissory note receivable - face value	$	315	$	315
Less: discount		(97)		(97)
		218		218
Accretion		57		45
Principal repayment		(207)		(174)
Carrying amount		68		89
Current portion		(68)		(19)
Long-term portion	**$**	**-**	**$**	**70**

While the litigation between the parties as described in Note 13 to the condensed interim financial statements for the three months ended March 31, 2017 was pending, the Company had stopped making certain payments related to the agreements with Photon Control R&D Ltd. Subsequent to March 31, 2017, the Company reached a settlement with Photon Control R&D Ltd. and all outstanding balances between the parties as at December 31, 2016, including the note receivable, were repaid in full on April 14, 2017.

(b) Compensation of key management:

The Company's key management 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 executive officers.

Total compensation expense for key management personnel for the three months ended March 31, 2017 and 2016 is as follows:

	March 31, 2017	March 31, 2016
Cash-based payments	$ 491	$ 77
Share-based payments	194	43
Total	**$ 685**	**$ 120**

Cash-based payments include salaries, bonuses, consulting fees, severance and other benefits. For the three months ended March 31, 2017, cash-based payments included consulting fees and one-time severance paid to the interim CEO.

CRITICAL ACCOUNTING ESTIMATES

The condensed interim consolidated financial statements have been prepared in accordance with IFRS. A summary of the significant accounting policies used in the preparation of the Company's financial statements is included in Note 2 of the consolidated financial statements and accompanying notes for the year ended December 31, 2016.

The measurement of certain assets and liabilities is dependent upon future events, the outcome of which will not be fully known until future reporting periods. Therefore, the preparation of the condensed interim consolidated financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses.

Actual results will vary from those estimated. Certain accounting policies are critical to understanding our reported financial results. These critical policies, which affect the reported amounts of revenue and the more significant areas involving management estimates, are described here.

CHANGES IN ACCOUNTING POLICIES

The Company did not adopt any changes to its accounting policies for the three months ended March 31, 2017.

FINANCIAL INSTRUMENTS

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 risk:

The following table provides information regarding the aged trade and other receivables as at March 31, 2017:

	Current	31-60 Days	61-90 Days	91 days +
As at March 31, 2017	69%	25%	1%	5%
As at December 31, 2016	70%	24%	3%	3%

The Company is exposed to credit risk associated with its trade and other receivables. Credit risk is minimized substantially by ensuring the credit worthiness of the entities with which it carries on business. At each period end, the Company reviews the collectability of outstanding receivables. Specific accounts are only written off once all collection efforts have been explored or when legal bankruptcy has occurred. During the three months ended March 31, 2017, the Company did not incur any bad debts expense (2016 - $Nil).

The Company has an agreement with Export Development Canada insuring its non-Canadian accounts receivable up to a maximum of $1,500 in US dollars. As at March 31, 2017 the maximum credit risk, which is the total of its uninsured trade and other receivables, was $203 or 3% (December 31, 2016 - $279 or 6%) of the net amounts outstanding.

(b) Market and foreign exchange risk:

The majority of the Company's 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.

At March 31, 2017, the Company held net current monetary assets in US dollars equal to $27,518 (December 31, 2016 - $8,433). The Company estimates the impact of a 10% change in the Canadian dollar exchange rate on its net current monetary assets to be $2,752 (December 31, 2016 - $843).

(c) Interest rate risk:

The company is not subject to significant interest rate risk as at March 31, 2017 or December 31, 2016.

(d) Liquidity risk:

As at March 31, 2017, the Company had access to a credit facility of $1,000. This credit facility currently remains unutilized (December 31, 2016 - unutilized).

The company is not subject to significant liquidity risk as at March 31, 2017 or December 31, 2016.

COMMITMENTS

As at March 31, 2017, the Company had entered into premises leases requiring the following future minimum lease payments and related costs as follows:

Remainder of 2017	$	250
2018		334
2019		334
2020		297
2021 and onwards		1,139
Total	**$**	**2,354**

SUBSEQUENT EVENT

On April 9, 2017, the Company signed a binding Settlement Agreement with Photon R&D which sets out the terms of the settlement reached among the parties to resolve all legal actions commenced by the Company against Photon R&D and certain others, as well as the counter-claims filed by Photon R&D against the Company. The Settlement Agreement is effective as of April 14, 2017. Pursuant to the terms of the Settlement Agreement, the Company acquired full ownership of all intellectual property, products, trademarks and other assets previously under dispute, and Photon R&D employees were transferred to the Company.

As consideration, the Company will pay a percentage of sales revenue to Photon R&D commencing January 1, 2017 for a period of 5 years, equal to 4.25% of revenues from sales of products currently under license from or incorporating intellectual property developed by Photon R&D. Also the Company is committed to paying the former CEO, who resigned on June 26, 2016, the sum of $400 and purchase the inventory and equipment of Photon R&D for $130 and $640 respectively. The Company will also pay Photon R&D for past due royalty amounts to December 31, 2016.

OUTSTANDING SHARE DATA

As at March 31, 2017 and as at the date of this report, a total of 108,485,718 common shares were issued and outstanding.

As at March 31, 2017, the Company had stock options outstanding to purchase 3,562,000 common shares. As at the date of this report, the Company had 3,502,000 share options outstanding.

As at March 31, 2017 and as at the date of this report, the Company had restricted stock units outstanding for 652,000 common shares.

RISKS AND UNCERTAINTIES

Our business is subject to significant risks and uncertainties and past performance is no guarantee of future performance. The risks and uncertainties in the Company's Management's Discussion and Analysis for the year ended December 31, 2016 which is available on SEDAR at www.sedar.com are those that we currently believe to be material, and do not represent all of the risks that we face. Additional risks and uncertainties, not presently known to us, may become material in the future or those risks that we currently believe to be immaterial may become material in the future. If any of the following risks actually occur, alone or in combination, our business, financial condition and results of operations, as well as the market price of our common shares, could be materially adversely affected.

The risk factors which should be taken into account in assessing the Company's activities, include, but are not necessarily limited to, those set out in the Company's MD&A for the year ended December 31, 2016.

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This MD&A contains certain statements and information that are not based on historical facts and constitute forward-looking statements or forward-looking information within the meaning of Canadian securities laws (collectively, "forward-looking statements"), including our business outlook for the short and longer term and statements regarding our strategy, plans and future operating performance. Forward-looking statements are provided to help you understand our views of our short and longer-term plans, expectations and prospects. We caution you that forward-looking statements may not be appropriate for other purposes.

Any statements that express or involve discussions with respect to predictions, expectations, beliefs, plans, projections, objectives, assumptions or future events or performance (often, but not always, identified by words or phrases such as "expects", "is expected", "anticipates", "believes", "plans", "projects", "estimates", "assumes", "intends", "strategy", "goals", "objectives", "potential", "possible" or variations thereof or stating that certain actions, events, conditions or results "may", "could", "would", "should", "might" or "will" be taken, occur or be achieved, or the negative of any of these terms and similar expressions) are not statements of historical fact and may be forward-looking statements. Forward-looking statements are not promises or guarantees of future performance; they represent our current views and may change significantly. Forward-looking statements are based on a number of material assumptions, including, but not limited to, those listed below, which could prove to be significantly incorrect:

- our ability to develop, manufacture and sell new products that meet the needs of our customers and gain commercial acceptance;
- our ability to continue to sell our products in line with quantity, price and delivery expectations;
- our ability to attract new business;
- our production being adversely affected by development, operating and regulatory risks;
- our ability to successfully complete new purchase orders along the timelines expected;
- continued and future demand for the Company's products;
- continued sales to the Company's major customers;
- continued financial health of the semiconductor industry;
- our ability to continue and further enhance revenue diversification and open new market opportunities; and
- our expectations regarding market risk, including interest rate changes, tax changes and foreign currency fluctuations.

Forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any results, performance or achievements expressed or implied by the forward-looking statements. Such uncertainties and factors include, among others:

- risks associated with the completion and certification of our new manufacturing facility;
- risks associated with compliance with regulatory bodies' quality system regulations;
- risks associated with the Company's ability to retain major customers;
- risks associated with shifts in demand for the Company's products and the Company's ability to expand its manufacturing capacity;
- risks associated with continuous technological change, evolving industry standards, shifting customer needs and new product introductions and enhancements;
- uncertainty relating to the timing of product development and commercial launch;
- risks associated with competition;
- uncertainty relating to operating results;
- risks associated with product liability claims;
- risks related to product pricing;

- risks associated with the Company’s intellectual property;
- uncertainty related to potential legal proceedings involving the Company;
- operational risks associated with manufacturing;
- uncertainty relating to general economic conditions and the cyclical nature of the semiconductor industry;
- uncertainty relating to fluctuations in currency exchange rates, particularly between the Canadian and U.S. dollars;
- uncertainty related to international operations, including additional development projects and other business opportunities;
- risks related to the volatility of the trading price and volume of the Company’s common shares;
- risks associated with attracting and retaining qualified personnel;
- risks related to managing and storing proprietary information and sensitive or confidential data relating to the Company’s operations electronically; and
- risks associated with compliance with various federal, provincial, local and international laws governing the environment.

This list is not exhaustive of the factors that may affect any of our forward-looking statements. Forward looking statements are statements about the future and are inherently uncertain, and our actual achievements or other future events or conditions may differ materially from those reflected in the forward-looking statements due to a variety of risks, uncertainties and other factors, including, without limitation, those referred to in this report under the heading “Risks and Uncertainties”.

The Company’s forward-looking statements are based on beliefs, expectations and opinions of management on the date the statements are made. For the reasons set forth above, readers should not place undue reliance on forward-looking statements. The Company undertakes no obligation to update or revise any forward-looking statements included herein if these beliefs, estimates and opinions or other circumstances should change, except as otherwise required by applicable law.