PHOTON CONTROL INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the second quarter ending June 30, 2011

(Unaudited)

This Management's Discussion and Analysis ("MD&A") of Photon Control Inc. (the "Company" or "Photon") is dated August 24, 2011. MD&A should be read in conjunction with the unaudited interim consolidated financial statements and accompanying notes for the period ended June 30, 2011, and the Audited Consolidated Financial Statements and accompanying notes for the fiscal year ended December 31, 2010.

Forward-Looking Statements

This MD&A contains forward looking statements, including statements regarding the business and anticipated financial performance of the Company, which involve risks and uncertainties. These risks and uncertainties may cause the Company's actual results to differ materially from those contemplated by the forward-looking statements. Factors that might cause or contribute to such differences include, among others, uncertainty as to the Company's ability to successfully complete new purchase orders along the timelines expected; the Company's need for funds to achieve its goals and uncertainties as to the availability and cost of financing the Company; uncertainty as to the continued and future demand for the Company's products; the Company's present reliance on four major customers for the majority of its sales; the Company's reliance on the financial health of the semiconductor industry, a vital part of its sales; the Company's ability to continue and further enhance revenue diversification and open new market opportunities; the development of competing technologies and the possibility of increased competition; the effect of slow growth in the Canadian, United States and international economies generally and other economic trends and conditions in the markets that the Company and its customers serve; the effect of the risks associated with technical difficulties or delays in product introductions, improvements, implementation, product pricing or other initiatives of the Company and its competitors; factors that may result in a reduction in capital expenditures and/or delayed buying decisions affecting demand for the Company's products; currency fluctuations; and the possibility that the Company will pursue additional development projects in order to support existing customers or pursue other business opportunities.

Forward-looking statements are based on the beliefs, opinions and expectations of the Company's management at the time they are made, and the Company may but does not assume any obligation to update its forward-looking statements if those beliefs, opinions or expectations, or other circumstances, should change except as may be required by applicable securities laws. Readers should not place undue reliance on forward-looking statements.

BUSINESS OVERVIEW

Photon Control Inc. designs and manufactures 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 provide high accuracy and reliability in extreme conditions and are supported by a team of experts that offer onsite installation, training, and support. Photon Control Inc. also provides engineering services for customized optical measurement systems. Headquartered in an ISO 9001:2008 manufacturing facility in Burnaby, BC, Photon Control Inc. is listed on the TSX Venture Exchange, trading under the symbol ''PHO".

Photon Control's approach to creating shareholder value has been to pursue Original Equipment Manufacturer (OEM) sales whether directly or through distributors 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's measurement and control instruments are intended for applications with high demands for precision, repeatable performance and reliability. The semiconductor manufacturers that are Photon Control customers set very high standards of supply chain management and Photon Control has satisfied these requirements.

Currently Photon Control supplies products to its 'Fortune 500' customer base through integrator contractors located in the USA, Europe, and Asia and directly supplies products to a second major capital equipment manufacturer located in Silicon Valley.

While focusing on manufacturing and distribution of high-quality products, Photon Control has a strong business relationship with Photon Control R&D Ltd., an engineering and R&D company, in order to enhance the effectiveness of its technical and customer support team and convert the Company's intellectual property (consisting of 12 issued and 10 pending patents) into commercial products.

Photon Control has a strong and highly skilled employee base and has successfully managed to recruit and retain qualified personnel through competitive employment terms relative to the local labour market. Reflective of steady order and backlog levels, as at June 30, 2011 Photon Control staff remained unchanged compared to the previous quarter, and included 32 full-time personnel representing a modest increase of 10% compared to 29 full-time personnel at the end of Q2 2010.

COMMERCIALIZED PRODUCTS AND BUSINESS TRENDS

The Company is supplying or starting to provide commercial products to the following market verticals through direct sales and in some cases through distributors for particular territories.

Manufacturing - Semiconductor Capital Equipment:

- OEM optical sensing solutions (sensors for positioning, spacing, detection, and related controls, robot alignment and positioning jigs, analytical tools for inspection of silicon wafers) or Silicone Wafer Sensing
- Spectrometers
- Fiber optic temperature sensors

Oil, Gas & Petrochemical:

- Optical flow meters for measurement of stack emissions (greenhouse gases, flares), fuel gas, associated gas, coal bed methane, biogas
- Total sulphur analyser for measurement of total sulphur content in diesel, gasoline, kerosene, jet fuel and other processed hydrocarbons
- Fiber optic temperature and pressure sensors for down-hole monitoring during SAGD extraction process

Power & Energy:

- Fiber Optic Temperature Sensor systems for monitoring of transformers, switchgear and power generators

Life Sciences:

- VIS / UV / NIR Spectrometers, Spectroscopy Light Sources
- Fiber Optic Temperature Sensors

Institutional:

- Spectrometers
- Fiber Optic Temperature Sensors

Food and Drug:

- Spectrometers

MARKETING

Photon Control has broad geographic representation with dedicated distributors worldwide. The Company's expanded sales and marketing efforts are resulting in the success of securing orders from new customers as well as follow-on orders from existing customers.

In Q2 2011, Photon Control continued to evaluate new opportunities by focusing on marketing and business development and addressing both the current and future demands of its market. In light of this objective, the Company actively participated in international tradeshows and industry events attending Sensor + Test 2011 June 7-9 in Nurnberg, Germany as well as MIOGE 2011 June 21-24, in Moscow, Russia. Photon Control presented its Spectrometers, Temperature Sensors, Down-hole Pressure and Temperature Sensor systems as well promoted the Company's OEM manufacturing capabilities along with seeking new distributorship.

During Q2 2011 Photon Control worked to build brand awareness by promoting new products, PowerTemp temperature measurement system along with Down-hole pressure and temperature sensor with media releases to gain media attention. Photon Control also continued to implement better communication procedures with existing distributors for increasing productivity. All these activities validate the Company's expanded sales and marketing efforts. Along with seeking new distributors and further research for business development, Photon Control Sales Executive for the Asia market signed on two non-exclusive distributorship agreements for spectrometers and temperature sensors in China. Photon Control continued to expand marketing initiatives, by developing new marketing collateral as well as implementing the new procedures to help strengthen and open communication channels with existing and potential customers.

CORPORATE VISION AND STRATEGY

Although economic and market uncertainties, including a number of challenges such as order timing and volatility, required Photon Control and its customers to reposition its business plans over the past three years, Photon Control remains focused and fully committed to its core values and long-term growth strategy.

Some of Photon Control's key operational objectives are:

- To enhance its sales opportunities on a global scale;
- Ensure optimal customer support
- Steadily expand manufacturing efficiency (lean), capacity and recruitment in order to meet increased customer demands;
- Implement operating cost structures that align with revenue growth;
- Maintain financial viability, create efficient financial planning and maintain strong budget controls in order to quickly adapt to new and changing market conditions;
- Renegotiate contracts with vendors and suppliers to obtain more favourable terms; and
- Adhere to strict inventory control procedures.

These activities are important development areas in continuing liquidity management and organizational efficiency in 2011.

SELECTED ANNUAL INFORMATION

Certain of the comparative figures in the following table have been reclassified to conform with the presentation adopted for 2010.

In addition, certain comparative figures below have been restated as a result of the Company adopting Internal Financial Rules Standards (IFRS) to allow true comparisons. Revenue, cost of goods sold, gross margin and expenses may have change slightly as a result of IFRS rules however, in all cases, net income is the same. A reconciliation of GAAP to IFRS for Q2 2010 income statement is available on Note 8 to the Q2 2011 Financial Statements.

	Six months ended June 30		
	2011	2010	2009
Total Revenues	6,764,085	7,451,432	1,319,860
Income (loss) before discontinued operations and extraordinary items	832,853	1,903,809	(351,657)
Income (loss) per share before discontinued operations and extraordinary items, Basic and diluted	0.01	0.02	(0.00)
Net income (loss)	832,853	1,903,809	(351,657)
Net income (loss) per share, Basic and diluted	0.01	0.02	(0.00)
Total assets	7,471,645	5,754,659	3,318,212
Total long-term financial liabilities	353,542	414,450	486,111
Cash dividends declared per Common Share	—	—	—

FIRST QUARTER 2011

Highlights

- Q2 2011 Sales of $3.5 million compared to Q2 2010 Sales of $3.8 million
- Q2 2011 Operating Expenses of $1 million compared to Q2 2010 of $0.7 million
- Q2 2011 Profit of $377,189 compared to Q2 2010 Profit of $1,009,655
- Q2 2011 Gross Margin of 40% compared to 42% for Q2 2010
- Q2 2011 Order Backlog of $2 million compared to $2.2 million for Q2 2010

Sales

During Q2 2011, Photon Control achieved solid sales and profit results for the quarter. Q2 2011 sales were $3.5 million compared to $3.8 million in Q2 2010, a decrease of $0.3 million or approximately 8%. However, compared to the previous quarter Q1 2011 the Company showed an increase in sales of $0.2 million or approximately 6%.

Expenses

General and administrative expenses totalled $699,520 in Q2 2011 compared to $465,449 in Q2 2010. This reflects the both an increase in legal cost as well as increase in accounting and finance services.

Research and development expenses totalled $207,566 in Q2 2011 compared to $190,170 in Q2 2010. This reflects an increase in consulting fees in support of new and existing products.

Business development and marketing expenses totalled $58,161 for Q2 2011. This increase of $23,617 when compared to Q2 2010 of $34,544 reflects the expansion of the marketing department and its activities including the promotion, tradeshow and convention attendance during Q2 2011.

Profit for the Period

The profit for Q2 2011 was $377,189 representing a decrease of approximately 63% compared to Q2 2010 profit of $1,009,655 mainly due to the increase in services, legal fees related to three lawsuits (two of the lawsuits were settled in May 2011; subsequently in Q3 2011, the Supreme Court of British Columbia released a decision in the litigation involving the Company and the former President); and negative impact on revenue of the lower U.S. dollar in 2011 versus 2010.

RESULTS OF OPERATIONS

In 2010 and 2011, Photon Control's focus on prudent operational structure, stricter capital allocation, diversification of its product range, and quality of customer relationships was intended to enhance revenue and open new market opportunities, and to develop a business and marketing alliance with new partners and distributors. The Company achieved many crucial milestones in both business and customer segments, resulting in sustained profitability and consistent delivery of high quality and value-added services to its customers. In 2010, Photon Control achieved the record annual sales and profit figures of $13.4 million and $2,715,933 respectively. These results were mainly attributed to an improved economic environment including the rebound in the semiconductor sector, supported by non-semiconductor order activity, and in combination with Photon Control's established operational efficiency programs. Photon Control continued to build on the positive momentum from 2010, recording solid sales and sustained profitability throughout the first half of 2011.

Q2 2011 Overview

Although Photon Control continued to experience challenges resulted from increased operating expenses, the Company remained encouraged by improvements in volume of orders and strong backlog throughout Q2 2011, and resource utilization.

As at June 30, 2011 the Company's $500,000 bank line of credit was not utilized due to the increase in cash flow from operations however, was and is available for use if needed. Although there can be no assurances, Photon Control believes that cash generated from operations, committed purchase orders, and the availability of the Company's line of credit will give Photon Control financial resources necessary to operate in the current year and the foreseeable future.

Product Sales and Operational Update

Product sales in Q2 2011 were $3.5 million compared to $3.8 million in Q2 2010, a decrease of approximately 8%. However, compared to the previous quarter Q1 2011 the Company showed an increase in product sales of $0.26 or approximately 6%, reporting the eight consecutive quarter of profit with Q2 2011.

Photon Control's sales to the semiconductor sector remained solid, contributing significantly to the second quarter 2011 results. Sales to non-semiconductor sector recorded $0.3 million, a slight decrease compared to $0.4 million in Q2 2010. However, the Company anticipates seeing positive results from non-semiconductor customer trials, which were underway during Q2 and subsequently in Q3 2011, and remains encouraged by the expansion of its distributor network.

The Company continued its diversification efforts by consistently expanded its lines of products. As announced in the media News Release dated May 12 and May 26, 2011, Photon Control launched a new line of temperature measurement tools specifically designed for the power industry and a new Downhole Pressure Temperature Sensor system, designed for Oil & Gas industry (Oil Sands). Also, the Company signed four distributor agreements for these product lines during the first half of 2011.

Gross Margin

The gross margin percentage for Q2 2011 of 40% decreased slightly from the Q2 2010 gross margin of 42%. In part, this was due to (a) product mix and (b) as the Company's products are priced in U.S. dollars, the current lower U.S. dollar compared to Q2 2010 had a significant impact on revenue.

Operating Expenses

General and administrative expenses totalled $699,520 in Q2 2011 compared to $465,449 in Q2 2010. General and administrative expenses increased through:

- accounting and finance staff and services of $20,737
- legal and accounting of $207,942
- insurance expenses of $16,110
- other expenses of $15,939

and offset by a decrease in:

- travel expenses of $9,107
- office expenses of $17,550.

Research and development expenses totalled $207,566 in Q2 2011 compared to $190,170 in Q2 2010 primarily due to a increase in consulting fees of $17,307.

Business development and marketing expenses totalled $58,161 in Q2 2011 compared to $34,544 in Q2 2010 due primarily to increases in:

- salaries of $1,848
- other expenses of $479
- promotional expenses of $17,745
- travel expenses of $3,545.

Other Expenses

Photon Control's products are priced in U.S. dollars. A continuing and substantial weakening of U.S. dollar through 2010 and 2011 resulted in a foreign exchange loss of $53,730 in Q2 2011 compared to a foreign exchange gain of $75,688 in Q2 2010.

Net Earnings

The net earnings for Q2 2011 were $377,189 compared to net earnings of $1,009,655 in Q2 2010. This decrease in operating results was attributable to a decrease in revenue and additional administrative costs (primarily legal).

ORDER BACKLOG

The second quarter of 2011 continued to report a strong order backlog. At June 30, 2011 Photon Control's backlog stood at $2 million. This represents the value of sales orders already fulfilled or waiting to be fulfilled in Q3 2011.

SUMMARY OF QUARTERLY RESULTS

The following table is a summary of Photon Control's financial results for the past eight quarters. Certain of the comparative figures in the following table have been reclassified to conform with the presentation adopted for 2010.

	June 31, 2011	March 31, 2011	December 31, 2010	September 30, 2010	June 30, 2010	March 31, 2010	December 31, 2009	September 30, 2009
Revenue	$ 3,513,782	$ 3,250,303	$ 2,890,493	$ 3,009,302	$ 3,868,535	$ 3,620,427	$ 2,577,936	$ 1,489,914
Net income / loss	$ 377,189	$ 455,664	$ 172,947	$ 639,182	$ 1,009,656	$ 894,158	$ 193,046	$ 343,340
Net income / loss per share Basic & Diluted	$ 0.00	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.01	$ 0.00	$ 0.00

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents at June 30, 2011 had a balance of $421,686 compared to $235,077 as at June 30, 2010. The Company had working capital of $4,624,144 as at June 30, 2011 compared to working capital of $2,833,863 as at June 30, 2010. This increase in both cash and working capital has resulted from continued revenue growth.

Cash provided by operations totalled $383,516 in Q2 2011 compared cash used by operations of $723,413 in Q2 2010. Cash used in investing activities was $30,274 in Q2 2011 compared to $2,335 in Q2 2010. Cash used in financing activities was $0 for Q2 2011 compared to $493,060 in Q2 2010 and relating to the Company's credit facility.

As at June 30, 2011, the Company's accounts payable and accrued liabilities was $1,412,342 which fall due for payment within twelve months of the balance sheet date.

Nature of and Continuing Operations

The Company has made efforts to diversify the industries that it serves in an attempt to reduce the impact of a downturn on any one segment. The continued manufacturing and distribution of existing products and the commercialization of new products in 2010 and 2011 form the basis of management's opinion that the Company will meet its liabilities and commitments as they become due. The Company is currently monitoring all expenditures and implementing cash management strategies to ensure that it has adequate cash reserves to fund identified expenditure requirements.

The Company is working with its bank to secure financing over and above the $500,000 line of credit it currently has. To this end, the Company has insured its receivables in order to receive additional asset-based financing.

Contractual Obligations

Leases:

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

2011 (as of June 30)		324,670
2012		216,443
	$	541,113

The above lease commitment amounts are prior to rental expense recoveries of $17,805 in 2011 in relation to sub-lease agreements executed in 2006 and 2007.

The Company entered into a lease agreement in June 2006 and in 2011 has recorded $21,524 (2010 – $27,414) in deferred rent to account for reduced rent benefits received.

Litigation:

In October 2001, a former member of management and President of the Company (the "Claimant") initiated arbitration proceeding asserting that certain amounts were owing to him by the Company. The Company had commenced an action against the Claimant for a declaration that it had properly rescinded a loan agreement between the Company and the Claimant dated March 5, 2001 (the "Loan Agreement") and that the debt owed to the Claimant (the "Claimant Debt"), being $340,887 as at the date of the Loan Agreement, was repayable in shares of the Company at a rate of one share per dollar of debt.

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

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

Subsequently, as announced in the News Release dated August 2, 2011, the Supreme Court of British Columbia has released a decision that the Company did not have the right to rescind the Loan Agreement and that this debt is repayable in accordance with the Loan Agreement. The amount of the Claimant Debt payable is $374,562 including interest as at September 30, 2010 plus interest thereafter.

A charge for the Claimant Debt in the amount of $310,499 was previously taken by the Company for long term liability on its financial statements and will now be a short-term liability. Appropriate adjustments to the charge will be made to reflect the decision of the Court in the Company's Q3 2011 financial statements.

The Court also ruled that the Claimant was dismissed without cause in 2001 and awarded 18 months notice at $130,000 per year in salary plus the value of the benefits payable to him.

The Court has not made a decision on the issue of the costs to be paid in relation to this litigation and accordingly, the Company is unable to confirm the final charge to be taken on its Q3 2011 financial statements. Also, during the current third quarter, the Company is considering its options regarding the decision.

As announced in the News Release dated September 22, 2010 and the Company's Management's Discussion and Analysis, Photon Control has filed two lawsuits in the United States, the first in the United States District Court, Northern District of California at San Francisco against Azbil North America, Inc. ("Azbil") (formerly Yamatake Sensing Control, Ltd.), a California company with offices in Santa Clara, California, and the second in the Superior Court of the State of California, County of Santa Clara, against Yamatake Corp. ("Yamatake"), a Japanese company with offices in Tokyo, Japan, which is the parent company of Azbil. The disputes related to Photon Control's proprietary and trade secret fiber optic temperature sensor technology.

As announced in the News Release dated May 24, 2011, Photon Control resolved its disputes with Azbil and Yamatake and both litigations have been dismissed without prejudice. The parties have agreed to continue their working relationship and have entered into a new agreement with the expectation that all parties involved will benefit from continued cooperation in the development and supply of fiber optic temperature sensors to their customers throughout the world. Photon Control will continue to provide products and technical support and assistance in the area of optical temperature sensors to both Azbil and its customers. Moreover, the parties have agreed to work together to develop and protect their intellectual property in the area of optical temperature sensors.

RELATED PARTY 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. 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.

The Company subleases space to Photon Control R&D Ltd. at the same facility. The Company charges Photon Control R&D Ltd. premises and related expenses to recover the Company's costs. Amounts outstanding with Photon Control R&D Ltd. are non-interest bearing, unsecured and due on demand. This account is active and payments are received on a monthly basis, and the balance is paid out at least twice during the year.

Six months ended June 30	2011	2010
Balance Sheet:		
Accounts Receivable	$ 920,620	$ 893,075
Note Receivable	184,552	212,601
Accounts payable	117,460	75,311
Statement of operations:		
Recovery of premises and related expenses	575,014	606,210
Engineering, research and development services	260,254	264,637
Royalty charges	85,124	62,189
Revenue from sales of products and services	117,227	44,625

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

SUBSEQUENT EVENTS

In Q3 2011, Photon Control presented its Spectrometers, Temperature Sensors, and promoted the Company's OEM manufacturing capabilities along with seeking new distributorship at Semicon West 2011 in San Francisco, California in July 2011. Also, Photon Control continued expanding its marketing and sales efforts in Asia as well improving the Company's website and creating marketing collateral. With heightened efforts of brand awareness in Asia during Q2 2011, Photon Control subsequently signed two non-exclusive distribution agreements for spectrometers and temperature sensors for Thailand and Indonesia.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The consolidated financial statements have been prepared in accordance with International Financial Rules Standards (IFRS). A summary of the significant accounting policies used in the preparation of our financial statements is included in note 2 of the consolidated financial statements for the year ended December 31, 2010. 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 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.

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 an actual FIFO cost basis and includes the cost of direct material, direct labour and other overhead costs. Labour costs are allocated to items based on actual labour hours input. Fixed and variable overhead are allocated to production activities in converting materials to finished goods.

Revenue Recognition

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

Research and Development Costs

Research costs are expensed as incurred. Development costs are expensed as incurred unless they meet the required criteria for deferral and amortization. There were no additional costs which were deferred in 2010, after deferring $219,071 in 2008 relating to development of a portable sulphur analyzer product. The Company amortizes previously deferred development costs, commencing with commercial production, over the expected future benefit period based upon quantities delivered compared to expected levels contracted to be delivered. In 2010, commercial production commenced and so the amount amortized in fiscal 2010 was $37,214 (2009 - $967), however, nil was amortized for 2011. The Company has a balance of $152,724, (Q1 2010 - $189,938) of deferred development expenses as at June 30, 2011.

Stock-based Compensation Plans

The Company accounts for employee stock options using the fair value based method. Under the fair value based method, compensation cost attributable to options granted to employees and directors is measured at the fair value at the grant date using the Black-Scholes option pricing model. Compensation expense is recognized over the vesting period of the underlying option.

Any consideration paid by employees on exercise of stock options or purchase of stock is credited to share capital. No compensation cost is recognized for options that employees forfeit if they fail to satisfy the service requirement for vesting. Compensation expense is recognized for stock-based payments to non-employees using the fair value based method.

There were 20,000 stock options granted to new employees during Q2 2011 compared to Nil stock options granted during Q2 2010.

Warranty Provision Estimate

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

Financial Instruments

The Company has classified its financial instruments as follows:

- Cash and cash equivalents and bank indebtedness, if any, as "held-for-trading".
- Trade accounts receivable and other amounts and due from related parties are classified as "loans and receivables".
- Accounts payable and accrued liabilities, amounts due to related parties and advances under credit facility are classified as "other financial liabilities".

All financial instruments are initially recognized at fair value and are subsequently accounted for based on their classification. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, financial assets and liabilities classified as held-for-trading are measured at fair value with changes in fair value recorded in the Consolidated Statements of Operations. Financial assets classified as "loans and receivables" and "other financial liabilities" are carried at amortized cost using the effective interest rate method. The fair values are based on quoted market bid process if available, otherwise fair value is obtained using discounted cash flow analysis. Transaction costs that are directly attributable to the issuance of financial assets or liabilities are accounted for as part of the carrying value at inception, and are recognized over the term of the assets or liabilities using the effective interest method. The adoption of these standards did not have an impact on the classification and valuation of financial instruments.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION OF IFRS

In 2008, the Canadian Accounting Standards Board stated that Canadian publicly accountable enterprises will be required to adopt IFRS by 2011 to replace Canadian GAAP.

The accompanying unaudited interim consolidated financial statements for the six months ended June 30, 2011 have been prepared to reflect our adoption of IFRS, with the effective date being January 1, 2010.

Note: The Company's unaudited interim consolidated financial statements for the six months ended June 30, 2011 contain a detailed description of the conversion to IFRS, including a line by line reconciliation of the Company's financial statements previously prepared under Canadian GAAP to those under IFRS for the six months ended June 30, 2010.

Credit Risk and Fair Value of Financial Assets and Financial Liabilities

In January 2009, the CICA issued EIC – 173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. The guidance requires that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. This guidance is applicable to fiscal periods ending on or after January 20, 2009. The adoption of this section did not have a material impact on the Company's consolidated financial statements.

Financial Instruments, Disclosure and Presentation

Effective January 1, 2009, the Company has adopted the enhanced disclosure requirements of amended CICA Section 3862, Financial Instruments - Disclosures. Refer to note 12 for fair value measurement disclosures using a fair value hierarchy that reflects the significance of the inputs in making the measurements.

Goodwill and Intangible Assets

In February 2008, the CICA issued new CICA 3064, Goodwill and Intangible Assets, replacing CICA 3062, Goodwill and Other Intangible Assets, and CICA 3450, Research and Development Costs. Collectively, these changes bring Canadian practice closer to International Financial Reporting Standards ("IFRS") and U.S. GAAP. The effective date of adopting this standard for the Company is January 1, 2009. This standard is not expected to impact the Company's financial statements.

International Financial Reporting Standards

The CICA's Accounting Standards Board has announced that Canadian publicly accountable enterprises will adopt IFRS as issued by the International Accounting Standards Board effective January 1, 2011. The Company is in the process of developing a plan for the implementation of IFRS and will assess the impact of the differences in accounting standards on the Company's consolidated financial statements.

OUTLOOK, BUSINESS RISKS AND UNCERTAINTY

Sales Risks

During 2010 Photon Control saw a recovery of demand from the semi-conductor market, resulting in sales to this market more than doubled compared with the previous year. The positive order trends and a solid backlog continued during the first half of fiscal year 2011. Photon Control endeavours to reduce the risk of key client dependence by continuing its initiative to diversify its product range and develop relationships with new distributors for products for the oil and gas industry, power, life sciences and manufacturing industries.

Going Concern Risk

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

Outlook, Market, Competition, and Foreign Exchange Risk

Encouraged by the improved economic environment in 2010, Photon Control demonstrated the resilience of the Company's business and ability to generate revenue for the foreseeable future, sustaining profitable financial results since the third quarter of 2009 and into the current fiscal year 2011. In addition, Photon Control continues to be positively influenced by the level of fulfilled and received purchase orders in 2011, which should result in solid revenue results.

While there can be no assurance of the ability of the Company to penetrate target markets, the Company endeavours to limit the effects of risk factors, including the competition risks, through its strategic planning, management processes and marketing research. The Company continues to focus on securing consistent delivery of high quality and value-added products and services.

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 of the values of financial instruments. The majority of the Company's sales revenues and trade receivables are denominated in United States dollars. As such, the Company may be subject to material, realized and unrealized exchange gains or losses resulting from above average changes in exchange rates between the Canadian and United States dollar. As at June 30, 2011, the Company did not utilize any forward exchange contracts to mitigate any of the risks as mentioned above. Photon manages its exposure to foreign currency fluctuation by maintaining Canadian and U.S. dollar bank accounts to offset foreign currency payables and planned expenditures. As at June 30, 2011, the Company was not exposed to significant credit or interest rate risk.

OUTSTANDING SHARE DATA

As at June 30, 2011 and the date hereof, the Company had 102,909,518 common shares issued and outstanding. There were outstanding stock options to purchase an additional 4,540,000 common shares of the Company as at June 30, 2011.

ADDITIONAL INFORMATION

Additional information and other publicly filed documents relating to the Company are available through the Canadian Securities Administrators' System for Electronic Document Analysis and Retrieval ("SEDAR") which can be accessed at www.sedar.com.