

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS OF
Photon Control Inc.

For the three and six months ended June 30, 2020 and 2019



PHOTON CONTROL INC.

Condensed Interim Consolidated Statements of Financial Position (Unaudited)

(In thousands of Canadian dollars)

	Note	June 30, 2020	December 31, 2019
Assets			
Current assets			
Cash and cash equivalents		\$ 41,057	\$ 33,400
Trade and other receivables		8,550	4,051
Income taxes receivable		-	714
Inventories		9,412	6,459
Prepaid expenses and deposits		775	575
Total current assets		59,794	45,199
Property and equipment	5	6,587	6,752
Intangible assets	6	3,804	3,386
Goodwill		971	849
Deferred tax assets		3,405	1,915
Total assets		\$ 74,561	\$ 58,101
Liabilities and Shareholders' Equity			
Current liabilities			
Accounts payable and accrued liabilities		\$ 5,737	\$ 4,318
Income taxes payable		5,491	-
Current portion of contingent consideration		1,699	1,419
Current portion of lease liabilities		280	272
Total current liabilities		13,207	6,009
Contingent consideration		1,157	1,473
Lease liabilities		1,105	1,241
Total liabilities		15,469	8,723
Shareholders' equity			
Share capital		29,486	29,366
Contributed surplus		4,984	4,838
Accumulated other comprehensive ("AOCI") gain (loss)		15	(121)
Retained earnings		24,607	15,295
Total shareholders' equity		59,092	49,378
Total liabilities and shareholders' equity		\$ 74,561	\$ 58,101

See accompanying notes to the unaudited condensed interim consolidated financial statements

Approved on behalf of the Board:

"Nigel Hunton", Director

"Ronan McGrath", Director



PHOTON CONTROL INC.

Condensed Interim Consolidated Statements of Net Income and Comprehensive Income (Unaudited)

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

	Note	Three months ended		Six months ended	
		June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Revenue	10	\$ 16,098	\$ 7,106	\$ 33,410	\$ 15,138
Cost of sales		6,376	3,215	13,100	7,017
Gross profit		9,722	3,891	20,310	8,121
Operating expenses					
General and administrative		1,851	2,171	4,006	3,696
Research and development		1,154	1,039	2,409	2,316
Sales and marketing		920	457	1,607	1,131
Total operating expenses		3,925	3,667	8,022	7,143
Operating income		5,797	224	12,288	978
Finance income		27	226	181	369
Accretion expense on contingent consideration		(106)	(134)	(228)	(277)
Change in fair value of contingent consideration		(467)	334	(555)	432
Foreign exchange (loss) gain		(1,518)	(472)	1,164	(1,058)
		(2,064)	(46)	562	(534)
Net income before taxes		3,733	178	12,850	444
Income taxes		1,060	69	3,538	265
Net income		2,673	109	9,312	179
Other comprehensive income:					
Unrealized gain (loss) from foreign exchange translation of sub		120	(28)	136	22
Total comprehensive income		\$ 2,793	\$ 81	\$ 9,448	\$ 201
Basic and diluted earnings per share					
Weighted average common shares, basic		104,565,672	106,290,362	104,544,358	107,682,165
Weighted average common shares, diluted		105,212,341	106,717,018	105,046,476	108,108,821
Basic earnings per share		\$ 0.03	\$ 0.00	\$ 0.09	\$ 0.00
Diluted earnings per share		\$ 0.03	\$ 0.00	\$ 0.09	\$ 0.00

See accompanying notes to the unaudited condensed interim consolidated financial statements



PHOTON CONTROL INC.

Condensed Interim Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

(In thousands of Canadian dollars)

	Note	Share capital	Contributed surplus	AOCI	Retained earnings	Total
Balance, December 31, 2018		\$ 30,833	\$ 4,463	\$ (125)	\$ 18,494	\$ 53,665
Exercise of stock options, net		22	(5)	-	-	17
Settlement of restricted share units		62	(62)	-	-	-
Repurchase of common shares for cancellation		(1,375)	-	-	(4,861)	(6,236)
Share-based payments	8 (d)	-	345	-	-	345
Adjustment on initial application of IFRS 16		-	-	-	(72)	(72)
Comprehensive income		-	-	22	179	201
Balance, June 30, 2019		29,542	4,741	(103)	13,740	47,920
Balance, December 31, 2019		29,366	4,838	(121)	15,295	49,378
Exercise of stock options, net		58	(50)	-	-	8
Settlement of restricted share units		62	(62)	-	-	-
Share-based payments	8 (d)	-	258	-	-	258
Comprehensive income		-	-	136	9,312	9,448
Balance, June 30, 2020		\$ 29,486	\$ 4,984	\$ 15	\$ 24,607	\$ 59,092

See accompanying notes to the unaudited condensed interim consolidated financial statements



PHOTON CONTROL INC.

Condensed Interim Consolidated Statements of Cash Flows (Unaudited)

(In thousands of Canadian dollars)

	Note	Three months ended		Six months ended	
		June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Operating activities					
Net income for the period		\$ 2,673	\$ 109	\$ 9,312	\$ 179
Adjustments for					
Depreciation of property and equipment		377	402	742	795
Amortization of intangible assets		219	243	415	486
Share-based payments		143	200	258	345
Accretion expense on contingent consideration		106	134	228	277
Change in fair value of contingent consideration		467	(334)	555	(432)
Finance income		(27)	(226)	(181)	(369)
Income tax expense		1,060	69	3,538	265
Net change in non-cash working capital items					
Trade and other receivables		(75)	1,535	(4,499)	698
Inventories		(1,334)	(341)	(2,449)	298
Prepaid expenses and deposits		(182)	18	(200)	(122)
Accounts payable and accrued liabilities		(1,582)	(747)	730	(427)
Income taxes (paid) received		(349)	(2,840)	1,177	(6,233)
Interest (paid) received		(52)	21	(80)	(29)
Net cash provided by (used in) operating activities		1,444	(1,757)	9,546	(4,269)
Financing activities					
Repurchase of common shares for cancellation		-	(3,737)	-	(6,236)
Payment of contingent consideration		(564)	(266)	(819)	(534)
Payment of lease liabilities		(61)	(65)	(128)	(128)
Proceeds from exercise of stock options		8	-	8	17
Net cash used in financing activities		(617)	(4,068)	(939)	(6,881)
Investing activities					
Acquisition of business	4	(844)	-	(844)	-
Purchase of property and equipment		(339)	(175)	(479)	(225)
Purchase of intangible assets		-	(19)	(24)	(30)
Interest received		79	205	261	398
Net cash (used in) provided by investing activities		(1,104)	11	(1,086)	143
Net (decrease) increase in cash and cash equivalents		(277)	(5,814)	7,521	(11,007)
Cash and cash equivalents, beginning of period		41,214	37,264	33,400	42,407
Effects of foreign exchange on cash and cash equivalents		120	(28)	136	22
Cash and cash equivalents, end of period		\$ 41,057	\$ 31,422	\$ 41,057	\$ 31,422

See accompanying notes to the unaudited condensed interim consolidated financial statements



1. Nature of business and continuing operations

Photon Control Inc. (“Photon Control” or the “Company”) was incorporated under the *Business Corporations Act of British Columbia* on August 9, 2002. The Company is listed on the Toronto Stock Exchange (the “TSX”) under the trading symbol PHO. The Company’s head office is located at 130-13500 Verdun Place, Richmond, BC, Canada, V6V 1V2. The address of the Company’s registered and records office is Suite 2600, Three Bentall Centre, 595 Burrard Street, PO Box 49314, Vancouver, British Columbia, Canada, V7X 1L3.

These condensed interim consolidated financial statements of the Company for the three and six months ended June 30, 2020 and 2019 comprise the statements of the Company and its subsidiaries. The financial statements were authorized for issue by the Board of Directors on August 4, 2020.

Photon Control designs, manufactures and distributes a wide range of optical sensors and systems to measure temperature and position for the semiconductor and other high technology industries.

2. Basis of presentation

Statement of compliance

The principal accounting policies applied in the preparation of these unaudited condensed interim consolidated financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise noted.

These unaudited condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, *Interim Financial Reporting*, as issued by the International Accounting Standards Board (“IASB”). The condensed interim consolidated financial statements have been prepared on a basis consistent with and should be read in conjunction with the most recent annual consolidated financial statements for the years ended December 31, 2019 and 2018, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the IASB. Changes to significant accounting policies are described in note 3.

The results for the three and six months ended June 30, 2020 and 2019 may not be indicative of the results that may be expected for the full year or any other period.

Use of critical accounting judgments and estimates

The preparation of the condensed interim consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. The critical judgments, estimates and assumptions applied in the condensed interim consolidated financial statements, including key sources of



estimation uncertainty, were the same as those applied in the last annual consolidated financial statements for the years ended December 31, 2019 and 2018.

3. Significant accounting policies

The accounting policies applied in these condensed interim consolidated financial statements were the same as those applied in the most recent annual consolidated financial statements for the years ended December 31, 2019 and 2018.

Uncertain tax position

The Company's uncertain tax position consists of payments received from the Canadian tax authority related to foreign tax credits claimed on historical tax returns from 2013 to 2017. The Company evaluates the tax position for recognition by determining whether it is probable that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. If it is determined that an uncertain income tax position is not probable of being accepted, the effect of the uncertain income tax treatment is reflected in the determination of income taxes based on the most likely amount or, if there are a wide range of possible outcomes, the expected value. The tax position is derecognized when it is no longer probable that the position will be sustained on audit and the Company will adjust income tax expense accordingly in the period in which the position changes.

Future accounting pronouncements

The Company reviewed future accounting pronouncements and determined that there are no standards that are not yet effective and that would be expected to have a material impact on the entity in the current or future reporting period and on foreseeable future transactions.

4. Business combination

In April 2020, the Company completed the acquisition of certain tangible and intangible assets of Micronor Inc. ("Micronor"), a supplier of fiber optic kinetic sensors based in Camarillo, California, USA, for cash consideration of \$844. The Company incurred acquisition related costs on legal fees, due diligence and other professional services which were expensed within general and administrative expenses on the condensed interim consolidated statements of net income and comprehensive income.

The acquisition expands the Company's presence in the non-semiconductor market and included inventories, property and equipment, and other intangible assets. The acquisition has been recorded as a business combination in compliance with IFRS 3, *Business Combinations*.

The acquisition also included a leased premise in Camarillo and in accordance with IFRS 16, *Leases*, the Company has elected not to recognize a right-of-use asset and lease liability as the remaining lease term at the Acquisition Date is less than 12 months.

The following table summarizes the consideration paid and the allocation of the purchase price to the estimated fair value of net identifiable assets acquired:

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(In thousands of Canadian dollars)

For the three and six months ended June 30, 2020 and 2019

Allocation to identifiable net assets:		
Inventories	\$	504
Property and equipment		98
Intangible assets		120
Goodwill		122
Total identifiable net assets acquired	\$	844

The goodwill recognized on the acquisition date represents the incremental cost not specifically attributable to the identifiable net assets acquired.

If new information obtained within one year of the date of acquisition about facts and circumstances that existed at the date of acquisition identifies adjustments to the above amounts, or any additional provisions that existed at the date of acquisition, then the accounting for the acquisition will be revised.

5. Property and equipment

	Computers, office furniture and equipment	Laboratory equipment	Leasehold improvements	Production equipment	Right-of-use assets	Total
Cost						
Balance, January 1, 2019	\$ 1,387	\$ 1,505	\$ 4,041	\$ 2,552	\$ -	\$ 9,485
Adjustment on application of IFRS 16	-	-	-	-	1,683	1,683
Additions for the period	84	233	3	47	15	382
Balance, December 31, 2019	1,471	1,738	4,044	2,599	1,698	11,550
Additions for the period	257	227	39	46	8	577
Balance, June 30, 2020	\$ 1,728	\$ 1,965	\$ 4,083	\$ 2,645	\$ 1,706	\$ 12,127
Accumulated Depreciation						
Balance, January 1, 2019	\$ 535	\$ 605	\$ 828	\$ 1,220	\$ -	\$ 3,188
Depreciation for the period	182	205	535	410	278	1,610
Balance, December 31, 2019	717	810	1,363	1,630	278	4,798
Depreciation for the period	86	100	269	147	140	742
Balance, June 30, 2020	\$ 803	\$ 910	\$ 1,632	\$ 1,777	\$ 418	\$ 5,540
Net Book Value						
At December 31, 2019	\$ 754	\$ 928	\$ 2,681	\$ 969	\$ 1,420	\$ 6,752
At June 30, 2020	925	1,055	2,451	868	1,288	6,587

For the three and six months ended June 30, 2020, the Company recorded depreciation expense of \$157 and \$310 (2019 - \$191 and \$375) within cost of sales and \$220 and \$432 (2019 - \$211 and \$420) within operating expenses, respectively.



Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(In thousands of Canadian dollars)

For the three and six months ended June 30, 2020 and 2019

6. Intangible assets

	Acquired technologies	Computer software and other	Reacquired rights	Other intangible assets	Total
Cost					
Balance, January 1, 2019	\$ 4,439	\$ 542	\$ 2,000	\$ -	\$ 6,981
Additions for the period	92	84	-	-	176
Balance, December 31, 2019	4,531	626	2,000	-	7,157
Additions for the period	14	10	-	809	833
Balance, June 30, 2020	\$ 4,545	\$ 636	\$ 2,000	\$ 809	\$ 7,990
Accumulated Amortization					
Balance, January 1, 2019	\$ 2,032	\$ 407	\$ 327	\$ -	\$ 2,766
Amortization for the period	734	84	187	-	1,005
Balance, December 31, 2019	2,766	491	514	-	3,771
Amortization for the period	278	38	93	6	415
Balance, June 30, 2020	\$ 3,044	\$ 529	\$ 607	\$ 6	\$ 4,186
Net Book Value					
At December 31, 2019	\$ 1,765	\$ 135	\$ 1,486	\$ -	\$ 3,386
At June 30, 2020	1,501	107	1,393	803	3,804

In June 2020, the Company acquired a license and distribution agreement through a strategic partnership with FiSens GmbH ("FiSens"). This agreement expands the Company's product and technology portfolio and provides an exclusive license to sell FiSens products and patented technology for semiconductor applications and a non-exclusive license to sell outside the semiconductor industry.

For the three and six months ended June 30, 2020, the Company recorded amortization expense of \$199 and \$377 (2019 - \$227 and \$454) within cost of sales and \$20 and \$38 (2019 - \$16 and \$32) within operating expenses, respectively.



Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(In thousands of Canadian dollars)

For the three and six months ended June 30, 2020 and 2019

7. Uncertain tax position

During the period, the Company amended its previously filed income tax return from 2018 with the Canadian tax authority to claim additional foreign tax credits. As at June 30, 2020, the Company accrued for an uncertain tax position of \$1,463 (December 31, 2019 - \$nil). Based on management's assessment, the uncertain tax position could decrease tax expense starting in the 2023 fiscal year, as tax years become statute barred for purposes of audit by the Canadian tax authority. As at June 30, 2020, the Company accrued interest of \$35 (2019 - \$nil) related to the uncertain tax position.

8. Share capital

(a) Issued and outstanding

	Number of common shares	Share capital	Contributed surplus
Balance as at December 31, 2018	109,867,913	\$ 30,833	\$ 4,463
Issued upon exercise of stock options	56,060	42	(18)
Issued upon settlement of restricted share units	79,598	88	(88)
Repurchase of common shares for cancellation	(5,490,000)	(1,597)	-
Share-based payments	-	-	481
Balance as at December 31, 2019	104,513,571	29,366	4,838
Issued upon exercise of stock options	36,199	58	(50)
Issued upon settlement of restricted share units	40,302	62	(62)
Repurchase of common shares for cancellation	-	-	-
Share-based payments	-	-	258
Balance as at June 30, 2020	104,590,072	\$ 29,486	\$ 4,984

(b) Stock options

For the six months ended June 30, 2020, the Company granted 957,000 stock options to employees of the Company (2019 – 965,000). The weighted average fair value of stock options granted is \$0.66 (2019 - \$0.58). The options have a five-year term and vest evenly over three years.

A summary of the activity in the Company's stock option plan is presented below:

	Number of options	Weighted average exercise price
Options outstanding, December 31, 2018	3,072,250	\$ 1.43
Granted	1,440,000	1.17
Exercised	(77,500)	0.62
Forfeited	(1,038,500)	1.65
Options outstanding, December 31, 2019	3,396,250	1.27
Granted	957,000	1.45
Exercised	(157,333)	1.46
Forfeited	(217,167)	1.58
Options outstanding, June 30, 2020	3,978,750	\$ 1.29

During the six months ended June 30, 2020, the Company issued 28,699 (2019 – 5,640) common shares for the cashless exercise of 149,833 (2019 – 10,500) stock options.

As at June 30, 2020, the Company had the following stock options outstanding, entitling the holders to purchase one common share for each stock option held as follows:

	Options outstanding	Weighted average remaining term (years)	Options exercisable	Weighted average remaining term (years)
\$0.00 - 0.99	1,172,750	2.65	636,083	1.20
\$1.00 - 1.49	1,603,500	3.22	983,498	2.90
\$1.50 - 1.99	1,020,000	4.02	275,000	2.45
\$2.00 - 2.50	182,500	2.91	115,000	2.90
	3,978,750	3.24	2,009,581	2.30

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(In thousands of Canadian dollars)

For the three and six months ended June 30, 2020 and 2019

The following weighted average assumptions were used in calculating the fair value of stock options granted during the period using the Black-Scholes model:

	Six months ended	
	June 30, 2020	June 30, 2019
Expected option life	5 years	5 years
Risk-free interest rate	1.25%	1.79%
Dividend yield	0%	0%
Volatility	54%	52%
Forfeiture	30%	30%

(c) Restricted share units (“RSUs”)

As at June 30, 2020, the Company had no RSUs issued and outstanding (December 31, 2019 – 43,000).

(d) During the three and six months ended June 30, 2020, the Company recorded \$143 and \$258 (2019 - \$200 and \$345) of share-based payments, respectively, relating to the fair value of stock options and RSUs vesting during the period with a corresponding increase to contributed surplus.

9. Related party transactions

The Company defines key management as the Board of Directors and the senior management team. The remuneration of key management for the three and six months ended June 30, 2020 and 2019 is as follows:

	Three months ended		Six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Cash-based payments	\$ 702	\$ 526	\$ 1,244	\$ 716
Share-based payments	54	147	110	184
Total	\$ 756	\$ 673	\$ 1,354	\$ 900

Cash-based payments include salaries, bonuses, consulting fees, severance, and other benefits.



Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(In thousands of Canadian dollars)

For the three and six months ended June 30, 2020 and 2019

10. Segmented information

(a) Revenue

The Company carries on business in the semiconductor industry and all sales and costs are made in this segment. Revenue is disaggregated by primary geographical market as follows:

Primary geographical markets	Three months ended		Six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Asia	\$ 8,627	\$ 1,378	\$ 18,249	\$ 4,878
United States	7,471	5,728	15,161	10,260
	\$ 16,098	\$ 7,106	\$ 33,410	\$ 15,138

(b) Assets

The Company's property and equipment and intangible assets are located primarily in Canada.

(c) Major customers

Sales to the Company's three largest customers accounted for 85% and 84% of the Company's total sales for the three and six months ended June 30, 2020 (2019 – 90% and 88%).

11. Expense by nature

	Three months ended		Six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Wages and employee benefits	\$ 4,154	\$ 2,743	\$ 7,974	\$ 5,393
Depreciation of property and equipment	377	402	742	795
Amortization of intangible assets	219	243	415	486
Share-based payments	143	200	258	345
Cost of sales and other	5,408	3,294	11,733	7,141
Total	\$ 10,301	\$ 6,882	\$ 21,122	\$ 14,160

