



CONSOLIDATED FINANCIAL STATEMENTS OF

## Photon Control Inc.

For the years ended December 31, 2017 and 2016



## Independent Auditors' Report



To the Shareholders of Photon Control Inc.:

We have audited the accompanying consolidated financial statements of Photon Control Inc., which comprise the consolidated statement of financial position as at December 31, 2017 and 2016, and the consolidated statements of earnings and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

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

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

### *Auditors' Responsibility*

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

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

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

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Photon Control Inc. as at December 31, 2017 and 2016 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Vancouver, British Columbia

March 14, 2018

*MNP LLP*

Chartered Professional Accountants

# PHOTON CONTROL INC.

## Consolidated Statements of Financial Position (In thousands of Canadian dollars)

|                                                      | December 31,<br>2017 | December 31,<br>2016 |
|------------------------------------------------------|----------------------|----------------------|
| <b>Assets</b>                                        |                      |                      |
| Current assets                                       |                      |                      |
| Cash                                                 | \$ 34,345            | \$ 32,508            |
| Trade and other receivables                          | 3,393                | 5,173                |
| Due from related party (note 5)                      | -                    | 189                  |
| Current portion of note receivable (note 5)          | -                    | 17                   |
| Inventories (note 6)                                 | 4,052                | 3,247                |
| Prepaid expenses and deposits                        | 279                  | 255                  |
| Assets held for sale (note 11)                       | 184                  | -                    |
| <b>Total current assets</b>                          | <b>42,253</b>        | <b>41,389</b>        |
| Note receivable (note 5)                             | -                    | 56                   |
| Restricted cash (note 10)                            | 53                   | 652                  |
| Property and equipment (note 7)                      | 6,930                | 755                  |
| Intangible assets (note 8)                           | 5,464                | 80                   |
| Goodwill (note 9)                                    | 849                  | -                    |
| Deferred tax asset (note 14)                         | -                    | 259                  |
| <b>Total assets</b>                                  | <b>\$ 55,549</b>     | <b>\$ 43,191</b>     |
| <b>Liabilities and Shareholders' Equity</b>          |                      |                      |
| Current liabilities                                  |                      |                      |
| Accounts payable and accrued liabilities             | \$ 4,003             | \$ 2,035             |
| Due to related party (note 5)                        | -                    | 1,814                |
| Income taxes payable                                 | 579                  | 420                  |
| Current portion of contingent consideration (note 5) | 1,321                | -                    |
| Deferred revenue (note 5)                            | -                    | 50                   |
| <b>Total current liabilities</b>                     | <b>5,903</b>         | <b>4,319</b>         |
| Contingent consideration (note 5)                    | 2,684                | -                    |
| Deferred tax liability (note 14)                     | 302                  | -                    |
| <b>Total liabilities</b>                             | <b>8,889</b>         | <b>4,319</b>         |
| Shareholders' equity                                 |                      |                      |
| Share capital (note 12)                              | 30,573               | 29,137               |
| Contributed surplus (note 12)                        | 4,154                | 3,494                |
| Retained earnings                                    | 11,933               | 6,241                |
| <b>Total shareholders' equity</b>                    | <b>46,660</b>        | <b>38,872</b>        |
| <b>Total liabilities and shareholders' equity</b>    | <b>\$ 55,549</b>     | <b>\$ 43,191</b>     |

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

Approved on behalf of the Board:

"Scott Edmonds", Director

"Neil McDonnell", Director

# PHOTON CONTROL INC.

## Consolidated Statements of Comprehensive Income

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

|                                                                | Year ended           |                      |
|----------------------------------------------------------------|----------------------|----------------------|
|                                                                | December 31,<br>2017 | December 31,<br>2016 |
| Revenue                                                        | \$ 43,813            | \$ 32,172            |
| Cost of sales                                                  | 20,522               | 15,952               |
| Gross profit                                                   | 23,291               | 16,220               |
| Operating expenses                                             |                      |                      |
| General and administrative                                     | 11,133               | 4,602                |
| Engineering                                                    | 3,159                | 1,245                |
| Sales and marketing                                            | 1,186                | 939                  |
| Total operating expenses                                       | 15,478               | 6,786                |
| Operating income                                               | 7,813                | 9,434                |
| Finance income                                                 | 176                  | 137                  |
| Accretion expense on contingent consideration (note 5)         | (639)                | -                    |
| Change in fair value of contingent consideration (note 5)      | (264)                | -                    |
| Gain on settlement of pre-existing relationships, net (note 5) | 3,200                | -                    |
| Foreign exchange loss                                          | (2,037)              | (186)                |
|                                                                | 436                  | (49)                 |
| Net income before tax                                          | 8,249                | 9,385                |
| Income tax (note 14)                                           | 2,557                | 2,869                |
| Net earnings and total comprehensive income                    | \$ 5,692             | \$ 6,516             |
| Basic and diluted earnings per share                           |                      |                      |
| Weighted average common shares, basic                          | 109,509,540          | 105,992,172          |
| Weighted average common shares, diluted                        | 113,832,668          | 113,619,998          |
| Basic earnings per share                                       | \$ 0.05              | \$ 0.06              |
| Diluted earnings per share                                     | \$ 0.05              | \$ 0.06              |

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

# PHOTON CONTROL INC.

## Consolidated Statements of Changes in Shareholders' Equity

(In thousands of Canadian dollars)

| Year ended December 31, 2017              |                  |                        |                      |                        |
|-------------------------------------------|------------------|------------------------|----------------------|------------------------|
|                                           | Share<br>Capital | Contributed<br>Surplus | Retained<br>Earnings | Total<br>Shareholders' |
| <b>Balance at December 31, 2016</b>       | <b>\$ 29,137</b> | <b>\$ 3,494</b>        | <b>\$ 6,241</b>      | <b>\$ 38,872</b>       |
| Net income and total comprehensive income | -                | -                      | 5,692                | 5,692                  |
| Share issuance                            | 1,589            | (181)                  | -                    | 1,408                  |
| Re-purchase of shares for cancellation    | (153)            | (459)                  | -                    | (612)                  |
| Share-based payments                      | -                | 1,300                  | -                    | 1,300                  |
| <b>Balance at December 31, 2017</b>       | <b>\$ 30,573</b> | <b>\$ 4,154</b>        | <b>\$ 11,933</b>     | <b>\$ 46,660</b>       |

  

| Year ended December 31, 2016              |                  |                        |                      |                        |
|-------------------------------------------|------------------|------------------------|----------------------|------------------------|
|                                           | Share<br>Capital | Contributed<br>Surplus | Retained<br>Earnings | Total<br>Shareholders' |
| <b>Balance at December 31, 2015</b>       | <b>\$ 28,218</b> | <b>\$ 3,694</b>        | <b>\$ (275)</b>      | <b>\$ 31,637</b>       |
| Net income and total comprehensive income | -                | -                      | 6,516                | 6,516                  |
| Share issuance                            | 1,315            | -                      | -                    | 1,315                  |
| Re-purchase of shares for cancellation    | (396)            | (933)                  | -                    | (1,329)                |
| Share-based payments                      | -                | 733                    | -                    | 733                    |
| <b>Balance at December 31, 2016</b>       | <b>\$ 29,137</b> | <b>\$ 3,494</b>        | <b>\$ 6,241</b>      | <b>\$ 38,872</b>       |

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

# PHOTON CONTROL INC.

## Consolidated Statements of Cash Flows

(In thousands of Canadian dollars)

|                                                     | Year ended           |                      |
|-----------------------------------------------------|----------------------|----------------------|
|                                                     | December 31,<br>2017 | December 31,<br>2016 |
| Operating activities                                |                      |                      |
| Net income for the period                           | \$ 5,692             | \$ 6,516             |
| Adjustments for                                     |                      |                      |
| Depreciation of property and equipment              | 758                  | 163                  |
| Amortization of intangible assets                   | 1,182                | 55                   |
| Share-based payments                                | 1,300                | 733                  |
| Accretion expense on contingent consideration       | 639                  | -                    |
| Change in fair value of contingent consideration    | 264                  | -                    |
| Accretion income on note receivable                 | (39)                 | 12                   |
| Gain on pre-existing relationships, net             | (3,200)              | -                    |
| Net change in non-cash working capital items        |                      |                      |
| Trade and other receivables                         | 1,780                | (1,607)              |
| Due to/from related party, net                      | (1,625)              | 1,618                |
| Inventories                                         | (966)                | (613)                |
| Prepaid expenses and deposits                       | (24)                 | (183)                |
| Deferred tax asset                                  | 259                  | 59                   |
| Accounts payable and accrued liabilities            | 1,968                | 791                  |
| Income taxes payable                                | 159                  | (190)                |
| Deferred revenue                                    | (50)                 | (18)                 |
| Deferred tax liability                              | 302                  | -                    |
| Net cash provided by operating activities           | 8,399                | 7,336                |
| Financing activities                                |                      |                      |
| Proceeds from exercise of stock options             | 1,408                | 1,315                |
| Restricted cash                                     | 599                  | (598)                |
| Proceeds from note receivable                       | 112                  | 9                    |
| Re-purchase of common shares for cancellation       | (612)                | (1,329)              |
| Payment of contingent consideration                 | (986)                | -                    |
| Net cash provided by (used in) financing activities | 521                  | (603)                |
| Investing activities                                |                      |                      |
| Purchase of property and equipment                  | (6,933)              | (439)                |
| Purchase of intangible assets                       | (150)                | (13)                 |
| Net cash used in investing activities               | (7,083)              | (452)                |
| Net increase in cash                                | 1,837                | 6,281                |
| Cash, beginning of period                           | 32,508               | 26,227               |
| Cash, end of period                                 | \$ 34,345            | \$ 32,508            |
| Supplementary information                           |                      |                      |
| Interest received                                   | \$ 189               | \$ 141               |
| Income taxes paid                                   | 1,837                | 3,000                |

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

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

(In thousands of Canadian dollars)

For the years ended December 31, 2017 and 2016

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## 1. Nature of business and continuing operations

Photon Control Inc. ("Photon Control" or the "Company") is a publicly-traded company listed on the TSX Venture Exchange (the "TSX-V") under the trading symbol PHO, and is incorporated under the laws of British Columbia, Canada. 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 595 Burrard Street, PO Box 49314, Suite 2600, Three Bentall Centre, Vancouver, British Columbia, Canada, V7X 1L3.

The consolidated financial statements of the Company for the years ended December 31, 2017 and 2016 comprise the statements of the Company and its subsidiaries, including a subsidiary, Photon Control (USA) Inc., incorporated in the United States of America in 2017. The financial statements were authorized for issue by the Board of Directors on March 14, 2018.

Photon Control designs, manufactures and distributes a wide range of optical sensors and systems to measure temperature and position. These products are used by the world's largest Wafer Fabrication Equipment ("WFE") manufacturers and end users in the semiconductor and related industries.

## 2. Basis of presentation

### Statement of compliance

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

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of financial statements as issued by the International Accounting Standards Board ("IASB") and IFRS Interpretations Committee ("IFRIC") applicable to companies reporting under IFRS. These consolidated financial statements have been prepared under the historical cost convention including International Accounting Standard 1, Presentation of Financial Statements ("IAS 1").

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.

### Use of critical accounting judgments and estimates

The preparation of the 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. Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements is as follows:

#### (a) Valuation of contingent consideration

The Company recognizes the fair value of contingent consideration relating to acquisitions on the date the transaction closes. Contingent consideration is classified as either a liability carried at amortized cost

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(In thousands of Canadian dollars)

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or equity within contributed surplus. Contingent consideration classified as a liability is carried at fair value with changes in fair value flowing through the consolidated statements of comprehensive income. Contingent consideration classified as equity is not remeasured subsequent to initial recognition.

Contingent consideration classified as a liability is measured at fair value based on management's best estimate of the probability of the attainment of specified revenue targets at the date of acquisition and is subsequently revalued at each financial reporting period. Management's estimate of the probability of the attainment of specified revenue targets takes into account management's evaluation of the revenue forecast for the respective acquired businesses and the risks thereon. Changes in management's estimate of the probability of achieving the specified target could have a material impact on the valuation of the contingent consideration classified as a liability. The current portion of contingent consideration is based on the Company's estimate of the value that will be payable within twelve months.

## **(b) Valuation of assets and liabilities in connection with a business combination**

In accordance with IFRS 3, Business Combinations, accounting for an acquisition requires management to allocate the purchase price paid for an acquisition to the fair value of identified assets and liabilities acquired, with any residual recorded as goodwill. The identification of assets and liabilities required both judgments and estimates regarding the identification of balances acquired and the fair value therein. The values of assets and liabilities are recorded at fair value based on management's best estimate. Key estimates and assumptions include the forecasted financial performance of the acquired company; projected customer attrition of the acquired customer base; and the expected use of assets and liabilities acquired among other considerations. Changes in certain estimates and assumptions could have a material impact on the valuation of assets and liabilities recognized on a business combination.

## **(c) Valuation of settlement of pre-existing relationships in connection with a business combination**

In accordance with IFRS 3, Business Combinations, the acquirer and acquiree may have a relationship that existed before they contemplated the business combination, whether contractual or non-contractual. The fair value of the settlement of pre-existing relationships would be recognized as a gain/loss on effective settlement separately on the consolidated statements of comprehensive income from the acquisition, and the consideration transferred for the acquisition would be increased/decreased by a corresponding amount.

Settlement of pre-existing relationships is measured at fair value based on management's best estimate of the probability of the attainment of specified revenue targets at the date of settlement and costs avoided as a result of the settlement. Management's estimate of the probability of the attainment of specified revenue targets takes into account management's evaluation of the revenue forecast associated with the pre-existing relationship and the risks thereon.

## **(d) Impairment of non-financial assets**

The Company reviews goodwill at least annually and other non-financial assets when there is any indication that the asset might be impaired. The Company estimates the value in use and fair value of its operating segment to which goodwill is allocated using discounted cash flow models that require assumptions about future cash flows, margins and discount rates.

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Notes to Consolidated Financial Statements

(In thousands of Canadian dollars)

For the years ended December 31, 2017 and 2016

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## 3. Significant accounting policies

### Consolidation

The financial statements of the Company consolidate the accounts of Photon Control Inc. and its subsidiaries. Subsidiaries are entities controlled by the Company. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Company.

Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

### Disposals of non-current assets and assets held for sale

Non-current assets are classified as held for sale if the carrying amount will be recovered principally through a sale transaction rather than through continued use, they are available for sale in their present condition and such sale is considered highly probable. The criteria for classification as held for sale include a firm decision by management or the Board of Directors to dispose of a business or a group of assets and the expectation that such disposal will be completed within a twelve month period.

Assets held for sale are carried at the lower of their carrying amount or fair value less costs to sell. Assets held for sale are classified as discontinued operations if the operations and cash flows can be clearly distinguished, both operationally and for financial reporting purposes, from the rest of the Company and they represent a separate major line of business or geographical area of operations, or are part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or is a subsidiary acquired with the view to resell.

### Foreign currency translation

#### (i) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the parent's functional currency. All financial information presented in Canadian dollars has been rounded to the nearest thousand.

The results and financial position of all the group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- Income and expenses for each statement of comprehensive income are translated at average exchange rates; and
- All resulting exchange differences are included in each statement of comprehensive income.

#### (ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange

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gains and losses resulting from the settlement of such transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statements of operation

## **Business combinations**

Acquisitions have been accounted for using the acquisition method required by IFRS 3. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value. The Company uses its best estimates and assumptions to accurately value assets and liabilities assumed at the acquisition date as well as contingent consideration, where applicable, and these estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company records adjustments to the assets acquired and liabilities assumed with a corresponding offset to goodwill. On conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded in profit or loss. Transaction costs the Company incurs in connection with a business combination are expensed as incurred.

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39, Financial Instruments: Recognition and Measurement, is measured at fair value with the changes in fair value recognized in the consolidated statements of comprehensive income.

Goodwill arising on acquisition is measured as the fair value of the consideration transferred less the net recognized amount of the estimated fair value of identifiable assets acquired and liabilities assumed (subject to certain exemptions to fair value measurement principles such as deferred tax assets or liabilities), all measured as of the acquisition date.

## **Cash**

Cash consists of cash on deposit.

## **Financial instruments**

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset, and the net amount reported in the statements of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

### **(a) Financial assets and liabilities at fair value through profit or loss**

A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges.

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Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statements of comprehensive income. Gains and losses arising from changes in fair value are presented in the statements of comprehensive income within finance income in the period in which they arise.

Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which is classified as non-current.

The Company does not carry financial assets or financial liabilities at fair value through profit or loss other than contingent consideration classified as a liability.

## **(b) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables are comprised of trade and other receivables, due from related party, note receivable, cash and restricted cash.

Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

## **(c) Financial liabilities at amortized cost**

Financial liabilities at amortized cost include accounts payable and accrued liabilities and due to related party. Financial liabilities are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, financial liabilities are measured at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

## **Impairment of financial and non-financial assets**

### **(a) Financial assets**

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar risk characteristics.

All impairment losses are recognized in the statements of comprehensive income. Any cumulative loss in respect of an available-for-sale financial asset recognized previously in other comprehensive income is transferred to the statements of comprehensive income.

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For financial assets measured at amortized cost and available-for-sale financial assets that are debt securities, an impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized.

## **(b) Non-financial assets**

The carrying amounts of the Company's non-financial assets, other than inventories which are separately assessed, are reviewed each reporting date to determine whether there are any events or changes that are indicators of impairment. If such indicators exist, then the asset's recoverable amount is estimated.

For the purpose of impairment testing, assets are grouped together in the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the cash-generating unit or "CGU"). The recoverable amount of an asset or cash-generating unit is the greater of its value in use and fair value less costs to sell. In assessing value in use, future discounted cash flows are estimated.

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in the statements of operations. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units, and then to reduce the carrying amounts of the other assets in the unit on a pro rata basis.

Management allocates and monitors its goodwill based on its CGU and accordingly, goodwill is assessed for impairment together with the assets and liabilities of that CGU.

The Company evaluates impairment losses, other than goodwill impairment, for potential reversals when events or circumstances warrant such consideration.

## **Inventories**

Inventory is comprised of optical, mechanical and electronic components and finished goods, and is stated at the lower of cost and net realizable value.

Cost is determined on a first in, first out basis, and includes the cost of direct materials, direct labour and other overhead costs. Labour costs are allocated to items based on actual labour rates. Fixed and variable overhead are allocated to production activities in converting materials to finished goods.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and selling expenses.

Inventory is regularly reviewed for obsolescence and is recorded net of any obsolescence provisions. When there is a significant change in economic circumstances, inventory that had been previously written down below cost may be written back up provided the reversal does not exceed the original write down.

## **Property and equipment**

All property and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the items. When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment. Subsequent costs are included in the asset's carrying

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amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

Depreciation is recognized in the statements of comprehensive income using the following depreciation methods and rates:

| Asset                                     | Method            | Rate                                                      |
|-------------------------------------------|-------------------|-----------------------------------------------------------|
| Laboratory equipment                      | Declining balance | 15 - 20%                                                  |
| Computers, office furniture and equipment | Declining balance | 20%                                                       |
| Production equipment                      | Declining balance | 30%                                                       |
| Leasehold improvements                    | Straight-line     | Lesser of initial term of lease and useful life of assets |

## Intangible assets

Identifiable intangible assets acquired either individually or with a group of other assets are initially recognized or measured at cost. Intangible assets with finite useful lives are amortized over their estimated useful lives. The amortization methods and estimated useful lives of intangible assets are as follows:

| Asset                       | Method            | Rate             |
|-----------------------------|-------------------|------------------|
| Patents                     | Declining balance | 25%              |
| Computer software and other | Declining balance | 30 - 100%        |
| Acquired technologies       | Declining balance | 30%              |
| Reacquired rights           | Straight-line     | Contractual term |

## Goodwill

Goodwill represents the excess of costs of an acquisition over the fair value of the identifiable net assets acquired.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

## Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are discounted where the effect is material.

A provision for warranties is recognized when the underlying products are sold. The provision is based on historical warranty data.

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(In thousands of Canadian dollars)

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## **Income tax**

The tax expense for the period comprises current and deferred tax. Tax is recognized in the statements of comprehensive income, except to the extent that it relates to items recognized directly in shareholders' equity. In this case, the tax is also recognized directly in shareholders' equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date in the countries where the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined on a non-discounted basis using tax rates (and laws) that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

## **Revenue recognition**

Revenue from sales of products is recognized when the goods are shipped and title passes, there is persuasive evidence of an arrangement, collection is probable and fees are fixed and determinable.

## **Research and development**

Development costs are capitalized in the event they meet capitalization criteria under IFRS, otherwise they are expensed as incurred. To date, no development costs have been capitalized.

## **Share capital**

Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from share capital, net of any tax effects.

## **Share-based payments**

The Company grants stock options to employees and directors. Each tranche in an award is considered a separate award with its own vesting period and grant-date fair value. Fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. The grant-date fair value of options granted to employees and directors is recognized as share-based payment expense, with a corresponding increase in equity, over the period that the individual becomes unconditionally entitled to the options. The amount recognized as an expense is adjusted to reflect the number of share options for which the related service vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of share options that do meet the related service conditions at the vesting date.

# PHOTON CONTROL INC.

Notes to Consolidated Financial Statements

(In thousands of Canadian dollars)

For the years ended December 31, 2017 and 2016

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## Earnings per share

Basic earnings per share ("EPS") is calculated by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by adjusting the net earnings and the weighted average number of common shares outstanding, for the effects of all dilutive potential common shares using the treasury stock method.

## 4. New standards and interpretations

### IFRS 9, Financial Instruments ("IFRS 9")

IFRS 9 is effective for years commencing on or after January 1, 2018, and will replace IAS 39, Financial Instruments: Recognition and Measurement. Under IFRS 9, financial assets and liabilities will be classified and measured based on the business model in which they are held and the characteristics of the associated contractual cash flows. IFRS 9 also includes a new general hedge accounting standard which will better align hedge accounting and risk management. IFRS 9 introduces new requirements for the impairment of financial assets. The Company is evaluating the impact of this standard on its consolidated financial statements.

### IFRS 15, Revenue from Contracts with Customers ("IFRS 15")

IFRS 15 is effective for years commencing on or after January 1, 2018, and replaces IAS 11, Construction Contracts; IAS 18, Revenue; International Financial Reporting Interpretations Committee ("IFRIC") 13, Customer Loyalty Programmes; IFRIC 15, Agreements for the Construction of Real Estate; IFRIC 18, Transfer of Assets from Customers; and Standing Interpretations Committee 31, Revenue - Barter Transactions Involving Advertising Services. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time, or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The Company will adopt IFRS 15 in its financial statements for the annual period beginning on January 1, 2018. The Company has determined that the adoption of IFRS 15 will have no material impact on the Company. The Company is continuing to evaluate the impact of disclosures to its future consolidated financial statements.

### IFRS 16, Leases ("IFRS 16")

IFRS 16 is effective for years commencing on or after January 1, 2019, and replaces IAS 17, Leases. The standard provides a single lease accounting model, requiring lessees to recognize assets and liabilities for almost all leases. The Company is evaluating the impact of this standard on its consolidated financial statements.

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## 5. Business combination

The Company had historical relationships with Photon Control R&D Ltd. ("Photon R&D") and DCD Management Ltd., both considered related parties whereby the companies had directors and shareholders in common. These relationships involved the Company outsourcing its research and development to Photon R&D and certain administrative functions to both Photon R&D and DCD Management Ltd. In connection with outsourcing its research and development functions, the Company entered into an agreement dated October 1, 2008 ("R&D Agreement") including various Addenda between 2009 and 2013 ("Addenda") with Photon R&D. In August 2016, the Company commenced a lawsuit in the Court against Photon R&D and others related to the Addenda and certain other matters, see Note 20.

As a result of these relationships, there were certain amounts owing between the Company and these related parties at December 31, 2016, including a note receivable and associated deferred revenue. These amounts and transactions occurred in the normal course of business and have since been settled.

On April 14, 2017 (the "Acquisition Date"), following a period of litigation, and as part of a settlement agreement with Photon R&D ("Settlement Agreement"), the Company completed the acquisition of certain tangible and intangible assets of Photon Control R&D Ltd. for cash consideration of \$770 and contingent consideration of \$4,088. In addition, the agreement included a gain on settlement of pre-existing relationships, net, which is comprised of:

|                                                              |           |              |
|--------------------------------------------------------------|-----------|--------------|
| Gain on settlement of pre-existing lawsuits                  | \$        | 6,300        |
| Loss on settlement of pre-existing agreements                |           | (3,100)      |
| <b>Gain on settlement of pre-existing relationships, net</b> | <b>\$</b> | <b>3,200</b> |

The acquisition included inventories, property and equipment, the transfer of all technical personnel and intellectual property to the Company as well as the clarification of the rights of ownership and exploitation of intellectual property. The Settlement Agreement also provided for the settlement of all amounts owing and payable, including the note receivable, between the Company and Photon R&D and certain other terms and conditions.

The contingent consideration relates to a royalty agreement included in the Settlement Agreement, which provides for quarterly royalties on revenues earned from defined products from January 1, 2017 to December 31, 2021. This royalty agreement replaces a previous arrangement.

The Settlement Agreement also includes terms of a 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 gain on settlement of pre-existing lawsuits include avoided litigation costs, and the impact of future royalties as part of the Settlement Agreement.

The Settlement Agreement also terminated an unfavourable pre-existing R&D Agreement and Addenda, resulting in a loss on settlement of pre-existing agreements.

# PHOTON CONTROL INC.

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The following table summarizes the fair value of consideration paid on the Acquisition Date and the allocation of the purchase price to the fair value of assets acquired. This reflects the final purchase price allocation which was adjusted from provisional amounts recorded in the Company's unaudited interim consolidated financial statements during the 2017 fiscal year:

|                                               |                 |
|-----------------------------------------------|-----------------|
| Cash on closing                               | \$ 770          |
| Fair value of contingent consideration        | 4,088           |
| Gain on settlement of pre-existing lawsuits   | 6,300           |
| Loss on settlement of pre-existing agreements | (3,100)         |
| <b>Total consideration</b>                    | <b>\$ 8,058</b> |

**Allocation to identifiable net assets:**

|                                      |                 |
|--------------------------------------|-----------------|
| Inventories                          | \$ 130          |
| Property and equipment               | 640             |
| Acquired technologies                | 4,439           |
| Reacquired rights                    | 2,000           |
| Goodwill                             | 849             |
| <b>Total allocated to net assets</b> | <b>\$ 8,058</b> |

The goodwill recognized on the acquisition represents the incremental cost not specifically attributable to the identifiable assets and liabilities acquired. The goodwill is underpinned by an assembled workforce that was transferred as well by the synergies the Company aims to achieve with the ability to completely serve the growing needs of its customers.

The contingent consideration is payable in cash and has been recorded as a liability on the consolidated statements of financial position at fair value based on management's best estimate of future revenues. The estimate uses a discount rate of 20% which is reflective of the inherent risk of the Company achieving these future revenues. As at the acquisition date, the fair value of the contingent consideration was estimated to be \$4,088.

For the year ended December 31, 2017, the Company recognized a change in fair value of contingent consideration of \$264 (2016 - \$Nil) as a result of a revision in management's estimate of the amount based on current information regarding the underlying revenue performance.

The following table shows a reconciliation of the contingent consideration liability:

|                                                    |              |
|----------------------------------------------------|--------------|
| Contingent consideration, January 1, 2017          | \$ -         |
| Liability arising from business combination        | 4,088        |
| Payment of contingent consideration                | (986)        |
| Accretion expense                                  | 639          |
| Change in fair value of contingent consideration   | 264          |
| <b>Contingent consideration, December 31, 2017</b> | <b>4,005</b> |

The table below presents the contingent consideration as at December 31, 2017 recorded on the consolidated statements of financial position:

|                   |                 |
|-------------------|-----------------|
| Current portion   | \$ 1,321        |
| Long term portion | 2,684           |
| <b>Total</b>      | <b>\$ 4,005</b> |

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The estimated amounts payable related to the contingent consideration could be higher or lower depending on the related future revenue outcome. Significant increases or decreases in related revenue would result in a higher or lower fair value of the contingent consideration liability, while significant increases or decreases in the discount rate and performance risk would result in a lower or higher fair value of the liability.

It is not practicable to estimate the revenue or profit of Photon R&D since the acquisition date as the business combination represents the integration of an external service provider, resulting in lower royalty costs and elimination of engineering support fees partially offset by increased staffing costs.

Costs directly attributable to the acquisition for the year ended December 31, 2017 of \$951 have been expensed in general and administrative and are included in the consolidated statements of comprehensive income.

In addition to the arrangements described above, the Company severed its relationship with DCD Management Ltd. settling all amounts owing and bringing all previously outsourced administrative functions in-house.

## 6. Inventories

|                  | December 31,<br>2017 | December 31,<br>2016 |
|------------------|----------------------|----------------------|
| Raw materials    | \$ 2,958             | \$ 1,538             |
| Work in progress | 569                  | 614                  |
| Finished goods   | 525                  | 1,095                |
| <b>Total</b>     | <b>\$ 4,052</b>      | <b>\$ 3,247</b>      |

For the year ended December 31, 2017, inventories recognized as an expense in cost of sales amounted to \$15,684 (2016 - \$11,835). During the period, inventories were reviewed for obsolescence as part of ongoing operations. As at December 31, 2017, the obsolescence provision against inventories totaled \$626 (2016 - \$628).

# PHOTON CONTROL INC.

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## 7. Property and equipment

|                                                                   | Laboratory<br>equipment | Computers,<br>office furniture<br>and equipment | Production<br>equipment | Leasehold<br>improvements | Total           |
|-------------------------------------------------------------------|-------------------------|-------------------------------------------------|-------------------------|---------------------------|-----------------|
| <b>Cost</b>                                                       |                         |                                                 |                         |                           |                 |
| Balance January 1, 2016                                           | \$ 346                  | \$ 368                                          | \$ 697                  | \$ 398                    | \$ 1,809        |
| Additions                                                         | -                       | 70                                              | 341                     | 28                        | 439             |
| Balance December 31, 2016                                         | 346                     | 438                                             | 1,038                   | 426                       | 2,248           |
| Additions                                                         | 772                     | 552                                             | 1,028                   | 3,941                     | 6,293           |
| Additions from acquisition of<br>Photon Control R&D Ltd. (note 5) | 329                     | 34                                              | 277                     | -                         | 640             |
| Disposals/write-offs                                              | -                       | -                                               | -                       | (400)                     | (400)           |
| Transfer - asset held for sale (note 11)                          | -                       | -                                               | (123)                   | -                         | (123)           |
| <b>Balance December 31, 2017</b>                                  | <b>\$ 1,447</b>         | <b>\$ 1,024</b>                                 | <b>\$ 2,220</b>         | <b>\$ 3,967</b>           | <b>\$ 8,658</b> |
| <b>Accumulated Depreciation</b>                                   |                         |                                                 |                         |                           |                 |
| Balance January 1, 2016                                           | \$ 295                  | \$ 274                                          | \$ 379                  | \$ 382                    | \$ 1,330        |
| Depreciation for the period                                       | 9                       | 23                                              | 121                     | 10                        | 163             |
| Balance December 31, 2016                                         | 304                     | 297                                             | 500                     | 392                       | 1,493           |
| Depreciation for the period                                       | 82                      | 65                                              | 307                     | 304                       | 758             |
| Disposals/write-offs                                              | -                       | -                                               | -                       | (400)                     | (400)           |
| Transfer - asset held for sale (note 11)                          | -                       | -                                               | (123)                   | -                         | (123)           |
| <b>Balance December 31, 2017</b>                                  | <b>\$ 386</b>           | <b>\$ 362</b>                                   | <b>\$ 684</b>           | <b>\$ 296</b>             | <b>\$ 1,728</b> |
| <b>Carrying Amounts</b>                                           |                         |                                                 |                         |                           |                 |
| At December 31, 2016                                              | \$ 42                   | \$ 141                                          | \$ 538                  | \$ 34                     | \$ 755          |
| <b>At December 31, 2017</b>                                       | <b>1,061</b>            | <b>662</b>                                      | <b>1,536</b>            | <b>3,671</b>              | <b>6,930</b>    |

Total depreciation of property and equipment for the year ended December 31, 2017 was \$758 (2016 - \$163).

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## 8. Intangible assets

|                                                                | Patents     | Computer software and other | Acquired technologies | Reacquired Rights | Total           |
|----------------------------------------------------------------|-------------|-----------------------------|-----------------------|-------------------|-----------------|
| <b>Cost</b>                                                    |             |                             |                       |                   |                 |
| Balance January 1, 2016                                        | \$ 378      | \$ 312                      | \$ -                  | \$ -              | \$ 690          |
| Additions                                                      | -           | 13                          | -                     | -                 | 13              |
| Balance December 31, 2016                                      | 378         | 325                         | -                     | -                 | 703             |
| Additions                                                      | -           | 150                         | -                     | -                 | 150             |
| Additions from acquisition of Photon Control R&D Ltd. (note 5) | -           | -                           | 4,439                 | 2,000             | 6,439           |
| Transfer - asset held for sale (note 11)                       | (378)       | -                           | -                     | -                 | (378)           |
| <b>Balance December 31, 2017</b>                               | <b>\$ -</b> | <b>\$ 475</b>               | <b>\$ 4,439</b>       | <b>\$ 2,000</b>   | <b>\$ 6,914</b> |
| <b>Accumulated Amortization</b>                                |             |                             |                       |                   |                 |
| Balance January 1, 2016                                        | \$ 337      | \$ 231                      | \$ -                  | \$ -              | \$ 568          |
| Amortization for the period                                    | 10          | 45                          | -                     | -                 | 55              |
| Balance December 31, 2016                                      | 347         | 276                         | -                     | -                 | 623             |
| Amortization for the period                                    | 8           | 34                          | 1,000                 | 140               | 1,182           |
| Transfer - asset held for sale (note 11)                       | (355)       | -                           | -                     | -                 | (355)           |
| <b>Balance December 31, 2017</b>                               | <b>\$ -</b> | <b>\$ 310</b>               | <b>\$ 1,000</b>       | <b>\$ 140</b>     | <b>\$ 1,450</b> |
| <b>Carrying Amounts</b>                                        |             |                             |                       |                   |                 |
| At December 31, 2016                                           | \$ 31       | \$ 49                       | \$ -                  | \$ -              | \$ 80           |
| <b>At December 31, 2017</b>                                    | <b>-</b>    | <b>165</b>                  | <b>3,439</b>          | <b>1,860</b>      | <b>5,464</b>    |

Total amortization of intangible assets for the year ended December 31, 2017 was \$1,182 (2016 - \$55).

## 9. Goodwill

Goodwill of \$849 arose as a result of the acquisition of Photon Control R&D Ltd. in 2017, see Note 5.

The Company performs its impairment test annually for its sole CGU containing goodwill. The Company has not identified any goodwill impairment for the year ended December 31, 2017. The Company's assessment could be impacted by a change in market factors or a change in management's estimate of forecasted financial performance. Reasonably possible changes in key estimates and assumptions are unlikely to cause the recoverable amount of goodwill to fall below the carrying value of the CGU.

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## 10. Restricted cash

In connection with the litigation proceedings between the Company and Photon Control R&D Ltd., Photon R&D obtained a court order to garnishee \$599 it claimed it was owed by the Company. The parties reached a Settlement Agreement in April 2017 and the garnisheered funds were returned to the Company in July 2017, see Notes 5 and 20.

Additionally, the Company holds a corporate credit card secured by a \$53 cash deposit, and the facility is subject to periodic review by the issuing bank.

|                                                 | December 31,<br>2017 | December 31,<br>2016 |
|-------------------------------------------------|----------------------|----------------------|
| Garnisheered funds (held in trust by the Court) | \$ -                 | \$ 599               |
| Credit card cash deposit                        | 53                   | 53                   |
| <b>Total</b>                                    | <b>\$ 53</b>         | <b>\$ 652</b>        |

## 11. Assets held for sale

On January 31, 2018, the Company entered into a letter of intent with King's Energy Inc. (the "OFM Transaction") to sell all the assets and rights associated with the Company's Optical Flow Meter product. On February 15, 2018, the Company completed the OFM Transaction with King's Energy Inc., see Note 21.

As a result of the OFM Transaction and in accordance with IFRS 5 - *Non-Current Assets Held for Sale and Discounted Operations*, the Company has presented the Optical Flow Meter product as Assets Held for Sale at December 31, 2017.

The carrying value of assets to be disposed of were as follows:

|                   | December 31,<br>2017 |
|-------------------|----------------------|
| Inventories       | \$ 161               |
| Intangible assets | 23                   |
| <b>Total</b>      | <b>\$ 184</b>        |

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## 12. Share capital

### (a) Authorized

Unlimited number of common shares without par value

### (b) Issued and outstanding

|                                        | Number of<br>Common<br>Shares | Share Capital    | Contributed<br>Surplus |
|----------------------------------------|-------------------------------|------------------|------------------------|
| <b>Balance as at December 31, 2015</b> | <b>103,971,518</b>            | <b>\$ 28,218</b> | <b>\$ 3,694</b>        |
| Issued upon exercise of stock options  | 5,543,500                     | 1,096            | -                      |
| Issued for restricted share units      | 308,000                       | 219              | -                      |
| Re-purchase of shares for cancellation | (319,500)                     | (85)             | (202)                  |
| Re-purchase of shares for treasury     | (1,155,000)                   | (311)            | (731)                  |
| Share-based payments                   | -                             | -                | 733                    |
| <b>Balance as at December 31, 2016</b> | <b>108,348,518</b>            | <b>29,137</b>    | <b>3,494</b>           |
| Issued upon exercise of stock options  | 2,827,000                     | 1,408            | -                      |
| Issued for restricted share units      | 258,000                       | 181              | (181)                  |
| Re-purchase of shares for cancellation | (579,800)                     | (153)            | (459)                  |
| Share-based payments                   | -                             | -                | 1,300                  |
| <b>Balance as at December 31, 2017</b> | <b>110,853,718</b>            | <b>\$ 30,573</b> | <b>\$ 4,154</b>        |

On December 24, 2015, the Company announced that the TSX Venture Exchange ("TSX-V") had accepted the Company's notice of intention to make a Normal Course Issuer Bid (the "2016 NCIB") for its common shares in compliance with the requirements of the TSX-V. As of January 4, 2016, the Company was able to commence making purchases of up to a maximum of 5,000,000 common shares, which represented approximately 5% of the Company's issued and outstanding common shares at the time. The 2016 NCIB period covered the period from January 4, 2016 to January 3, 2017. For the year ended December 31, 2016, the Company re-purchased 1,474,500 of its common shares for a total cost of \$1,329. As at January 4, 2017, all of the common shares re-purchased through the 2016 NCIB had been cancelled.

On December 29, 2016, the Company announced that the TSX-V had accepted the Company's notice of intention to make a Normal Course Issuer Bid (the "2017 NCIB") for its common shares in compliance with the requirements of the TSX-V. As of January 4, 2017, the Company was able to commence making purchases of up to a maximum of 5,400,000 common shares, which represented approximately 5% of the Company's issued and outstanding common shares at the time. The 2017 NCIB covers the period from January 4, 2017 to January 3, 2018. For the year ended December 31, 2017, the Company re-purchased and cancelled 579,800 of its common shares for a total cost of \$612. As at December 31, 2017, all of the common shares re-purchased through the 2017 NCIB had been cancelled.

### (c) Stock options

The Company has a Stock Option Plan (the "Option Plan") from which it makes awards to employees, directors and consultants.

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The Company's Option Plan was adopted by the Board of Directors on June 22, 2015 and last confirmed by the shareholders of the Company on June 15, 2017. The number of common shares to be reserved and authorized for issuance pursuant to options granted under the Option Plan, including common shares issuable under the Company's restricted share unit plan ("RSU Plan") or any other share-based compensation arrangements, is 10% of the issued and outstanding common shares from time to time. At December 31, 2017, the Company was authorized to grant 11,085,371 options and RSUs, of which it had 3,804,500 options and RSUs issued and outstanding, leaving 7,280,871 options available for future issue.

Options are awarded at a Canadian dollar exercise price equal to the closing market price of the Company's common shares on the day prior to the date of grant. The options generally vest over four years with one-quarter of the options vesting on each of the first, second, third and fourth anniversaries of the grant date. Options granted to executives and directors generally vest over three years with one-third of the options vesting on each of the first, second and third anniversaries of the grant date. The options have a five-year term from date of grant.

A summary of the activity in the Company's Stock Option Plan is presented below:

|                                               | Number of<br>options | Weighted<br>average<br>exercise price |
|-----------------------------------------------|----------------------|---------------------------------------|
| <b>Options outstanding, January 1, 2016</b>   | <b>8,478,000</b>     | <b>\$ 2.88</b>                        |
| Granted                                       | 2,667,000            | 0.71                                  |
| Exercised                                     | (5,543,500)          | 0.11                                  |
| Forfeited                                     | (1,295,000)          | 0.60                                  |
| Expired                                       | (20,000)             | 0.49                                  |
| <b>Options outstanding, December 31, 2016</b> | <b>4,286,500</b>     | <b>0.67</b>                           |
| Granted                                       | 2,775,500            | 1.50                                  |
| Exercised                                     | (2,827,000)          | 0.50                                  |
| Forfeited                                     | (799,000)            | 1.20                                  |
| Expired                                       | (22,500)             | 0.71                                  |
| <b>Options outstanding, December 31, 2017</b> | <b>3,413,500</b>     | <b>\$ 1.22</b>                        |

As at December 31, 2017, the Company had 3,413,500 share purchase options outstanding (2016 - 4,286,500), entitling the holders to purchase one common share for each option held as follows:

|                 | Options<br>Outstanding | Weighted<br>average<br>remaining<br>term (years) | Options<br>Exercisable | Weighted<br>average<br>remaining<br>term (years) |
|-----------------|------------------------|--------------------------------------------------|------------------------|--------------------------------------------------|
| \$0.150 - 0.699 | 437,500                | 2.99                                             | 290,000                | 3.04                                             |
| \$0.700 - 0.999 | 754,500                | 3.71                                             | 421,750                | 3.77                                             |
| \$1.000 - 1.449 | 300,000                | 4.57                                             | -                      | -                                                |
| \$1.450 - 1.499 | 1,416,500              | 4.42                                             | 270,000                | 4.42                                             |
| \$1.500 - 1.999 | 505,000                | 4.92                                             | 90,000                 | 4.87                                             |
|                 | <b>3,413,500</b>       | <b>4.17</b>                                      | <b>1,071,750</b>       | <b>3.83</b>                                      |

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

|                         | Year ended           |                      |
|-------------------------|----------------------|----------------------|
|                         | December 31,<br>2017 | December 31,<br>2016 |
| Expected option life    | 5 years              | 5 years              |
| Risk-free interest rate | 0.46% to 1.62%       | 0.66% to 1.89%       |
| Dividend yield          | 0%                   | 0%                   |
| Volatility              | 43% to 75%           | 95% to 208%          |

(d) Restricted Share Units ("RSUs")

The Company has a RSU Plan from which it makes awards to executives and directors.

The Company's RSU Plan was adopted by the Board of Directors on March 30, 2016 and approved by the shareholders of the Company on May 3, 2016. The maximum number of common shares that may be issued pursuant to the RSU Plan is limited to 1,000,000 common shares. In addition, the maximum number of common shares that may be reserved for issuance under the RSU Plan, including common shares issuable under the Company's Option Plan or any other share-based compensation arrangements, is 10% of the issued and outstanding common shares from time to time. At December 31, 2017, the Company had issued 1,000,000 RSUs pursuant to the RSU Plan, of which 391,000 RSUs were issued and outstanding, leaving nil RSUs available for future issue.

RSU transactions are summarized as follows:

|                                           | Number of<br>RSUs |
|-------------------------------------------|-------------------|
| <b>RSU outstanding, January 1, 2016</b>   | -                 |
| Granted                                   | 1,132,000         |
| Settled                                   | (308,000)         |
| Forfeited                                 | (172,000)         |
| <b>RSU outstanding, December 31, 2016</b> | <b>652,000</b>    |
| Granted                                   | 176,000           |
| Settled                                   | (258,000)         |
| Forfeited                                 | (179,000)         |
| <b>RSU outstanding, December 31, 2017</b> | <b>391,000</b>    |

- (e) During the year ended December 31, 2017, the Company recorded \$1,300 (2016 - \$733) of share-based payments relating to the fair value of the options and RSUs vesting during the period with a corresponding increase to contributed surplus.

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## 13. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and not disclosed in this note.

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.

The remuneration of key management for the year ended December 31, 2017 and 2016 is as follows:

|                      | Year ended           |                      |
|----------------------|----------------------|----------------------|
|                      | December 31,<br>2017 | December 31,<br>2016 |
| Cash-based payments  | \$ 2,450             | \$ 554               |
| Share-based payments | 938                  | 887                  |
| <b>Total</b>         | <b>\$ 3,388</b>      | <b>\$ 1,441</b>      |

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

## 14. Income tax

The following table reconciles the expected income taxes at the Canadian statutory income tax rates to the amounts recognized in the consolidated statements of comprehensive income for the years ended December 31, 2017 and 2016:

|                                             | Year ended           |                      |
|---------------------------------------------|----------------------|----------------------|
|                                             | December 31,<br>2017 | December 31,<br>2016 |
| Income before taxes                         | \$ 8,249             | \$ 9,384             |
| Statutory tax rate                          | 26%                  | 26%                  |
| Expected income taxes                       | 2,144                | 2,441                |
| Non-deductible items                        | 345                  | 254                  |
| Change in estimates                         | 12                   | 174                  |
| Change in deferred tax asset not recognized | 55                   | -                    |
| <b>Total income taxes</b>                   | <b>\$ 2,557</b>      | <b>\$ 2,869</b>      |
| Current tax expense                         | 1,996                | 2,809                |
| Deferred tax expense                        | 561                  | 60                   |
| <b>Total income taxes</b>                   | <b>\$ 2,557</b>      | <b>\$ 2,869</b>      |

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Deferred taxes reflect the tax effects of temporary differences between the carrying amounts of assets (liabilities) for financial reporting purposes and their corresponding value for tax purposes. The deferred tax assets as at December 31, 2017 and 2016 are comprised of the following:

|                                             | December 31,<br>2017 | December 31,<br>2016 |
|---------------------------------------------|----------------------|----------------------|
| Property and equipment                      | \$ (133)             | \$ 81                |
| Contingent consideration                    | 1,347                | -                    |
| Intangible assets                           | (1,660)              | 3                    |
| Reserves                                    | 144                  | 164                  |
| Note receivable                             | -                    | 11                   |
| Non-capital losses                          | 49                   | -                    |
| Financing costs                             | 6                    | -                    |
| Total deferred tax (liability) asset        | (247)                | 259                  |
| Deferred tax asset not recognized           | (55)                 | -                    |
| <b>Total deferred tax (liability) asset</b> | <b>\$ (302)</b>      | <b>\$ 259</b>        |

The unrecognized deductible temporary differences are as follows:

|                                                            | December 31,<br>2017 | December 31,<br>2016 |
|------------------------------------------------------------|----------------------|----------------------|
| Property and equipment                                     | \$ (491)             | \$ 311               |
| Contingent consideration                                   | 4,990                | -                    |
| Intangible assets                                          | (6,148)              | 13                   |
| Reserves                                                   | 530                  | 631                  |
| Note receivable                                            | -                    | 41                   |
| Non-capital losses                                         | 232                  | -                    |
| Financing costs                                            | 28                   | -                    |
| <b>Total unrecognized deductible temporary differences</b> | <b>\$ (859)</b>      | <b>\$ 996</b>        |

## 15. Segmented information

The Company has one operating and one reportable segment. The Company's operations are entirely related to revenues and operations of the Company's products used by the largest Wafer Fabrication Equipment ("WFE") manufacturers and end users in the semiconductor and related industries.

The Company's chief operating decision maker is the Chief Executive Officer.

### (a) Geographic information:

Information regarding revenue earned from customers by geographic segment is as follows:

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|               | Year ended           |                      |
|---------------|----------------------|----------------------|
|               | December 31,<br>2017 | December 31,<br>2016 |
| United States | \$ 26,146            | \$ 24,636            |
| Asia          | 17,440               | 6,638                |
| Canada        | 121                  | 816                  |
| Europe        | 106                  | 81                   |
| <b>Total</b>  | <b>\$ 43,813</b>     | <b>\$ 32,172</b>     |

(b) Assets:

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

(c) Major customers:

Sales to the Company's three largest customers accounted for 78% of the Company's sales for the year ended December 31, 2017 (2016 - 75%).

## 16. Commitments

Under operating lease agreements for office premises, the Company is required to make future annual minimum lease payments as follows:

|                  |                 |
|------------------|-----------------|
| 2018             | \$ 334          |
| 2019             | 334             |
| 2020             | 297             |
| 2021             | 285             |
| 2022 and onwards | 854             |
| <b>Total</b>     | <b>\$ 2,104</b> |

## 17. Financial instruments and fair values

### Measurement categories, fair values and valuation methods

As explained in Note 3, financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the statements of operations or other comprehensive income. Those categories are: fair value through profit or loss; loans and receivables; available for sale assets; and, for liabilities, amortized cost.

The Company's financial assets and liabilities are measured using amortized costs which approximates fair value due to the nature of these instruments.

|                       | December 31, 2017 |                  | December 31, 2016 |                  |
|-----------------------|-------------------|------------------|-------------------|------------------|
|                       | Carrying Value    | Fair Value       | Carrying Value    | Fair Value       |
| Financial assets      | \$ 37,792         | \$ 37,792        | \$ 38,595         | \$ 38,595        |
| Financial liabilities | 4,003             | 4,003            | 3,849             | 3,849            |
| <b>Total</b>          | <b>\$ 41,795</b>  | <b>\$ 41,795</b> | <b>\$ 42,444</b>  | <b>\$ 42,444</b> |

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## Fair value hierarchy

Financial assets and liabilities that are recognized on the statements of financial position at fair value follow in a hierarchy that is based on the significance of the inputs used in making the measurements. The levels in the hierarchy are:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices)
- Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs)

The following financial assets and liabilities are measured at fair value on a recurring basis using quoted prices in active markets for identifiable assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3):

| December 31, 2017        | Carrying Value | Level 1 | Fair Value |          |  |
|--------------------------|----------------|---------|------------|----------|--|
|                          |                |         | Level 2    | Level 3  |  |
| Financial liabilities    |                |         |            |          |  |
| Contingent consideration | \$ 4,005       | \$ -    | \$ -       | \$ 4,005 |  |

| December 31, 2016        | Carrying Value | Level 1 | Fair Value |         |      |
|--------------------------|----------------|---------|------------|---------|------|
|                          |                |         | Level 2    | Level 3 |      |
| Financial liabilities    |                |         |            |         |      |
| Contingent consideration | \$ -           | \$ -    | \$ -       | \$ -    | \$ - |

The Company has used a discounted cash flow valuation technique in calculating the fair value of the contingent consideration. This valuation technique included inputs relating to estimated cash outflows under the arrangement and the use of a discount rate appropriate to the Company (20%). The fair value measurements are sensitive to the discount rate used in calculating the fair values. A 1% increase in the discount rate would reduce the fair value of the contingent consideration by \$61. During the year ended December 31, 2017, the Company recorded accretion expense of \$639 in relation to contingent consideration, reflecting the change in fair value of liability that is attributable to credit risk.

## Financial risk factors

The Company is exposed to a number of risks. These risks include credit risk, liquidity risk and market risk. The Company has established policies and procedures to manage these risks, with the objective of minimizing the adverse effects that changes in the variable underlying these risks could have on the Company's consolidated financial statements.

### Credit risk

Credit risk is the risk that a counter-party will not meet their obligations under a financial instrument or customer contract, leading to a financial loss being incurred by the Company. Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash, trade and other receivables, due from related party, note receivable and restricted cash.

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The Company limits its exposure to credit loss by maintaining its cash and restricted cash with high credit quality financial institutions in Canada and the United States.

The Company provides credit to its customers in the normal course of operations. The Company minimizes its credit risk associated with its trade and other receivables by performing credit evaluations on customers, maintaining regular and ongoing contact with customers, routinely reviewing the status of individual trade and other receivables balances and following up on overdue amounts.

From time to time, the Company does enter into agreements with very large customers that, due to the size of the transaction, will result in some concentration of credit risk. The Company estimates, on a continuing basis, the probable losses on its accounts and records a provision for losses based on the estimated realizable value of the accounts. Management does not believe that there is significant credit risk arising from any of the Company's current customers; however, should one of the Company's large customers be unable to settle amounts due, the impact on the Company could be significant. The maximum exposure to loss arising from trade and other receivables is equal to their total carrying amounts.

The following table provides information regarding the aging of trade and other receivables as at December 31, 2017 and 2016:

|                                | Neither past<br>due<br>nor impaired | Aged<br>1 - 30<br>days | Aged<br>31 - 60<br>days | Aged<br>61 - 90<br>days | Aged<br>90 +<br>days |
|--------------------------------|-------------------------------------|------------------------|-------------------------|-------------------------|----------------------|
| <b>As at December 31, 2017</b> | <b>91%</b>                          | <b>10%</b>             | <b>0%</b>               | <b>-1%</b>              | <b>0%</b>            |
| As at December 31, 2016        | 86%                                 | 8%                     | 2%                      | 2%                      | 2%                   |

As at December 31, 2017, 9% (2016 - 14%) of the Company's trade and other receivables was past due. The definition of items that are past due was determined by reference to the Company's standard credit terms, net of any provisions for losses. 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 year ended December 31, 2017, the Company incurred \$16 of bad debts expense (2016 - \$9).

The Company reviews financial assets past due on an ongoing basis with the objective of identifying potential matters that could delay the collection of funds at an early stage.

## Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages liquidity risk through budgeting, ongoing management and forecasting of operating cash flows, review of trade and other receivables balances, management of cash, and use of credit facilities and equity financings when appropriate.

At December 31, 2016, the Company had a credit facility with a Canadian Chartered bank of up to \$1,000, which was unutilized. In 2017, the Company removed the credit facility and no longer had a credit facility as at December 31, 2017.

As at December 31, 2017, the Company had a \$80 credit card facility with a Canadian Chartered bank.

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## Market risk

### *Foreign exchange risk*

The Company operates internationally and generates revenues and incurs expenses in foreign currencies, holds cash, and has operations based in the United States carried through its wholly owned subsidiaries.

The Company's financial results are reported in Canadian dollars. The Company's exposure to foreign currency risk is primarily related to fluctuations in the value of the Canadian dollar relative to the United States dollar (USD"), as a majority of the Company's revenues are earned in USD. As such, the Company may be subject to material, realized and unrealized foreign exchange gains or losses resulting from above average changes in exchange rates between the Canadian and the United States dollar.

At December 31, 2017, the Company held net current monetary assets in USD equal to \$34,966 (2016 - \$18,028). The Company estimates the impact of a 10% change in the Canadian dollar exchange rate on its net current monetary assets to be \$3,497 (2016 - \$1,803).

### *Interest rate risk*

The Company is exposed to interest rate risk by virtue of holding cash.

The Company's objective in managing its cash is to provide sufficient funds to meet day-to-day requirements and placing excess cash in short-term deposits.

## 18. Expenses by nature

|                                        | Year ended           |                      |
|----------------------------------------|----------------------|----------------------|
|                                        | December 31,<br>2017 | December 31,<br>2016 |
| Wages and employee benefits            | \$ 10,303            | \$ 4,312             |
| Share-based payments                   | 1,300                | 733                  |
| Depreciation of property and equipment | 758                  | 163                  |
| Amortization of intangible assets      | 612                  | 55                   |
| Cost of sales and other                | 22,457               | 17,475               |
| <b>Total</b>                           | <b>\$ 35,430</b>     | <b>\$ 22,738</b>     |

## 19. Capital risk management

The Company considers shareholders' equity as capital, the book value of which totaled \$46,660 at December 31, 2017 (2016 - \$38,872).

The Company manages its capital structure to safeguard its ability to operate as a going concern, to provide sufficient resources to meet day-to-day operating requirements, to allow it to enhance existing product offerings as well as develop new ones, and to have the financial ability to expand the size of its operations by taking on new customers. In managing its capital structure, the Company takes into consideration various factors, including the growth of its business and related infrastructure and the upfront cost of taking on new clients.

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The Company's officers and senior management are responsible for managing the Company's capital and do so through regular meetings and regular review of financial information. The Company's Board of Directors is responsible for overseeing this process.

## 20. Litigation

The following describes the litigation proceedings between the Company and Photon Control R&D Ltd., all of which have been resolved as of the date of these financial statements.

In connection with an arrangement to outsource its research and development functions, the Company entered into an agreement dated October 1, 2008 with Photon R&D. As Photon R&D had directors and shareholders in common with the Company, consisting of the Company's Chairman and largest shareholder, as well as the Company's President and CEO, the R&D Agreement was considered a related party transaction under applicable securities regulation and stock exchange rules ("R&D Transaction").

Between 2009 and 2013, pursuant to various addenda entered into between the Company and Photon R&D, the R&D Agreement came to include not just payments for services but also standby payments for engineering services, royalty payments ranging from 10% to 25% of product sales, provided certain rights for R&D to exploit certain of the products and intellectual property produced under the R&D Agreement. The outsourcing of certain of the Company's administrative functions were added to the relationship over time as well.

In August 2016, the Company commenced a lawsuit in the Court against Photon R&D and others (the "Claim") related to the Addenda and certain other matters. In the Claim, the Company claimed that the Addenda, which in effect purported to limit the Company's rights and impose obligations on the Company and constituted material changes to the R&D Agreement, should be set aside as null and void.

In September 2016 and in December 2016, the Company applied to the Court for interlocutory relief pending trial of the Claim. The Court granted the Company, among other things, a right of access to all intellectual property ("IP") developed by Photon R&D for the Company, prohibited Photon R&D from initiating contact with the Company's customers and prohibited Photon R&D from manufacturing products for the Company's customers, with minor exceptions.

As part of the interim relief granted, the Company was required to pay a total of \$599 into court as security, all of which was returned to the Company following settlement of the litigation.

On April 9, 2017, the Company signed a binding Settlement Agreement with Photon R&D which set 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 and its terms are effective as of April 14, 2017, see Note 5.

On June 1, 2017, a consent order was entered into with the Court ordering that all proceedings among the parties including all counter-claims and third party claims, be dismissed, without costs to any party. On July 6, 2017, the \$599 that was paid into court as security pursuant to a garnishment order were ordered by the Court to be returned to the Company, see Note 10.

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## **21. Subsequent event**

On February 15, 2018, the Company completed the OFM Transaction with Kings Energy Inc. for minimum gross proceeds of \$350, see Note 11.