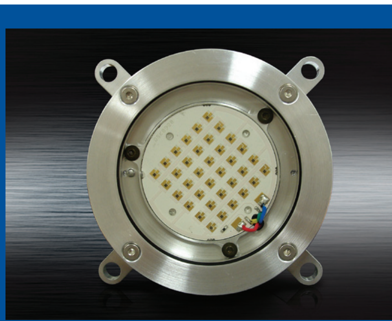
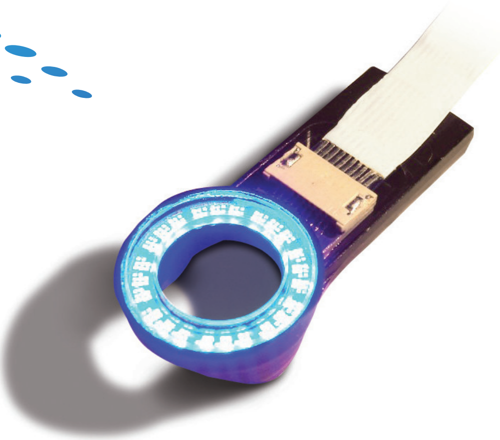
ProPhotonix Limited



Admission to AIM



LIBERTAS

Libertas Capital Corporate Finance

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt as to the contents of this document or the action you should take, you should immediately seek your own personal financial advice from your stockbroker, bank manager, solicitor, accountant or other independent professional adviser authorised pursuant to the Financial Services and Markets Act 2000 (FSMA) if you are resident in the United Kingdom or, if not, another appropriately authorised independent financial adviser.

The Company and the directors of the Company, whose names appear on page 5 of this document, accept responsibility for the information contained in this document and compliance with the AIM Rules and Prospectus Rules. To the best of the knowledge and belief of such directors, who have taken all reasonable care to ensure that such is the case, the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

Application has been made in accordance with the AIM Rules for the Common Shares of the Company already in issue and to be issued to be admitted to trading on AIM. It is expected that such application to AIM will become effective and that dealings will commence on 23 December, 2010.

AIM is a market designed primarily for emerging or smaller companies to which a higher investment risk tends to be attached than to larger or more established companies. AIM securities are not admitted to the Official List of the United Kingdom Listing Authority.

A prospective investor should be aware of the risks of investing in such companies and should make the decision to invest only after careful consideration and, if appropriate, consultation with an independent financial adviser.

Each AIM Company is required pursuant to the AIM Rules for Companies to have a nominated adviser. The nominated adviser is required to make a declaration to the London Stock Exchange on admission in the form set out in Schedule Two to the AIM Rules for Nominated Advisers.

The London Stock Exchange has not itself examined or approved the contents of this document.

This document, which comprises an admission document required by the AIM Rules for Companies, has been prepared in connection with the proposed application for admission of the Enlarged Share Capital to trading on AIM, a market of London Stock Exchange plc. This document does not constitute a prospectus for the purposes of section 85(1) of the FSMA and the Prospectus Rules of the Financial Services Authority. The Company is not making an offer of transferable securities to the public within the meaning of section 102B of FSMA.

The whole of the text of this document should be read and in particular your attention is drawn to the section entitled "Risk Factors" set out in part II of this document.

ProPhotonix Limited

(Incorporated in the Commonwealth of Massachusetts, USA under the Business Corporation Act of the Commonwealth of Massachusetts, USA)

Placing of 4,125,000 New Common Shares at 20p per Share, Capitalisation of $1,274,544 of Bonds by way of the issue of 4,031,646 New Common Shares at 20p per share and Application for Admission to AIM

Nominated Adviser and Broker:

Libertas Capital Corporate Finance Limited

Common Share capital on Admission

Authorised	*Issued and fully paid*
250,000,000 Common Shares	52,614,001 Common Shares

Libertas Capital Corporate Finance Limited, which is regulated in the United Kingdom by the Financial Services Authority, is acting as nominated adviser and broker to the Company in connection with the proposed admission of the entire issued and to be issued common share capital to trading on AIM. Its responsibilities as the Company's nominated adviser under the AIM Rules are owed solely to the London Stock Exchange plc and are not owed to the Company or to any director or to any other person in respect of his decision to acquire shares in the Company in reliance on any part of this document. No representation or warranty, express or implied, is made by Libertas Capital Corporate Finance Limited as to any of the contents of this document. Libertas Capital Corporate Finance Limited will not be offering advice and will not otherwise be responsible for providing customer protections to recipients of this document or for advising them on the contents of this document or any other matter.

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Copies of this document will be available for collection, free of charge, from Libertas Capital Corporate Finance Limited, 16 Berkeley Street, London W1J 8DZ for one month from the date of this document.

TABLE OF CONTENTS

EXPECTED TIMETABLE OF EVENTS

Admission Document publication date	20 December 2010
Admission effective and commencement of dealings on AIM of the Common Shares	8.00 a.m. on 23 December 2010
Despatch of definitive share certificates for the Placing Shares and the Capitalisation Shares	31 December 2010

PLACING AND CAPITALISATION STATISTICS

Placing Price	20p
Number of Placing Shares to be issued pursuant to the Placing	4,125,000
Number of Common Shares to be issued pursuant to the Capitalisation	4,031,646
Number of Common Shares in issue on Admission	52,614,001
Placing Shares as percentage of the Enlarged Share Capital	7.8%
Gross proceeds of the Placing	£825,000
Capitalisation Shares as a percentage of the Enlarged Share Capital	7.7%
Estimated net proceeds of the Placing receivable by the Company	£615,000
Market capitalisation of the Company on Admission at the Placing Price	£10.5 million
Ticker	PPIX
CUSIP code (Existing Shares)	743465 106
ISIN code (Existing Shares)	US7434651060
CUSIP code (Placing Shares)	U74312106
ISIN code (Placing Shares)	USU743121068

DIRECTORS, SECRETARY AND ADVISERS

Directors	Mark Blodgett *(Chairman and Chief Executive Officer)* Timothy Losik *(Chief Financial Officer)* Dietmar Klenner *(Non-Executive Director)* Raymond Oglethorpe *(Non-Executive Director)* Duncan Byatt *(Non-Executive Director)*
Company Secretary	Thomas B. Rosedale
Registered Office	Corporate Filing Solutions, Inc. 425 Boylston Street, 3rd Floor Boston, Massachusetts 02116 USA
Company Principal Office	32 Hampshire Road Salem, New Hampshire 03079 USA
Nominated Adviser and Broker	Libertas Capital Corporate Finance Limited 16 Berkeley Street London W1J 8DZ
Reporting Accountant	Baker Tilly Corporate Finance LLP 25 Farringdon Street London EC4A 4AB
US Auditors	Caturano and Company, P.C. 80 City Square Boston, Massachusetts 02129
Legal Adviser to the Company *(English Law)*	K&L Gates LLP 110 Cannon Street London EC4N 6AR
Legal Adviser to the Company *(US Law)*	K&L Gates LLP State Street Financial Center One Lincoln Street Boston, Massachusetts 02111 USA
Legal Adviser to the Nominated Adviser and Broker	Eversheds LLP One Wood Street London EC2V 7WS
Principal Registrar	Computershare Trust Company N.A. 250 Royall Street Canton, Massachusetts 02021 USA
Branch Registrar (Placing Shares)	Computershare Investor Services (Jersey) Limited Queensway House Hilgrove Street St. Helier Jersey JE4 9XY Channel Islands
Depositary	Computershare Investor Services PLC PO Box 82 The Pavilions Bridgwater Road Bristol BS99 6ZZ

DEFINITIONS

"Admission"	the admission of the Enlarged Share Capital to trading on AIM and such admission becoming effective in accordance with Rule 6 of the AIM Rules for Companies
"AIM"	the market of that name operated by the London Stock Exchange plc
"AIM Rules"	AIM Rules for Companies and AIM Rules for Nominated Advisers
"AIM Rules for Companies"	the AIM Rules for Companies published by the London Stock Exchange from time to time
"AIM Rules for Nominated Advisers"	the AIM Rules for Nominated Advisers published by the London Stock Exchange from time to time
"Articles"	the Articles of Organization of the Company as amended or restated from time to time and as further described in paragraph 3 of Part VI of this document
"Board" or the "Directors"	the board of directors of the Company, whose names appear on page 5 of this document
"By-laws"	the by-laws of the Company as amended or restated from time to time and as further described in paragraph 3.2 of Part VI of this document
"Capitalisation"	the capitalisation of an amount of $1,274,544 owing by the Company under the ProPhotonix Holdings Secured Bonds by way of the issue of 4,031,646 new Common Shares at the Placing Price
"Capitalisation Shares"	the 4,031,646 New Common Shares to be issued by the Company pursuant to the Capitalisation
"City Code"	the City Code on Takeovers and Mergers published by the Panel (as amended from time to time)
"Combined Code"	the UK Corporate Governance Code published in June 2010 by the Financial Reporting Council
"Common Shares"	shares of common stock with a par value of $0.001 each in the capital of the Company
"Companies Act"	the Companies Act 2006
"Company" or "ProPhotonix"	ProPhotonix Limited, a company incorporated in the Commonwealth of Massachusetts, USA
"CREST"	the system for the paperless settlement of trades in listed securities operated by Euroclear
"CREST Manual"	the document entitled "CREST Reference Manual" issued by Euroclear
"CREST Regulations"	the Uncertificated Securities Regulations 2001 (SI 2001 No. 3755), as amended from time to time
"Disclosure and Transparency Rules"	the Disclosure and Transparency Rules published by the FSA as amended from time to time
"Enlarged Share Capital"	the issued share capital of the Company immediately following Admission being the Existing Common Shares, the Capitalisation Shares and the Placing Shares
"Euroclear"	Euroclear UK & Ireland Limited
"Exchange Act"	the United States Securities Exchange Act of 1934 (as amended)

"Existing Common Shares"	the 44,407,355 Common Shares issued, outstanding and fully paid prior to the Placing
"FSA"	the Financial Services Authority
"FSMA 2000"	the Financial Services and Markets Act 2000 (as amended)
"Group"	the Company and its subsidiaries at the date of this document
"Invoice Discounting Agreement"	the invoice discounting agreement entered into between ProPhotonix UK and Barclays Bank PLC as described in paragraph 11.6 of Part VI of this Document
"Libertas"	Libertas Capital Corporate Finance Limited, nominated adviser and broker to the Company
"Libertas Shares"	the 50,000 new Common Shares to be issued by the Company to Libertas in part payment for services provided pursuant to the Placing Agreement
"London Stock Exchange"	the London Stock Exchange plc
"Massachusetts Business Corporation Act"	the Massachusetts Business Corporation Act (M.G.L. ch. 156D)
"New Common Shares"	the Common Shares to be issued by the Company in connection with the Placing and the Capitalisation
"North American Assets Sale Transaction"	the sale by the Company of substantially all the assets of StockerYale Canada, Inc (a wholly owned subsidiary of the Company) and its speciality optical fiber business as described in paragraph 11.5 of Part VI of this Document
"Options"	the options to purchase Common Shares granted or to be granted pursuant to the Plans
"Panel"	the U.K. Panel on Takeovers and Mergers
"Pink Sheets"	the Pink Quote, an electronic quotation system operated by Pink OTC Markets that displays quotes from broker dealers for securities that are traded over the counter, that is to say off exchange, directly between two parties
"Placing"	the conditional placing of the Placing Shares pursuant to the Placing Agreement
"Placing Agreement"	the conditional agreement dated 20 December 2010 between Libertas, the Company and the Directors relating to the Placing, further details of which are set out in paragraph 11 of Part VI of this document
"Placing Price"	20 pence per Common Share
"Placing Shares"	the 4,125,000 new Common Shares to be issued by the Company pursuant to the Placing
"Plans"	the 2000 Stock Option and Incentive Plan, the 2004 Stock Option and Incentive Plan and the 2007 Stock Incentive Plan as described in paragraph 6.3 of Part VI of this document
"ProPhotonix Bonds"	Bonds held by the former owners of ProPhotonix UK issued as part of the purchase of the company by the Company as described in paragraph 11.7 of Part VI of this document
"ProPhotonix Holdings Secured Bonds"	the ProPhotonix Holdings Secured Bond as described in paragraph 11.8 of Part VI of this Document
"ProPhotonix Ireland"	ProPhotonix (Irl) Limited, a wholly owned subsidiary of the Company, formerly known as StockerYale (Ire) Limited

"ProPhotonix Ireland Secured Bonds"	the ProPhotonix Ireland Secured Bonds as described in paragraph 11.8 of Part VI of this Document
"ProPhotonix UK"	ProPhotonix Limited, a wholly owned subsidiary of the Company, formerly known as Photonic Products Limited
"ProPhotonix Holding"	StockerYale (UK) Limited, a wholly owned subsidiary of the Company
"Recognised Investment Exchange"	investment exchanges as defined in section 285 of FSMA 2000 including AIM
"Regulation S"	Regulation S promulgated under the Securities Act
"Restricted Stock Awards"	the restricted stock awards to purchase Common Shares granted or to be granted pursuant to the Plans
"Securities Act"	the United States Securities Act of 1933 (as amended)
"Shareholders"	the holders of Common Shares
"Subsidiaries"	those subsidiaries of the Company listed in paragraph 9 of Part VI of this document
"US", "USA" or "United States"	the United States of America, each state thereof, its territories and possessions
"US$" or "$"	the United States dollar
"€" or "Euro"	the official currency of the Eurozone or Euro Area
"Warrants"	warrants to purchase Common Shares
"£" or "Sterling"	the British pound sterling

GLOSSARY OF TECHNICAL TERMS

Array — an order or arrangement of LED

Chip — usually made up of silicon, a chip is a minute semiconductor which contains hundreds and thousands of electronic components. It is also known as an integrated circuit

Chip-on-board (COB) — a semiconductor assembly technology wherein the microchip or die is directly mounted on and electrically interconnected to its final circuit board, instead of undergoing traditional assembly or packaging

Die — a semiconductor that has not yet been packaged. Also known as a group of "chips"

HB LEDs — high brightness LEDs

Incandescent lighting — light produced when a filament is heated to incandescence using an electric current (e.g., light bulb). Incandescent lighting is very inefficient—turning much of its energy into heat rather than light—and is gradually being replaced in many applications by LEDs and other devices

Laser — an acronym derived from Light Amplification by Stimulated Emission of Radiation, denoting a device which emits coherent light of a specific wavelength

LED — also known as a light-emitting diode; an LED is a solid-state semiconductor that emits light. LEDs are used in a variety of display and lighting applications, and consume less power than incandescent bulbs

Light engine — a sub-system used to generate light, which typically includes a lamp module, optics and projection lens

Light source — any device serving as a source of illumination

Packaged LED — an LED package has an optical lens, bonding wire (to bond the package to the printed circuit board), electrodes, and resin to encapsulate the LED for protection

Photon — a quantum of electromagnetic energy commonly known as a particle of light

RGB — acronym for red, green and blue, which are the three primary colours of light. Also refers to the colour model for displays and monitors, where combinations of illuminated red, green and blue pixels are used to create a wide variety of colours

Semiconductor — a material whose electrical resistance can be switched between insulating and conducting. Silicon is the most commonly used semiconductor material and the basic material for building most electronics chips

PART I

INFORMATION ABOUT THE COMPANY

1. Introduction

ProPhotonix Limited, formerly StockerYale, Inc., designs and manufactures LED arrays and light engines through its subsidiary ProPhotonix Ireland, located near Cork, Ireland and produces laser modules and distributes laser diodes through its subsidiary ProPhotonix UK, located near Stansted, UK. The business of the Company began in the area of optical technology. Following the sale in 2009 of the Group's North American operations, it is now focused on the development and expansion of its LED array light engine activities in the machine vision and medical markets as well as the development of its businesses within the general illumination sector. From 1996 until April 2009 the Company was listed on Nasdaq. The shares are currently quoted on the OTC, Pink Sheets.

ProPhotonix is seeking admission to AIM and proposes to raise approximately £825k before expenses of the Placing. The net proceeds of the Placing, amounting to approximately £615k, will be used to provide additional working capital. Concurrent with the Placing, the Company will convert $1,274,544 of debt owed in connection with certain outstanding bonds into equity by way of the issue of 4,031,646 New Common Shares at the Placing Price.

2. Key Business Strengths and Strategic Opportunity

ProPhotonix has established a strong position in the machine vision sector supplying both LED light engines and laser modules to this market. Building on this base, the Company has identified opportunities to grow its business significantly over the medium-term to long-term. The Company plans to use its expertise and know-how in the field of LED arrays and light engines to grow its market share in the machine vision sector as well as the medical market and, in the longer-term, penetrate a number of markets outside of the machine vision space which are both substantially larger than that of the machine vision market and growing more strongly. The Company believes this strategy is underpinned by the following factors:

- The Company has significant expertise, know-how and proprietary technology in the LED array and light engine space. Utilizing the Company's chip-on-board LED technology, its expertise in thermal management, electronics and optical systems, the Company produces high powered LED arrays. The Directors believe that this technology and know-how can be applied to significant and growing markets such as the medical and general illumination markets. The Directors believe that the Company can repeat the success it has had in securing customers in the area of medical applications in these new markets.

- The Company has proven ability to produce products for highly demanding applications and supply customers with critical components. The Directors believe that the quality of its customer base can act as an endorsement for its products and capabilities and can assist in attracting new customers.

- The Company's area of focus, High Brightness LED applications, is projected to exhibit strong growth in the medium-term across a wide range of markets, notably the general illumination market where the transition from traditional incandescent and fluorescent mediums to more energy efficient LED technology is just beginning. The increased application of LED technologies represents a significant potential growth opportunity for the Company.

In addition to the growth opportunities outlined above, ProPhotonix intends to continue to grow its market share in the laser module sector through the development of its recently launched InViso™ range of laser modules that are designed to meet the demanding requirements of high performance machine vision applications and complement the Company's LED machine vision systems. The Company also intends to identify and evaluate potential acquisitions and joint venture opportunities in the LED sector consistent with and complementary to the Company's strategic objectives.

3. History and Background of the Company

ProPhotonix is a US Company that was incorporated in 1951, originally operating in the field of optics and industrial illumination systems and, more recently, optical components for the telecommunications industry. Over the last seven years the Group has focused on the design and manufacture of LED systems through its subsidiary ProPhotonix Ireland at its facility in Cork. The Group also designs and manufactures laser modules and subcomponents, and distributes diodes through its subsidiary ProPhotonix UK at its facility near Stansted airport in the UK. The Group's products are used for a number of applications and markets including machine vision, industrial inspection and sensors, defence, and medical equipment.

The business of the Group has been developed through internal growth and the acquisition of synergistic businesses. In October 2009, the Group completed the sale of its North American laser and optical fibre operations to Coherent, Inc., one of the world's leading suppliers of lasers and laser systems, for a total consideration of approximately $18 million. The proceeds of the sale were used to significantly reduce the Group's indebtedness and for general working capital purposes.

4. Business Overview

ProPhotonix Ireland designs and manufactures high performance LED lighting systems to provide customers with high-intensity, long-lasting illumination sources. The Company's COBRA chip-on-board LED units offer greater brightness compared to standard LEDs, draw less power and are not subject to the influences of oxidation, resulting in a typical life span of 30,000-50,000 hours. The Company has developed specialized know-how and expertise in a number of areas, including the selection and design of thermally efficient substrates, the optical design of lens and diffuser systems, the design of cooling systems for extremely high power illuminators and the science of LED lifetime testing. The Group's LED systems can be engineered into a variety of geometrical configurations making them suitable for a range of specialised applications within the solar, semiconductor, flat panel glass, electronics and medical industries which require the properties and benefits that LEDs can deliver. The Group has historically focused its LED development and sales activities in the machine vision market.

ProPhotonix UK manufactures custom designed low-cost laser modules and other electro-optical sub-assemblies and optoelectronic components based on semiconductor laser diode technology. Its products include thermo-electrically cooled laser modules, laser alignment systems, circular beam laser diode modules and elliptical beam modules, receptacle packaged laser diodes and pigtailed laser diodes. These products are used in a wide variety of medical, industrial, military and commercial applications. For example, the Group's laser modules are used for patient alignment in medical scanners, in bank note scanners to identify counterfeit Euro notes via fluorescence and in food and diamond sorting applications. ProPhotonix UK is also an authorized distributor of visible, infrared and blue violet laser diodes for Sanyo Electric Co., Ltd., Opnext, Inc. and Sony Corp.

The Group's products are currently sold to over 500 customers, primarily in North America, Europe and the Pacific Rim. No individual customer accounted for more than 10 per cent. of total revenues and the top ten customers accounted for 37 per cent. of total revenues in 2009. ProPhotonix's global sales organization sells directly to OEM customers, and the Group also works with approximately 17 distributors and machine vision integrators to sell its products. Its sales and application engineers are based in Oregon, New York, Ireland, United Kingdom and Germany.

The raw materials and components used in the Group's products are purchased from a number of different suppliers and are in general available from several sources. The Group's suppliers include Sanyo, Sony and Opnext for the supply of laser diodes and Nichia, Cree and Lumileds for LED chips.

5. Overview of the market

5.1 LED Market Overview

Market Background

In the early 1960s, research into electroluminescence led to the discovery of light emitting diodes (LEDs). By the late 1960s, a number of suppliers were producing LEDs commercially for use in indicators and alphanumerical displays. Over the following years the performance of LEDs improved.

In the late 1990s High Brightness (HB) LEDs became available making the technology suitable for use as a source of illumination rather than just indicators. This increase in performance meant that LEDs began to be used in outdoor signage and displays. The development of "white" LEDs (a major breakthrough made by the Nichia Corporation in the early 1990's) along with progressive improvements in the performance of LEDs has paved the way for the penetration of LEDs into a much wider range of applications.

The market for High Brightness LEDs is $6 billion in 2010 and is expected to grow to $14.9 billion by 2013 (*Strategies Unlimited – August 2009*). The largest market is for mobile appliances where LEDs are used to backlight mobile phone screens. The Directors believe that it is the general illumination sector that presents the greatest opportunity for growth for the Group. This is demonstrated by the fact that despite a decline in the overall lighting market in 2009, the LED lighting market grew by 24 per cent. reflecting the increased use of HB LEDS in general lighting applications. The value of HB LEDs used in general illumination in 2010 is anticipated to be $817 million, approximately 45 times larger than the machine vision market currently addressed by the Group.

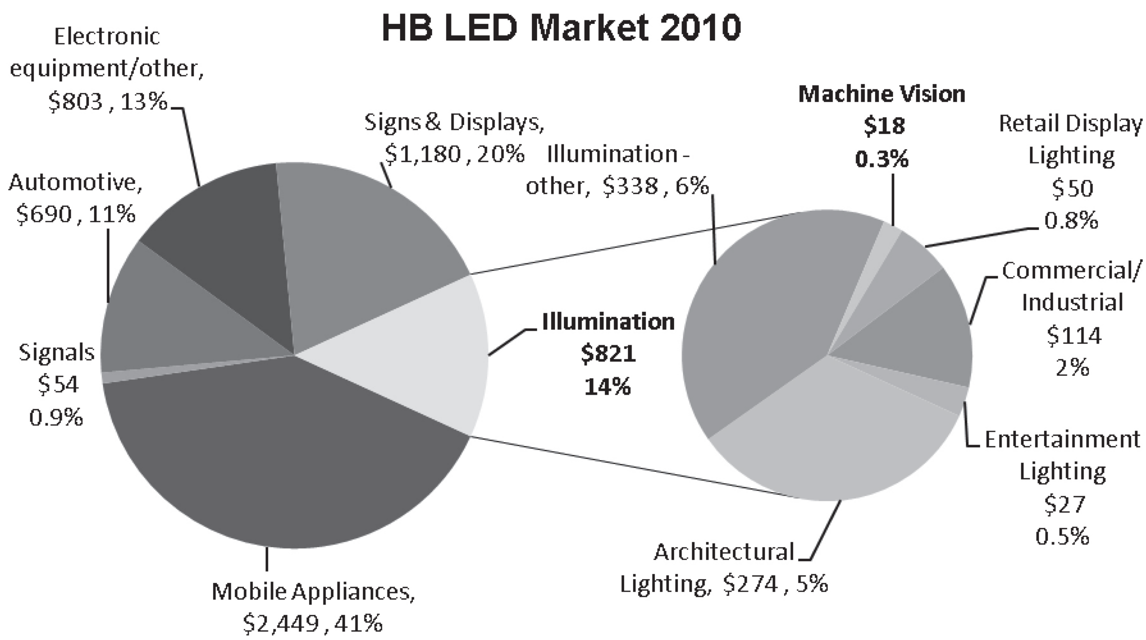

Fig. 1: Source: "High Brightness LED Market Review and Forecast 2009", Strategies Unlimited

NOTE: Values refer only to the cost of LED chips used in each of these markets.

The table below summarises the Company's target markets. As shown below, the combined architectural and commercial/industrial markets are forecast to grow at a compound annual rate of 44.2 per cent. from 2010 to 2012, more than doubling in size. In addition, these markets are approximately twelve times larger than the machine vision market on which the Company has historically focused.

Selected LED Powered Fixtures and Devices
Market Estimated Revenues 2007 – 2012

		2007	*2008*	*2009*	*2010*	*2011*	*2012*
Architectural(1)	US$ m	623	832	942	1,176	1,645	2,186
Commercial/Industrial(1)	US$ m	84	168	209	276	489	833
Medical(2)	US$ m	98	117	141	172	212	266
Machine Vision(3)	US$ m	n/a	133	101	108	119	135
Total	US$ m	n/a	1,250	1,393	1,732	2,465	3,420

Source:

1) Source: Strategies Unlimited - LED Lighting Fixtures Report 2009 - figure includes Entertainment lighting
2) Electronicast Consultants 2009, Semiconductor Today, Company estimates
3) Source:IMS Research - The World market for Machine Vision 2010

Machine Vision

Machine vision systems consist of a combination of lighting, detectors and computers that enable the automation of processes in a wide variety of industries, including automotive, food and beverage, chemical, pharmaceutical, solar and semiconductor.

The market for lighting systems for the machine vision sector is estimated at $108 million in 2010 and is forecast to grow to $154 million by 2013 (*IMS Research, February 2010*). Recent growth in the machine vision market has been driven by the improved performance of LED systems as compared to traditional light sources such as halogen (fiber optic) and fluorescent systems.

Medical

LEDs are used in a wide range of applications in the medical and dental markets, including blood sensors and photodynamic therapy such as teeth whitening, hair growth/restoration, acne treatment and other cosmetic procedures. The technology is also used as a light source in medical equipment such as endoscopes. This is a growing market with many of the possible applications still in the research stage. In addition the penetration of LEDs is still very low relative to more established light sources like halogen and xenon. Use of LEDs in the medical and dental markets is forecast to increase by an annual growth rate of 30.8 per cent. reaching volumes of 1.783 billion LEDs in 2013. The medical market is an OEM market and with the LED portion of it estimated at $140 million in 2010, 39 per cent. of this market is accounted for by the use of LEDs as a light source for medical instruments.

General Illumination

LED lighting offers a number of advantages over incandescent and fluorescent lighting. It is more robust, longer lasting and is more compact. Its compact nature has led to the rapid adoption of LEDs in the backlighting of LCD monitors and other similar applications. Typically LED lighting lasts three times longer than fluorescent lighting and twenty times longer than incandescent lighting. LEDs were initially used in the lighting market in colour applications in the architectural and entertainment sectors due to availability in a wide range of colours with colour changing easily controlled by software. Since then their use has expanded into more general applications.

The global lighting fixtures market (including all lighting types) in 2007 was estimated to be between $85 and $90 billion. The Company estimates that in 2009, this market is in the order of $100 billion and that LEDs accounted for just 3 per cent. of this market. With the increased performance of HB LEDs and the availability of high power white LEDs, the range of addressable applications is increasing rapidly.

5.2 **Laser Module Market Overview**

ProPhotonix UK manufactures low power diode based laser modules, combining diode laser technology with quality optics, sophisticated electronics and rugged modular packaging. This combination of attributes makes ProPhotonix diode based laser modules suitable for a variety of applications.

It is estimated that lasers account for 29.1 per cent. of the market for machine vision lighting systems, which equates to a $31.4 million market for diode-based laser modules in 2008.

ProPhotonix focuses on five sectors in the laser module market:

- Laser Targeting & Industrial Alignment Systems
- Patient Alignment Systems
- Show Lasers and Display
- Machine Vision Lasers
- Low Level Laser Therapy

Laser Targeting & Industrial Alignment Systems – Lasers are widely used in high-precision targeting and alignment applications. They improve accuracy, provide for simpler system set-up and minimize industrial production times, providing highly visible target identification and alignment in an number of applications including industrial, drilling and mining machinery, high-precision guidance systems and laser sights for ballistics accuracy. ProPhotonix has significant experience in the design of laser systems for laser targeting applications and has supplied customers in these markets for approximately 7 years.

Patient Alignment Systems – Because of their reliability and versatility, laser alignment systems are used in medical applications providing an effective and accurate method of aligning patients in applications such as Computerized Tomography (CT) Scanners, Magnetic Resonance Imaging (MRI) Scanners, Intensity Modulated Radiation Therapy (IMRT) and Positron Emission Tomography (PET) Systems.

Show Lasers and Display – Automated laser displays, often synchronized with audio and pyrotechnics, are widely used in the entertainment, retail and leisure sectors. Show and display laser systems require high brightness and laser accuracy for optimum definition and precise colour projection. Laser diodes and laser modules supplied by ProPhotonix are designed with wavelengths and powers selected to achieve exceptional brightness and image clarity.

Machine Vision Lasers – Lasers are used in machine vision systems in the measurement, recognition and positioning of items in applications where the items being monitored are typically moving at high speed in an automated production or processing environment. The size and position of items is detected by the reading of deformations in laser generated light reflected from those items. The Company is developing a range of high-performance line generating laser modules, under the InViso™ brand, for machine vision applications. This new product range was announced in January 2010 at Photonics West, the international optics trade show, and is expected to go into commercial production in the second half of 2010.

Low Level Laser Therapy (LLLT) – LLLT, also known as Cold Laser Therapy, is a medical and veterinary procedure involving the use of Lasers to either inhibit or stimulate cells or a drug injected into the body, to create a reaction that aids the patient's treatment. LLLT has been used to treat a range of medical conditions including soft tissue injuries, wound healing, nerve regeneration and skin conditions. Similar techniques are also finding application in non-invasive cosmetic treatments, including laser liposuction, hair re-growth and skin rejuvenation, as well as some addiction therapies and laser acupuncture. ProPhotonix makes laser modules for LLLT with a wide range of wavelengths and powers and the Company designs modular solutions to meet specific application needs.

6. ProPhotonix LED Technology

6.1 Overview

A light-emitting diode (LED) is a semiconductor device that emits light when an electric current passes through it. Most LEDs are sold as packaged LEDs. An LED package has an optical lens, bonding wire (to bond the package to the printed circuit board), electrodes, and resin to encapsulate the LED for protection. Examples of packaged LEDs are shown in Figures 2 and 3. These packages can be affixed to a heat-sinking substrate using either "through hole" mounting or surface mounting. The through-hole mounted devices are often referred to as t-pack LEDs.

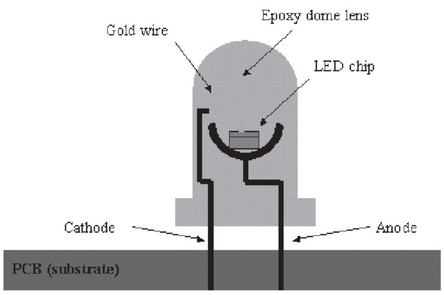

Fig.2: T-pack LED

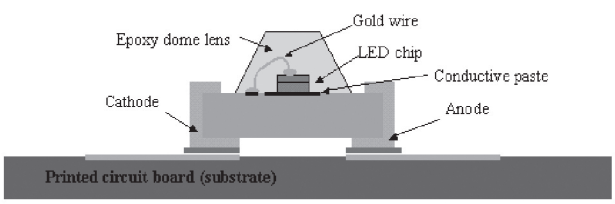

Fig. 3: Surface mount LED

An LED array is an arrangement of LEDs. They can be built using several methods, the choice of method depending on the manner in which the chips themselves are packaged by the LED semiconductor manufacturer. It is also possible to procure wafers of bare, unpackaged chips, also called "dice". ProPhotonix utilises "chip-on-board" technology in order to produce LED arrays

(Fig.4). This has a number of advantages relative the use of the more standard forms of LED packaging such as t-pack LEDs.

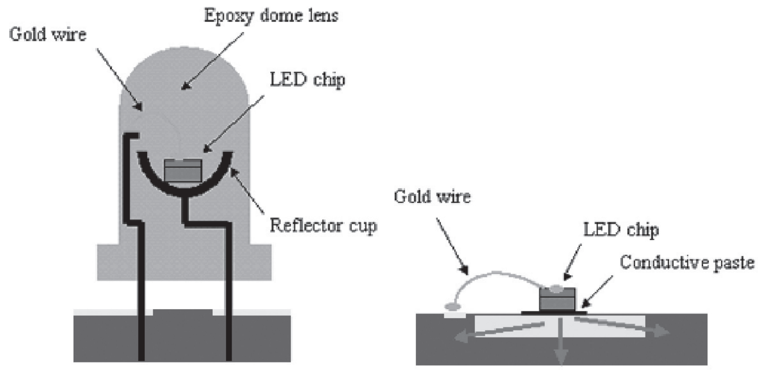

Fig.4: Standard LED vs. LED packaged with Chip-on-board technique

Assemblies built from t-pack LEDs may result in lower uniformity in lighting, and heat-sinking is typically more problematic. Furthermore, they are bulky due to the size (several millimetres) of each t-pack device. The advantages of chip-on-board LED arrays are:

- Compactness
- High intensity due to tight packing density
- High uniformity, even at close working distances
- Efficient heat dissipation

Chip-on-board LED arrays are amenable to superior heat-sinking during continuous, moderate-power operation. The key to efficient design is to ensure that LED PN junction temperatures are as low as possible, resulting in longer lifetimes as well as in improved wavelength and intensity stability. In the case of a t-pack LED the heat is largely directed away from the PN junction via the electrodes. In contrast, with ProPhotonix Ireland's chip-on-board technology, the chips are placed in intimate contact with a custom designed, thermally efficient substrate structure.

6.2 ProPhotonix's LED Light engine expertise

ProPhotonix Ireland has developed considerable expertise in the design and manufacture of chip-on-board LED devices, and has developed a good understanding of the critical thermal management issues. It has a six year track record of success in novel product development and customer acquisition. This success has been enabled by a strong technical pedigree, which started from a background in semiconductor processing 15 years ago at CorkOpt, Ltd., a University College Cork spin-off whose technology was acquired by the Company in 2000.

ProPhotonix has developed and produces high specification LED arrays capable of very high light intensities. The development of these products has been accomplished through a combination of key skills in a number of areas in the design and manufacture of LED light engines and modules, including design and manufacturing expertise in the areas of COB technology, thermal design, optical systems and electronics.

The Group's sales team works closely with customers to understand their needs and within the business with the engineering and development and the production teams in order to meet customer needs. If an appropriate standard product which would satisfy the customer's needs does not exist, a bespoke solution can be developed that might range from a simple array of LEDs to a complete lighting fixture with calibrated optical output, sophisticated control and ethernet communications.

Once a design is finalised, a physical prototype is produced and, following customer approval, the product is manufactured. The Company's manufacturing system is flexible enough to permit the production of a wide variety of parts in varying quantities ranging from small volume runs with short lead times to economically efficient large production runs. The Group also offers a range of standard products to the machine vision market:

- SpecBright – this product range includes area lights, ring lights, spotlights and line lights for the machine vision market.
- Cobra – a range of high-brightness front light and back light LED illumination for linescan and web inspection.
- Lotus – a range of line lights that provide a replacement for fluorescent line lights for machine vision applications.

The Group has a research and development facility in Cork which also includes offices for engineering, sales, marketing and administration, a modern production assembly/test area and a class 100,000 clean room with environmental controls, controlled entry procedures and an anti-static floor.

The Group's manufacturing process involves in-house and out-sourced elements. Chip-on-board (COB) processing and other high value added assembly is carried out in-house and intermediate assembly and piece part processing are outsourced. The Directors regard the Group's automated COB LED manufacturing capability, which incorporates chip handling, die attach, plasma etching, wire bonding and encapsulating, as an important part of the Group's technical strength.

7. Intellectual property

ProPhotonix owns a variety of intellectual property including patents, proprietary software, technical know-how and expertise, designs, process techniques and inventions. The Group holds four patents. The Directors believe that no particular patent, or related group of patents, is so important to the Group that its their loss would affect significantly the business of the Group as a whole. Where appropriate, the Group seeks patent protection for inventions and developments made by its personnel and incorporated into its products or otherwise falling within its fields of interest. Certain of the Group's technology is protected as trade secrets. The Group has a number of registered and unregistered trade marks.

The Group will periodically enter into licence arrangements with third parties to licence in and out patents, know-how and other intellectual property rights.

The COB manufacturing process is not unique to ProPhotonix; however, the Group is the registered proprietor of a number of patents covering specific COB techniques used in illumination products including patents relating to:

Ringlighting: The patent relates to a configuration of LEDs arranged in a ring combined with an annular Fresnel lens which in combination produce uniform illumination over a target plane.

Modular lighting: The patent relates to a linear illumination unit comprising a line of LED's and a separate lens which allows the spread and mixing of light in a linear direction. The modular units may be interconnected to allow seamless linear light.

Illuminator and production method: The patent relates to the design and production method of an illuminator in which copper conductors are located in cavities drilled in an insulating substrate. The conductors act as electrical and heat conductors and layers of bonding on the underside of the cavities in the substrate provide heat dissipation resulting in optical efficiency, good thermal dissipation and low production costs.

8. Competition

The market for the Group's products is fragmented and includes a large number of competitors, many of which are small or privately owned or which compete with ProPhotonix on a limited geographic, industry specific or application-specific basis. The Group also competes in certain target markets with competitors that are part of large industrial groups and have access to substantially greater financial and other technical resources than those of ProPhotonix.

In the laser module business, the Company competes against Power Technology, Inc. and Coherent, Inc. in the United States, Global Laser Ltd. and Schafter & Kirchhoff GMBH in Europe, as well as several other smaller laser manufacturers. The laser diode distribution business competes principally with the manufacturers themselves as well as a range of large and small electronic component distributors.

In the LED machine vision market companies work with readily available standard packaged LED devices, producing low to medium powered products. In contrast the Group focuses on the higher performance end of the market taking advantage of its COB technology. The Group's high-intensity LED systems business competes with similar products from Elcos GMBH (subsidiary of Perkin Elmer, Inc.) and Schott GmbH.

The Directors believe that the global lighting fixture market was a $100 billion market in 2009 with many different companies competing for a share of this attractive market. The LED portion of this market is currently estimated to be small at less than 3 per cent. in 2009. While general lighting companies such as Philips Lighting, Osram and GE offer a range of LED products to the lighting fixture market, many do not manufacture LED light engines which will be the Company's focus. Bridgelux, LightingScience and ENFIS currently manufacture LED light engines.

There are a large number of LED fixture manufacturers, such as Neo-Neon and Color Stars and a few smaller companies, specialising solely in the architectural LED fixture market competing in this area. There are also many architectural lighting companies that offer a range of LED products, along with traditional fluorescent, halogen and incandescent lighting fixtures, including Dialight, Targetti, Louis Poulsen and Bega. In addition, some entertainment lighting companies also offer LED products to the architectural lighting market.

9. Warrants & Options

The Company has granted warrants to subscribe for a total of 7,886,688 Common Shares representing 15.0 per cent. of the Enlarged Share Capital to 11 holders. The exercise prices of the majority of the Warrants are above the Placing Price and the Directors believe that this will remain the case for some time. Further details on the terms of the outstanding Warrants, including exercise price and period, are described in paragraph 2.9 of Part VI of this document.

The Company has also issued warrants to subscribe for 82,500 new Common Shares to Libertas representing 0.16 per cent. of the Enlarged Share Capital in part compensation for its services in connection with the Placing and Admission.

The Company has granted 4,834,432 Options and unvested Restricted Stock Awards that are outstanding at the date of this document and the Company has authority to grant a further 5,436,693 equity incentive awards pursuant the Plans. Further details of the outstanding Options and Restricted Stock Awards and the terms of the Plans are set out in paragraph 6 of Part VI.

10. Current Trading and Recent Financial Changes and Events:

In 2006 ProPhotonix Holdings issued an aggregate amount of US$2,400,000 of the ProPhotonix Bonds. Further details of the ProPhotonix Bonds are set out in paragraph 11.7 of Part VI of this Document. On 30 October 2010 and 10 December, the Company and the holders of the ProPhotonix Bonds entered into amendments of the terms of the bonds. Prior to the amendments, the bonds matured in full on 30 November 2010 in the amount of $1,596,000. The amendments provide that upon payment of $150,000 on 30 October 2010 of principal, the balance of the bonds ($1,493,000) will be repaid in monthly instalments of $50,000 principal plus interest over the period from 30 November 2010 through 30 November 2012. On 31 December 2012 the balance of the bond (then expected to be approximately $243,000) is due in full.

In 2006 ProPhotonix Holdings also issued an aggregate amount of US$4,750,000 of the ProPhotonix Holdings Secured Bonds. Further details of the ProPhotonix Bonds are set out in paragraph 11.8 of Part VI of this Document.

On 14 December 2010, the Company and the holder of the ProPhotonix Holdings Secured Bonds agreed to restructure the ProPhotonix Holdings Secured Bonds. Prior to this agreed restructuring, the ProPhotonix Holdings Secured Bonds were payable monthly, principal plus interest, through July 2011 and October 2011 when €914,112 and $1,413,386, respectively, were payable in full. The restructuring provides that the ProPhotonix Holdings Secured Bond shall be reduced by $1,274,544 through a conversion of debt to ProPhotonix Common Shares at the Placing Price resulting in the issue of 4,031,646 new Common Shares. The remaining balance assigned to and assumed by ProPhotonix Ireland as part of the ProPhotonix Ireland Secured Bond.

In 2008 ProPhotonix Ireland issued an aggregate amount of €935,000 of the ProPhotonix Ireland Secured Bonds. Further details of the ProPhotonix Ireland Secured Bonds are set out in paragraph 11.8 of Part VI of this Document. In connection with the restructuring of the ProPhotonix Holdings Secured Bonds described above the Company and the holder of the ProPhotonix Ireland Secured Bonds entered into a restructuring of the ProPhotonix Ireland Secured Bonds such that interest only shall be paid monthly on the outstanding balance through 30 June 2012 on the ProPhotonix Ireland Secured Bonds and thereafter equal monthly payments of principal and interest over the period 31 July 2012 through 30 June 2015.

In 2008 ProPhotonix UK entered into the Invoice Discounting Agreement with Barclays Bank PLC. Further details of the Invoice Discounting Agreement are set out in paragraph 11.6 of Part V of this Document. On 25 November 2010 ProPhotonix UK and Barclays Bank PLC agreed to extend the minimum term of the Invoice Discounting Agreement from 6 February 2011 to 25 May 2012.

In October 2009 the Company sold substantially all the assets of StockerYale Canada, Inc (a wholly owned subsidiary of the Company) and its speciality optical fiber business. The sum of approximately $750,000 being the final element of the cash consideration payable to the Company in connection this transaction was received by the Company on 13 October 2010. Further details of the North American Assets Sale Transaction are set out in paragraph 11.5 of Part VI of this Document.

Consistent with recent results, the Group has continued to experience increasing revenue and improving financial performance and EBITDA, excluding costs relating to the Admission and Placing. Current trading is in line with the Company's expectations. There has been no material change in the trading trends of the Group since 30 September 2010 the date of the last publicly announced results of the Company.

11. Indebtedness

The Group has in issue various bonds being the ProPhotonix Bonds, ProPhotonix Ireland Secured Bonds and the ProPhotonix Holdings Secured Bonds. As noted above the Company has agreed variations to the terms of these Bonds. As part of these variations $1,274,544 of the amount owing under the ProPhotonix Holdings Secured Bonds is to be capitalised by way of the issue of 4,031,646 new Common Shares at the Placing Price to Mark Hawtin, the holder of the ProPhotonix Holdings Secured Bonds. Mr Hawtin is the holder of 2,096,919 Common Shares, being 4.72 per cent of the issued share capital of the Company prior to the Placing and the Capitalisation. Following completion of the Placing and the Capitalisation Mr Hawtin will hold 6,128,565 Common Shares, being 11.65 per cent of the Enlarged Share Capital. Further details of significant shareholders in the Company are set out in paragraph 5.1 of Part VI of the Admission Document.

12. Reasons for Admission and use of proceeds

The Directors of ProPhotonix believe that Admission will assist the Company and Group in its development by:

- raising its profile generally and within in the optics and LED sectors specifically;
- providing investment and working capital to fund growth;
- enhancing the Company's ability to pay for acquisitions by enabling it to issue publicly traded securities; and
- enabling the Company to attract and retain highly qualified staff by offering equity incentives.

It is intended that the net proceeds of the Placing receivable by the Group, of approximately £615,000, will be used to provide working capital resources.

13. Directors and the Proposed Directors

The Board as at the date of this document comprises two executive and three non-executive directors. Brief summaries of the Board members' biographies are set out below:

Mark Wentworth Blodgett (age 53)

Chairman and Chief Executive Officer

Mr. Blodgett has been a member of the Board and an executive officer of the Company since 1989 when he acquired the majority of the shares of the Company. Previously Mr. Blodgett worked for a private merchant bank from 1988 until 1989, was Corporate Vice President at Drexel Burnham Lambert, Inc. from 1980 until 1988 and was an associate in the area of mergers and acquisitions for Citibank N.A. from 1979 until 1980. Mr. Blodgett is a member of the World Presidents Organization and serves on the Board of Trustees of Pomfret School. Mr. Blodgett graduated in 1979 from the University of St. Andrews with a M.A. (honours) in economics.

Timothy "Tim" Paul Losik (age 52)

Chief Operating Officer and Chief Financial Officer

Mr. Losik, a member of the board since June 2010, was appointed COO and CFO in early 2008 with responsibility for all day-to-day operations across the Group's worldwide operating units and to head its financial organisation. Prior to joining the Company, Mr. Losik served as the Chief Financial Officer at Bluesocket, Inc., a privately held provider of enterprise mobility solutions. Prior to Bluesocket, he was Vice President of Operations and Chief Financial Officer of Globalware Solutions, Inc., a privately held supply chain management company. From 2002 to 2004, Mr. Losik was Chief Operating Officer and Chief Financial Officer of Omtool, LTD., a Nasdaq-listed software company. From 1986 to 2000, Mr. Losik served in various positions at Hadco Corporation, a NYSE-listed advanced printed circuit manufacturer, including Senior Vice President of manufacturing and Senior Vice President and Chief Financial Officer and ultimately as the Senior Vice President of global printed circuit board operations at Sanmina-SCI upon Hadco's acquisition by Sanmina-SCI in December 2000.

Raymond "Ray" Joseph Oglethorpe (age 66)

Non-Executive Director

Mr. Oglethorpe is currently President of Oglethorpe Holdings, LLC, a private investment company, and has served on the Board of Trustees of The George Washington University since 1999. Mr. Oglethorpe served as President of America Online, Inc. from 2000 until his retirement in 2002. Prior to that time, Mr. Oglethorpe was a senior vice president responsible for directing the technologies and member services organizations of America Online, Inc. Mr. Oglethorpe has been a member of the Board since 2000. Mr. Oglethorpe has been designated by the independent members of the Board of Directors as Lead Director of the Company.

Dietmar Klenner (age 56)

Non-Executive Director

Mr. Klenner is an independent advisor and consultant to both foreign real estate firms and companies seeking investment opportunities in Austria. From April 2004 to March 2008, Mr. Klenner was a co-founder and Managing Partner of Argus Wealth Management AG. From July 2002 until February 2006, Mr. Klenner was Managing Partner of Meridian Global Advisors, which he also co-founded. From December 1989 until June 2002, Mr. Klenner worked for KS Securities Asset Management, which he co-founded and where he served as Chief Executive Officer and Managing Partner. Mr. Klenner has been a member of the Board since 2003.

Duncan Ian Arthur Campbell Byatt (age 48)

Non-Executive Director

Duncan Byatt has been an investment professional for some twenty-five years, starting his career at Ivory & Sime, Edinburgh in 1984. He has spent time living in Japan, Europe and Africa. From 1991 to early 1998 he managed the Gartmore US Small Company funds from London. These were among the largest and most successful investment funds of their type at the time. He was a Principal of Gartmore Investment Management Limited. In late 1998 he founded Eagle & Dominion Asset Management, and launched two new investment funds, principally to invest in growth companies in the US and Europe. In late 2006 he was appointed Senior Managing Director at Bear Stearns Asset Management, London, and headed the Global Growth Equity Team there until early 2008. The Eagle & Dominion funds were restructured in May 2007 to be able to invest in global growth companies. He continues to be a Director of these funds. During 2009 he undertook the planning and launch of The Foundation of Prince William and Prince Harry, and until July of this year was its Chief Executive.

14. Key management and employees

The Group currently employs 88 people. Brief summaries of the biographies of the key senior employees of the Group are set out below:

Simon Stanley

Managing Director of ProPhotonix Ireland

Mr. Stanley joined ProPhotonix in 1997 and is responsible for product development and operations for its high performance LED lighting systems. After joining the company, Mr. Stanley assumed increasing levels of responsibility in engineering, product development and worldwide sales management and was promoted to Managing Director in 2007. He was an inventor instrumental in the award of the Company's LED-packaging patent in 2004. He holds a B.Sc. in Applied Physics, with specialization in fibre optic communications and optical semiconductor devices.

Jeremy Lane

Managing Director of Prophotonix UK

Mr. Lane joined ProPhotonix in 2009 and is responsible for product development and operations for its laser modules and other electro-optical sub-assemblies and optoelectronic devices. Mr. Lane has two technical degrees (B.Sc. in Chemistry and Ph.D. in Polymer Science). Prior to joining ProPhotonix Mr. Lane was Managing Director – International Sales, at Brewer Science, a $100 million supplier to the global semiconductor industry and has held senior sales and technical appointments at multi-national specialty chemicals and engineering materials companies.

Phil Feeley

Corporate Controller

Mr. Feeley joined ProPhotonix in 2005 and is responsible for financial reporting and analysis, cost accounting, budgeting and forecasting, as well as SEC reporting. Mr. Feeley has extensive experience in merger and acquisition financial modeling. He spent 10 years with General Electric as a divisional Controller, as well as previous controller assignments with General Signal and Honeywell.

15. Corporate Governance

The Directors acknowledge the importance of the principles set out in the Combined Code. Although compliance with the Combined Code is not compulsory for companies admitted to AIM, the Directors intend to apply the principles as far as practicable and appropriate for a company of its nature and size incorporated in Massachusetts, USA. The Board also proposes to follow, as far as practicable, the recommendations on corporate governance of the Quoted Companies Alliance for companies with shares traded on AIM.

The Board is responsible for formulating, reviewing and approving the Group's strategy, budgets and corporate actions. Following Admission, the Directors intend to hold Board meetings four times a year and at other times as and when required. Mr. Oglethorpe has been designated by the independent members of the Board of Directors as Lead Director of the Company. The Company has an audit committee, a remuneration committee and a nomination committee with effect from Admission. Details of the committees are set out below.

Audit Committee

The audit committee is currently chaired by Raymond Oglethorpe and will also be comprised of Duncan Byatt and Dietmar Klenner. The audit committee is responsible for providing formal and transparent arrangements for considering how to apply suitable financial reporting and internal control principles having regard to good corporate governance and for monitoring external audit functions including the cost-effectiveness, independence and objectivity of the Group's auditors.

Remuneration Committee

The remuneration committee is currently chaired by Dietmar Klenner and will also be comprised of Raymond Oglethorpe and Duncan Byatt. The remuneration committee is responsible for establishing a formal and transparent procedure for developing policy on executive remuneration and to set the remuneration packages of individual Directors. This includes agreeing with the Board the framework for remuneration of the Chief Executive, all other executive Directors, the Company Secretary and such other members of the executive management of the Company as it is designated to consider. It is also responsible for determining the total individual remuneration packages of each Director including, where appropriate, bonuses, incentive payments and share options. No Director will play a part in any decision about his own remuneration.

Nomination Committee

The nomination committee will meet as required for the purpose of considering new or replacement appointments to the Board. The nomination committee is currently chaired by Dietmar Klenner and will also be comprised of Raymond Oglethorpe and Duncan Byatt.

Share dealing code

The Company has adopted and will operate a share dealing code for Directors and applicable employees in order to ensure compliance with Rule 21 of the AIM Rules and will take proper steps to ensure compliance by the Directors and those employees.

16. Dividend Policy

Whilst it remains the Directors' intention to consider the payment of a dividend when appropriate and when commercially prudent, they currently consider it prudent to retain cash to fund the further expansion of the Company. As a result, the Directors do not expect to pay cash dividends for the foreseeable future.

17. The Placing and the Capitalisation

On Admission, the Company will have 52,614,001 Common Shares issued, outstanding and fully paid and a market capitalisation of approximately £10.5 million (US$16.6 million) at the Placing Price. The Placing comprises the issue of 4,125,000 Placing Shares at the Placing Price, raising £615,000 (approximately US$970,000), net of expenses to be paid out of the Placing proceeds.

All of the Common Shares being offered in the Placing are being placed by Libertas, on a reasonable endeavours basis, with institutional and other investors.

The Common Shares being offered pursuant to the Placing will represent 7.8 per cent. of the Enlarged Share Capital. The Common Shares being offered pursuant to the Placing will rank *pari passu* in all respects to the Existing Common Shares. Further details of the Placing Agreement are set out in paragraph 11 of Part VI of this document.

The Capitalisation comprises the capitalisation of an amount of $1,274,544 owing under the ProPhotonix Holdings Secured Bond by way of the issue of 4,031,646 new Common Shares at the Placing Price. The Common Shares being issued in connection with the Capitalisation will represent 7.7 per cent. of the Enlarged Share Capital. The Common Shares being issued pursuant to the Capitalisation will rank *pari passu* in all respects to the Existing Common Shares.

18. Admission, settlement, dealings and CREST

Application has been made to the London Stock Exchange for all of the Existing Common Shares and the Placing Shares and the Capitalisation Shares to be admitted to trading on AIM. It is expected that Admission will take place, and that dealings on AIM in the Common Shares will commence, on 23 December 2010. CREST is a paperless settlement procedure enabling securities to be evidenced otherwise than by a physical certificate and transferred otherwise than by a written instrument. However, due to restrictions on transfer under the US Securities Act, the Placing Shares and the Capitalisation Shares must be held in certificated form for a period of at least 12 months, and perhaps as many as 24 months or until registered in the US, following Admission and, as such, the Placing

Shares and the Capitalisation Shares will not be eligible for settlement through CREST during that time. The Placing Shares and the Capitalisation Shares are not, and will not be, registered in the US, and the certificates representing the Placing Shares and the Capitalisation Shares will bear a legend to that effect as well as describing that (i) transfers of the Placing Shares and the Capitalisation Shares are prohibited except in accordance with the provisions of Regulation S, pursuant to registration under the US Securities Act or pursuant to an exemption from such registration and (ii) that hedging transaction involving the Placing Shares and the Capitalisation Shares may not be conducted unless in compliance with the US Securities Act. Accordingly, settlement of transactions in the Placing Shares and the Capitalisation Shares following Admission will not take place within the CREST system.

Although the Placing Shares and the Capitalisation Shares will not be immediately eligible for settlement through CREST following Admission, the Company has arranged for Computershare Investor Services plc, in its capacity as Depositary to issue Depositary Interests in respect of the Existing Common Shares, which are expected to be eligible for admission to CREST. Settlement of transactions in those Depositary Interests representing the Existing Common Shares may take place within the CREST system if the relevant shareholder so wishes and makes an application to CREST. Holders of Existing Common Shares who wish to retain share certificates will be able to do so. Due to the restrictions imposed by the US Securities Act, the Placing Shares and the Capitalisation Shares on the one hand, and the Existing Common Shares on the other, will each have separate International Securities Identification Number (ISIN) codes and accordingly will be quoted, traded and settled separately. Holders wishing to make enquiries as to how to move Existing Common Shares to/from CREST and to/from the US should contact the Depositary (Computershare Investor Services plc) on +44 0870 702 0003 ext 1075.

Further details of the transfer restrictions in respect of the Placing Shares and the Capitalisation Shares are set out in Part V of this document.

19. Lock-in arrangements

The Directors of the Company, who will hold between them approximately 6.54 per cent. of the Company's Enlarged Share Capital, have each undertaken to the Company and Libertas not to directly or indirectly sell or dispose of or permit the sale or disposal of any Common Shares (subject to certain limited exceptions) held by them prior to the anniversary of Admission and that any such disposal for a further 12 months thereafter shall be through the broker of the Company, and in such orderly manner as the broker of the Company shall reasonably determine.

Certain types of share transfers are permitted notwithstanding the lock-in arrangements including, but not limited to (i) transfers in connection with an acquisition of the Company or tender offer, (ii) transfer or disposal of Common Shares pursuant to a court order; and (iii) transfers upon death to heirs or personal representatives.

Further details of the lock-in arrangements are set out in paragraph 11.3 of Part VI of this document.

20. US Federal Securities Law Restrictions On Transfer and US Domicile

The Placing Shares and the Capitalisation Shares will not be registered under the Securities Act or qualified under the applicable securities laws of any of the states of the US. The Placing Shares and the Capitalisation Shares are only being offered outside the United States to non-US persons in reliance on Regulation S. The Placing Shares and the Capitalisation Shares are accordingly subject to certain restrictions on transfer, including a restriction against hedging transactions involving the Common Shares unless conducted in compliance with the Securities Act and (as set out below) the share certificates in respect of the Placing Shares will bear legends with respect to such transfer restrictions. Placees and subsequent purchasers of the Placing Shares will be deemed to have agreed to be bound by the transfer restrictions and to have agreed not to effect transfers of the Placing Shares except to transferees who also agree to be bound by the restrictions, while the restrictions are still applicable.

Further details of the transfer restrictions are set out in Part V of this document.

The Company is incorporated and existing under the laws of the Commonwealth of Massachusetts, USA and is subject to the provisions of the Massachusetts Business Corporation Act. There are a number of differences between a company incorporated in the US and a public limited company incorporated in the UK. In particular it should be noted that, unlike companies incorporated under the UK Companies Act, the Shareholders do not hold a pre-emptive right to acquire unissued shares in the capital of the Company whether under the Articles or Massachusetts corporate law. Further details of some of the differences between the company and a company incorporated in the UK are set out in Part IV of this document.

21. Taxation

The attention of investors is drawn to the information regarding UK taxation and US taxation, insofar as it may be applicable to UK residents in relation to the Placing and Admission, set out in paragraph 14 of Part VI of this document. All information in this document in relation to taxation is intended only as a general guide to the current tax position for UK investors as at the date of this document and is not intended to constitute personal tax advice for any person. You are strongly advised to consult your own independent professional tax advisers regarding the tax consequences of purchasing and owning the Company's Common Shares.

22. Further information

Your attention is drawn to the further information set out in Parts III to IV of this document which provide financial and additional information on the Company, and in particular to the Risk Factors relating to the Company and relating to any investment in Common Shares set out in Part II of this document.

PART II

RISK FACTORS

In addition to the other relevant information set out in this document, the following general and specific risk factors should be considered carefully in evaluating whether to make an investment in the Company.

Investors should note that the value of Common Shares may go down as well as up and there is no certainty that they will get back the full amount they invest. Any person considering an investment in Common Shares is recommended to consult an investment advisor, authorised under the Financial Services and Markets Act 2000, or an appropriately authorised independent adviser, prior to making any such investment.

1. General Risk Factors

Trading success

The value of Common Shares will be dependent upon the success of the trading activities undertaken by the Group.

Dependence on directors and senior management

The success of the Group, in common with other businesses of a similar size, will be dependant on the expertise and experience of its directors and senior management. Measures are in place and are under review to reward and retain key individuals and to protect the Group from the impact of staff turnover. However, risks in this area cannot be totally eliminated.

Availability of finance

In order for the Group to capitalise on growth opportunities in its chosen markets in the longer-term, it may be necessary to raise further funds by way of equity or debt or a combination of both. The Group's business may be constrained to the extent that it is unable to raise further equity finance or that banks are not willing to provide any additional debt and other facilities required.

The AIM market

AIM is not the Official List. It is a market designed primarily for emerging or smaller companies. The market in the Common Shares may therefore be relatively illiquid or subject to fluctuations. Consequently it may be difficult for Shareholders to realise any investment in the Company.

The AIM Rules for Companies are less demanding than those of the Official List. An investment in shares that are listed on AIM is likely to carry a higher risk than an investment in shares on the Official List.

Share price fluctuations

The price that Shareholders and other investors may realise for their holding of Common Shares, when they are able to do so, may be influenced by a large number of factors, some of which are specific to the Company and some of which are extraneous. Shareholders and other investors in the Company may realise less than the original amount invested by them.

2. Specific Risk Factors

The Group operates in a rapidly changing environment that involves a number of risks, some of which are beyond its control. Forward looking statements concerning the expected future revenues, earnings or financial results or concerning project plans, performance, or development of products and services, as well as other estimates related to future operations are necessarily only estimates of future results and there can be no assurance that actual results will not materially differ from expectations. Forward-looking statements represent management's current expectations and are inherently uncertain. The Group does not undertake any obligation to update forward-looking statements. If any of the following risks actually occur, the Group's financial condition and operating results could be materially adversely affected.

Disruption in financial and currency markets could have a negative effect on the Group's business

Whilst the recent financial and economic crisis did not impair materially the Group's ability to operate its business, there can be no assurance that there will not be any future disruption in financial markets and confidence in major economies, which would lead to challenges in the operation of the Group's business. Economic developments affect businesses such as ProPhotonix in a number of ways. The current tightening of credit in financial markets adversely affects the ability of customers and suppliers to obtain financing for significant purchases and operations and could result in a decrease in orders and spending for the Company's products and services. The Group is unable to predict the likely duration and severity of any future disruption in financial markets and adverse economic conditions and the effects they will have on its business and financial condition.

The Group has a history of losses and may never achieve or sustain profitability.

The Group has experienced operating losses over the last several years and may continue to incur losses and negative operating cash flows. The Group has historically financed its operations with proceeds from debt financings and the sale of equity securities. The Group anticipates that it will continue to incur net losses during 2011 there can be no assurance that the Group will achieve profitability or be capable of sustaining profitable operations.

Securities the Company issues to fund its operations could dilute or otherwise adversely affect its Shareholders.

The Group may need to raise additional funds through public or private debt or equity financings to fund its operations. If it raises funds by issuing equity securities, or if it issues additional equity securities to acquire assets, a business or another company, the percentage ownership of Shareholders will be reduced. If the Group raises funds by issuing debt securities, it may be required to agree to covenants that substantially restrict its ability to operate its business. The Group may not obtain sufficient financing on terms that are favorable to investors or it. The Group may delay, limit or eliminate some or all of its proposed operations if adequate funds are not available.

In addition, upon issuance of the Common Shares upon exercise of outstanding warrants or share options, the percentage ownership of the Shareholders would be diluted substantially.

The unpredictability of the Group's results may cause the trading price of its Common Shares to fluctuate or decline.

The Group's operating results have varied during its operating history and are likely to continue to vary significantly from period-to-period as a result of a number of factors, many of which are outside of its control and any one of which may cause its share price to fluctuate.

Factors that can impact the Company's share price include the implementation of its new business strategy, which makes prediction of future revenues difficult. The Group's ability to accurately forecast revenues from sales of its products is further limited by the development and sales cycles related to its products, which make it difficult to predict the quarter in which sales will occur. In addition, the Group's expense levels are based, in part, on its expectations regarding future revenues, and its expenses are generally fixed, particularly in the short term. The Group may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. Any significant shortfall of revenues in relation to the Group's expectations could cause significant declines in its quarterly operating results.

Due to the above factors, the Company believes that period-to-period comparisons of its operating results may not be good indicators of its future performance. The Group's operating results for any particular period may fall short of its expectations or those of Shareholders or securities analysts. In this event, the trading price of the Common Shares would likely fall.

Our purchase and sale agreement with the buyer of our North American assets includes indemnification obligations.

On 13 October 2009, the Company sold substantially all of the North American assets of Stocker Yale Canada, Inc. and its specialty optical fiber product line to Coherent, Inc. ("Coherent"). Pursuant to the purchase and sale agreement, the Company agreed to indemnify Coherent for any losses sustained, for any breach of, or inaccuracy in, any of the representations or warranties and breach of any covenants the Company made to Coherent, subject, in most cases, to a basket and a cap of US$15,000,000. Most of the representations and warranties expired on 13 October 2010, but certain others survive through the applicable statute of limitations or indefinitely. Should any of the Company's representations or warranties prove to be inaccurate, or should the Company breach any of its covenants, the Company could be obligated to pay Coherent certain sums, in most cases up to US$15,000,000. Payment of such indemnification obligations, capped or uncapped, may negatively affect the Company's liquidity and its ability to continue operations. Further details of this purchase and sale agreement are set out in paragraph 11.5 of Part VI.

Other factors can cause the Company's share price to be volatile and it may continue to fluctuate in the future

The Company's Common Shares has experienced significant price and volume fluctuations in recent years. Since January 2008, its Common Shares have closed as low as $0.04 per share and as high as $0.88 per share. These fluctuations often have no direct relationship to the Group's operating performance. The market price for its Common Shares may continue to be subject to wide fluctuations in response to a variety of factors, some of which are beyond its control. Some of these factors include:

- the results and effects of litigation;
- the Group's financial performance and prospects;
- sales by selling Shareholders of Common Shares issued and issuable in connection with the Company's private placements;
- general financial and other market conditions; and
- domestic and international economic conditions.

The Group depends on a limited number of suppliers and may not be able to ship products on time if it is unable to obtain an adequate supply of raw materials and equipment on a timely basis.

In certain product areas, the Group depends on a limited number of suppliers for raw materials and equipment used to manufacture its products. The Group depends on its suppliers to supply critical components in adequate quantities, consistent quality and at reasonable costs. If the Group's suppliers are unable to meet its demand for critical components at reasonable costs, and if the Group is unable to obtain an alternative source, or the price for an alternative source is prohibitive, its ability to maintain timely and cost-effective production of its products would be harmed. The Group generally relies on purchase orders rather than long-term agreements with its suppliers; therefore, its suppliers may stop supplying materials and equipment to it at any time. If the Group is unable to obtain components in adequate quantities it may incur delays in shipment or be unable to meet demand for its products, which could harm its revenues and damage its relationships with customers and prospective customers.

The Group has many competitors in its field and its technologies may not remain competitive.

The Group participates in a rapidly evolving field in which technological developments are expected to continue at a rapid pace. The Group has many competitors in the United States and abroad, including various fiber optic component manufacturers, universities and other private and public research institutions.

In the laser market, the Group competes against Power Technology, Inc. in the United States, Schafter & Kirchoff GMBH in Europe and several other smaller laser manufacturers. The Group's high-intensity LED systems compete with LED systems of Elcos, a subsidiary of Perkin Elmer, and Schott North America Inc. and Schott AG. The Group's success depends upon its ability to develop and maintain a competitive position in the product categories and technologies on which it focuses. To be successful in the laser and optical components industries, the Group will need to keep pace with rapid changes in technology, customer expectations, and new product introductions by competitors and evolving industry standards, any of which could render its existing products obsolete if it fails to respond in a timely manner. The Group could experience delays in the introduction of new products. If others develop innovative proprietary laser products or optical components that are superior to the Group's, or if it fails to accurately anticipate technology and market trends and respond on a timely basis with its own innovations, the Group's competitive position may be harmed and it may not achieve sufficient growth in its revenues to attain or sustain profitability.

Many of the Group's competitors have greater capabilities and experience and greater financial, marketing and operational resources than it. Competition is intense and is expected to increase as new products enter the market and new technologies become available. To the extent that competition in the Group's markets intensifies, it may be required to reduce its prices in order to remain competitive. If it does not compete effectively, or if the Group reduces it prices without making commensurate reductions in its costs, the Group's revenues and profitability, and its future prospects for success, may be harmed.

The Group's customers are not obligated to buy material amounts of its products and may cancel or defer purchases on short notice

The Group's customers typically purchase the Company's products under individual purchase orders rather than long-term contracts or contracts with minimum purchase requirements. Therefore, the Group's customers may cancel, reduce or defer purchases on short notice without significant penalty. Accordingly, sales in a particular period are difficult to predict. Decreases in purchases, cancellations of purchase orders or deferrals of purchases may have a material adverse effect on the Group, particularly if it does not anticipate them. There can be no assurance that the Group's revenue from key customers will not decline in future periods.

The Group's products could contain defects, which could result in reduced sales of those products or in claims against it.

Despite testing both by the Group and its customers, errors have been found and may be found in the future in its existing or future products. These defects may cause the Group to incur significant warranty, support and repair costs, divert the attention of its technical personnel from its product development efforts and harm the Group's relationship with its customers. Defects, integration issues or other performance problems in its illumination and optical products could result in personal injury or financial or other damages to its customers or could damage market acceptance of its products. The Group's customers could also seek damages from it for their losses. A product liability claim brought against the Group, even if unsuccessful, would likely be time consuming and costly to defend.

The Group is subject to risks of operating internationally.

The Group distributes and sells some of its products internationally, and the Group's success depends in part on its ability to manage its international operations. Sales outside the United States accounted for 57 per cent. of its total revenue for the year ended 31 December, 2009. The Group is subject to risks associated with operating in foreign countries, including:

- foreign currency risks;
- costs of customizing products for foreign countries;
- imposition of limitations on conversion of foreign currencies into dollars;
- remittance of dividends and other payments by foreign subsidiaries;
- imposition or increase of withholding and other taxes on remittances and other payments on foreign subsidiaries;
- hyperinflation and imposition or increase of investment and other restrictions by foreign governments;
- compliance with multiple, conflicting and changing governmental laws and regulations;
- longer sales cycles and problems collecting accounts receivable;

- labor practices, difficulties in staffing and managing foreign operations, political instability and potentially adverse tax consequence; and
- import and export restrictions and tariffs.

If the Group is unable to manage these risks, it may face significant liability, the Group's international sales may decline and its financial results may be adversely affected.

The Group is subject to the risk of losing its tax loss carry forward assets

The Group is currently resident in the US for tax purposes, however if the location of the management and control of the Company were to change, this may have an impact on the residency status of the Company and its ability to utilise any tax losses carried forwards it currently has.

The Group may be held liable for income tax not withheld on interest for certain bondholders

Under Irish and UK tax regulations the Group is required to withhold income tax on interest payments to certain bondholders. The Group has not withheld these tax payments in the past and could therefore be held liable for the payments of these taxes if the recipients of the interest failed to file proper tax returns. Additionally the Company could incur penalties for non-compliance regardless of the tax filing status of the recipients.

The Company may be required to comply with US federal securities law reporting and corporate governance regulations in the future

Under Section 12(g) and Rule 12g-l of the United States Securities Exchange Act of 1934 (as amended) (the "**Exchange Act**"), companies that exceed certain size parameters must register under the Exchange Act and file annual and other reports with the US Securities and Exchange Commission. In particular, if the company has $10 million or more in assets on the last day of its most recent three fiscal years and any class of equity securities held by 300 or more record holders, wherever resident, it will be required to register under the Exchange Act, including making all filings under the Exchange Act that have not been made since the time the Company's reporting obligations ceased in January 2010. This registration and compliance would be required even though the Company will not have conducted a registered offering in the US or listed its securities on any US trading market. Although the Company does not currently exceed the shareholder threshold, Admission of the Common Shares on AIM and subsequent trading of the Common Shares through this market will likely increase the number of record holders of the Company's Common Shares, and the Company will not be able to control how many record holders it may have in the future. In addition, if the Company is required to register under the Exchange Act, it will also become subject to the United States Sarbanes Oxley Act of 2002 ("SOX"), and possibly the internal controls assessment requirements of Section 404 under SOX.

Compliance with the Exchange Act and SOX would entail significant additional general and administrative expense. Compliance would also require significant management attention, resulting in a diversion of management from revenue-generating activities to compliance activities. The Company may not have the resources or may otherwise be unable to comply with the reforms required by these regulations, and in particular, the Company could be required to make significant adaptations to its financial reporting and processes. Any of the above or other related implications of being subject to these regulations could materially and adversely impair the Company's results of operations and cash flow.

PART III

FINANCIAL INFORMATION

SECTION A: ACCOUNTANT'S REPORT ON THE HISTORICAL FINANCIAL INFORMATION

The following is the full text of a report on ProPhotonix Limited from Baker Tilly Corporate Finance LLP, the Reporting Accountants, to the Directors of ProPhotonix Limited.

BAKER TILLY
25 Farringdon Street
London EC4A 4AB
www.bakertilly.co.uk

The Directors
ProPhotonix Limited
32 Hampshire Road
Salem
New Hampshire 03079
USA

20 December 2010

Dear Sirs

PROPHOTONIX LIMITED ("the Company")

We report on the financial information set out Part III, Section B of this document ("Historical Financial Information"). The Historical Financial Information has been prepared for inclusion in the Admission Document dated 20 December 2010 ("Admission Document") of the Company on the basis of the accounting policies set out in notes 1 and 2 to the Historical Financial Information.

This report is required by paragraph 20.1 of Annex I of Appendix 3.1.1 of the Prospectus Rules as if they had been applied by part (a) of Schedule Two to the AIM Rules and is given for the purpose of complying with that paragraph and for no other purpose. We have not audited or reviewed the financial information for the six month period ended 30 June 2010 as set out in Part III Section C of the Admission Document or the financial information for the three month period ended 30 September 2010 as set out in Part III Section D of the Admission Document and accordingly do not express an opinion thereon.

Save for any responsibility arising under paragraph 20.1 of Annex I of Appendix 3.1.1 of the Prospectus Rules as if they had been applied by part (a) of Schedule Two to the AIM Rules to any person as and to the extent there provided, to the fullest extent permitted by law, we do not accept or assume responsibility will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 20.1 of Annex I of Appendix 3.1.1 of the Prospectus Rules as if it had been applied by part (a) of Schedule Two to the AIM Rules, consenting to its inclusion in the Admission Document.

Responsibilities

The Directors of the Company are responsible for preparing the Historical Financial Information on the basis of preparation set out in notes 1 and 2 and in accordance with US GAAP.

It is our responsibility to form an opinion as to whether the Historical Financial Information gives a true and fair view, for the purposes of the Admission Document, and to report our opinion to you.

Basis of opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the Historical Financial Information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the Historical Financial Information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Historical Financial Information is free from material misstatement whether caused by fraud or other irregularity or error.

Opinion

In our opinion, the financial information gives, for the purposes of the Admission Document, a true and fair view of the state of affairs of the Group as at the dates stated and of its consolidated balance sheets, consolidated statement of operations, consolidated statement of cash flows and consolidated statement of stockholders' equity and comprehensive loss for the periods then ended in accordance with the basis of preparation set out in notes 1 and 2 and in accordance with US GAAP as described in notes 1 and 2.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in any jurisdictions other than the United Kingdom and accordingly should not be relied upon as if it had been carried out in accordance with those other standards and practices.

Declaration

For the purposes of part (a) of Schedule Two to the AIM Rules we are responsible for this report as part of the Admission Document and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Admission Document in compliance with item 1.2 of Annex I and item 1.2 of Annex III of Appendix 3.1.1 of the Prospectus Rules as if it had been applied by part (a) of Schedule Two to the AIM Rules.

Yours faithfully

Baker Tilly Corporate Finance LLP

Regulated by the Institute of Chartered Accountants in England and Wales

Baker Tilly Corporate Finance LLP is a limited liability partnership registered in England and Wales, registered no. OC325347. A list of the names of members is open to inspection at the registered office 2 Bloomsbury Street London WC1B 3ST

SECTION B: HISTORICAL FINANCIAL INFORMATION

PROPHOTONIX LIMITED

CONSOLIDATED BALANCE SHEETS

As at 31 December,	*2009*	*2008*	*2007*
Assets		*(in thousands)*	
Current assets:			
Cash and cash equivalents	$4,478	$1,635	$1,577
Restricted cash	–	7	18
Accounts receivable, less allowances of $5 in 2009, $18 in 2008 and $0 in 2007	1,473	1,673	1,880
Inventories (Note 5)	1,282	1,418	1,870
Prepaid expenses and other current assets	502	114	235
Current assets – discontinued operations	–	4,900	5,195
Total current assets	7,735	9,747	10,775
Net property, plant and equipment (Note 6)	3,835	4,241	4,940
Goodwill (Note 7)	508	4,410	5,892
Acquired intangible assets, net (Note 8)	1,260	1,795	3,518
Other long-term assets	38	303	591
Long-term assets – discontinued operations	–	6,813	8,322
Total assets	$13,376	$27,309	$34,038
Liabilities and Stockholders' Equity (Deficit)			
Current liabilities:			
Current portion of long-term debt, net of unamortized discount of $358 in 2009, $856 in 2008 and $516 in 2007 (Note 9)	$3,798	$4,118	$1,308
Revolver (Note 9)	568	3,869	–
Capital lease obligations	85	119	155
Current portion of financing lease obligations (Note 16)	413	444	447
Accounts payable	1,142	2,829	1,816
Accrued expenses	1,117	916	1,161
Current liabilities – discontinued operations	–	2,638	3,382
Total current liabilities	7,123	14,933	8,269
Long-term debt, net of unamortized discount of $193 in 2009, $658 in 2008 and $907 in 2007 (Note 9)	3,281	6,372	11,864
Capital lease obligations, net of current portion	24	95	271
Financing lease obligations, net of current portion (Note 16)	3,196	3,225	3,200
Deferred income taxes	67	353	931
Long-term liabilities – discontinued operations	–	52	4
Total Liabilities	13,691	25,030	24,539
Commitments and contingencies (Note 16)			
Stockholders' equity (deficit):			
Common stock, par value $0.001 shares authorized 100,000,000; 44,616,458 shares issued and outstanding at 31December, 2009, 43,464,413 at 31 December, 2008 and 38,555,618 at 31 December, 2007	45	43	39
Paid-in capital	103,048	103,270	99,698
Accumulated deficit	(103,526)	(103,552)	(93,267)
Accumulated other comprehensive income	118	2,518	3,029
Total stockholders' equity (deficit)	(315)	2,279	9,499
Total liabilities and stockholders' equity	$13,376	$27,309	$34,038

See the notes to historical financial information.

CONSOLIDATED STATEMENT OF OPERATIONS

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
		(except per share amounts)	
Revenue	$10,456	$14,751	$12,820
Cost of sales	(7,298)	(10,112)	(9,187)
Gross profit	3,158	4,639	3,633
Operating expenses:			
Selling	(1,598)	(1,931)	(2,380)
General and administrative	(4,082)	(5,860)	(5,076)
Amortization of intangibles	(694)	(999)	(1,243)
Research and development	(555)	(536)	(474)
Asset impairment	(4,377)	–	–
Total operating expenses	11,306	9,326	9,173
Loss from operations	(8,148)	(4,687)	(5,540)
Other income (expense)	928	(3,029)	120
Interest expense	(393)	(263)	(156)
Amortization of debt discount and financing costs	(1,704)	(2,183)	(1,302)
Loss from continuing operations before income tax benefit	(9,317)	(10,162)	(6,878)
Income tax benefit	3,966	367	445
Loss from continuing operations	(5,351)	(9,795)	(6,433)
Loss from discontinued operations, net of tax	(701)	(490)	(2,023)
Gain on sale of discontinued operations, net of tax	4,875	–	–
Income/(loss) from discontinued operations	4,174	(490)	(2,023)
Net loss	$(1,177)	$(10,285)	$(8,456)
Basic and diluted net loss per share from continuing operations	$(0.12)	$(0.26)	$(0.18)
Basic and diluted net loss per share from discontinued operations	$(0.02)	$(0.01)	$(0.06)
Basic and diluted net income per share from gain on sale of discontinued operations	$0.11	$–	$–
Basic and diluted net loss per share	$(0.03)	$(0.27)	$(0.24)
Basic and diluted weighted average shares outstanding	43,641	38,523	34,920

See the notes to historical financial information.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE LOSS

(in thousands)

	Common Stock						
	Shares	*Par $0.001*	*Paid in Capital*	*Accumulated Deficit*	*Accumulated Other Comprehensive Income*	*Total Stockholders Equity (Deficit)*	*Comprehensive Income (Loss)*
Balance 31 December, 2006	33,233	$33	$94,699	$(84,811)	$2,269	$12,190	
Sale of common stock and warrants, net of issuance costs of $42	2,000	2	2,230			2,232	
Issuance of common stock to acquire Spectrode LLC	215		264			264	
Issuance of common stock for Laurus financings	675	1	639			640	
Issuance of restricted stock and share-based compensation	1,111	2	532			534	
Exercise of options to purchase common stock	140		109			109	
Exercise of warrants for common stock	1,182	1	1,225			1,226	
Cumulative translation adjustment					760	760	760
Net loss				(8,456)		(8,456)	(8,456)
Comprehensive net loss for the year ended 31 December, 2007							$(7,696)
Balance 31 December, 2007	38,556	$39	$99,698	(93,267)	$3,029	$9,499	
Sale of common stock and warrants, net of issuance costs of $81	2,254	2	551			553	
Issuance of common stock and warrants for financings	100		867			867	
Issuance of common stock to secure financing commitment	1,629	2	959			961	
Issuance of restricted stock, net of forfeitures, and share-based compensation	(51)	–	735			735	
Issuance of common stock to settle liabilities	976		460			460	
Cumulative translation adjustment					(511)	(511)	(511)
Net loss				(10,285)		(10,285)	(10,285)
Comprehensive net loss for the year ended December 31, 2008							$(10,796)
Balance 31 December, 2008	43,464	$43	$103,270	$(103,552)	$2,518	$2,279	
Cumulative effect of change in accounting principle – January 2009 1, reclassification of warrants to liability (Note 2)			(1,495)	1,203		(292)	
Sale of common stock with warrants, net of issuance costs of $0	10	–	13			13	
Issuance of warrants for financings	–		38			38	
Reclassification of warrant liability to equity (Note 2)			242			242	
Cancellation of previously issued restricted stock, and share-based compensation, net of forfeitures	(338)	–	612			612	
Issuance of common stock to settle liabilities	1,480	2	368			370	
Recognition of currency translation adjustment upon sale					(2,601)	(2,601)	
Cumulative translation adjustment					201	201	201
Net loss				(1,177)		(1,177)	(1,177)
Comprehensive net loss for the year ended 31 December, 2009							$(976)
Balance 31 December, 2009	44,616	$45	$103,048	$(103,526)	$118	$(315)	

See the notes to historical financial information.

CONSOLIDATED STATEMENT OF CASH FLOWS

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Operations			
Net loss	$(1,177)	$(10,285)	$(8,456)
Loss from discontinued operations, net of tax	(701)	(490)	(2,023)
Gain on sale of discontinued operations, net of tax	4,875	–	–
Loss from continuing operations	(5,351)	(9,795)	(6,433)
Adjustments to reconcile net loss to net cash used in operating activities:			
Stock-based compensation expense	514	508	385
Depreciation and amortization	1,213	1,657	1,862
Amortization of debt discount and financing costs	1,704	2,183	1,302
Non cash interest expense	211	283	300
(Gain)/loss on disposal of assets	(29)	85	–
Asset impairment	4,377	–	–
Provision for inventories	39	55	200
Provision for bad debts	16	46	49
Change in fair value of warrant liability	(50)	–	–
Deferred taxes	(3,944)	(308)	(319)
Other change in assets and liabilities:			
Accounts receivable	175	(237)	(94)
Inventories	153	(91)	(101)
Prepaid expenses and other current assets	(303)	104	284
Accounts payable	(1,791)	1,590	(57)
Accrued expenses	590	(375)	(481)
Other assets and liabilities	18	260	36
Net cash used in continuing operations	(2,458)	(4,035)	(3,067)
Net cash used in discontinued operations	(17)	(40)	160
Net cash used in operating activities	(2,475)	(4,075)	(2,907)
Investing			
Acquisition, net of cash acquired	–	–	(112)
Proceeds from disposal of assets	–	12	–
Financing obligation payments	(271)	(254)	(338)
Purchase of property, plant and equipment	(64)	(164)	(318)
Net cash used in continuing operations	(335)	(406)	(768)
Net cash provided by (used in) discontinued operations	13,010	(191)	(247)
Net cash provided by (used in) investing activities	12,675	(597)	(1,015)
Financing			
Net proceeds from sale of common stock	13	553	2,232
Borrowings of revolving credit facilities, net	(3,372)	1,107	420
Proceeds from long-term debt issuance	500	1,959	3,320
Principal repayment of long-term debt	(4,658)	(1,589)	(2,669)
Decrease (increase) in restricted cash	7	–	(7)
Proceeds from exercise of options to purchase common stock	–	–	109
Exercise of warrants to purchase common stock	–	–	1,226
Debt acquisition costs	(400)	(21)	(216)
Net cash provided by (used in) continuing activities	(7,910)	2,009	4,415
Net cash provided by (used in) discontinued operations	(62)	11	(3)
Net cash provided by (used in) financing activities	(7,972)	2,020	4,412
Effect of exchange rate	615	2,710	(279)
Net change in cash and equivalents	2,843	58	211
Cash and equivalents at beginning of year	1,635	1,577	1,366
Cash and equivalents at end of year	$4,478	$1,635	$1,577
Supplemental of cash flow information:			
Cash paid for interest	$450	$146	$119
Cash paid for income tax	$–	$4	$125
Fair value of restricted stock issued	$–	$114	$1,650
Common stock and warrants issued in connections with financings	$528	$–	$–
Cashless exercise of warrants	$–	$–	45
Issuance of common stock to settle liabilities	$370	$460	$–
Common stock issued in connection with financings	$–	$961	$640
Warrants issued in connection with financings	$38	$420	$1,292
Assets acquired under lease agreements	$371	$202	$–
Acquisitions, net of cash acquired:			
Fair value of assets acquired	–	–	376
Fair value of common stock issued	–	–	(264)
Cash paid, net of cash acquired	$–	$–	$112

NOTES TO FINANCIAL INFORMATION

(1) ORGANIZATION AND BASIS OF PRESENTATION

ProPhotonix Limited (also referred to in this document as "ProPhotonix", "we", the "Company", "the issuer", and formerly known as StockerYale, Inc.) operates in two segments: as an independent designer and manufacturer of LED systems; and as a distributor of laser diodes and manufacturer of laser modules through its ProPhotonix U.K. subsidiary, formerly known as Photonic Products Ltd. The Company's products serve a wide range of applications and industries including machine vision and industrial inspection, biomedical, defense and security, and other commercial applications.

ProPhotonix was incorporated on 27 March, 1951 under the laws of the Commonwealth of Massachusetts. In December 1995, the company completed the registration of its common stock with the U.S. Securities and Exchange Commission and its stock now trades on the Pink OTC Market under the trading symbol "STKR.PK". The shareholders of the Company authorized the name change in May 2010 which took effect in June 2010.

The accompanying consolidated financial information has been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the consolidated financial information, during the years ended 31 December, 2009, 2008 and 2007, the Company recorded net losses of $1,177,000, $10,285,000, and $8,456,000 respectively. Net cash used in operating activities from continuing operations for the same time periods were $2,458,000, $4,035,000, and $3,067,000 respectively. The Directors have prepared projected cash flow information for the period through December 31, 2012 taking account of the proceeds of the Placing and the forecast development of the Group's revenues and cost base. The Directors have also considered actions they could take in response to reasonable cash flow sensitivities arising from adverse movements in trading performance. After making enquiries and considering the risk of a downturn in trading performance, the Directors are of the opinion that the Group has adequate resources to continue in operational existence for the foreseeable future, that is for at least twelve months from the date of this document. For these reasons, they continue to adopt the going concern basis of accounting in preparing the financial information. The consolidated financial information does not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

On 13 October, 2009, the Company and its wholly owned subsidiary, StockerYale Canada, Inc. ("SYC"), sold substantially all North American assets and rights of SYC and the Company's specialty optical fiber product line to Cohenernt, Inc. The sale price consisted of a cash payment of $15,000,000 (of which $750,000 was placed in escrow for one year) and the assumption of certain liabilities, including approximately $3,425,000 of accounts payable, accrued expenses and other obligations associated with the assets sold. Proceeds from the transaction were used to pay off in full all obligations owed to Laurus Master Fund, Ltd. and its related entities (approximately $7,900,000 including fees), fees related to the transaction of approximately $1,100,000, the settlement of various obligations of approximately $950,000, and for working capital and general corporate purposes for the Company's ongoing and future operations. The financial information presents the entities sold as discontinued operations. As a result of the sale, the company recognized a gain of approximately $2,601,000 related to the deferred currency translation adjustment of StockerYale Canada, Inc. subsidiary at the time of the sale. This is reported as a part of the gain from discontinued operations.

Prior to the sale, the Company reported three segments: Lasers, Photonic Products, and Optical Components. The entire optical component segment and a portion of the laser segment were sold. The Company will continue to operate its LED systems and Photonic Products businesses, which are based in Ireland and the United Kingdom.

On 30 October, 2010 and 14 December, 2010 the Company and its wholly owned subsidiary, StockerYale UK Limited, amended the bonds held by the former shareholders of Photonic Products Ltd. See Note 9.

On 10 December 2010, the Company and its wholly owned subsidiaries, StockerYale UK Limited, Photonic Products Limited and StockerYale Ireland amended the ProPhotonix Holdings Secured Bonds. See Note 9.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial information reflects the application of the Company's most significant accounting policies as described in this note and elsewhere in the accompanying consolidated financial information and notes.

Principles of Consolidation

The accompanying consolidated financial information includes the financial information of the Company and its wholly owned subsidiaries, StockerYale (IRL) Ltd., StockerYale Waterloo Acquisition Inc., StockerYale (UK) Ltd., which owns 100 per cent. of Photonics Products Ltd., and Lasiris Holdings, Inc., which holds all of the outstanding shares of StockerYale Canada. See Note 15 for information about the Company's sale of the assets in 2009, including those of StockerYale Canada. All intercompany balances and transactions have been eliminated.

Cash and cash equivalents

The Company considers cash equivalents to consist of highly liquid investments with original maturities of three months or less when purchased.

Restricted cash

Restricted cash includes a sublease payment that was made in advance equal to two month's rent at year end 2007 and one month's rent at year end 2008.

Accounts receivable

The Company reviews the financial condition of new customers prior to granting credit. After completing the credit review, the Company establishes a credit line for each customer. Periodically, the Company reviews the credit line for major customers and adjusts the credit limit based upon an updated financial condition of the customer, historical sales and payment information and expected future sales. The Company has a large number of customers; therefore, material credit risk is limited.

The Company periodically reviews the collectibility of its accounts receivable. Provisions are established for accounts that are potentially uncollectible. Determining adequate reserves for accounts receivable requires management's judgment. Conditions impacting the collectibility of the Company's receivables could change causing actual write-offs to be materially different than the reserved balances.

Changes in the allowance for doubtful accounts were as follows:

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Balance at beginning of period	$18	$–	$22
Charges to costs and expenses	16	46	26
Account write-offs and other deductions	(29)	(28)	(48)
Balance at end of period	$5	$18	$–

Inventory

The Company values inventories at the lower of cost or market using the first in, first-out ("FIFO") method. The Company periodically reviews the quantities of inventory on hand and compares these amounts to the expected usage for each particular product or product line. The Company records as a charge to cost of sales any amounts required to reduce the carrying value amount of the inventory to net realizable value. Actual results could be different from management's estimates and assumptions.

Intangible assets

The Company's intangible assets consist of goodwill, and other intangibles assets, which are comprised of trademarks, acquired patents and patented technologies, distributor and customer relationships and related contracts, trade and brand names and associated logos, technology design and programs, non-compete agreements and other intangible assets, which are being amortized over their useful lives. The Company is monitoring the operating performance of its reporting units and other market factors. Goodwill is tested for impairment on an annual basis, and between annual tests in certain circumstances, and written down when impaired. The Company has elected the end of the fourth quarter to complete its annual goodwill impairment test.

Long-lived assets

The Company reviews the recoverability of its long-lived assets including property, plant and equipment and amortizing intangible assets when events or changes in circumstances occur that indicate that the carrying value of the assets may not be recoverable. This review is based on the Company's ability to recover the carrying value of the assets from expected undiscounted future cash flows. If impairment is indicated, the Company measures the loss based on the difference between the carrying value and fair value of the asset using various valuation techniques including discounted cash flows. If an impairment loss exists, the amount of the loss will be recorded in the consolidated statement of operations. It is possible that future events or circumstances could cause these estimates to change.

Loss per share

The Company calculates basic and diluted net loss per common share by dividing the net loss applicable to common stockholders by the weighted average number of shares of common stock outstanding. Common stock equivalents that were outstanding as of 31 December, 2009, 2008 and 2007, but were considered anti-dilutive securities and excluded from the diluted net income per share calculations, were as presented below:

		31 December,	
	2009	*2008*	*2007*
Options outstanding	3,005,098	2,819,889	2,422,617
Warrants outstanding	8,042,938	8,476,383	6,443,316
Unvested restricted stock grants	490,689	1,368,394	2,515,413
Total potentially dilutive common stock equivalents	11,538,725	12,664,666	11,381,346

Revenue recognition

The Company recognizes revenue from sales of products and funded research and development and product development for commercial companies and government agencies, net of applicable sales tax. The Company recognizes revenue from product sales at the time of shipment and when persuasive evidence of an arrangement exists, performance of the Company's obligation is complete, the price to the buyer is fixed or determinable, and collectibility is reasonably assured. The Company's custom products are supplied to original equipment manufacturers and produced in accordance with a customer-approved design. Custom product revenue is recognized when the criteria for acceptance has been met. Title to the product generally passes upon shipment, as products are generally shipped FOB shipping point. In certain limited situations, distributors have the right to return products. Such rights of return have not precluded revenue recognition because the Company has a long history with such returns and accordingly is able to estimate a reserve for their cost.

Revenues from funded research and development and product development is recognized based on contractual arrangements, which may be based on cost reimbursement or fixed fee-for-service models. Revenue from reimbursement contracts is recognized as services are performed and collectibility is reasonably assured. On fixed-price contracts, revenue is generally recognized on a percentage-of completion basis based on proportion of costs incurred to the total estimated costs of the contract or under the proportional performance method. Over the course of a fixed-price contract, the Company routinely evaluates whether revenue and profitability should be recognized in the current period. The Company estimates the proportional performance on their fixed-price contracts on a monthly basis utilizing hours incurred to date as a percentage of total estimated hours to complete the project. If the Company does not have a sufficient basis to measure progress toward completion, revenue is recognized upon completion of performance. This method is used because reasonably dependable estimates of costs and revenue earned can be made, based on historical experience and milestones identified in any particular contract. When the current estimates of total contract revenue and contract costs indicate a loss, a provision for the entire loss on the contract is recorded.

If a contract involves the provision of multiple elements and the elements qualify for separation, total estimated contract revenue is allocated to each element based on the relative fair value of each element provided. The amount of revenue allocated to each element is limited to the amount that is not contingent upon the delivery of another element in the future. Revenue is then recognized for each element as described above.

Warranty

The Company provides warranties for most products for periods up to one year. The warranty is limited to the cost of the product and the Company will repair or replace the product as required. The Company monitors the actual warranty repair costs and trends versus the reserve as a per cent. of sales. The Company adjusts annually the warranty provision based on actual experience and for any particular known instances. Warranty Reserves:

	Years Ended 31 December,		
	2009	*2008*	*2007*
		(in thousands)	
Balance at beginning of period	$116	$98	$89
Charges to costs and expenses	29	47	38
Account write-offs and other deductions	(47)	(29)	(29)
Balance at end of period	$98	$116	$98

Property, plant and equipment

Property, plant and equipment are valued at the lower of cost or estimated carrying values. The Company provides for depreciation on a straight-line basis over the assets estimated useful lives or lease terms, if shorter. The following table summarizes the estimated useful lives by asset classification:

Asset Classification	*Estimated Useful Life*
Building and building improvements	10 to 40 years
Computer equipment	3 to 5 years
Machinery and equipment	5 to 10 years
Furniture and fixtures	3 to 10 years

Total depreciation expense from continuing operations of property, plant and equipment was approximately $0.5 million, $0.6 million and $0.6 million in 2009, 2008 and 2007 respectively. Maintenance and repairs are expensed as incurred.

Income taxes

The Company accounts for income taxes under the liability method. Under this method the Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the financial information or tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial reporting and tax basis of the assets and liabilities using tax rates expected to be in place when the differences reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more likely than not to be realized. Additional information on the Company's income tax provision and deferred tax assets and liabilities may be found at Note 10.

Stock-based compensation

The Company has stock-based compensation plans for its employees, officers, and directors. The plans permit the grant of a variety of awards with various terms and prices as determined by the Governance, Nominating and Compensation Committee of the Company's Board of Directors (the "GNCC"). Generally the grants vest over terms of two to four years and are priced at fair market value, or in certain circumstances 110 per cent. of the fair market value, of the common stock on the date of the grant. The options are generally exercisable after the period or periods specified in the option agreement, but no option may be exercised after 10 years from the date of grant.

Additionally, in the case of incentive stock options, the exercise price may not be less than 100 per cent. of the fair market value of the Company's common stock on the date of grant, except in the case of a grant to an employee who owns or controls more than 10 per cent. of the combined voting power of all classes of the Company's stock or the stock of any parent or subsidiary. In that case, the exercise price shall not be less than 110 per cent. of the fair market value on the date of grant. In the case of non-qualified stock options, the exercise price shall not be less than 85 per cent. of the fair market value of the Company's common stock on the date of grant, except in the case of a grant to an independent director; in which case the exercise price shall be equal to fair market value determined by reference to market quotations on the date of grant.

During 2009, the Company recognized approximately $514,000 of equity-based compensation related to restricted stock and options, of which approximately $512,000 was expensed to general and administrative expense, and approximately $2,000 was expensed to selling expense. During 2008, the Company recognized approximately $508,000 of equity-based compensation related to restricted stock and options, of which approximately $506,000 was expensed to general and administrative expense, and approximately $2,000 was expensed to selling expense. During 2007, the Company recognized approximately $385,000 of equity-based compensation related to restricted stock and options, of which approximately $384,000 was expensed to general and administrative expense, and approximately $1,000 was expensed to selling expense.

Stock Option Awards – The fair value of each option grant is estimated using the Black-Scholes option pricing model. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. Expected volatility was calculated based on the historical volatility of the Company's stock at the time of the award. The average expected option term was estimated using the simplified method. The risk-free interest rate is based on U.S. Treasury zero-coupon issues assumed at the date of grant and no dividends were assumed in the calculation. The compensation expense recognized for all equity-based awards is net of estimated forfeitures for the twelve month periods ending 31 December, 2009 2008, and 2007. Forfeitures are estimated based on the historical trends.

On 16 January, 2009, the GNCC adopted a stock option incentive program for 2009. The GNCC adopted a policy of granting performance-based options to purchase shares of the Company's common stock to various executive officers and key employees; all of which are subject to the achievement of performance goals. Options for a total of 1,865,000 shares of common stock were granted under this performance-based program on January 16, 2009. As the performance goals were not met, the options terminated. The Company did not incur any stock compensation expense related to this plan during 2009.

On 17 March, 2008, the GNCC adopted a stock option incentive program for 2008. The GNCC adopted a policy of granting performance-based options to purchase shares of the Company's common stock to various executive officers and key employees; all of which were subject to the achievement of performance goals. As the performance goals were not met, the options immediately terminated and the previously accrued compensation cost of approximately $490,000 was reversed in the fourth quarter of 2008, resulting in no net compensation recorded in 2008 related to the program. Options to purchase a total of 1,522,300 shares of common stock were granted under this performance-based program on 17 March, 2008, all of which were forfeited when the performance goals were not met.

The fair value of options at the date of grant was estimated using the Black-Scholes option pricing model. The weighted average assumptions for grants during the years ended 31 December, 2009 and 31 December, 2008 were as follows:

	Twelve months ended 31 December,		
	2009	*2008*	*2007*
Volatility.	101.4%-104.8%	99.2%	N/A
Expected option life	6.08 years	5.7 years	N/A
Interest rate (risk free)	1.54%-2.86%	2.49%	N/A
Dividends	N/A	N/A	N/A
Weighted average grant date fair value	$0.12	$0.39	N/A

	Options Outstanding	*Weighted Average Exercise Price per Share*	*Weighted Average Remaining Contractual Term (in Years)*	*Aggregate Intrinsic Value (in thousands)*
Balance at 31 December, 2006	2,859,083	$4.86	5.18	$490
Granted	–	–		
Exercised	(140,752)	0.77		
Cancelled	(295,714)	7.62		
Balance at 31 December, 2007	2,422,617	$4.76	4.16	$185
Vested and Exercisable at 31 December, 2007	2,311,185	$4.93	3.69	$93
Balance at 31 December, 2007	2,422,617	$4.76	4.16	$185
Granted	2,314,572	0.50		
Exercised	–	–		
Cancelled	(1,749,300)	1.66		
Balance at 31 December, 2008	2,987,889	$3.45	4.58	$–
Vested and Exercisable at 31 December, 2008	2,195,617	$4.26	3.21	$–
Balance at 31 December, 2008	2,987,889	3.45	4.58	–
Granted	2,906,996	0.15		
Exercised	–	–		
Cancelled	(2,889,787)	0.55		
Balance at 31 December, 2009	3,005,098	$2.87	5.56	$–
Vested and Exercisable at 31 December, 2009	1,810,651	$4.44	3.28	$–

At 31 December, 2009, there was $100,000 of total unrecognized compensation cost related to non-vested stock options granted. The cost is expected to be recognized over the next 1.5 years. At 31 December, 2008, there was $213,000 of total unrecognized compensation cost related to non-vested stock options granted. The cost was expected to be recognized over the next 1.6 years. At 31 December, 2007, there was $16,000 of total unrecognized compensation cost related to non-vested stock options granted. The cost is expected to be recognized over the next year. Total stock option expense booked in 2009, 2008 and 2007 were approximately $104,000, $90,000 and $56,000, respectively. There were no options exercised during 2009 and 2008. The intrinsic value of the options exercised during 2007 was approximately $96,000.

Restricted Share Awards – The Company periodically awards to a number of key employees restricted shares of common stock. The awards vest in equal annual installments over a period of four years, assuming continued employment, with some exceptions. The fair market value of the award at the time of the grant is amortized over the vesting period. The fair value of the awards is based on the fair market value of the Company's common stock on the date of issue, which is the closing market price on the date of the award. During 2009, the Company did not grant any shares of restricted stock. During 2008, the Company granted 165,000 shares of restricted stock at a weighted average fair value of $0.69 per share on the grant date. During 2007, the Company granted 1,223,401 shares of restricted stock at a weighted average fair value of $1.35 per share on the grant date.

On 30 June, 2007, the GNCC approved the ProPhotonix Limited Management Incentive Plan. The Management Incentive Plan is designed to recognize and reward the achievement of financial, business and management goals that are essential to the success of ProPhotonix and its subsidiaries. The Management Incentive Plan covers certain executive and senior employees of ProPhotonix, as determined by the GNCC.

Upon satisfaction and achievement of financial targets, as determined by the Board of Directors or the GNCC based on the financial results of the target period, each participant shall receive a grant of fully-vested shares of the Company's common stock, $.001 par value per share. As of 31 December, 2008 certain executives were eligible to receive up to 1,109,000 shares of ProPhotonix's common stock under the Management Incentive Plan. As of 31 December, 2009, no shares had been earned or issued related to the Management Incentive Plan. This incentive plan and all grants and awards made under the plan shall be made under the terms of the Company's 2007 Stock Incentive Plan. This plan has now been cancelled.

A summary of the status of the Company's non-vested shares of restricted stock for 2009, 2008 and 2007, as well as changes during 2009, 2008 and 2007 are presented below:

	Shares	*Weighted Average Grant-Date Fair Value*
Non-vested at 31 December, 2006	1,272,088	$1.03
Granted	1,223,401	1.35
Vested	(324,870)	1.01
Cancelled	(112,621)	0.94
Non-vested at 31 December, 2007	2,057,998	$1.22
Granted	165,000	$0.69
Vested	(629,354)	1.17
Cancelled	(225,250)	1.27
Non-Vested at 31 December, 2008	1,368,394	$1.17
Granted	–	–
Vested	(539,674)	$1.12
Cancelled	(338,031)	1.29
Non-Vested at 31 December, 2009	490,689	$1.15

As of 31 December, 2009, there was approximately $437,000 of total unrecognized compensation cost related to non-vested restricted share awards. The cost is expected to be recognized over the next 1.3 years. As of 31 December, 2009, 1,626,443 shares were vested. As of 31 December, 2008, 1,086,769 shares were vested. As of December 31, 2007, 457,415 shares were vested. The total fair value of shares vested during 2009, 2008 and 2007 were approximately $604,000, $739,000 and $329,000, respectively. Total compensation from continuing operations booked in 2009, 2008 and 2007 was approximately $410,000, $418,000 and $329,000, respectively.

Translation of foreign currencies

The Company translates the financial information of its foreign subsidiaries. The functional currency of the foreign subsidiaries is the local country's currency. The Company's operating results are affected by fluctuations in the value of the U.S. dollar as compared to currencies in foreign countries, as a result of our transactions in these foreign markets. Accordingly, all assets and liabilities of foreign subsidiaries are translated into U.S. dollars using the foreign currency exchange rate prevailing at the balance sheet date, while income and expense accounts are translated at average exchange rates during the year. All cumulative translation gains or losses from the translation into the Company's reporting currency are included as a separate component of stockholder's equity (accumulated other comprehensive loss) in the accompanying consolidated balance sheets. Foreign currency transaction (gains)/losses from continuing operations recorded in the statement of operations as other (income)/expense were approximately $(1,367,000), $2,737,000 and $(18,000) for 2009, 2008 and 2007, respectively.

Fair values of financial instruments

The Company's financial instruments consist mainly of cash and cash equivalents, accounts receivable, short-term debt, accounts payable and long-term debt. The estimated fair value of these financial instruments approximates their carrying value due to the short-term maturity of certain instruments and the variable interest rates associated with certain instruments, which have the effect of re-pricing such instruments regularly. As of 31 December, 2009, the Company estimated the fair value of long term fixed rate debt to be approximately $9,700,000 compared to its carrying value of $7,800,000. As of 31 December, 2008, the Company estimated the fair value of long term fixed rate debt to be approximately $5,400,000 compared to its carrying value of $6,500,000. The Company's fixed rates on long-term debt approximates the market rate at 31 December, 2007.

Warrants

On 31 October, 2006, the Company issued warrants for the purchase of 2,375,000 shares of the Company's common stock, which had exercise price reset features. If StockerYale (UK) Ltd. prepaid all amounts outstanding under the bond prior to the third anniversary of the date of issuance, then the number of shares of the Company's common stock purchasable upon exercise of the warrant would have changed to the following numbers: (i) 1,900,000 if the bond was repaid in full prior to the first anniversary of the date of issuance; (ii) 2,018,750 if the bond was repaid in full prior to the second anniversary of the date of issuance; and (iii) 2,137,500 if the bond was repaid in full prior to the third anniversary of the date of issuance. These warrants have an exercise price of $1.15 and expire in October 2016. The Company adopted FASB guidance on 1 January, 2009 under which certain warrants that were previously treated as stockholders' equity under the derivative treatment exemption were no longer eligible for equity treatment. Effective 1 January, 2009, the fair value of these common stock purchase warrants was reclassified from equity to liability status as if these warrants were treated as a derivative liability since their date of issue in October 2006. On 1 January, 2009, the Company reclassified from additional paid-in capital, as a cumulative effect adjustment, $1.2 million to beginning retained earnings and $0.3 million to a long-term warrant liability. On 31 October, 2009, the fair market value of these warrants, approximately $242,000, was reclassified as equity, as the re-pricing feature of the warrant had lapsed per the agreement. The Company recognized a gain of approximately $50,000 from the change in fair value of these warrants for the year ended 31 December, 2009.

The common stock purchase warrants were not issued with the intent of effectively hedging any future cash flow, fair value of any asset, liability or any net investment in a foreign operation. The warrants did not qualify for hedge accounting, therefore all changes in the fair value of these warrants was recognized in earnings until reclassified to equity in October, 2009.

These common stock purchase warrants do not trade in an active securities market, and the Company estimated the fair value of these warrants using the Black-Scholes option pricing model using the following assumptions:

	31 October, 2009	*1 January, 2009*
Volatility	137.8%	101.4%
Expected option life	7.0 years	7.8 years
Interest rate (risk free)	3.41%	2.46%
Dividends	$0.0	$0.0

Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of trade receivables. The risk is limited due to the relatively large number of customers composing the Company's customer base and their dispersion across many industries and geographic areas within the United States, Canada, United Kingdom, Europe and Asia. The Company performs ongoing credit evaluations of existing customers' financial condition. The Company has a large number of customers; therefore, concentrated credit risk is limited to only a small number of customers. The Company had no customer accounting for 10 per cent. or more of consolidated revenues in 2009, 2008 or 2007. The Company had no customer that accounted for 10 per cent. of the outstanding receivables balance at 31 December, 2009, 2008 or 2007.

The Company maintains their cash and cash equivalents in bank deposit accounts, which at times may exceed federally insured limits. The Company believes they are not exposed to any significant credit risk on cash and cash equivalents.

Use of estimates

The preparation of financial information in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial information and the reported amounts of income and expenses during the reporting periods. Actual results in the future could vary from the amounts derived from management's estimates and assumptions.

(3) RECENT ACCOUNTING PRONOUNCEMENTS

Revenue Recognition. In April 2010, the FASB issued an accounting standard update defining a milestone and determining what criteria must be met to apply the milestone method of revenue recognition for research or development transactions. The update provides guidance on the criteria which must be met to determine if the milestone method of revenue recognition is appropriate, whether a milestone is substantive and the disclosures that must be made if the method is elected. This standard should be applied on a prospective basis for milestones reached in fiscal years, and interim periods within those years, beginning on or after 15 June, 2010, with earlier adoption permitted. If early adoption is elected and the period of adoption is not the beginning of the Company's fiscal year, the amendments should be applied retrospectively from the beginning of the year of adoption. We do not expect this update to have a material impact on our consolidated financial position, results of operations and cash flows.

Revenue Recognition. In October 2009, the Financial Accounting Standards Board (FASB) issued revenue recognition guidance for arrangements with multiple deliverables. The new guidance eliminates the residual method of revenue recognition and allows the use of management's best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence (VSOE), vendor objective evidence (VOE) or third-party evidence (TPE) is unavailable. For the Company, this guidance is effective for all new or materially modified arrangements entered into on or after January 1, 2011 with earlier application permitted as of the beginning of a fiscal year. Full retrospective application of the new guidance is optional. The Company adopted this guidance effective January 1, 2009, and there was no impact on its consolidated financial position.

Business Combinations. In December 2007, the FASB issued new guidance on business combinations. This guidance establishes principles and requirements for how the Company: (1) recognizes and measures in its financial information the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and (3) determines what information to disclose to enable users of the financial information to evaluate the nature and financial effects of the business combination. The business combinations guidance also requires acquisition-related transaction and restructuring costs to be expensed rather than treated as part of the cost of the acquisition. This guidance applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 15 December, 2008. The Company adopted the business combination guidance on 1 January, 2009 and will only impact the Company if any acquisitions are completed subsequently.

In April 2009, the FASB issued guidance relating to accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies. This pronouncement amends the guidance on business combinations to clarify the initial and subsequent recognition, subsequent accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. This pronouncement requires that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, as determined in accordance with the fair value measurements guidance, if the acquisition-date fair value can be reasonably estimated. If the acquisition-date fair value of an asset or liability cannot be reasonably estimated, the asset or liability would be measured at the amount that would be recognized in accordance with the accounting guidance for contingencies. This pronouncement became effective for the Company as of 1 January, 2009, and the provisions of the pronouncement are applied prospectively to business combinations with an acquisition date on or after the date the guidance became effective. The adoption of this pronouncement did not have a material impact on the Company's financial position or results of operations.

Fair Value Measurements and Disclosures. In April 2009, the FASB issued additional guidance on fair value measurements and disclosures. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants under current market conditions. The new guidance requires an evaluation of whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. If there has been a significant decrease in activity, transactions or quoted prices may not be indicative of fair value and a significant adjustment may need to be made to those prices to estimate fair value. Additionally, an entity must consider whether the observed transaction was orderly (that is, not distressed or forced). If the transaction was orderly, the obtained price can be considered a relevant, observable input for determining fair value. If the transaction is not orderly, other valuation techniques must be used when estimating fair value. This guidance, which was applied by the Company prospectively as of 30 June, 2009, did not impact the Company's results of operations, cash flows or financial position.

In August 2009, the FASB issued additional guidance on the fair value measurement of liabilities. The new guidance provides clarification on the measurement and reporting of a liability in circumstances in which a quoted price in an active market for the identical liability is not available. This guidance was effective for the reporting period beginning October 1, 2009. The adoption of this pronouncement did not have a material impact on the Company's financial position or results of operations.

Derivatives and Hedging. In March 2008, the FASB issued new disclosure requirements for derivative instruments and hedging activities. The new disclosure requirements will provide users of financial information with an enhanced understanding of: (1) how and why an entity uses derivative instruments; (2) how derivative instruments and related hedged items are accounted for; and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This guidance requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative instruments. This statement applies to all entities and all derivative instruments. This guidance is effective for financial information issued for fiscal years and interim periods beginning after 15 November, 2008. The Company adopted this guidance on 1 January, 2009 and it did not impact the Company's results of operations, cash flows or financial position.

In June 2008, the FASB ratified the consensus reached by the Emerging Issues Task Force (EITF) which clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which would qualify as a scope exception to derivative accounting. The Company adopted this guidance as of 1 January, 2009 and it did not have a material impact on the Company's consolidated financial information.

Financial Instruments. In April 2009, the FASB issued guidance to require disclosures about fair value of financial instruments in interim financial statements, in addition to the annual financial statements as already required. This guidance was applied by the Company as of 30 June, 2009 and it did not have a material impact on the Company's results of operations, cash flows or financial position.

Subsequent Events. In May 2009, the FASB issued guidance on subsequent events which establishes general standards of accounting for disclosure of events that occur after the balance sheet date but before financial information are issued or are available to be issued. This guidance is based on the same principles as currently exist in auditing standards and was issued by the FASB to include accounting guidance that originated as auditing standards into the body of authoritative literature issued by the FASB. The standard addresses the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial information, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial information and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The Company adopted this guidance during the quarterly period ended 30 June, 2009.

In January 2010, the FASB issued ASU No. 2010-06, "Improving Disclosures about Fair Value Measurements" ("ASU 2010-06"), which is included in the ASC Topic 820 (Fair Value Measurements and Disclosures). ASU 2010-06 requires new disclosures on the amount and reason for transfers in and out of Level 1 and 2 fair value measurements. ASU 2010-06 also requires disclosure of activities, including purchases, sales, issuances, and settlements within the Level 3 fair value measurements and clarifies existing disclosure requirements on levels of disaggregation and disclosures about inputs and valuation techniques. ASU 2010-06 is effective for interim and annual reporting periods beginning after 15 December, 2009. The adoption of this standard did not have a material effect on our financial statements.

(4) ACQUISITIONS

Acquisition of Spectrode LLC

On 18 October, 2007, ProPhotonix acquired substantially all of the assets of Spectrode LLC, a developer of pulsed thulium-doped fiber lasers for an aggregate purchase price of $376,000 consisting of $100,000 in cash and 214,174 unregistered shares of ProPhotonix's common stock. Under the terms of the agreement, all of Spectrode's patents and patents pending will be assigned to ProPhotonix, including the patent application for its "Gain Switched Fiber Laser System." Spectrode LLC will receive a continuing royalty payment equal to 1 per cent. of sales revenue for lasers using the Spectrode technology over the lifetime of the patents or any patents issued or for 20 years, whichever is longer.

The number of shares of the Company's common stock issued to Spectrode LLC was calculated based on the average closing price per share of the Company's common stock on the Nasdaq Global Market for the period ending on the trading day prior to the closing of the acquisition.

The purchase price for Spectrode LLC was allocated among the tangible assets and its intellectual property. The fair value of the purchased technology was based on the relief from royalty method.

The total purchase price, which included the related acquisition costs of approximately $12,000 of the $376,088, exceeded the fair value of the acquired net assets by $7,900 which was recorded as goodwill. The following represents the allocation of the aggregate purchase price to the acquired net assets of Spectrode LLC:

Purchase Price:	
Value of common stock issued	$263,823
Cash	100,000
Direct acquisition costs	12,264
Total purchase consideration paid	$376,088

Fair value of assets acquired and liabilities assumed:	
Equipment	$103,100
Goodwill	7,900
Identifiable intangible assets	265,088
Total Purchase consideration made	$376,088

No liabilities were assumed under the asset purchase agreement. These assets were sold as a part of the sale of North American assets to Coherent, Inc. on 13 October, 2009. See footnote 15.

(5) INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out basis) or market value when applicable and include materials, labor and overhead. Inventories are as follows:

Years Ended 31 December,	*2009*	*2008* (*in thousands*)	*2007*
Finished goods	$204	$198	$432
Work in-process	131	130	229
Raw materials	947	1 090	1,209
Net Inventories	$1,282	$1,418	$1,870

Management performs quarterly reviews of inventory and disposes of items not required by their manufacturing plan and reduces the carrying cost of inventory to the lower of cost or market value.

(6) PROPERTY, PLANT AND EQUIPMENT

Major classes of property, plant and equipment were as follows:

Years Ended 31 December,	*2009*	*2008* (*in thousands*)	*2007*
Land	$306	$306	$306
Buildings and improvements	5,897	5,946	6,015
Machinery and equipment	2,414	2,325	2,631
Furniture and fixtures	1,029	995	1,011
Property, plant and equipment	$9,646	$9,572	$9,963
Less accumulated depreciation	(5,811)	(5,331)	(5,023)
Net property, plant and equipment	$3,835	$4,241	$4,940

Depreciation expense from continuing operations was approximately $510,000, $624,000 and $619,000, in the years ended 31 December, 2009, 2008 and 2007, respectively.

(7) GOODWILL

The Company uses a two-part impairment test in which it first estimates the fair value of its reporting units by using forecasts of discounted cash flows and then compares that value to the carrying value which requires that certain assumptions and estimates be made regarding industry economic factors and future profitability of reporting units to assess the need for an impairment charge. The methodology the Company uses to allocate certain corporate expenses is based on each segment's use of services and/or direct benefit to its employees. While the Company believes it has made reasonable estimates and assumptions to calculate the fair value of the reporting segments' and implied fair value of goodwill, the impairment analysis is highly sensitive to actual versus forecast results. If the estimated value is less than the carrying value the Company moves to the second step of the impairment test to determine if goodwill is impaired.

In connection with the annual fair value test of goodwill, performed at the end of the fourth quarter 2009, the Company concluded that an impairment of goodwill in the Photonic Products segment existed. The Company determined the carrying value of the reporting unit was in excess of its fair value. Based on the second step, the Company concluded that the entire balance of goodwill was impaired. The Company recorded a non-cash goodwill impairment charge of $4.4 million.

The changes in the carrying amount of goodwill for the years ended 31 December, 2009, 2008 and 2007 were as follows:

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Beginning of the year	$4,410	$5,892	$5,788
Effect of exchange rate	475	(1,482)	104
Impairment charge	(4,377)	–	–
End of year	$508	$4,410	$5,892

Goodwill as of 31 December, 2009 relates to the LED reporting unit.

(8) INTANGIBLE ASSETS

Intangible assets consist of trademarks, acquired patents and patented technologies, distributor and customer relationships and related contracts, trade and brand names and associated logos, technology design and programs, non-compete agreements and other intangible assets. There are no intangible assets with indefinite lives. There were no intangible assets acquired in 2009. Intangible assets and their respective useful lives are as follows:

	Useful Life
Acquired trade name	8 Years
Acquired customer contracts and relationships	5 – 8 Years
Acquired non compete agreements	3 Years
Acquired technology design and programs	8 Years
Scheduled order listing	3 Years
Other	4 – 7 Years

Gross carrying amounts and accumulated amortization of intangible assets were as follows as of 31 December, 2009 for each intangible asset class.

	Gross Carrying Amount	*Accumulated Amortization*	*Net Balances*
		(in thousands)	
Acquired patents, patented technology and purchased technology	$1,526	$(1,493)	$33
Trademarks	171	(171)	–
Acquired trade name	482	(190)	292
Acquired customer contracts and relationships	1,957	(1,253)	704
Acquired non compete agreement	634	(634)	–
Acquired technology design and programs	331	(132)	199
Other	108	(76)	32
Total	$5,209	$(3,949)	$1,260

Gross carrying amounts and accumulated amortization of intangible assets were as follows as of 31 December, 2008 for each intangible asset class.

	Gross Carrying Amount	*Accumulated Amortization*	*Net Balances*
		(in thousands)	
Acquired patents, patented technology and purchased technology	$1,531	$(1,469)	$62
Trademarks	171	(171)	–
Acquired trade name	438	(118)	320
Acquired customer contracts and relationships	1,779	(796)	983
Acquired non compete agreement	576	(416)	160
Acquired technology design and programs	301	(82)	219
Other	98	(47)	51
Total	$4,894	$(3,099)	$1,795

Gross carrying amounts and accumulated amortization of intangible assets were as follows as of 31 December, 2007 for each intangible asset class.

	Gross Carrying Amount	*Accumulated Amortization*	*Net Balances*
		(in thousands)	
Acquired patents, patented technology and purchased technology	$1,531	$(1,337)	$194
Trademarks	171	(171)	–
Acquired trade name	604	(88)	516
Acquired customer contracts and relationships	2,454	(590)	1,864
Acquired non compete agreement	795	(309)	486
Acquired technology design and programs	415	(61)	354
Other	143	(39)	104
Total	$6,113	$(2,595)	$3,518

	Actual Expense		*Estimated Future Expense*						
	2007	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*	*Thereafter*
					(in thousands)				
Amortization expense of intangible assets	$1,243	$999	$694	$402	$333	$186	$186	$153	$–

(9) DEBT

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Acquired note payable to Barclays Bank, paid in full at 31 December, 2009. At 31 December, 2008 having an interest rate of 2.65% above Barclays base rate (3.15% at 31 December, 2008)	$–	$22	$60
Borrowings under Revolving Credit facility with Barclays Bank Sales Financing with an interest rate of 2.55% above Barclays base rate (3.05% as of 31 December, 2009)	568	710	–
Borrowings under Line of Credit Agreement with Laurus Master Fund, Ltd., paid in full at 31 December, 2009 At 31 December, 2008 having an interest rate of the prime rate plus 1% (4.25% at 31 December, 2008)	–	3,159	2,838
Notes Payable to Laurus Master Fund, Ltd. and affiliates originally maturing on 30 June, 2010, with an interest rate of prime plus 2%, and paid in full at 31 December, 2009. Net of unamortized discount of $460 at 31 December, 2008 and $371 at 31 December, 2007	–	2,690	3,379
Note Payable to an affiliate of Laurus Master Fund, Ltd. paid in full at 31 December, 2009. At 31 December, 2008 having an interest rate of 10.5%, net of unamortized discount of $90and $139 at 31 December, 2007	–	676	861
Senior Fixed Rate Secured Bond to a private investor with an interest rate of 12%, maturing on 30 July, 2011 net of unamortized discount of $91 at 31 December, 2009 and $166 at 31 December, 2008	2,312	1,028	–
Note Payable to a private investor, matured on 15 January, 2008, with an interest rate of 10.25%	–	–	35
Senior Fixed Rate Secured Bond payable to a private investor, maturing on 31 October, 2011 with an interest rate of 10%, net of unamortized discount of $460 at 31 December, 2009 and $798 at 31 December, 2008 and $1,052 at 31 December, 2007	2,581	3,674	3,599
Bonds payable to the former stockholders of Photonic Products Ltd. maturing on 30 November, 2010, with an interest rate of 7%, at 31 December, 2009 and with an interest rate of LIBOR plus 1% (3.22%) at 31 December, 2008	2,186	2,400	2,400
Sub-total debt	7,647	14,359	13,172
Less – revolver	(568)	(3,869)	–
Less–Current portion of long-term debt, net of discount	(3,798)	(4,118)	(1,308)
Total long-term debt	$3,281	$6,372	$11,864

BORROWING AGREEMENTS

Photonic Products Ltd.

StockerYale (UK) Ltd., a wholly owned subsidiary of the Company, issued bonds to each of the former stockholders of Photonic Products Ltd. ("ProPhotonix Bonds") with an aggregate initial principal amount equal to $2,400,000. Under the terms of issuance, the outstanding principal accrued interest at an annual rate of 1 per cent. above the LIBOR rate as determined on the first business day of each month. All unpaid principal plus accrued but unpaid interest under the bonds was originally due and payable on 31 October, 2009.

On 7 October, 2009, the Company and StockerYale (UK) Ltd. entered into a Deed of Variation with the bondholders in which the Company and StockerYale (UK) Ltd. agreed: a) to make principal payments to one of the bondholders of $120,000 on 31 October, 2009 and $120,000 on 8 January, 2010 plus monthly payments of simple interest at an annual rate of 7 per cent. on the outstanding amounts until paid; and (b) to make monthly payments to each of the other two bondholders in the aggregate amount of $47,000 on the last day of each calendar month, beginning on 30 November, 2009 and to continue until and including 31 October, 2010 plus monthly payments of simple interest at an annual rate of 7 per cent. to be made on the last day of each month beginning on 30 November, 2009 through 30 November, 2010 when a balloon payment of $1,596,000 will be due.

StockerYale (UK) Ltd. may elect to prepay the bonds at any time, in whole or in part, without penalty or premium. If StockerYale (UK) Ltd. fails to make any payments under the bonds, the former stockholders of Photonic Products Ltd. may have the right to require payment from the Company in the form of newly issued shares of the Company's common stock.

On 30 October, 2010 and 14 December, 2010, the Company and the holders of the ProPhotonix Bonds entered into Deeds of Variation of the ProPhotonix Bonds. The amendments required a payment on 30 October, 2010 against the principal balance in the amount of $150,000. The ProPhotonic Bonds are amended to pay the outstanding balance as of 31 October, 2010 monthly over the period from 30 November, 2010 through 30 November, 2012 at the rate of $50,000 principal plus simple interest (at 11 per cent. per annum). On 31 December, 2012 the remaining balance (approximately $243,000) of the ProPhotonix Bonds shall be payable in full. The key repayment terms of the ProPhotonix Bonds, under this amendment, are as follows:

(a)	Principal:	$1,493,000
(b)	Interest Rate:	11 per cent. per annum, payable monthly
(c)	Repayment term:	31 October, 2010 to 30 November, 2012
(d)	Monthly principal:	$50,000
(e)	Balloon payment:	$243,000 due 31 December, 2012

As of 31 December, 2009, $2,186,000 was outstanding under the bonds issued to the stockholders of Photonic Products Ltd., which has been recorded as current portion of long-term debt.

As of 31 December, 2008 and 2007, $2,400,000 was outstanding under the bonds issued to the stockholders of Photonic Products Ltd., and was recorded as long-term debt at 30 December, 2007 and as current portion of long-term debt at 31 December, 2008.

Laurus Master Fund

On 14 October, 2009, the Company paid in full its obligations to Laurus Master Fund, Ltd. and its affiliates described below. As discussed in Note 1, approximately $7,900,000 of the proceeds from the 13 October, 2009 sale were used to repay approximately $7,060,000 of borrowings under the line of credit and notes payable with Laurus along with $645,000 of related deferred fees and $173,000 of accrued interest on 14 October, 2009.

Line of Credit Agreement:

On 28 June, 2006, the Company entered into a Security and Purchase Agreement, as amended at various times through 13 October, 2009, with Laurus Master Fund, Ltd ("Laurus"), establishing a three-year revolving line of credit of up to $4 million limited to qualifying receivables and inventories as defined in the agreement. The Security and Purchase Agreement granted a security interest in and lien upon all of the Company's assets in favor of Laurus. The note could be prepaid at any time without penalty or premium.

On 16 April, 2009, the Company and Laurus entered into an agreement, effective 31 March, 2009, to extend the overadvance of $500,000 by amending the note. This amendment granted a fee, payable in cash, to Laurus of $400,000 which was paid on 14 October, 2009.

On 28 July, 2009, the Company entered into a Waiver and Amendment with Laurus and its affiliates, dated as of July 16, 2009, to amend the line of credit under the Security and Purchase agreement and the Term Note Payable. The Waiver and Amendment extended the due date of the line of credit from 28 June, 2009 to 15 October, 2009 and revised the interest rate on the outstanding balance to 10 per cent. per annum. As discussed above, this obligation was included in the $7,060,000 of borrowings repaid on 14 October, 2009.

At 31 December, 2009, the line of credit was paid in full.

At 31 December, 2008, $3,159,324 was outstanding under the line of credit, which included the $500,000 over draft, and was classified as revolver. The credit line availability at 31 December, 2008 was approximately $235,000.

At 31 December, 2007, $2,838,000 was outstanding under the line of credit, which was classified as long-term debt. The credit line availability at 31 December, 2007 was approximately $100,000.

Term Note Payable:

On 30 December, 2005, under the terms of a Securities Purchase Agreement, as amended at various times through 13 October, 2009, the Company issued a secured term note in the aggregate principal amount of $4 million to Laurus. The note was collateralized by certain assets of the Company.

On 28 July, 2009, the Company entered into a Waiver and Amendment with Laurus and its affiliates, dated as of 16 July, 2009, to amend the line of credit under the Security and Purchase agreement and the Term Note Payable. The Waiver and Amendment allowed the Company to defer principal payments between 1 June, 2009 through 1 October, 2009 which was due and payable on 15 October, 2009 and revised the interest rate on the outstanding balances to 12 per cent. per annum. As discussed above, this obligation was included in the $7,060,000 of borrowings repaid on 14 October, 2009.

At 31 December, 2009, the combined notes were paid in full.

At 31 December, 2008, $3,916,671 was outstanding under the combined notes, which was classified as $1,408,326 short-term debt and $2,508,345 long-term debt and reported net of $550,794 of unamortized debt discount, which was classified as $418,176 short-term and $132,618 long-term.

At 31 December, 2007, $4,750,000 was outstanding under the combined notes, which was classified as $1,256,913 short-term debt and $3,493,087 long-term debt and reported net of $509,875 of unamortized debt discount, which was classified as $261,502 short-term and $248,373 long-term.

Private Investor Notes and Bond

On 12 May, 2005, the Company issued a $1.5 million note to Eureka, initially due and payable in full on 12 September, 2005. The Company also issued to Eureka five-year common stock warrants to purchase 250,000 shares at an exercise price per share of $0.90. The aggregate purchase price of the note and warrants ($1.5 million) was allocated between the note and warrants based upon their relative fair market value. The difference between the face amount of the note of $1,500,000 and the aggregate purchase price of the note of $1,341,362 was recorded as a debt discount of $158,638 and is being amortized over the life of the note. The Company used the Black-Scholes Model to calculate the fair value of the warrants. The underlying assumptions included in the Black-Scholes Model were: a risk-free interest rate of 3.87 per cent., an expected life of five years and an expected volatility of 116 per cent. with no dividend yield. These warrants were exercised during the quarter ended 30 September, 2007 for proceeds of $225,000.

On 16 August, 2007, the Eureka Interactive Fund Ltd. (Eureka) agreed to transfer the promissory notes and bonds described below, as well as all of the unexercised warrants previously issued to Eureka, to a private investor.

On 26 August, 2005, the Company entered into an amendment to the note in which the maturity date of the note was extended to 31 December, 2005. On 15 December, 2005, the maturity date of the note was extended to 15 January, 2007. The note accrues interest on the outstanding principal balance at the rate of 10 per cent. per year. The aggregate outstanding principal amount of the note and accrued interest was payable in equal installments of $50,000 on the 15th day of each month, with the entire balance of unpaid principal and interest previously due on 15 January, 2007. As a part of the 15 December, 2005 agreement, the Company issued to the holder additional five-year common stock warrants to purchase 150,000 shares at an exercise price per share of $0.90. An additional debt discount was recorded in the amount of $90,149 and is being amortized over the life of the note. The Company used the Black-Scholes Model to calculate the fair value of the warrants. The underlying assumptions included in the Black-Scholes Model were: a risk-free interest rate of 4.40 per cent., an expected life of five years and an expected volatility of 92 per cent. with no dividend yield. These warrants were exercised during the quarter ended September 30, 2007 for proceeds of $135,000.

On 25 September, 2007, the same private investor exercised warrants, in addition to the exercise of warrants relating to the 12 May, 2005 note and the 26 August, 2005 amendment as noted above, for the purchase of 740,741 shares of the Company's common stock at a per share price of $1.17, or approximately $867,000. The 740,741 warrants were acquired by the private investor on 16 August, 2007. These warrants were originally issued in conjunction with an equity financing arrangement with Eureka in August, 2005.

On 27 December, 2006, the Company entered into Amendment No. 3 to the note. The amendment extended the maturity date of the note from 15 January, 2007 to 15 January, 2008.

At 31 December, 2008, the note has been paid in full.

At 31 December, 2007, $34,796 was outstanding under the note, which was classified as short-term debt.

Photonic Products Ltd. Financing

On 31 October, 2006, StockerYale (UK) Ltd. issued a 10 per cent. Senior Fixed Rate Secured Bond ("SYUK Bonds"), as amended at various times, in the original principal amount of $4,750,000 to Eureka Interactive Fund Limited. The bond is due on 31 October, 2011. StockerYale (UK) Ltd. agreed to make payments of principal and interest over the term; however, an amount equal to 50 per cent. of the original principal sum of $4,750,000 will be paid on 31 October, 2011. The outstanding principal on the bond accrues interest at an annual rate of 10 per cent. StockerYale (UK) Ltd. may prepay the bond at any time, in whole or in part, without penalty or premium. The bond is secured by all of the equity interests of Photonic Products Ltd. owned by StockerYale (UK) Ltd. The Company used the net proceeds to make the cash payment for the acquisition of Photonic Products Ltd. The remaining proceeds were used for transaction fees and working capital. On 16 August, 2007, the Eureka Interactive Fund Limited transferred this bond to a private investor.

In connection with the issuance of the bond on 31 October, 2006, the Company issued a Common Stock Purchase Warrant to Eureka to purchase 2,375,000 shares of its common stock for a purchase price of $1.15 per share. The warrant expires on the tenth anniversary of the date of issuance. The aggregate proceeds of the bond and warrants of $4,750,000 were allocated between the bond and the common stock warrants based upon their relative fair market value. The proceeds price allocated to the bond was $3,255,349 and the proceeds allocated to the common stock warrants was $1,494,651. The difference between the aggregate face amount of the bond of $4,750,000 and the initial carrying value of the bond was recorded as a debt discount of $1,494,651 and is being amortized over the life of the bond. The Company used the Black-Scholes Model to calculate the fair value of the warrants. The underlying assumptions included in the Black-Scholes Model were: a risk-free interest rate of 4.61 per cent., an expected life of ten years and an expected volatility of 102 per cent. with no dividend yield.

On 27 May, 2008, the private investor to whom Eureka assigned the bonds, loaned the company an additional $500,000 payable over the remaining term of the original loan, at the same fixed 10 per cent. interest rate. As a part of the 27 May, 2008 agreement, the Company issued to the private investor additional ten-year common stock warrants to purchase 269,663 shares of common stock at an exercise price per share of $0.60. An additional debt discount was recorded in the amount of $119,373 and is being amortized over the remaining life of the note. The Company used the Black-Scholes Model to calculate the fair value of the warrants. The underlying assumptions included in the Black-Scholes

Model were: a risk-free interest rate of 4.80 per cent., an expected life of ten years and an expected volatility of 98 per cent. with no dividend yield.

On 30 October, 2008, the private investor agreed to forego principal payments on the combined notes for the months of September 2008 through December 2008. The Company issued 616,743 shares of common stock to the private investor to settle approximately $247,000 of principal payments.

On 13 January, 2009, StockerYale (UK) Limited, a wholly owned subsidiary of the Company and the private investor, entered into an agreement to forego the principal payments of $61,674 per month under such bond for six months totaling $370,044 in consideration of the issuance of 1,480,176 shares of common stock of the Company to the private investor.

On 9 June, 2009, the private investor and the Company entered into a Transfer Agreement under which they agreed to transfer $1,000,000 of debt (the "Transfer Amount") from the Bond to the Senior Fixed Rate Secured Bond described below.

On 9 March, 2010, the private investor and the Company entered into an amendment to the Bond reducing the interest rate from 10 per cent. to 8 per cent., in consideration of an advance payment of $200,000 in principal and a revised prospective principal payment schedule. In addition, the same private investor agreed to reduce to interest rate on the *StockerYale Ireland Senior Fixed Rate Secured Bond* (below) from 12 per cent. to 8 per cent. as a part of this amendment.

On 10 December, 2010, the Company and a private investor entered into a binding restructuring of SYUK Bond. The bond will be amended to convert $1,274,544 of the balance into Common Shares of ProPhotonix at the at the price equal to the per share price of the equity offering described in footnote (1) and to transfer the remaining balance $942,124 to the StockerYale Ireland Bond, as described below. The bond will be cancelled thereafter.

At 31 December, 2009, $3,040,206 remained outstanding under the combined note which has been classified as $1,048,458 short-term debt and $1,991,748 long- term debt and reported net of $459,656 of unamortized debt discount, which has been reported as $283,863 as short-term and $175,793 as long-term. On 31 December, 2009, the Company was $308,370 (principal only) in arrears. On 1 March, 2010, the private investor signed a waiver for any breach or default under the agreement.

At 31 December, 2008, $4,471,926 remained outstanding under the combined note which has been classified as $740,091 short-term debt and $3,731,835 long-term debt and reported net of $798,251 of unamortized debt discount, which has been reported as $338,595 as short-term and $459,656 as long-term.

At 31 December, 2007, $4,651,041 remained outstanding under the note which was classified as $593,750 short-term debt and $4,057,291 long-term debt and reported net of $1,051,725 of unamortized debt discount, which was reported as $345,984 as short-term and $705,741 as long-term.

StockerYale Ireland Senior Fixed Rate Secured Bond

On 24 July, 2008, StockerYale (IRL) Ltd. issued a three-year 12 per cent. Senior Fixed Rate Secured Bond ("SYI Bond"), as amended at various times, to a private investor in the original principal amount of €935,000 ($1,472,905 at 24 July, 2008) secured by all of the assets of StockerYale (IRL) Ltd. The bond matures on 30 July, 2011. StockerYale (IRL) Ltd. agreed to make payments of principal and interest of approximately €31,000 over the term beginning 30 August, 2008. The outstanding principal on the bond accrues interest at an annual rate of 12 per cent. StockerYale (IRL) Ltd. may prepay the bond at any time, in whole or in part, without penalty or premium. The Company used the net proceeds for working capital.

In connection with the issuance of the bond, the Company issued warrants to the private investor to purchase 636,404 shares of its common stock for a purchase price of $0.45 per share. The warrant expires on the tenth anniversary of the date of issuance. The Company used the Black-Scholes Model to calculate the fair value of the warrants. The underlying assumptions included in the Black-Scholes Model were: a risk-free interest rate of 4.03 per cent.; an expected life of ten years; and an expected volatility of 98 per cent. with no dividend yield. The total value of the warrants was recorded as a debt discount of approximately $220,000 and will be amortized over the life of the bond, using the effective interest method.

On 9 June, 2009, the same private investor loaned the company an additional $500,000 payable over the remaining term of the original loan, at the same fixed 12 per cent. interest rate. As a part of the agreement, the Company issued to the private investor additional ten-year common stock warrants to purchase 500,000 shares of common stock at an exercise price per share of $0.10. An additional debt discount was recorded in the amount of $38,086 and is being amortized over the remaining life of the note. The Company used the Black-Scholes Model to calculate the fair value of the warrants. The underlying assumptions included in the Black-Scholes Model were: a risk-free interest rate of 3.86 per cent., an expected life of seven years, an expected volatility of 105.04 per cent. and no dividend yield.

Also on 9 June, 2009, the Company and private investor entered into a Transfer Agreement under which they agreed to transfer $1,000,000 of debt (the "Transfer Amount") from the StockerYale UK Bond described above to the Senior Fixed Rate Secured Bond. Interest accrues and is payable monthly and the amount is payable on 30 July, 2011.

On 10 December, 2010, the Company and a private investor entered into a binding restructuring of the SYI Bond. The amendment provides that StockerYale Ireland shall assume €692,128 ($942,124) of the balance of the SYUK Bond, which will then be combined with the existing SYI Bond. This bond is secured by the assets of StockerYale Ireland. The SYI Bond will be amended such that interest only shall be paid monthly on the outstanding balance through 30 June, 2012 and thereafter equal monthly payments of principal and interest over the three year period 1 July, 2012 through 30 June, 2015. The Company will also pay a restructuring fee of $50,000 to the private investor. The key repayment terms of the SYI Bond, under this amendment, are as follows:

(a)	Principal:	€1,972,523
(b)	Interest Rate:	8 per cent. per annum
(c)	Interest payments only:	present through 30 June, 2012
(d)	Principal Repayment term:	36 months; 31 July, 2012 through 30 June, 2015
(e)	Monthly principal and interest:	€61,812

At 31 December, 2009, $2,402,620 remained outstanding under the note, which has been classified as $921,170 short-term debt and $1,481,450 long-term debt and reported, net of $90,586 of unamortized debt discount, which has been reported as $73,702 short-term and $16,684 long-term. On 31 December, 2009, the Company was $216,731 (principal only) in arrears. On 1 March, 2010, the private investor signed a waiver for any breach or default under the agreement.

At 31 December, 2008, $1,193,829 remained outstanding under the bond, which has been classified as $403,817 short-term debt and $790,012 long-term debt and reported, net of $165,810 of unamortized debt discount, which has been reported as $100,050 short-term and $65,760 long-term.

Barclays Bank, PLC

On 6 February, 2008, the Company's ProPhotonix U.K. subsidiary entered into a Confidential Invoice Discounting Agreement with Barclays Bank Sales Financing ("Barclays"). Under the Discounting Agreement, a three-year revolving line of credit was established. The Discounting Agreement provides for a revolving line of credit not to exceed an aggregate principal amount of £700,000 ($1,115,000) and grants a security interest in and lien upon all of ProPhotonix U.K.'s trade receivables in favor of Barclays. ProPhotonix UK may borrow a total amount at any given time up to £700,000, limited to qualifying receivables as defined. The proceeds from this line of credit were used to pay in full the outstanding amount under the overdraft facility between ProPhotonix U.K. and Barclays Bank, PLC.

The facility requires the maintenance of certain financial covenants including annual sales and minimum tangible net worth. Barclays also reserves the right to review the facility in the event of losses in any 3-month rolling period. On 26 June, 2009, ProPhotonix U.K. agreed to amend the terms of the Agreement with Barclays. Under the amended terms, the maximum amount allowed outstanding under the line of credit is £650,000 ($1,035,000 USD). The outstanding principal under the note accrues interest at an annual rate of 2.65 per cent. above Barclays base rate. The interest rate was 3.15 per cent.

as of 31 December, 2009. ProPhotonix U.K. may elect to prepay amounts due under the facility at any time, in whole or in part, without penalty or premium upon 3 months notice.

On 18 February, 2010, ProPhotonix U.K. entered into an amendment to the revolving credit facility agreement, which removed the minimum tangible net worth requirement of £350,000 ($528,000 USD) as of 31 March, 2010. The amendment further states that if ProPhotonix U.K.'s net worth did not increase in line with projections as provided to Barclays on 18 January, 2010, then Barclays may in its sole discretion review the terms on which it continues to make the facility available. The amount outstanding under the facility was $841,000 as of 31 March, 2010 and $568,000 as of 31 December, 2009, all of which was classified as short term debt under revolving credit facility. ProPhotonix U.K. was in technical default on 31 December, 2009. ProPhotonix U.K. entered into an amendment on 18 February, 2010 to waive this default at 31 December, 2009.

At 31 December, 2008, $710,000 was outstanding under the facility, all of which was classified as short term debt under revolving lines of credit.

On 25 November, 2010 ProPhotonix U.K. and Barclays extended the minimum term of the Confidential Invoice Discounting Agreement through 25 May, 2012. The original minimum term of the Agreement ends on 7 February, 2011. All other terms of the Agreement remain in place pursuant to the Agreement as amended.

(10) TAXES

The Company had net deferred tax assets totaling $29.6 million as of 31 December, 2009, $26.9 million as of 31 December, 2008 and $25.2 million as of 31 December, 2007. Realization of the deferred tax assets is dependent upon the Company's ability to generate sufficient future taxable income and, if necessary, execution of tax planning strategies.

The Company's historical operating losses raise considerable doubt as to when, if ever, any of the deferred tax assets will be realized. As a result, management has provided a valuation allowance for the net deferred tax assets. In the event management determines that sufficient future taxable income may be generated in subsequent periods and the previously recorded valuation allowance is no longer needed, the Company will decrease the valuation allowance by providing an income tax benefit in the period that such a determination is made. Because of its historical operating losses, the Company has not been subject to income taxes since 1996. The Company has recorded a deferred tax asset for one of its non-U.S. subsidiaries related to net operating losses.

With respect to any future uncertain tax positions, the Company intends to record interest and penalties, if any, as a component of income tax expense. It did not have any accrued interest and penalties related to uncertain tax positions as of 31 December, 2009.

The Company is subject to taxation in the U.S., Canada, the United Kingdom, Ireland and various states and local jurisdictions. As a result of the Company's tax loss position, the tax years 1999 through 2009 remain open to examination by the federal and most state tax authorities. In addition, the tax years 2002 through 2009 are open to examination in foreign jurisdictions. As of December 31, 2009, the Company did not have any tax examinations in process.

The components of the provision (benefit) for income taxes of continuing operations are as follows:

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Current			
Federal	$(3,644)	$–	$–
State	–	–	–
Foreign	–	–	–
Sub-total	(3,644)	–	–
Deferred			
Federal	–	–	–
State	–	–	–
Foreign	(322)	(367)	(445)
Sub-total	(322)	(367)	(445)
Total	$(3,966)	$(367)	$(445)

The income tax (benefit)/provision included in the accompanying statement of operations are as follows:

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Continuing Operations	$(3,966)	$(367)	$(445)
Discontinued Operations	3,644	–	–
Total	$(322)	$(367)	$(445)

The following is a reconciliation of the federal income tax benefit for continuing operations calculated at the statutory rate of 34 per cent. to the recorded amount:

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Applicable statutory federal income tax benefit	$(3,168)	$(3,648)	$(3,026)
State income taxes, net of federal income tax benefit	(494)	(569)	(472)
Non-deductible items	173	199	51
Foreign tax rate differential	19	22	137
Other	(81)	(89)	(57)
Valuation allowance	(415)	3,718	2,922
Net income tax benefit	$(3,966)	$(367)	$(445)

The significant items comprising the deferred tax asset and liability at 31 December, 2009, 2008 and 2007 are as follows:

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Net operating loss carry forwards	$26,503	$27,367	$23,463
Foreign net operating loss carry forwards	2,683	3,278	2,316
Financial reporting reserves not yet deductible for tax purpose	66	77	128
Accelerated depreciation and property-basis differences	(771)	(1,906)	(1,019)
Other	496	433	570
Valuation allowance	(28,701)	(29,116)	(25,398)
Total	$276	$133	$60
Intangible asset-basis differences	$(343)	$(486)	$(991)
Deferred tax liability, net	$(67)	$(353)	$(931)

The Company's deferred tax liability relates to the difference in the basis of its intangible assets acquired in a foreign jurisdiction.

As of 31 December, 2009, the Company had United States net federal operating loss carry forwards (NOLs) of approximately $67.2 million available to offset future taxable income, if any. These carry forwards expire through 2029 and are subject to review and possible adjustment by the Internal Revenue Service. Under Internal Revenue Code Section 382, certain substantial changes in the Company's ownership may result in a substantial limitation on the amount of net operating loss and tax credit carryforwards, which may be utilized in future years. The Company has performed an analysis to determine whether or to what extent such limitations could apply. Based on this analysis, the Company has approximately $52 million of net operating losses subject to an annual limitation of which $16.5 million will expire prior to becoming available for use. The Company has reduced its tax attributes for the expected expiration of the net operating loss and research credits. The Company's remaining net operating losses are not subject to limitation. It is possible that additional changes in ownership can further limit the amounts of net operating losses which may be utilized.

The Company's historical operating losses raise considerable doubt as to when, if ever, any of the deferred tax assets will be realized. As a result, management has provided a full valuation allowance for the net deferred tax assets. The Company also has Canadian federal NOLs of approximately $2.2 million available to offset future taxable income, if any. These carry forwards expire through 2026 and are subject to review and possible adjustment by the Canadian Revenue Agency. The Company may be subject to limitations of the use of the Canadian NOLs as a result of changes in ownership. The Company's historical operating losses raise considerable doubt as to when, if ever, any of the deferred tax assets will be realized. As a result, management has provided a full valuation allowance for the net deferred tax assets.

The Company also has a United Kingdom NOL of approximately $3.5 million, of which a $1.0 million deferred tax asset is not reserved.

The Company must determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. A tax position that meets the more-likely-than-not threshold is then measured to determine the amount of benefit to recognize in the financial information. Based on its assessment, the Company has concluded that there are no significant uncertain tax positions that require recognition in the financial information.

(11) UNREGISTERED SALES OF EQUITY SECURITIES

On 27 June, 2008, the Company's wholly-owned subsidiary, StockerYale Waterloo Acquisition Inc., filed an Offer to Purchase and Circular with Canadian securities regulatory authorities, relating to an offer to purchase all of the outstanding common shares of Virtek Vision International Inc. (Virtek) upon the terms and subject to the conditions set forth in the Offer to Purchase and Circular.

In connection with the offer, ProPhotonix arranged for financing of up to $22.0 million from Valens in order to fund the acquisition of all of the outstanding common shares of Virtek. On 30 June, 2008, in connection with the commitment of Valens to provide the financing, ProPhotonix issued an aggregate of 1,628,664 shares of common stock of ProPhotonix to Valens. The fair value of the common stock was $960,912 based upon the market price on the date of issuance and was expensed when the loan commitment expired unused.

On 26 January, 2007, the Company entered into a Securities Purchase Agreement with Smithfield Fiduciary LLC, a fund that is managed by Highbridge Capital Management, LLC. Under the terms of the agreement, the Company sold and issued to Smithfield Fiduciary LLC for an aggregate purchase price of $2.3 million, (i) 2,000,000 shares of common stock of the Company at a per share purchase price of $1.15 (a discount to the 30 day trading average) and (ii) a warrant to purchase 1,000,000 shares of common stock of the Company at an exercise price of $1.72 per share. The warrant expires on the tenth anniversary of the date of issuance.

The Company used the Black-Scholes Model to calculate the fair value of the warrants, which totaled $1,292,814. The underlying assumptions included in the Black-Scholes Model were: a risk-free interest rate of 4.88 per cent., an expected life of ten years and an expected volatility of 101 per cent. with no dividend yield.

The warrant and the shares of common stock issued and sold under the agreement were issued and sold under the exemption from the registration and prospectus delivery requirements of the Securities Act of 1933 under Section 4(2) and Rule 506 of Regulation D as a sale by the Company not involving a public offering. No underwriters were involved with the issuance and sale of the securities.

The Company and Smithfield Fiduciary LLC also entered into a Registration Rights Agreement under which the Company agreed, at its sole expense, to file a registration statement within seven business days to register for resale under the Securities Act of 1933, as amended, the shares issuable upon exercise of the warrant and the shares of common stock issued and sold to Smithfield Fiduciary LLC under the Securities Purchase Agreement. The Company filed a registration statement that was declared effective 14 February, 2007.

On 26 January, 2007, Private Opportunities Fund LP exchanged a warrant, dated 13 December, 2004, for 30,534 shares of common stock. The warrant was originally exercisable for 250,000 shares of common stock at a purchase price of $1.38 per share.

On 28 February, 2007, Private Opportunities Fund LP exercised a warrant, dated 3 February, 2004, for a total of 11,087 shares of common stock. The warrant was originally exercisable for 125,000 shares of common stock at a purchase price of $1.50 per share.

On 25 September, 2007, a private investor exercised warrants to purchase 1,140,741 shares of the Company's common stock from warrants exercised at an average per share price of $1.08 per share, or approximately $1,226,667.

The Company used the net proceeds from the transaction with Smithfield Fiduciary LLC and the private investor for general corporate purposes, including to invest in its information technology infrastructure and to accelerate operational improvements.

On 24 December, 2008, the Company entered into a Stock and Warrant Purchase Agreement to a group of private investors, including the Company's Chairman and CEO and three of the Company's directors. Under the terms of the Agreement the Company agreed to issue and sell an aggregate of 4,254,000 shares of common stock, $0.001 par value per shares at a per share purchase price of $0.25, for an aggregate purchase price of $1,063,500. In addition, the investors would also receive warrants to purchase up to an aggregate of 2,127,000 shares of the Company's common stock. The warrants are exercisable at any time after issuance at a per share price of $0.50 and expire on the fifth anniversary of the issue date. As of 31 December, 2009, the Company sold and issued for gross proceeds of $563,500, a total of 2,254,000 shares of common stock and issued warrants to purchase

1,127,000 shares of common stock. The remaining balance due under the Agreement of $500,000 is not reflected in the balance sheet at 31 December, 2008 or 2009 because the funds had not been received nor had the common stock or warrants been issued by the Company. The Company used the proceeds from the financing for working capital and general corporate purposes.

The Company used the Black-Scholes Model to calculate the fair value of the warrants issued, which totaled approximately $81,000. The underlying assumptions included in the Black-Scholes Model were: a risk-free interest rate of 1.54 per cent., an expected life of five years and an expected volatility of 101 per cent. with no dividend yield.

On 29 January, 2009, pursuant to the terms of the December 2008 Stock and Warrant Purchase Agreement, the Company issued and sold to a director an aggregate of 10,000 shares of common stock at a per share purchase price of $0.25, for an aggregate purchase price of $2,500. The director also received a warrant to purchase up to an aggregate of 5,000 shares of the Company's common stock. The warrant is exercisable at any time at a per share price of $0.50 and expires on the fifth anniversary of the issue date.

As of 31 December, 2009, there were 8,042,938 shares reserved for warrants with the following exercise prices and expiration dates:

No. Warrants	*Exercise Price*	*Expiration Date*
156,250	$1.17 –$1.17	2010
102,000	$1.38 –$3.12	2011
18,621	$0.80 –$0.80	2012
1,127,000	$0.50 –$0.50	2013
5,000	$0.50 –$0.50	2014
475,000	$1.23 –$1.44	2015
3,603,000	$1.15 –$3.12	2016
1,150,000	$0.80 –$1.72	2017
906,067	$0.45 –$0.60	2018
500,000	$0.10 –$0.10	2019
8,042,938		

(12) STOCK OPTION PLANS

On 22 May, 2007, the shareholders of the Company approved the adoption of the Company's 2007 Stock Incentive Plan (the 2007 Plan). Under this plan, the Company may issue options, restricted stock, restricted stock units and other stock-based awards to its employees, officers, directors, consultants and advisors. An aggregate of 5,300,000 shares of the Company's common stock were initially reserved for issuance under the 2007 Plan. In addition, there is an annual increase to the number of shares reserved for issuance under the 2007 Plan equal to the lesser of (i) 1,000,000 shares of common stock, (ii) 5 per cent. of the outstanding shares of common stock of the Company, or (iii) an amount determined by the Board of Directors of the Company. As of 31 December, 2009 and 2008, there were 6,300,000 shares reserved for issuance. On December 2, 2009, as sufficient shares were available for future stock option plans, the Board of Directors voted to not reserve for an additional 1,000,000 shares of common stock into the 2007 Plan, an annual feature of the 2007 plan. The Company's executive officers are eligible to receive stock based awards under the 2007 Plan on the terms and conditions determined by the GNCC.

Also on 22 May, 2007, the Board of Directors of the Company approved an amendment to the Company's Policy Regarding Compensation of Independent Directors, which provides that all awards of stock shall be made under the 2007 Plan, instead of the Company's 2004 Stock Option and Incentive Plan. On 5 March, 2008, the Board of Directors approved the Amended and Restated Policy Regarding Compensation of Independent Directors, which provides for an increase from $30,000 to $50,000 in the annual compensation of independent directors and that all awards shall be options to purchase shares of common stock instead of shares of restricted stock.

In May 2004, the Company adopted the 2004 Stock Option and Incentive Plan (the 2004 Option Plan) for the purpose of issuing both Incentive Options and Nonqualified Options to officers, employees and directors of the company. A total of 2,500,000 shares of common stock were reserved for issuance under this plan. Options were granted under the 2004 Option Plan on terms and prices as determined by the Board of Directors. Each option will be exercisable after the period or periods specified in the option agreement, but no option may be exercised after the expiration of 10 years from the date of grant.

In May 2000, the Company adopted the 2000 Stock Option and Incentive Plan for the purpose of issuing both Incentive Options and Nonqualified Options to officers, employees and directors of the Company. A total of 2,800,000 shares of common stock were reserved for issuance under this plan. Options were granted under the 2000 Option Plan on terms and at prices as determined by the Board of Directors. Each option will be exercisable after the period or periods specified in the option agreement, but no option may be exercised after the expiration of 10 years from the date of grant.

In March 1996, the Company adopted the 1996 Stock Option and Incentive Plan (the 1996 Option Plan) for the purpose of issuing both Incentive Options and Nonqualified Options to officers, employees and directors of the Company. A total of 1,200,000 shares of common stock are reserved for issuance under this plan. Options were granted under the 1996 Option Plan on terms and at prices as determined by the Board of Directors, Each option will be exercisable after the period or periods specified in the option agreement, but no option may be exercised after the expiration of 10 years from the date of grant.

The Company had 7,057,073 shares available for future grants of options and restricted shares on 31 December, 2009. The following table summarizes information about the stock options outstanding as of 31 December, 2009. There is no intrinsic value on any of the options at 31 December, 2009.

Range of Exercise Prices	*Options Outstanding*	*Weighted Average Contractual Life (years)*	*Weighted Average Exercise Price*	*Options Exercisable*	*Weighted Average Exercise Price*
\$0.08 – \$0.99	1,686,731	7.9	\$0.34	492,284	\$0.61
\$1.00 – \$1.99	442,817	4.2	\$1.24	442,817	\$1.24
\$2.00 – \$3.99	196,950	2.8	\$2.84	196,950	\$2.84
\$4.00 – \$6.99	125,400	2.4	\$4.85	125,400	\$4.85
\$7.00 – \$11.99	469,800	1.5	\$10.67	469,800	\$10.67
\$12.00 – \$38.00	83,400	0.9	\$15.64	83,400	\$15.64
\$0.08 – \$38.00	3,005,098	5.6	\$2.87	1,810,651	\$4.60

(13) EMPLOYEE STOCK PURCHASE PLAN

In May 2000, the Company adopted the 2000 Employee Stock Purchase Plan (the Stock Purchase Plan), which permits the eligible employees of the Company and its subsidiaries to purchase shares of the Company's common stock, at a discount, through regular monthly payroll deductions of up to 10 per cent. of their pre-tax gross salary. Subject to adjustment for stock splits, stock dividends and similar events, a maximum of 300,000 shares of common stock may be issued under the Stock Purchase Plan. During the years ended 31 December, 2009, 2008 and 2007, there were no shares issued under the Stock Purchase Plan.

(14) EMPLOYEE BENEFIT PLANS

On 17 January, 1994, the Company established the ProPhotonix 401(k) Plan (the Plan). Under the Plan, employees are allowed to make pre-tax retirement contributions. In addition, the Company may make matching contributions, not to exceed 100 per cent. of the employee contributions, and profit sharing contributions at its discretion. The Company made matching contributions of \$30,000, \$44,000 and \$40,000 in the years ended 31 December, 2009, 2008 and 2007, respectively. The Company incurred costs of approximately \$3,000, \$2,500 and \$2,800 in 2009, 2008 and 2007, respectively to administer the Plan.

(15) DISCONTINUED OPERATIONS

During 2005, the Company's management and the Board of Directors made a decision to discontinue its Singapore operation as well as its fiber optic illumination and galvanometer businesses. Accordingly, during 2005 the results of those operations were reclassified as discontinued operations.

During 2006, the Company completed the divestitures of these three businesses in exchange for aggregate consideration of up to $525,000 in cash and notes receivable and a 5 per cent. royalty on future sales of a specific product royalty up to a maximum of $35,000.

Amounts recorded as income from discontinued operations for the year ended 31 December, 2008 and 2007, primarily resulted from additional cash consideration received under certain notes receivable.

On 13 October, 2009, the Company and SYC, entered into an agreement and sold substantially all North American assets and rights of SYC and the Company's specialty optical fiber product line to Cohenernt, Inc. The purchase price consisted of a cash payment of $15,000,000 and the assumption of certain liabilities, including approximately $3,425,000 of accounts payable and other obligations associated with the sold assets. A portion of the cash payment, $750,000, was placed in escrow for a one year period which amount was received on 13 October, 2010. The assets to be sold or disposed of and liabilities to be transferred and the results of those operations are classified and included in discontinued operations for all periods presented. Proceeds from the transaction were used to pay the Laurus debt in the amount of $7,900,000 (including fees), expenses associated with the transaction and settlement of various obligations of approximately $2,050,000. These divestitures are reflected as discontinued operations on the accompanying financial information.

Revenues from the discontinued operations for the years ended 31 December, 2009, 2008 and 2007 were $11.2 million, $17.4 million and $17.1 million, respectively. The losses from discontinued operations for the years ended 31 December, 2009, 2008 and 2007 were $701,000, $490,000 and $2,023,000, respectively. Interest expense of $962,000, $1,066,000 and $1,144,000 was allocated to discontinued operations for the periods of 2009, 2008 and 2007, respectively. The Company based the allocation on the historic cash consumption of the different segments from 2002 to 2008, as these segments included the allocation of corporate expenses as well. For this analysis the Company determined that approximately 88 per cent. of the actual cash interest paid for the period of 2007, 2008 and through 13 October, 2009 should be allocated to discontinued operations. The Company recorded a gain of approximately $8.5 million on the sale of discontinued operations in the fourth quarter of 2009.

(16) COMMITMENTS AND CONTINGENCIES

Lease obligation treated as financing

On 30 December, 2005, the Company closed a sale-leaseback transaction on the Company's Salem, New Hampshire headquarters with 55 Heritage LLC. The terms of the Real Estate Purchase Agreement dated 29 November, 2005, as amended on 22 December, 2005, between the Company and the buyer were that (i) the Company agreed to sell the property to the buyer for $4,700,000, and (ii) the Company agreed to lease from the buyer (a) approximately 32,000 square feet of the property for an initial term of five years with a rental rate during such period of $192,000 per year in base rent and (b) approximately 63,000 square feet of the property for an initial term of five years with rental rates ranging from approximately $220,500 to $315,000 per year in base rent, plus a pro rata share of all operating costs of the property. Because the transaction did not qualify as a sale for accounting purposes, the net proceeds were classified as a financing lease obligation. This was primarily due to the terms of the lease agreement. Accordingly, the Company continues to carry the value of the building on its balance sheet and record depreciation expense until the criteria to record a sale are met. In 2009, the Company recorded $211,000 as non-cash interest expense and $60,000 as a decrease of the lease obligation due to the annual payments being more than the reduction in the deposit amount left with the landlord of $116,000. In 2008, the Company recorded $283,000 as non-cash interest expense and $29,000 as an increase of the lease obligation due to a reduction in the deposit amount left with the landlord of $190,000. During 2007, the Company recorded $300,000 as non-cash interest expense and $38,000 as an increase of the lease obligation due to a reduction in the deposit amount left with the landlord of $169,000.

On 14 October, 2009, the Company amended the lease, dated 30 December, 2005, to reduce the rentable space from approximately 95,000 square feet to approximately 51,000 square feet. This agreement changed the base rent for November and December 2009 to $16,949 per month, and for the calendar year to approximately $150,000. In addition, the tenant's share of expenses was reduced. The Company has made approximately 45,000 square feet of the space available for sublease.

At 31 December, 2009, $3,609,000 was recorded on the balance sheet as a financing lease obligation, which has been classified as $413,000 short-term obligation and $3,196,000 long-term obligation, and has been reported net of a $31,500 deposit. The net book value of the building at 31 December, 2009 was approximately $3,100,000.

At 31 December, 2008, $3,669,000 was recorded on the balance sheet as a financing lease obligation, which has been classified as $444,000 short-term obligation and $3,225,000 long-term obligation, and has been reported net of a $157,500 deposit. The net book value of the building at 31 December, 2008 was approximately $3,410,000.

At 31 December, 2007, $3,647,000 was recorded on the balance sheet as a financing lease obligation, which was classified as $447,000 short-term obligation and $3,200,000 long-term obligation, and has been reported net of a $347,500 deposit. The net book value of the building at 31 December, 2007 was approximately $3,714,000.

Other obligations and contingent liabilities

The Company's Canadian subsidiary, StockerYale Canada Inc., is the prime tenant of the property located at 275 Kesmark Street, Montreal, Quebec, Canada. The Company is ultimately liable for the lease payments under the sub lease arrangements, described below, and the contingent liability amounts to approximately $253,000 of lease payments in the aggregate plus operating costs.

On 13 October, 2009, SYC executed a Lease Amending Agreement (the "Montreal Lease Amendment") with the landlord to amend the Lease Agreement dated as of 22 December, 2005 (the "Montreal Lease"). The Montreal Lease Amendment shortens the term of the Montreal Lease from having an expiration date of 30 November, 2015 to: (a) with respect to space subleased by Coherent from SYC, the date of one year from Closing plus the option by Coherent to extend for up to three additional months; and (b) with respect to space being subleased by an existing subtenant of SYC, the date of termination of such sublease. In connection with such amendment, SYC paid the landlord CDN$550,000, plus applicable taxes, which included cash and the forfeiture by SYC of prepaid rent.

The Company also subleases a portion of the Montreal facility to another company which sub lease ends on 31 October, 2015. The Company has provided notice to the subtenant of the termination of the sublease and is currently renegotiating the sublease to end at the same time as the sub lease with Coherent.

On 12 June, 2008, StockerYale (IRL) Ltd. entered into a commitment to a new lease of approximately 10,000 square feet for its operations in Cork, Ireland. The lease term began on 22 August, 2008 for a term of five years with rent and service charges of €102,000 per year.

Photonics Products Ltd. leases approximately 13,000 square feet of space in Hatfield Broad Oak, Hertfordshire, UK. The lease runs for a term of nine years ending 29 September, 2013. It also leases approximately 4,000 square feet in Bishops Stortford, UK, through September 2011, which is now vacant. The Company is attempting to find a sub-tenant for this property. The annual rent for the Bishops Stortford property is £32,000. Photonic Products Ltd. also leases a sale office in Huntington Beach, California.

The Company utilizes, or has assumed, capital leases to finance purchases of equipment or vehicles. There was approximately $124,000 and $240,000 payable in principal and interest under these leases at 31 December, 2009 and 31 December, 2008, respectively. The terms of these leases are from two to five years and expire between 2010 and 2011. Monthly payments on these leases range from $1,500 per month to approximately $4,800 per month and include interest rates that range from 5.9 per cent. to 12.0 per cent. The Company records these as depreciation expense on the consolidated statement of operations.

The net book value of assets under capital lease at 31 December, 2009, 2008 and 2007 are as follows:

	2009	*2008*	*2007*
Assets under capital lease	$593,000	$553,000	$700,000
Less–accumulated depreciation	(416,000)	(328,000)	(288,000)
Assets under capital lease, net	$177,000	$225,000	$412,000

Scheduled future maturities of debt, operating, financing and capital lease obligations for the next five years:

Due by period	*2010*	*2011*	*2012*	*2013*	*2014*	*2015+*	*Total*
				(in thousands)			
Debt obligations	$4,724	$3,474	$–	$–	$–	$–	$8,198
Salem building lease obligations	413	–	–	–	–	–	413
Operating lease obligations	336	323	285	140	–	–	1,084
	$5,473	$3,797	$285	$140	$–	$–	$9,695

Due by period	*2010*	*2011*	*2012*	*2013*	*2014*	*Less interest*	*Total*
				(in thousands)			
Capital lease obligations	$95	$29	$–	$–	$–	$(15)	$109

The Company expensed approximately $309,000, $393,000 and $318,000 in rent for the years ended 31 December, 2009, 2008 and 2007, respectively.

(17) LEGAL PROCEEDINGS

The Company settled a law suit in December 2007. Beginning in May 2005, three putative securities class action complaints were filed in the United States District Court for the District of New Hampshire against the Company and certain of the Company's Directors and Officers, purportedly on behalf of some of the Company's shareholders. The complaints, which assert claims under the Securities Exchange Act of 1934, allege that some disclosures made by the Company in press releases dated 19 April, 2004 and 21 April, 2004 were materially false or misleading. The three complaints were consolidated into one action and assigned to a single federal judge. On 26 June, 2007, a settlement agreement between the Company and the lead plaintiffs in the class action lawsuit was submitted to the United States District Court for the District of New Hampshire for its approval. Under the terms of the proposed settlement, which would resolve all claims asserted against the Company and the individual defendants, plaintiffs would receive $3.4 million, to be paid entirely by the Company's insurance carrier. On 21 August, 2007, the Court preliminarily approved the proposed settlement. On 18 December, 2007, the Court entered an Order and Final Judgment in the class action lawsuit, which provided final approval of the settlement agreement and dismissed all claims of the members of the class against the Company and the individual defendants with prejudice (which means that they cannot be re-filed).

The Company is party to various legal proceedings generally incidental to its business. Although the disposition of any legal proceedings cannot be determined with certainty, it is the Company's opinion that any pending or threatened litigation will not have a material adverse effect on the Company's results of operations, cash flow or financial condition.

(18) SEGMENT INFORMATION

Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief decision-making group, in making decisions how to allocate resources and assess performance. The Company's chief decision-maker is the Chief Executive Officer. The Company's accounting policies and method of presentation for segments is consistent with that used throughout the consolidated financial information.

Following the sale described in Note 15, the Company operates in two segments: LED's (light emitting diode systems) and Photonic Products. In the LED segment, the Company designs and manufactures LED systems for the inspection, machine vision, medical and military markets. The Photonic Products segment distributes laser diodes and designs and manufactures custom laser diodes modules for industrial, commercial and medical applications. The policies relating to segments are the same as the Company's corporate policies.

The Company evaluates performance and allocates resources based on revenues and operating income (loss). The operating loss for each segment includes selling, research and development and expenses directly attributable to the segment. In addition, the operating loss includes amortization of acquired intangible assets, including any impairment of these assets and of goodwill. Certain of the Company's indirect overhead costs, which include corporate general and administrative expenses, are allocated between the segments based upon an estimate of costs associated with each segment. Segment assets include accounts receivable, inventory, machinery and equipment, goodwill and intangible assets directly associated with the product line segment.

All revenues and costs associated with our discontinued businesses have been eliminated from segment reporting, so that the net effect is to report from continuing operations only.

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Revenues:			
LED's	$3,657	$4,681	$3,020
Photonic Products	6,799	10,070	9,800
Total revenues	$10,456	$14,751	$12,820
Gross profit:			
LED's	$1,221	$1,837	$911
Photonic Products	1,937	2,802	2,722
Total gross profit	$3,158	$4,639	$3,633
Operating loss			
LED's	$(1,140)	$(1,259)	$(1,169)
Photonic Products	(7,008)	(3,428)	(4,371)
Total operating loss	$(8,148)	$(4,687)	$(5,540)

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Current assets:			
LED's	$1,479	$1,155	$820
Photonic Products	1,778	2,050	3,110
Corporate	4,478	1,642	1,650
Total current assets	$7,735	$4,847	$5,580
Net, Property, plant & equipment:			
LED's	$188	$189	$159
Photonic Products	432	480	845
Corporate	3,215	3,572	3,936
Total property, plant & equipment	$3,835	$4,241	$4,940
Net, Intangible assets:			
LED's	$33	$60	$194
Photonic Products	1,227	1,735	3,324
Corporate	–	–	–
Total intangible assets	$1,260	$1,795	$3,518
Goodwill:			
LED's	$508	$508	$508
Photonic Products	–	3,902	5,384
Corporate	–	–	–
Total goodwill	$508	$4,410	$5,892
Other assets:			
LED's	$–	$–	$–
Photonic Products	20	–	–
Corporate	18	303	591
Total other assets	$38	$303	$591

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Total assets:			
LED's	$2,208	$1,911	$1,681
Photonic Products	3,457	8,302	12,663
Corporate	7,711	5,383	6,177
Total assets	$13,376	$15,596	$20,521
Revenues by geographic area:			
Europe and United Kingdom	$5,136	$7,065	$5,261
United States	4,332	5,724	4,729
Asia & the rest of the world	988	1,962	2,830
Total	$10,456	$14,751	$12,820

The Company's long-lived assets consist of property, plant and equipment, goodwill and intangible assets located in the following geographic locations:

Years Ended 31 December,	*2009*	*2008*	*2007*
		(in thousands)	
Long-lived assets by geographic area:			
United States	$3,220	$3,578	$3,947
Europe	724	749	849
United Kingdom	1,659	6,119	9,554
Total	$5,603	$10,446	$14,350

SECTION C: UNAUDITED INTERIM CONDENSED FINANCIAL STATEMENTS FOR THE SIX MONTH PERIOD ENDING 30 JUNE 2010

PROPHOTONIX LIMITED
(formerly STOCKERYALE, INC.)

CONDENSED CONSOLIDATED BALANCE SHEETS

In thousands except share and per share data

Unaudited

	30 June, 2010	*31 December, 2009*
Assets		
Current assets:		
Cash and cash equivalents	$1,663	$4,478
Accounts receivable less allowances of $33 at 30 June, 2010 and $5 at 31 December, 2009	2,177	1,473
Inventories	1,403	1,282
Prepaid expenses and other current assets	232	502
Total current assets	5,475	7,735
Net property, plant and equipment	3,613	3,835
Goodwill	431	508
Acquired intangible assets, net	1,002	1,260
Other long-term assets	37	38
Total assets	$10,558	$13,376
Liabilities and Stockholders' Deficit		
Current liabilities:		
Revolving credit facility	$628	$568
Current portion of long-term debt, net of unamortized discount of $303 at 30 June, 2010 and $358 at 31 December, 2009	2,942	3,798
Current portion of capital and financing lease obligations	253	498
Accounts payable	1,497	1,142
Accrued expenses	1,376	1,117
Total current liabilities	6,696	7,123
Long-term debt, net of unamortized discount of $55 at 30 June, 2010 and $193 at 31 December, 2009	2,673	3,281
Capital and financing lease obligations, net of current portion	3,327	3,220
Deferred income taxes, net	–	67
Total liabilities	12,696	13,691
Stockholders' deficit:		
Common stock, par value $0.001; shares authorized 250,000,000; 44,605,778 shares issued and outstanding at 30 June, 2010 and 44,616,458 shares issued and outstanding at 31 December, 2009	45	45
Paid-in capital	103,330	103,048
Accumulated other comprehensive income	314	118
Accumulated deficit	(105,827)	(103,526)
Total stockholders' deficit	(2,138)	(315)
Total liabilities and stockholders' deficit	$10,558	$13,376

See notes to unaudited condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

In thousands except per share data

Unaudited

	Six months ended 30 June,	
	2010	*2009*
Revenue	$7,147	$5,454
Cost of sales	4,498	3,961
Gross profit	2,649	1,493
Operating expenses:		
Sales and marketing expenses	974	813
General and administrative	2,712	2,292
Research and development	356	268
Amortization of intangibles	195	361
Loss from operations	(1,588)	(2,241)
Other (income) and expense, net	92	(1,345)
Amortization of debt discount and financing costs	193	1,173
Interest expense	326	76
Loss from continuing operations before income tax benefit	(2,199)	(2,145)
Income tax provision/(benefit)	(65)	(9)
Loss from continuing operations	(2,134)	(2,136)
Loss from discontinued operations, net of tax	(109)	(189)
Loss on sale of discontinued operations, net of tax	(58)	–
Net loss	$(2,301)	$(2,325)
Basic and diluted net loss per share from continuing operations	$(0.05)	$(0.05)
Basic and diluted net loss per share from discontinued operations	$0.00	$0.00
Basic and diluted net loss per share	$(0.05)	$(0.05)
Basic and diluted weighted average shares outstanding:	44,177	43,166

See notes to unaudited condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

In thousands

	Six months ended 30 June,	
	2010	*2009*
Operations		
Net loss	$(2,301)	$(2,325)
Loss from discontinued operations, net of tax	(167)	(189)
Loss from continuing operations	(2,134)	(2,136)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Stock based compensation	282	317
Depreciation and amortization	443	635
Amortization of debt discount and financing costs	193	1,173
Non cash interest expense	(2)	136
Fair value of warrants	–	(146)
Provision for inventories	19	57
Provision for bad debts	37	4
Deferred income taxes	(65)	(9)
Other change in assets and liabilities:		
Accounts receivable	(925)	535
Inventories	(251)	(30)
Prepaid expenses and other current assets	264	(343)
Accounts payable	463	(348)
Accrued expenses	329	242
Net cash provided by (used in) operating activities	(1,347)	87
Net cash provided by (used in) discontinued operations	(167)	1,444
Net cash provided by (used in) operating activities	(1,514)	1,531
Financing		
Net proceeds from sale of common stock	–	12
Net borrowing (repayment) of revolving credit facility.	90	(377)
Proceeds from long-term debt issuance	–	500
Principal repayment of long-term debt	(1,351)	(594)
Net cash used in financing activities	(1,261)	(459)
Net cash used in discontinued operations	–	(6)
Net cash used in financing activities	(1,261)	(465)
Investing		
Payment of financing obligation	(73)	(164)
Net proceeds from sale of assets	3	–
Purchase of plant and equipment	(79)	(28)
Net cash used in continuing investing activities	(149)	(192)
Net cash used in discontinued operations	–	(321)
Net cash used in investing activities	(149)	(513)
Effect of exchange rate on cash	109	(1,023)
Net change in cash and equivalents	(2,815)	(470)
Cash and equivalents, beginning of period	4,478	1,635
Cash and equivalents, end of period	$1,663	$1,165
Supplemental disclosure of cash flow information:		
Cash paid for interest	$369	$69
Assets acquired under lease arrangement	$–	$276
Fair value of warrant modifications and issuances (in connection with financing)	$–	$38
Issuance of common stock to settle liabilities	$–	$370

See notes to unaudited condensed consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT AND COMPREHENSIVE INCOME (LOSS)

In thousands

Unaudited

	Common Stock				*Accumulated*		
	Shares	*Par $0.001*	*Paid in Capital*	*Accumulated Deficit*	*Other Comprehensive Income*	*Total Stockholders' Equity (Deficit)*	*Comprehensive Income (Loss)*
Balance 31 December, 2009	44,616	$45	$103,048	$(103,526)	$118	$(315)	
Share-based compensation, includes forfeiture of restricted stock	(10)	–	282	282			
Cumulative translation adjustment	196	196	196				
Net loss				(2,301)		(2,301)	(2,301)
Comprehensive net loss for the year ended 30 June, 2010							$(2,105)
Balance 30 June, 2010	44,606	$45	$103,330	$(105,827)	$314	$(2,138)	

See notes to unaudited condensed consolidated financial statements.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) ORGANIZATION AND BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by ProPhotonix Limited (the "Company") in accordance with United States Generally Accepted Accounting Principles (US GAAP) and, in the opinion of management, reflect all adjustments of a normal recurring nature necessary for a fair statement of (i) the results of operations for the six month periods ended 30 June, 2010 and 2009, (ii) the financial position at 30 June, 2010 and 31 December, 2009, and (iii) the cash flows for the six month periods ended 30 June, 2010 and 2009. These interim results are not necessarily indicative of results for a full year or any other interim period.

On 13 October, 2009, the Company and its wholly owned subsidiary, StockerYale Canada, Inc. ("SYC"), sold substantially all North American assets and rights of SYC and the Company's specialty optical fiber product line to Coherent Inc. The sale price consisted of a cash payment of $15,000,000 (of which $750,000 was placed in escrow for one year) and the assumption of certain liabilities, including approximately $3,425,000 of accounts payable, accrued expenses and other obligations associated with the assets sold. Proceeds from the transaction were used to pay off in full all obligations owed to Laurus Master Fund, Ltd. and its related entities (approximately $7,900,000 including fees), fees related to the transaction of approximately $1,100,000, the settlement of various obligations of approximately $950,000, and for working capital and general corporate purposes for the Company's ongoing and future operations. Accordingly, the condensed consolidated financial statements present the sold entities as discontinued operations. The escrow ($750,000) was received by the Company on 13 October, 2010.

Prior to the sale, the Company reported three segments: lasers, Photonic Products, and optical components. The entire optical component segment and a portion of the laser segment were sold. The Company will continue to operate its LED systems and Photonic Products businesses, which are based in Ireland and the United Kingdom.

On 27 May, 2010 the shareholders of the Company approved by a majority vote of all of the outstanding shares of the Company's Common Stock to change its name from StockerYale, Inc. to ProPhotonix Limited.

On 27 May, 2010 the shareholders of the Company approved by a majority vote of all of the outstanding shares of the Company's Common Stock to grant the Directors the discretionary authority to, at any time and from time to time until the next annual meeting of Shareholders, amend the Articles and increase the authorized Common Shares by up to an additional 150,000,000 shares. As a result, the Directors have the authority to issue up to 250,000,000 Common Shares.

On 19 August, 2010, the Company announced its intentions seeking admission of the Company's shares to the London Stock Exchange, plc (AIM listing) and to raise capital through an equity placement concurrent with the AIM listing. The net proceeds of such a capital raise will be used to fund the LED business expansion strategy, including investments in product development and manufacturing capacity, to further develop the laser module business, and to provide additional working capital. In connection with these efforts, the Company incurred and expensed professional fees of approximately $511,000 during the six months ended, 30 June, 2010.

The accompanying consolidated financial statements and notes are condensed and do not contain certain information included in the annual financial statements and notes of the Company. These unaudited condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report. These statements are prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company's continuation as a going concern is dependent on its ability to generate sufficient cash flow to meet its obligations on a timely basis through improved operations and/or additional financing. In addition to the proposed capital raise, discussed above, the Company has renegotiated all of its term debt obligations extending the payment period over 24 to 48 months. (see Footnote 8). The Company's management is optimistic in regards to the proposed capital raise and believes it will have sufficient capital for at least the next twelve months.

(2) USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of income and expenses during the reporting periods. Actual results in the future could vary from the amounts derived from management's estimates and assumptions.

(3) PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, StockerYale (IRL) Ltd., StockerYale Waterloo Acquisition Inc., StockerYale (UK) Ltd., which owns 100 per cent. of Photonics Products Ltd., and Lasiris Holdings, Inc., which holds all of the outstanding shares of StockerYale Canada. See Note 14 for information about the Company's sale of the assets in 2009, including those of StockerYale Canada. All intercompany balances and transactions have been eliminated.

(4) RECENT ACCOUNTING PRONOUNCEMENTS

In January 2010, the FASB issued ASU No. 2010-06, "Improving Disclosures about Fair Value Measurements" ("ASU 2010-06"), which is included in the ASC Topic 820 (Fair Value Measurements and Disclosures). ASU 2010-06 requires new disclosures on the amount and reason for transfers in and out of Level 1 and 2 fair value measurements. ASU 2010-06 also requires disclosure of activities, including purchases, sales, issuances, and settlements within the Level 3 fair value measurements and clarifies existing disclosure requirements on levels of disaggregation and disclosures about inputs and valuation techniques. ASU 2010-06 is effective for interim and annual reporting periods beginning after 15 December, 2009. The adoption of this standard did not have a material effect on our financial statements.

In February 2010, the FASB issued ASU No. 2010-09, "Amendments to Certain Recognition and Disclosure Requirements" ("ASU 2010-09"), which is included in the FASB Accounting Standards Codification (the "ASC") Topic 855 (Subsequent Events). ASU 2010-09 clarifies that an SEC filer is required to evaluate subsequent events through the date that the financial statements are issued. ASU 2010-09 is effective upon the issuance of the final update and did not have a significant impact on the Company's financial statements. All subsequent events since 30 June, 2010 to the date of the issuance of this document have been disclosed.

In April 2010, the FASB issued ASU No. 2010-17, "Milestone Method of Revenue Recognition" ("ASU 2010-17"), which is included in the ASC topic 605 (Revenue Recognition). ASU 2010-17 is an accounting standard update defining a milestone and determining what criteria must be met to apply the milestone method of revenue recognition for research or development transactions. The update provides guidance on the criteria which must be met to determine if the milestone method of revenue recognition is appropriate, whether a milestone is substantive and the disclosures that must be made if the method is elected. This standard should be applied on a prospective basis for milestones reached in fiscal years, and interim periods within those years, beginning on or after 15 June, 2010, with earlier adoption permitted. If early adoption is elected and the period of adoption is not the beginning of the Company's fiscal year, the amendments should be applied retrospectively from the beginning of the year of adoption. The adoption of this standard did not have a material impact on our consolidated financial position, results of operations and cash flows.

(5) LOSS PER SHARE

The Company calculates basic and diluted net loss per common share by dividing the net loss applicable to common stockholders by the weighted average number of shares of common stock outstanding. Common stock equivalents that were outstanding as of 30 June, 2010 and 2009, but were considered anti-dilutive securities and excluded from the diluted net income per share calculations, were as presented below:

	30 June,	
	2010	*2009*
Options outstanding	4,741,462	3,519,759
Warrants outstanding	8,042,938	8,522,850
Unvested restricted stock grants	402,274	1,145,971
Total potentially dilutive common stock equivalents	13,186,674	13,188,580

In 2010, approximately 646,000 of outstanding options, and approximately 235,000 shares of the unvested restricted stock were cancelled as a result of the sale of the North American operations.

(6) REVENUE RECOGNITION

The Company recognizes revenue from product sales at the time of shipment and when persuasive evidence of an arrangement exists, performance of the Company's obligation is complete, the price to the buyer is fixed or determinable, and collectability is reasonably assured. The Company's custom products are designed and supplied to original equipment manufacturers and produced in accordance with a customer-approved design. The Company's custom product revenue is recognized when the criteria for acceptance has been met. Title to the product generally passes upon shipment, as products are generally shipped FOB shipping point. In certain limited situations, distributors have the right to return products. Such rights of return have not precluded revenue recognition because the Company has a long history with such returns and accordingly are able to estimate a reserve for their cost.

Revenues from funded research and development and product development are recognized based on contractual arrangements, which may be based on cost reimbursement models. Revenue from reimbursement contracts is recognized as services are performed.

If a contract involves the provision of multiple elements and the elements qualify for separation, total estimated contract revenue is allocated to each element based on the relative fair value of each element provided. The amount of revenue allocated to each element is limited to the amount that is not contingent upon the delivery of another element in the future. Revenue is then recognized for each element as described above.

(7) WARRANTY

The Company provides warranties on most products for periods of up to one year. The warranty is limited to the cost of the product and the Company will repair or replace the product as required. The Company monitors the actual warranty repair costs and trends versus the reserve as a percent of sales. The Company adjusts the warranty provision based on actual experience and for any particular known instances.

Warranty Reserves:

Six months ended 30 June	*2010*	*2009*
	(in thousands)	
Balance at 31 December	$98	$116
Charges to costs and expenses	20	12
Account write-offs and other deductions	(17)	(8)
Balance at 30 June	$101	$120

(8) INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out basis) or market and include materials, labor and overhead. Inventories are as follows:

	30 June, 2010	*31 December, 2009*
	(in thousands)	
Finished goods	$223	$204
Work-in-process	106	131
Raw materials	1,074	947
Net inventories	$1,403	$1,282

(9) STOCK BASED COMPENSATION PLANS AND STOCK-BASED COMPENSATION EXPENSE

The Company has stock-based compensation plans for its employees, officers, and directors. The plans permit the grant of a variety of awards with various terms and prices as determined by the Governance, Nominating and Compensation Committee ("GNCC") of the Company's Board of Directors. The grants vest over terms of two to four years and are priced at fair market value or in certain circumstances 110 per cent. of the fair market value, of the common stock on the date of the grant. The options are generally exercisable after the period specified in the option agreement, but no option may be exercised after 10 years from the date of grant.

Additionally, in the case of incentive stock options, the exercise price may not be less than 100 per cent. of the fair market value of the Company's common stock on the date of grant. However, there is an exception in the case of a grant to an employee who owns or controls more than 10 per cent. of the combined voting power of all classes of the Company's stock or the stock of any parent or subsidiary. In that case, the exercise price shall not be less than 110 per cent. of the fair market value on the date of grant. In the case of non-qualified stock options, the exercise price shall not be less than 100 per cent. of the fair market value of the Company's common stock on the date of grant.

Stock Option Awards

The fair value of each option grant is estimated using the Black-Scholes option pricing model. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. Expected volatility is calculated based on the historical volatility of the Company's stock, at the time of the award. The average expected option term is estimated using the simplified method. The risk-free interest rate is based on U.S. Treasury zero-coupon issues assumed at the date of grant and no dividends were assumed in the calculation. The compensation expense recognized for all equity-based awards is net of estimated forfeitures for the six months ending 30 June, 2010 and 2009. Forfeitures are estimated based on the historical trends.

On 16 January, 2009, the GNCC adopted a stock option incentive program for 2009. The GNCC adopted a policy of granting performance-based options to purchase shares of the Company's common stock to various executive officers and key employees; all of which are subject to the achievement of performance goals. Options for a total of 1,865,000 shares of common stock were granted under this performance-based program on 16 January, 2009. As the performance goals were not met, the options terminated. The Company did not incur any stock compensation expense related to this plan during 2009.

During the second quarter of 2010, the GNCC approved various non-qualified stock option awards to purchase shares of the Company's common stock to various officers, directors and employees. These options vest between the six-month and four year anniversary of the Grant Date, provided that the recipient continues to serve the Company in that capacity until each such vesting date. Options for a total of 2,410,562 shares of common stock were granted. The exercise price for these options was set at or above the market price on the date of the grant.

The fair value of options at the date of grant was estimated using the Black-Scholes option pricing model. There were 2,410,562 options granted during the six months ended 30 June, 2010. The assumptions for grants during the six months ended 30 June, 2010 and 2009 were as follows:

Six months ended 30 June	*2010* *(in thousands)*	*2009*
Volatility	111.6%-112.2%	101.4%-104.8%
Expected option life	5.5 – 6.08 years	6.08 years
Interest rate (risk free)	3.05%-3.83%	1.54%-2.86%
Dividends	0	0
Weighted average grant date fair value	$0.08	$0.12

A summary of option activity as of 30 June, 2010, and changes during the first six months is presented below:

	Options Outstanding	*Weighted Average Exercise Price per Share*	*Weighted Average Remaining Contractual Term (in Years)*
Balance at 31 December, 2009	3,005,098	$2.87	5.56
Granted	2,410,562	0.11	N/A
Exercised	–	–	N/A
Cancelled	(674,198)	4.26	N/A
Balance at 30 June, 2010	4,741,462	$1.26	7.73
Exercisable at 30 June, 2010	1,498,944	$3.71	3.86
Vested and Expected to Vest at 30 June, 2010	4,449,606	$1.33	7.61

As of 30 June, 2010, there was a total unrecognized compensation cost of approximately $188,000 related to non-vested stock options outstanding. The cost is expected to be recognized over the next 0.98 years. There were no options exercised in the six months ended 30 June, 2010 or 30 June, 2009. Total expense recorded in the six months ending 30 June, 2010 and 2009 was approximately $84,000 and $81,000, respectively.

Restricted Share Awards ("RSAs")

The Company has awarded to a number of employees restricted shares of the Company's common stock. The RSAs vest in equal annual installments over a period of four years. The fair market value of the RSAs is based on the fair market value per share of the Company's common stock on the date of grant and is amortized over the vesting period.

A summary of the status of the Company's RSAs as of 30 June, 2010, and changes during the first six months is presented below:

	Shares	*Weighted Average Grant-Date Fair Value*
Non-vested at 31 December, 2009	490,689	$1.15
Granted	–	–
Vested	(77,735)	0.97
Cancelled	(10,680)	1.24
Non-vested at 30 June, 2010	402,274	$1.18

As of 30 June, 2010, there was a total unrecognized compensation cost of approximately $225,000 related to non-vested RSAs. The Company expects to recognize the costs over the next 1.1 years. Total expense recorded in the six months ended 30 June, 2010 and 2009 were approximately $198,000 and $236,000, respectively.

(10) COMPREHENSIVE LOSS

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The following table summarizes all components of the Company's comprehensive loss.

Six months ended 30 June	*2010*	*2009*
	(in thousands)	
Net loss	$(2,301)	$(2,325)
Other comprehensive income (loss):	–	–
Cumulative translation adjustment	196	(151)
Comprehensive loss	$(2,105)	$(2,476)

(11) GOODWILL

The Company uses a two-part impairment test in which it first estimates the fair value of its reporting units by using forecasts of discounted cash flows and then compares that value to the carrying value which requires that certain assumptions and estimates be made regarding industry economic factors and future profitability of reporting units to assess the need for an impairment charge. The methodology the Company uses to allocate certain corporate expenses is based on each segments use of services and/or direct benefit to its employees. While the Company believes it has made reasonable estimates and assumptions to calculate the fair value of the reporting segments' and implied fair value of goodwill, the impairment analysis is highly sensitive to actual versus forecast results. If the estimated value is less than the carrying value the Company moves to the second step of the impairment test to determine if goodwill is impaired. Goodwill as of 30 June, 2010 relates to the LED reporting unit.

(12) INTANGIBLE ASSETS

Intangible assets consist of trademarks, acquired patents and patented technologies, distributor and customer relationships and related contracts, trade and brand names and associated logos, technology design and programs, non-compete agreements and other intangible assets. There are no intangible assets with indefinite lives. Acquired patented technologies and trademarks are amortized over their estimated useful lives of between 3 - 16 years.

Gross carrying amounts and accumulated amortization of intangible assets were as follows as of 30 June, 2010 for each intangible asset class.

	Gross Carrying Amount	*Accumulated Amortization*	*Net Carrying Value*
		(in thousands)	
Acquired patents, patented technology and purchased technology	$1,526	$(1,506)	$20
Trademarks	171	(171)	–
Acquired trade name	456	(208)	248
Acquired customer contracts and relationships	1,852	(1,304)	548
Acquired non-compete agreement	600	(600)	–
Acquired technology design and programs	313	(145)	168
Other	102	(84)	18
Total	$5,020	$(4,018)	$1,002

Gross carrying amounts and accumulated amortization of intangible assets were as follows as of 31 December, 2009 for each intangible asset class.

	Gross Carrying Amount	*Accumulated Amortization*	*Net Carrying Value*
		(in thousands)	
Acquired patents, patented technology and purchased technology	$1,526	$(1,493)	$33
Trademarks	171	(171)	–
Acquired trade name	482	(190)	292
Acquired customer contracts and relationships	1,957	(1,253)	704
Acquired non-compete agreement	634	(634)	–
Acquired technology design and programs	331	(132)	199
Other	108	(76)	32
Total	$5,209	$(3,949)	$1,260

Amortization of intangible assets was approximately $195,000 and $361,000 for the six months ended 30 June, 2010 and 2009.

As of 30 June, 2010, the estimated future amortization expense of intangible assets, in thousands, is as follows:

			Estimated Future Expense (in thousands)			
	2010	*2011*	*2012*	*2013*	*2014*	*thereafter*
Amortization expense of intangible assets	$189	$315	$176	$176	$146	$–

(13) DEBT

A summary of the debt obligations of the Company is as follows:

	30 June, 2010	*31 December, 2009*
	(in thousands)	
Borrowings under Revolving Credit Facility with Barclays Bank Sales Financing with an interest rate of 2.65 per cent. above Barclays base rate (3.15 per cent. at 30 June, 2010 and 31 December, 2009)	$628	$568
Senior Fixed Rate Secured Bond to a private investor with an interest rate of 8 per cent. at 30 June, 2010 and 12 per cent. at 31 December, 2009, maturing on 30 July, 2011 net of unamortized discount of $47 at 30 June, 2010 and $91 at 31 December, 2009	1,734	2,312
Senior Fixed Rate Secured Bond payable to a private investor, maturing on 31 October, 2011 with an interest rate of 8 per cent. on 30 June, 2010 and 10 per cent. at 31 December, 2009, net of unamortized discount of $311 at 30 June, 2010 and $460 at 31 December, 2009	2,097	2,581
Bonds payable to the former stockholders of Photonic Products Ltd. maturing on 30 November, 2010, with an interest rate of 7 per cent., at 30 June, 2010 and 31 December, 2009	1,784	2,186
Sub-total debt	6,243	7,647
Less – revolving credit facility	(628)	(568)
Less—Current portion of long-term debt, net of unamortized discount	(2,942)	(3,798)
Total long-term debt, net of unamortized discount	$2,673	$3,281

Photonic Products Ltd.

StockerYale (UK) Ltd., a wholly owned subsidiary of the Company, issued bonds to each of the former stockholders of Photonic Products Ltd. with an aggregate initial principal amount equal to $2,400,000 (ProPhotonix Bonds). Under the terms of issuance, the outstanding principal accrued interest at an annual rate of 1 per cent. above the LIBOR rate as determined on the first business day of each month. All unpaid principal plus accrued but unpaid interest under the bonds was originally due and payable on 31 October, 2009.

On 7 October, 2009, the Company and StockerYale (UK) Ltd. entered into a Deed of Variation with the bondholders in which the Company and StockerYale (UK) Ltd. agreed: (a) to make principal payments to one of the bondholders of $120,000 on 31 October, 2009 and $120,000 on 8 January, 2010 plus monthly payments of simple interest at an annual rate of 7 per cent. on the outstanding amounts until paid; and (b) to make monthly payments to each of the other two bondholders in the aggregate amount of $47,000 on the last day of each calendar month, beginning on 30 November, 2009 and to continue until and including 31 October, 2010 plus monthly payments of simple interest at an annual rate of 7 per cent. to be made on the last day of each month beginning on 30 November, 2009 through 30 November, 2010 when a balloon payment of $1,596,000 will be due.

StockerYale (UK) Ltd. may elect to prepay the bonds at any time, in whole or in part, without penalty or premium. If StockerYale (UK) Ltd. fails to make any payments under the bonds, the former stockholders of Photonic Products Ltd. may have the right to require payment from the Company in the form of newly issued shares of the Company's common stock.

On 30 October, 2010 and 14 December, the Company and the holders of the ProPhotonix Bonds entered into a Deeds of Variation of the ProPhotonix Bonds. The amendments required a payment on 30 October, 2010 against the principal balance in the amount of $150,000. The ProPhotonix Bonds are amended to pay the outstanding balance as of 31 October, 2010 monthly over the period from 30 November, 2010 through 30 November, 2012 at the rate of $50,000 principal plus simple interest (at 11 per cent. per annum). On 31 December, 2012 the remaining balance (approximately $243,000) of the ProPhotonix Bonds shall be payable in full. The key repayment terms of the ProPhotonix Bonds, under this amendment, are as follows:

(a)	Principal:	$1,493,000
(b)	Interest Rate:	11 per cent. per annum, payable monthly
(c)	Repayment term:	31 October, 2010 to 30 November, 2012
(d)	Monthly principal:	$50,000
(e)	Balloon payment:	$243,000 due 31 December, 2012

As of 30 June, 2010, $1,784,000 was outstanding under the bonds issued to the stockholders of Photonic Products Ltd., which has been recorded as current portion of long-term debt.

As of 31 December, 2009, $2,186,000 was outstanding under the bonds issued to the stockholders of Photonic Products Ltd., and was recorded as current portion of long-term debt.

Private Investor Bonds

Photonic Products Ltd. Financing

On 31 October, 2006, StockerYale (UK) Ltd. issued a 10 per cent. Senior Fixed Rate Secured Bond ("SYUK Bond"), as amended at various times, in the original principal amount of $4,750,000 to Eureka Interactive Fund Limited. The bond is due on 31 October, 2011. StockerYale (UK) Ltd. agreed to make payments of principal and interest over the term; however, an amount equal to 50 per cent. of the original principal sum of $4,750,000 will be paid on 31 October, 2011. The outstanding principal on the bond accrues interest at an annual rate of 10 per cent. StockerYale (UK) Ltd. may prepay the bond at any time, in whole or in part, without penalty or premium. The bond is secured by all of the equity interests of Photonic Products Ltd. owned by StockerYale (UK) Ltd. The Company used the net proceeds to make the cash payment for the acquisition of Photonic Products Ltd. The remaining proceeds were used for transaction fees and working capital. On 16 August, 2007, the Eureka Interactive Fund Limited transferred this bond to a private investor.

In connection with the issuance of the bond on 31 October, 2006, the Company issued a Common Stock Purchase Warrant to Eureka to purchase 2,375,000 shares of its common stock for a purchase price of $1.15 per share. The warrant expires on the tenth anniversary of the date of issuance. The aggregate proceeds of the bond and warrants of $4,750,000 were allocated between the bond and the common stock warrants based upon their relative fair market value. The proceeds price allocated to the bond was $3,255,349 and the proceeds allocated to the common stock warrant was $1,494,651. The difference between the aggregate face amount of the bond of $4,750,000 and the initial carrying value of the bond was recorded as a debt discount of $1,494,651 and is being amortized over the life of the bond. The Company used the Black-Scholes Model to calculate the fair value of the warrants. The underlying assumptions included in the Black-Scholes Model were: a risk-free interest rate of 4.61 per cent., an expected life of ten years and an expected volatility of 102 per cent. with no dividend yield.

On 13 January, 2009, StockerYale (UK) Limited, a wholly owned subsidiary of the Company and the private investor, entered into an agreement to forego the principal payments of $61,674 per month under such bond for six months totaling $370,044 in consideration of the issuance of 1,480,176 shares of common stock of the Company to the private investor.

On 9 June, 2009, the private investor and the Company entered into a Transfer Agreement under which they agreed to transfer $1,000,000 of debt (the "Transfer Amount") from the SYUK Bond to the SYI Bond described below.

On 9 March, 2010, the private investor and the Company entered into an amendment to the Bond reducing the interest rate from 10 per cent. to 8 per cent., in consideration of an advance payment of $200,000 in principal and a revised prospective principal payment schedule. In addition, the same private investor agreed to reduce to interest rate on the SYI Bond from 12 per cent. to 8 per cent. as a part of this amendment.

On 10 December, 2010, the Company and a private investor entered into a binding restructuring of SYUK Bond. The bond will be amended to convert $1,274,544 of the balance into Common Shares of ProPhotonix at the at the price equal to the per share price of the equity offering described in footnote (1) and to transfer the remaining balance $942,124 to StockerYale Ireland Bond. The bond will be cancelled thereafter.

At 30 June, 2010, $2,407,679 remained outstanding under the combined note which has been classified as $787,428 short-term debt and $1,620,251 long-term debt and reported net of $310,883 of unamortized debt discount, which has been reported as $256,497 as short-term and $54,386 as long-term.

At 31 December, 2009, $3,040,206 remained outstanding under the combined note which has been classified as $1,048,458 short-term debt and $1,991,748 long-term debt and reported net of $459,666 of unamortized debt discount, which has been reported as $283,863 as short-term and $175,793 as long-term. On 31 December, 2009, the Company was $308,370 (principal only) in arrears. On 1 March, 2010, the private investor signed a waiver for any breach or default under the agreement at 31 December, 2009.

StockerYale Ireland Senior Fixed Rate Secured Bond

On 24 July, 2008, StockerYale (IRL) Ltd. issued a three-year 12 per cent. Senior Fixed Rate Secured Bond ("SYI Bond"), as amended at various times, to a private investor in the original principal amount of €935,000 ($1,472,905 at 24 July, 2008) secured by all of the assets of StockerYale (IRL) Ltd. The bond matures on 30 July, 2011. StockerYale (IRL) Ltd. agreed to make payments of principal and interest of approximately €31,000 over the term beginning 30 August, 2008. The outstanding principal on the bond accrues interest at an annual rate of 12 per cent. (reduced to 8 per cent. on 9 March, 2010). StockerYale (IRL) Ltd. may prepay the bond at any time, in whole or in part, without penalty or premium. The Company used the net proceeds for working capital.

In connection with the issuance of the bond, the Company issued warrants to the private investor to purchase 636,404 shares of its common stock for a purchase price of $0.45 per share. The warrant expires on the tenth anniversary of the date of issuance. The Company used the Black-Scholes Model to calculate the fair value of the warrants. The underlying assumptions included in the Black-Scholes

Model were: a risk-free interest rate of 4.03 per cent.; an expected life of ten years; and an expected volatility of 98 per cent. with no dividend yield. The total value of the warrants was recorded as a debt discount of approximately $220,000 and is being amortized over the life of the bond, using the effective interest method.

On June 9, 2009, the same private investor loaned the company an additional $500,000 payable over the remaining term of the original loan, at the same fixed 12 per cent. interest rate. As a part of the agreement, the Company issued to the private investor additional ten-year common stock warrants to purchase 500,000 shares of common stock at an exercise price per share of $0.10. An additional debt discount was recorded in the amount of $38,086 and is being amortized over the remaining life of the note. The Company used the Black-Scholes Model to calculate the fair value of the warrants. The underlying assumptions included in the Black-Scholes Model were: a risk-free interest rate of 3.86 per cent., an expected life of seven years, an expected volatility of 105.04 per cent. and no dividend yield.

Also on 9 June, 2009, the Company and private investor entered into a Transfer Agreement under which they agreed to transfer $1,000,000 of debt (the "Transfer Amount") from the SYUK Bond described above to the SYI Bond. Interest accrues and is payable monthly and the amount is payable on 30 July, 2011.

At 30 June, 2010, $1,781,480 remained outstanding under the combined note which has been classified as $672,922 short-term debt and $1,108,558 long-term debt and reported net of $47,067 of unamortized debt discount, which has been reported as $46,202 as short-term and $865 as long-term.

On 10 December, 2010, the Company and a private investor entered into a binding restructuring of the SYI Bond. The amendment provides that StockerYale Ireland shall assume €692,128 ($942,124) of the balance of the SYUK Bond, which will then be combined with the existing SYI Bond. This bond is secured by the assets of StockerYale Ireland. The SYI Bond will be amended such that interest only shall be paid monthly on the outstanding balance through 30 June, 2010 and thereafter equal monthly payments of principal and interest over the three year period 1 July, 2012 through 30 June, 2015. The Company will also pay a restructuring fee of $50,000 to the private investor. The key repayment terms of the SYI Bond, under this amendment, are as follows:

(a)	Principal:	€1,972,523
(b)	Interest Rate:	8 per cent. per annum
(c)	Interest payments only:	present through 30 June, 2012
(d)	Principal Repayment term:	36 months; 31 July, 2012 through 30 June, 2015
(e)	Monthly principal and interest:	€61,812

At 31 December, 2009, $2,402,620 remained outstanding under the note, which has been classified as $921,170 short-term debt and $1,481,450 long-term debt and reported, net of $90,586 of unamortized debt discount, which has been reported as $73,702 short-term and $16,684 long-term. On 31 December, 2009, the Company was $216,731 (principal only) in arrears. On 1 March, 2010, the private investor signed a waiver for any breach or default under the agreement at 31 December, 2009.

Barclays Bank, PLC

On 6 February, 2008, the Company's ProPhotonix U.K. subsidiary entered into a Confidential Invoice Discounting Agreement with Barclays Bank Sales Financing ("Barclays"). Under the Discounting Agreement, a three-year revolving line of credit was established. The Discounting Agreement provides for a revolving line of credit not to exceed an aggregate principal amount of £700,000 ($1,055,000) and grants a security interest in and lien upon all of ProPhotonix U.K.'s trade receivables in favor of Barclays.

The facility requires the maintenance of certain covenants. The Company may elect to prepay amounts due under the facility at any time, in whole or in part, upon 3 months notice. If the prepayment amount comes before the end of the "Minimum Period of the Agreement", Barclays reserves the right to charge fees in accordance with the terms and conditions of the agreement. On 26 June, 2009, ProPhotonix U.K. agreed to amend the terms of the Agreement with Barclays. Under the amended terms, the maximum amount allowed outstanding under the line of credit is £650,000 ($980,000 USD at 30 June, 2010). The outstanding principal under the note accrues interest at an annual rate of 2.65 per cent. above Barclays base rate.

On 18 February, 2010, ProPhotonix U.K. entered into an amendment to the revolving credit facility agreement, which removed the minimum tangible net worth requirement of £350,000 ($527,000 USD) as of 31 March, 2010 and 30 June, 2010. The amendment states that if ProPhotonix U.K.'s net worth did not increase in line with projections as provided to Barclays on 18 January, 2010, then Barclays may in its sole discretion review the terms on which it continues to make the facility available. The amount outstanding under the facility was $628,000 as of 30 June, 2010 and $568,000 as of 31 December, 2009, all of which was classified as short term debt under revolving credit facility. ProPhotonix U.K. was in technical default on 31 December, 2009 which Barclays waived as part of the 18 February, 2010 amendment.

On 25 November, 2010 ProPhotonix U.K. and Barclays extended the minimum term of the Confidential Invoice Discounting Agreement through 25 May, 2012. The original minimum term of the Agreement ends on 7 February, 2011. All other terms of the Agreement remain in place pursuant to the Agreement as amended.

(14) DISCONTINUED OPERATIONS

On 13 October, 2009, the Company and SYC, entered into an agreement and sold substantially all North American assets and rights of SYC and the Company's specialty optical fiber product line to Coherent Inc. The purchase price consisted of a cash payment of $15,000,000 and the assumption of certain liabilities, including approximately $3,425,000 of accounts payable and other obligations associated with the sold assets. A portion of the cash payment, $750,000, was placed in escrow for a one year period which amount was received on 13 October, 2010. The results of those operations are classified and included in discontinued operations for all periods presented. Proceeds from the transaction were used to pay certain outstanding debt in the amount of $7,900,000 (including fees), expenses associated with the transaction and settlement of various obligations of approximately $2,050,000. These divestitures are reflected as discontinued operations on the accompanying condensed consolidated financial statements. On 5 May, 2010, the Company agreed to pay Coherent Inc. approximately $58,000 related to the net asset value calculation in the agreement. This amount was recorded as a loss from discontinued operations and is included in the amounts below.

Revenues from the discontinued operations for the six months ended 30 June, 2010 and 2009 were $0.0 and $6.9 million, respectively. The loss from discontinued operations for the six months ended 30 June, 2010 and 2009 was $167,000 and $189,000, respectively. Interest expense was allocated to discontinued operations for the six months ending 30 June, 2009.

(15) COMMITMENTS AND CONTINGENCIES

Lease obligation treated as financing

On 30 December, 2005, the Company closed a sale-leaseback transaction on the Company's Salem, New Hampshire headquarters with 55 Heritage LLC. The terms of the Real Estate Purchase Agreement dated 29 November, 2005, as amended on 22 December, 2005, between the Company and the buyer were that (i) the Company agreed to sell the property to the buyer for $4,700,000, and (ii) the Company agreed to lease from the buyer (a) approximately 32,000 square feet of the property for an initial term of five years with a rental rate during such period of $192,000 per year in base rent and (b) approximately 63,000 square feet of the property for an initial term of five years with rental rates ranging from approximately $220,500 to $315,000 per year in base rent, plus a pro rata share of all operating costs of the property. Because the transaction did not qualify as a sale for accounting purposes, the net proceeds were classified as a financing lease obligation. This was primarily due to the terms of the lease agreement. Accordingly, the Company continues to carry the value of the building on its balance sheet and record depreciation expense until the criteria to record a sale are met. The Company expects that it will recognize this sale during the fourth quarter ending 31 December, 2010. The lease expires on 31 December, 2010. On 14 October, 2009, the Company amended the lease, dated 30 December, 2005, to reduce the rentable space from approximately 95,000 square feet to approximately 51,000 square feet. This agreement changed the base rent for November and December, 2009 to an annualized rate of approximately $203,000 per year, and for the 2010 calendar year to approximately $150,000. In addition, the tenant's share of expenses was reduced.

At 30 June, 2010, $3,533,000 was recorded on the balance sheet as a financing lease obligation, which was classified as $206,000 short-term obligation and $3,327,000 long-term obligation, and has been reported net of a $28,200 deposit.

At 31 December, 2009, $3,609,000 was recorded on the balance sheet as a financing lease obligation, which has been classified as $413,000 short-term obligation and $3,196,000 long-term obligation, and has been reported net of a $31,500 deposit.

Other obligations

The Company's Canadian subsidiary, StockerYale Canada Inc., is the prime tenant of the property located at 275 Kesmark Street, Montreal, Quebec, Canada. The Company is ultimately liable for the lease payments under the sub lease arrangements, described below, and the contingent liability amounts to approximately $180,000 of lease payments in the aggregate plus operating costs.

On 13 October, 2009, SYC executed a Lease Amending Agreement (the "Montreal Lease Amendment") with the landlord to amend the Lease Agreement dated as of 22 December, 2005 (the "Montreal Lease"). The Montreal Lease Amendment shortens the term of the Montreal Lease from having an expiration date of 30 November, 2015 to: (a) with respect to space subleased by Coherent from SYC, 12 January, 2011; and (b) with respect to space being subleased by an existing subtenant of SYC, the date of termination of such sublease. In connection with such amendment, SYC paid the landlord CDN$550,000, plus applicable taxes, which included cash and the forfeiture by SYC of prepaid rent.

(16) SEGMENT INFORMATION

Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief decision-making group, in making decisions how to allocate resources and assess performance. The Company's chief decision-maker is the Chief Executive Officer. The Company's accounting policies and method of presentation for segments is consistent with that used throughout the consolidated financial statements.

Following the sale described in Note 14, the Company operates in two segments: LED's (light emitting diode systems) and Photonic Products. In the LED segment, the Company designs and manufactures LED systems for the inspection, machine vision, medical and military markets. The Photonic Products segment distributes laser diodes and designs and manufactures custom laser diodes modules for industrial, commercial and medical applications. The policies relating to segments are the same as the Company's corporate policies.

The Company evaluates performance and allocates resources based on revenues and operating income (loss). The operating loss for each segment includes selling, research and development and expenses directly attributable to the segment. In addition, the operating loss includes amortization of acquired intangible assets, including any impairment of these assets and of goodwill. Certain of the Company's indirect overhead costs, which include corporate general and administrative expenses, are allocated between the segments based upon an estimate of costs associated with each segment. Segment assets include accounts receivable, inventory, machinery and equipment, goodwill and intangible assets directly associated with the product line segment.

All revenues and costs associated with our discontinued businesses have been eliminated from segment reporting, so that the net effect is to report from continuing operations only.

	Six months ended 30 June, 2010 (in thousands)			*Six months ended 30 June, 2009 (in thousands)*		
	LED	*Photonic Products*	*Total*	*LED*	*Photonic Products*	*Total*
Net Sales	$2,974	$4,173	$7,147	$1,794	$3,660	$5,454
Gross Profit	1,487	1,162	2,649	621	872	1,493
Operating Loss..	(255)	(1,333)	(1,588)	(608)	(1,633)	(2,241)

	30 June, 2010 (in thousands)				*31 December, 2009 (in thousands)*			
	LED	*Photonic Products*	*Corporate*	*Total*	*LED*	*Photonic Products*	*Corporate*	*Total*
Total current assets	$1,802	$2,012	$1,661	$5,475	$1,173	$1,778	$4,784	$7,735
Property, plant & equipment, net	$182	$360	$3,071	$3,613	$188	$432	$3,215	$3,835
Acquired intangible assets, net	$20	$982	–	$1,002	$33	$1,227	–	$1,260
Goodwill	$431	$–	–	$431	$508	$–	–	$508
Other long-term assets	$–	$20	$17	$37	$–	$20	$18	$38
Total	$2,435	$3,374	$4,749	$10,558	$1,902	$3,457	$8,017	$13,376

The Company's sales by geographic region are denominated in U.S. dollars. These sales are as follows:

	Six months ended 30 June, (in thousands)	
	2010	*2009*
Sales by region		
Europe and United Kingdom	$4,026	$2,566
Domestic – United States	1,973	2,463
Asia and Rest of World	1,148	425
Total	$7,147	$5,454

SECTION D: PRESS RELEASE PERTAINING TO THE UNAUDITED FINANCIAL RESULTS FOR THE THREE MONTHS PERIOD ENDING 30 SEPTEMBER 2010

On 26 October 2010 the Company announced third quarter financial results, the latest published results, which are provided below:

Salem, N.H. – 26 October 2010 – ProPhotonix Limited, formerly StockerYale, Inc. (Pink Sheet OTC: STKR), a designer and manufacturer of LED arrays and light engines, produces laser modules and distributes laser diodes for industrial OEMs, medical and defense markets, announces its financial results for the third quarter ended 30 September, 2010. Results are reported from continuing operations and exclude discontinued operations, unless otherwise stated.

Third Quarter 2010 Financial Results

Total revenue for the third quarter of 2010 of $3.9 million increased 66 per cent. from the third quarter of 2009. The increase in sales was due to a $1.1 million increase in the LED segment, a 142 per cent. increase and a $0.4 million increase in the Photonic Products segment.

Gross profit was $1.6 million for the three months ended 30 September, 2010, a 116 per cent. increase compared to the third quarter of 2009. During the three months ended 30 September, 2010, gross margin was 40 per cent. compared with 31 per cent. in the third quarter of 2009, mainly due to increased volumes, mix of products and improved productivity in our LED segment.

Operating expenses totaled $2.0 million for the third quarter of 2010, an increase of 33 per cent. as compared to the third quarter of 2009. The 2010 operating expenses include costs of approximately $194,000 related to the proposed admission of the Company's shares to the London Stock Exchange's AIM Market. Non-cash amortization of intangible assets decreased to $99,000 versus $198,000 for the third quarter of 2009. Sales and marketing expenses increased by approximately $166,000, or 43 per cent., associated with the increase in revenue plus increased advertising, and marketing and product management personnel. Research and development expenses were 3 per cent. higher at $161,000 due to increased engineering resources in the Company's LED business. General and administrative expenses, excluding AIM charges, increased $129,000, or 14 per cent., versus the third quarter of 2009.

Excluding AIM Admission expenses, adjusted EBITDA was $27,000, a $540,000 improvement over the prior year. EBITDA loss was $167,000 for the quarter compared to an EBITDA loss of $515,000 for the third quarter of 2009. Net loss from continuing operations, excluding fees relating to AIM, were $0.3 million, or $0.01 per share. Net loss including discontinued operations was $0.5 million or $0.01 per share. This compares to net loss of $1.5 million or $0.03 per share for the third quarter of 2009.

Consolidated Statements of Operations

(Unaudited)

($ In thousands except share and per share data)

	Three months ended 30 September,	
	2010	*2009*
Net Sales	$3,899	$2,347
Cost of Sales	2,345	1,627
Gross Profit	1,554	720
Research & Development Expenses	161	156
Selling, General & Administrative Expenses	1,816	1,327
Amortization of Intangible Assets	99	198
Operating Loss	(522)	(961)
Other income/(expense), net	237	(415)
Amortization of debt discount and financing costs	(86)	(209)
Interest expense	(112)	(45)
Loss Before Taxes from Continuing Operations	(483)	(1,630)
Tax benefit	46	205
Net Loss from Continuing Operations	(437)	(1,425)
Loss from Discontinued Operations	(17)	(25)
Net Loss	$(454)	$(1,450)
Loss Per Share		
Loss from Continuing Operations	($0.01)	($0.03)
Income/(Loss) from Discontinued Operations	($0.00)	($0.00)
Net loss per share	($0.01)	($0.03)
Weighted Average Shares Outstanding	44,407,504	44,108,929

Consolidated Balance Sheet

(Unaudited)

($ in Thousands)

	30 September, 2010	*31 December, 2009*
Assets		
Current Assets	$5,284	$7,736
Property, Plant & Equipment, Net	3,629	3,835
Other Assets	1,447	1,805
	$10,360	$13,376
Liabilities & Stockholders Deficit		
Total Current Liabilities	$8,172	$7,123
Long Term Debt	1,413	3,281
Long Term Lease and Other Liabilities	3,392	3,287
Stockholders Deficit	(2,617)	(315)
Total Liabilities & Stockholders Deficit	$10,360	$13,376

Use of Non-GAAP Financial Measures

The Company provides non-GAAP financial measures, such as EBITDA, to complement its consolidated financial statements presented in accordance with GAAP. Non-GAAP financial measures do not have any standardized definition and, therefore, are unlikely to be comparable to similar measures presented by other reporting companies. These non-GAAP financial measures are intended to supplement the user's overall understanding of the Company's current financial and operating performance and its prospects for the future. Specifically, the Company believes the non-GAAP results provide useful information to both management and investors by identifying certain expenses, gains and losses that, when excluded from the GAAP results, may provide additional understanding of the Company's core operating results or business performance, which management uses to evaluate financial performance for purposes of planning for future periods. However, these non-GAAP financial measures are not intended to supersede or replace the Company's GAAP results.

The Company uses EBITDA (earnings before interest, taxes, depreciation, amortization, and stock-based compensation) as a non-GAAP financial measure in this press release. A reconciliation of EBITDA to net income/(loss) for the third quarter ended 2010 is as follows:

	Three months ended 30 September, (in thousands)	
	2010	*2009*
Net Loss	(454)	(1,450)
Loss from discontinued operations	17	25
Plus:		
Interest and other (income)/expense (net)	(125)	460
Depreciation	131	138
Intangible asset amortization	99	198
Stock based compensation	125	110
Tax benefit	(46)	(205)
Amortization of Debt Discount & Financing Costs	86	209
EBITDA loss	(167)	(515)
One-time charges – AIM Admission costs	194	–
Adjusted EBITDA gain / (loss)	7	(515)

PART IV

EFFECT OF US DOMICILE OF THE COMPANY

The Company is incorporated and existing under the laws of the Commonwealth of Massachusetts, USA and is subject to the provisions of the Massachusetts Business Corporation Act (M.G.L. ch. 156D). There are a number of differences between the corporate structure of the Company and that of a public limited company incorporated in the UK that are set out below.

Share allotments and borrowing powers

Companies incorporated under the Companies Act must explicitly authorise directors to allot shares under section 551 of the Companies Act. It is usual for UK companies to place restrictions on the authority of directors to allot shares. In particular, it is a requirement under section 551 of the Companies Act that such authority be limited to expire after a specified time period, of no longer than five years, with shareholder approval required for renewal.

The Board may also approve the issue of shares and other equity securities of the Company, but such authority is limited to the number of shares authorised for issue by a majority of the voting power of the capital stock (which, at the date of this document, is a majority of the voting power of the Common Shares). Such authorisation is recorded in the Articles and may only be altered by a requisite vote of such shareholders. Currently, the Company has been authorised to issue a total of 250,000,000 Common Shares, of which 44,407,355 Common Shares are issued, outstanding and fully paid prior to Admission. Please see paragraph 3.2(a) of Part VI of this document for further details of this authority.

In addition, UK companies may impose limits on their borrowing powers by, for example, specifying that borrowed amounts may not exceed a multiple of the company's capital and reserves. Such a limitation is extremely rare for US companies. Therefore, the Company does not have any self-imposed limitations on its ability to borrow funds.

Pre-emptive rights

Companies incorporated under the Companies Act are subject to pre-emption rights on new shares issued by the Company pursuant to section 561 of the Companies Act. These rights provide for existing shareholders to have a right of first refusal on the issue of new shares for cash.

By comparison, the Shareholders do not hold a pre-emptive right to acquire unissued shares under the Massachusetts corporate law, except to the extent so provided for in the Articles or by contract. The Articles do not provide for any pre-emptive rights.

Takeovers

The Company will not be subject to the City Code as it is incorporated in the US and its place of central management and control is outside of the UK, the Channel Islands and the Isle of Man and is not therefore considered resident in the UK for the purposes of the City Code.

Under Massachusetts corporate law, the Directors may evaluate and determine whether or not to pursue a business combination, merger or other takeover proposal. Generally under Massachusetts law, a court will defer to the Directors' "business judgment" in their response to such a proposed transaction. Such "business judgment" presumption leaves the Board with the ability to reject a takeover offer and to take certain actions to position the Company against a takeover in the future. If a plan of merger is adopted by the Directors, it must be approved by the Shareholders, except in certain limited circumstances. Unless otherwise restricted by law or the plan of merger, a business combination may be abandoned by the Company even after receiving the approval of the Shareholders.

The US federal securities laws also regulate certain types of takeover activity. In particular, the Williams Act (which is part of the Exchange Act) regulates tender offers and requires public disclosure, by means of a filing with the US Securities Exchange Commission, of acquisitions of a substantial block of equity securities in a publicly traded company. Many of the provisions of the Williams Act will not apply to the Company unless and until it has a class of shares registered under the Exchange Act.

Limitation of Director liability

While both the Companies Act and Massachusetts corporate law allow for indemnification of directors, the scope of indemnification allowed under Massachusetts corporate law is broader than under the Companies Act. Section 309A of the Companies Act generally prohibits UK companies from exempting directors from, or indemnifying them against, liabilities in instances where the directors are found to be negligent, in default, or in breach of duty or trust (subject to certain recent statutory relaxations, whereby directors may (if a company so chooses) be indemnified against third party proceedings and the costs of defending actions brought against them by the company).

By comparison, the Company's Articles eliminate any monetary liability of directors to the Company or its Shareholders for breaches of fiduciary duty as a director, except (i) for any breach of the director's duty of loyalty to the Company or its Shareholders; (ii) for acts or omissions not in good faith or which involved intentional misconduct or a knowing violation of the law; (iii) in connection with unlawful payments of dividends or in connection with loans to officers and directors as set forth in Sections 61 and 62 of the Massachusetts Business Corporation Law (M.G.L. ch. 156B); or (iv) for any transaction from which the director derived an improper personal benefit.

In addition, the Company's Articles permit the Company to indemnify officers and directors to the fullest extent permitted by law. The Articles provide that the Company will indemnify its directors and officers against all expenses, except (i) for actions determined to not be made in good faith and in the reasonable belief that such action was in the best interests of the Company; (ii) in connection with a criminal matter that the director or officer had reasonable cause to believe such conduct was illegal; and (iii) in connection with an improper personal benefit. With respect to a controversy that is settled or compromised, indemnification may be limited unless a court of competent jurisdiction determines that indemnification is proper. Section 8.52 of the Massachusetts Business Corporation Act requires the Company to indemnify any director against reasonable expenses incurred if such director is wholly successful, on the merits or otherwise, in the defense of any proceeding to which such director was a party because of his or her position as a director.

The Articles provide that the Company will reimburse or advance defense expenses to a director or officer in connection with any such proceeding for which indemnification is allowed, subject to an undertaking by such director or officer to repay such expenses in limited circumstances where indemnification is not granted.

The Company has entered into indemnification agreements with its principal executives and Directors.

Shareholder notifications of interests

As a company incorporated under the laws of the Commonwealth of Massachusetts, the Company is not subject to the provisions of the Disclosure and Transparency Rules and, consequently, Shareholders would not ordinarily be subject to any requirement to disclose to the Company the level of their interests in Common Shares. However, in line with current best practice for companies incorporated outside the UK whose shares are admitted to trading on AIM, the Company has elected to incorporate certain provisions of the Disclosure and Transparency Rules into its By-laws, further details of which are set out in paragraph 3.2(e) of Part VI of this document. It should be noted that the provisions regarding notification of interests in shares contained in the Disclosure and Transparency Rules do not apply to the Company, therefore the Company is not able to rely on such rules for the purposes of satisfying its obligations to publish notifications of relevant changes to its significant shareholders in accordance with Rule 17 of the AIM Rules..

Additional corporate matters

The following provisions of Massachusetts law are generally applicable to the Company, reflected in the Articles, and standard for US corporations, but may not be typical for UK companies:

- in general, the holders of a majority of the stock issued and outstanding and entitled to vote, present in person or represented by proxy, shall constitute a quorum for action at all meetings of the Shareholders;
- the quorum required for action at a meeting of the Board is a majority of the number of directors currently serving on the Board.

A summary of the terms of the Articles and certain other provisions of Massachusetts corporate law are set forth in paragraph 3 of Part VI of this document.

PART V

U.S. RESTRICTIONS ON THE TRANSFER OF PLACING SHARES AND CAPITALISATION SHARES ISSUED TO NON-US PERSONS

Securities Laws

The distribution of this document and the offer of Placing Shares in certain jurisdictions may be restricted by law and therefore persons into whose possession this document comes should inform themselves about and observe any such restriction, including those in the following paragraphs which relate to the United States. Any failure to comply with those restrictions may constitute a violation of the securities laws of any such jurisdiction. This document does not constitute an offer to subscribe for or buy any of the Placing Shares or Capitalisation Shares to any person in any jurisdiction to whom it is unlawful to make any such offer or solicitation in any such jurisdiction.

United States

The Placing Shares have not been, and will not be, registered under the Securities Act or the applicable securities laws and regulations of any state of the United States and may not be offered or sold in the United States or to US persons, except pursuant to an exemption from the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the Company may offer Placing Shares and the Capitalisation Shares only through US registered broker-dealers or individuals or entities exempt from broker-dealer registration requirements under the Exchange Act and applicable state securities laws to persons reasonably believed to be Accredited Investors or to persons outside the United States in "offshore transactions" pursuant to Regulation S.

Each person in the United States considering an investment in the Placing Shares, Capitalisation Shares or Libertas Shares should read this Part V in its entirety.

Each person in the United States who purchases Placing Shares, Capitalisation Shares or Libertas Shares shall be required to make certain representations and warranties and agree to certain matters.

Regulation S Offering

Because the Placing Shares, the Capitalisation Shares and the Libertas Shares are being offered in reliance on Regulation S, and because neither the issue nor the resale of the Placing Shares, Capitalisation Shares or Libertas Shares has been registered under the Securities Act, the Placing Shares, the Capitalisation Shares and the Libertas Shares constitute "restricted securities" as such term is defined in Rule 144 under the Securities Act and shall bear a legend. A subscriber for or a subsequent purchaser of Placing Shares, Capitalisation Shares or Libertas Shares may not offer, sell or otherwise transfer Placing Shares, Capitalisation Shares or Libertas Shares in the United States or to, or for the account or benefit of, any US person, except pursuant to Regulation S, the registration requirements of the Securities Act or an exemption therefrom. Hedging transactions in the Placing Shares, Capitalisation Shares or Libertas Shares may not be conducted, directly or indirectly, unless in compliance with the Securities Act.

In addition to the foregoing, all of the Placing Shares, the Capitalisation Shares and the Libertas Shares are subject to the conditions listed under section 903(b)(3), or Category 3, of Regulation S, including a one-year distribution compliance period. Under Category 3, Offering Restrictions (as defined under Regulation S) must be in place in connection with the Placing and additional restrictions are imposed on re-sales of the Placing Shares, Capitalisation Shares or Libertas Shares as described below.

Prior to one year after the later of (1) the time when the Placing Shares, the Capitalisation Shares and the Libertas Shares are first offered to persons other than distributors in reliance upon Regulations S or (2) the date of closing of the Placing, or such longer period as may be required under applicable law (the "Compliance Period"):

(a) every purchaser of Placing Shares, Capitalisation Shares or Libertas Shares other than a distributor will be required to certify that it is not a US person and is not acquiring the securities for the account or benefit of any US person or is a US person who purchased securities in a transaction that did not require registration under the Securities Act;

(b) every purchaser of the Placing Shares, Capitalisation Shares or Libertas Shares will be required to agree to resell such Placing Shares, Capitalisation Shares or Libertas Shares only in accordance with the provisions of Regulation S, pursuant to registration under the Securities Act or pursuant to an available exemption therefrom; and will be required to agree to not engage in hedging transactions with regard to the securities unless in compliance with the Securities Act;

(c) the Placing Shares, the Capitalisation Shares and the Libertas Shares will contain a legend to the effect that transfer is prohibited except in accordance with the restrictions set forth in (a) and (b) above during the Compliance Period;

(d) each distributor selling securities to a distributor, a dealer (as defined in Section 2(a)(12) of the Securities Act), or a person receiving a selling concession, fee or other remuneration will be required to send a confirmation or other notice to the purchaser stating that the purchase is subject to the same restrictions on offers and sales that apply to a distributor; and

(e) the Company will be required to refuse to register any transfer of the Placing Shares, Capitalisation Shares or Libertas Shares not made in accordance with the provisions of Regulation S or pursuant to registration under the Securities Act or an exemption from registration under the Securities Act.

Additional Representations

In addition to the applicable representations set forth above, each purchaser of Placing Shares, the Capitalisation Shares or Libertas Shares may be required to represent to and agree with, the Company as follows:

(a) the purchaser understands that until such time as the restrictions on transfer set forth herein are no longer applicable, the Placing Shares, Capitalisation Shares or Libertas Shares may remain in certificated form and carry a restrictive legend as specified above;

(b) the purchaser understands that Placing Shares, Capitalisation Shares or Libertas Shares will remain in certificated form and will not be capable of settlement through CREST until expiration of the Restricted Period, and then only upon (A) the Company having made appropriate arrangements through CREST for the issue of depository interests in respect thereof; and (B) delivery of the certificated security certificate to the Principal Registrar, Branch Registrar or UK Transfer Agent (as applicable) together with such evidence as the Company may require (in its sole discretion) to demonstrate that the transfer restrictions set forth in this document are no longer applicable; and

(c) the purchaser acknowledges that the Company, Nominated Adviser and Broker, the Placing Agent and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and warranties and agrees that if any such acknowledgement, representation or warranty deemed to have been made by virtue of its purchase of Placing Shares, Capitalisation Shares or Libertas Shares is no longer accurate, it shall promptly notify the Company, the Placing Agent and Nominated Adviser; and if it is acquiring any Placing Shares, Capitalisation Shares or Libertas Shares as a fiduciary or agent for one or more accounts it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

Additional Matters

All of the Placing Shares, Capitalisation Shares and the Libertas Shares will be "restricted securities" as defined in Rule 144 under the Securities Act. As such, the Placing Shares, Capitalisation Shares and the Libertas Shares may not be resold unless registered under the Securities Act or pursuant to an exemption therefrom. Rule 144 is a well-known exemption that allows the resale of restricted securities if a number of conditions are met, including, without limitation, a holding period, the availability of adequate current information about the Company and compliance with trading volume restrictions. Because the Company is not a reporting company (i.e. it does not have a class of equity securities registered under the Securities Exchange Act of 1934, as amended, and does not file regular reports with the US Securities and Exchange Commission) and does not intend to become a reporting company, the Placing Shares, the Capitalisation Shares and the Libertas Shares may not be eligible for sale under Rule 144 for the foreseeable future. A liquid trading market for the Common Shares does not currently exist in the United States, and the Company does not expect such a market to develop soon.

The Company may impose or modify transfer restrictions and require additional certifications and/or related documentation to evidence a Shareholder's compliance with applicable securities laws and regulations.

PART VI

ADDITIONAL INFORMATION

1. The Company

1.1 The Company was incorporated and registered in the Commonwealth of Massachusetts, USA on 27 March, 1951 with the name Stocker & Yale, Inc. The Company's name was changed to ProPhotonix Limited on 21 June, 2010.

1.2 The Company's registered office in the Commonwealth of Massachusetts is Corporate Filing Solutions, Inc., 425 Boylston Street, 3rd Floor, Boston, Massachusetts 02116, USA and its principal place of business is located at 32 Hampshire Road, Salem, New Hampshire 03079, USA (telephone number: 1 603-893-8778).

1.3 The Company's legal and commercial name at the date of this document is ProPhotonix Limited. The Company is domiciled in the Commonwealth of Massachusetts, USA. The primary legislation under which the Company operates is the Massachusetts Business Corporation Act (M.G.L. ch. 156D).

1.4 In accordance with Massachusetts corporate law, the liability of Shareholders is limited.

2. Share capital of the Company

2.1 The authorised and issued share capital of the Company as at the date of this document and Admission is as set out below. All the issued share capital of the Company is fully paid and non-assessable.

At the date of this document

Authorised *$*	*Number*		*Issued** *Number*	*Issued and fully paid**	*Issued and fully paid* *Number*
250,000	250,000,000	Common Shares of $0.001 each	44,603,528	44,407,355	44,407,355

At Admission (assuming the Placing is fully subscribed)

Authorised *$*	*Number*		*Issued and fully paid*	*Number*
250,000	250,000,000	Common Shares of $0.001 each	52,614,000	52,614,000

*The total issued share capital includes 196,024 uninvested Restricted Stock Awards and a permanent adjustment of 149 shares.

2.2 The following is a summary of the changes in the Company's issued share capital during the period from 1 January, 2007 to the date of this document:

(a) On 26 January, 2007, the Company issued to Smithfield Fiduciary LLC for an aggregate purchase price of $2,300,000 (i) 2,000,000 Common Shares and (ii) a Warrant to purchase 1,000,000 Common Shares at an exercise price of US$1.72 per share. The Warrant expires on the tenth anniversary of the date of issuance.

(b) On 26 January, 2007, Private Opportunities Fund LP exchanged a Warrant dated 13 December, 2004 and the Company issued 30,534 Common Shares. The Warrant was originally exercisable for 250,000 Common Shares at a purchase price of US$1.38 per share.

(c) On 28 February, 2007, Private Opportunities Fund LP exercised a Warrant dated 3 February, 2004 pursuant to a cashless exercise provision and the Company issued 11,087 Common Shares. The Warrant was originally exercisable for 125,000 Common Shares at a purchase price of US$1.50 per share.

(d) On 19 June, 2007, in connection with the amendment of a term loan note, the Company issued to Laurus Master Fund Ltd. an aggregate of 300,000 Common Shares at a per share purchase price of $0.01.

(e) On 25 September, 2007, the Company issued an aggregate of 1,140,741 Common Shares to Mark Hawtin upon the exercise of outstanding Warrants. The aggregate purchase price received by the Company upon the exercise of the Warrants and the issue of the Common Shares was $1,226,666.97.

(f) On 18 October, 2007, the Company issued 214,174 Common Shares as partial consideration for the purchase of substantially all of the assets of Spectrode LLC. The fair market value of the shares was calculated based on the average closing price per share of the Company's Common Shares on the Nasdaq Global Market for the 10 trading day period ending on 17 October, 2007, the trading day prior to the closing of the acquisition.

(g) In connection with the amendment and restatement of certain term loan notes, on 28 December, 2007, the Company issued (i) 75,000 Common Shares at a per share purchase price of $0.01 to PSource Structured Debt Limited, and (ii) 300,000 Common Shares at a per share purchase price of $0.01 to Valens U.S. SPV I, LLC.

(h) During 2007 the Company issued an aggregate of 1,125,780 Common Shares, net of forfeitures, to employees as compensation in the form of restricted grants. Also during 2007, several of the Company's employees exercised at total of 140,752 Options for its Common Shares.

(i) On 4 January, 2008 the Company issued 10,219 Common Shares to an employee upon retirement.

(j) In January, 2008, the Company issued 139,788 Common Shares to BRL Law Group LLC.

(k) On 31 March, 2008, the Company issued an aggregate of 100,000 Common Shares to Laurus Master Fund, Ltd. at a per share purchase price of $0.01.

(l) In April, 2008 the Company issued 200,000 Common Shares to BRL Law Group LLC.

(m) On 30 June, 2008, the Company issued an aggregate of 1,628,664 Common Shares to Valens Offshore SPV II, Corp. in consideration for $960,912.

(n) In July, 2008, the Company issued 19,531 Common Shares.

(o) On 31 October, 2008, the Company issued 616,743 Common Shares to Mr. Hawtin in consideration of Mr. Hawtin's agreement to forego certain principal payments totalling $246,697 due from ProPhotonix UK.

(p) On 24 December, 2008, the Company issued to certain investors an aggregate of 2,254,000 Common Shares at a per share purchase price of $0.25, for aggregate proceeds of $563,500. The investors also received common stock purchase warrants to purchase up to an aggregate of 1,127,000 Common Shares. The Warrants are exercisable at any time at a per share price of $0.50 and expire on the fifth anniversary of the issue date.

Name	*Amount of Investment*	*Number of Shares Purchased*	*Number of Shares Issuable upon Exercise of Warrants*
Mark W. Blodgett	$7,500	30,000	15,000
Raymond Oglethorpe	$50,000	200,000	100,000
Robert Drummond	$3,000	12,000	6,000
Ben Levitan	$3,000	12,000	6,000
Pictet Private Equity Investors S.A.	$500,000	2,000,000	1,000,000
Total:	$563,500	2,254,000	1,127,000

(q) During 2008 the Company cancelled as forfeitures 60,250 Common Shares previously issued as compensation as a result of employee departures.

(r) On 13 January, 2009, the Company issued 1,480,176 Common Shares to Mr. Hawtin in consideration of Mr. Hawtin's agreement to forego certain principal payments totalling $370,044 due from ProPhotonix UK.

(s) On 29 January, 2009, the Company issued Dietmar Klenner 10,000 Common Shares and 5,000 Warrants on the same terms as to other investors in (p) above.

2.3 At the date of this document the Directors are authorised to issue up to 250,000,000 Common Shares.

2.4 The primary legislation under which the Common Shares are governed is the Massachusetts Business Corporation Act (M.G.L. ch. 156D). The Common Shares are in registered form and, subject to the provisions of the CREST Regulations, the Directors may permit the holding of any class (other than Common Shares issued pursuant to Regulation S) of shares in uncertificated form and title to such shares may be transferred by means of a relevant system (as defined in the CREST Regulations). The Registrar is in charge of maintaining the Company's register of members. Where shares are held in certificated form, share certificates will be sent to the registered members by first class post or recognized national courier.

2.5 No Common Shares are currently held in treasury by the Company or held by any other person on its behalf and no Common Shares are currently held by any subsidiary of the Company.

2.6 The Company does not have in issue any shares which do not represent capital.

2.7 The Common Shares the subject of the Placing and the Capitalisation (including the Libertas Shares) are expected to be issued (conditional upon Admission) pursuant to a resolution passed at a meeting of a committee of the Board held on 13 December, 2010.

2.8 Save as set out in paragraphs 2.9, 6.1 and 11.4 of this Part VI, no share or loan capital of the Company is under option or agreed, conditionally or unconditionally, to be put under option.

2.9 At the date of this document, the Warrants granted by the Company in respect of Common Shares which remain outstanding will be as follows:

Warrantholder	*Exercise price per share*	*Date of grant*	*Date first exercisable*	*Date of expiry*	*Number of shares under warrant*
Mark Blodgett	$0.50	24/12/2008	24/12/2008	24/12/2013	15,000
Robert Drummond	0.50	24/12/2008	24/12/2008	24/12/2013	6,000
Mark Hawtin	0.45	25/07/2008	25/07/2008	25/07/2018	636,404
Mark Hawtin	0.60	30/05/2008	30/05/2008	30/05/2018	269,663
Mark Hawtin	0.10	09/06/2009	09/06/2009	09/06/2019	500,000
Dietmar Klenner	0.50	29/01/2009	29/01/2009	29/01/2014	5,000
Eureka Fund	1.15	31/10/2006	31/10/2006	31/10/2016	2,375,000
Laurus Master Fund Ltd.	1.23	24/09/2003	24/09/2003	24/09/2015	225,000
Laurus Master Fund Ltd.	1.34	24/09/2003	24/09/2003	24/09/2015	150,000
Laurus Master Fund Ltd.	1.44	24/09/2003	24/09/2003	24/09/2015	100,000
Laurus Master Fund Ltd.	0.80	13/07/2005	13/07/2005	13/07/2017	150,000
Laurus Master Fund/PSource Ltd.	1.38	08/12/2004	08/12/2004	08/12/2016	50,000
Laurus Master Fund/PSource Ltd.	1.56	20/02/2004	20/02/2004	20/02/2016	375,000
Laurus Master Fund/PSource Ltd.	1.60	08/12/2004	08/12/2004	08/12/2016	33,000
Laurus Master Fund/PSource Ltd.	1.71	08/12/2004	08/12/2004	08/12/2016	12,000
Laurus Master Fund/PSource Ltd.	1.75	20/02/2004	20/02/2004	20/02/2016	250,000
Laurus Master Fund/PSource Ltd.	1.94	20/02/2004	20/02/2004	20/02/2016	75,000
Laurus Master Fund/PSource Ltd.	3.12	10/06/2004	10/06/2004	10/06/2016	400,000
Ben Levitan	0.50	24/12/2008	24/12/2008	24/12/2013	6,000
Oglethorpe Family Limited Partnership	0.50	24/12/2008	24/12/2008	24/12/2013	100,000
Pictet Private Equity Investors	0.50	24/12/2008	24/12/2008	24/12/2013	1,000,000
Smithfield Fiduciary LLC	0.80	13/07/2005	13/07/2005	13/07/2012	18,621
Smithfield Fiduciary LLC	1.38	08/12/2004	08/12/2004	08/12/2011	50,000

Warrantholder (continued)	*Exercise price per share*	*Date of Grant*	*Date first exercisable*	*Date of expiry*	*Number of shares under warrant*
Smithfield Fiduciary LLC	1.60	08/12/2004	08/12/2004	08/12/2011	33,000
Smithfield Fiduciary LLC	1.71	08/12/2004	08/12/2004	08/12/2011	12,000
Smithfield Fiduciary LLC	1.72	26/01/2007	26/01/2007	26/01/2017	1,000,000
Smithfield Fiduciary LLC	3.12	10/06/2004	10/06/2004	10/06/2011	40,000
Total					7,886,688

3. Articles of Organization and By-laws

3.1 In its Articles, the purposes of the Company are "to design, manufacture, assemble and market measuring and inspection instruments and machine components and accessories; and to carry on any other service, business operation or activity which may be lawfully carried out by a corporation organized under the corporate law of the Commonwealth of Massachusetts." in addition, in its most recent annual report for the fiscal year ending 31 December, 2009, which was filed with the Commonwealth of Massachusetts on 21 April, 2010, the business of the Company was described as "LED and diode sales."

3.2 The Articles and By-laws contain provisions, *inter alia*, to the following effect:

(a) Capital structure

The Company has one class of capital stock authorized, the Common Shares. The Directors are authorized to issue up to 250,000,000 Common Shares (common stock, par value $0.001 per share). Such authority arises from, (i) the current 100,000,000 Common Shares authorized for issuance pursuant to the Articles; and (ii) a vote of the Shareholders at the Company's annual meeting of Shareholders on 27 May, 2010. At the annual meeting, the Shareholders granted the Directors the discretionary authority to, at any time and from time to time until the next annual meeting of Shareholders, amend the Articles and increase the authorized Common Shares by up to an additional 150,000,000 shares. As a result, the Directors have the authority to issue up to 250,000,000 Common Shares.

(b) Voting rights

In accordance with Massachusetts corporate law, the By-laws state that each share is entitled to one vote and partial shares, if any, are entitled to a proportional vote. Only shares of capital stock of the Company are entitled to a vote. The holders of a majority in interest of all capital stock issued and outstanding and entitled to vote at a meeting constitutes a quorum to conduct business at such meeting. Unless required by law, all matters before the Shareholders shall be decided by the vote of the holders of a majority of the shares voting. Massachusetts corporate law delineates certain matters that require a greater percentage of affirmative votes.

(c) Transfer of shares

The Articles do not address restrictions on the transfer of Common Shares. Nevertheless, such restrictions may be imposed by the Articles, the By-laws or by contract. The By-laws provide that the Company shall register no transfer of Common Shares unless such transfer is made in compliance with the registration requirements of the US Securities laws or an exemption therefrom.

(d) Dividends and other distributions

Dividends and other distributions are governed by Massachusetts corporate law. Such provisions are not addressed in the Articles. Generally, distributions may not be be made if the Company is not a going concern, or if after the distribution is declared, the Company would be unable to pay its existing and reasonably foreseeable debts, liabilities and obligations.

(e) Disclosure of Significant Shareholding

The By-laws provide that a person must notify the Company of the percentage of all the voting rights attributable to the issued and outstanding Common Shares which are exercisable at a meeting of Shareholders at the relevant time (the "Voting Rights") if the percentage of Voting Rights which he holds directly or indirectly as a Shareholder or through his direct or indirect holding of financial instruments as set out in the Disclosure and Transparency Rules (or a combination of such holdings): (a) reaches, exceeds or falls below 3 per cent. and each 1 per cent. threshold thereafter up to 100 per cent.; or (b) reaches, exceeds or falls below an applicable threshold in sub-paragraph (a) as a result of events changing the breakdown of Voting Rights and on the basis of information disclosed by the Company in accordance with the requirements of the Disclosure and Transparency Rules (together, a "Notifiable Interest"). In addition, the Board may serve a disclosure notice ("Disclosure Notice") in writing on any Shareholder whom the Board knows, or has reasonable cause to believe, to hold a Notifiable Interest, requiring such Shareholder to indicate in writing whether or not such Shareholder holds a Notifiable Interest and, where that person holds a Notifiable Interest, to give such further information in respect of such Notifiable Interest as may be required by the Board. If a Disclosure Notice has been served on a Shareholder and the Company has not received the information required in respect of the specified Common Shares in writing within a period of fourteen days after the service of the Disclosure Notice, then the Board may apply certain restrictions on the specified Common Shares.

(f) Winding up

Voluntary dissolution of the Company is not addressed in the Articles. As a result, Massachusetts corporate law governs voluntary and involuntary dissolution and winding up. The Shareholders would have to approve any resolution by the Directors to voluntarily dissolve.

(g) Changes in capital

Changes in capital are not addressed by the Articles. Massachusetts corporate law permits the Directors to issue that number of shares of capital stock authorized by the Shareholders. Changes in the capital structure of the Company must be approved by the Shareholders.

(h) Redemption/Purchase of Shares

The Articles do not address redemption of capital stock. Under Massachusetts corporate law, the Company may acquire its own shares. Because the Articles do not prohibit the reissuance of shares so acquired, those shares, when acquired, would constitute authorized but unissued shares that are eligible for issuance.

(i) Variation of class rights

At this time, the Company has authorized only one class of capital stock, the Common Shares. Massachusetts corporate law provides generally that alterations of the rights of a class of capital stock would require authorization by the affected class.

(j) General meetings

Meetings of the Shareholders may be held anywhere in the United States. All other aspects of shareholder meetings are currently governed by applicable Massachusetts corporate law.

(k) Borrowing powers

The Company is empowered to borrow without restriction under the Articles.

(l) Directors

See Part IV with respect to the limitation of liability and indemnification of Directors. The business of the Company is managed by the Directors. According to the By-laws, the number of Directors is determined by the Shareholders at the annual meeting of Shareholders. That number may not be less than three, unless there are fewer than three Shareholders. Directors need not be Shareholders and are elected by a plurality of votes of the Common Shares at each annual meeting. Directors, unless they resign or removed, are elected and serve until the next annual meeting of Shareholders and until their successor is chosen and qualified. Vacancies on the board of directors may be filled by the remaining Directors and the replacement serves until the expiration of the term of the replaced Director. At any meeting of the board of Directors, a majority of the Directors then in office constitutes a quorum to conduct business.

(m) *Gratuities and pensions*

None of the Articles or By-laws address gratuities and pensions.

4. Directors' interests in the Company

4.1 The interests of the Directors, their immediate families and the persons connected with them within the meaning of section 252 of the Companies Act, all of which are beneficial, in the issued ordinary share capital of the Company as at the date of this document and at Admission are and will be as follows:

As at the date of this document

Director	*Number of Common Shares*	*Percentage of issued share capital*
Mark Blodgett	2,587,173	5.83%
Timothy Losik	150,000	0.34%
Dietmar Klenner	91,878	0.21%
Raymond Oglethorpe	469,227	1.06%
Duncan Byatt	70,000	0.16%

At Admission

Director	*Number of Common Shares*	*Percentage of issued share capital*
Mark Blodgett	2,587,173	4.92%
Timothy Losik	150,000	0.29%
Dietmar Klenner	91,878	0.17%
Raymond Oglethorpe	469,227	0.89%
Duncan Byatt	70,000	0.13%

In addition the Directors between them hold Options, Warrants or other convertible securities to subscribe for a total of 4,099,908 new Common Shares as more particularly described in paragraphs 2.9 and 6.1 of this Part VI of this document. Restricted stock awards ("RSA") that have not yet vested are deemed outstanding and are therefore included in the number of common shares reported as beneficially owned by the Directors in this paragraph 4.1. As at the date of this document, Directors held 141,774 of these.

4.2 Save as disclosed in this paragraph 4, none of the Directors, nor any member of their respective immediate families, nor any person connected with them within the meaning of section 252 of the Companies Act, is or, immediately following Admission, will be interested in any share capital of the Company.

4.3 There are no outstanding loans granted or guarantees provided by the Company to or for the benefit of any of the Directors.

4.4 No Director has any interest, whether direct or indirect, in any transaction which is or was unusual in its nature or conditions or significant to the business of the Company taken as a whole and which was effected by the Company during the current or immediately preceding financial year, or during any earlier financial year and which remains in any respect outstanding or unperformed.

5. Major Shareholders

5.1 Save as disclosed in this paragraph 5 the Directors are not aware of any person (other than the Directors, as set out in paragraph 4.1 above) who, directly or indirectly, jointly or severally at the date of this document and at Admission is or will be interested in 3 per cent. or more of the issued share capital or the enlarged issued share capital of the Company.

As at the date of this document

Shareholder	*Number of Common Shares*	*Percentage of issued share capital*
Lewis Asset Management	6,221,598	14.01%
Empire Capital Management	5,492,500	12.37%
Anthony Marchese	2,173,051	4.89%
GAM Fund Management	2,120,000	4.77%
Mark Hawtin	2,096,919	4.72%
Pictet Private Equity Investors	2,000,000	4.50%

At Admission

Shareholder	*Number of Common Shares*	*Percentage of issued share capital*
Lewis Asset Management	6,221,598	11.82%
Mark Hawtin	6,128,565	11.65%
GAM Fund Management	5,870,000	11.16%
Empire Capital Management	5,492,500	10.44%
Anthony Marchese	2,173,051	4.13%
Pictet Private Equity Investors	2,000,000	3.80%

5.2 No major Shareholder has any different voting rights to the other holders of Common Shares.

5.3 So far as the Directors are aware the Company is not directly or indirectly controlled by any person.

This part intentionally left blank

6. Options and Stock Option Plans

6.1 At the date of this document the Directors hold Options to subscribe for Common Shares as follows:

Optionholder	*Exercise price per share*	*Date of grant**	*Date of expiry***	*Number of shares under option*
Mark Blodgett	$11.75	02/04/2001	02/04/2011	310,000
Mark Blodgett	$4.85	15/05/2002	15/05/2012	125,400
Mark Blodgett	$0.73	01/10/2002	01/10/2012	74,000
Mark Blodgett	$1.30	06/01/2003	06/01/2013	101,000
Mark Blodgett	$0.63	15/08/2004	15/08/2014	99,000
Mark Blodgett	$2.06	17/05/2004	17/05/2014	20,000
Mark Blodgett	$1.22	30/07/2004	30/07/2014	200,000
Mark Blodgett	$0.25	16/12/2008	16/12/2018	168,000
Mark Blodgett	$0.16	16/01/2009	16/01/2019	266,650
Mark Blodgett***	$0.11	04/05/2010	04/05/2020	1,000,000
Duncan Byatt	$0.25	19/04/2010	19/04/2020	29,166
Duncan Byatt	$0.08	27/05/2010	27/05/2020	140,000
Duncan Byatt	$0.12	29/06/2010	29/06/2020	75,000
Dietmar Klenner	$0.67	02/09/2003	02/09/2013	10,000
Dietmar Klenner	$2.06	17/05/2004	17/05/2014	20,000
Dietmar Klenner	$0.69	02/06/2008	02/06/2018	72,463
Dietmar Klenner	$0.08	27/05/2009	27/05/2019	72,463
Dietmar Klenner***	$0.11	04/05/2010	04/05/2020	174,926
Dietmar Klenner	$0.08	27/05/2010	27/05/2020	140,000
Timothy Losik	$0.16	16/12/2008	16/12/2018	100,000
Timothy Losik	$0.16	16/01/2009	16/01/2019	100,000
Timothy Losik***	$0.11	04/05/2010	04/05/2020	200,000
Ray Oglethorpe	$12.50	31/05/2001	31/05/2011	11,500
Ray Oglethorpe	$3.98	22/05/2002	22/05/2012	11,500
Ray Oglethorpe	$0.67	22/05/2003	22/05/2013	5,500
Ray Oglethorpe	$0.67	02/09/2003	02/09/2013	6,000
Ray Oglethorpe	$2.06	17/05/2004	17/05/2014	25,000
Ray Oglethorpe	$0.69	02/06/2008	02/06/2018	79,710
Ray Oglethorpe	$0.08	27/05/2009	27/05/2019	79,710
Ray Oglethorpe***	$0.11	04/05/2010	04/05/2020	242,920
Ray Oglethorpe	$0.08	27/05/2010	27/05/2020	140,000

* Granted pursuant to the 2000, 2004 and 2007 Company Stock Option Plans summarised at paragraph 6.3 of this Part VI.

** Grants vest over 4 years at 25 per cent. per year.

*** Grants vest on the sixth month of issue.

6.2 As at the date of this document, Options exercisable over 3,282,286 Common Shares at an average price of $1.68 per share are held by current and former employees of the Group. These options may be exercised in whole or in part at any time until May 2020. To the extent not exercised by that date they will lapse and cease to be capable of exercise thereafter.

6.3 The Company has Options issued under three incentive plans, (i) the 2000 Stock Option and Incentive Plan (the "2000 Plan"); (ii) the 2004 Stock Option and Incentive Plan (the "2004 Plan"); and (iii) the 2007 Stock Incentive Plan (the "2007 Plan" and each a "Plan" and collectively, the "Plans"). The 2000 Plan and the 2004 Plan have each been superseded and replaced by the 2007 Plan and the Company has resolved not to grant any further awards under any prior Plan. The following summary, unless otherwise noted, refers to the 2007 Plan.

(a) General

Historically, the Company has rewarded the contribution that its directors, officers, employees and consultants have made to its business by granting awards pursuant to the Plans. Each of the Plans is an omnibus incentive plan authorizing a range of equity incentives that may be awarded by the Directors or a designated committee thereof, subject to applicable law and Plan restrictions.

(b) Eligibility

Company employees, directors, consultants, officers and advisors.

(c) Grant of Options

The Plan is administered by the Directors who have the authority to grant awards and to adopt, amend and repeal such administrative rules, guidelines and practices relating to the Plan as they deem advisable. The Directors may correct any defect, supply any omission or reconcile any inconsistency in the Plan or any award in the manner and to the extent they deem expedient to carry the Plan into effect and the Directors shall be the sole and final judge of such expediency. All decisions by the Directors shall be made in their sole discretion and shall be final and binding. No Director or person acting pursuant to the authority delegated by the Board shall be liable for any action or determination relating to or under the Plan made in good faith. Such powers, to the extent permitted by applicable law, may be delegated to one or more committees or subcommittees of the board of directors. In addition, the Directors may, to the extent permitted by applicable law, delegate to one or more executive officers of the Company the power to grant awards to employees or officers of the Company or any of its present or future subsidiary corporations and to exercise such other powers under the Plan as the Directors may determine; provided that the Directors shall fix the terms of the awards to be granted by such executive officers (including the exercise price of such awards, which may include a formula by which the exercise price will be determined) and the maximum number of shares subject to awards that the executive officers may grant; provided further, however, that no executive officer shall be authorized to grant awards to any "executive officer" of the Company (as defined by Rule 3b-7 under the Exchange Act).

(d) Price

The exercise price per share of each award shall not be less than the closing price per share of the Common Stock as reported on the Nasdaq Global Market on the date of grant (or other market or exchange on which the Company's securities are listed or quoted for trading).

(e) Exercise of Options

Each award is exercisable at such times and subject to such terms and conditions as the Directors may specify in the applicable award agreement. Awards may be exercised by delivery to the Company of a written notice of exercise signed by the proper person or by any other form of notice (including electronic notice) approved by the Directors together with payment in full, as specified in the Plan, including, without limitation, appropriate tax withholding, for the number of shares for which the award is exercised.

(f) Limits of the Plan

(i) *No Right To Employment or Other Status.* No person shall have any claim or right to be granted an award, and the grant of an award shall not be construed as giving a participant the right to continued employment or any other relationship with the Company. The Company expressly reserves the right at any time to dismiss or otherwise terminate its relationship with a participant free from any liability or claim under the Plan, except as expressly provided in the applicable award.

(ii) *No Rights As Shareholder.* Subject to the provisions of the applicable award, no person shall have any rights as a shareholder with respect to any Common Shares distributed with respect to an award until becoming the record holder of such shares.

(iii) *Term of Plan.* No awards shall be granted under the Plan after the completion of ten years from the earlier of (i) the date on which the Plan was adopted by the board of directors or (ii) the date the Plan was approved by the Company's shareholders, but awards previously granted may extend beyond that date.

(g) *Acceleration*

The Directors may at any time provide that any award shall become immediately exercisable in full or in part, free of some or all restrictions or conditions, or otherwise realizable in full or in part, as the case may be.

(h) *Rights attaching to New Common Shares*

The participants in the Plan have no pre-emptive or other rights to new Common Shares.

(i) *Amendment*

The Directors may amend, suspend or terminate the Plan or any portion thereof at any time, provided that no such amendment, suspension or termination shall affect any rights of participants under any awards previously granted.

(j) *Provisions for Foreign Participants.*

The Board may modify awards granted to participants who are foreign nationals or employed outside the United States or establish subplans or procedures under the Plan to recognize differences in laws, rules, regulations or customs of such foreign jurisdictions with respect to tax, securities, currency, employee benefit or other matters.

7. Directors' Service Agreements/Letters of Appointment

7.1 Mark Blodgett

Mr. Blodgett entered into a service agreement with the Company on 13 December, 2010. The terms of the agreement provide for (*inter alia*): (i) a salary of $410,000 (ca. £273,333) per annum. Mark Blodgett voluntarily agreed to a 10 per cent. reduction to his contractual salary entitlement effective from 1 January, 2009 and was paid $369,000 (ca. £246,000) for the financial year ended 31 December, 2009. This reduction is expected to continue for at least the current financial year, (ii) a bonus calculated and payable at the absolute discretion of the Board, (iii) termination on twelve months' notice by either party or summarily by the Company if Mr. Blodgett is, among other things, guilty of gross misconduct, (iv) private medical insurance, and (v) 20 days holiday per annum. Mr. Blodgett is subject to certain restrictive covenants. The agreement provides for Mr. Blodgett (a) to be paid his base salary for the 12 month notice period upon termination of his employment; and (b) to be paid 12 months salary and benefits if his employment is terminated by the Company without cause or by him with good reason (as defined therein) in the 12 month period following a change of control.

7.2 Timothy Losik

Mr. Losik is an employee of the Company. Tim Losik voluntarily agreed to a 10 per cent. reduction to his contractual salary entitlement effective from 1 May, 2009 and was paid $188,300 (ca. £125,533) for the financial year ended 31 December, 2009; his current salary is $180,000 per annum. This reduction is expected to continue for at least the current financial year. Mr Losik's employment can be terminated at will on immediate notice. In connection with his employment Mr Losik may receive a bonus calculated and payable at the absolute discretion of the Board. He also receives private medical insurance, and is entitled to 20 days holiday per annum.

7.3 Dietmar Klenner

Mr. Klenner was appointed in 2008 and on 13 December, 2010 entered into a letter of appointment. He is paid a fee of $50,000 annually in cash and shares, subject to review by the Directors in accordance with the letter of appointment. The cash portion of $15,000 is to be paid quarterly in advance. Additionally he will receive options with an exercise amount of $35,000 and a strike price set at fair market value on the day of grant. Mr. Klenner's appointment is for an initial period until the next annual general meeting of Shareholders and is terminable at any time on 1 months' notice by either party. Mr. Klenner is subject to certain restrictive covenants. The letter of appointment does not provide for any benefits to be given to Mr. Klenner upon termination of his appointment.

7.4 **Raymond Oglethorpe**

Mr. Oglethorpe was appointed in 2000 and on 13 December, 2010 entered into a letter of appointment. He is paid a fee of $50,000 annually in cash and shares, subject to review by the Directors in accordance with the letter of appointment. The cash portion of $15,000 is to be paid quarterly in advance. Additionally he will receive options with an exercise amount of $35,000 and a strike price set at fair market value on the day of grant. Mr. Oglethorpe's appointment is for an initial period and is terminable at any time on 1 months' notice by either party. Mr. Oglethorpe is subject to certain restrictive covenants. The letter of appointment does not provide for any benefits to be given to Mr. Oglethorpe upon termination of his appointment.

7.5 **Duncan Byatt**

Mr. Byatt was appointed in April, 2010 and entered into a of appointment dated 13 December, 2010. He is paid a fee of $50,000 annually in cash and shares, subject to review by the Directors in accordance with the letter of appointment. The cash portion of $15,000 is to be paid quarterly in advance. Additionally he will receive options with an exercise amount of $35,000 and a strike price set at fair market value on the day of grant. Mr. Byatt's appointment is for an initial period until the next annual general meeting of Shareholders and is terminable at any time on 1 months' notice by either party. Mr. Byatt is subject to certain restrictive covenants. The letter of appointment does not provide for any benefits to be given to Mr. Byatt upon termination of his appointment.

7.6 Save as disclosed in paragraphs 7.1 and 7.2 of Part VI, there are no arrangements under which any Director has agreed to waive or vary future emoluments nor have there been any waivers or variations of such emoluments during the financial year immediately preceding the date of this document.

7.7 The aggregate remuneration and benefits in kind paid to the Directors for the financial period ending 31 December, 2009 was approximately $1,000,000. It is estimated that under the agreements currently in force, the aggregate remuneration and benefits in kind to be paid to the Directors for the financial period ended 31 December, 2010 will be approximately $900,000.

8. Additional Information on the Board

8.1 Aside from directorships held within the Group the Directors hold or have held the following directorships or been a partner in the following partnerships within the five years prior to the date of this document:[5]

Name of Director	*Current Directorships*	*Past Directorships*
Mark Blodgett	None	None
Timothy Losik	None	None
Dietmar Klenner	None	Argus Wealth Management KS Securities Meridian Global Advisors LLC
Raymond Oglethorpe	Oglethorpe Holdings Investment	Artifact Software Development Bridgevine Internet Marketing
Duncan Byatt	Carse Estate Limited DB Property Development Limited	Eagle & Dominion Fund Management

8.2 On 24 May, 2005, the US Securities and Exchange Commission gave final approval to a settlement resolving an SEC investigation in relation to the Company and Mark Blodgett. The SEC found that the Company and Mark Blodgett had failed to take adequate steps to verify the accuracy of certain material information contained in two press releases relating to a customer order issued by the Company on 19 and 21 April, 2004 which were inaccurate and was also critical of certain sales of Common Shares by Mark Blodgett that took place at that time. Both the Company and Mark Blodgett consented to the entry of an SEC order without admitting or denying wrongdoing and, as part of this, Mark Blodgett consented to the payment of certain sums relating to the sales and also a civil penalty. The Company also agreed to follow formal processes thereafter with respect to public communications, share dealing by directors and others and corporate governance. The Company has subsequently implemented strong corporate governance policies and practices and currently has a 97.8 per cent. Corporate Governance Quotient, as determined by International Shareholder Services.

8.3 Save as disclosed above none of the Directors has:

(a) any unspent convictions in relation to indictable offences;

(b) had any bankruptcy order made against him or entered into any voluntary arrangements;

(c) been a director of a company which has been placed in receivership, compulsory liquidation, creditors' voluntary liquidation, administration, been subject to a voluntary arrangement or any composition or arrangement with its creditors generally or any class of its creditors whilst he was a director of that company or within the 12 months after he ceased to be a director of that company;

(d) been a partner in any partnership which has been placed in compulsory liquidation, administration or been the subject of a partnership voluntary arrangement whilst he was a partner in that partnership or within the 12 months after he ceased to be a partner in that partnership;

(e) been the owner of any assets or a partner in any partnership which has been placed in receivership whilst he as a partner in that partnership or within the 12 months after he ceased to be a partner in that partnership;

(f) been publicly criticised by any statutory or regulatory authority (including designated professional bodies);

(g) been disqualified by a court from acting as a director of any company or from acting in the management or conduct of the affairs of a Company; and

(h) had a name other than his/her existing name.

9. Details of Subsidiaries

The Company, which is the parent company of the Group, has the following directly or indirectly held wholly owned subsidiary undertakings:

Name	*Country of registration or incorporation*	*Nature of business*	*Type of shares held*	*Proportion of shares and voting rights held*
StockerYale (UK) Limited	England and Wales, U.K.	Holding company	Ordinary	100%
ProPhotonix Limited	England and Wales, U.K.	Operating company	Ordinary	100%
ProPhotonix U.K. Shell Limited	England and Wales, U.K.	Shell company	Ordinary	100%
ProPhotonix (Irl) Limited	Republic of Ireland	Operating company	Ordinary and Preference	100%
Lasiris Holdings, Inc.	Canada	Shell company	Ordinary	100%
StockerYale Canada Inc.	Canada	Shell company	Ordinary	100%
StockerYale Waterloo Acquisition, Inc.	Canada	Shell company	Ordinary	100%

10. Employees

The number of the Group's permanent employees at the end of each of the last three financial years, the last of which ended 31 December, 2009 are as follows:

Financial period end	*Number of employees*
31 December, 2007	83
31 December, 2008	71
31 December, 2009	71

11. Material contracts

The following section contains summaries of the principal terms of material contracts (not being contracts entered into in the ordinary course of business) entered into by any member of the Group within the two years immediately preceding the date of this document and any other contracts (not being contracts entered in to the ordinary course of business) entered into by any member of the Group which contains any provision under which any member of the Group has any obligation or entitlement which is material to the Group as at the date of this document:

11.1 *Placing Agreement*

On 20 December, 2010 the Company entered into the Placing Agreement with Libertas and the Directors pursuant to which Libertas has agreed to use its reasonable endeavours to procure subscribers for the Placing Shares at the Placing Price. The Placing Agreement is conditional, *inter alia*, on the issued and to be issued Common Shares being admitted to AIM by no later than 31st January, 2011.

In consideration of its services in connection with Admission and the Placing, the Company will pay Libertas a corporate finance fee of £150,000 of which £140,000 is payable in cash and £10,000 payable in shares at the Placing Price through the issue of 50,000 New Common Shares, and a commission of 6 per cent. on the aggregate subscription price of the Placing Shares at the Placing Price in relation to shares placed with investors introduced by Libertas. In addition, pursuant to a warrant instrument dated 20 December, 2010, Libertas have been granted warrants to subscribe for Common Shares exercisable for a period of 5 years. The total number of warrants will be equal to 2 per cent. of the shares forming part of the Placing and the exercise price will be equal to the Placing Price.

The Placing Agreement contains warranties given by the Company and the Directors as to the accuracy of the information contained in this document and other matters relating to the Company and its business. The liability of the Directors under these warranties is limited in time and amount. In addition, the Company has given indemnities to Libertas in respect of certain matters. Libertas is entitled to terminate the Placing Agreement prior to Admission, principally in the event of a breach of the Placing Agreement or of any of the warranties contained in it or if an event of *force majeure* arises.

11.2 *Nominated Adviser and Broker Agreement*

On 20 December, 2010 the Company entered into an agreement with Libertas, pursuant to which the Company appointed Libertas to act as nominated adviser and broker to the Company for a fixed period of one year from the date of the agreement and thereafter subject to termination on the giving of 3 months' notice by either party. In consideration of its services, the Company will pay Libertas an annual retainer of £40,000.

11.3 *Lock-in Agreements*

Pursuant to agreements dated 20 December, 2010 made between the Company, Libertas and the Directors, the Directors have agreed, save in the certain limited circumstances described below, not to dispose of any Common Shares for a period of 12 months from Admission and, for the next following period of 12 months, not to dispose of any Common Shares other than through the Company's broker from time to time.

Certain disposals are permitted including: (i) the acceptance of a general offer (or an agreement or undertaking to accept such an offer) for the share capital of the Company made in accordance with the City Code, or the execution of an irrevocable undertaking to accept such an offer; (ii) a transfer to a trustee to create a new settlement or a beneficiary under a trust, the beneficiaries of which are the relevant Director and/or a member of the relevant Director's family; and (iii) a disposal on death.

11.4 ***Libertas Warrant Instrument***

By a warrant instrument dated 20 December, 2010, the Company created and issued 82,500 Warrants to Libertas each of which entitles the holder to subscribe for one Common Share in cash at a price of 20 pence per Common Share at any time from Admission to and including fifth anniversary of Admission.

11.5 ***Sale of StockerYale Assets***

On 13 October, 2009, the Company entered into a purchase and sale agreement with StockerYale Canada, Inc., a wholly-owned subsidiary of the Company, and Coherent, Inc. ("Coherent") principally providing for the sale of substantially all of the assets of StockerYale Canada, Inc. ("SYC") and its specialty optical fiber ("SOF") business (collectively, SYC and SOF, the "Businesses"). The purchase price consisted of a cash payment of $15,000,000 by Coherent to the Company and SYC, and assumption by Coherent of certain liabilities of the Company and SYC, which includes approximately $3,400,000 of accounts payable and the obligations of the Company and SYC under the contracts transferred to Coherent with respect to the Businesses. A portion of the cash payment (approximately $750,000) was held in escrow and was received on 13 October, 2010. The Company and SYC also agreed not to compete with the Businesses, as described in the Purchase Agreement, for five years. Certain indemnification obligations of the Company will survive the expiration of the escrow period.

11.6 ***Barclays Invoice Discounting Agreement***

On 6 February, 2008 ProPhotonix UK entered into a revolving invoice discounting agreement with Barclays Bank Plc ("Barclays") for a minimum three year period. The Invoice Discounting Agreement grants a security interest in and lien upon all of ProPhotonix UK trade receivables in favour of Barclays. The proceeds from this line of credit were used to pay in full the outstanding amount of a then existing overdraft facility between ProPhotonix UK and Barclays.

The Invoice Discounting Agreement requires the maintenance of certain financial covenants including annual sales and minimum tangible net worth. Barclays also reserves the right to review the Invoice Discounting Agreement in the event of losses in any three month rolling period. On 26 June, 2009, ProPhotonix UK agreed to amend the terms of the Agreement with Barclays. Under the amended terms, the maximum amount allowed outstanding under the line of credit was reduced to £650,000 ($1,035,000 USD). On 18 February, 2010, the Company entered into an amendment to the revolving credit facility agreement, which removed the minimum tangible net worth requirement of £350,000 ($523,000 USD) as of 31 March, 2010 and 30 June, 2010. The amendment further states that if ProPhotonix UK's net worth did not increase in line with projections as provided to Barclays on 18 January, 2010, then Barclays may in its sole discretion review the terms on which it continues to make the facility available. The outstanding principal under the note accrues interest at an annual rate of 2.65 per cent. above Barclays base rate.

On 25 November, 2010, ProPhotonix UK and Barclays extended the minimum term of the Invoice Discounting Agreement to 25 May, 2012.

ProPhotonix U.K. may elect to prepay amounts due under the facility at any time, in whole or in part, upon 3 months notice. If the prepayment amount comes before the end of the "Minimum Period of the Agreement", Barclays reserves the right to charge fees in accordance with the terms and conditions of the agreement.

11.7 ***ProPhotonix UK Acquisition Agreement and ProPhotonix Bonds***

Pursuant to a stock purchase agreement ("ProPhotonix UK SPA") dated 31 October, 2006 between Antony Brian Pope, Johanna Pope and Damon Cookman (together, the "ProPhotonix UK Shareholders"), the Company and ProPhotonix Holdings, the ProPhotonix UK Shareholders sold the entire issued share capital of ProPhotonix UK to the Company and ProPhotonix Holdings in consideration for cash, shares and ProPhotonix Bonds issued by ProPhotonix

Holdings to each of the ProPhotonix UK Shareholders with an aggregate principal amount equal to US$2,400,000 in the following proportions US$1,296,000 to Johanna Pope, US$864,000 to Antony Pope; and US$240,000 to David Cookman, each pursuant to instruments in the same form made on 31 October, 2006 as amended by the deed of variation dated 7 October, 2009. Under the ProPhotonix UK SPA, ProPhotonix Holdings covenants to the ProPhotonix UK Shareholders that until such time as the ProPhotonix Bonds are redeemed in full, unless it first obtains the written consent of the ProPhotonix UK Shareholders, ProPhotonix Holdings shall not (a) incur or create any indebtedness, (b) sell or in any way encumber any of its assets, or (c) or allow ProPhotonix UK to sell or in any way encumber any of its assets (save in the normal course of trading) and the ProPhotonix UK Shareholders are subject to a non-competition restrictive covenant until 31 October, 2011.

Pursuant to the deed of variation dated 7 October, 2009, the original parties to the ProPhotonix UK SPA agreed to vary certain of the deferred payment provisions contained in the ProPhotonix UK SPA as follows: (a) to pay Johanna Pope on account of the $1,070,400 owed on the date of this document pursuant to the bond issued to her: (i) monthly payments of US$28,200 from 30 November, 2009 until and including 31 October, 2010; (ii) monthly payments of simple interest on the balance of the capital sum outstanding of 7 per cent. per annum from 30 November, 2009 until 30 November, 2010; and (iii) the sum of US$957,600 on 30 November, 2010; and (b) to pay Antony Pope on account of the $713,600 owed on the date of this document pursuant to the bond issued to him: (i) monthly payments of US$18,800 from 30 November, 2009 until and including 31 October, 2010; (ii) monthly payments of simple interest on the balance of the capital sum outstanding of 7 per cent. per annum from 30 November, 2009 until 30 November, 2010; and (iii) the sum of US$638,400 on 30 November, 2010; and (iv) in the event that the Company, prior to 30 November, 2010, completes an equity financing from investors who are not current or then current board members, officers, 5 per cent. stockholders or lenders of the Company or its subsidiaries, then 25 per cent. of the net proceeds received by the Company shall be used to pre-pay the outstanding balance under the ProPhotonix Bonds, on a pro rata basis.

On 30 October, and 14 December, 2010, the Company and the holders of the ProPhotonix Bonds entered into Deeds of Variation of the ProPhotonix Bonds. The amendments required a payment on 30 October, 2010 against the principal balance in the amount of $150,000. The ProPhotonix Bonds are amended to amortise the outstanding balance as of 31 October, 2010 monthly over the period from 30 November, 2010 through 30 November, 2012 at the rate of $50,000 principal plus simple interest at 11 per cent. per annum. On 31 December, 2012 the remaining balance (approximately $243,000) of the Prophotonix Bonds shall be payable in full. The Key repayment terms of the ProPhotonix Bonds, under this amendment, are as follows:

(a)	Principal:	$1,493,000
(b)	Interest Rate:	11 per cent.
(c)	Repayment term:	31 October, 2010 to 30 November, 2012
(d)	Monthly principal:	$50,000
(e)	Monthly interest:	Simple interest on the outstanding balance each month
(f)	Balloon payment:	$243,000; 31 December, 2012

11.8 ***Secured Bonds Issued to Mark Hawtin by ProPhotonix Holdings and ProPhotonix Ireland***

ProPhotonix Holdings Secured Bond

By a resolutions of the Board passed on 31 October, 2006, ProPhotonix Holdings created and issued a $4,750,000 of 10 per cent. Senior Fixed Rate Secured Bond (the "ProPhotonix Holdings Secured Bond") to The Eureka Interactive Fund Limited ("Eureka") pursuant to an instrument made on 31 October, 2006 and in connection with this (i) ProPhotonix Holdings and the Company granted Eureka a security interest in all the shares of ProPhotonix Products held by ProPhotonix Holdings and the Company pursuant to a charge dated 31 October, 2006 (the "Charge Over Shares"); and (ii) the Company issued a common stock purchase warrant dated 31 October, 2006 to Eureka to purchase 2,375,000 shares of common stock of the Company for a purchase price of US$1.15 per share (the "Warrant"). Pursuant to the transfer agreement dated 16 August, 2007 Eureka assigned all its rights in the ProPhotonix Holdings Secured Bond, the Charge Over Shares and the Warrant to Mark Hawtin. On 30 May, 2008, Mr. Hawtin agreed to amend the ProPhotonix Holdings Secured Bond increasing the principal amount to US$4,903,646 and advancing an additional US$500,000 to ProPhotonix UK under the bond. In connection with the amendment, the Company issued to Hawtin a warrant to purchase 269,663 Common Shares at an exercise price of US$0.60 per share (the "Amendment Warrant"). The Amendment Warrant has substantially the same terms and conditions as the Warrant and is in substantially the same form as the Warrant. On 31 October, 2008, Mr. Hawtin agreed to a further amendment of the ProPhotonix Holdings Secured Bond. Mr. Hawtin agreed to forego the principal payments of $61,674 per month under the ProPhotonix Holdings Secured Bond for four months; a forbearance totaling $246,697. In consideration of Mr. Hawtin's forbearance, the Company issued Mr. Hawtin 616,743 Common Shares. On 13 January, 2009, the Company issued 1,480,176 Common Shares to Mr. Hawtin in consideration of Mr. Hawtin's agreement to forego certain principal payments totalling $370,044 due from ProPhotonix Holdings. On 9 June, 2009, ProPhotonix Holdings and ProPhotonix Ireland entered into a transfer agreement to, among other things, transfer US$1,000,000 in principal amount from the ProPhotonix Holdings Secured Bond to the ProPhotonix Ireland Secured Bond. An agreement dated 10 March, 2010 restated the repayment schedule to the ProPhotonix Holdings Secured Bond such that, as of 1 March, 2010, the key repayment terms of the ProPhotonix Holdings Secured Bond are as follows:

(a)	Principal:	$2,855,184
(b)	Interest Rate:	8 per cent.
(c)	Repayment term:	31 March, 2010 to 30 October, 2011
(d)	Balloon payment:	$1,413,386
(e)	Monthly principal and interest:	$79,299

On 10 December, 2010, the Company and Mr. Hawtin entered into a Restructuring of the ProPhotonix Holdings Secured Bond. The bond will be amended to capitalise $1,274,544 of the balance by way of the issue of 4,031,646 Common Shares of ProPhotonix at the Placing Price and to transfer the remaining balance $942,124 to ProPhotonix Ireland. The bond will be cancelled thereafter.

ProPhotonix Ireland Secured Bond

On 24 July, 2008, ProPhotonix Ireland issued a €935,000 12 per cent. senior fixed rate secured bond to Hawtin (the "ProPhotonix Ireland Secured Bond") in the original principal amount of €935,000. In connection with issue of the ProPhotonix Ireland Secured Bond, the Company issued a warrant to purchase 636,404 Common Shares at an exercise price per share of US$0.45 and Hawtin received a security interest in all of the assets of ProPhotonix Ireland. The warrant expires ten years from the date of issuance. On 9 June, 2009, following certain payments of principal and interest under the ProPhotonix Ireland Secured Bond, ProPhotonix Ireland and Hawtin entered into an amendment of the ProPhotonix Ireland Secured Bond providing for the advance of an additional US$500,000 to ProPhotonix Ireland and the transfer of US$1,000,000 in principal amount of the ProPhotonix Holdings Secured Bond to the ProPhotonix Ireland Secured Bond. In consideration of the amendment, the Company issued Hawtin a Warrant to purchase 500,000 Common Shares at US$0.10 per share. The bond was relabelled as Euro 1,785,810 12 per cent. Senior Fixed Rate Secured Bond. As of 1 March, 2010, the key repayment terms of the ProPhotonix Ireland Secured Bond are as follows:

(a)	Principal:	€1,633,458
(b)	Interest Rate:	8 per cent.
(c)	Repayment term:	31 March, 2010 to 30 October, 2011
(d)	Balloon payment:	€865,843
(e)	Monthly principal and interest:	€54,003

On 10 December, 2010, the Company and Mr. Hawtin entered into a binding restructuring of the ProPhotonix Ireland Secured Bond. The amendment provides that ProPhotonix Ireland shall assume €692,128 ($942,124) of the balance of the ProPhotonix Holdings Secured Bond which such bond is secured by the assets of ProPhotonix Ireland. The amended ProPhotonix Ireland Secured Bond will be amended such that interest only shall be paid monthly on the outstanding balance through 30 June, 2012 and thereafter equal monthly payments of principal and interest over the three year period 1 July, 2012 through 30 June, 2015. The Company will also pay a

restructuring fee of $50,000. The key repayment terms of the ProPhotonix Ireland Secured Bond, under this amendment, are as follows:

(a)	Principal:	€1,972,523
(b)	Interest Rate:	8 per cent.
(c)	Interest payments only:	present through 30 June, 2012
(d)	Principal Repayment term:	36 months; 31 July, 2012 through 30 June, 2015
(e)	Monthly principal and interest:	€61,812

11.9 ***Heritage Finance Lease***

On 29 December, 2005, the Company entered into a sale-leaseback transaction with 55 Heritage (Salem), LLC ("Heritage") pursuant to which the Company agreed to sell 32 Hampshire Drive, Salem, New Hampshire, USA (the "Property") to Heritage for $4,700,000 and to lease the Property from Heritage for a period of five years (with an option to extend for a further five years). On 14 October, 2009, the lease was amended to reduce the space rented by the Company to 51,000 square feet at an annual cost of $152,000 per annum. The lease expires on 31 December, 2010.

12. Litigation

The Company is not involved in any governmental legal or arbitration proceedings which may have or have had in the 12 months preceding the date of this document a significant effect on the Company's financial position or profitability or the financial position or profitability of the Group as a whole and, so far as the Directors are aware, there are no such proceedings pending or threatened against the Company or any member of the Group.

13. Working capital

The Directors are of the opinion, having made due and careful enquiry, that the working capital available to the Company and the Group is sufficient for its present requirements, that is for at least 12 months from the date of Admission.

14. Taxation

14.1 ***United Kingdom***

The following paragraphs are intended as a general guide only for shareholders who are resident and ordinarily resident in the United Kingdom for tax purposes, holding Common Shares as investments and not as securities to be realised in the course of a trade, and are based on current legislation and HM Revenue & Customs practice. Any prospective purchaser of Common Shares who is in any doubt about his tax position or who is subject to taxation in a jurisdiction other than the UK should consult his own professional adviser immediately.

(a) **Taxation on dividends**

A dividend paid to a non-corporate Shareholder is treated as being paid with a tax credit equal to one ninth of the net dividend. Thus, for such Shareholders, there will be a tax credit of 10 per cent. on the gross dividend, that gross dividend being equal to the sum of the net dividend and the accompanying tax credit. Individual Shareholders whose income is within the starting or basic rate bands will be liable to tax at 10 per cent. on their gross dividend income and, if eligible for the tax credit, the tax credit will therefore satisfy their income tax liability on UK dividends.

Individual Shareholders who are liable to income tax at the higher rate will be charged to tax at 32.5 per cent. on their gross dividend income. After taking account of the 10 per cent. tax credit, where available, this will represent additional tax of 25 per cent. of the net dividend received.

Additional rate tax will apply to individual shareholders with annual taxable income in excess of £150,000 and the trustees of UK trusts. The additional rate will be 42.5 per cent on gross dividend income. After taking account of the 10 per cent. tax credit, where available, this will represent additional tax of 36.1 per cent. of the net dividend received.

Where a UK income tax liability arises on dividends received, a credit may be available for any overseas tax withheld from the dividend payment.

Subject to certain exceptions for certain insurance companies and companies that hold shares as trading stock, a UK resident corporate Shareholder that receives a dividend paid by the Company will normally be exempt from corporation tax on the dividend. The exemptions are not comprehensive and are also subject to anti-avoidance rules and corporate Shareholders are advised to take their own advice. Where a dividend paid by the Company is exempt, the corporate Shareholder receiving the dividend will not be entitled to relief, either by credit or deduction, against UK taxation for any overseas tax paid or suffered in relation to the dividend receipt.

Persons who are not resident in the UK should consult their own tax advisers on whether or not they can benefit from all or part of any tax credit and what relief or credit may be claimed in the jurisdiction in which they are resident.

(b) **Taxation on chargeable gains**

For the purpose of UK tax on chargeable gains, the issue of Common Shares pursuant to the Offer will be regarded as an acquisition of a new holding in the share capital of the Company, acquired on the date of allotment. The amount paid for the Common Shares will constitute the base cost of a shareholder's holding.

If a shareholder who is a UK individual or a trustee of a UK trust disposes of all or some of his Common Shares, a liability to Capital Gains Tax ("CGT") may arise. The extent of the tax liability on any gains which may arise will depend on the availability of the annual CGT exemption and any other tax relief such as existing capital losses.

A UK resident corporate Shareholder holding shares as an investment will be subject to corporation tax on any gain arising, subject to potential mitigation by indexation allowance and losses available for relief. An exemption from corporation tax on any such gain may be available if the corporate Shareholder holds at least 10 per cent. of the Company's ordinary share capital.

Shareholders who are not normally resident in the UK for tax purposes may not, depending on their personal circumstances, be liable to UK taxation on chargeable gains arising from the sale or other disposal of their Shares (unless they carry on a trade, profession or vocation in the UK through a branch or agency with which their Shares are connected). Individual Shareholders who are temporarily neither UK resident nor ordinarily resident may also be liable to UK capital gains tax on chargeable gains realised on their return to the UK. Shareholders who are resident for tax purposes outside the UK may be subject to foreign taxation on capital gains depending on their personal circumstances.

(c) **Stamp duty and Stamp Duty Reserve Tax ("SDRT")**

The statements below are intended as a general guide to the current position. They do not apply to certain intermediaries who are not liable to stamp duty or SDRT, or (except where stated otherwise) to persons connected with depositary arrangements or clearance services, who may be liable at a higher rate. While it is proposed to admit to trading on AIM the whole of the common share capital of the Company, the stamp duty/SDRT treatment of Common Shares held in certificated form will differ from that of Common Shares held in uncertificated form for settlement in CREST.

Common Shares held in Certificated Form

No stamp duty or SDRT should be payable on the issue of Placing Shares. Any instrument effecting or evidencing a transfer of Common Shares held in certificated form which is executed in the UK may not (except in criminal proceedings) be given in evidence or be available for any purpose whatsoever in the UK unless duly stamped. Any instrument of transfer executed outside the UK which relates to any matter or thing done, or to be done in the UK may not (except in criminal proceedings) be given in evidence or be available for any purpose whatsoever in the UK, unless duly stamped after it has first been received in the UK.

The rate of stamp duty is 0.5 per cent. on the value of the consideration for the relevant transfer, rounded up to the next multiple of £5. Interest on the stamp duty will accrue from 30 days after the date the instrument was executed. No charge to stamp duty will arise in relation to the transfer of Common Shares held in certificated form provided that all instruments relating to the transfer are executed and retained outside the UK and no do not relate to matters or actions performed in the UK. No charge to SDRT will arise in respect of an agreement to transfer Common Shares held in certificated form, provided such shares are not registered in any register kept in the UK by or on behalf of the Company.

Common Shares held in uncertificated form

Due to the restrictions of the CREST system, shares of companies incorporated outside the UK may not be settled directly on the CREST system. Accordingly, Common Shares held within the CREST system in uncertificated form will be held in the form of "depositary interests" issued by the Depositary. Agreements to transfer depositary interests may be liable to SDRT at the rate of 0.5 per cent. of the value of the consideration for the transfer. Interest on the SDRT will accrue from 30 days after the date of the agreement. However, no SDRT will be payable on such agreements provided that the terms of The Stamp Duty Reserve Tax (UK Depositary Interests in Foreign Securities) Regulations 1999 (as amended) are met. These provide for exemption from liability to pay SDRT on agreements to transfer depositary interests provided, *inter alia*, that the underlying shares are: (i) issued by a body corporate not incorporated, and whose central management and control is not exercised, in the UK; (ii) not registered in a register kept in the UK by or on behalf of the body corporate by which they are issued; and (iii) are of the same class in the body corporate as securities which are listed on a recognised stock exchange or are of a type which would have been treated as so listed immediately before 28 November, 2001. As neither a listing on AIM nor trading on the US OTC Bulletin Board market constitutes a listing on a "recognised stock exchange", it is not currently anticipated that exemption from SDRT will be available in respect of agreements to transfer depositary interests.

Persons who are not resident in the UK should consult their own tax advisers on the possible application of such provisions and on what relief or credit may be claimed for any such tax credit in the jurisdiction in which they are resident. These comments are intended only as a general guide to the current tax position in the UK as at the date of this document. The comments assume that Common Shares are held as an investment and not as an asset of financial trade.

The Company takes no responsibility for the withholding of tax of source.

If you are in any doubt as to your tax position, or are subject to tax in a jurisdiction other than the UK, you should consult your professional adviser.

14.2 ***United States Taxation – Material United States ("US") Federal Income and Estate Tax Consequences to Non-US Holders***

The following is a general discussion of the material US federal income and estate tax consequences of the ownership and disposition of Common Shares by a non-US holder that acquires these shares pursuant to this offering. The discussion is based on provisions of the Internal Revenue Code of 1986 as amended, (the "Code"), applicable US Treasury regulations promulgated thereunder and administrative and judicial interpretations, all as in effect on the date of this document, and all of which are subject to change, possibly on a retroactive basis. The discussion is limited to non-US holders that hold Common Shares as a "capital asset" within the meaning of Section 1221 of the Code – generally, property held for investment. As used in this discussion, the term "non-US holder" means a beneficial owner of Common Shares that is not, for US federal income tax purposes:

- an individual who is a US citizen or resident of the United States for US federal income tax purposes (generally, the latter includes a non-US individual who: (i) is a lawful permanent resident of the United States; (ii) is present in the US for or in excess of certain periods of time; or (iii) makes a valid election to be treated as a US person);
- a corporation or partnership, including any entity treated as a corporation or partnership for US federal income tax purposes, created or organized in or under the laws of the United States or any state of the United States or the District of Columbia;

- an estate the income of which is includible in gross income for US federal income tax purposes regardless of its source; or
- a trust: (i) if a US court is able to exercise primary supervision over the administration of the trust and one or more US persons have authority to control all substantial decisions of the trust; or (ii) that has a valid election in effect under applicable US Treasury regulations to be treated as a US person.

If a partnership holds the Common Shares, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. If you are a partner of a partnership holding the Common Shares, you should consult your tax advisors.

This summary is based upon provisions of the US Internal Revenue Code, or the "Code", and Treasury Regulations, rulings and judicial decisions as of the date of this prospectus. Those authorities may be changed, perhaps retroactively, so as to result in United States federal income and estate tax consequences different from those summarized below. This summary does not address all aspects of United States federal income and estate taxes and does not deal with foreign, state, local or other tax considerations that may be relevant to non-US holders in light of their personal circumstances. In addition, it does not represent a detailed description of the United States federal income and estate tax consequences applicable to you if you are subject to special treatment under the United States federal income tax laws (including, for example, if you are a United States expatriate, a life insurance company, a tax-exempt organisation, a regulated investment company, a dealer in securities or currency, a bank or other financial institution, a pension plan, an owner (directly, indirectly, or constructively) of 5 per cent. or more of the Company's Common Shares, an investor whose functional currency is other than the US dollar, have elected mark-to-market accounting, have acquired Common Shares as compensation, hold Common Shares as part of a hedge, straddle, constructive sale, conversion or other transaction, and/or a special status corporation such as a "controlled foreign corporation", a "passive foreign investment company" or a corporation that accumulates earnings to avoid United States federal income tax or an investor in a pass-through entity). A change in law could alter significantly the tax considerations that are described in this summary.

Prospective investors should consult with their tax advisors regarding the US federal, state, local, and non-US income and other tax considerations with respect to owning and disposing of the Company's Common Shares.

(a) **Circular 230 Disclaimer**

UNDER IRS STANDARDS OF PROFESSIONAL PRACTICE, CERTAIN TAX ADVICE THAT MAY BE USED TO SUPPORT THE PROMOTION OR MARKETING OF TRANSACTIONS OR ARRANGEMENTS MUST MEET REQUIREMENTS AS TO FORM AND SUBSTANCE. TO ASSURE COMPLIANCE WITH THESE STANDARDS, THE COMPANY AND ITS ADVISORS TO THIS OFFERING INFORM YOU THAT:

(i) THIS COMMUNICATION IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED UNDER THE US INTERNAL REVENUE CODE;

(ii) THIS ADVICE WAS WRITTEN TO SUPPORT THE PROMOTION OR MARKETING OF THE TRANSACTIONS AND MATTERS ADDRESSED HEREIN; AND

(iii) YOU SHOULD SEEK ADVICE BASED ON YOUR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.

(b) **Dividends**

Distributions (if any) on Common Shares by the Company will constitute dividends for US federal income tax purposes to the extent they are paid from current or accumulated earnings and profits, as determined under US federal income tax principles. If a distribution exceeds the Company's current and accumulated earnings and profits, the excess will be treated as a return of the non-US holder's investment up to such holder's tax basis in the

Company's Common Shares. Any excess will be treated as capital gain, subject to the tax treatment described below in "Gain on Disposition of Common Shares."

Any dividend (out of earnings and profits) paid to a non-US holder of the Common Shares generally will be subject to withholding of United States federal income tax at a 30 per cent. rate or such lower rate as may be specified by an applicable income tax treaty. A non-US holder of the Company's Common Shares who wishes to claim the benefit of an applicable treaty rate for dividends will be required to complete Internal Revenue Service Form. W-8BEN (or other applicable form), certify under penalty of perjury that such holder is eligible for benefits under the applicable treaty, and provide other additional information as required. The non-US holder of Common Shares must periodically update the information on such forms. Special certification and other requirements apply to certain non-US holders that are pass-through entities rather than corporations or individuals. In addition, US Treasury regulations provide special procedures for payments of dividends through certain intermediaries.

Dividends that are effectively connected with the conduct of a trade or business by the non-US holder within the United States (and, where a tax treaty applies, are attributable to a United States permanent establishment of the non-US holder) are not subject to the withholding tax, provided certain certification and disclosure requirements are satisfied, including providing the Company with an Internal Revenue Service Form W-8ECI (or other applicable form). Instead, such dividends are subject to United States federal income tax on a net income basis in the same manner as if the non-US holder were a United States person as defined under the Code. Any such effectively connected dividends received by a foreign corporation may be subject to an additional "branch profits tax" at a 30 per cent. rate or such lower rate as may be specified by an applicable income tax treaty.

A non-US holder of the Common Shares eligible for a reduced rate of United States withholding tax pursuant to an income tax treaty may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the Internal Revenue Service.

(c) **Gain on Disposition of Common Shares**

Any gain realised on the disposition of the Common Shares generally will not be subject to United States federal income tax unless:

(i) the gain is effectively connected with a trade or business of the non-US holder in the United States (and, if required by an applicable income tax treaty, is attributable to a United States permanent establishment of the non-US holder);

(ii) the non-US holder is an individual who is present in the United States for 183 days or more in the taxable year of that disposition, and certain other conditions are met; or

(iii) the Company is or has been a "United States real property holding corporation" for United States federal income tax purposes and certain other conditions are met.

An individual non-US holder described in the first bullet point immediately above will be subject to tax on the net gain derived from the sale under regular graduated United States federal income tax rates. An individual non-US holder described in the second bullet point immediately above will be subject to a flat 30 per cent. tax on the gain derived from the sale, which may be offset by United States source capital losses, even though the individual is not considered a resident of the United States. If a non-US holder that is a foreign corporation falls under the first bullet point immediately above, it will be subject to tax on its net gain in the same manner as if it were a United States person as defined under the Code and, in addition, may be subject to the branch profits tax equal to 30 per cent. of its effectively connected earnings and profits or at such lower rate as may be specified by an applicable income tax treaty.

(d) **Federal Estate Tax**

Common Shares held by an individual non-US holder at the time of death will be included in such holder's gross estate for United States federal estate tax purposes, unless an applicable estate tax treaty provides otherwise.

(e) **Information Reporting and Backup Withholding**

The Company must report annually to the Internal Revenue Service and to each non-US holder the amount of dividends paid to such holder and the tax withheld with respect to such dividends, regardless of whether withholding was required. Copies of the information returns reporting such dividends and withholding may also be made available to the tax authorities in the country in which the non-US holder resides under the provisions of an applicable income tax treaty.

A non-US holder will be subject to backup withholding for dividends paid to such holder unless such holder certifies under penalty of perjury that it is a non-US holder (and the payor does not have actual knowledge or reason to know that such holder is a United States person as defined under the Code), or such holder otherwise establishes an exemption.

Information reporting and, depending on the circumstances, backup withholding will apply to the proceeds of a sale of the Common Shares within the United States or conducted through certain United States-related financial intermediaries, unless the beneficial owner certifies under penalty of perjury that it is a non-US holder (and the payor does not have actual knowledge or reason to know that the beneficial owner is a United States person as defined under the Code) or such owner otherwise establishes an exemption. Certain stockholders, including all corporations, are exempt from the backup withholding rules.

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules may be allowed as a refund or a credit against a non-US holder's United States federal income tax liability provided the required information is furnished to the Internal Revenue Service.

The foregoing discussion of US Federal Income tax considerations is not tax advice and is not based on an opinion of counsel. Accordingly, each prospective non-US holder of Common Shares should consult their own tax advisor with respect to the federal, state, local and non-US tax consequences of the ownership and disposition of Common Shares.

15. Consents

15.1 Baker Tilly Corporate Finance LLP of 25 Farringdon Street, London EC4A 4AB has given and not withdrawn its written consent to (a) the inclusion of its report set out in Part III Section A of this document in the form and context in which it appears and has authorised the contents of the report referred to above for the purposes of the AIM Rules and (b) the inclusion in this document of references to its name in the form and context in which they appear.

15.2 Libertas has given and not withdrawn its consent to the issue of this document with inclusion herein of references to its opinion and name in the form and context in which they are included.

16. No significant change

Other than as disclosed in paragraphs 10 and 11 in Part I of this document there has been no significant change in the trading or financial position of the Group since 30 September, 2010, being the date to which the last unaudited interim consolidated financial information of the Group was published.

17. Other information

17.1 There are no specific dates on which entitlement to dividends or interest thereon on Common Shares arises and there are no arrangements in force for the waiver of future dividends.

17.2 The total costs and expenses payable by the Company in connection with or incidental to the Placing and Admission are estimated to be £585,000 (exclusive of VAT) of which £375,000 have already been paid as at the date of this document and £210,000 will be paid from the proceeds of the Placing. The gross sum expected to be raised by the Placing is £825,000 and the net proceeds of the Placing (after the deduction of expenses excluding VAT related to the Placing and Admission which are outstanding and payable following Admission) are estimated to be £615,000.

17.3 The accounting reference date of the Company is currently 31 December.

17.4 Caturano and Company, P.C. of 80 City Square, Boston Massachusetts, 02129 USA have been the statutory auditors of the Company for the years ending 31 December, 2007, 2008 and 2009. Caturano and Company, P.C. is a member of the Private Companies Practice Session (PCPS) of the American Institute of Certified Public Accountants and is registered with the Public Company Accounting Oversight Board.

17.5 Save as disclosed in this document, as far as the Directors are aware:

(a) there are no environmental issues that may affect the Company's utilisation of its tangible fixed assets;

(b) there are no known trends, uncertainties, demands or events that are reasonably likely to have a material adverse effect on the Group's prospects for at least the current financial year;

(c) the Company is not dependent on any patents or licences, industrial, commercial or financial contracts or new manufacturing processes which are of fundamental importance to its business or profitability; and

(d) there are no exceptional factors that have influenced the Group's activities.

17.6 Save as disclosed in this document, no person (excluding professional advisers as stated in this document and trade suppliers) has received directly or indirectly from the Group within the 12 months preceding the Company's application for Admission and no persons have entered into contractual arrangements to receive:

(a) fees totalling £10,000 or more;

(b) securities in the Company with a value of £10,000 or more;

(c) any other benefit with a value of £10,000 or more at the date of Admission.

17.7 Save as disclosed in this document, the Company does not hold a proportion of the capital of any undertaking likely to have a significant effect on the assessment of the Company's assets and liabilities, financial position or profits and losses.

17.8 Save as disclosed in this document, the Company has no principal investments for the period covered by the historic financial information contained in this document and has no principal investments in progress and no principal future investments in relation to which it has made a firm financial commitment.

17.9 Where information has been sourced from a third party, it has been accurately reproduced and, as far as the Company is aware and is able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of any such information in this document is indicated by way of a footnote.

18. Copies of this document

Copies of this document will be available, free of charge, at the offices of Libertas Capital Corporate Finance Limited at 16 Berkeley Street, London W1J 8DZ from the date of this document during normal business of any weekday, Saturdays and public holidays excepted, for one month from the date of Admission.

Dated: 20 December, 2010

Perivan Financial Print 218450