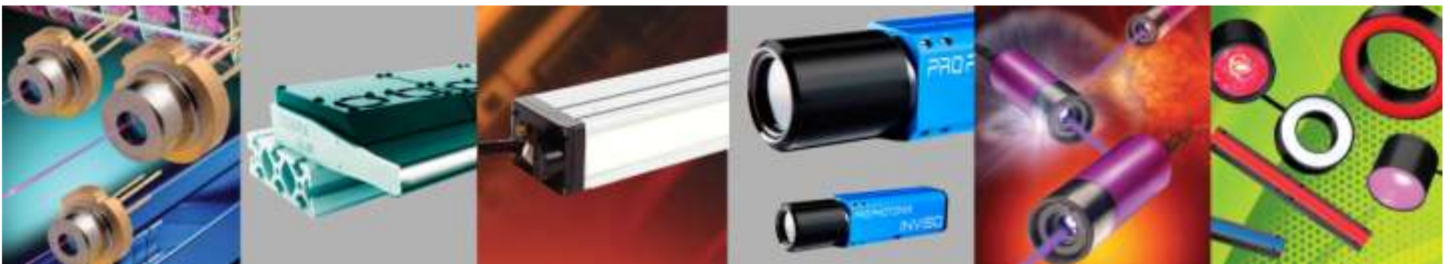
PROPHOTONIX LIMITED
2011 ANNUAL REPORT



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2011 Chairman's Letter

Dear Fellow Shareholders:

ProPhotonix made considerable progress in 2011, building on the strong foundations laid in 2010. We have invested significantly in our R&D and sales efforts, added to our product offering, increased production capacity, and expanded our geographical reach. We enter 2012 in a stronger financial position having strengthened our balance sheet through an equity placement with institutional investors last July.

ProPhotonix consists of two business units: an LED systems manufacturing business based in Ireland, and a laser modules production and laser diode distribution division located in the United Kingdom. Corporate, marketing and the North American sales activities are based in Salem, New Hampshire, USA. With comparatively faster growth in the LED market in 2011, LED system revenue exceeded laser revenue for the first time. The Company's revenue growth in 2011 was driven by a 26.1% increase in the LED division. Despite lower laser sales, the laser division remains profitable and is poised for improvement in 2012. Overall revenues grew 12%, notwithstanding the fragile global economy which led to a slowdown in sales to several customers, especially in the solar equipment industry in the second half of the year.

At the beginning of 2011, we reorganized the Company's sales force from a product focused approach to a geographic full-product line sales basis. We expect this shift to lead to more cross-selling initiatives creating new opportunities for ProPhotonix. The Company sells its products into the industrial (73%), medical (18%) and defense/security (9%) markets. All of these markets continue to offer growth potential for ProPhotonix and, as a direct result of our new selling approach, have an increased number of opportunities in each of these markets as we move into 2012. In addition, late in 2011 we significantly bolstered our sales force in North America, partnered with an exclusive distributor in China and selectively increased our sales capacity in certain European markets, most notably in Germany. The build out of the sales organization is not complete and we plan to increase our direct sales presence and distribution network in 2012.

ProPhotonix's products are, and always have been, targeted towards customers who have a requirement for high-quality and often custom products. To ensure that both our laser and LED products remain best-in-class, we have continued to make investments in R&D and applications engineering, and successfully introduced several new LED and laser products to market in 2011.

Your Board remains confident in the future of the Company and I would like to take this opportunity to thank you for your continued support and interest in ProPhotonix.

Respectfully submitted,

Mark W. Blodgett

Chairman & Chief Executive Officer

April 11, 2012

Director Remuneration Report

For the year ended December 31, 2011

Executive Director Compensation - Executive Director Compensation is reviewed by the Independent Non-Executive Directors.

Non-Executive Director compensation is established periodically.

						Expensed in 2011 based on stock compensation rules, without consideration of forfeitures				
Executive Director	**Salary**	**Bonus**	**Pension**	**Other (1)**	**Total Cash Compensation**	**Options**	**RSA's**	**Total**	**Total All Compensation 2011**	**Total All Compensation 2010**
Mark Blodgett (2)	$371,500	$ -	$4,346	$9,050	$384,986	$24,572	$37,400	$61,972	$446,868	$626,108
Tim Losik	188,750	-	5,500	525	194,775	12,005	25,125	37,130	231,905	265,233
Total Executive Compensation	**$560,250**	**$ -**	**$9,846**	**$9,575**	**$579,671**	**$36,577**	**$62,525**	**$99,102**	**$678,773**	**$891,341**
Non-Executive Director										
Dieter Klenner	$ -	$ -	$ -	$15,000	$15,000	$12,826	$3,750	$16,576	$31,576	$50,860
Ray Oglethorpe	-	-	-	15,000	15,000	13,261	4,375	17,636	32,636	58,576
Timothy Steel	-	-	-	11,250	11,250	5,441	-	5,441	16,691	-
Vincent Thompson	-	-	-	11,250	11,250	5,441	-	5,441	16,691	-
Total Non-Executive Compensation	**$ -**	**$ -**	**$ -**	**$52,500**	**$52,500**	**$39,969**	**$8,125**	**$45,094**	**$97,594**	**$109,436**

Director Share Options:

Director	Options @ 12/31/10	Options Granted	Options Forfeited	Options @ 12/31/11
Mark Blodgett	2,364,050	1,000,000	(310,000)	3,054,050
Tim Losik	400,000	500,000	-	900,000
Dieter Klenner	489,852	166,666	-	656,518
Ray Oglethorpe	601,840	166,666	(11,500)	757,006
Timothy Steel	-	195,433	-	195,433
Vincent Thompson	-	195,433	-	195,433
Total All Directors	**3,855,742**	**2,224,198**	**(321,500)**	**5,758,440**

(1) Other compensation for Executive Directors is for paid life insurance for the benefit of the director. Other compensation for non-executive directors represents cash payments expensed in the current year.
(2) Company paid housing expenses for Mr. Blodgett in the amount of $76,711 and moving expenses from the U.S. to the U.K. in the amount of $7,073.

ProPhotonix Limited

Consolidated Financial Statements

Years Ended December 31, 2011 and 2010

FINANCIAL STATEMENTS

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Item	Page
Independent Auditor's Report	7
Consolidated Balance Sheets as of December 31, 2011 and 2010	8
Consolidated Statements of Operations for the Years Ended December 31, 2011 and 2010	9
Consolidated Statements of Stockholders' Equity / (Deficit) and Comprehensive Loss for the Years Ended December 31, 2011 and 2010	10
Consolidated Statements of Cash Flows for the Years Ended December 31, 2011 and 2010	11
Notes to Consolidated Financial Statements	12

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
ProPhotonix Limited
Salem, New Hampshire

We have audited the accompanying consolidated balance sheets of ProPhotonix Limited (formerly known as StockerYale, Inc.) and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity (deficit) and comprehensive loss, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

McGladrey & Pullen, LLP

Boston, Massachusetts
April 11, 2012

FINANCIAL STATEMENTS

PROPHOTONIX LIMITED

(formerly StockerYale, Inc.)

CONSOLIDATED BALANCE SHEETS

($ in thousands except share and per share data)

December 31	**2011**	**2010**
Assets		
Current assets:		
Cash and cash equivalents	$ 4,066	$ 1,811
Accounts receivable, less allowances of $13 in 2011 and $47 in 2010	2,405	1,957
Inventories	1,694	1,892
Prepaid expenses and other current assets	288	295
Total current assets	8,453	5,955
Net property, plant and equipment	653	906
Goodwill	458	468
Acquired intangible assets, net	332	610
Other long-term assets	36	66
Total assets	$ 9,932	$ 8,005
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities:		
Revolving credit facility	$ 643	$ 641
Current portion of long-term debt	1,587	600
Capital lease obligations	-	24
Accounts payable	1,456	2,003
Income taxes payable	29	-
Accrued expenses	778	1,368
Total current liabilities	4,493	4,636
Long-term debt, net of current portion	1,631	3,407
Other long-term liabilities	178	150
Total liabilities	6,302	8,193
Stockholders' equity (deficit):		
Common stock, par value $0.001; shares authorized 150,000,000 at December 31, 2011 and 100,000,000 at December 31, 2010; 76,059,456 shares issued and outstanding at December 31, 2011 and 52,510,174 shares issued and outstanding at December 31, 2010	76	53
Paid-in capital	110,751	105,678
Accumulated deficit	(107,618)	(106,175)
Accumulated other comprehensive income	421	256
Total stockholders' equity (deficit)	3,630	(188)
Total liabilities and stockholders' equity (deficit)	$ 9,932	$ 8,005

See the notes to consolidated financial statements.

PROPHOTONIX LIMITED
(formerly StockerYale, Inc.)
Consolidated Statements of Operations
($ in thousands except share and per share data)

	Years Ended December 31,	
	2011	**2010**
Net Revenue	$ 16,977	$ 15,194
Cost of Revenue	10,613	9,384
Gross Profit	6,364	5,810
Research & Development Expenses	899	750
Selling, General & Administrative Expenses	6,030	7,215
Amortization of Intangible Assets	275	390
Asset Impairment	-	226
Operating Loss	(840)	(2,771)
Other Income / (Expense), net	(184)	688
Amortization of Debt Discount and Financing Costs	-	(551)
Interest Expense	(363)	(552)
Loss Before Taxes from Continuing Operations	(1,387)	(3,186)
Tax Provision (Benefit)	37	(111)
Net Loss from Continuing Operations	(1,424)	(3,075)
Gain on Sale of Discontinued Operations, net of tax	-	542
Loss from Discontinued Operations, net of tax	(19)	(116)
Net Loss	$ (1,443)	$ (2,649)
Loss Per Share: Basic and diluted:		
Net loss from continuing operations	($0.02)	($0.07)
Gain on sale of discontinued operations, net	$0.00	$0.01
Loss from discontinued operations, net	($0.00)	($0.00)
Net loss per share	($0.02)	($0.06)
Basic and diluted weighted average shares outstanding	63,485,600	44,950,980

See the notes to consolidated financial statements.

PROPHOTONIX LIMITED

(formerly StockerYale, Inc.)

CONSOLIDATED STATEMENTS 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 Loss
Balance December 31, 2009	44,616	$ 45	$103,048	$ (103,526)	$ 118	$ (315)	
Sale of common stock, net of expenses	3,825	4	859	-	-	863	
Share based compensation, net of forfeitures	(13)	-	501	-	-	501	
Issuance of common stock to settle liabilities / debt	4,082	4	1,270	-	-	1,274	
Cumulative translation adjustment					138	138	138
Net loss				(2,649)		(2,649)	$ (2,649)
Comprehensive loss for the year ended Dec. 31, 2010							$ (2,511)
Balance December 31, 2010	52,510	$ 53	$105,678	$ (106,175)	$ 256	$ (188)	
Sale of common stock, net of expenses of $350	23,550	23	4,874	-	-	4,897	
Share based compensation, net of forfeitures	-	-	199	-	-	199	
Cumulative translation adjustment					165	165	165
Net loss				(1,443)		(1,443)	$ (1,443)
Comprehensive loss for the year ended Dec. 31, 2011							$ (1,278)
Balance December 31, 2011	76,060	$ 76	$110,751	$ (107,618)	$ 421	$ 3,630	

See the notes to consolidated financial statements.

PROPHOTONIX LIMITED

(formerly StockerYale, Inc.)

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

Years Ended December 31	**2011**	**2010**
Operating		
Net loss	**$ (1,443)**	**$ (2,649)**
Gain on sale of discontinued operations, net of tax	-	542
Loss from discontinued operations, net of tax	(19)	(116)
Net loss from continuing operations	**(1,424)**	**(3,075)**
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	199	501
Depreciation and amortization	601	917
Foreign exchange loss	281	130
Amortization of debt discount and financing costs	-	551
Non cash interest income	-	(7)
(Gain) loss on disposal of assets	8	(632)
Asset impairment	-	226
Provision for inventories	61	37
Provision for bad debts	-	49
Deferred taxes	-	(113)
Other changes in assets and liabilities:		
Accounts receivable	(567)	(669)
Inventories	100	(698)
Prepaid expenses and other current assets	(1)	278
Accounts payable	(529)	901
Income taxes payable	29	-
Accrued expenses	(584)	276
Other assets and liabilities	29	-
Net cash used in continuing operations	**(1,797)**	**(1,328)**
Net cash used in discontinued operations	(19)	(116)
Net cash used in operating activities	**(1,816)**	**(1,444)**
Investing		
Proceeds from disposal of assets	-	3
Financing obligation payments	-	(136)
Purchase of property, plant and equipment	(95)	(464)
Net cash used in continuing operations	**(95)**	**(597)**
Net cash provided by discontinued operations	**-**	692
Net cash provided by (used in) investing activities	**(95)**	**95**
Financing		
Net proceeds from sale of common stock	4,897	863
Borrowings of revolving credit facilities, net	8	57
Principal repayment of long-term debt	(753)	(2,248)
Net cash provided by (used in) financing activities	**4,152**	**(1,328)**
Effect of exchange rate on cash	14	10
Net change in cash and equivalents	2,255	(2,667)
Cash and equivalents at beginning of period	1,811	4,478
Cash and equivalents at end of period	**$ 4,066**	**$ 1,811**
Supplemental cash flow information:		
Cash paid for interest	$ 363	$ 564
Cash paid for income tax	$ 15	$ -
Non cash investing and financing activities:		
Issuance of common stock to settle liabilities / debt	$ -	$ 1,274
Common stock issued in connection with financings	$ -	$ 16
Warrants issued in connections with financings	$ -	$ 24
Write-off of assets from sale-leaseback transaction	$ -	$ 2,821
Write-off of finance lease from sale-leaseback transaction	$ -	$ (3,450)

See the notes to consolidated financial statements.

PROPHOTONIX LIMITED

(formerly StockerYale, Inc.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) ORGANIZATION AND BASIS OF PRESENTATION

ProPhotonix Limited (also referred to in this document as “ProPhotonix”, “we”, or the “Company”) 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 Limited subsidiary. 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.

On May 27, 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.

ProPhotonix Limited was incorporated on March 27, 1951 in the Commonwealth of Massachusetts and is currently incorporated in the state of Delaware. In December 1995, the Company completed the registration of its common stock with the U.S. Securities and Exchange Commission. The common stock of the Company now trades on the Pink OTC Market in the U.S. under the trading symbol “STKR.PK”. On December 23, 2010, the Company gained admission to the London Stock Exchange, plc (AIM listing), under the trading symbols “PPIR” and “PPIX”.

The accompanying consolidated financial statements have 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 statements, during the years ended December 31, 2011 and 2010, the Company recorded net losses of $1,443,000 and $2,649,000, respectively. Net use of cash flow for operating activities from continuing operations for the same time periods were $1,797,000 and $1,328,000, respectively. The consolidated financial statements do 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 July 13, 2011, the Company sold approximately 23.25 million shares of common stock on the London Stock Exchange, AIM listing at a price of £0.14 ($0.22) per share for a total of £3.0 million, net of expenses (approximately $4.9 million). As a result of the Company's cash balance, reduced debt levels, refinanced debt agreements and its focus on two core business segments, management believes that it has adequate capital to sustain current operations through March 31, 2013.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements reflect the application of the Company’s most significant accounting policies as described in this note and elsewhere in the accompanying consolidated financial statements and notes.

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, ProPhotonix (IRL) Limited, StockerYale Waterloo Acquisition Inc., StockerYale (UK) Ltd., which owns 100% of ProPhotonix Limited, and ProPhotonix Holdings, Inc., which holds all of the outstanding shares of StockerYale Canada (see note 14 for more information on the sale of the assets of StockerYale Canada). All intercompany balances and transactions have been eliminated.

RECLASSIFICATIONS

Certain reclassifications have been made to the 2010 consolidated financial statements, with no effect on net loss, to be consistent with the classifications presented in 2011.

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.

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 collectability 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 collectability 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 December 31	**2011**	**2010**
	In thousands	
Balance at beginning of period	$ 47	$ 5
Charges to costs and expenses	-	49
Account write-offs and other deductions	(34)	(7)
Balance at end of period	$ 13	$ 47

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, trademarks, acquired patents and patented technologies, distributor and customer relationships and related contracts, technology design and programs, non-compete agreements and other intangible assets which, except for goodwill, are being amortized over their useful lives. Goodwill is tested for impairment on an annual basis, and between annual tests in certain circumstances, and written down when and if 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 statements 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 common shares outstanding.

As of December 31, 2011, 6,567,940 shares underlying options and 7,828,188 shares underlying warrants were excluded from the calculation of diluted shares, as their effects were anti-dilutive.

As of December 31, 2010, 4,638,408 shares underlying options and 7,963,188 shares underlying warrants were excluded from the calculation of diluted shares, as their effects were anti-dilutive.

REVENUE RECOGNITION

The Company recognizes revenue from product sales at the time of shipment and when persuasive evidence of an arrangement exists, performance of our obligation is complete, the price to the buyer is fixed or determinable, and collectability is reasonably assured. Custom products are designed and 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 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 or fixed fee-for-service models. Revenue from reimbursement contracts is recognized as services are performed. 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 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, subject to any project management assessments as to the status of work performed. 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.

The FASB issued amended revenue recognition guidance for arrangements with multiple deliverables under the FASB Accounting Standards Update ("ASU") 2009-13, *Multiple-Deliverable Revenue Arrangements* ("ASU 2009-13"). The new guidance eliminates the prior residual method of revenue recognition and establishes a hierarchy of methods to determine the selling price. The highest level in the hierarchy is vendor-

specific objective evidence ("VSOE") of selling price and is limited to the price charged when the same deliverable is sold separately, or for a deliverable that is not yet sold separately, the price established by management if it is probable that the price, once established, will not change before the separate introduction of the deliverable to the marketplace. When VSOE does not exist, the next level of the hierarchy is third-party evidence of selling price, which would exist if any other vendor separately sells a generally interchangeable product. When neither VSOE nor third-party evidence exists, the allocation is based on the vendor's best estimate of the price that the deliverable would be sold for if it was sold on a standalone basis. ASU 2009-13 is effective in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Company adopted the guidance effective January 1, 2011.

For those arrangements that include multiple deliverables, the Company first determines whether each service or deliverable meets the separation criteria of FASB ASC 605-25, *Revenue Recognition—Multiple-Element Arrangements*. In general, a deliverable (or a group of deliverables) meets the separation criteria if the deliverable has stand-alone value to the customer and, if the arrangement includes a general right of return related to the delivered item, that delivery or performance of the undelivered item(s) is considered probable and is substantially in control of the Company. Each deliverable that meets the separation criteria is considered a separate ''unit of accounting". The Company allocates the total arrangement consideration to each unit of accounting using the relative selling price method. The amount of arrangement consideration that is allocated to a delivered unit of accounting is limited to the amount that is not contingent upon the delivery of another unit of accounting. When vendor-specific objective evidence or third-party evidence is not available, adopting the relative selling price method of allocation permits the Company to recognize revenue on specific elements as completed based on the estimated selling price. Changes in judgments made in estimating the selling price of the various deliverables could significantly affect the timing or amount of revenue recognition. After the arrangement consideration has been allocated to each unit of accounting, the Company applies the appropriate revenue recognition method for each unit of accounting based on the nature of the arrangement and the services included in each unit of accounting. All deliverables that do not meet the separation criteria of FASB ASC 605-25 are combined into one unit of accounting, and the most appropriate revenue recognition method is applied.

WARRANTY

The Company provides standard 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 in relation to the reserve as a percent of sales. The Company adjusts annually the warranty provision based on actual experience and for any particular known instances.

Warranty Reserves:

	Years Ended December 31,	
	2011	**2010**
	In thousands	
Balance at beginning of period	$ 155	$ 98
Charges to costs and expenses	39	90
Account write-offs and other deductions	(35)	(33)
Balance at end of period	$ 159	$ 155

ADVERTISING EXPENSE

The Company expenses advertising costs as incurred. Advertising expenses for the years ended 2011 and 2010 were approximately $330,000 and $278,000, respectively.

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	Term of the lease or 10-40 years
Computer equipment	3 to 5 years
Machinery and equipment	5 to 10 years
Furniture and fixtures	3 to 10 years

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 statements 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. The Company recognizes the tax benefit of tax positions to the extent that the benefit will more likely than not be realized. The determination as to whether the tax benefit will more likely than not be realized is based upon the technical merits of the tax position as well as consideration of the available facts and circumstances. With respect to any uncertain tax positions, the Company records interest and penalties, if any, as a component of income tax expense. It did not have any interest and penalties related to uncertain tax positions during the years ended December 31, 2011 or 2010. Additional information on the Company's income tax provision and deferred tax assets and liabilities may be found at Note 9.

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 Remuneration Committee of the Company's Board of Directors ("GNRC"). Generally the grants vest over terms of two to four years and are priced at fair market value, or in certain circumstances 110% 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% 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% 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% 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% 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 2011, the Company recognized approximately $199,000 of stock-based compensation related to restricted stock and options, all of which was charged to selling, general and administrative expense. During 2010, the Company recognized approximately $501,000 of stock-based compensation related to restricted stock and options, all of which was charged to selling, general and administrative 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 expensed 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 based on historical trends. The risk-free interest rate is based on U.S. Treasury zero-coupon issues assumed at the date of grant and generally no dividends are assumed in the calculation. The compensation expense recognized for all equity-based awards is net of estimated forfeitures. Forfeitures are estimated based on the historical trends.

Restricted Share Awards— The Company periodically awards restricted shares of common stock to employees. 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 2010 and 2009, the Company did not grant any shares of restricted stock.

TRANSLATION OF FOREIGN CURRENCIES

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. For foreign subsidiaries, whose functional currency is not the U.S. dollar, assets and liabilities are translated using the foreign exchange rates prevailing at the balance sheet date, and income and expense accounts using average exchange rates for the period. Cumulative transaction 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.

As of October 1, 2011, management determined the functional currency of StockerYale (UK) Ltd, and ProPhotonix Limited is the Euro. As of this date the balance sheet was remeasured in Euros and all historical foreign currency translation adjustments reported within accumulated other comprehensive loss remain as a component of accumulated other comprehensive loss.

Foreign currency transaction losses from continuing operations recorded in the statements of operations as other income (expense), net were approximately $327,000 and $80,000 for 2011 and 2010, respectively.

FAIR VALUES OF FINANCIAL INSTRUMENTS

The Company's financial instruments consist mainly of cash and cash equivalents, accounts receivable, revolving credit facility, accounts payable and long-term debt. The estimated fair value of these financial instruments, with the exception of fixed rate long-term debt, 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. The carrying value of fixed rate long-term debt approximates fair value.

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% or more of consolidated revenues in either 2011 or 2010. The Company had one customer that accounted for 10% of the outstanding accounts receivable balance at December 31, 2011 and 2010. The Company maintains its cash and cash equivalents in bank deposit accounts, which at times may exceed insured limits. At December 31, 2011, the amount in excess of governmental insurance protection was approximately $3.7 million. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

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) RECENT ACCOUNTING PRONOUNCEMENTS

Goodwill Impairment Test

In December 2010, the Financial Accounting Standards Board (the "FASB") issued authoritative guidance which modifies the requirements of Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. This guidance was effective for fiscal years beginning after December 15, 2010. The adoption of this guidance did not impact our consolidated balance sheets or statements of operations.

In September, 2011, the FASB issued updated guidance concerning the testing of goodwill impairment. This guidance modifies goodwill impairment testing by allowing the inclusion of qualitative factors in the assessment of whether a two-step goodwill impairment test is necessary. Thus, entities are no longer required to calculate the fair value of a reporting unit unless they conclude through an assessment of qualitative factors that it is more likely than not that the unit's carrying value is greater than its fair value. When an entity's qualitative assessment reveals that goodwill impairment is more likely than not, the entity must perform the two-step goodwill impairment test. The adoption of this guidance is not expected to have a material impact on our consolidated balance sheets or statements of operation.

Fair Value Measurements and Disclosures

In May 2011, the FASB issued additional guidance on fair value disclosures. This guidance is intended to establish common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") and International Financial Reporting Standards ("IFRS"). This guidance is effective for the first interim or annual

reporting period beginning after December 15, 2011. The adoption of this guidance is not expected to have a material impact on our consolidated balance sheets or statements of operations.

Other Comprehensive Income

In June 2011, the FASB issued a new accounting standard for the presentation of comprehensive income. The new standard requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new standard also requires presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement, or statements, when the components of net income and the components of other comprehensive income are presented. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. As this standard relates only to the presentation of other comprehensive income, the adoption of this accounting standard will not have an impact on our consolidated financial position, results of operations and cash flows.

(4) INVENTORIES

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

Years Ended December 31	**2011**	**2010**
	In thousands	
Finished goods	$ 362	$ 413
Work in-process	141	164
Raw materials	1,191	1,315
Net inventories	$ 1,694	$ 1,892

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.

(5) PROPERTY, PLANT AND EQUIPMENT

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

Years Ended December 31	**2011**	**2010**
	In thousands	
Buildings and building improvements	$ 284	$ 283
Computer equipment	414	934
Machinery and equipment	1,738	1,801
Furniture and fixtures	622	690
Property, plant and equipment	$ 3,058	$ 3,708
Less accumulated depreciation	(2,405)	(2,802)
Net property, plant and equipment	$ 653	$ 906

Depreciation expense from continuing operations was approximately $326,000 and $527,000 in the years ended December 31, 2011 and 2010, respectively. In 2005, the Company entered into a sale-leaseback transaction on the Company's headquarters which was recorded as a finance lease in accordance with

accounting standards. See Note 15 for a description of the transaction and write-off of the assets ($2,821,000 net book value) related to the finance lease upon completion of the sale in 2010.

(6) 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.

In connection with the annual fair value test of goodwill, performed at the end of the fourth quarter 2011, and at the end of the fourth quarter 2010, the Company concluded that no impairment existed.

The changes in the carrying amount of goodwill for the years ended December 31, 2011 and 2010 was as follows:

	December 31, 2011	December 31, 2010
	(In thousands)	
Beginning of the year	$ 468	$ 508
Effect of exchange rate	(10)	(40)
Impairment charge	-	-
End of year	$ 458	$ 468

Goodwill as of December 31, 2011 and 2010 relates to the LED reporting unit.

(7) INTANGIBLE ASSETS

Intangible assets consist of trademarks, acquired patents and patented technologies, distributor and customer relationships and related contracts, 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 2011. During 2010, the Company, including its subsidiaries, changed its name from StockerYale, Inc. to ProPhotonix Limited. As a result of this name change, the Company recorded an impairment charge of approximately $226,000 related to a previously acquired trade name. Intangible assets and their respective useful lives are as follows:

	Useful Life
Acquired patents, patented technology and purchased technology	5 – 8 Years
Acquired customer contracts and relationships	5 – 8 Years
Acquired non compete agreements	3 Years
Acquired technology design and programs	8 Years
Other	3 – 7 Years

Gross carrying amounts and accumulated amortization of intangible assets were as follows as of December 31, 2011 for each intangible asset class.

	Gross Carrying Amount	Accumulated Amortization	Net Balances
		(in thousands)	
Acquired patents, patented technology and purchased technology	$ 291	$ (291)	$ -
Acquired customer contracts and relationships	1,900	(1,682)	218
Acquired non compete agreement	615	(615)	-
Acquired technology design and programs...............................	322	(212)	110
Other	105	(101)	4
Total	$ 3,233	$ (2,901)	$ 332

Gross carrying amounts and accumulated amortization of intangible assets were as follows as of December 31, 2010 for each intangible asset class.

	Gross Carrying Amount	Accumulated Amortization	Net Balances
		(in thousands)	
Acquired patents, patented technology and purchased technology	$ 291	$ (284)	$ 7
Acquired customer contracts and relationships	1,901	(1,460)	441
Acquired non compete agreement	616	(616)	-
Acquired technology design and programs...............................	321	(168)	153
Other	105	(96)	9
Total	$ 3,234	$ (2,624)	$ 610

	Actual Expense		Estimated Future Expense				
	2010	2011	2012	2013	2014	2015	Thereafter
	In thousands						
Amortization expense of intangible assets...........................	$ 390	$ 275	$ 122	$ 122	$ 88	$ -	$ -

(8) DEBT

Years Ended December 31	2011	2010
	In thousands	
Bonds payable to the former stockholders of Photonic Products Ltd. maturing on December 31, 2012, with an interest rate of 11%, at December 31, 2011 and at December 31, 2010	$ 793	$ 1,393
Senior Fixed Rate Secured Bond to a private investor, maturing on June 30, 2015, with an interest rate of 8% at December 31, 2011 and at December 31, 2010.	$ 2,425	$ 2,614
Borrowings under Revolving Credit facility with Barclay's Bank Sales Financing with an interest rate of 2.65% above Barclay's base rate (3.15% as of December 31, 2011 and 2010).	643	641
Sub-total debt	3,861	4,648
Less – revolving credit facility	(643)	(641)
Less—Current portion of long-term debt	(1,587)	(600)
Total long-term debt	$ 1,631	$ 3,407

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. with an aggregate initial principal amount equal to $2,400,000 (Photonic Bonds).

On October 30, 2010 and December 10, 2010, the Company and the holders of the Photonic Bonds entered into Deeds of Variation of the Photonic Bonds. The amendments required a payment on October 30, 2010 against the principal balance in the amount of $150,000. The Photonic Bonds were amended to pay the outstanding balance as of October 31, 2010 monthly over the period from November 30, 2010 through November 30, 2012 at the rate of $50,000 principal plus simple interest (at 11% per annum). On December 31, 2012, the remaining balance (approximately $243,000) of the Photonic Bonds shall be payable in full. The key repayment terms of the Photonic Bonds, under this amendment, are as follows:

(a) Principal as of December 10, 2010:	$1,443,000
(b) Interest Rate:	11% per annum, payable monthly
(c) Repayment term:	October 31, 2010 to November 30, 2012
(d) Monthly principal:	$50,000
(e) Balloon payment:	$243,000 due December 31, 2012

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.

As of December 31, 2011, $793,000 was outstanding under the bonds issued to the stockholders of Photonic Products Ltd., which was classified as current portion of long-term debt.

As of December 31, 2010, $1,393,000 was outstanding under the bonds issued to the stockholders of Photonic Products Ltd., which was classified as $600,000 current portion of long-term debt, and $793,000 as long-term debt.

Private Investor Notes and Bond

ProPhotonix Limited Financing

On October 31, 2006, StockerYale (UK) Ltd. issued a 10% Senior Fixed Rate Secured Bond ("SYUK Bond"), as amended at various times, in the original principal amount of $4,750,000 StockerYale (UK) Ltd. may prepay the bond at any time, in whole or in part, without penalty or premium. The bond was 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.

In connection with the issuance of the bond on October 31, 2006, the Company issued a Common Stock Purchase Warrant 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 were $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 was 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%, an expected life of ten years and an expected volatility of 102% with no dividend yield.

On June 9, 2009, the bondholder 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 ProPhotonix (IRL) Limited ("PPI" Bond) described below.

On December 10, 2010, with an effective date of December 23, 2010, the Company and the bondholder entered into a binding term sheet to amend the terms of all debt owed by the Company to the bondholder. The amendment converted approximately $1,275,000 of the SYUK bond into shares of common stock, at a conversion price of £0.20 ($0.31) per share and the remaining balance was assigned to and assumed by ProPhotonix (IRL) Limited as part of the PPI Bond.

As of December 31, 2010 the entire balance was transferred or converted and the bond was cancelled. All related debt discount was expensed as a result of the extinguishment.

ProPhotonix (IRL) Limited Senior Fixed Rate Secured Bond

On July 24, 2008, ProPhotonix (IRL) Limited issued a three-year 12% Senior Fixed Rate Secured Bond("PPI Bond"), as amended at various times, to a bondholder in the original principal amount of €935,000 ($1,472,905 at July 24, 2008) secured by all of the assets of ProPhotonix (IRL) Limited. The bond was to originally mature on July 30, 2011. ProPhotonix (IRL) Limited agreed to make payments of principal and interest of approximately €31,000 over the term beginning August 30, 2008. The outstanding principal on the bond accrued interest at an original annual rate of 12%. ProPhotonix (IRL) Limited 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 bondholder 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%; an expected life of ten years; and an expected volatility of 98% with no dividend yield. The total value of the warrants was recorded as a debt discount of approximately $220,000 and was amortized over the life of the bond, using the effective interest method.

On June 9, 2009, the bondholder loaned the company an additional $500,000 payable over the remaining term of the original loan, at the same fixed 12% interest rate. As a part of the agreement, the Company issued to the bondholder 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 was 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%, an expected life of seven years, an expected volatility of 105.04% and no dividend yield.

Also on June 9, 2009, the Company and bondholder 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 PPI Bond. Interest accrues and is payable monthly and the amount was originally payable on July 30, 2011.

On December 10, 2010, the Company and the bondholder entered into a binding restructuring of the PPI Bond. The amendment provided that ProPhotonix (IRL) Limited assume €692,128 ($942,124) of the balance of the SYUK Bond, which was then combined with the existing PPI Bond. This bond is secured by the assets of ProPhotonix (IRL) Limited. The PPI Bond was amended such that interest only is paid monthly on the outstanding balance through June 30, 2012 and thereafter equal monthly payments of principal and interest over the three year period July 1, 2012 through June 30, 2015. The Company also paid a restructuring fee of $50,000 to the bondholder. The key repayment terms of the PPI Bond, under the most recent amendment, are as follows:

(a) Principal as of December 10, 2010:	€1,972,523 ($2,614,000)
(b) Interest Rate:	8% per annum
(c) Interest payments only:	through June 30, 2012
(d) Principal Repayment term:	36 months (July 31, 2012 through June 30, 2015)
(e) Monthly principal and interest:	€61,812 ($82,000)

At December 31, 2011, $2,424,917 remained outstanding under the note, which was classified as $794,027 current portion of long-term debt and $1,630,890 as long term debt.

At December 31, 2010, $2,614,184 remained outstanding under the note, which was classified as long-term debt.

Barclays Bank, PLC

On February 6, 2008, the Company's ProPhotonix Limited subsidiary in the U.K. 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 originally provided for a revolving line of credit not to exceed an aggregate principal amount of £700,000 ($1,083,000) and grants a security interest in and lien upon all of ProPhotonix Limited's trade receivables in favor of Barclays. The Company originally could 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 Limited and Barclays Bank, PLC.

The facility requires the maintenance of certain financial covenants including a minimum tangible net worth. On March 8, 2010, the Company entered into an amendment to the revolving credit facility agreement, which temporarily removed the minimum tangible net worth requirement of £350,000 ($541,000 USD as of December 31, 2011) as of March 31, 2010 and June 30, 2010. Barclays also reserves the right to review the facility in the event of losses at the ProPhotonix Limited subsidiary in any 3-month rolling period. The maximum amount allowed outstanding under the line of credit is £650,000 ($1,006,000 USD as of December 31, 2011). The outstanding principal under the note accrues interest at an annual rate of 2.65% above the Barclays base rate. The interest rate was 3.15% as of December 31, 2011.

On November 25, 2010, the Company entered into an amendment to the revolving credit facility agreement to extend the minimum period to May 25, 2012 from the original termination date of February 6, 2011.

The amount outstanding under the facility was $643,000 as of December 31, 2011 and $641,000 as of December 31, 2010, all of which was classified as a short term debt under revolving credit facility. As of December 31, 2011, the Company had approximately $25,000 available under this facility.

(9) TAXES

The Company had net deferred tax assets, before considering the full valuation allowance, totaling $30.0 million as of December 31, 2011 and $29.0 million as of December 31, 2010. 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.

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 2000 through 2011 remain open to examination by the federal and most state tax authorities. In addition, the tax years 2007 through 2011 are open to examination in foreign jurisdictions. As of December 31, 2011, 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 December 31,

	2011	2010
	In thousands	
Current		
Federal	$ —	$ —
State	—	—
Foreign	37	(46)
Sub-total	37	(46)
Deferred		
Federal	—	—
State	—	—
Foreign	—	(65)
Sub-total	—	(65)
Total provision (benefit)	$ 37	$ (111)

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

Years Ended December 31,

	2011	2010
	In thousands	
Continuing Operations	$ 37	$ (111)
Discontinued Operations	28	150
Total	$ 65	$ 39

The significant items comprising the deferred tax asset and liability at December 31, 2011 and 2010 are as follows:

Years Ended December 31,

	2011	2010
	In thousands	
Net operating loss carry forwards	$ 25,397	$ 24,289
Foreign net operating loss carry forwards	3,548	4,235
Financial reporting reserves not yet deductible for tax purpose	10	16
Accelerated depreciation and property-basis differences	68	57
Other	860	911
Valuation allowance	(29,750)	(29,276)
Total	$ 133	$ 232
Intangible asset-basis differences	(133)	(232)
Deferred tax liability, net	$ -	$ -

The Company's deferred tax liability, at December 31, 2011 and 2010 relates to the difference in the basis of its intangible assets acquired in a foreign jurisdiction.

As of December 31, 2011, the Company had United States federal net operating loss carry forwards (NOLs) of approximately $64.1 million available to offset future taxable income, if any. These carry forwards expire through 2031 and are subject to review and possible adjustment by the Internal Revenue Service. The Company may be subject to limitations under Section 382 of the Internal Revenue Service Code 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. At December 31, 2011, the Company also has Canadian federal NOLs of approximately $2.0 million available to offset future taxable income, if any. These carry forwards expire through 2031 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. At December 31, 2011, the Company also has a United Kingdom NOL of approximately $6.5 million, for which management has provided a full valuation allowance against. The valuation allowance increased by approximately $474,000 and $575,000 for the years ended December 31, 2011 and 2010.

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 statements. As of December 31, 2011 and 2010, the Company has cumulatively recorded long-term liabilities of $178,000 and $150,000 respectively, relative to the sale of its North American operations to Coherent, Inc.

(10) UNREGISTERED SALES OF EQUITY SECURITIES AND WARRANTS

On December 23, 2010, the Company listed on the London Stock Exchange-AIM. In the course of this listing, the Company sold 3,825,000 shares of common stock at £0.20 ($0.31 as of December 23, 2010) per share. Also, the Company issued an additional 50,000 shares of common stock for fees associated with the listing in lieu of cash (fair value of approximately $16,000 at grant date).

On December 23, 2010, pursuant to the terms of the Company's listing on the London Stock Exchange-AIM, the Company issued a warrant to purchase up to an aggregate of 76,500 shares of the Company's common stock to Libertas Capital Corporate Finance Limited. The warrant is exercisable at any time at a per share price of £0.20 and expires on the fifth anniversary of the grant date. 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 2.09%, an expected life of five years and an expected volatility of 156% with no dividend yield. The fair value of the warrant issue was approximately $22,000 at grant date.

On July 13, 2011, the Company sold approximately 23,250,000 shares of common stock on the London Stock Exchange, AIM listing at a price of £0.14 ($0.22) per share for a total of £3.0 million, net of expenses (approximately $4.9 million).

Warrants

As of December 31, 2011, there were 7,828,188 common shares underlying outstanding warrants with the following exercise prices and expiration dates:

Number of Common Shares Underlying Warrants	Exercise Price	Expiration Date
18,621	$0.80 –$0.80	2012
1,127,000	$0.50 –$0.50	2013
5,000	$0.50 –$0.50	2014
551,500	$0.32 –$1.44	2015
3,570,000	$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
7,828,188		

(11) STOCK OPTION PLANS

Under the Company's 2007 Stock Incentive Plan (the 2007 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% 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 December 31, 2011, there were 8,300,000 shares reserved for issuance and there were 7,300,000 shares reserved at December 31, 2010.

In May 2010, the Board of Directors approved the Second Amended and Restated Policy Regarding Compensation of Independent Directors, which provided that the $50,000 annual compensation of independent directors be divided into a $15,000 cash payment and an option to purchase shares of common stock that have an aggregate market value of $35,000 as of the date of the grant and that the prior $5,000 additional annual compensation given to chairs of committees be revoked. In August 2010, the Board of Directors approved the Third Amended and Restated Policy Regarding Compensation of Independent Directors, which added a provision for an initial grant to new directors of an option to purchase 75,000 shares of common stock. There were no options issued as a part of or after the August 2010 amendment. In March 2011, the Board of Directors approved the Fourth Amended and Restated Policy Regarding Compensation of Independent Directors, which revoked the provision that provides the initial 75,000 option grant to new directors.

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. No further grants are allowed under this plan.

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. No further grants are allowed under this plan.

The Company had 1,564,244 shares available for future grants of options and restricted shares December 31, 2011. The following table summarizes information about the stock options outstanding as of December 31, 2011. The intrinsic value on the options outstanding at December 31, 2011 is approximately $23,000. The intrinsic value of the options exercisable at December 31, 2011 is approximately $3,000.

During 2011 and 2010, the GNRC approved various qualified and non-qualified stock option awards to purchase shares of the Company's common stock to various officers, directors and employees. There were 2,549,198 options granted during the year ended December 31, 2011 and 2,410,562 options were granted during the year ended December 31, 2010. 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. The exercise price for these options range from $0.09 to $0.21 per share in 2011, to $0.08 to $0.12 per share in 2010.

The weighted average assumptions for grants during the years ended December 31, 2011 and December 31, 2010 used in the Black-Scholes option pricing model were as follows:

	Twelve months Ended December 31, 2011	Twelve months Ended December 31, 2010
Volatility………………………………………..	162.1%-167.2%	111.6%-112.2%
Expected option life……………………………	5.3 years	5.5 – 6.08 years
Interest rate (risk free)………………………….	1.81%-2.54%	3.05%-3.83%
Dividends……………………………………….	$0	$0
Weighted average grant date fair value………...	$0.12	$0.08

	Options Outstanding	Weighted Average Exercise Price per Share ($)	Weighted Average Remaining Contractual Term (in Years)
Balance at December 31, 2009	3,005,098	2.87	5.56
Granted	2,410,562	0.11	
Exercised	-	-	
Cancelled	(777,252)	4.05	
Balance at December 31, 2010	4,638,408	1.23	7.25
Vested and Exercisable at December 31, 2010	3,349,286	1.65	6.77
Balance at December 31, 2010	4,638,408	1.23	7.25
Granted	2,549,198	0.12	
Exercised	-	-	
Cancelled	(619,666)	6.23	
Balance at December 31, 2011	6,567,940	0.33	7.70
Vested and Exercisable at December 31, 2011	3,383,786	0.52	6.57
Vested and Expected to Vest at December 31, 2011	6,224,834	0.34	7.57

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	6,040,540	8.2	$ 0.16	2,856,386	$ 0.19
1.00 – 1.99	320,900	2.1	1.25	320,900	1.25
2.00 – 3.99	76,500	2.1	2.35	76,500	2.35
4.00 – 6.99	125,400	0.4	4.85	125,400	4.85
7.00 – 11.99	4,600	0.2	7.20	4,600	7.20
$ 0.08 – 11.99	6,567,940	7.7	$ 0.33	3,383,786	$ 0.52

At December 31, 2011, there was approximately $258,000 of total unrecognized compensation cost related to stock options granted. The cost is expected to be recognized over the next 2.08 years. Total stock option expense recorded in 2011 and 2010 was approximately $83,000 and $198,000, respectively. There were no options exercised during 2011 and 2010.

On March 14, 2012, and on March 22, 2012, the GNRC approved qualified stock option awards to purchase shares of the Company's common stock to officers, and employees. A total of 2,085,000 options were granted

on these two dates. These options vest over a four year anniversary of the grant date, provided that the recipient continues to serve the Company in that capacity until each such vesting.

A summary of the status of the Company's non-vested shares of restricted stock for 2011 and 2010 and changes during 2011 and 2010 are presented below:

	Shares	Weighted Average Grant-Date Fair Value
Non-vested at December 31, 2009	490,689	$ 1.15
Granted	-	-
Vested	(281,735)	1.18
Cancelled	(12,930)	1.26
Non-Vested at December 31, 2010	196,024	$ 1.10
Granted	-	-
Vested	(158,524)	$ 1.20
Cancelled	-	-
Non-Vested at December 31, 2011	37,500	$ 0.67

As of December 31, 2011, there was approximately $1,000 of total unrecognized compensation cost related to restricted stock awards. The cost is expected to be recognized in January 2012. As of December 31, 2011, 2,066,702 shares were vested. As of December 31, 2010, 1,908,178 shares were vested. The total fair value of shares vested during 2011 and 2010 was approximately $190,000 and $332,000. Total compensation from continuing operations recorded in 2011 and 2010 was approximately $116,000 and $303,000, respectively.

(12) 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% 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 December 31, 2011 and 2010, there were no shares issued under the Stock Purchase Plan.

(13) EMPLOYEE BENEFIT PLANS

On January 17, 1994, the Company established the StockerYale, Inc. 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% of the employee contributions, and profit sharing contributions at its discretion. The Company made matching contributions of $27,000 in the year ended December 31, 2011 and $30,000 in the year ended December 31, 2010. The Company incurred costs of approximately $2,300 in 2011 and approximately $3,000 in 2010 to administer the Plan.

The Company also has voluntary contribution pension schemes in Ireland and in the United Kingdom. In the United Kingdom, the Company contributes a maximum of 3% of the participating employee salaries, with one exception, where the maximum contribution is 10%. The plan is voluntary, with plan administration costs coming out of the plan itself. The Company made contributions of approximately $38,000 and $35,000 in the

years ended December 31, 2011 and 2010, respectively. In Ireland, the Company also has a voluntary plan that matches contributions for those participating employees with minimum of 6 months of service. After two years of service, the Company will match up to a maximum of 5% of salary. The Company made contributions of approximately $28,000 and $24,000 in the years ended December 31, 2011 and 2010, respectively. Plan administration costs come out of the plan itself.

(14) DISCONTINUED OPERATIONS

SYC was sold to Coherent on October 13, 2009, and has been reported as discontinued operations. Amounts recorded in loss from discontinued operations for the years ended December 31, 2011 and 2010 represent the professional fees and other expenses associated with the sold business. The loss from discontinued operations for the years ended December 31, 2011 and 2010 was $19,000 and $116,000, respectively. The Company recorded a gain of approximately $0.5 million on the sale of discontinued operations in 2010 related to the working capital adjustment.

(15) COMMITMENTS AND CONTINGENCIES

Lease obligation treated as financing

On December 30, 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 November 29, 2005, as amended on December 22, 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. Accordingly, the Company carried the value of the building on its balance sheet and recorded depreciation expense until the criteria to record a sale were met on December 31, 2010; the expiration date of the lease. The Company recognized a gain of approximately $660,000 upon completion of the sale at December 31, 2010.

On December 31, 2010, the Company amended the lease to reduce the rentable space to 3,600 square feet. The term of the lease was amended to require monthly tenant at-will payments with a 90 day termination notice. Base rent was amended from $16,949 per month to $2,550 per month and the tenant's share of expense was reduced.

Other obligations and contingent liabilities

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

ProPhotonix Limited (UK) leases approximately 13,000 square feet of space in Hatfield Broad Oak, Hertfordshire, UK. The lease has a term of nine years ending September 29, 2013.

The Company's Canadian subsidiary, StockerYale Canada Inc., was the prime tenant of the property located at 275 Kesmark Street, Montreal, Quebec, Canada. The lease ended in mid January, 2011.

The Company utilizes, or has assumed, capital leases to finance purchases of equipment or vehicles. There was approximately $0 and $29,000 payable in principal and interest under these leases at December 31, 2011

and December 31, 2010, respectively. The Company records depreciation expense on assets acquired under a capital lease in the consolidated statement of operations.

The net book value of assets acquired under capital leases at December 31, 2011 and December 31, 2010, is as follows:

	2011	2010
Assets under capital lease	$ 571,000	$ 573,000
Less—accumulated depreciation	(497,000)	(430,000)
Assets under capital lease, net	$ 74,000	$ 143,000

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

Due by period	2012	2013	2014	2015 +	Total
			in thousands		
Debt obligations	$ 2,230	$ 861	$ 770	$ —	$3,861
Operating lease obligations	274	152	—	—	426
	$ 2,504	$ 1,013	$ 770	$ —	$4,287

The Company expensed approximately $313,000 and $369,000 in rent for the years ended December 31, 2011 and 2010, respectively.

(16) LEGAL PROCEEDINGS

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.

(17) SUBSEQUENT EVENTS

The Company has evaluated subsequent events through April 11, 2012, the date which the financial statements were available to be issued, and there were no events that impacted these financial statements or required additional disclosure to the financial statements.

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