POET

TECHNOLOGIES INC.

Consolidated Financial Statements Years ended December 31, 2016, 2015 and 2014

INDEPENDENT AUDITORS' REPORT

To the Audit Committee of the
Board of Directors and Shareholders
of **POET Technologies Inc.**

We have audited the accompanying consolidated financial statements of POET Technologies Inc., which comprise the consolidated statements of financial position as at December 31, 2016, 2015 and 2014, and the consolidated statements of operations and deficit, comprehensive loss, changes in shareholders' equity and cash flows for the years ended December 31, 2016, 2015 and 2014, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion the financial statements present fairly, in all material respects, the consolidated financial position of POET Technologies Inc. as at December 31, 2016, 2015 and 2014, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2016, 2015 and 2014 in accordance with IFRS as issued by the International Accounting Standards Board.

Marcum LLP

Hartford, CT
April 3, 2017

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POET TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Expressed in US Dollars)

December 31,	**2016**	2015	2014
Assets			
Current			
Cash	**$ 14,376,282**	$ 14,409,996	$ 11,287,864
Short-term investments (Note 2)	**589,275**	-	-
Accounts receivable (Note 4)	**292,849**	-	-
Prepaids and other current assets (Note 5)	**758,917**	150,923	243,501
Inventory (Note 6)	**1,116,880**	-	-
	17,134,203	14,560,919	11,531,365
Property and equipment (Note 7)	**9,364,210**	947,107	1,058,860
Patents and licenses (Note 8)	**449,676**	426,813	260,721
Intangible assets (Note 9)	**876,865**	-	-
Goodwill (Note 22)	**7,681,003**	-	-
	$ 35,505,957	$ 15,934,839	$ 12,850,946
Liabilities			
Current			
Accounts payable and accrued liabilities (Note 10)	**$ 1,624,344**	$ 515,421	$ 451,724
	1,624,344	515,421	451,724
Deferred tax liability (Note 22)	**1,596,307**	-	-
Deferred rent	**42,665**	-	-
	3,263,316	515,421	451,724
Shareholders' Equity			
Share capital (Note 11(b))	**103,357,862**	81,027,171	61,688,953
Warrants (Note 12)	**5,985,378**	2,013,747	6,458,659
Contributed surplus (Note 13)	**29,062,874**	25,618,159	23,616,664
Accumulated other comprehensive loss	**(2,088,117)**	(2,388,987)	(584,552)
Deficit	**(104,075,356)**	(90,850,672)	(78,780,502)
	32,242,641	15,419,418	12,399,222
	$ 35,505,957	$ 15,934,839	$ 12,850,946

Commitments and contingencies (Note 15)

On behalf of the Board of Directors

Director

Director

POET TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
(Expressed in US Dollars)

For the Years Ended December 31,	2016	2015	2014
Revenue	**$ 1,861,747**	$ -	$ -
Cost of sales	**1,379,838**	-	-
Gross margin	**481,909**	-	-
Operating expenses			
Selling, marketing and administration (Note 20)	**11,260,576**	8,614,109	9,677,705
Research and development (Note 20)	**2,893,016**	3,532,492	2,277,927
Impairment loss (Notes 2, 7 and 21)	**63,522**	-	-
Loss on disposal of property and equipment (Note 7)	**46,738**	-	-
Other income, including interest	**(66,872)**	(76,431)	(169,832)
Operating expenses	**14,196,980**	12,070,170	11,785,800
Net loss from operations	**(13,715,071)**	(12,070,170)	(11,785,800)
Change in fair value of contingent consideration (Note 22)	**(283,130)**	-	-
Net loss before income tax recovery	**(13,431,941)**	(12,070,170)	(11,785,800)
Income tax recovery (Note 23)	**(207,257)**	-	-
Net loss	**(13,224,684)**	(12,070,170)	(11,785,800)
Deficit, beginning of year	**(90,850,672)**	(78,780,502)	(66,994,702)
Net loss	**(13,224,684)**	(12,070,170)	(11,785,800)
Deficit, end of year	**$(104,075,356)**	$(90,850,672)	$(78,780,502)
Basic and diluted net loss per share (Note 14)	**$ (0.06)**	$ (0.07)	$ (0.08)

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Expressed in US Dollars)

For the Years Ended December 31,	2016	2015	2014
Net loss	**$(13,224,684)**	$(12,070,170)	$(11,785,800)
Other comprehensive income (loss) - net of income taxes			
Exchange differences on translating foreign operations	**300,870**	(1,804,435)	(572,959)
Comprehensive loss	**$(12,923,814)**	$(13,874,605)	$(12,358,759)

POET TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Expressed in US Dollars)

For the Years Ended December 31,	2016	2015	2014
Share Capital			
Beginning balance	**$ 81,027,171**	$ 61,688,953	$ 42,911,455
Funds from the exercise of warrants and compensation warrants	**1,943,919**	9,373,245	8,404,265
Fair value of warrants and compensation warrants exercised	**901,417**	4,444,912	3,545,406
Warrant exercise incentive	**-**	-	(31,712)
Funds from the exercise of stock options	**1,654,988**	2,703,436	1,481,716
Fair value assigned to stock options exercised	**1,737,879**	2,816,625	1,261,156
Commons shares issued on business acquisitions	**12,050,000**	-	-
Common shares issued to settle liabilities	**1,843,629**	-	-
Common shares issued on public offering	**9,349,254**	-	4,546,000
Warrants issued on public offering	**(5,985,378)**	-	(1,869,231)
Share issue costs	**(1,165,017)**	-	-
Common shares issued for reduction of license fee	**-**	-	1,439,898
December 31,	**103,357,862**	81,027,171	61,688,953
Warrants			
Beginning balance	**2,013,747**	6,458,659	8,135,590
Fair value of warrants issued	**5,985,378**	-	1,869,231
Fair value of warrants and compensation warrants exercised	**(901,417)**	(4,444,912)	(3,545,406)
Fair value of expired warrants	**(1,112,330)**	-	(756)
December 31,	**5,985,378**	2,013,747	6,458,659
Contributed Surplus			
Beginning balance	**25,618,159**	23,616,664	20,261,067
Stock-based compensation	**4,070,264**	4,818,120	4,615,997
Fair value of stock options exercised	**(1,737,879)**	(2,816,625)	(1,261,156)
Fair value of expired warrants	**1,112,330**	-	756
December 31,	**29,062,874**	25,618,159	23,616,664
Accumulated Other Comprehensive Loss			
Beginning balance	**(2,388,987)**	(584,552)	(11,593)
Other comprehensive income (loss) attributable to common shareholders - translation adjustment	**300,870**	(1,804,435)	(572,959)
December 31,	**(2,088,117)**	(2,388,987)	(584,552)
Deficit			
Beginning balance	**(90,850,672)**	(78,780,502)	(66,994,702)
Net loss	**(13,224,684)**	(12,070,170)	(11,785,800)
December 31,	**(104,075,356)**	(90,850,672)	(78,780,502)
Total shareholders' equity	**$ 32,242,641**	$ 15,419,418	$ 12,399,222

POET TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in US Dollars)

For the Years Ended December 31,	**2016**	2015	2014
CASH (USED IN) PROVIDED BY:			
OPERATING ACTIVITIES			
Net loss	**$ (13,224,684)**	$ (12,070,170)	$ (11,785,800)
Adjustments for:			
Depreciation of property and equipment (Note 7)	**1,448,525**	276,139	210,717
Amortization of patents and licenses (Note 8)	**49,775**	43,722	26,238
Amortization of intangibles (Note 9)	**23,266**	-	-
Loss on disposition of property and equipment (Note 7)	**46,738**	-	-
Impairment of non-current asset held for sale (Notes 2, 7 and 21)	**63,522**	-	-
Stock-based compensation (Note 13)	**4,070,264**	4,818,120	4,615,997
Change in fair value of contingent consideration (Note 22)	**(283,130)**	-	-
Income tax recovery (Note 23)	**(207,257)**	-	-
Deferred rent	**42,665**	-	-
Shares issued on the reduction of license fee	**-**	-	1,439,898
	(7,970,316)	(6,932,189)	(5,492,950)
Net change in non-cash working capital accounts:			
Accounts receivable	**(77,415)**	-	-
Prepaid and other current assets	**(443,590)**	92,578	23,908
Inventory	**(841,806)**	-	-
Accounts payable and accrued liabilities	**(628,292)**	63,697	195,697
Cash flows from operating activities	**(9,961,419)**	(6,775,914)	(5,273,345)
INVESTING ACTIVITIES			
Cash proceeds from acquisitions	**18,791**	-	-
Proceeds from the disposal of property and equipment (Note 7)	**37,195**	-	-
Purchase of property and equipment (Note 7)	**(1,208,532)**	(164,386)	(365,785)
Purchase of patents and licenses (Note 8)	**(72,638)**	(209,814)	(161,283)
Advances made prior to acquisition (Note 22)	**(500,000)**	-	-
Purchase of short-term investments	**(598,148)**	-	-
Cash flows from investing activities	**(2,323,332)**	(374,200)	(527,068)
FINANCING ACTIVITIES			
Issue of common shares for cash, net of issue costs (Note 11)	**11,783,144**	12,076,681	14,400,269
Cash flows from financing activities	**11,783,144**	12,076,681	14,400,269
EFFECT OF EXCHANGE RATE CHANGES ON CASH	**467,893**	(1,804,435)	(572,959)
NET CHANGE IN CASH	**(33,714)**	3,122,132	8,026,897
CASH, beginning of year	**14,409,996**	11,287,864	3,260,967
CASH, end of year	**$ 14,376,282**	$ 14,409,996	$ 11,287,864

1. DESCRIPTION OF BUSINESS

POET Technologies Inc. is incorporated in the Province of Ontario. POET Technologies Inc. and its subsidiaries (the "Company") are developers of the planar opto-electronic technology (“POET”) platform semiconductor process IP for monolithic fabrication of integrated circuit devices containing both electronic and optical elements on a single die. The Company also designs, manufactures and sells photonic sensing and optical light source products. The Company's head office is located at 120 Eglinton Avenue East, Suite 1107, Toronto, Ontario, Canada M4P 1E2. These consolidated financial statements of the Company were approved by the Board of Directors of the Company on March 31, 2017.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements of the Company and its subsidiaries were prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

The preparation of financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed below:

Basis of presentation
These consolidated financial statements include the accounts of POET Technologies Inc. and its subsidiaries; ODIS Inc. ("ODIS"), Opel Solar Inc., BB Photonics Inc., BB Photonics UK Limited (collectively "BB Photonics") and DenseLight Semiconductors Pte. Ltd ("DenseLight"). All intercompany balances and transactions have been eliminated on consolidation.

Business combinations
Acquisitions of businesses are accounted for using the acquisition method. The acquisition cost is measured at the acquisition date at the fair value of the consideration transferred, including all contingent consideration.

Subsequent changes in contingent consideration are accounted for through the consolidated statements of operations and deficit and consolidated statements of comprehensive loss in accordance with the applicable standards.

Goodwill arising on acquisition is initially measured at cost, being the difference between the fair value of the consideration transferred including the recognized amount of any non-controlling interest in the acquiree and the net recognized amount (generally fair value) of the identifiable assets and liabilities assumed at the acquisition date. If the net of the amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer’s previously held interest in the acquiree (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain.

Acquisition-related costs, other than those that are associated with the issue of debt or equity securities that the Company incurs in connection with a business combination, are expensed as incurred.

Foreign currency translation
These consolidated financial statements are presented in U.S. dollars ("USD"), which is the Company's presentation currency.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Items included in the financial statements of each of the Company's subsidiaries are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities not denominated in the functional currency of an entity are recognized in the statement of operations and deficit.

Assets and liabilities of entities with functional currencies other than U.S. dollars are translated into the presentation currency at the year end rates of exchange, and the results of their operations are translated at average rates of exchange for the year. The resulting translation adjustments are included in accumulated other comprehensive loss in shareholders' equity. Additionally, foreign exchange gains and losses related to certain intercompany loans that are permanent in nature are included in accumulated other comprehensive loss.

Financial Instruments

Financial instruments are required to be classified as one of the following: held-to-maturity; loans and receivables, fair value through profit or loss; available-for-sale or other financial liabilities.

The Company's financial instruments include cash, short-term investments, accounts receivable, accounts payable and accrued liabilities. The Company designated its cash and short-term investments as fair value through profit or loss and its accounts payable and accrued liabilities as other financial liabilities.

Fair value through profit or loss financial assets are measured at fair value with gains and losses recognized in operations. Financial assets, loans and receivables and other financial liabilities are measured at amortized cost. Available-for-sale financial assets are measured at fair value with unrealized gains and losses recognized in other comprehensive loss.

Fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, the fair value of a financial instrument that is quoted in active markets is based on the bid price for a financial asset held and the offer price for a financial liability. When an independent price is not available, fair value is determined by using a valuation methodology that refers to observable market data. Such a valuation technique includes comparisons with a similar financial instrument where an observable market price exists, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. If no reliable estimate can be made, the Company measures the financial instrument at cost less impairment as a last resort.

Accounts receivable

Accounts receivable are amounts due from customers from the sale of products or services in the ordinary course of business. Accounts receivables are classified as current (on the consolidated statements of financial position) if payment is due within one year of the reporting period date, and are initially recognized at fair value and subsequently measured at amortized cost.

The provision policy for doubtful accounts of the Company is based on the ageing analysis and management's ongoing evaluation of the recoverability of the outstanding receivables. A considerable amount of judgement is required in assessing the ultimate realization of these receivables, including the assessment of the creditworthiness and the past collection history of each customer. If the financial conditions of these customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. As at the balance sheet date, no provision was required for accounts receivable.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventory

Inventory consists of raw material inventory, work in process, and finished goods and are recorded at the lower of cost and net realizable value. Cost is determined on a first in first out basis and includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventory to its present condition.

An assessment is made of the net realizable value of inventory at each reporting period. Net realizable value is the estimated selling price less the estimated cost of completion and the estimated costs necessary to make the sale. When circumstances that previously caused inventories to be written down no longer exist or when there is clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of any write down previously recorded is reversed so that the new carrying amount is the lower of the cost and the revised net realizable value. Raw materials are not written down unless the goods in which they are incorporated are expected to be sold for less than cost, in which case, they are written down by reference to replacement cost of the raw materials, as this is the best indicator of net realizable value.

Property and equipment

Property and equipment are recorded at cost. Depreciation is calculated based on the estimated useful life of the asset using the following method and useful lives:

Machinery and equipment	Straight Line, 5 years
Leasehold improvements	Straight Line, 5 years or life of the lease, whichever is less
Office equipment	Straight Line, 5 years

Patents and licenses

Patents and licenses are recorded at cost and amortized on a straight line basis over 12 years. Ongoing maintenance costs are expensed as incurred.

Impairment of long-lived assets

The Company's tangible and intangible assets are reviewed for indications of impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. An assessment is made at each reporting date whether there is any indication that an asset may be impaired.

An impairment loss is recognized when the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in profit and loss for the year. The recoverable amount is the greater of the asset's fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit ("CGU") to which the asset belongs.

An impairment loss is reversed if there is an indication that there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

The Company reported an impairment loss of $63,522 (note 21) for the year ended December 31, 2016. The Company did not record an impairment loss in 2015 and 2014.

Goodwill

Goodwill represents the excess of the cost of an acquired business over the fair value of the identifiable assets acquired net of liabilities assumed. Goodwill is measured at cost less accumulated impairment losses and is not amortized. Goodwill is tested for impairment on an annual basis or whenever facts or circumstances indicate that the carrying amount may exceed its recoverable amount.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Contingent consideration
The Company may pay future consideration related to acquisitions based upon performance measures contractually agreed at the time of purchase. Management estimates the future consideration payable based on underlying contract terms, and best estimates of the future performance of the acquiree. Depending on the future performance of the acquiree, management estimates of the amounts payable for future consideration related to acquisitions may materially differ from the consideration ultimately paid.

Income taxes
The Company follows the liability method of accounting for income taxes. Under this method, deferred income taxes are provided on differences between the financial reporting and income tax bases of assets and liabilities and on income tax losses available to be carried forward to future years for tax purposes. Deferred income taxes are measured using the substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Valuation allowances are provided to reduce deferred income tax assets to the amount expected to be realized.

Revenue recognition

Sale of goods
Revenue from the sale of goods is recognized when significant risks and rewards of ownership are transferred to the buyer, there is persuasive evidence of an arrangement, collection is probable and fees are fixed and determinable.

Service revenue
Revenue from services that are one year or less is recognized when the services are completed. Revenue from services of a long-term nature is recognized by reference to the stage of completion of the transaction at the end of the reporting period determined by services performed to date as a percentage of total services and the amount of revenue, stage of completion, and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Interest income
Interest income on cash and cash equivalents classified as fair value through profit or loss is recognized as earned using the effective interest method.

Other income - Government Grants
Grants received exclusively from governmental agencies such as the Department of Defense of the United States of America, NASA and Productivity and Innovation Credit Scheme Singapore ("PIC Grant"), relating to research and development or expenditure on technology, are recognized as other income. Government grants from the United States are based on the agreed upon milestones of the projects. PIC Grants are offered as a percentage of qualifying expenditures. PIC Grants are paid out in cash. Other income earned on government grants in 2016 was $14,027 (2015 - nil and 2014 - $169,832).

Intangible assets

Research and development costs
Research costs are expensed in the year incurred. Development costs are also expensed in the year incurred unless the Company believes a development project meets IFRS criteria as set out in IAS 38, *Intangible Assets*, for deferral and amortization. IAS 38 requires all research costs be charged to expense while development costs are capitalised only after technical and commercial feasibility of the asset for sale or use have been established. This means that the entity must intend and be able to complete the intangible asset and either use it or sell it and be able to demonstrate how the asset will generate future economic benefits. Development costs are tested for impairment whenever events or changes indicate that its carrying amount may not be recoverable.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In-Process Research and Development
Under IFRS, in-process research and development ("IPR&D") acquired in a business combination that meets the definition of an intangible asset is capitalized with amortization commencing when the asset is ready for use (i.e., when development is complete). The Company acquired $714,000 of IPR&D when it acquired BB Photonics Inc.

Customer relationships
Intangible assets include customer relationships acquired with the acquisition of DenseLight. Customer relationships is an externally acquired intangible asset and is measured at cost less accumulated amortization and any accumulated impairment losses. Customer relationships are amortized on a straight-line basis over their estimated useful lives and is tested for impairment whenever events or changes indicate that their carrying amount may not be recoverable. The useful life of customer relationships was determined to be 5 years.

Stock-based compensation
Stock options and warrants awarded to non employees are accounted for using the fair value of the instrument awarded or service provided whichever is considered more reliable. Stock options and warrants awarded to employees are accounted for using the fair value method. The fair value of such stock options and warrants granted is recognized as an expense on a proportionate basis consistent with the vesting features of each tranche of the grant. The fair value is calculated using the Black-Scholes option pricing model with assumptions applicable at the date of grant.

Loss per share
Basic loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the year. Diluted loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the year after giving effect to potentially dilutive financial instruments. The dilutive effect of stock options and warrants is determined using the treasury stock method.

Short-term investments
The short-term investments of $589,275 consist of guaranteed investment certificates (GICs) held with one Canadian chartered bank and earn interest at a rate of 0.50%. The GICs have maturity dates between May 2017 and October 2017. Investments are carried at fair value.

3. RECENT ACCOUNTING PRONOUNCEMENTS

The following is a summary of recent accounting pronouncements that may affect the Company:

IFRS 15, Revenue from Contracts with Customers ("IFRS 15"). The IASB issued IFRS 15, which is effective for annual periods beginning on or after January 1, 2018. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time and over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The Company is in the process of assessing the impact of this standard on its consolidated financial statements. Based on current assessment, the Company does not expect that this new standard will impact how the Company currently recognizes revenue.

(Expressed in US Dollars)

3. RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

IFRS 16, Leases ("IFRS 16") sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, the customer (lessee) and the supplier (lessor). This will replace IAS 17, Leases ("IAS 17") and related Interpretations. IFRS 16 provides revised guidance on identifying a lease and for separating lease and non-lease components of a contract. IFRS 16 introduces a single accounting model for all lessees and requires a lessee to recognize right-of-use assets and lease liabilities for leases with terms of more than 12 months, unless the underlying asset is of low value, and depreciation of lease assets is reported separately from interest on lease liabilities in the income statement. Under IFRS 16, lessor accounting for operating and finance leases will remain substantially unchanged. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier application permitted for entities that apply IFRS 15, Revenue from Contracts with Customers. The Company is in the process of assessing the impact of this standard on its consolidated financial statements.

4. ACCOUNTS RECEIVABLE

The carrying amounts of accounts receivable approximate their fair value and are originally denominated in the following currencies before conversion to US dollars below at December 31:

			2016		2015		2014
Product sales	United States dollar	**$**	**292,849**	$	-	$	-

In determining the recoverability of a trade receivable, the Company considers any change in the credit quality of the trade receivable from the date credit was initially granted up to the reporting date. The trade receivables that are neither past due nor impaired relates to customers that the company has assessed to be creditworthy based on the credit evaluation process performed by management.

5. PREPAIDS AND OTHER CURRENT ASSETS

The following table reflects the details of prepaids and other current assets at December 31:

		2016		2015		2014
Sales tax recoverable and other current assets	**$**	**147,119**	$	52,401	$	96,226
Security deposits on leased properties		**272,026**		-		-
Prepaid expenses		**339,772**		98,522		147,275
	$	**758,917**	$	150,923	$	243,501

6. INVENTORY

The following table reflects the details of inventory at December 31:

		2016		2015		2014
Raw materials	**$**	**662,458**	$	-	$	-
Finished goods		**358,386**		-		-
Work in process		**96,036**		-		-
	$	**1,116,880**	$	-	$	-

(Expressed in US Dollars)

7. PROPERTY AND EQUIPMENT

	Equipment not in service	Leasehold improvements	Machinery and equipment	Office equipment	Total
Cost					
Balance, January 1, 2014	$ -	$ -	$ 958,949	$ 8,746	$ 967,695
Additions	3,152	-	314,973	47,660	365,785
Balance, December 31, 2014	3,152	-	1,273,922	56,406	1,333,480
Additions	7,024	5,896	126,181	25,285	164,386
Reclassification	(10,176)	10,176	-	-	-
Balance, December 31, 2015	-	16,072	1,400,103	81,691	1,497,866
Additions (1) (Note 21)	602,830	667,342	8,498,051	244,860	10,013,083
Disposals (1) (Note 21)	-	(16,072)	(64,747)	(11,734)	(92,553)
Reclassification/impairment (2)	-	-	(98,522)	-	(98,522)
Balance,December 31, 2016	602,830	667,342	9,734,885	314,817	11,319,874
Accumulated Depreciation					
Balance, January 1, 2014	-	-	62,000	1,903	63,903
Depreciation for the year	-	-	203,008	7,709	210,717
Balance, December 31, 2014	-	-	265,008	9,612	274,620
Depreciation for the year	-	3,104	258,190	14,845	276,139
Balance, December 31, 2015	-	3,104	523,198	24,457	550,759
Depreciation for the year	-	83,189	1,320,050	45,286	1,448,525
Disposals (1)	-	(3,104)	(34,940)	(5,576)	(43,620)
Balance, December 31, 2016	-	83,189	1,808,308	64,167	1,955,664
Carrying Amounts					
At December 31, 2014	$ 3,152	$ -	$ 1,008,914	$ 46,794	$ 1,058,860
At December 31, 2015	$ -	$ 12,968	$ 876,905	$ 57,234	$ 947,107
At December 31, 2016	$ 602,830	$ 584,153	$ 7,926,577	$ 250,650	$ 9,364,210

(1) During 2016, the Company (a) reduced its operations in Toronto and disposed of $27,806 of its property and equipment for proceeds of $2,195 and recorded a loss on the disposal of property and equipment of $16,931. The Company disposed of an additional $64,747 of machinery and equipment at a loss of $29,807 (b) added $217,722 of new equipment, however, only $119,200 was purchased during the year, $98,522 was purchased in 2015 but was classified as a prepaid deposit as it was not placed in use at December 31, 2015 (c) through the acquisition of DenseLight and BB Photonics, the Company acquired $8,706,029 of leaseholds improvements, machinery and office equipment (d) purchased an additional $1,089,332 of machinery and office equipment at DenseLight, $602,830 of which has not yet been placed into service.

(2) $35,000 was reclassified to non-current assets held for sale and was sold in July 2016, while $63,522 was recorded as an impairment loss on the consolidated statements of operations and deficit.

8. PATENTS AND LICENSES

Cost	
Balance, January 1, 2014	$ 166,152
Additions	161,283
Balance, December 31, 2014	327,435
Additions	209,814
Balance, December 31, 2015	537,249
Additions	72,638
Balance, December 31, 2016	609,887

(Expressed in US Dollars)

8. PATENTS AND LICENSES (Continued)

Accumulated Amortization		
Balance, January 1, 2014		40,476
Amortization		26,238
Balance, December 31, 2014		66,714
Amortization		43,722
Balance, December 31, 2015		110,436
Amortization		49,775
Balance, December 31, 2016		160,211
Carrying Amounts		
At December 31, 2014	$	260,721
At December 31, 2015	$	426,813
At December 31, 2016	$	449,676

9. INTANGIBLE ASSETS

		Technology		Customer Relationships		Total
Cost						
Balance, January 1, 2014, 2015 and 2016	$	-	$	-	$	-
Acquired through the acquisition of DenseLight		-		186,131		186,131
Acquired through the acquisition of BB Photonics		714,000		-		714,000
Balance, December 31, 2016		714,000		186,131		900,131
Accumulated Amortization						
Balance, January 1, 2014, 2015 and 2016		-		-		-
Amortization for the year		-		23,266		23,266
Balance, December 31, 2016		-		23,266		23,266
Carrying Amounts						
At January 1, 2014, 2015 and 2016	$	-	$	-	$	-
At December 31, 2016	$	714,000	$	162,865	$	876,865

10. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at December 31 was as follows:

		2016		2015		2014
Trade payable	**$**	**768,066**	$	337,564	$	79,406
Payroll related liabilities		**628,378**		104,788		113,338
Accrued liabilities		**183,037**		73,069		258,980
Lease commitment		**44,863**		-		-
	$	**1,624,344**	$	515,421	$	451,724

Payroll related liabilities at December 31, 2016 includes $450,000 of bonus payable to the CEO along with $87,751 of past salaries due to some current and former employees of DenseLight.

(Expressed in US Dollars)

11. SHARE CAPITAL

(a) AUTHORIZED

Unlimited number of common shares

One special voting share

(b) COMMON SHARES ISSUED

	Number of Shares	Amount
Balance, January 1, 2014	132,676,115	$ 42,911,455
Shares issued on the exercise of stock options	4,824,950	1,481,716
Fair value of stock options exercised	-	1,261,156
Shares issued on private placements	7,692,307	4,546,000
Fair value of warrants and compensation warrants issued	-	(1,869,231)
Shares issued on the exercise of warrants and compensation warrants	19,384,712	8,404,265
Fair value of warrants and compensation warrants exercised	-	3,545,406
Warrant exercise incentive	-	(31,712)
Shares issued for reduction of license fee	2,000,000	1,439,898
Balance, December 31, 2014	166,578,084	61,688,953
Shares issued on the exercise of stock options	8,106,300	2,703,436
Fair value of stock options exercised	-	2,816,625
Shares issued on the exercise of warrants and compensation warrants	22,413,431	9,373,245
Fair value of warrants and compensation warrants exercised	-	4,444,912
Balance, December 31, 2015	197,097,815	81,027,171
Shares issued on public offering	34,800,000	9,349,254
Cost of shares issued on public offering	-	(1,165,017)
Fair value of warrants issued	-	(5,985,378)
Shares issued to settle subsidiary accounts payable	2,386,386	1,843,629
Shares issued on business combination	15,607,240	12,050,000
Shares issued on the exercise of stock options	5,648,000	1,654,988
Fair value of stock options exercised	-	1,737,879
Shares issued on the exercise of warrants and compensation warrants	3,794,412	1,943,919
Fair value of warrants exercised	-	901,417
Balance, December 31, 2016	259,333,853	$ 103,357,862

(Expressed in US Dollars)

11. SHARE CAPITAL (Continued)

On February 13, 2014, the Company completed a $4,546,000 ($5,000,000 CAD) private placement financing. The financing consisted of 7,692,307 units at a price of $0.59 ($0.65 CAD) per unit. Each unit comprised one common share and one common share purchase warrant. One warrant allows the holder to acquire one additional common share of the Company at an exercise price of $0.91 ($1.00 CAD) per share for a year of 2 years, expiring on February 12, 2016. No commission was payable with respect to this financing.

The fair value of the warrants was estimated using the Black-Scholes option pricing model with the following assumptions: dividend yield of 0%, interest rate of 1.017%, volatility of 92.22% and estimated life of 2 years. The estimated fair value assigned to the warrants was $1,869,231 ($2,076,923 CAD).

During 2014, the Company paid $31,712 ($35,000 CAD) as incentives for the exercise of warrants.

On November 2, 2016 the Company completed a Short Form Base Shelf and Supplemental Prospectus offering of 34,800,000 units at a price of $0.269 (CAD$0.36) per unit for gross proceeds of $9,349,254 (CAD$12,528,000). Each unit consists of one common share and one common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share of the Company at a price of $0.388 (CAD$0.52) per share for a period of five years. The agents received cash commissions in the aggregate of $654,447 (CAD$876,960). Additional issue costs approximated $510,570 (CAD$666,618).

The fair value of the warrants was estimated using the Black-Scholes option pricing model with the following assumptions: dividend yield of 0%, interest rate of 0.68%, volatility of 91.37% and estimated life of 5 years. The estimated fair value assigned to the warrants was $5,985,378 ($8,015,323 CAD).

12. WARRANTS

The following table reflects the continuity of warrants:

	Average Exercise Price	Number of Warrants	Historical Fair value
Balance, January 1, 2014	$ 0.48	42,478,569	$ 8,135,590
Warrants issued	0.91	7,692,307	1,869,231
Expired	(0.29)	(3,500)	(756)
Exercised	(0.43)	(19,384,712)	(3,545,406)
Balance, December 31, 2014	0.61	30,782,664	6,458,659
Warrants and compensation warrants exercised	(0.42)	(22,413,431)	(4,444,912)
Balance, December 31, 2015	0.79	8,369,233	2,013,747
Warrants issued	0.39	34,800,000	5,985,378
Warrants and compensation warrants exercised	(0.51)	(3,794,412)	(901,417)
Expired	(1.02)	(4,574,821)	(1,112,330)
Balance, December 31, 2016	$ 0.39	34,800,000	$ 5,985,378

(Expressed in US Dollars)

13. STOCK OPTIONS AND CONTRIBUTED SURPLUS

Stock Options

On July 7, 2016, shareholders of the Company approved amendments to the Company's fixed 20% stock option plan (as amended, referred to as the "2016 Plan"). Under the 2016 Plan, the board of directors may grant options to acquire common shares of the Company to qualified directors, officers, employees and consultants. The 2016 Plan provides that the number of common shares issuable pursuant to options granted under the 2016 Plan and pursuant to other previously granted options is limited to 44,352,885 (the “Number Reserved”). Any subsequent increase in the Number Reserved must be approved by shareholders of the Company and cannot, at the time of the increase, exceed 20% of the number of issued and outstanding shares. The stock options vest in accordance with the policies determined by the Board of Directors from time to time consistent with the provisions of the 2016 Plan which grants discretion to the Board of Directors.

Stock option transactions and the number of stock options outstanding were as follows:

	Number of Options	Weighted average Exercise Price
Balance, January 1, 2014	23,732,750	$ 0.38
Expired/cancelled	(825,000)	1.01
Exercised	(4,824,950)	0.31
Granted	6,155,000	1.26
Balance, December 31, 2014	24,237,800	0.61
Expired/cancelled	(1,068,000)	1.13
Exercised	(8,106,300)	0.43
Granted	11,655,000	1.19
Balance, December 31, 2015	26,718,500	0.89
Expired/cancelled	(1,290,000)	0.96
Exercised	(5,648,000)	0.37
Granted	4,025,000	0.62
Balance, December 31, 2016	23,805,500	$ 0.96

During the year ended December 31, 2016, the Company granted 4,025,000 (2015 - 11,655,000, 2014 - 6,155,000) stock options to officers, employees and consultants of the Company to purchase common shares at an average price of $0.62 (2015 - $1.19, 2014 - $1.26) per share.

During the year ended December 31, 2016, the Company recorded stock-based compensation of $4,070,264 (2015 - $4,818,120, 2014 - $4,615,997) relating to stock options that vested during the year.

The stock options granted were valued using the Black-Scholes option pricing model using the following assumptions:

	2016	2015	2014
Weighted average exercise price	**$ 0.62**	$ 1.19	$ 1.26
Weighted average risk-free interest rate	**1.05%**	0.98%	1.58%
Weighted average dividend yield	**0%**	0%	0%
Weighted average volatility	**104.3%**	102.7%	102%
Weighted average estimated life	**10 years**	5 years	5 years
Weighted average share price	**$ 0.62**	$ 1.19	$ 1.26

(Expressed in US Dollars)

13. STOCK OPTIONS AND CONTRIBUTED SURPLUS (Continued)

Share price on the various grant dates were:

	2016	2015	2014
First grant	**$ 0.75**	$ 1.31	$ 1.31
Second grant	**0.74**	1.59	1.10
Third grant	**0.66**	1.33	1.64
Fourth grant	**0.71**	1.14	1.13
Fifth grant	**0.62**	1.13	-
Sixth grant	**0.46**	1.25	-
Seventh grant	**-**	1.19	-
Eigth grant	**-**	0.83	-
Ninth grant	**-**	0.72	-
Tenth grant	**-**	0.63	-
Eleventh grant	**-**	0.74	-
Twelfth grant	**-**	0.62	-
Thirteenth grant	**-**	0.65	-

The underlying expected volatility was determined by reference to the Company's historical share price movements, its dividend policy and dividend yield and past experience relating to the expected life of granted stock options.

The weighted average remaining contractual life and weighted average exercise price of options outstanding and of options exercisable as at December 31, 2016 are as follows:

	Options Outstanding			**Options Exercisable**	
Exercise Range	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Number Exercisable	Weighted Average Exercise Price
$0.11 - $0.25	860,000	$ 0.23	1.91	860,000	$ 0.23
$0.28 - $0.31	487,500	$ 0.28	0.70	487,500	$ 0.28
$0.34 - $0.37	50,000	$ 0.33	3.63	50,000	$ 0.33
$0.38 - $0.86	7,156,000	$ 0.55	5.58	3,537,250	$ 0.47
$0.87 - $1.64	15,252,000	$ 1.23	3.35	7,960,499	$ 1.31
	23,805,500	$ 0.96	3.91	12,895,249	$ 0.96

Contributed Surplus

The following table reflects the continuity of contributed surplus:

	Amount
Balance, January 1, 2014	$ 20,261,067
Stock-based compensation	4,615,997
Fair value of stock options exercised	(1,261,156)
Fair value of expired warrants	756
Balance, December 31, 2014	23,616,664
Stock-based compensation	4,818,120
Fair value of stock options exercised	(2,816,625)
Balance, December 31, 2015	25,618,159
Stock-based compensation	4,070,264
Fair value of stock options exercised	(1,737,879)
Fair value of expired warrants	1,112,330
Balance, December 31, 2016	$ 29,062,874

(Expressed in US Dollars)

14. LOSS PER SHARE

	2016	2015	2014
Numerator			
Net loss	**$ (13,224,684)**	$ (12,070,170)	$ (11,785,800)
Denominator			
Weighted average number of common shares outstanding	**220,058,321**	185,091,882	156,488,296
Weighted average number of common shares outstanding - diluted	**220,058,321**	185,091,882	156,488,296
Basic and diluted loss per share	**$ (0.06)**	$ (0.07)	$ (0.08)

The effect of common share purchase options, warrants, compensation warrants and shares to be issued on the net loss in 2016, 2015 and 2014 is not reflected as they are anti-dilutive.

15. COMMITMENTS AND CONTINGENCIES

The Company has three facilities; head office located in Toronto, Canada, development operations located in San Jose, California and operating facilities located in Singapore. The Company has operating leases for development operations and operating facilities expiring January 31, 2017 (not renewed) and February 15, 2019 respectively. As at December 31, 2016, the Company's head office was on a month to month lease term.

Rent expense under these leases was $312,842 for the year ended December 31, 2016 (2015 - $204,987, 2014 - $153,398).

Remaining minimum annual rental payments to the lease expiration date is as follows:

2017	$ 387,157
January 1, 2018 through 2019	419,420
	$ 806,577

The Company has a letter of guarantee ("LG") in the amount of $578,330 in the name of the landlord in Singapore. DenseLight owes $130,934 of unpaid rent plus accrued penalties. The LG was put in place as a guarantee that the unpaid rent would be paid by April 30, 2017 based on an agreed repayment plan.

16. RELATED PARTY TRANSACTIONS

Compensation to key management personnel were as follows:

	2016	2015	2014
Salaries	**$ 2,047,634**	$ 1,979,601	$ 1,363,417
Share-based payments (1)	**3,061,686**	3,283,361	1,167,245
Total	**$ 5,109,320**	$ 5,262,962	$ 2,530,662

(1) Share-based payments are the fair value of options granted to key management personnel and expensed during the various years as calculated using the Black-Scholes model.

In 2014, the Company settled $100,000 that was advanced to the former CEO of the Company. The amount was non interest bearing and short-term in nature. The Company settled the amount due from the former CEO in return for a reduction in his compensation and certain other entitlements.

(Expressed in US Dollars)

16. RELATED PARTY TRANSACTIONS (Continued)

In 2014, the former CEO of the Company received a severance package of $185,000 to be paid over one year. The full amount of the severance package was accounted for in 2014.

The Company paid or accrued $113,250 for the year ended December 31, 2016 (2015 - $104,790, 2014 - $174,549) to a law firm, of which a director is counsel, for legal services rendered to the Company.

In 2016, the Company paid or accrued $150,000 in consulting fees to a director for strategic, technology, integration and general business consulting services.

All transactions with related parties have occurred in the normal course of operations and are measured at the exchange amounts, which are the amounts of consideration established and agreed to by the related parties.

17. SEGMENT INFORMATION

The Company and its subsidiaries operate in a single segment; the design, manufacture and sale of semi-conductor products and services for military and commercial applications. The Company's operating and reporting segment reflects the management reporting structure of the organization and the manner in which the chief operating decision maker regularly assesses information for decision making purposes, including the allocation of resources. A summary of the Company's operations is below:

ODIS

Odis is the developer of the POET platform semiconductor process IP for monolithic fabrication of integrated circuit devices containing both electronic and optical elements on a single die.

BB Photonics

BB Photonics develops photonic integrated components for the datacenter market utilizing embedded dielectric technology that is intended to enable onchip athermal wavelength control and lower the total solution cost of datacenter photonic integrated circuits.

DenseLight

DenseLight designs, manufactures, and delivers photonic optical light source products and solutions to the communications, medical, instrumentations, industrial, defense, and security industries. DenseLight processes III-V based optoelectronic devices and photonic integrated circuits through its in-house wafer fabrication and assembly & test facilities.

On a consolidated basis, the Company operates geographically in Singapore, the United States and Canada. Geographical information is as follows:

			2016	
As of December 31,	**Singapore**	**US**	**Canada**	**Consolidated**
Current assets	$ 2,118,561	$ 10,058,018	$ 4,957,624	$ 17,134,203
Property and equipment	9,039,069	322,633	2,508	9,364,210
Patents and licenses	-	449,676	-	449,676
Goodwill and intangible assets	7,086,149	1,471,719	-	8,557,868
Total Assets	$ 18,243,779	$ 12,302,046	$ 4,960,132	$ 35,505,957

(Expressed in US Dollars)

17. SEGMENT INFORMATION (Continued)

Year Ended December 31,		**Singapore**		**US**		**Canada**		**Consolidated**
Sales	**$**	**1,861,747**	**$**	**-**	**$**	**-**	**$**	**1,861,747**
Cost of sales		**1,379,838**		**-**		**-**		**1,379,838**
Selling, marketing and administration		**2,908,465**		**7,200,243**		**1,151,868**		**11,260,576**
Research and development		**770,033**		**2,122,983**		**-**		**2,893,016**
Impairment loss		**-**		**63,522**		**-**		**63,522**
Loss on disposal of property and equipment		**-**		**29,807**		**16,931**		**46,738**
Other income		**(14,027)**		**-**		**(52,845)**		**(66,872)**
Net loss from operations	**$**	**3,182,562**	**$**	**9,416,555**	**$**	**1,115,954**	**$**	**13,715,071**

2015

As of December 31,		Singapore		US		Canada		Consolidated
Current assets	$	-	$	3,055,947	$	11,504,972	$	14,560,919
Property and equipment		-		924,443		22,664		947,107
Patents and licenses		-		426,813		-		426,813
Total Assets	$	-	$	4,407,203	$	11,527,636	$	15,934,839

Year Ended December 31,		Singapore		US		Canada		Consolidated
General and administration	$	-	$	6,622,514	$	1,991,595	$	8,614,109
Research and development		-		3,532,492		-		3,532,492
Other income		-		-		(76,431)		(76,431)
Net loss from operations	$	-	$	10,155,006	$	1,915,164	$	12,070,170

2014

As of December 31,		Singapore		US		Canada		Consolidated
Current assets	$	-	$	3,106,274	$	8,425,091	$	11,531,365
Property and equipment		-		1,054,636		4,224		1,058,860
Patents and licenses		-		260,721		-		260,721
Total Assets	$	-	$	4,421,631	$	8,429,315	$	12,850,946

Year Ended December 31,		Singapore		US		Canada		Consolidated
General and administration	$	-	$	5,827,262	$	3,850,443	$	9,677,705
Research and development		-		2,277,927		-		2,277,927
Other income		-		(169,832)		-		(169,832)
Net loss from operations	$	-	$	7,935,357	$	3,850,443	$	11,785,800

(Expressed in US Dollars)

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial instruments consist of cash, short-term investments, accounts receivable, and accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest risk arising from these financial instruments. The Company estimates that the fair value of these instruments approximates fair value due to their short term nature.

The Company has classified financial assets and (liabilities) as follows at December 31:

	2016	2015	2014
Fair value through profit or loss, measured at fair value:			
Cash	**$ 14,376,282**	$ 14,409,996	$ 11,287,864
Short-term investments	**589,275**	-	-
Loans and receivable, measured at amortized cost:			
Accounts receivable	**292,849**	-	-
Other liabilities, measured at amortized cost:			
Accounts payable and accrued liabilities	**(1,624,344)**	(515,421)	(451,724)

Financial instruments recorded at fair value on the balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly.

Level 3 - valuation techniques based on inputs for the asset or liability that are not based on observable market data.

Cash was determined using level 1 inputs. Short-term investments were determined using level 2 inputs.

Credit Risk

The Company is exposed to credit risk associated with its accounts receivable. The Company has accounts receivable from both governmental and non-governmental agencies. Credit risk is minimized substantially by ensuring the credit worthiness of the entities with which it carries on business. Credit terms are provided on a case by case basis. The Company has not experienced any significant instances of non-payment from its customers.

The Company's accounts receivable ageing at December 31 was as follows:

	2016	2015	2014
Current	**$ 125,610**	$ -	$ -
31 - 60 days	**16,346**	-	-
61 - 90 days	**75,816**	-	-
> 90 days	**75,077**	-	-
	$ 292,849	$ -	$ -

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

Exchange Rate Risk

The functional currency of each of the entities included in the accompanying consolidated financial statements is the local currency where the entity is domiciled. Functional currencies include the US, Singapore and Canadian dollar. Most transactions within the entities are conducted in functional currencies. As such, none of the entities included in the consolidated financial statements engage in hedging activities. The Company is exposed to a foreign currency risk with the Canadian and Singapore dollar. A 10% change in the Canadian and Singapore dollar would increase or decrease other comprehensive loss by $620,560.

Liquidity Risk

The Company currently does not maintain credit facilities. The Company's existing cash and cash resources are considered sufficient to fund operating and investing activities beyond one year from the issuance of these consolidated financial statements.

19. CAPITAL MANAGEMENT

In the management of capital, the Company includes shareholders' equity (excluding accumulated other comprehensive loss and deficit), cash and short-term investments. The components of capital on December 31, 2016 were:

Cash and short-term investments	$ 14,965,557
Shareholders' equity	$138,406,114

The Company's objective in managing capital is to ensure that financial flexibility is present to increase shareholder value through growth and responding to changes in economic and/or market conditions; to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business and to safeguard the Company’s ability to obtain financing should the need arise.

In maintaining its capital, the Company has a strict investment policy which includes investing its surplus capital only in highly liquid, highly rated financial instruments.

The Company reviews its capital management approach on an ongoing basis.

(Expressed in US Dollars)

20. EXPENSES

Research and development costs can be analysed as follows:

	2016	2015	2014
Wages and benefits	**$ 1,299,758**	$ 1,241,054	$ 899,758
Subcontract fees	**1,013,539**	1,560,819	582,943
Stock-based compensation	**373,196**	552,416	641,176
Supplies	**206,523**	178,203	154,050
	$ 2,893,016	$ 3,532,492	$ 2,277,927

Selling, marketing and administration costs can be analysed as follows:

	2016	2015	2014
Stock-based compensation	**$ 3,697,068**	$ 4,265,704	$ 3,974,821
Wages and benefits	**3,073,687**	1,306,051	1,700,600
Depreciation and amortization	**1,521,566**	319,863	236,955
General expenses	**1,292,341**	1,012,340	662,672
Professional fees	**715,716**	812,115	907,794
Management and consulting fees	**611,861**	665,771	595,667
Rent	**348,337**	232,265	159,298
Shares issued as reduction of license fee (Note 24)	**-**	-	1,439,898
	$11,260,576	$ 8,614,109	$ 9,677,705

21. NON CURRENT ASSET HELD FOR SALE

During the year ended December 31, 2016, the Company reclassified $98,522 from prepaids and other current assets to property and equipment. During the year management determined that the equipment would not be used to generate future cash flows and committed to a plan to dispose of the equipment by December 31, 2016.

Management used a market approach to determine the equipment's fair value less cost of sell. Key assumptions included the cost of similar assets, the impact of customization and unique use. The fair value less cost to sell was determined to be $35,000 which is greater than its value in use. The Company recorded an impairment loss of $63,522 on the equipment and reclassified $35,000 from property and equipment to non current assets held for sale. The equipment was sold for $35,000 in July 2016.

22. BUSINESS ACQUISITIONS

DenseLight

On May 11, 2016, the Company acquired all the issued and outstanding shares of DenseLight, a designer, manufacturer and provider of photonic sensing and optical light source products for consideration of $10,500,000. The all stock purchase was accomplished with the issuance of 13,611,150 common share of the Company at a price of $0.7714 per share. The Company also committed to issuing shares representing $1,000,000 to the sellers in the event that DenseLight meets or exceeds a pre-determined revenue target during calendar 2016.

This acquisition provides the Company with direct and preferred access to a fab infrastructure for future product development, access to product sales and channel distribution networks and a broader product portfolio of photonic products, technology and know-how.

Upon closing the acquisition, the Company negotiated a settlement agreement relating to obligations that were due to past or current employees of DenseLight. As part of the settlement agreement, the Company issued 1,738,236 common shares at a price of $0.7714 per share for a total of $1,343,629. The Company also paid $240,266 to current and past employees as part of the debt settlement. Accounts payable and accrued liabilities include $184,570 still due to past and current employees that will be paid over the next 3 months.

The Company also settled a loan of $500,000 owing to EDB Investments Pte. Ltd., an investor in DenseLight, with the issuance of 648,150 shares at a price of 0.771 per share.

Former management shareholders of DenseLight agreed not to sell, transfer, pledge or otherwise dispose of the shares of the Company for a period of six months, at which time they may each sell up to 25% of their shares. They may sell an additional 25% of the shares after twelve months. Thereafter, all management shareholders shall be able to sell the remaining shares after 24 months from closing. Former non-management shareholders of DenseLight agreed not to sell, transfer, pledge or otherwise dispose of the shares they received for six months, at which time they may sell up to 25% of the shares received. Thereafter, they may sell the remaining shares after 12 months from closing.

On acquisition, DenseLight held accounts receivable and unbilled revenue in the amount of $198,898 which reflected their fair value. The Company does not expect that there will be any contractual cash flows that may not be realized. The billed receivables at closing have been subsequently collected.

The acquisition has been accounted for using the acquisition method of accounting. Acquisition related costs of $197,284 were expensed in the year and included in selling, marketing and administrative expenses.

A final assessment of the fair value of identifiable assets and liabilities acquired has been completed. The assessment of the purchase price allocation on the date of purchase has been determined as follows:

(Expressed in US Dollars)

22. BUSINESS ACQUISITIONS (Continued)

Fair value of consideration paid

Fair value of 13,611,150 shares issued	$ 10,500,000
Contingent consideration payable	283,130
Total consideration	$ 10,783,130

Recognised amounts of identifiable net assets:

Cash	$ 2,971
Accounts receivables and unbilled revenue	198,898
Prepaid and other current assets	293,386
Inventory	319,257
Property and equipment	8,635,650
Customer relationships	186,131
Goodwill	6,630,544
Trade payables	(2,979,546)
Loans and advances	(1,000,000)
Deferred tax liability	(1,504,161)
Net assets acquired	$ 10,783,130

Loans and advances include $500,000 that was advanced to DenseLight by the Company prior to its acquisition. This advance was used by DenseLight to cover the expenses required for the development under the Development Services Agreement between DenseLight and the Company, based on the special pricing negotiated between the parties.

The purchase and sale agreement provides for an additional $1,000,000 worth of shares to be issued to the sellers should gross revenue from DenseLight exceed certain targets for 2016. The fair value of this contingent consideration payable is determined by estimating the probability of the Company making that future payment and then discounting it to present value using a discount rate of 9% being the estimated cost of debt for the Company. At December 31, 2016, DenseLight did not exceed the established revenue targets for 2016. The Company has therefore adjusted the fair value of contingent consideration to nil through earnings.

From the date of acquisition, DenseLight contributed $1,861,747 to consolidated revenues and $3,182,562 to consolidated net loss. Had the acquisition occurred on January 1, 2016, the Company estimates that DenseLight's contribution to consolidated revenue would have been $2,316,169 (unaudited) and would have contributed net loss of $2,344,976 (unaudited). In determining these amounts, the Company assumed that the preliminary fair value adjustments that arose on the acquisition date would have been the same had the acquisition occurred on January 1, 2016.

A deferred tax liability of $1,504,161 was created on the date of purchase and related to the fair value adjustment of the assets acquired. The change in the fair value assets acquired arising from amortization or the sale of assets resulted in a deferred tax recovery of $207,257. Deferred tax liability at December 31, 2016 was $1,303,567.

BB Photonics

On June 22, 2016, the Company acquired all the issued and outstanding shares of BB Photonics, a designer of integrated photonic solutions for the data communications market for consideration of $1,550,000. The all stock purchase was accomplished with the issuance of 1,996,090 common share of the Company at a price of $0.777 per share.

(Expressed in US Dollars)

22. BUSINESS ACQUISITIONS (Continued)

The acquisition of BB Photonics provides the Company with additional differentiated intellectual property and know-how for product development which will enable the Company to better service its first identified commercialization market, the end-to-end data communications market, and augment its sensing roadmap.

The acquisition has been accounted for using the acquisition method of accounting. Acquisition related costs of $59,930 were expensed in the year and included in selling, marketing and administrative expenses.

A final assessment of the fair value of identifiable assets and liabilities acquired has been completed. The assessment of the purchase price allocation on the date of purchase has been determined as follows:

Fair value of consideration paid

Fair value of 1,996,090 shares issued	$	1,550,000

Recognised amounts of identifiable net assets:

Cash	$	15,820
Property and equipment		70,379
Intangibles		714,000
Goodwill		1,050,459
Trade payables		(7,918)
Deferred tax liability		(292,740)
Net assets acquired	$	1,550,000

From the date of acquisition, BB Photonics contributed nil to consolidated revenues and $181,782 to consolidated net loss. Had the acquisition occurred on January 1, 2016, the Company estimates that BB Photonics' contribution to consolidated revenue would have been nil (unaudited) and it would have contributed net loss of $272,793 (unaudited). In determining these amounts, the Company assumed that the preliminary fair value adjustments that arose on the acquisition date would have been the same had the acquisition occurred on January 1, 2016.

A deferred tax liability of $292,740 was created on the date of purchase and related to the fair value adjustment of the assets acquired.

(Expressed in US Dollars)

23. INCOME TAXES

The following table reconciles the expected income tax recovery at the Canadian statutory income tax rate of 26.5% for 2016 (2015 - 26.5%, 2014 - 26.5%) to the amounts recognized in operations.

For the Year Ended December 31,	**2016**	2015	2014
Net loss before taxes	**$ 13,431,941**	$ 12,070,170	$ 11,785,800
Expected current income tax recovery	**3,559,000**	3,198,595	3,123,200
Deferred tax recovery	**207,257**	-	-
	3,766,257	3,198,595	3,123,200
Changes from:			
Amounts not deductible for tax purposes	**(1,079,000)**	(1,276,802)	(1,604,700)
Other non-deductible items	**-**	(2,700)	(6,100)
Deductible share issuance costs	**118,000**	56,000	100,000
Fair value consideration	**116,000**	-	-
Effect of prior years' loss adjustment	**-**	-	171,600
Foreign tax differential	**507,213**	879,000	563,300
Unrecognized tax losses	**(3,221,213)**	(2,854,093)	(2,347,300)
Income tax recovery recognized	**$ 207,257**	$ -	$ -

The following table reflects future income tax assets at December 31:

	2016	2015	2014
Resource assets	**$ 1,024,271**	$ 1,024,271	$ 1,024,271
Gross unamortized share issue costs	**1,050,599**	328,119	544,278
Canadian non-capital losses	**10,137,652**	9,451,357	7,544,985
US non-capital losses	**63,725,982**	58,742,322	52,682,069
Singapore non-capital losses	**37,448,290**	-	-
	113,386,794	69,546,069	61,795,603
Unrecognized deferred tax assets	**(113,386,794)**	(69,546,069)	(61,795,603)
Future income tax assets recognized	**$ -**	$ -	$ -

In accordance with Section 382 of the Internal Revenue Code, the usage of the Company’s net operating loss carry forward could be subject to annual limitation if there have been greater than 50% ownership changes.

24. REDUCTION OF LICENSE FEE

In 2014 the University of Connecticut agreed to convert certain royalty rights into a significant investment in the Company. The parties agreed to restructure the payment provisions of the License Agreement by reducing royalty payments to three percent (3%) of amounts received from unaffiliated third parties in respect of the exploitation of the Intellectual Property defined in the License Agreement, in consideration for 2,000,000 common shares of the Company. The common shares were valued at $1,439,898 (CAD $1,580,000). The market value of shares was determined using the quoted market price of the Company's stock on the TSX.V on the date of the agreement between the Company and the University of Connecticut.