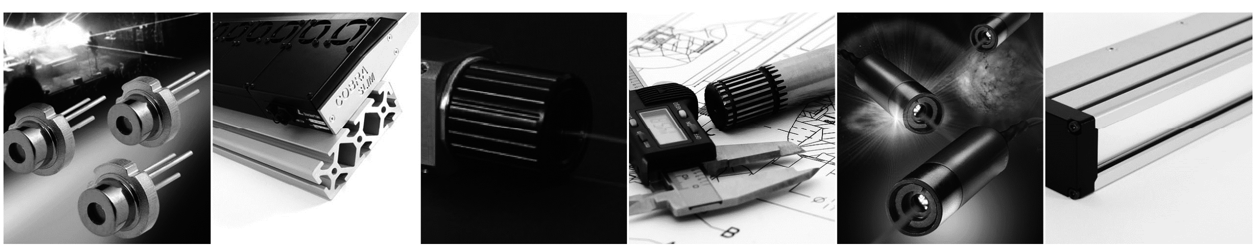
PROPHOTONIX LIMITED
2013 ANNUAL REPORT



Solutions for LEDs

ProPhotonix Limited (IRE)
3020 Euro Business Park
Little Island
Cork, Ireland
+353-21-5001300

Solutions for Lasers

ProPhotonix Limited
Sparrow Lane,
Hatfield Broad Oak
Hertfordshire, CM22 7BA UK
+44-1279-717170

Corporate

ProPhotonix Limited
32 Hampshire Road
Salem, NH 03079
+1-603-893-8778

Business Activities:

ProPhotonix consists of two business units: an LED systems manufacturing business based in Ireland (Cork), and a laser modules production and laser diode distribution business located in the United Kingdom (Hatfield Broad Oak). Corporate headquarters and the North American sales activities are based in Salem, New Hampshire, USA. The fundamental strategy of the Company is growth in revenue through its existing customers, new customer activity, and new product and market expansion.

ProPhotonix Limited sells its products principally into three markets: industrial, (primarily machine vision illumination), medical, and homeland security and defense. The Company foresees growth opportunities in all three markets it serves which are briefly described below:

Industrial (Machine Vision)

Within the industrial market, machine vision is the term used to describe computerized analysis for controlling manufacturing processes, for example automated inspection. In terms of quality and speed, lighting is often a critical component in machine vision and the Company manufactures both LED systems and lasers designed specifically for this market. The recently enhanced 3D Pro Laser line generators and improved LED line light family specifically address this market.

Medical

The Company has experienced successes in the medical (including dental) market and has gained a foothold in the market, supplying a variety of applications, with current customers including the world leader in stationary imaging equipment, a portable x-ray equipment manufacturer, a dental imaging manufacturer and also a pioneer in the manufacturing of devices offering eye tracking capability utilizing ProPhotonix's custom infrared LED arrays. The Company intends to broaden its product marketing effort in the medical field since it offers significant long-term revenue growth opportunities.

Homeland Security & Defense

LED systems, laser modules and laser diodes are used in a wide variety of applications in the security and defense fields. The Company currently supplies several defense sighting manufacturers in the US and Europe, as well as leading manufacturers of Auto Number Plate Recognition systems. This market offers significant growth opportunities for ProPhotonix over the next several years and the Company is currently marketing its laser and LED capabilities to additional security and Optical Character Recognition systems companies in this market space.

2013 Annual Report to Shareholders

To the Shareholders of ProPhotonix Limited:

2013 was a year of change and progress for ProPhotonix. Our investments in sales and marketing continue to bear fruit, as evidenced by our booking and revenue growth, as well as new customer activity. Financially, the Company is improving and begins 2014 with a solid financial platform for progressive growth. Product development and customer driven initiatives, which represent the future revenue growth of ProPhotonix, continue at a blistering pace. Our strategy of growth and prosperity and the path to success are clear. I am pleased with our progress, but certainly not satisfied, as there is still much to accomplish.

Customer Initiatives:
We made significant progress on many fronts in 2013, driven by improved effectiveness of sales and marketing throughout the business. The book to bill ratio ended at 1.13 versus 1.08 in 2012, which represented a booking growth rate of 16.9% year over year. Revenue grew 12.2% over 2012. The revenue growth came from new customer activity which accounted for $1.5 million of the total $1.7 million revenue increase. Of particular note are the 69% increase in bookings and 40% growth in revenue in the Americas region. Backlog increased from $5.3 million at December 31, 2012 to $6.9 million at December 31, 2013- a 31% increase.

Financial Progress:
Financial results improved through revenue growth, margin improvement, and lower general and administrative costs. Gross profit increased by 38.6% from 2012, and the net loss decreased from $2.9 million in 2012 to $571,000[(1)] in 2013- a 80% improvement. EBITDA dramatically improved from a loss of $2.6 million in 2012 to a loss of $98,000[(1)] in 2013- a 96% improvement.

Striking improvement is evident in the 2013 second half results as follows:

- Second half revenue grew 16% year over year and 12% sequentially from the first half.
- The second half 2013 operating loss narrowed to $82,000 compared to $517,000[(1)] in the first half, the result of significant cost reductions in general and administrative costs.
- Second half net income reflects a profit of $366,000, driven by foreign currency exchange conversions (a non-cash benefit) of $551,000, versus a net loss of $937,000[(1)] in the first half.
- The first half EBITDA loss declined from $1.4 million in 2012 to $275,000[(1)] in 2013, while second half 2013 EBITDA improved from a loss of $1.2 million in 2012 to a PROFIT of $177,000 in 2013.

Even with this great progress, our focus to profitability remains relentless to achieve our intended goals.

The balance sheet also improved in 2013 following the capital restructuring. During 2013, we secured $2.5 million of additional term debt capacity plus increased our revolving credit facility with Barclays Bank from $1.1 million to $2.3 million. We enter 2014 with $1.8 million of unused and available credit from our various credit facilities.

Product development and market development:
Customer driven product development activity has never been stronger. Customer funded development initiatives undertaken in 2013 with completion through 2014 amount to approximately $800,000 of order bookings, of which we expect $700,000 to be recognized revenue in 2014. These potential high volume OEM (custom) applications include illuminators for the semiconductor, optical sorting, and medical (endoscopy and vascular imagining) markets. We expect to begin shipping production orders from these projects during 2014. In addition, new projects we take on in 2014 will have revenue growth opportunities in 2014 and beyond.

[1] Excludes $582,000 non-recurring charges in the first half 2013.

Internal product development continues apace, with product enhancements and extensions that include:

Structured Light Lasers – 3DPro Family enhanced with adjustable focus capability
3DPro Family to include green (520nm) wavelength
LED Line Lights – Cobra and Lotus Families extended feature enhancements

New product research and development in 2013 includes a joint cooperation with a local university and research center to develop capability for a Compact Fiber Coupled High Power UV Laser Light Source. On success, we believe the target markets for this capability include: commercial printing, UV curing and maskless lithography. We expect to have demonstrator proto-type units in early 2014 with initial commercial shipments in the second half of 2014. Our technology roadmap in this area includes: single-mode fiber coupled lasers, multi-spectral beam combiners, multi-channel beam combiners, and expansion of the multi-mode fiber laser product. Target markets for future systems include sensing, such as optical sorting, medical, and microscopy applications.

We are constantly on the hunt for emerging and underserved markets where our capabilities may be deployed. The UV LED market is one such high growth market opportunity. The UV spectrum falls into three ranges (UVC 200-280nm, UVB 280-315nm, UVA 315-400nm) each having specific application attributes. ProPhotonix currently provides UVA LED curing lamps to customers for OEM specific applications. New high growth markets for UV LED illuminators includes disinfection, DNA sequencing, protein analysis, drug discovery, plus the continuing adoption of LEDs for curing applications. LEDs are ideally suited to this market for cost, efficiency, reliability, and longevity versus traditional technology. We work with industry leaders in UV epitaxy and are constantly evaluating UV LED technologies. Market research indicates the market for UV LEDs will grow from $45 million in 2012 to $270 million in 2017 at a CAGR of 43%.[2] As our market research evolves, we expect to increase product investments to serve this market.

Strategy – Growth to Prosperity

ProPhotonix's short-term perspective is governed by three simple goals: sustained positive EBITDA, cash flow, and net income. We will accomplish these goals through a relentless focus on cost management and most importantly through revenue growth. We are committed to revenue growth through our existing customer base, but also by winning new customers. As mentioned above, $1.5 million of the revenue growth in 2013 was from new customers. These new customers span several markets including: 3D Scanning for 3D printing, Warehouse Robotics, Transport Container Monitoring and Inspection, Medical Devices, Aeronautics, and Industrial Automation and Inspection. We must build on the 2013 success, furthering new customer revenue, while growing within our existing customer base by helping them prosper with products for their applications.

ProPhotonix's growth in the medium-term will be accomplished with not only new customer wins in our currently served markets, but also through expansion into new markets and with new products as mentioned above. In addition to the few important areas where we are focused, we will continuously evaluate additional high growth opportunities.

In conclusion, I am deeply grateful for the continued support of you, our customers, suppliers and service providers, investors, and co-workers!

Respectfully submitted,

Tim Losik
President and Chief Executive Officer

[2] UV LED Technology & Application Trends Report, Yole Developpement, April 2013.

Director Remuneration Report

For the year ended December 31, 2013

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

Executive Director	Salary ($)	Bonus ($)	Pension ($)	Other (1) ($)	Total Cash Compensation ($)	Options ($)	Total ($)	Total All Compensation 2013 ($)	Total All Compensation 2012 ($)
Tim Losik	264,582	-	5,625	750	270,957	-	-	270,957	232,311
Total Executive Compensation	**264,582**	**-**	**5,625**	**750**	**270,957**	**-**	**-**	**270,957**	**232,311**
Non-Executive Director									
Ray Oglethorpe	-	-	-	25,000	25,000	3,731	3,731	28,731	24,378
Timothy Steel	-	-	-	25,000	25,000	3,731	3,731	28,731	24,738
Vincent Thompson	-	-	-	25,000	25,000	3,731	3,731	28,731	24,738
Mark Weidman	-	-	-	12,500	12,500	3,731	3,731	16,231	-
Total Non-Executive Compensation	**-**	**-**	**-**	**87,500**	**87,500**	**14,924**	**14,924**	**102,424**	**74,214**

Director Share Options:

Director	Options @ 12/31/12	Options Granted	Options Forfeited	Options @ 12/31/13
Tim Losik	1,400,000	-	-	1,400,000
Ray Oglethorpe	995,506	700,000	(11,500)	1,684,006
Timothy Steel	445,433	700,000	-	1,145,433
Vincent Thompson	445,433	700,000	-	1,145,433
Mark Weidman	-	700,000	-	700,000
Total All Directors	**3,286,372**	**2,800,000**	**(11,500)**	**6,074,872**

(1) Other compensation for the Executive Director 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.

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ProPhotonix Limited

Consolidated Financial Statements

Years Ended December 31, 2013 and 2012

FINANCIAL STATEMENTS

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Independent Auditors' Report

The Board of Directors
ProPhotonix Limited
32 Hampshire Road
Salem
New Hampshire
United States of America

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of ProPhotonix Limited and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operations and comprehensive loss, stockholders' equity / (deficit), and cash flows for the years then ended, and the related notes to the consolidated financial statements.

This report is made solely to the company's stockholders, as a body, in accordance with the terms of our engagement. Our audit work has been undertaken so that we might state to the company's stockholders those matters we have been engaged to state to them in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's stockholders, as a body, for our audit work, for this report, or for the opinions we have formed.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant 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 is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of ProPhotonix Limited and its subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

kpmg LLP

KPMG LLP

Cambridge
United Kingdom

22 April 2014

FINANCIAL STATEMENTS

PROPHOTONIX LIMITED

CONSOLIDATED BALANCE SHEETS

($ in thousands except share and per share data)

December 31	**2013**	**2012**
Assets		
Current assets:		
Cash and cash equivalents	$ 402	$ 1,278
Accounts receivable, less allowances of $19 in 2013 and $31 in 2012	2,559	2,225
Inventories	2,003	2,033
Prepaid expenses and other current assets	220	234
Total current assets	5,184	5,770
Net property, plant and equipment	303	523
Goodwill	486	467
Acquired intangible assets, net	102	218
Other long-term assets	354	23
Total assets	$ 6,429	$ 7,001
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities:		
Revolving credit facility	$ 1,127	$ 662
Current portion of long-term debt	265	2,387
Capital lease obligations	10	10
Accounts payable	1,542	2,000
Accrued expenses	1,296	1,084
Total current liabilities	4,240	6,143
Long-term debt, net of current portion	2,445	-
Long-term portion of capital lease obligations	-	10
Other long-term liabilities	178	178
Total liabilities	6,863	6,331
Stockholders' equity (deficit):		
Common stock, par value $0.001; shares authorized 150,000,000 at December 31, 2013 and December 31, 2012; 83,665,402 shares issued and outstanding at December 31, 2013 and 76,059,457 at December 31, 2012	84	76
Additional paid-in capital	111,302	110,893
Accumulated deficit	(111,674)	(110,521)
Accumulated other comprehensive income	(146)	222
Total stockholders' equity (deficit)	(434)	670
Total liabilities and stockholders' equity	$ 6,429	$ 7,001

See the notes to consolidated financial statements.

PROPHOTONIX LIMITED
Consolidated Statements of Operations and Comprehensive Loss
($ in thousands except share and per share data)

	Years Ended December 31, 2013	Years Ended December 31, 2012
Revenue	$ 15,599	$ 13,904
Cost of Revenue	(9,628)	(9,597)
Gross Profit	5,971	4,307
Research & Development Expenses	(941)	(922)
Selling, General & Administrative Expenses	(6,091)	(6,403)
Amortization of Intangible Assets	(120)	(118)
Operating Loss	(1,181)	(3,136)
Other Income / (Expense), net	295	490
Warrant & Debt Acquisition Expense	(103)	-
Interest Expense	(237)	(257)
Loss Before Taxes	(1,226)	(2,903)
Tax Benefit	73	-
Net Loss	$ (1,153)	$ (2,903)
Other Comprehensive Loss:		
Foreign currency translation	(368)	(199)
Total Comprehensive Loss	$ (1,521)	$ (3,102)
Loss Per Share:		
Basic and diluted:		
Net loss per share	($0.01)	($0.04)
Basic and diluted weighted average shares outstanding	80,496,977	76,059,457

See the notes to consolidated financial statements.

PROPHOTONIX LIMITED

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY / (DEFICIT)

(in thousands)

	Common Stock					
	Shares	Par $0.001	Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity (Deficit)
Balance December 31, 2011	76,059	$ 76	$110,751	$ (107,618)	$ 421	$ 3,630
Share based compensation, net of forfeitures	-	-	143	-	-	143
Translation adjustment					(199)	(199)
Net loss.............................				(2,903)		(2,903)
Balance December 31, 2012	76,059	$ 76	$110,893	$ (110,521)	$ 222	$ 670
Share based compensation, net of forfeitures	-	-	169	-	-	169
Issuance of common stock to settle liabilities	7,606	8	185	-	-	193
Issuance of warrants for financings	-	-	55	-	-	55
Translation adjustment					(368)	(368)
Net loss.............................				(1,153)		(1,153)
Balance December 31, 2013	83,665	$ 84	$111,302	$ (111,674)	$ (146)	$ (434)

See the notes to consolidated financial statements.

Values may not add due to rounding

PROPHOTONIX LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

Years Ended December 31	**2013**	**2012**
Operating		
Net loss	$ **(1,153)**	$ **(2,903)**
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	169	143
Depreciation and amortization	332	396
Foreign exchange (gain) loss	(408)	(188)
Amortization of debt discount and financing costs	96	-
Loss on disposal of assets	(7)	-
Provision for inventories	120	75
Provision for bad debts	(12)	25
Other changes in assets and liabilities:		
Accounts receivable	(222)	199
Inventories	(8)	(372)
Prepaid expenses and other current assets	20	57
Accounts payable	(518)	505
Accrued expenses	171	261
Other assets and liabilities	(9)	21
Net cash used in operating activities	**(1,429)**	**(1,782)**
Investing		
Purchase of property, plant and equipment	(17)	(67)
Net cash used in investing activities	**(17)**	**(67)**
Financing		
Borrowings of revolving credit facilities, net	438	-
Proceeds from issuance of debt	800	-
Principal repayment of long-term debt	(339)	(889)
Debt issuance costs	(398)	-
Net cash provided by (used in) financing activities	**501**	**(889)**
Effect of exchange rate on cash	69	(50)
Net change in cash and equivalents	(876)	(2,788)
Cash and equivalents at beginning of period	1,278	4,066
Cash and equivalents at end of period	**$ 402**	**$ 1,278**
Supplemental cash flow information:		
Cash paid for interest	$ 263	$ 228
Common stock issued in connection with financing	$ 193	$ -
Warrants issued in connection with financing	$ 55	$ -

See the notes to consolidated financial statements.

PROPHOTONIX LIMITED

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 through ProPhotonix (IRL) Limited; and as a distributor of laser diodes and manufacturer of laser modules through ProPhotonix Limited, a U.K. subsidiary. The operating units are ProPhotonix (IRL) Limited based in Cork, Ireland, ProPhotonix Limited, a U.K. subsidiary based near Stansted, United Kingdom and ProPhotonix Limited, based in Salem, New Hampshire, U.S.A. The Company's products serve a wide range of applications and industries including machine vision and industrial inspection, biomedical, defense and security, and other commercial applications.

ProPhotonix Limited was incorporated on March 27, 1951 in the Commonwealth of Massachusetts and is currently incorporated in the state of Delaware. The common stock of the Company now trades on the OTC Market in the U.S. under the trading symbol "STKR" and is also on 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, 2013 and 2012, the Company recorded net losses of $1,153,000 and $2,903,000, respectively. Net use of cash flow for operating activities from continuing operations for the same time periods were $1,429,000 and $1,782,000, 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 June 20, 2013, the Company entered into an amendment with the PPI Bond bondholder who waived any and all events of default and amended the terms of the PPI Bond. The amendment restructures the existing Bond as described in Note 8. Also on June 20, 2013, the Company entered into a term note agreement with the holder of the PPI Bond allowing for an additional $1,000,000 of available funds as described in Note 8. Under the terms of this note, the Company must use 50% of any amounts advanced to make additional principal payments under the PPI Bond. Finally, on June 20, 2013, the Company entered into a term note agreement with a Lender, affiliated with the Company CEO, for $2.0 million of available funds as described in Note 8. On November 29, 2013, the Company entered into an amendment with Barclays bank that increased the maximum line of credit from £650,000 to £1,400,000, as described in Note 8. The Company believes with this loan capacity that it has adequate available working capital to continue to trade for at least the next twelve months from the approval of these financial statements.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements are prepared in conformity with Generally Accepted Accounting Principles ("U.S. GAAP") and 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, a U.K. subsidiary, and ProPhotonix Holdings, Inc., which holds all of the outstanding shares of StockerYale Canada. All intercompany balances and transactions have been eliminated.

CASH AND CASH EQUIVALENTS

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

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. The Company also has accounts receivables insurance at ProPhotonix Limited, a U.K. subsidiary, which allows the Company to submit a claim on overdue receivables in excess of 60 days past invoice due date. 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	**2013**	**2012**
	In thousands	
Balance at beginning of period	$ 31	$ 13
Charges (recoveries) to costs and expenses	(10)	25
Account write-offs and other deductions	(2)	(7)
Balance at end of period	$ 19	$ 31

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 market. 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 when indicators of impairment are present, 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, 2013, 12,615,690 shares underlying options and 8,582,567 shares underlying warrants were excluded from the calculation of diluted shares, as their effects were anti-dilutive.

As of December 31, 2012, 9,355,890 shares underlying options and 7,809,567 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 free on board (FOB) at shipping point. In certain limited situations, distributors may have the right to return products. Such rights of return may preclude the Company from recognizing revenue until the return period has ended.

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. 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. 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.

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”. 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,	
	2013	**2012**
	In thousands	
Balance at beginning of period	$ 164	$ 159
Charges (recoveries) to costs and expenses	(4)	18
Account write-offs and other deductions	(14)	(13)
Balance at end of period	$ 146	$ 164

ADVERTISING EXPENSE

The Company expenses advertising costs as incurred. Advertising expenses for the years ended 2013 and 2012 were approximately $181,000 and $250,000, 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 capital 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 asset and 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, 2013 or 2012.

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 2013, the Company recognized approximately $169,000 of stock-based compensation related to restricted stock and options, all of which was charged to selling, general and administrative expense. During 2012, the Company recognized approximately $143,000 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 ratably 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 2013 and 2012, 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.

Management has determined the functional currency of StockerYale (UK) Ltd, and ProPhotonix Limited, a U.K. subsidiary, is the euro. The functional currency of ProPhotonix (IRL) Limited is the euro, while the functional currency of ProPhotonix Limited U.S.A. is the U.S. dollar.

Foreign currency transaction losses from continuing operations recorded in the statements of operations as other income (expense), net were approximately $178,000 and $471,000 for 2013 and 2012, 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.

December 31, 2013, the Company estimated the fair value of long term fixed rate debt to be approximately $4,433,000 compared to its carrying value of $4,072,000.

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 believes that its 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 2013 or 2012. The Company had one customer that accounted for 10% of the outstanding accounts receivable balance at December 31, 2013 and 2012. The Company maintains its cash and cash equivalents in bank deposit accounts, which at times may exceed insured limits. At December 31, 2013, the amount in excess of governmental insurance protection was approximately $0.4 million, measured across all entities and jurisdictions. At December 31, 2012, the amount in excess of governmental insurance protection was approximately $1.0 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

The Company has reviewed recently issued accounting pronouncements to determine the impact that these pronouncements are expected to have on the financial statements when adopted in future periods. In March, 2013, the Financial Accounting Standards Board ("FASB") issued authoritative guidance on accounting for the cumulative translation adjustment upon de-recognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. This guidance requires that the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The adoption of this guidance did not have an impact on our consolidated financial position, results of operation or 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	2013	2012
	In thousands	
Finished goods	$ 403	$ 460
Work in-process	218	176
Raw materials	1,382	1,397
Net inventories	$ 2,003	$ 2,033

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	2013	2012
	In thousands	
Buildings and building improvements	$ 301	$ 290
Computer equipment	437	427
Machinery and equipment	1,843	1,785
Furniture and fixtures	523	703
Property, plant and equipment	$ 3,104	$ 3,205
Less accumulated depreciation	(2,801)	(2,682)
Net property, plant and equipment	$ 303	$ 523

Depreciation expense from continuing operations was approximately $212,000 and $278,000 in the years ended December 31, 2013 and 2012, respectively.

(6) GOODWILL

The Company uses a three-step approach to a goodwill impairment test. First, ASU 2011-08 allows entities with the option to first use an assessment of qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If a conclusion is reached that reporting unit fair value is not more likely than not below carrying value, no further impairment testing is necessary. If further testing is necessary, the second step is to estimate the fair value of its reporting units by using forecasts of discounted cash flows and compare 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 third 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 2013, and at the end of the fourth quarter 2012, the Company concluded that no impairment existed.

The changes in the carrying amount of goodwill for the years ended December 31, 2013 and 2012 was as follows:

	December 31, 2013	December 31, 2012
	(In thousands)	
Beginning of the year...	$ 467	$ 458
Effect of exchange rate	19	9
End of year..	$ 486	$ 467

Goodwill as of December 31, 2013 and 2012 relates to the LED reporting unit.

(7) INTANGIBLE ASSETS

Intangible assets consist of distributor and customer relationships and related contracts, technology design and programs, and other intangible assets. There are no intangible assets with indefinite lives. There were no intangible assets acquired in 2013. Intangible assets and their respective useful lives are as follows:

	Useful Life
Acquired customer contracts and relationships	5 – 8 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, 2013 for each intangible asset class.

	Gross Carrying Amount	Accumulated Amortization	Net Balances
		(in thousands)	
Acquired customer contracts and relationships	2,062	(2,011)	51
Acquired technology design and programs	349	(298)	51
Other	114	(114)	-
Total	$ 2,525	$ (2,423)	$ 102

Gross carrying amounts and accumulated amortization of intangible assets were as follows as of December 31, 2012 for each intangible asset class.

	Gross Carrying Amount	Accumulated Amortization	Net Balances
		(in thousands)	
Acquired customer contracts and relationships	2,061	(1,935)	126
Acquired technology design and programs	349	(257)	92
Other	114	(114)	-
Total	$ 2,524	$ (2,306)	$ 218

	Actual Expense		Estimated Future Expense
	2012	2013	2014
		In thousands	
Amortization expense of intangible assets	$ 118	$ 120	$ 102

(8) DEBT

Years Ended December 31	2013(1)	2012
	In thousands	
Bonds payable to the former stockholders of Photonic Products Ltd. maturing on December 31, 2012 (see notes below relative to a default), with an interest rate of 11%, at December 31, 2013 and at December 31, 2012.	$ -	$ 243
Senior Fixed Rate Secured Bond ("PPI Bond") to a private investor, maturing on June 30, 2017 with an interest rate of 8%, net of unamortized debt discount of $45,000 at December 31, 2013 and with an interest rate of 8%, with no unamortized debt discount at December 31, 2012	$ 1,750	$ 2,144

Years Ended December 31	2013(1)	2012
	In thousands	
Senior Fixed Rate Secured Bond to a private investor, maturing on May 19, 2017, with an interest rate of 12.25%, at December 31, 2013 …………………………………….	320	-
Senior Fixed Rate Secured Bond to a private investor, maturing on May 19, 2017, with an interest rate of 12.25%, at December 31, 2013 …………………………………….	640	-
Borrowings under Revolving Credit facility with Barclays Bank Sales Financing with an interest rate of 2.50% above Barclay's base rate at December 31, 2013 and 2.65% above Barclay's base rate at December 31, 2012 (3.0% as of December 31, 2013 and 3.15% as of December 31, 2012)...	1,127	662
Sub-total debt...	3,837	3,049
Less – revolving credit facility ………………………………………..	(1,127)	(662)
Less—Current portion of long-term debt	(265)	(2,387)
Total long-term debt	$ 2,445	$ -

(1) As of December 31, 2013, the Company had approximately $ 1,759,000 available under the various borrowing facilities.

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).

In 2010, the Company and the holders of the Photonic Bonds entered into Deeds of Variation of the Photonic Bonds. 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 was to have been paid in full.

The original key repayment terms of the Photonic Bonds, under this amendment, were 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

As of December 31, 2012, $243,000 was outstanding under the bonds issued to the stockholders of Photonic Products Ltd., which was classified as current portion of long-term debt. The bonds were not paid in full on December 31, 2012 as required by the Bond agreement. However, on April 30, 2013, the bonds were paid in full satisfaction of the outstanding amount.

Private Investor Notes and Bond

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. 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. Also on June 9, 2009, the Company and bondholder consolidated $1.0 million of other bonds between the Company and bondholder to the PPI Bond.

On December 10, 2010, the Company and the bondholder entered into an amendment of the PPI Bond, such that interest only was 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 December, 2010 amendment, were:

(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)

On June 20, 2013 the bondholder entered into an amendment and waiver agreement with the Company waiving all events of default from inception of the bond through the date of the amendment. In addition, the bondholder also agreed to amend the terms of the bond as follows:

(a) Convert € 144,324 ($193,132) of the balance of the bond into common stock of the Company with a subsequent transfer of such common stock to the Term Loan holder, described below as part of the Term Loan provided to the Company

(b) Issue 1,900,000 warrants over common stock of the Company exercisable at a price of $0.03 per share through June 20, 2023 as described in Note 10. The fair value of these warrants of $55,185 was deducted from the carrying value of the bond and is being amortized over the remaining term of the PPI Bond

(c) Principal as of June 20, 2013: € 1,426,540 ($1,909,281)

(d) Interest Rate: 8% per annum

(e) Interest payments only: June 30, 2013 through June 30, 2014

(f) Principal Repayment: €15,000 per month plus interest July 1, 2014 through June 30, 2015, thereafter principal and interest monthly €56,378 ($75,456) from July 1, 2015 through June 30, 2017*

(g) One-time fee of €31,413 ($42,043) payable on June 30, 2017. This fee is being accrued ratably over the life of the loan, payable in June, 2017. In addition, the Company recorded debt acquisition costs of $134,484 which is being amortized over the life of the amended term note.

* In addition to the terms above, the bondholder will be entitled to accelerated principal payments, on a quarterly basis, equal to 30% of Free Cash Flow (defined as earnings before interest, taxes, depreciation, and amortization (EBITDA) minus debt repaid and interest paid, minus capital expenditures not financed, and minus taxes paid, each during such calendar quarter). Such payments shall be made within 45 days of the end of such calendar quarter.

At December 31, 2013, $1,794,702 remained outstanding under the note, which has been classified as $123,912 current portion of long term debt and $1,670,790 long term debt and reported net of $44,857 of unamortized debt discount, which has been reported as $19,209 as short-term and $25,648 as long-term.

At December 31, 2012, $2,143,803 was outstanding under the bond all of which was classified as current portion of long-term debt. The Company was in default in respect of its repayment obligations under the bond at December 31, 2012.

Term Notes:

PPI Bond Holder

On June 20, 2013, the Company entered into a Term Loan agreement with the PPI Bond holder to provide up to $1.0 million of loan availability subject to certain terms as follows:

(a) Available Loan (subject to (b) below): $1.0 million
(b) 50% of each advance shall be used to repay amounts owed under the PPI Bond
(c) Interest Rate: 12.25% per annum
(d) Interest payments only: June 30, 2013 through May 31, 2014
(e) Principal Repayment term: 36 months (June 1, 2014 through May 19, 2017)

The Company recorded debt acquisition costs of $70,437 which is being amortized over the life of the term note. In addition, the Company is accruing a back-end fee of $15,000 ratably over the life of the loan, payable in May, 2017.

At December 31, 2013, $320,000 remained outstanding under the note, which has been classified as $53,415 current portion of long-term debt and $266,585 as long term debt. As of December 31, 2013, the Company had $680,000 available under this borrowing facility. Given the requirement to apply 50% of advances under this facility against the outstanding balance of the PPI Bond, this gives net available funding of $340,000.

Tiger Investments 1 LLC

On June 20, 2013, the Company entered into a Term Loan agreement with a Lender, which is owned and controlled by the wife of Tim Losik, Patricia Losik. As Mr. Losik is a director and the Chief Executive of the Company, the entry into the Loan Facility constitutes a "related party transaction" for the purposes of AIM Rule 13.

The Term Loan provides availability to the Company of up to $2.0 million during the term of the Loan, as follows, subject to certain restrictions:

(a) Available Loan:	$2.0 million
(b) Interest Rate:	12.25% per annum
(c) Interest payments only:	June 30, 2013 through May 19, 2014
(d) Principal Repayment term:	36 months (June 1, 2014 through May 19, 2017)

The Company recorded debt acquisition costs of $165,817 which is being amortized over the life of the term note. In addition, the Company is accruing a back-end fee of $60,000 over the life of the loan, payable in May, 2017.

At December 31, 2013, $640,000 remained outstanding under the note, which has been classified as $106,830 current portion of long-term debt and $533,170 as long term debt. As of December 31, 2013, the Company had $1,360,000 available under this borrowing facility.

Barclays Bank, PLC

On February 6, 2008, ProPhotonix Limited, a U.K. subsidiary, entered into a Confidential Invoice Discounting Agreement, as amended at various times, 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 ($1,132,000), later reduced to £650,000 ($1,051,000), and grants a security interest in and lien upon all of ProPhotonix Limited, a U.K. subsidiary, 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 facility requires the maintenance of certain financial covenants including a minimum tangible net worth.

On November 29, 2013, the Company entered into an amendment to the revolving credit facility to (i) increase the line from £650,000 to £1,400,000; (ii) to reduce the discount rate from 2.65% plus Barclays base rate to 2.50% plus Barclays base rate and service charges and extended the minimum period of this amendment to 24 months through November 29, 2015. The Company recorded debt acquisition costs of $27,172 which is being amortized over the two year amendment period.

The amount outstanding under the facility was $1,127,000 as of December 31, 2013 and $662,000 as of December 31, 2012, all of which was classified as a short term debt under revolving credit facility. As of December 31, 2013, the Company had approximately $59,000 available under this facility.

(9) TAXES

The Company had deferred tax assets, before considering the full valuation allowance, totaling approximately $27.3 million as of December 31, 2013 and approximately $27.7 million as of December 31, 2012. 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 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 2013 remain open to examination by the federal and most state tax authorities. In addition, the tax years 2007 through 2013 are open to examination in foreign jurisdictions. As of December 31, 2013, the Company did not have any tax examinations in process. On March 21, 2014, the Company was notified by the Internal Revenue Service of its intent to audit the tax year 2012.

The significant items comprising the deferred tax asset and liability at December 31, 2013 and 2012 are as follows:

Years Ended December 31,

	2013	2012
	In Thousands	
Net operating loss carry forwards	$ 25,010	$ 25,080
Foreign net operating loss carry forwards	1,611	1,693
R&D tax credit	525	525
Other	124	406
Valuation allowance	(27,270)	(27,704)
Total	$ -	$ -

As of December 31, 2013, the Company had United States federal net operating loss carry forwards (NOLs) of approximately $62.5 million (2012: $62.7 million) available to offset future taxable income, if any. These carry forwards expire through 2033 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, 2013, the Company also has Canadian federal NOLs of approximately $1.5 million (2012: $1.5 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, 2013, the Company also has a United Kingdom NOL of approximately $4.6 million (2012: $4.5 million) for which management has provided a full valuation allowance against. The total valuation allowance against deferred tax assets has decreased by $0.1 million (2012: decreased by $2.0 million). At December 31, 2013, the Company also has an Ireland NOL of approximately $2.3 million (2012: $1.5 million) for which management has provided a full valuation allowance against. The total valuation allowance against deferred tax assets decreased by $0.4 million (2012: decreased by $2.0 million).

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, 2013 and 2012, the Company has cumulatively recorded long-term liabilities of $178,000 and $178,000 respectively, relative to the sale of its North American operations to Coherent, Inc. This represents the only significant uncertain tax position of the Company.

(10) UNREGISTERED SALES OF EQUITY SECURITIES AND WARRANTS

On June 20, 2013, €144,324 ($193,132) of the PPI Bond (Note 8) was converted in exchange for 7,605,946 shares of common stock of the Company; such shares were issued to the Term Loan holder in partial consideration relating to securing the Term Loan. Also on June 20, 2013, the Company issued a Warrant in partial consideration for the Term Loan issued by the PPI Bond holder, described in Note 8. The Warrant for 1,900,000 shares of common stock of the Company is exercisable at a price of $0.03 per share through June 20, 2023.

Warrants

As of December 31, 2013, there were 8,582,567 common shares outstanding warrants with the following exercise prices and expiration dates:

Number of Common Shares Warrants	Exercise Price	Expiration Date
5,000	$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
1,900,000	$0.03	2023
8,582,567		

(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. On April 17, 2012, the Board of Directors approved amendments No. 2 and No. 3 to the 2007 Stock Incentive Plan. Amendment No. 2 provided for various administrative matters and updated the definition of "exercise price". Amendment No. 3 increased the stock available for Awards to 11,300,000 shares of common stock; plus an annual increase to be added on the first day of each of the Company's fiscal years during the period beginning in fiscal year 2013 and ending on the second day of fiscal year 2017 equal to the lesser of (i) 2,000,000 shares of common stock, (ii) 5% of the outstanding shares on such date, or (iii) an amount determined by the Board. Also, this amendment provides that the per participant limit increased to 2 million shares per calendar year. As of December 31, 2013, there were 13,300,000 shares reserved for issuance and there were 11,300,000 shares reserved at December 31, 2012. The Company had 55,544 shares available under the plan for future grants of options and restricted shares December 31, 2013.

In May, 2012, the Board of Directors approved the Third Amended and Restated Policy Regarding Compensation of Independent Directors, (i) cash compensation is increased from $15,000 to $25,000 per annum paid in arrears each quarter; (ii) the number of shares for the option grant for 2012 only shall be calculated as follows: the lesser of 250,000 option shares or the non-cash component of compensation ($25,000) divided by the mid market price as quoted on LSE – AIM on the date of grant as converted into USD at the closing foreign currency exchange rate. Also, in accordance with the foregoing calculation the 2012 annual stock option grants to non-employee Directors of the Company (the “Annual Grants”) to be issued as of the date of this meeting (the “Option Date”) shall each be for an option to purchase up to 250,000 shares at a per share exercise price of $0.0924, and that such options shall vest and become exercisable as to 25% of the original number of shares subject to each option on each of the first, second, third and fourth anniversaries of the Option Date, until fully vested on the fourth anniversary of the Option Date.

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. 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. No further grants are allowed under this plan.

The following table summarizes information about the stock options outstanding as of December 31, 2013. There is no intrinsic value on the options outstanding at December 31, 2013 or December 31, 2012.

During 2013 and 2012, the Remuneration Committee 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 3,500,000 options granted during the year ended December 31, 2013 and 3,085,000 options were granted during the year ended December 31, 2012. These options vest over either a two year or a four year anniversary of the grant date, provided that the recipient continues to serve the Company in that capacity until each such vesting. The weighted average assumptions for grants during the years ended December 31, 2013 and December 31, 2012 used in the Black-Scholes option pricing model were as follows:

	Twelve months Ended December 31, 2013	Twelve months Ended December 31, 2012
Volatility………………………………………..	224.1%	188.7%-189.6%
Expected option life……………………………	4.5 years	4.3 years
Interest rate (risk free)………………………….	1.19%	0.62%-0.93%
Dividends……………………………………….	$0	$0
Weighted average grant date fair value………...	$0.02	$0.10

	Options Outstanding	Weighted Average Exercise Price per Share ($)	Weighted Average Remaining Contractual Term (in Years)
Balance at December 31, 2011	6,567,940	0.33	7.70
Granted	3,085,000	0.10	
Exercised	-	-	
Cancelled	(297,050)	2.55	
Balance at December 31, 2012	9,355,890	0.19	7.70
Vested and Exercisable at December 31, 2012	9,135,139	0.19	7.67
Balance at December 31, 2012	9,355,890	0.19	6.70
Granted	3,500,000	0.02	
Exercised	-	-	
Cancelled	(240,200)	0.92	
Balance at December 31, 2013	12,615,690	0.13	7.63
Vested and Exercisable at December 31, 2013	5,519,840	0.20	6.24
Vested and Expected to Vest at December 31, 2013	12,372,730	0.13	7.58

Range of Exercise Prices	Options Outstanding	Weighted Average Contractual Life (years)	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
$ 0.02 – 0.99	12,335,290	7.8	$ 0.10	5,239,440	$ 0.14
1.00 – 1.99	215,400	0.6	1.22	215,400	1.22
2.00 – 3.99	65,000	0.4	2.06	65,000	2.06
$ 0.02 – 3.99	12,615,690	7.6	$ 0.13	5,519,840	$ 0.20

At December 31, 2013, there was approximately $330,000 of total unrecognized compensation cost related to stock options granted. The cost is expected to be recognized over the next 1.50 years. Total stock option expense recorded in 2013 and 2012 was approximately $169,000 and $142,000, respectively. There were no options exercised during 2013 and 2012.

Restricted Share Awards ("RSAs")

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

As of December 31, 2013, there was no unrecognized compensation cost related to non-vested RSAs. Total expense recorded in the nine months ended December 31, 2013 and 2012 was approximately $0 and $1,000, 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, 2013 and 2012, there were no shares issued under the Stock Purchase Plan.

(13) EMPLOYEE DEFINED CONTRIBUTION 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 $33,000 in the year ended December 31, 2013 and $31,000 in the year ended December 31, 2012. The Company incurred costs of approximately $1,100 in 2013 and approximately $1,700 in 2012 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 $44,000 and $41,000 in the years ended December 31, 2013 and 2012, 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 $20,000 and $22,000 in the years ended December 31, 2013 and 2012, respectively. Plan administration costs come out of the plan itself.

(14) COMMITMENTS AND CONTINGENCIES

Other obligations and contingent liabilities

The Company leases approximately 3,600 square feet for its corporate headquarters and sales office in Salem, New Hampshire. The term of the lease requires monthly tenant at-will payments with a 90 day termination notice. Base rent is $2,550 per month plus the tenant's share of expenses.

ProPhotonix (IRL) Limited leases approximately 10,000 square feet for its operations in Cork, Ireland. The original five year lease term ended on August 22, 2013 with rent and service charges of €102,000 per year. The lease is still under re-negotiation, however, the rent and service charges are now €77,000 per year.

ProPhotonix Limited, a U.K. subsidiary, leases approximately 13,000 square feet of space in Hatfield Broad Oak, Hertfordshire, U.K. The original lease had a term of nine years ending September 29, 2013 at £87,000 per year, at which time the Company renegotiated the lease for an additional 3 years. Rent charges are £70,000 per year under the renegotiated terms of the lease.

The Company utilizes, or has assumed, capital leases to finance purchases of equipment or vehicles. There was approximately $10,000 and $22,000 payable in principal and interest under these leases at December 31, 2013 and December 31, 2012, 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, 2013 and December 31, 2012, is as follows:

	2013	2012
Assets under capital lease	$ 631,000	$ 621,000
Less—accumulated depreciation	(606,000)	(574,000)
Assets under capital lease, net	$ 25,000	$ 47,000

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

Due by period	2014	2015	2016	2017	2018	Total
				in thousands		
Debt obligations	$ 275	$ 774	$ 1,106	$ 565	$ -	$2,720
Operating lease obligations	149	115	87	—	—	351
	$ 424	$ 889	$ 1,193	$ 565	$ -	$3,071

The Company expensed approximately $269,000 and $293,000 in rent for the years ended December 31, 2013 and 2012, respectively.

(15) 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.

(16) SEGMENT INFORMATION

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

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

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

	2013	2012
	(In thousands)	
Years Ended December 31		
Revenues:		
LEDs	$ 6,599	$ 6,023
Laser & diodes	9,000	7,881
Total revenues	$ 15,599	$ 13,904
Gross profit:		
LEDs	$ 2,947	$ 2,103
Laser & diodes	3,024	2,204
Total gross profit	$ 5,971	$ 4,307
Operating (loss)		
LEDs	$ (806)	$ (1,831)
Laser & diodes	(375)	(1,305)
Total operating (loss)	$ (1,181)	$ (3,136)

	2013	2012
	(In thousands)	
Years Ended December 31		
Current assets:		
LEDs	$ 1,984	$ 2,107
Laser & diodes	2,737	2,257
Corporate	463	1,406
Total current assets	$ 5,184	$ 5,770
Property, plant & equipment:		
LEDs	$ 179	$ 275
Laser & diodes	120	225
Corporate	4	23
Total property, plant & equipment	$ 303	$ 523
Intangible assets:		
LEDs	$ —	$ —
Laser & diodes	102	218
Corporate	—	—
Total intangible assets	$ 102	$ 218
Goodwill:		
LEDs	$ 486	$ 467
Laser & diodes	—	—
Corporate	—	—
Total goodwill	$ 486	$ 467

	2013	2012
Other assets:		
LEDs	$ 28	$ 18
Laser & diodes	—	—
Corporate	326	5
Total other assets	$ 354	$ 23

	2013	2012
	(In thousands)	
Years Ended December 31		
Total assets:		
LEDs	2,677	2,867
Laser & diodes	2,959	2,700
Corporate	793	1,434
Total assets	$ 6,429	$ 7,001
Revenues by geographic area:		
United States	$ 4,585	$ 3,507
Canada, Mexico & So. America	274	257
Europe	8,148	7,756
Asia & the rest of the world	2,592	2,384
Total	$ 15,599	$ 13,904

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

	2013	2012
	(In thousands)	
Years Ended December 31		
Long-lived assets by geographic area:		
United States and North America	$ 4	$ 23
Europe	666	742
UK	222	443
Total	$ 892	$ 1,208

(17) SUBSEQUENT EVENTS

The Company has evaluated subsequent events through April 22, 2014, the date which the financial statements were available to be issued, and there were no additional events that impacted these financial statements or required additional disclosure to the financial statements.

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