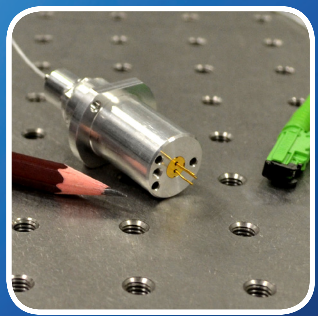
PRO PHOTONIX

Making Light Work For You

Annual Report 2015



About the pictures on the front cover (left to right):

COBRA Cure FX2 UV LED Curing System

The COBRA Cure FX2 is an innovative UV LED Curing system, delivering up to 8.4W/cm^2 or 17J/cm^2. Its innovative design incorporates the many benefits of a LED curing systems as well as unique end-user focused features to guarantee a consistent, reliable cure over the lifetime of the system.

UV LED Flood Light

The UV LED Flood Light is utilized for applications where a wider cure area and higher intensity of light is required. It is equipped with 144 high power LEDs with integrated reflectors for creating a uniform curing area. The Flood light produces a curing area of 100 mm x 100 mm with an output of up to 1.6W/cm^2 @ a working distance of 50mm.

COBRA CURE FX1 UV LED Curing System

COBRA Cure FX1 is a compact, fan-cooled UV LED curing system in a scalable form factor that produces a uniform line with a peak irradiance of 6 W/cm^2 and peak energy density (dose) of 5 J/cm^2. COBRA Cure FX1 is offered in numerous optical configurations and is available in a range of wavelengths including 365nm, 385nm 395nm and 405nm.

Fiber Coupled Laser Diode Module

The 200mW output power, 405nm, Fiber-Coupled Laser Diode Module (FCLD) was designed for use in large scale arrays. The outputs from the lasers formed a one dimensional array forming rectangular shaped outputs (10µm x 5µm) with a pitch of 20µm between each rectangular spot. Due to the high powers involved, the lasers were placed in a customized water-cooled heat sink to ensure the laser diode, located in the laser module housing, were maintained to within 1°C to extend the laser modules lifetime. ProPhotonix designed the modules to be easily replaceable using a simple quick-release system for setting the laser modules in the heat sink and providing low loss, high environmental protection connectors at the fiber ends.

Solutions for LEDs
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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.

2015 Annual Report to Shareholders

To the Shareholders of ProPhotonix Limited:

We entered 2015 with positive financial movement from the prior year, but also with economic and currency headwinds. Neither of these challenges abated during the year making continuing financial success all the more meaningful. 2015 has again been a landmark year in a number of respects – including our first full year of positive net income since 1994. We have also now achieved five consecutive half-yearly periods of positive EBITDA and three consecutive half-yearly periods of positive operating income. During 2015, operating income increased 723% and EBITDA increased 84%. In addition to a continuation of improving financial results, the ProPhotonix team has been diligently pursuing new customers, new product and market initiatives, which helps set the stage for 2016.

Operating Income growth	723%
EBITDA growth	84%
Net Income positive	not since 1994
Four provisional/patent applications	
Three, three-year customer supply agreements	

Financial Progress:

Our financial performance continues to improve. Although revenue fell by 12% during 2015, the year over year comparatives are significantly impacted by foreign currency conversion rates. While revenue for 2015 was $14.4 million, this would have been $15.8 million using the same average currency conversion rates in 2014 (2014: $16.4 million). Our margin rate improved to 41.4% from 39.1% in 2014. The improvement in the gross margin rate is attributable to product mix and continuing cost reductions. All of these factors contributed to the financial improvement of ProPhotonix and positive net income. The balance sheet also continued to improve in 2015. Term debt was reduced by $750,000 in accordance with the various loan facilities, and the total available credit from these various loan facilities was $2.0 million as of December 31, 2015.

($000's)	2015	2014
Sales	$ 14,411	$ 16,431
Gross Profit	5,970	6,425
Gross Margin Rate	41.4%	39.1%
Income from Operations	790	96
Net Income (Loss)	$ 280	$ (1,340)
EBITDA	$ 1,168	$ 634

During 2015, order bookings declined 2.4% to $15.7 million from 2014, but the book-to-bill ratio increased to 1.09 (2014: 0.98). However, if you factor in the impact of foreign currency conversion, our order rate for 2015 would have been $17.3 million (a 7.6% improvement), using average 2014 conversion rates. Our order backlog at December 31, 2015 was $5.6 million.

Customer and Product Development Initiatives:

In addition to the new customer activity in 2015, we entered into three (3) three-year supply agreements with customers and have received and fulfilled production orders for two of the three agreements beginning in Q4, 2015. We will begin commercial shipments on the third agreement in the first quarter 2016.

During the year, the ProPhotonix engineering team completed the development of several products and implemented a number of new technology capabilities. We announced eight new manufactured products. The Company filed four provisional/patent applications in 2015 as a continuation of intellectual property protection on our unique inventions and solutions.

Over the past two years, I have highlighted the Ultra Violet (UV) LED market as a high potential target market. We announced the COBRA Cure™ in 2014, and in 2015 we announced the COBRA Cure FX UV lamp. These products are ideally suited to a range of UV curing applications, including printing, adhesives, and coatings. Our UV LED product development plan includes variants of the FX lamp and additional UV light sources with higher power, configurable interfaces, and advanced sensing capabilities.

Building On Change:

Strategically, the Company is in transition. Historically, our product development has been customer directed. This approach has served us well for specific applications and we continue to offer bespoke product solutions. Over the past two years, we have assessed various markets and product features in order to develop a product strategy focusing on specific markets to complement our direct customer engagement. To this end, we are concentrating our engineering talents in a couple of defined market areas that we believe are poised for fast market expansion.

The first of these is the ultra violet (UV) LED and laser market for various applications including: printing, curing, 3D printing, bio-luminescence, medical microscopy, and other applications. Market research shows that the 2014 market size for UV LED applications was approximately $90 million with projected growth to $500 million by 2019, a compound average annual growth rate of nearly 40% (Yole Developpement, UV LEDs - Technology, Manufacturing and Application Trends, 2015).

Our other focus is on the continuing market requirement for multi-wavelength devices and systems; both laser and LED solutions. More and more customers are seeking multi-wavelength solutions requiring innovative optics, complex electronics, on-board sensing capabilities, and sophisticated software control. We see obvious opportunities which include a broad range of optical sensing and inspection applications in microscopy, industrial and security markets. We are in the research and development phase of these products and expect to announce various laser and LED products in the coming months.

I am happy with our improved financial performance, but we can still do better! We continue to build on the 2015 successes, furthering new customer revenue, while growing within our existing customer base by helping all customers prosper with ever evolving products for their applications. ProPhotonix' near-term perspective has not changed: 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.

In conclusion, I thank you, my co-workers, our customers, suppliers, service providers, and investors for your continued support!

Respectfully submitted,

Tim Losik
President and Chief Executive Officer

Director Remuneration Report

For the year ended December 31, 2015

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 ($)	Total All Compensation 2015 ($)	Total All Compensation 2014 ($)
Tim Losik	300,750	-	6,000	-	306,750	52,291	52,291	359,041	335,771
Total Executive Compensation	**300,750**	**-**	**6,000**	**-**	**306,750**	**52,291**	**52,291**	**359,041**	**335,771**
Non-Executive Director									
Ray Oglethorpe	-	-	-	25,000	25,000	2,968	2,968	27,968	28,507
Timothy Steel	-	-	-	25,000	25,000	2,968	2,968	27,968	28,507
Vincent Thompson	-	-	-	25,000	25,000	2,968	2,968	27,968	28,507
Mark Weidman	-	-	-	25,000	25,000	2,968	2,968	27,968	28,507
Total Non-Executive Compensation	**-**	**-**	**-**	**100,000**	**100,000**	**11,872**	**11,872**	**111,872**	**114,028**

Director Share Options:

Director	Options @ 12/31/14	Options Granted	Options Forfeited	Options @ 12/31/15
Tim Losik	4,900,000	-	-	4,900,000
Ray Oglethorpe	1,809,006	150,000	-	1,959,006
Timothy Steel	1,295,433	150,000	-	1,445,433
Vincent Thompson	1,295,433	150,000	-	1,445,433
Mark Weidman	850,000	150,000	-	1,000,000
Total All Directors	**10,149,872**	**600,000**	**-**	**10,749,872**

(1) 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, 2015 and 2014

FINANCIAL STATEMENTS

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Independent Auditors' Report

The Board of Directors
ProPhotonix Limited

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, 2015 and 2014, and the related consolidated statements of operations and comprehensive loss, stockholders' (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, 2015 and 2014, 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
March 22, 2016

FINANCIAL STATEMENTS

PROPHOTONIX LIMITED

CONSOLIDATED BALANCE SHEETS

($ in thousands except share and per share data)

December 31	**2015**	**2014**
Assets		
Current assets:		
Cash and cash equivalents	$ 434	$ 331
Accounts receivable, less allowances of $21 in 2015 and $20 in 2014	2,751	2,606
Inventories	1,550	1,686
Prepaid expenses and other current assets	140	180
Total current assets	4,875	4,803
Net property, plant and equipment	132	184
Goodwill	385	429
Other long-term assets	81	36
Total assets	**$ 5,473**	$ 5,452
Liabilities and Stockholders' Equity / (Deficit)		
Current liabilities:		
Revolving credit facility	$ 1,334	$ 1,128
Current portion of long-term debt	966	668
Accounts payable	1,260	1,463
Accrued expenses	1,035	965
Total current liabilities	4,595	4,224
Long-term debt, net of current portion	508	1,585
Other long-term liabilities	178	178
Total liabilities	**5,281**	5,987
Stockholders' Equity / (Deficit):		
Common stock, par value $0.001; shares authorized 250,000,000 at December 31, 2015 and at December 31, 2014; 83,665,402 shares issued and outstanding at December 31, 2015 and at December 31, 2014	84	84
Additional paid-in capital	111,860	111,583
Accumulated deficit	(112,734)	(113,014)
Accumulated other comprehensive income	982	812
Total stockholders' equity / (deficit)	**192**	(535)
Total liabilities and stockholders' equity	**$ 5,473**	$ 5,452

See the notes to consolidated financial statements.

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

	Years Ended December 31, 2015	Years Ended December 31, 2014
Revenue	$ 14,411	$ 16,431
Cost of Revenue	(8,441)	(10,006)
Gross Profit	5,970	6,425
Research & Development Expenses	(654)	(879)
Selling, General & Administrative Expenses	(4,526)	(5,350)
Amortization of Intangible Assets	-	(100)
Operating Income	790	96
Other Income, net	131	93
Foreign Currency Translation Losses	(259)	(1,031)
Warrant & Debt Acquisition Expense	(158)	(198)
Interest Expense	(224)	(300)
Income (Loss) Before Taxes	280	(1,340)
Income Taxes	-	-
Net Income (Loss)	$ 280	$ (1,340)
Other Comprehensive Income:		
Foreign currency translation	170	958
Total Comprehensive Income / (Loss)	$ 450	$ (382)
Income (Loss) Per Share: Basic and diluted:		
Net Income (loss) per share	$0.003	($0.016)
Basic and diluted weighted average shares outstanding	83,665,402	83,665,402

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, 2013	83,665	$ 84	$111,302	$ (111,674)	$ (146)	$ (434)
Share based compensation, net of forfeitures	-	-	280	-	-	280
Translation adjustment	-	-	-	-	958	958
Net Loss	-	-	-	(1,340)	-	(1,340)
Balance December 31, 2014	83,665	$ 84	$111,583	$ (113,014)	$ 812	$ (535)
Share based compensation, net of forfeitures	-	-	277	-	-	277
Translation adjustment	-	-	-	-	170	170
Net Income	-	-	-	280	-	280
Balance December 31, 2015	**83,665**	**$ 84**	**$111,860**	**$ (112,734)**	**$ 982**	**$ 192**

See the notes to consolidated financial statements.

PROPHOTONIX LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

Years Ended December 31	**2015**	**2014**
Cash flows from operating activities		
Net income (loss)	**$ 280**	**$ (1,340)**
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	277	280
Depreciation and amortization	101	258
Foreign exchange (gain) / loss	(51)	1,066
Amortization of debt discount and financing costs	130	186
Loss on disposal of assets	-	4
Provision for inventories	95	55
Provision for bad debts	4	5
Other changes in assets and liabilities:		
Accounts receivable	(362)	(395)
Inventories	(127)	38
Prepaid expenses and other current assets	22	23
Accounts payable	(58)	100
Accrued expenses	136	(248)
Other assets and liabilities	(47)	(2)
Net cash provided by operating activities	**400**	**30**
Investing		
Purchase of property, plant and equipment	(77)	(64)
Net cash used in investing activities	**(77)**	**(64)**
Financing		
Borrowings of revolving credit facilities, net	312	144
Proceeds from issuance of debt	-	175
Principal repayment of long-term debt	(750)	(292)
Net cash (used in) provided by financing activities	**(438)**	**27**
Effect of exchange rate on cash	218	(64)
Net change in cash and equivalents	103	(71)
Cash and equivalents at beginning of period	331	402
Cash and equivalents at end of period	**$ 434**	**$ 331**
Supplemental cash flow information:		
Cash paid for interest	$ 224	$ 303

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 manufacturer of laser modules and a distributor of laser diodes 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 traded on the London Stock Exchange, plc (AIM listing), under the trading symbol "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 year ended December 31, 2015, the Company recorded a net income of $280,000, and during the year ended December 31, 2014, the Company recorded a net loss of $1,340,000. Net cash flow from operating activities for the same time periods were $400,000 and $30,000, 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. The Company believes that it has adequate available working capital to continue to trade for at least the next twelve months from the issuance of these financial statements.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements are prepared in conformity with U.S. 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 (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 also covers most of the larger customers at the ProPhotonix (IRL) Limited subsidiary, and 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	**2015**	**2014**
	In thousands	
Balance at beginning of period	$ 20	$ 19
Charges to costs and expenses	6	3
Account write-offs and other deductions	(5)	(2)
Balance at end of period	$ 21	$ 20

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 the asset is determined not to be recoverable, 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.

INCOME (LOSS) PER SHARE

The Company calculates basic and diluted net income (loss) per common share by dividing the net income (loss) applicable to common stockholders by the weighted average number of common shares outstanding.

As of December 31, 2015, 22,965,040 shares underlying options and 8,026,067 shares underlying warrants would have been included in the calculation of diluted shares. However, as the exercise price exceeded the market price on December 31, 2015, none of these have been included in the calculation of earnings per share.

As of December 31, 2014, 22,365,040 shares underlying options and 8,577,567 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 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 upon completion of performance, subject to any project management assessments as to the status of work performed.

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, 2015	2014
	In thousands	
Balance at beginning of period	$ 146	$ 146
Charges to costs and expenses	109	36
Account write-offs and other deductions	(121)	(36)
Balance at end of period	$ 134	$ 146

ADVERTISING EXPENSE

The Company expenses advertising costs as incurred. Advertising expenses for the years ended 2015 and 2014 were approximately $81,000 and $82,000, 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, 2015 or 2014.

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. Generally the grants vest over terms of one 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 2015, the Company recognized approximately $277,000 of stock-based compensation related to options, all of which was charged to general and administrative expense. During 2014, the Company recognized approximately $280,000 of stock-based compensation related to options, all of which was charged to 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.

During 2014, the Company implemented the 2014 stock incentive plan, which is described in Note 11.

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 deficit (accumulated other comprehensive income) in the accompanying consolidated balance sheets.

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

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.

At December 31, 2015, the Company estimated the fair value of long term fixed rate debt to be approximately $1,849,000 compared to its carrying value of $1,783,000.

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 2015 or 2014. The Company had no customer that accounted for 10% of the outstanding accounts receivable balance at December 31, 2015 and had one customer that accounted for 10% of the outstanding accounts receivable balance at December 31, 2014. The Company maintains its cash and cash equivalents in bank deposit accounts, which at times may exceed insured limits. At December 31, 2015, the amount in excess of governmental insurance protection was approximately $0.3 million, measured across all entities and jurisdictions. At December 31, 2014, the amount in excess of governmental insurance protection was approximately $0.2 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 August 2014, the FASB updated the Accounting Standards Codification and amended Subtopic 205-40, Presentation of Financial Statement – Going Concern. This amended guidance requires that in connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable).

Management's evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued (or at the date that the financial statements are available to be issued when applicable).

Substantial doubt about an entity's ability to continue as a going concern exists when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or available to be issued). The term probable is used consistently with its use in Topic 450, Contingencies.

When management identifies conditions or events that raise substantial doubt about an entity's ability to continue as a going concern, management should consider whether its plans that are intended to mitigate those relevant conditions or events will alleviate the substantial doubt. The mitigating effect of the management's plans should be considered only to the extent that (1) it is probable that the plans will be effectively implemented and, if so (2) it is probable that the plans will mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern.

If conditions or events raise substantial doubt about an entity's ability to continue as a going concern, but the substantial doubt is alleviated as a result of consideration of management's plans, the entity should disclose information that enables users of the financial statements to understand all of the following:

a. Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans)
b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations
c. Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern.

If conditions or events raise substantial doubt about an entity's ability to continue as a going concern, and substantial doubt is not alleviated after consideration of management's plans, an entity should include a statement in the footnotes indicating that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or available to be issued). Additionally, the entity should disclose information that enables users of the financial statements to understand all of the following:

a. Principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern
b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations
c. Management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern.

The amendments are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company will evaluate this reporting requirement and adopt with the year beginning January 1, 2016. However the adoption of these requirements is not expected to have a significant impact on the Company's financial statements.

In May 2014, the FASB amended the Accounting Standards Codification and created a new Topic 606, Revenue from Contracts with Customers. The new guidance establishes a single comprehensive contract-based model for entities to use in accounting for revenue arising from contracts with customers. The new model significantly changes existing GAAP, requires substantial judgment in its application, and will generally require companies to make more disclosures about revenue. The core principle of the amendment is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the new guidance, an entity will (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the contract's performance obligations; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The new standard provides for two alternative implementation methods. The first is to apply the new standard retrospectively to each prior reporting period presented. This method does allow the use of certain practical expedients. The second method is to apply the new standard retrospectively in the year of initial adoption and record a cumulative effect adjustment for the impact of adjusting contracts open at the date of adoption. Under this transition method, we would apply this guidance retrospectively only to contracts that are not completed contracts at the date of initial application. We would then recognize the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings. This method also requires us to disclose comparative information for the year of adoption.

In August, 2015, the FASB issued AS 2015-14, which deferred the effective date of this guidance to the year beginning after December 15, 2017.

We will adopt the FASB's amended guidance for our year beginning January 1, 2017; early adoption is not permitted. We are currently evaluating the new guidance and have not determined the impact this standard may have on our financial statements nor have we decided upon the method of adoption.

In April, 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs, with amendments to Subtopic 835-30. Section 3 amends paragraphs 835-30-45-1 through 45-1A, 835-30-45-3 through 45-4, and 835-30-55-8, with a link to transition paragraph 835-30-65-1, as follows:

Interest—Imputation of Interest

Other Presentation Matters

- **a.** 835-30-45-1 The guidance in this Section does not apply to the amortization of premium and discount of assets and liabilities that are reported at fair value and the debt issuance costs of liabilities that are reported at fair value.
- **b.** 835-30-45-1A The discount or premium resulting from the determination of present value in cash or noncash transactions is not an asset or liability separable from the note that gives rise to it. Therefore, the discount or premium shall be reported in the balance sheet as a direct deduction from or addition to the face amount of the note. Similarly, debt issuance costs related to a note shall be reported in the balance sheet as a direct deduction from the face amount of that note. The discount, premium, or debt issuance costs shall not be classified as a deferred charge or deferred credit.
- **c.** 835-30-45-2 The description of the note shall include the effective interest rate. The face amount shall also be disclosed in the financial statements or in the notes to the statements.
- **d.** 835-30-45-3 Amortization of discount or premium shall be reported as interest expense in the case of liabilities or as interest income in the case of assets. Amortization of debt issuance costs also shall be reported as interest expense.

The Company has adopted this revised guidance and includes it in the presentation of the balance sheet and in FN 8.

(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	2015	2014
	In thousands	
Finished goods	$ 369	$ 327
Work in-process	252	226
Raw materials	929	1,133
Net inventories	$ 1,550	$ 1,686

Management performs quarterly reviews of inventory and either reserves or disposes of items not required by their manufacturing plan, as well as 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	2015	2014
	In thousands	
Buildings and building improvements	$ 253	$ 276
Computer equipment	407	413
Machinery and equipment	1,511	1,668
Furniture and fixtures	399	410
Property, plant and equipment	$ 2,570	$ 2,767
Less accumulated depreciation	(2,438)	(2,583)
Net property, plant and equipment	$ 132	$ 184

Depreciation expense from operations was approximately $101,000 and $158,000 in the years ended December 31, 2015 and 2014, respectively.

(6) GOODWILL

The Company uses a three-step approach to a goodwill impairment test. First, ASU 2011-08 allows entities 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 unit's use of services and/or direct benefit to its employees. While the Company believes it has made reasonable estimates and assumptions to calculate the fair value of the reporting units and implied fair value of goodwill, the impairment analysis is highly sensitive to actual versus forecast results. Finally, if the estimated value is less than the carrying value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill.

In connection with the annual impairment test of goodwill, performed at the end of the fourth quarter 2015, and at the end of the fourth quarter 2014, the Company concluded that no impairment existed.

The changes in the carrying amount of goodwill for the years ended December 31, 2015 and 2014 were as follows:

	December 31, 2015		December 31, 2014	
	(In thousands)			
Beginning of the year	$	429	$	486
Effect of exchange rate		(44)		(57)
End of year	$	385	$	429

The Company operates in two reporting units: LED's (light emitting diode systems) and Laser & Diodes. Goodwill as of December 31, 2015 and 2014 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 2015. 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, 2015 for each intangible asset class.

	Gross Carrying Amount	Accumulated Amortization	Net Balances
		(in thousands)	
Acquired customer contracts and relationships	1,850	(1,850)	-
Acquired technology design and programs	313	(313)	-
Other	102	(102)	-
Total	$ 2,265	$ (2,265)	$ -

Gross carrying amounts and accumulated amortization of intangible assets were as follows as of December 31, 2014 for each intangible asset class.

	Gross Carrying Amount	Accumulated Amortization	Net Balances
		(in thousands)	
Acquired customer contracts and relationships	1,942	(1,942)	-
Acquired technology design and programs	329	(329)	-
Other	107	(107)	-
Total	$ 2,378	$ (2,378)	$ -

	Actual Expense 2014	2015
	In thousands	
Amortization expense of intangible assets	$ 100	$ -

(8) DEBT

Years Ended December 31		**2015(1)**	**2014**
		In thousands	
Senior Fixed Rate Secured Bond ("PPI Bond") to a private investor, maturing on June 30, 2017 with an interest rate of 8%, December 31, 2015 and at December 31, 2014.	**Principal Amount**	**$902**	**$1.434**
	Less: Unamortized discount and debt issuance costs	**$ (33)**	**$ (88)**
	Long-term debt less unamortized discount and debt issuance costs	**$869**	**$1,346**
Senior Fixed Rate Secured Bond to a private investor, maturing on June 20, 2017, with an interest rate of 12.25%, at December 31, 2015 and at December 31, 2014.	**Principal Amount**	**$213**	**$334**
	Less: Unamortized discount and debt issuance costs	**$ (10)**	**$ (28)**
	Long-term debt less unamortized discount and debt issuance costs	**$203**	**$306**
Senior Fixed Rate Secured Bond to a private investor, maturing on June 20, 2017, with an interest rate of 12.25%, at December 31, 2015 and at December 31, 2014	**Principal Amount**	**$426**	**$669**
	Less: Unamortized discount and debt issuance costs	**$ (24)**	**$ (67)**
	Long-term debt less unamortized discount and debt issuance costs	**$402**	**$602**

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, 2015 and at December 31, 2014 (3.0% as of December 31, 2015 and at December 31, 2014).	**Principal Amount**	**$1.334**	**$1,140**
	Less: Unamortized discount and debt issuance costs	**$ -**	**$ (12)**
	Long-term debt less unamortized discount and debt issuance costs	**$1,334**	**$1,128**
Total All Debt	**Principal Amount**	**$2.875**	**$3,577**
	Less: Unamortized discount and debt issuance costs	**$ (67)**	**$ (196)**
	Long-term debt less unamortized discount and debt issuance costs	**$2,808**	**$3,381**

(1) As of December 31, 2015, the Company had approximately $ 2,027,000 available under the various borrowing facilities.

BORROWING AGREEMENTS

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 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 ($61,486) from July 1, 2015 through June 30, 2017*

(g) One-time fee of €31,413 ($34,259) 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 have been made within 45 days of the end of such calendar quarter, or as agreed to by the lender.

At December 31, 2015, $901,876 remained outstanding under the note, which has been classified as $589,189 current portion of long term debt and $312,687 long term debt and reported net of $9,458 of unamortized debt discount, which has been reported as $8,506 short-term and $952 as long-term and reported net of unamortized debt acquisition costs of $23,048, which have been reported as $20,729 short-term and $2,320 as long-term.

At December 31, 2014, $1,433,877 remained outstanding under the note, which has been classified as $420,992 current portion of long term debt and $1,012,885 long term debt and reported net of $25,648 of unamortized debt discount, which has been reported as $16,190 short-term and $9,458 as long-term and reported net of unamortized debt acquisition costs of $62,503, which have been reported as $39,455 short-term and $23,048 as long-term.

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 June 30, 2014
(e) Principal Repayment term: 36 months (July 1, 2014 through June 20, 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 June, 2017.

At December 31, 2015, $212,775 remained outstanding under the note, which has been classified as $137,487 current portion of long-term debt and $75,288 as long term debt and reported net of unamortized debt acquisition costs of $10,034, which have been reported as $9,051 short-term and $984 as long-term. As of December 31, 2015, the Company had net available funding of $305,000.

At December 31, 2014, $334,486 remained outstanding under the note, which has been classified as $121,711 current portion of long-term debt and $212,775 as long term debt and reported net of unamortized debt acquisition costs of $28,529, which have been reported as $18,495 short-term and $10,034 as long-term. As of December 31, 2014, the Company had net available funding of $305,000.

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 June 30, 2014
(d) Principal Repayment term:	36 months (July 1, 2014 through June 20, 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 June, 2017.

At December 31, 2015, $425,551 remained outstanding under the note, which has been classified as $274,974 current portion of long-term debt and $150,577 as long term debt and reported net of unamortized debt acquisition costs of $23,622, which have been reported as $21,306 short-term and $2,316 as long-term. As of December 31, 2015, the Company had $1,220,000 available under this borrowing facility.

At December 31, 2014, $668,973 remained outstanding under the note, which has been classified as $243,422 current portion of long-term debt and $425,551 as long term debt and reported net of unamortized debt acquisition costs of $67,161, which have been reported as $43,539 short-term and $23,622 as long-term As of December 31, 2014, the Company had $1,220,000 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, later reduced to £650,000, and grants a security interest in and lien upon all of ProPhotonix Limited, a U.K. subsidiary, trade receivables in favor of Barclays. The 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 was fully amortized over the two year amendment period to November, 2015.

On February 10, 2016, the Company entered into an amendment to the revolving credit facility to (i) increase the line from £1,400,000 to £1,500,000; (ii) to reduce the discount rate from 2.50% plus Barclays base rate to 2.00% plus Barclays base rate and service charges (iii) increase the early payment ceiling from 80% to 85% and extended the minimum period of this amendment to 12 months through February 10, 2017.

The amount outstanding under the facility was $1,334,000 as of December 31, 2015 and $1,140,000 as of December 31, 2014 and reported net of unamortized debt acquisition costs of $12,454, all of which was classified as a short term debt under revolving credit facility. As of December 31, 2015, the Company had approximately $502,000 available under this facility.

(9) TAXES

The Company had deferred tax assets, before considering the full valuation allowance, totaling approximately $26.9 million as of December 31, 2015 and approximately $27.1 million as of December 31, 2014. 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 2001 through 2015 remain open to examination by the federal and most state tax authorities. In addition, the tax years 2008 through 2015 are open to examination in foreign jurisdictions.

The following is a reconciliation of the federal income tax provision calculated at the statutory rate of 34% to the recorded amount:

	2015	2014
	In thousands	
Years Ended December 31,		
Income (Loss) before taxes	$ 280	$ (1,340)
Reconciliation		
Applicable statutory federal income tax benefit	95	(456)
Foreign tax rate differential	(38)	230
Non deductible items	33	38
Valuation allowance	(90)	126
Net income tax provision	$ -	$ -

The significant items comprising the deferred tax asset and liability at December 31, 2015 and 2014 are as follows:

Years Ended December 31,

	2015	2014
	In Thousands	
Domestic net operating loss carry forwards	$ 25,092	$ 25,160
Foreign net operating loss carry forwards	1,477	1,602
R&D tax credit	525	525
Other	313	278
Valuation allowance	(27,407)	(27,565)
Total	$ -	$ -

As of December 31, 2015, the Company had United States federal net operating loss carry forwards (NOLs) of approximately $62.1 million (2014: $62.2 million) available to offset future taxable income, if any. These carry forwards expire through 2034 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, 2015, the Company also has Canadian federal NOLs of approximately $1.2 million (2014: $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. At December 31, 2015, the Company also has a United Kingdom NOL of approximately $4.4 million (2014: $4.6 million). At December 31, 2015, the Company also has an Ireland NOL of approximately $2.3 million (2014: $2.6 million). The total valuation allowance against deferred tax assets decreased by $0.2 million (2014: decreased by $0.3 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, 2015 and 2014, 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

Warrants

As of December 31, 2015, there were 8,026,067 common shares outstanding warrants with the following exercise prices and expiration dates:

Number of Common Shares Warrants	Exercise Price	Expiration Date
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
8,026,067		

(11) STOCK OPTION PLANS

On June 9, 2014, the Company implemented the creation of a 2014 stock incentive plan.

New remuneration policy for senior management

Summary

In order to incentivize the achievement of its objectives, the Company has implemented a new remuneration policy for its senior management with the following elements:

- A one-off substantial performance based option grant to key senior management at market value
- No further grants intended to said senior management through the end of the three-year measurement period
- Cliff vesting on December 31, 2016 at different levels dependent on achievement against the performance target (zero below 50% up to 100% vesting at 90% attainment)
- 10 year option term

***Performance measure* -** The performance measure is the driving factor behind the new policy. Broadly, the target is EBITDA equal to 90% of the term debt and lease principal payments, and all interest payments, which are due during the performance period. Such payments would, on the basis of current obligations, amount to approximately $3.0 million in total. Achievement of this objective will result in full vesting. The committee and board believe that achievement of the objective will result in the creation of significant stockholder value.

Under the Company's 2014 Stock Incentive Plan (the 2014 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 10,200,000 shares of the Company's common stock were initially reserved for issuance under the 2014 Plan. In addition, there is an annual increase to the number of shares reserved for issuance under the 2014 Plan equal to the lesser of (i) 2,000,000 shares of common stock, (ii) 5% of the outstanding shares of common stock of the Company, or (iii) an amount determined by the Board of Directors of the Company.

As of December 31, 2015, there were 3,400,000 shares available to be issued from this plan.

In May, 2014, the Board of Directors approved the Seventh Amended and Restated Policy Regarding Compensation of Independent Directors, (i) cash compensation is $25,000 per annum paid in arrears each quarter in installments of $6,250; and (ii) options to purchase 150,000 shares of the Company's common stock, $.001 par value per share (the "Common Stock"), such that each Independent Director who is serving as director of the Company on the date of each annual meeting of stockholders (or special meeting in lieu thereof) beginning with the 2014 annual meeting, shall automatically be granted on such day an option (the "Option Award") entitling the recipient to acquire 150,000 shares of Common Stock, pursuant to the Company's 2014 Stock Incentive plan for 2015 & the 2007 Stock Incentive Plan (the "Plan") for 2014.

In May 2007, the Company adopted the 2007 Stock Option and Incentive Plan (the 2007 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 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, 2015. There is no intrinsic value on the options outstanding, and exercisable, at December 31, 2015. The intrinsic value on the options outstanding, and exercisable, at December 31, 2014 is approximately $8,000.

During 2015 and 2014, 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 600,000 options granted during the year ended December 31, 2015 and there were 10,500,000 options granted during the year ended December 31, 2014. These options vest over a one year, three 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, 2015 and December 31, 2014 used in the Black-Scholes option pricing model were as follows:

	Twelve months Ended December 31, 2015	Twelve months Ended December 31, 2014
Volatility………………………………………..	226.2%	237.58%
Expected option life……………………………	7.75 years	5.1 years
Interest rate (risk free)………………………….	2.01%	1.71%
Dividends……………………………………….	$0	$0
Weighted average grant date fair value………...	$0.0314	$0.0366

	Options Outstanding	Weighted Average Exercise Price per Share ($)	Weighted Average Remaining Contractual Term (in Years)
Balance at December 31, 2013	12,615,690	0.13	7.63
Granted	10,500,000	0.04	
Exercised	-	-	
Cancelled	(750,650)	0.56	
Balance at December 31, 2014	22,365,040	0.07	7.97
Vested and Exercisable at December 31, 2014	8,175,238	0.11	6.32
Balance at December 31, 2014	22,365,040	0.07	7.97
Granted	600,000	0.03	
Exercised	-	-	
Cancelled	-	-	
Balance at December 31, 2015	22,965,040	0.07	7.03
Vested and Exercisable at December 31, 2015	12,045,040	0.09	5.90
Vested and Expected to Vest at December 31, 2015	22,561,632	0.07	6.99

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	22,965,040	7.0	$ 0.07	12,045,040	$ 0.09

At December 31, 2015, there was approximately $164,000 of total unrecognized compensation cost related to stock options granted (2014: $419,000). The cost is expected to be recognized over the next 1.02 years. Total stock option expense recorded in 2015 and 2014 was approximately $277,000 and $280,000, respectively. There were no options exercised during 2015 and 2014.

(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, 2015 and 2014, there were no shares issued under the Stock Purchase Plan.

(13) EMPLOYEE DEFINED CONTRIBUTION PLANS

On January 17, 1994, the Company established the ProPhotonix Limited 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 $25,000 in the year ended December 31, 2015 and $27,000 in the year ended December 31, 2014. The Company incurred costs of approximately $2,000 in 2015 and approximately $1,200 in 2014 to administer the Plan. Approximately $15,000 of the $27,000 contributed by the Company was non cash, as the Company was allowed to offset these payments from the forfeitures remaining in the account, and as allowed by 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 $46,000 in each of the years ended December 31, 2015 and 2014. In Ireland, the Company also has a voluntary plan that matches contributions for those participating employees with minimum of 6 months of service. After two years of service, the Company will match up to a maximum of 5% of salary. The Company made contributions of approximately $28,000 and $32,000 in the years ended December 31, 2015 and 2014, 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. The lease is still under re-negotiation, however, the rent and service charges are now €72,000 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. At December 31, 2015 and at December 31, 2014, these capital leases were paid in full. 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, 2015 and December 31, 2014, is as follows:

	2015	2014
Assets under capital lease	$ 565,000	$ 594,000
Less—accumulated depreciation	(559,000)	(582,000)
Assets under capital lease, net	$ 6,000	$ 12,000

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

Due by period	2016	2017	2018	2019	2020	Total
				in thousands		
Debt obligations....................	$ 966	$ 508	$ -	$ -	$ -	$1,474
Revolving credit facility	1,334	-	-	-	-	1,334
Operating lease obligations....	78	-	-	-	-	78
	$ 2,378	$ 508	$ -	$ -	$ -	$2,886

The Company expensed approximately $217,000 and $241,000 in rent for the years ended December 31, 2015 and 2014, 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, defense 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 profit / (loss) for each segment includes selling, research and development and expenses directly attributable to the segment. In addition, the operating profit / (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.

Years Ended December 31	2015	2014
	(In thousands)	
Revenues:		
LEDs	$ 6,578	$ 7,111
Laser & diodes	7,833	9,320
Total revenues	$ 14,411	$ 16,431
Gross profit:		
LEDs	$ 3,136	$ 3,288
Laser & diodes	2,834	3,137
Total gross profit	$ 5,970	$ 6,425
Operating profit (loss):		
LEDs	$ 502	$ 126
Laser & diodes	288	(30)
Total operating profit	$ 790	$ 96

Years Ended December 31	2015	2014
	(In thousands)	
Current assets:		
LEDs	$ 1,659	$ 2,201
Laser & diodes	2,729	2,222
Corporate	487	380
Total current assets	$ 4,875	$ 4,803
Property, plant & equipment:		
LEDs	$ 50	$ 64
Laser & diodes	73	116
Corporate	9	4
Total property, plant & equipment	$ 132	$ 184
Goodwill:		
LEDs	$ 385	$ 429
Laser & diodes	—	—
Corporate	—	—
Total goodwill	$ 385	$ 429
Other assets:		
LEDs	$ 76	$ 30
Laser & diodes	—	—
Corporate	5	6
Total other assets	$ 81	$ 36

Years Ended December 31	2015	2014
	(In thousands)	
Total assets:		
LEDs	2,170	2,797
Laser & diodes	2,802	2,265
Corporate	501	390
Total assets	$ 5,473	$ 5,452
Revenues by geographic area:		
United States	$ 4,865	$ 4,724
Canada, Mexico & So. America	1,048	419
Europe	6,703	8,531
Asia & the rest of the world	1,795	2,757
Total	$ 14,411	$ 16,431

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

Years Ended December 31	2015	2014
	(In thousands)	
Long-lived assets by geographic area:		
United States and North America	$ 9	$ 4
Europe	435	545
UK	72	64
Total	$ 516	$ 613

(17) SUBSEQUENT EVENTS

The Company has evaluated subsequent events through March 21, 2016, 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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