

# **ZECOTEK PHOTONICS INC.**

## **CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE MONTHS ENDED OCTOBER 31, 2007 AND 2006**

### **NOTICE**

The interim financial statements of the company have been prepared by and are the responsibility of the company's management and have not been reviewed by the Company's independent auditor.

**ZECOTEK PHOTONICS INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**(Expressed in Canadian Dollars)**

	<b>October 31, 2007</b> <b>(Unaudited)</b>	<b>July 31, 2007</b> <b>(Audited)</b>
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 2,151,164	\$ 1,577,863
Accrued interest receivable	438	5,416
Share subscription receivable	16,000	-
Goods and services tax recoverable	64,245	34,346
Prepaid expenses	99,042	46,601
<b>Total Current Assets</b>	<b>2,330,889</b>	<b>1,664,226</b>
Due from related parties	70,739	65,209
Restricted short term investments	20,000	20,000
Deposits	94,511	653,689
Property and equipment	1,167,178	567,151
Equipment under capital lease	34,050	48,643
Patent costs	171,737	137,112
Intangible assets and development costs	1	1
<b>Total Assets</b>	<b>\$ 3,889,105</b>	<b>\$ 3,156,031</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 299,220	\$ 325,344
Current portion of obligations under capital lease	6,764	6,764
Share subscription received	-	14,145
Liabilities of discontinued operations	53,254	53,254
	359,238	399,507
Obligations under capital lease	29,732	34,471
<b>Shareholders' Equity</b>		
Share capital (note 3(b))	24,308,207	21,809,339
Contributed surplus (note 3(g))	3,331,296	2,955,552
Deficit	(24,139,368)	(22,042,838)
<b>Total Shareholders' Equity</b>	<b>3,500,135</b>	<b>2,722,053</b>
<b>Basis of Presentation (note 1)</b>		
<b>Commitments (note 6)</b>		
<b>Subsequent Event (note 8)</b>		
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 3,889,105</b>	<b>\$ 3,156,031</b>

Approved, on behalf of the Board:

"Faouzi Zerrouk"  
 Director

"Erich Sager"  
 Director

See accompanying Notes to Consolidated Financial Statements

**ZECOTEK PHOTONICS INC.**  
**CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT**  
(Expressed in Canadian Dollars)  
(Unaudited)  
Three months ended October 31, 2007 and 2006

	<b>2007</b>	<b>2006</b>
<b>REVENUE</b>		
Interest income	\$ 11,673	\$ -
<b>EXPENSES</b>		
General and administrative ( <i>note 5</i> )	1,084,053	879,346
Research and development ( <i>note 4</i> )	932,094	657,200
Amortization	52,724	8,052
Foreign exchange	39,332	2,458
	2,108,203	1,547,056
<b>Net loss for the year</b>	<b>(2,096,530)</b>	<b>(1,547,056)</b>
<b>Deficit, Beginning of Year</b>	<b>(22,042,838)</b>	<b>(13,801,155)</b>
<b>Deficit, End of Year</b>	<b>\$(24,139,368)</b>	<b>\$(15,348,211)</b>
<b>Loss per common share – basic and diluted</b>	<b>\$(0.05)</b>	<b>\$(0.04)</b>
<b>Weighted average number of common shares outstanding – basic and diluted (<i>note 3(f)</i>)</b>	<b>40,767,877</b>	<b>34,697,350</b>

See accompanying Notes to Consolidated Financial Statements

**ZECOTEK PHOTONICS INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Expressed in Canadian Dollars)**  
**(Unaudited)**  
**Three months ended October 31, 2007 and 2006**

	<b>2007</b>	<b>2006</b>
<b>Operating Activities:</b>		
Net loss for the year	\$(2,096,530)	\$(1,547,056)
Adjustments for items not involving cash:		
Amortization – property and equipment	52,104	8,052
Amortization – patent costs	620	-
Stock-based compensation ( <i>note 3(e)</i> )	360,789	366,261
	(1,683,017)	(1,172,743)
Changes in non-cash working capital:		
Accrued interest receivable	4,978	23,228
Share subscription receivable	(16,000)	-
Goods and services tax recoverable	(29,899)	99,507
Prepaid expenses	(52,441)	(39,970)
Accounts payable and accrued liabilities	(26,126)	(170,067)
<b>Net Cash Used in Operating Activities</b>	<b>(1,802,505)</b>	<b>(1,260,045)</b>
<b>Investing Activities:</b>		
Proceeds on disposal of (purchase of) short term investments	-	1,750,000
Deposits received	559,178	-
Acquisition of property and equipment	(637,538)	(348,447)
Patent costs incurred	(32,245)	(22,891)
	(113,605)	1,378,662
<b>Financing Activities:</b>		
Proceeds from shares issued, net of issuance costs	2,513,825	6,000
Share subscriptions received	(14,145)	-
Repayments of obligations under capital lease	(4,739)	-
Advances from related parties	-	8,994
Advances to related parties	(5,530)	-
	2,489,411	14,994
<b>Increase in cash and cash equivalents</b>	<b>573,301</b>	<b>133,611</b>
Cash and cash equivalents, Beginning of Year	1,577,863	249,014
<b>Cash and cash equivalents, End of Year</b>	<b>\$ 2,151,164</b>	<b>\$ 382,625</b>

See accompanying Notes to Consolidated Financial Statements

**ZECOTEK PHOTONICS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Expressed in Canadian Dollars)**  
**(Unaudited)**  
**Three months ended October 31, 2007 and 2006**

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## **1. BASIS OF PRESENTATION**

Zecotek Photonics Inc. (the “Company”) is a public company incorporated under the laws of the Province of British Columbia, Canada. The Company changed its name from Zecotek Medical Systems Inc. on November 26, 2007.

These interim financial statements have been prepared in accordance with generally accepted accounting principles on a going concern basis, which presumes that the Company will be able to realize assets and discharge liabilities in the normal course of business for the foreseeable future. The Company has incurred significant losses since its inception. To date, the Company has no products in commercial production or use and does not currently have any revenues other than interest earned on short-term investments. These factors, among others, raise uncertainty about the ability of the Company to continue as a going concern. The continued operations of the Company are dependent upon the ability of the Company to obtain further equity financing, the support of its principal shareholders, and successfully bring its technologies to market and achieving future profitable operations, the outcome of which cannot be predicted at this time.

These financial statements do not give effect to adjustments, if any, that would be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and liquidate its liabilities in other than the normal course of business and at amounts which may differ from those shown in the financial statements.

Certain information and disclosure normally required to be included in notes to annual consolidated financial statements have been condensed or omitted. These interim consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements for the year ended July 31, 2007. The consolidated interim financial statements have been prepared following the same accounting policies and methods of computation as the audited consolidated financial statements for the year ended July 31, 2007.

Certain comparative figures have been reclassified to conform with the current period’s presentation.

## **2. FINANCIAL INSTRUMENTS AND RISKS**

The fair values of financial instruments are estimated at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, they cannot be determined with precision. Changes in assumptions can significantly affect estimated fair values.

The carrying value of cash and cash equivalents, short term and restricted short term investments, accrued interest receivable, due from related parties, deposits, accounts payable and accrued liabilities, subscriptions received, obligations under capital lease, and liabilities of discontinued operations approximate their fair value.

Financial instruments that potentially subject the Company to concentration of credit risks consist principally of cash and short term investments. The Company places its cash in high credit quality financial institutions. Concentration of credit risks with respect to receivables is limited.

Financial risk is the risk to the Company’s results of operations that arises from fluctuations in interest rates and foreign exchange rates and the degree of volatility of these rates, as well as credit risk associated with the financial stability of the issuers of the financial instruments. The Company’s short term investments are invested in fixed rate securities.

**ZECOTEK PHOTONICS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**2. FINANCIAL INSTRUMENTS AND RISKS - Continued**

Foreign currency risk

The Company is exposed to fluctuations in the exchange rates between the Canadian dollar and other currencies including Singapore dollars, US dollars, Euros, and Swiss Francs. Most of the transactions in the Company's Singapore operations are undertaken in Singapore dollars. The company monitors fluctuations and takes action, if deemed necessary to mitigate its risks.

**3. SHARE CAPITAL**

**a) Authorized**

The authorized share capital of the Company is an unlimited number of common voting shares with no par value.

**b) Issued and outstanding common shares:**

	<b>Number of Shares</b>	<b>Amount</b>
<b>Balance, July 31, 2006</b>	<b>34,692,741</b>	<b>\$ 16,246,313</b>
Private placement	3,043,478	3,067,733
Exercise of options	553,000	584,671
Exercise of agent options	507,102	588,578
Exercise of warrants	1,016,957	1,322,044
<b>Balance, July 31, 2007</b>	<b>39,813,278</b>	<b>21,809,339</b>
Private placement (i)	1,563,000	2,353,638
Exercise of agent options (ii)	27,494	31,912
Exercise of warrants (iii)	87,168	113,318
<b>Balance, October 31, 2007</b>	<b>41,490,940</b>	<b>\$ 24,308,207</b>

- i) On September 6, 2007, the Company completed a non-brokered private placement of 1,563,000 units issued at \$1.60 per unit, resulting in gross proceeds of \$2,500,800. Each unit consists of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share for a period of eighteen months at a price of \$2.00 per share. The Company paid a finder's fee equal to 5% of the gross proceeds of the sale of the shares and issued non-transferable finder's warrants to purchase shares equal in number to 5% of the units sold under the private placement. The estimated fair value of agents' warrants granted was determined to be \$22,122 (\$0.28 per share), using the Black-Scholes option pricing model (note 10(d)).
- ii) During the quarter ended October 31, 2007, 27,494 agent options at \$0.90 per share were exercised for total cash proceeds of \$24,745. Contributed surplus amounts of \$7,167 related to these options were consequently transferred to the share capital account. One half share purchase warrant was attached to each share received in the exercise of options, giving rise to 13,747 warrants. These warrants expire November 12, 2007 and have an exercise price of \$1.30.
- iii) During the quarter ended October 31, 2007, 87,168 warrants were exercised at \$1.30 per share for total cash proceeds of \$113,318.

**ZECOTEK PHOTONICS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**3. SHARE CAPITAL - Continued**

**c) Common share purchase warrants**

	<b>Number of warrants</b>	<b>Weighted average exercise price</b>
<b>Balance, July 31, 2006</b>	3,194,700	\$ 1.30
Warrants exercised	(1,016,670)	1.30
<b>Balance, July 31, 2007</b>	<b>2,178,030</b>	<b>1.30</b>
Warrants exercised	(71,583)	1.30
Warrants granted	781,500	2.00
<b>Balance, October 31, 2007</b>	<b>2,887,947</b>	<b>\$ 1.49</b>

At October 31, 2007, the share purchase warrants outstanding and exercisable were as follows:

<b>Number of common shares to be issued</b>	<b>Exercise price</b>	<b>Date of expiry</b>
2,106,447	\$ 1.30	November 12, 2007
781,500	2.00	March 6, 2009

**d) Agent's warrants and options**

	<b>Number of warrants</b>	<b>Weighted average exercise price</b>
<b>Balance, July 31, 2006</b>	<b>638,940</b>	<b>\$ 0.90</b>
Agents' options exercised	(507,102)	0.90
Agents' warrants granted on exercise of options	253,551	1.30
Agents' warrants exercised	(6,287)	1.30
Agents' warrants granted in private placement	213,043	0.90
<b>Balance, July 31, 2007</b>	<b>592,145</b>	<b>1.07</b>
Agents' options exercised	(27,494)	0.90
Agents' warrants granted on exercise of options	13,747	1.30
Agents' warrants exercised	(15,585)	1.30
Agents' warrants granted in private placement	78,150	2.00
<b>Balance, October 31, 2007</b>	<b>640,963</b>	<b>\$ 1.19</b>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**3. SHARE CAPITAL - Continued**

**d) Agent's warrants and options - Continued**

At October 31, 2007, the agents' options and warrants outstanding and exercisable were as follows:

<b>Number of common shares to be issued</b>	<b>Exercise price</b>	<b>Date of expiry</b>
<b>104,344</b>	<b>\$0.90</b>	<b>November 12, 2007</b>
<b>245,426</b>	<b>1.30</b>	<b>November 12, 2007</b>
<b>213,043</b>	<b>0.90</b>	<b>February 18, 2009</b>
<b>78,150</b>	<b>2.00</b>	<b>March 6, 2009</b>

The fair value of agents' options and warrants has been estimated at the date of grant of options using the Black-Scholes option pricing model using the following weighted average assumptions:

	<u>October 31, 2007</u>	<u>July 31, 2007</u>
Annualized stock volatility	78.3%	77.9%
Risk-free interest rate	4.3%	4.1%
Expected option/warrant life	1.5 years	2.0 years
Dividend payments	0.0%	0.0%

**e) Stock options**

On December 28, 2007, the shareholders approved a new stock option plan. Under the plan, the Company may grant options to purchase common shares in the Company to employees, directors, officers, and consultants of the Company. The exercise price of the options is to be determined by the Board of Directors but generally will be equal to or greater than the market price of the shares at the grant date. Options will vest according to the following schedule:

- 25% - on grant date
- 25% - six months after grant date
- 25% - twelve months after grant date
- 25% - eighteen months after grant date

The Company has reserved 8,340,000 common shares for issuance of stock options to employees, directors, officers and consultants of the Company.



**ZECOTEK PHOTONICS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**3. SHARE CAPITAL - Continued**

**e) Stock options - Continued**

Stock option transactions and the number outstanding are summarized below:

	<b>Number of options</b>	<b>Weighted average exercise price</b>
<b>Balance, July 31, 2006</b>	4,835,000	\$ 1.22
Options granted	720,000	1.04
Options exercised	(553,000)	0.78
Options expired	(533,000)	1.44
<b>Balance, July 31, 2007</b>	4,469,000	1.22
Options granted	100,000	1.30
<b>Balance, July 31, 2007</b>	<b>4,569,000</b>	<b>\$ 1.22</b>

At October 31, 2007, 3,645,250 options had vested, which have a weighted average exercise price of \$1.16.

The estimated fair value of options granted to employees, directors, officers and consultants is amortized to expense over the vesting period of the options, resulting in compensation expense and addition to contributed surplus of \$360,789 for the three months ended October 31, 2007 (2006 – \$366,261).

The weighted average fair value of stock options granted during the three months ended October 31, 2007 has been estimated at the date of grant using the Black-Scholes option pricing model as \$0.86 per share (2006 - \$0.59) using the following weighted average assumptions:

	October 31, 2007	July 31, 2006
Annualized stock volatility	78.0%	74.0%
Risk-free interest rate	4.4%	4.1%
Expected option life	5 years	4.4 years
Dividend payments	0.0%	0.0%

**ZECOTEK PHOTONICS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**3. SHARE CAPITAL - Continued**

**e) Stock options - Continued**

The following summarizes options outstanding at July 31, 2007:

<b>Exercise price</b>	<b>Number of options</b>	<b>Number of options Exercisable</b>	<b>Weighted average remaining life (years)</b>
\$0.50	560,000	560,000	2.17
\$0.70	260,000	260,000	2.22
\$0.72	100,000	100,000	3.24
\$0.75	574,000	574,000	2.87
\$0.80	160,000	80,000	4.21
\$0.93	140,000	140,000	3.39
\$0.99	100,000	75,000	3.68
\$1.05	160,000	120,000	3.77
\$1.10	300,000	150,000	4.23
\$1.20	100,000	50,000	4.25
\$1.30	100,000	25,000	4.95
\$1.55	240,000	180,000	3.60
\$1.76	1,775,000	1,331,250	3.53
	<b>4,569,000</b>	<b>3,645,250</b>	<b>3.33</b>

The Black-Scholes model, used by the Company to calculate option values, was developed to estimate fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differs from the Company's stock option awards. This model also requires highly subjective assumptions, including future stock price, volatility, and expected time until exercise, which greatly affect the calculated values.

**f) Escrow Shares**

As at October 31, 2007 a total of 8,795,628 (2006 – 10,820,003) of the issued shares were held in escrow, the release of which is subject to a pre-determined schedule through January of 2011. The escrowed shares are to be included in the computation of the weighted-average number of common shares outstanding.

**g) Contributed Surplus**

	<b>Oct 31, 2007</b>	<b>July 31, 2007</b>
<b>Balance, beginning of period</b>	<b>\$ 2,955,552</b>	<b>\$ 1,558,457</b>
Options granted (note 10(e))	360,789	1,530,686
Options exercised	-	(153,671)
Agents' options exercised (note 10(b)(ii))	(7,167)	(132,187)
Agents' warrants granted (note 10(b)(i))	22,122	152,267
<b>Balance, end of period</b>	<b>\$ 3,331,296</b>	<b>\$ 2,955,552</b>

**ZECOTEK PHOTONICS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**4. RESEARCH AND DEVELOPMENT EXPENSES**

During the three months ended October 31, 2007, the Company incurred research and development expenses of \$932,094 (2006 - \$657,200) which it considered to not meet the criteria for initial capitalization of such costs, including costs not directly attributable to specific product development, such as overhead.

**5. GENERAL AND ADMINISTRATIVE**

	<b>2007</b>	<b>2006</b>
Consulting and other professional	\$ 313,917	\$ 180,950
Filing fees	18,262	4,608
Insurance	24,210	-
Legal	52,664	23,236
Marketing and promotion	29,049	-
Office and miscellaneous	33,585	20,051
Rent and storage	91,641	82,009
Salaries and benefits	83,556	140,732
Stock-based compensation ( <i>note 10(e)</i> )	360,789	366,261
Travel	76,380	61,499
<b>Total</b>	<b>\$ 1,084,053</b>	<b>\$ 879,346</b>

**6. COMMITMENTS**

The Company has entered into leases for its facilities in Vancouver and Singapore. The Company has also entered into leases for an apartment for certain employees and a residence for the Chief Executive Officer in Singapore. Minimum required lease payments under these leases are as follows:

2008	315,547
2009	193,500
2010	80,630
	<hr/>
	\$ 589,677
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**ZECOTEK PHOTONICS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**7. SEGMENT INFORMATION**

The Company has principal operations in Canada and Singapore. Geographic information by country is as follows:

<b>Property and equipment, at amortized cost</b>	<b>2007</b>	<b>2006</b>
Canada	\$ 23,858	\$ 31,389
Singapore	1,130,406	302,782
Other	12,914	-
	\$ 1,167,178	\$ 334,171
<b>Revenue</b>	<b>2007</b>	<b>2006</b>
Canada	\$ 11,646	\$ -
Singapore	-	-
Other	27	-
	\$ 11,673	\$ -

**8. SUBSEQUENT EVENT**

On December 20, 2007, the Company completed a private placement of 2,156,300 units issued at \$1.60 per unit, resulting in gross proceeds of \$3,450,080. Each unit consists of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share for a period of twenty four months at a price of \$2.10 per share. The Company paid a finder's fee equal to 7% of the gross proceeds of the sale of the shares and issued non-transferable finder's warrants to purchase shares equal in number to 7% of the units sold under the private placement.