

ADVANCED PHOTONIX INC
Form 10-Q
February 11, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

- ☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 28, 2012
OR

- ☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-11056

ADVANCED PHOTONIX, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

33-0325826
(I.R.S. Employer Identification No.)

2925 Boardwalk, Ann Arbor, Michigan 48104
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code
(734) 864-5600

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days:

YES ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ☐ NO ☒

As of February 4, 2013, there were 31,161,147 shares of Class A Common Stock, \$.001 par value, outstanding.

Advanced Photonix, Inc.
Form 10-Q
For the Quarter Ended December 28, 2012

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PART I -- FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

Advanced Photonix, Inc.
Condensed Consolidated Balance Sheets

	December 28, 2012 (Unaudited)	March 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 559,000	\$ 3,249,000
Receivables, net	3,770,000	4,539,000
Inventories	3,702,000	3,594,000
Prepaid expenses and other current assets	450,000	261,000
Total current assets	8,481,000	11,643,000
Equipment and leasehold improvements, net	3,033,000	3,301,000
Goodwill	4,579,000	4,579,000
Intangibles and patents, net	3,760,000	4,538,000
Other assets	345,000	322,000
Total Assets	\$ 20,198,000	\$ 24,383,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,108,000	\$ 872,000
Accrued compensation	708,000	866,000
Accrued subcontracting costs	427,000	355,000
Other accrued expenses	671,000	651,000
Current portion of long-term debt - bank term loan	333,000	333,000
Current portion of long-term debt - bank line of credit	-	500,000
Current portion of long-term debt – MEDC/MSF	547,000	532,000
Total current liabilities	3,794,000	4,109,000
Long-term debt, less current portion – MEDC/MSF	517,000	929,000
Long-term debt, less current portion – bank term loan	417,000	667,000
Warrant liability	-	26,000
Total liabilities	4,728,000	5,731,000
Commitments and contingencies		
Shareholders' equity:		
Class A Common Stock, \$.001 par value, 100,000,000 authorized;		
December 28, 2012 – 31,161,147 shares issued and outstanding,		
March 31, 2012 – 31,159,431 shares issued and outstanding	31,000	31,000
Additional paid-in capital	58,570,000	58,446,000
Accumulated deficit	(43,131,000)	(39,825,000)
Total shareholders' equity	15,470,000	18,652,000
Total Liabilities and Shareholders' Equity	\$ 20,198,000	\$ 24,383,000

See notes to condensed consolidated financial statements.

Advanced Photonix, Inc.

Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended		Nine Months Ended	
	December 28, 2012	December 30, 2011	December 28, 2012	December 30, 2011
Sales, net	\$ 5,834,000	\$ 6,518,000	\$ 17,636,000	\$ 22,991,000
Cost of products sold	3,381,000	3,828,000	10,965,000	13,356,000
Gross profit	2,453,000	2,690,000	6,671,000	9,635,000
Operating expenses:				
Research, development and engineering	1,558,000	1,660,000	4,271,000	5,066,000
Sales and marketing	527,000	484,000	1,528,000	1,664,000
General and administrative	1,087,000	1,062,000	3,259,000	3,521,000
Amortization expense	293,000	344,000	876,000	1,028,000
Total operating expenses	3,465,000	3,550,000	9,934,000	11,279,000
Loss from operations	(1,012,000)	(860,000)	(3,263,000)	(1,644,000)
Other income (expense):				
Interest income	7,000	1,000	7,000	5,000
Interest expense	(34,000)	(30,000)	(97,000)	(93,000)
Interest expense, related parties	--	(10,000)	--	(38,000)
Change in fair value of warrant liability	13,000	84,000	26,000	719,000
Other income	--	3,000	22,000	3,000
Net loss	\$ (1,026,000)	\$ (812,000)	\$ (3,305,000)	\$ (1,048,000)
Basic & diluted loss per share	\$ (0.03)	\$ (0.03)	\$ (0.11)	\$ (0.03)
Weighted average common shares outstanding				
Basic & diluted	31,161,000	30,972,000	31,161,000	30,828,000

See notes to condensed consolidated financial statements.

Advanced Photonix, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended	
	December 28, 2012	December 30, 2011
Cash flows from operating activities:		
Net loss	\$(3,305,000)	\$(1,048,000)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation	583,000	806,000
Amortization	876,000	1,028,000
Stock based compensation expense	124,000	480,000
Change in fair value of warrant liability	(26,000)	(719,000)
Changes in operating assets and liabilities:		
Receivables – net	769,000	665,000
Inventories	(108,000)	451,000
Prepaid expenses and other assets	(212,000)	(44,000)
Accounts payable and accrued expenses	170,000	(1,468,000)
Net cash provided by (used in) operating activities	(1,129,000)	151,000
Cash flows from investing activities:		
Capital expenditures	(316,000)	(543,000)
Change in restricted cash	--	500,000
Patent expenditures	(98,000)	(159,000)
Net cash used in investing activities	(414,000)	(202,000)
Cash flows from financing activities:		
Proceeds on bank term loan	--	998,000
Payments on bank term loan	(250,000)	(727,000)
Net payments on bank line of credit	(500,000)	(494,000)
Payments on MEDC/MSF term loan	(397,000)	(425,000)
Payments on related parties debt	--	(449,000)
Proceeds from exercise of stock options	--	25,000
Net cash used in financing activities	(1,147,000)	(1,072,000)
Net decrease in cash and cash equivalents	(2,690,000)	(1,123,000)
Cash and cash equivalents at beginning of period	3,249,000	4,744,000
Cash and cash equivalents at end of period	\$559,000	\$3,621,000
	December 28, 2012	December 30, 2011
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$81,000	\$144,000

See notes to condensed consolidated financial statements.

Advanced Photonix, Inc.
Notes to Condensed Consolidated Financial Statements
December 28, 2012

Note 1. Basis of Presentation

Business Description

General – Advanced Photonix, Inc. ® (the Company, we or API), was incorporated under the laws of the State of Delaware in June 1988. The Company is a leading supplier of optoelectronic semiconductors which are packaged into components, sub-systems and full systems for high-speed optical receivers (HSOR), custom optoelectronic products and Terahertz (THz) instrumentation, serving a variety of global markets. The Company supports the customers from the initial concept and design phase of the product, through testing to full-scale production. The Company has two manufacturing facilities located in Camarillo, California and Ann Arbor, Michigan.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and the Company's wholly owned subsidiaries, Silicon Sensors Inc. (SSI) and Picometrix®, LLC (Picometrix). The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). All material inter-company accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, necessary for a fair presentation of the financial position and the results of operations for the periods presented have been included. Operating results for the nine-month period ended December 28, 2012 are not necessarily indicative of the results that may be expected for the balance of the fiscal year ending March 31, 2013.

These unaudited condensed consolidated financial statements should be read in conjunction with Management's Discussion and Analysis and the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2012, filed with the SEC on June 29, 2012.

Note 2. Recent Pronouncements and Accounting Changes

In September 2011, the FASB issued updated guidance that modifies the manner in which the two-step impairment test of goodwill is applied. Under the amendments in this update, an entity has the option to first assess 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, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test prescribed by existing standards.

The adoption of this guidance did not impact the Company's consolidated financial statements.

Note 3. Stock Based Compensation

The Company has three stock equity plans: The 1997 Employee Stock Option Plan, the 2000 Stock Option Plan and the 2007 Equity Incentive Plan. As of December 28, 2012, no additional awards may be issued under either the 1997 Employee Stock Option Plan or the 2000 Stock Option Plan. There are 2,500,000 shares authorized for issuance under the 2007 Equity Incentive Plan, with 263,295 shares remaining available for future grant.

Options and restricted stock awards may be granted to employees, officers, directors and consultants. Options typically vest over a period of one to four years and are exercisable up to ten years from the date of issuance. The option exercise price equals the stock's market price on the date of grant. Restricted stock awards typically vest over a period of six months to four years, and the shares subject to such awards are generally not transferrable until the awards vest.

The following table summarizes information regarding options outstanding and options exercisable at each of the quarterly periods through the nine months ended December 30, 2011 and December 28, 2012, respectively, and the changes during the periods then ended:

	Number of Options Outstanding (000's)	Weighted Average Exercise Price per Share	Number of Shares Exercisable (000's)	Weighted Average Exercise Price per Share
Balance as of March 31, 2011	2,161	\$1.65	1,933	\$1.74
Granted	368	\$1.52		
Exercised	(16)	) \$0.57		
Expired or forfeited	(37)	) \$1.69		
Balance as of July 1, 2011	2,476	\$1.64	1,980	\$1.72
Granted	160	\$0.95		
Exercised	(27)	) \$0.83		
Expired or forfeited	--	\$--		
Balance as of September 30, 2011	2,609	\$1.60	1,972	\$1.74
Granted	--	\$--		
Exercised	--	\$--		
Expired or forfeited	--	\$--		
Balance as of December 30, 2011	2,609	\$1.60	2,347	\$1.70
Vested & expected to Vest, December 30, 2011	2,531	\$1.60		
	Number of Options Outstanding (000's)	Weighted Average Exercise Price per Share	Number of Shares Exercisable (000's)	Weighted Average Exercise Price per Share
Balance as of March 31, 2012	2,267	\$1.75	1,994	\$1.88
Granted	125	\$0.63		
Exercised	(5)	) \$0.44		
Expired or forfeited	(5)	) \$0.44		
Balance as of June 29, 2012	2,382	\$1.69	2,023	\$1.86
Granted	67	\$0.62		

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Exercised	--	\$--		
Expired or forfeited	(11	) \$2.26		
Balance as of September 28, 2012	2,438	\$1.66	2,058	\$1.83
Granted	--	\$--		
Exercised	--	\$--		
Expired or forfeited	(31	) \$1.19		
Balance as of December 28, 2012	2,407	\$1.67	2,085	\$1.81
Vested & expected to Vest, December 28, 2012	2,353	\$1.69		

Information regarding stock options outstanding as of December 28, 2012 is as follows:

Price Range	Shares (in 000s)	Options Outstanding	
		Weighted Average Exercise Price	Weighted Average Remaining Life
\$0.44 - \$1.25	628	\$ 0.74	7.38
\$1.26 - \$2.50	1,474	\$ 1.82	4.41
\$2.51 - \$5.34	305	\$ 2.84	2.51

Price Range	Shares (in 000s)	Options Exercisable	
		Weighted Average Exercise Price	Weighted Average Remaining Life
\$0.44 - \$1.25	306	\$ 0.72	5.72
\$1.26 - \$2.50	1,474	\$ 1.82	4.41
\$2.51 - \$5.34	305	\$ 2.84	2.51

The intrinsic value of options exercised during the three and nine month periods ended December 28, 2012 was zero and \$1,100, respectively. The intrinsic value of options exercised during the three and nine month periods ended December 30, 2011 was zero and \$21,132, respectively.

During the third quarter of fiscal 2012 and fiscal 2013, there were no restricted shares issued. The restricted share transactions are summarized below:

	Shares (000's)	Weighted Average Grant Date Fair Value Per Share	
Unvested, March 31, 2011	70	\$	0.44
Granted	55	\$	1.51
Vested	(70)	) \$	0.44
Expired or forfeited	--	\$	--
Unvested, July 1, 2011	55	\$	1.51
Granted	198	\$	.98
Vested	--	\$	--
Expired or forfeited	--	\$	--
Unvested, September 30, 2011	253	\$	1.10
Granted	--	\$	--
Vested	(55)	) \$	1.51
Expired or forfeited	--	\$	--
Unvested, December 30, 2011	198	\$	0.98

	Shares (000's)	Weighted Average Grant Date Fair Value Per Share	
Unvested, March 31, 2012	246	\$	0.84
Granted	--	\$	--
Vested	--	\$	--
Expired or forfeited	--	\$	--

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Unvested, June 29, 2012	246	\$	0.84
Granted	--	\$	--
Vested	(76	) \$	0.82
Expired or forfeited	--	\$	--
Unvested, September 28, 2012	170	\$	0.84
Granted	--	\$	--
Vested	--	\$	--
Expired or forfeited	--	\$	--
Unvested, December 28, 2012	170	\$	0.84

The Company estimates the fair value of stock-based awards utilizing the Black-Scholes pricing model for stock options and using the intrinsic value for restricted stock. The fair value of the awards is amortized as compensation expense on a straight-line basis over the requisite service period of the award, which is generally the vesting period. The Black-Scholes fair value calculations involve significant judgments, assumptions, estimates and complexities that impact the amount of compensation expense to be recorded in current and future periods. The factors include:

1. The time period that option awards are expected to remain outstanding has been determined based on the average of the original award period and the remaining vesting period in accordance with the SEC's short-cut approach pursuant to SAB No. 107, "Disclosure about Fair Value of Financial Statements". The expected term assumption for awards issued during the nine month periods ended December 28, 2012 and December 30, 2011 was 6.3 years. As additional evidence develops from the employee's stock trading history, the expected term assumption will be refined to capture the relevant trends.
2. The future volatility of the Company's stock has been estimated based on the weekly stock price from the acquisition date of Picometrix (May 2, 2005) to the date of the latest stock grant. The expected volatility assumption for awards issued during both the nine month periods ended December 28, 2012 and December 30, 2011 averaged 67%. As additional evidence develops, the future volatility estimate will be refined to capture the relevant trends.
3. A dividend yield of zero has been assumed for awards issued during nine month periods ended December 28, 2012 and December 30, 2011, based on the Company's actual past experience and the fact that Company does not anticipate paying a dividend on its shares in the near future.
4. The Company has based its risk-free interest rate assumption for awards issued during the nine month periods ended December 28, 2012 and December 30, 2011 on the implied yield available on U.S. Treasury issues with an equivalent expected term, which averaged 0.8% and 1.7% during each of the respective periods.
5. The forfeiture rate, for awards issued during both the nine month periods ended December 28, 2012 and December 30, 2011, was 17% and was based on the Company's actual historical forfeiture history.

The Company's stock-based compensation expense is classified in the table below:

	Three months ended		Nine months ended	
	December 28, 2012	December 30, 2011	December 28, 2012	December 30, 2011
Cost of Products Sold	\$3,000	\$23,000	\$10,000	\$52,000
Research, development & engineering expense	12,000	69,000	35,000	155,000
General and Administrative expense	28,000	133,000	69,000	249,000
Sales and Marketing expense	3,000	10,000	10,000	24,000
Total Stock Based Compensation	\$46,000	\$235,000	\$124,000	\$480,000

At December 28, 2012, the total stock-based compensation expense related to unvested stock options and restricted shares granted to employees and independent directors under the Company's stock option plans but not yet recognized was \$216,000. This expense will be amortized on a straight-line basis over a weighted-average period of approximately 2.3 years and will be adjusted for subsequent changes in estimated forfeitures.

Note 4. Credit Risk

Pervasiveness of Estimates and Risk - The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash equivalents and trade accounts receivable.

Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits. We have never experienced any losses related to these balances. All of the Company's non-interest bearing cash balances were fully insured at December 28, 2012 due to a temporary federal program in effect through December 31, 2012. Under the program, there is no limit to the amount of insurance for eligible accounts. Beginning in calendar year 2013, insurance coverage will revert to \$250,000 per depositor at each financial institution, and our non-interest bearing cash balances may again exceed federally insured limits.

Accounts receivable are unsecured and the Company is at risk to the extent such amounts become uncollectible. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. Any unanticipated change in the customers' credit worthiness or other matters affecting the collectability of amounts due from such customers could have a material effect on the results of operations in the period in which such changes or events occur. As of December 28, 2012, one customer individually comprised 10% or more of accounts receivable (for 12% of total accounts receivable). As of March 31, 2012, two customers individually comprised 10% or more of accounts receivable (combining for 29% of total accounts receivable). The allowance for doubtful account balance was \$39,000 on December 28, 2012 and on March 31, 2012.

Note 5. Detail of Certain Asset Accounts

Cash and Cash Equivalents - The Company considers all highly liquid investments, with an original maturity of three months or less when purchased, to be cash equivalents.

Inventories - Inventories, which include material, labor and manufacturing overhead, are stated at the lower of cost (on a first in, first out method) or market. Inventories consist of the following at December 28, 2012 and March 31, 2012:

	December 28, 2012		March 31, 2012
Raw material	2,387,000	\$	2,342,000
Work-in-process	802,000		949,000
Finished products	513,000		303,000
Inventories, net	\$ 3,702,000	\$	3,594,000

Slow moving and obsolete inventories are reviewed throughout the year to assess whether a cost adjustment is required. Our review of slow moving and obsolete inventory begins with a listing of all inventory items which have not moved regularly within the past 12 months. In addition, any residual inventory, which is customer specific and remaining on hand at the time of contract completion, is included in the list. The complete list of slow moving and obsolete inventory is then reviewed by the production, engineering and/or purchasing departments to identify items that can be utilized in the near future. These items are then excluded from the analysis and the remaining amount of slow-moving and obsolete inventory is then further assessed and a write down is recorded when warranted. Additionally, non-cancelable open purchase orders for parts we are obligated to purchase where demand has been reduced may also be reserved. Impairments for open purchase orders where the market price is lower than the purchase order price are also recorded. The impairments established for excess, slow moving, and obsolete inventory create a new cost basis for those items. The cost basis of these parts is not subsequently increased if the circumstances which led to the impairment change in the future. If a product that had previously been impaired is subsequently sold, the amount of reduced cost basis is reflected as cost of goods sold.

Intangible Assets - Intangible assets that have definite lives consist of the following (dollars in thousands):

	Weighted Average Lives in Years	December 28, 2012 Amortization Method	Carrying Value	Accumulated Amortization	Intangibles Net
Customer list	15	Straight Line	\$ 190	\$ 97	\$ 93
Trademarks	15	Cash Flow	2,270	1,066	1,204
Technology	10	Cash Flow	10,950	9,716	1,234
Patents pending			676	--	676
Patents	10	Straight Line	859	306	553
Total					
Intangibles			\$ 14,945	\$ 11,185	\$ 3,760

	Weighted Average Lives in Years	March 31, 2012 Amortization Method	Carrying Value	Accumulated Amortization	Intangibles Net
Customer list	15	Straight Line	\$ 475	\$ 372	\$ 103
Trademarks	15	Cash Flow	2,270	949	1,321
Technology	10	Cash Flow	10,950	9,027	1,923
Patents pending			673	--	673
Patents	10	Straight Line	764	246	518
Total					
Intangibles			\$ 15,132	\$ 10,594	\$ 4,538

Amortization expense for the three-month periods ended December 28, 2012 and December 30, 2011 was \$293,000 and \$344,000, respectively. The current patents held by the Company have remaining useful lives ranging from 2 years to 20 years. Amortization expense for the nine-month periods ended December 28, 2012 and December 30, 2011 was \$876,000 and \$1.0 million, respectively.

The cash flow method of amortization is based upon management's estimate of how the intangible asset contributes to our cash flows and best represents the pattern of how the economic benefits of the intangible asset will be consumed or used up. Such amortization is initially derived from the estimated undiscounted cash flows that were used in determining the original fair value of the intangible asset at the acquisition date and is monitored for significant

changes in subsequent periods.

Assuming no impairment to the intangible value, future amortization expense for intangible assets and patents, excluding patents pending, are as follows by fiscal year (in thousands):

Intangible Assets and Patents		
Remainder of 2013	\$	292
2014		981
2015		539
2016		267
2017		270
2018 & after		735
Total	\$	3,084

Patent pending costs of \$676,000 are not included in the future amortization chart above. These costs will be amortized beginning the month the patents are granted.

Note 6. Debt

Total outstanding debt of the Company as of December 28, 2012 and March 31, 2012 consisted of the following (in thousands):

	December 28, 2012		March 31, 2012	
Bank term loan	\$	750	\$	1,000
Bank line of credit		0		500
MEDC/MSF loans		1,064		1,461
Total	\$	1,814	\$	2,961

Bank Debt

On September 25, 2008, API executed a loan agreement (the PrivateBank Loan Agreement) with The PrivateBank and Trust Company (PrivateBank). The initial PrivateBank Loan Agreement provided the Company with a term loan and a \$3.0 million line of credit. On September 23, 2011, the Company entered into a fifth amendment to the PrivateBank Loan Agreement (the Fifth Amendment) which established a new \$1.0 million term loan and extended the existing \$3.0 million line of credit. The term loan was to be repaid in monthly principal payments of \$20,833, plus interest at prime plus 0.5%, until maturity on October 1, 2015. The line of credit incurred interest at prime plus 0.5% and any outstanding borrowings were due on September 25, 2014. The availability under the line of credit was determined by a calculation of a borrowing base that includes a percentage of accounts receivable and inventory.

The line of credit was guaranteed by each of the Company's wholly-owned subsidiaries and the term loan was secured by a security agreement among API, the Company's subsidiaries and PrivateBank, pursuant to which PrivateBank received a first-priority security interest in certain described assets.

On January 31, 2012, API entered into a loan and security agreement (and such other documents which constitute the SVB Loan Agreement) with Silicon Valley Bank (SVB) and terminated the PrivateBank Loan Agreement by paying off the outstanding balances. The terms of the SVB Loan Agreement provide for a \$5 million line of credit with a \$3 million Export-Import (EX-IM) sublimit at an interest rate that ranges from prime plus 50 basis points on up to prime plus 375 basis points depending on the Company's liquidity ratio and adjusted six month rolling EBITDA as defined in the SVB Loan Agreement. The SVB Loan Agreement contains a covenant for an initial minimum six month rolling adjusted EBITDA of negative \$1,250,000 which reduces over time to \$1 as of April, 2013. There is also a minimum

liquidity ratio of 2.25 based on outstanding cash, receivables and debt as defined in the SVB Loan Agreement. The amount that can be drawn on the line of credit is subject to a formula based on the Company's outstanding receivables and inventory. In addition, the SVB Loan Agreement provides for a \$1 million term loan with principal payable over three years in equal monthly installments and interest at a rate ranging from prime plus 100 basis points to prime plus 425 basis points dependent on the Company's liquidity ratio and adjusted six month rolling EBITDA as defined in the SVB Loan Agreement. Under the SVB Loan Agreement, the Company may prepay all, but not less than all, of the term loan by paying a prepayment premium equal to (i) 1.00% of the amount outstanding if prepayment occurs before the first anniversary of the term loan; (ii) 0.50% of the amount outstanding if prepayment occurs after the first, but before the second anniversary of the term loan; and (iii) 0.25% of the amount outstanding if prepayment occurs after the second anniversary of the term loan. In addition, if the term loan becomes due and payable because of the occurrence and continuance of an Event of Default (as defined in the SVB Loan Agreement), the Company will be required to pay a termination fee equal to 1.00% of the amount outstanding.

On October 25, 2012, the Company and SVB agreed to modify the initial covenants retroactive to the September 28, 2012 quarter end, and revise the interest rate structure and other terms of the SVB Loan Agreement. The amendment provided for a three month rolling EBITDA calculation with up to negative \$1 million allowed through November 2012. The minimum adjusted EBITDA as defined in the SVB Loan Agreement reduces over time to \$1 beginning in April 2013. The liquidity ratio was relaxed from 2.25 to 2.00. The maximum interest rate on any outstanding line of credit balances widened from prime plus 375 to prime plus 400 basis points depending on the Company's liquidity ratio and adjusted three month rolling EBITDA. The maximum interest rate on the SVB term loan widened from prime plus 425 basis points up to prime plus 450 basis points depending on the Company's liquidity ratio and adjusted three month rolling EBITDA. Finally, The Company has been given an additional \$500,000 in Permitted Liens for a total of \$750,000. The interest rates on the SVB term loan and line of credit as of December 28, 2012 were 6.25% and 5.75%, respectively, and 6.75% and 6.25%, respectively, as of October 25, 2012. The Company was in compliance loan covenants at quarter end, had nothing outstanding on the SVB line of credit with approximately \$2.6 million in additional borrowing capacity as of December 28, 2012.

The EX-IM line of credit with SVB is guaranteed by API and its subsidiaries and all borrowings under the SVB Loan Agreement are secured by a first priority security interest that the Company and its subsidiaries granted to SVB over substantially all their respective assets. The terms of the SVB term loan and line of credit are three years and two years, respectively, the latter of which can be extended by mutual consent.

Total interest payments made to the Company's bank lenders during the nine months ended December 28, 2012 and December 30, 2011 were \$43,000 and \$42,000, respectively. Total interest payments made to the Company's bank lenders during both the three months ended December 28, 2012 and December 30, 2011 were \$13,000.

Subsequent to the quarter end, the Company entered into a secured debt agreement with Partners for Growth III, L.P. (PFG) on February 8, 2013 which is subordinated to SVB's senior secured position (the PFG Loan Agreement). In conjunction with this transaction, the Company executed a second amendment to the SVB loan to allow PFG a subordinated position and to adjust the previous covenant levels. The terms of the PFG Loan Agreement provide for receipt by the Company of \$2.5 million in cash in return for monthly principal and interest payments over a period of 42 months at an initial interest rate of 11.75%. The interest rate may reduce by 2% to 9.75% based on the achievement of certain revenue and adjusted EBITDA metrics in future periods. Consistent with a second amendment to the SVB Loan Agreement, the PFG Loan Agreement provides for a rolling three month adjusted EBITDA covenant on a go forward basis and a minimum liquidity ratio of 2.25 to 1.00. The new adjusted EBITDA covenant begins at a negative adjusted EBITDA of \$750,000 for the period from January to June 2013, negative adjusted EBITDA of \$300,000 for July through October 2013, adjusted EBITDA of \$1 for November 2013 through February 2014, and a minimum of \$100,000, thereafter subject to reset based on mutual agreement once a fiscal year 2015 budget is submitted to the lenders. The Company is restricted under the agreement from borrowing more than \$1.5M on the SVB line of credit for the first six months of the PFG Loan Agreement.

As part of the consideration for the PFG Loan Agreement, the Company will grant PFG and certain of its affiliates warrants to purchase up to 1,195,000 shares of the Company's Class A Common Stock upon receiving NYSE MKT's approval of an additional listing application covering the shares of Class A Common Stock issuable under such warrants. 995,000 of the shares issuable under the warrants will be granted at initial strike price equal to the lower of (i) \$0.50 per share, or (ii) the volume-weighted average price per share of the Company's Class A Common Stock on the NYSE MKT stock exchange for the ten (10) trading days ending on the business day immediately preceding the warrant grant, and the remaining 200,000 shares issuable under the warrants will be granted at a \$1.00 strike price. In the event that the Company achieves at least \$32,600,000 in Revenues and \$412,000 in EBITDA during the fiscal year ending March 31, 2014, the warrant agreements pursuant to which the warrants will be issued (the PFG Warrant Agreements) provide that an aggregate of 100,000 of the \$0.50 warrants and an aggregate of 100,000 of the \$1.00 warrants will be cancelled. The PFG Warrant Agreements also include a net exercise provision pursuant to which the

warrant holders would receive the number of shares equal to (i) the product of (A) the number of warrants exercised multiplied by (B) the difference between (1) the fair market value of a share of Class A Common Stock (with fair value generally being equal to the highest closing price of the Company's Class A Common Stock during the 45 consecutive trading days prior to the date of exercise) and (2) the strike price of the warrant, (ii) divided by the fair market value of a share of Class A Common Stock. In addition, in the event the Company is acquired, liquidates, conducts a public offering, or the warrants expire, each warrant holder will have the right to "put" its warrants to the Company in exchange for a per share cash payment that varies with the number of shares issuable under each warrant, but in the aggregate will not exceed \$250,000.

The PFG Loan Agreement will close upon the Company's issuance of the warrants and the satisfaction of other closing conditions customary for transactions of this nature. The Company expects to close the PFG Loan Agreement during the week of February 11, 2013.

Subsequent to the quarter end, a Second Amendment to the SVB Loan Agreement was signed and provided for an increase in the liquidity covenant from 2.00: 1.00 to 2.25: 1.00, a revision to the three month rolling adjusted EBITDA covenant to conform to the EBITDA covenant in the PFG Loan Agreement, a change to the streamline reporting trigger, and an agreement to waive the restriction on granting any security interest to other parties to permit the Company to enter into the PFG Loan Agreement. The Company currently enjoys streamline reporting if it has at least \$1 in adjusted EBITDA and a liquidity ratio of at least 2.50: 1.00. The streamline reporting provision was amended to permit the Company to provide streamlined reporting any time it has more than \$3 million in cash and line of credit availability, and no funds drawn against the line of credit. The interest rate structure of the loan remains substantially the same. The Second Amendment to the SVB Loan Agreement will become effective upon the closing of the PFG Loan Agreement.

MEDC/MSF Loans

The Michigan Economic Development Corporation (MEDC) entered into two unsecured loan agreements with the Company's subsidiary Picometrix: one in fiscal 2005 (MEDC-loan 1) and one in fiscal 2006 (MEDC-loan 2). Both loans have been modified as to the interest rate and principal repayment terms in prior years. Currently both loans have an interest rate of 4% and the maturity dates on MEDC-loan 1 and on MEDC-loan 2 are November, 2014 and September, 2014, respectively.

Interest payments made to the MEDC/MSF were \$38,000 and \$58,000 during the nine months ended December 28, 2012 and December 30, 2011, respectively. Interest payments made to the MEDC/MSF were \$10,000 and \$20,000 during the three months ended December 28, 2012 and December 30, 2011, respectively.

Related Parties Debt

As a result of the 2005 acquisition of Picotronics, Inc., the Company issued four year promissory notes (the Picometrix Notes) to Robin Risser, the Company's COO, and Steve Williamson, the Company's CTO (collectively, the Note Holders) in the aggregate principal amount of \$2,900,500. API had the option of prepaying the Picometrix Notes without penalty. The maturity date of the Picometrix Notes was subsequently extended in a series of amendments. In particular, on November 29, 2010, the Company and the Note Holders entered into the fifth amendment to the Picometrix Notes (the Fifth Note Amendment). The Fifth Note Amendment required the Company to pay the Note Holders a restructuring fee of \$156,312 (11%) and extended the due dates for the remaining principal balance payments on the Picometrix Notes (in the aggregate amount of \$1,400,500) through September 1, 2012.

As part of the Fifth Note Amendment, the interest rate on the Picometrix Notes was increased from prime plus 1% to prime plus 2%, and interest was to be paid quarterly through the maturity date. The Company received Board approval to pay both the September 1, 2011 and December 1, 2011 principal payments on September 1, 2011. Pursuant to the terms of the SVB Loan Agreement, on January 31, 2012, the Company used \$728,735 of the proceeds of the term loan to pay all indebtedness (including accrued interest) owed to the Note Holders.

Interest payments made to Related Parties during the nine month periods ended December 28, 2012 and December 30, 2011 were zero and \$44,000, respectively. Interest payments made to Related Parties during the three month periods ended December 28, 2012 and December 30, 2011 were zero and \$13,000, respectively.

Note 7. Stockholders' Equity

Warrants

At December 28, 2012, the Company had the following warrants outstanding and exercisable which could be exchanged into shares of Class A Common Stock:

	Shares (000's)	Exercise Price
2007 Warrants	0	\$ 1.7900
2010 Warrants	267	\$ 1.4040
Total	267	

At March 31, 2012, the Company had the following warrants outstanding and exercisable which could be exchanged into shares of Class A Common Stock:

	Shares (000's)	Exercise Price
2007 Warrants	630	\$ 1.7900
2010 Warrants	267	\$ 1.4040
Total	897	

On September 14, 2007, the Company completed a private placement (the 2007 Offering). Each unit sold by the Company in the 2007 Offering consisted of four (4) shares of the Company's Class A Common Stock, par value \$0.001 per share (the 2007 Offering Shares) and one (1) five year warrant exercisable for one share of Class A Common Stock at an exercise price of \$1.85 (each a 2007 Warrant). The Company sold a total of 741,332 units consisting of 2,965,332 (2007) Offering Shares and 741,332 (2007) Warrants, of which 33,000 units consisting of 132,000 (2007) Offering Shares and 33,000 (2007) Warrants were to related parties at the prevailing closing stock price of \$1.83 per share, for an aggregate purchase price of \$4.5 million. The offer and sale of the 2007 Offering Shares and 2007 Warrants were made pursuant to Rule 506 promulgated pursuant to the Securities Act and each of the investors was an accredited investor as defined by Rule 501 promulgated pursuant to the Securities Act. The exercise price for the 2007 Warrants was subject to adjustment based on a formula contained in the private placement agreement each investor in the 2007 Offering executed, if the Company issued Class A Common Stock in the future below the \$1.85 exercise price. The exercise price was reduced to \$1.79 in June 2010 as a result of the issuance of Class A Common Stock to the MEDC and MSF at a price of \$0.54 per share. Accordingly, the number of warrants has been increased by 24,095 as a result of the change in the exercise price. The 2007 Warrants expired during the quarter ended September 28, 2012,, were not exercised and therefore are no longer outstanding.

In connection with the Fifth Note Amendment to the Picometrix Notes described in Note 6, the Company issued 267,196 warrants to Robin Risser and Steve Williamson (the 2010 Warrants). Each 2010 Warrant is exercisable over a five year period for one share of the Company's Class A Common Stock at an exercise price of \$1.404 subject to adjustment, based on a formula in the warrants agreements pursuant to which the 2010 Warrants were issued, if the Company issues Class A Common Stock in the future below \$1.404. Future adjustments cannot reduce the exercise price below \$1.17. As a result of the exercise price reset feature, the fair values of the warrants are recorded as a liability.

The Company records the change in the fair value of warrants accounted for as liabilities as a loss or income to its consolidated statement of operations. Such amounts were an income item of \$26,000 and \$719,000 for the nine months ended December 28, 2012 and December 30, 2011, respectively. For the three months ended December 28, 2012 and December 30, 2011, the change in fair value of the warrants were income items of \$13,000 and \$84,000, respectively. The 2010 Warrants had a fair value of \$26,000 as of March 31, 2012 and had no fair value at the end of the current quarter.

The fair value of the warrants was estimated using the Monte Carlo option pricing model using the following assumptions:

	December 28, 2012	December 30, 2011
Expected term (in years)	2.9	3.9
Volatility	63.3%	72.20%
Expected dividend	--	--
Risk-free interest rate	0.35%	2.0%

Expected volatility is based primarily on historical volatility using the weekly stock price for the most recent period equivalent to the term of the warrants. A dividend yield of zero has been assumed based on the Company's actual past experience and the fact that the Company does not anticipate paying a dividend on its shares in the future. The Company has based its risk-free interest on the implied yield available on U.S. Treasury issues with equivalent expected term.

The inputs used to determine the fair value of the warrants are classified as Level 3 inputs in the FASB's fair value hierarchy, primarily regarding the computation of historical volatility. Management classified these as Level 3 measurements as they are based on unobservable inputs and involve management judgment.

The following chart represents the activity in the Company's Level 3 warrant liability during the nine months ended December 28, 2012 and year ended March 31, 2012.

	For Periods Ended	
	Nine Months Ended December 28, 2012	Year Ended March 31, 2012
Level 3 Warrants, beginning of period	\$ 26,000	\$ 732,000
Change in fair value of warrant liability	(26,000)	(706,000)
Level 3 Warrants, end of period	\$ -	\$ 26,000

Note 8. Earnings Per Share

The Company's net earnings per share calculations are in accordance with FASB ASC 260-10. Accordingly, basic earnings (loss) per share are computed by dividing net earnings (loss) by the weighted average number of shares outstanding for each period. The calculation of loss per share is as follows:

	Three months ended	
	December 28, 2012	December 30, 2011
Basic and Diluted		
Weighted Average Basic Shares Outstanding	31,161,000	30,972,000
Dilutive effect of Stock Options and Warrants	--	--
Weighted Average Diluted Shares		
Outstanding	31,161,000	30,972,000
Net loss	\$ (1,026,000)	\$ (812,000)
Basic and Diluted loss per share	\$ (0.03)	\$ (0.03)

	Nine months ended	
	December 28, 2012	December 30, 2011
Basic and Diluted		
Weighted Average Basic Shares Outstanding	31,161,000	30,828,000
Dilutive effect of Stock Options and Warrants	--	--
Weighted Average Diluted Shares		
Outstanding	31,161,000	30,828,000
Net loss	\$ (3,305,000)	\$ (1,048,000)
Basic and Diluted loss per share	\$ (0.11)	\$ (0.03)

The dilutive effect of stock options and warrants for each of the periods was not included in the calculation of diluted loss per share because to do so would have had an anti-dilutive effect as the Company had a net loss for the period. As of December 28, 2012, the number of anti-dilutive shares excluded from diluted earnings per share totaled approximately 2.35 million shares, which includes 267,000 anti-dilutive warrants.

Note 9. Fair Value of Financial Instruments

The carrying value of all financial instruments potentially subject to valuation risk (principally consisting of cash equivalents, accounts receivable, accounts payable, and debt) approximates the fair value based upon the short-term nature of these instruments, and in the case of debt, the prevailing interest rates available to the Company.

Note 10. Subsequent Events

Subsequent to the quarter end, the Company entered into a secured debt agreement with Partners for Growth III, L.P. (PFG) on February 8, 2013 which is subordinated to SVB's senior secured position (the PFG Loan Agreement). In conjunction with this transaction, the Company executed a second amendment to the SVB loan to allow PFG a subordinated position and to adjust the previous covenant levels. The terms of the PFG Loan Agreement provide for receipt by the Company of \$2.5 million in cash in return for monthly principal and interest payments over a period of 42 months at an initial interest rate of 11.75%. The interest rate may reduce by 2% to 9.75% based on the achievement of certain revenue and adjusted EBITDA metrics in future periods. Consistent with a second amendment to the SVB Loan Agreement, the PFG Loan Agreement provides for a rolling three month adjusted EBITDA covenant on a go forward basis and a minimum liquidity ratio of 2.25 to 1.00. The new adjusted EBITDA covenant begins at a negative adjusted EBITDA of \$750,000 for the period from January to June 2013, negative adjusted EBITDA of \$300,000 for July through October 2013, adjusted EBITDA of \$1 for November 2013 through February 2014, and a minimum of \$100,000, thereafter subject to reset based on mutual agreement once a fiscal year 2015 budget is submitted to the lenders. The Company is restricted under the agreement from borrowing more than \$1.5M on the SVB line of credit for the first six months of the PFG Loan Agreement.

As part of the consideration for the PFG Loan Agreement, the Company will grant PFG and certain of its affiliates warrants to purchase up to 1,195,000 shares of the Company's Class A Common Stock upon receiving NYSE MKT's approval of an additional listing application covering the shares of Class A Common Stock issuable under such warrants. 995,000 of the shares issuable under the warrants will be granted at initial strike price equal to the lower of (i) \$0.50 per share, or (ii) the volume-weighted average price per share of the Company's Class A Common Stock on the NYSE MKT stock exchange for the ten (10) trading days ending on the business day immediately preceding the warrant grant, and the remaining 200,000 shares issuable under the warrants will be granted at a \$1.00 strike price. In the event that the Company achieves at least \$32,600,000 in Revenues and \$412,000 in EBITDA during the fiscal year ending March 31, 2014, the warrant agreements pursuant to which the warrants will be issued (the PFG Warrant Agreements) provide that an aggregate of 100,000 of the \$0.50 warrants and an aggregate of 100,000 of the \$1.00 warrants will be cancelled. The PFG Warrant Agreements also include a net exercise provision pursuant to which the warrant holders would receive the number of shares equal to (i) the product of (A) the number of warrants exercised multiplied by (B) the difference between (1) the fair market value of a share of Class A Common Stock (with fair value generally being equal to the highest closing price of the Company's Class A Common Stock during the 45 consecutive trading days prior to the date of exercise) and (2) the strike price of the warrant, (ii) divided by the fair market value of a share of Class A Common Stock. In addition, in the event the Company is acquired, liquidates, conducts a public offering, or the warrants expire, each warrant holder will have the right to "put" its warrants to the Company in exchange for a per share cash payment that varies with the number of shares issuable under each warrant, but in the aggregate will not exceed \$250,000.

The PFG Loan Agreement will close upon the Company's issuance of the warrants and the satisfaction of other closing conditions customary for transactions of this nature. The Company expects to close the PFG Loan Agreement during the week of February 11, 2013.

Subsequent to the quarter end, a Second Amendment to the SVB Loan Agreement was signed and provided for an increase in the liquidity covenant from 2.00: 1.00 to 2.25: 1.00, a revision to the three month rolling adjusted EBITDA covenant to conform to the EBITDA covenant in the PFG Loan Agreement, a change to the streamline reporting trigger, and an agreement to waive the restriction on granting any security interest to other parties to permit the Company to enter into the PFG Loan Agreement. The Company currently enjoys streamline reporting if it has at least \$1 in adjusted EBITDA and a liquidity ratio of at least 2.50: 1.00. The streamline reporting provision was amended to permit the Company to provide streamlined reporting any time it has more than \$3 million in cash and line of credit availability, and no funds drawn against the line of credit. The interest rate structure of the loan remains substantially the same. The Second Amendment to the SVB Loan Agreement will become effective upon the closing of the PFG Loan Agreement.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

Certain statements contained in this Management's Discussion and Analysis (MD&A), including, without limitation, statements containing the words "may," "will," "can," "anticipate," "believe," "plan," "estimate," "continue," and similar expressions constitute "forward-looking statements." These forward-looking statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including risks described in the Risk Factors sections of our Annual Report on Form 10-K for the period ended March 31, 2012 (the 2012 Form 10-K) and elsewhere in this filing. Except for our ongoing obligation to disclose material information as required by federal securities laws, we do not intend to update you concerning any future revisions to any forward-looking statements to reflect events or circumstances occurring after the date of this report. The following discussion should be read in conjunction with the Risk Factors as well as our financial statements and the related notes.

Overview

We are a leading supplier of optoelectronic semiconductors packaged into high-speed optical receivers (HSOR), custom optoelectronic subsystems and Terahertz (THz) instrumentation, serving a variety of global OEMs. Our patented high-speed optical receivers include Avalanche Photodiode (APD) technology and PIN (positive-intrinsic-negative) photodiode technology based upon III-V materials, including InP, InAlAs, and GaAs. Our optoelectronic subsystems are based on our silicon Large Area Avalanche Photodiode (LAAPD), PIN photodiode, FILTRODE® detectors and LED assemblies. Our Terahertz sensor product line is targeted at the industrial, homeland security and military markets. Using our patented fiber coupled technology and high speed Terahertz generation and detection sensors, we are engaged in transferring Terahertz technology from the laboratory to the factory floor for use in non-destructive testing and real time quality control. All of these products rely on our proprietary light and radiation detection technology.

Global Economic Conditions

The credit markets and the financial services industry continue to experience a period of significant disruption with significant levels of monetary intervention from the United States and other governments. Continued concerns about the systemic impact of potential long-term or widespread recession, energy costs, geopolitical issues, the availability and cost of credit, the global commercial and residential real estate markets and related mortgage markets and reduced consumer confidence have contributed to increased market volatility and diminished expectations for most developed and emerging economies. As a result of these market conditions, the cost and availability of capital and credit has been and may continue to be adversely affected. Continued turbulence in the United States and international markets and economies could restrict our ability to refinance our existing indebtedness, increase our costs of borrowing, limit our access to capital necessary to meet our liquidity needs and materially harm our operations or our ability to implement our business strategy.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based on the condensed consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements requires us to make judgments and estimates that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statement and the reported amount of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Actual results may differ from such estimates under different assumptions or conditions.

Certain prior year balances have been reclassified in the consolidated financial statements to conform to the current year presentation.

Application of Critical Accounting Policies

Application of our accounting policies requires management to make certain judgments and estimates about the amounts reflected in the financial statements. We use historical experience and all available information to make these estimates and judgments, although differing amounts could be reported if there are changes in the assumptions and estimates. Estimates are used for, but not limited to, the accounting for the allowance for doubtful accounts, inventory write-downs, valuation of intangible assets and goodwill, depreciation and amortization, warranty costs, taxes and contingencies. We have identified the following accounting policies as critical to an understanding of our financial statements and those areas most dependent on judgment and estimates.

Revenue Recognition

Revenue is derived principally from the sales of the Company's products. We recognize revenue when the basic criteria of SEC Staff Accounting Bulletin No. 104 are met. Specifically, we recognize revenue when persuasive evidence of an arrangement exists, usually in the form of a purchase order, when shipment has occurred since our terms are FOB source, or when services have been rendered, title and risk of loss have passed to the customer, the price is fixed or determinable and collection is reasonably assured in terms of both credit worthiness of the customer and there are no post shipment obligations or uncertainties with respect to customer acceptance.

We sell certain of our products to customers with a product warranty that provides warranty repairs at no cost. The length of the warranty term is one year from date of shipment. We accrue the estimated exposure to warranty claims based upon historical claim costs. We review these estimates on a regular basis and adjust the warranty provisions as actual experience differs from historical estimates or as other information becomes available.

We do not provide price protection or a general right of return. Our return policy only permits product returns for warranty and non-warranty repair or replacement and requires pre-authorization by us prior to the return. Credit or discounts, which have been historically insignificant, may be given at our discretion and are recorded when and if determined.

We predominantly sell directly to original equipment manufacturers with a direct sales force with limited sales through representatives, value added resellers (VAR's) and distributors. Distributor and VAR sales represented 11% of total revenue for the nine months ended December 28, 2012. Significant terms and conditions of distributor agreements include FOB source, net 30 days payment terms, with no return and limited exchange rights, and no price protection. Since the product transfers title to the distributor at the time of shipment by us, the products are not considered inventory on consignment.

Revenue is also derived from technology research and development contracts. We recognize revenue from these contracts as services and/or materials are provided.

Impairment of Long-Lived Assets

As of December 28, 2012 and March 31, 2012, our consolidated balance sheet included \$4.6 million in goodwill. Goodwill represents the excess purchase price over amounts assigned to tangible or identifiable intangible assets acquired and liabilities assumed from our business acquisitions.

Goodwill and intangible assets that are not subject to amortization are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. During the nine months ended December 28, 2012, the Company adopted new FASB guidance relative to goodwill impairment whereby in its annual assessment of goodwill impairment, the Company has the option to first assess 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 before performing the two-step impairment test. If after assessing the totality of events or circumstances, the Company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is not necessary. Step one of the two-step impairment test is to compare the fair value of the reporting unit with the unit's carrying amount, including goodwill. If this test indicates that the fair value is less than the carrying value, then step two is required to compare the implied fair value of the reporting unit's goodwill with the carrying amount of the reporting unit's goodwill. If the carrying amount of the asset exceeds its fair value, an impairment loss will be recognized in an amount equal to that excess. We have selected March 31 as the date for our annual impairment test.

We continue to meet the criteria of operating in a single segment and having a single reporting unit. We determine the fair value of our single reporting unit to be equal to our market capitalization plus a control premium. Market capitalization is determined by multiplying the shares outstanding on the assessment date by the average market price of our Class A Common Stock over a 10-day trading period before and a 10-day trading period after each assessment date. We use this 20-day duration to remove inherent market fluctuations that may affect any individual closing price. We believe that our market capitalization alone does not fully capture the fair value of our business as a whole, or the substantial value that an acquirer would obtain from its ability to obtain control of our business. As such, in determining fair value, we add a control premium, which seeks to give effect to the increased consideration a potential acquirer would be required to pay in order to gain sufficient ownership to set policies, direct operations and make decisions. Our valuation as of December 28, 2012 indicated there were no impairments of Goodwill as the fair value calculated as described above was \$18.2 million including a control premium of \$3.6 million, while our carrying value including Goodwill was \$15.5 million.

As evidenced above, our stock price and control premium are significant factors in assessing our fair value for purposes of the goodwill impairment assessment. Our stock price can be affected by, among other things, changes in industry or market conditions, changes in our results of operations, and changes in our forecasts or market expectations relating to future results. Our stock price has fluctuated from a high of \$0.80 to a low of \$0.38 on an intra-day basis during the past nine months of fiscal 2013.

The carrying value of long-lived assets, including amortizable intangibles and property and equipment, are evaluated whenever events or changes in circumstances indicate that a potential impairment has occurred relative to a given asset or assets. Impairment is deemed to have occurred if projected undiscounted cash flows associated with an asset are less than the carrying value of the asset. The estimated cash flows include our assumptions of cash inflows and outflows directly resulting from the use of that asset, or group of assets used in conjunction with specific assets, in operations. The amount of the impairment loss recognized is equal to the excess of the carrying value of the asset, or asset groups, over its then estimated fair value. As a result of the operating loss in fiscal year 2012, we performed an impairment evaluation and concluded that for the fiscal year ended March 31, 2012 there were no impairments of any amortizing intangibles or property and equipment expected based upon future undiscounted cash flows over the remaining estimated lives. As a result of the FY 2013 operating loss, we performed an impairment evaluation relative to the depreciating and amortizing assets and concluded there is sufficient expected future cash flows in excess of the carrying value.

Deferred Tax Asset Valuation Allowance

We record deferred income taxes for the future tax consequences of events that were recognized in our financial statements or tax returns. We record a valuation allowance against deferred tax assets when, in management's judgment, it is more likely than not that the deferred income tax assets will not be realized in the foreseeable future. Consistent with the 2012 Form 10-K, we have continued a full valuation allowance on our net Deferred Tax Assets as of December 28, 2012.

Inventories

Inventories, which include material, labor and manufacturing overhead, are stated at the lower of cost (on a first in–first out basis) or market. Slow moving and obsolete inventories are reviewed throughout the year to assess whether a cost adjustment is required. Our review of slow moving and obsolete inventory begins with a listing of all inventory items which have not moved regularly within the past 12 months. In addition, any residual inventory, which is customer specific and remaining on hand at the time of contract completion, is included in the list. The complete list of slow moving and obsolete inventory is then reviewed by the production, engineering and/or purchasing departments to identify items that can be utilized in the near future. These items are then excluded from the analysis and the remaining amount of slow-moving and obsolete inventory is then further assessed and a write down is recorded when warranted. Additionally, non-cancelable open purchase orders for parts we are obligated to purchase where demand has been reduced may also be written down. Impairments for open purchase orders where the market price is lower than the purchase order price are also recorded. The impairments established for excess, slow moving, and obsolete inventory create a new cost basis for those items. The cost basis of these parts is not subsequently increased if the circumstances which led to the impairment change in the future. If a product that had previously been impaired is subsequently sold, the amount of reduced cost basis is reflected as cost of goods sold.

RESULTS OF OPERATIONS

Revenues

We predominantly operate in one industry segment, consisting of light and radiation detection devices, that we sell to multiple end markets including telecommunications, industrial sensing/non destructive testing (NDT), military-aerospace, medical, and homeland security. Revenues by market consisted of the following (in thousands):

Revenues	Three months ended						Nine months ended					
	December 28, 2012			December 30, 2011			December 28, 2012			December 30, 2011		
Telecommunications	\$	1,953	33 %	\$	1,905	29 %	\$	5,691	32 %	\$	9,524	42 %
Industrial Sensing/NDT		2,551	44 %		2,827	43 %		7,803	44 %		8,330	36 %
Military/Aerospace		1,090	19 %		1,361	21 %		3,451	20 %		3,295	14 %
Medical		240	4 %		308	5 %		691	4 %		828	4 %
Homeland Security		0	0 %		117	2 %		0	0 %		1,014	4 %
Total Revenues	\$	5,834	100 %	\$	6,518	100 %	\$	17,636	100 %	\$	22,991	100 %

Our revenues for the quarter ended December 28, 2012 were \$5.8 million, a decrease of 10% (or \$0.7 million) from revenues of \$6.5 million for the quarter ended December 30, 2011. On a year to date basis, our revenues were \$17.6 million, a decrease of \$5.4 million or 23% from revenues of \$23.0 million for the nine months ended December 30, 2011. Sequentially, revenues increased 4% or \$248,000 from the quarter ended September 28, 2012. We experienced revenue decreases in four of five markets for the quarter and nine months ended December 28, 2012 compared to the prior year period.

Telecommunications revenues in the third quarter and nine months of fiscal 2013 increased by \$48,000 or 3% and decreased by \$3.8 million or 40% respectively from the prior year periods. The quarterly increase year over year was tempered by supply chain issues. The lower revenue for the nine months of this year compared to the nine months last year was explained by lower 100 Gigabyte (G) line side sales given the transition of a large customer to our next generation product and increased competition which resulted in downward pressure on pricing in advance of implementation of cost reduced models and continued supply chain issues. Telecommunications revenue on a consecutive quarterly basis increased 9%, or \$160,000, from the second quarter of fiscal 2013. The higher sales experienced in the third quarter of fiscal 2013 resulted from the timing of revenue on a military communication program. Revenues of 100G units remained subdued given key component supply constraints.

Industrial Sensing/NDT market revenues for the third quarter and nine months of fiscal 2013 were \$2.6 million and \$7.8 million respectively, a decrease of 10% or \$276,000 over the prior year quarter and a decrease of 6% or \$527,000 over the prior year nine month results. All declines were due to the slowdown seen in this market for Optosolutions product platform partially offset by increased revenues in the Terahertz product platform. Revenue increased 3%, or \$70,000, from the second quarter of fiscal 2013 on the increased Terahertz product sales.

Military/Aerospace market revenues in the third quarter and nine months of fiscal 2013 were \$1.1 million and \$3.5 million respectively, a decrease of 20% from the comparable prior year third quarter and a 5% increase over the prior year nine month activity. Revenues increased by \$34,000 (or 3%) from the second quarter of fiscal 2013. The sequential increase is due to the timing of orders for certain Optosolutions missile platforms. The third quarter of fiscal 2013 revenue decline of \$271,000 relative to the third quarter of fiscal 2012 was the result of the same timing of orders for certain Optosolutions missile platforms. The years to date revenues are up \$156,000 on the strength of the Terahertz F-35 development contracts.

Medical market revenues in the third quarter and nine months ended December 28, 2012 were \$240,000, and \$691,000 respectively, a quarterly decrease of \$68,000 or 22% and a nine month decrease of \$137,000 or 17%. These fluctuations are the result of one customer introducing a new product that does not require our product.

Homeland Security revenues were zero for the third quarter and nine months ended December 28, 2012, compared to \$117,000 in the third quarter of fiscal 2012 and \$1.0 million for the nine months of fiscal 2012. The decrease was the result of the completion of the In-Q-Tel anomaly detection system development contract in fiscal 2012. Any near term revenues will be dependent on placement by the Transportation Security Administration of our Terahertz based anomaly detectors on the qualified products list.

The macroeconomic environment and military spending slowdown has had a negative impact on our Optosolutions product platform. Supply chain issues have constrained and in the near term are expected to constrain our revenue growth in the telecommunication 100G market. We see demand strengthening as 100G enters a growth phase and we expect to resolve the supply chain issues. Terahertz continues to gain adoption in the industrial market as our value added resellers accelerate the market adoption. Given the near term outlook and supply constraints, our guidance for the second half is to be flat relative to the first half revenues. We do expect a return to growth in our fiscal 2014 as the industrial market improves in Optosolutions, our HSOR supply chain issues are resolved, and the Terahertz revenues transition from contract based to product based revenue.

Gross Profit

Gross profit for the third quarter of fiscal 2013 was \$2.5 million compared to \$2.7 million for the third quarter of fiscal 2012, a decrease of \$237,000 on a revenue decrease of \$684,000. Year to date gross profit was \$6.7 million (38% of sales) down from \$9.6 million (42% of sales) in the nine months of fiscal 2012. The lower gross profit for the third quarter of fiscal 2013 relative to fiscal 2012 was attributable to weakness in our Optosolutions products. The lower gross profit for the nine months of fiscal 2013 relative to fiscal 2012 was primarily due to decreased volume and prices on HSOR products.

Gross profit percentage was 42.0% for the third quarter of fiscal 2013 compared to 41.3% in the third quarter of fiscal 2012 and 35.3% in the second quarter of fiscal 2013. The fiscal 2013 third quarter gross margin rate improved year over year and sequentially given the favorable product mix and cost reduction efforts.

Operating Expenses

Total operating expenses for the quarter and nine months ended December 28, 2012 were \$3.5 million and \$9.9 million respectively, a decrease of \$85,000 and \$1.3 million over the comparable fiscal 2012 periods. On a year to date basis, decreases occurred in every category of spending due to the austerity measures put in place pending the return of volume on our HSOR products. Total operating expenses for the third quarter of fiscal 2013 were up \$217,000 when compared to the second quarter of fiscal 2013, the result of higher engineering activity on Terahertz contracts.

Research, Development and Engineering (RD&E) expenses decreased by \$102,000 (or 6%) in the third quarter of fiscal 2013 compared to the third quarter of fiscal 2012 due to lower engineering headcount. RD&E costs decreased by \$795,000 in the first nine months of fiscal 2013 relative to the first nine months of fiscal 2012 primarily due to lower salaries from headcount reductions and reduced prototype expenditures.

Sales and Marketing (S&M) expenses increased by \$43,000 (or 9%) in the third quarter of fiscal 2013 compared to the prior year third quarter and decreased \$136,000 (or 8%) in the first three quarters of fiscal 2013 versus the same period in fiscal 2012. The increase was primarily attributable to the timing of commissionable sales in the third quarter. On a year to date basis, the decrease is due to lower commissions paid on lower revenues and reduced trade show activity.

General and Administrative (G&A) expenses increased \$25,000 for third quarter of fiscal 2013 when compared to the same period in fiscal 2012 as a result of higher legal costs. G&A expenses for the nine months ended fiscal 2013 were \$262,000 less than the same period in fiscal 2012 because of lower stock compensation expense including independent director's compensation.

Amortization expense for the third quarter of 2013 decreased \$51,000 to \$293,000 compared to the third quarter of fiscal 2012. For the first nine months of fiscal 2013 versus fiscal 2012 the amortization expense declined by \$152,000. We utilize the cash flow amortization method on the majority of our intangible assets which means lower amortization as the assets near the end of their lives.

The non-cash expensing of stock option and restricted stock grants included in operating expenses was \$46,000 and \$124,000 for the three and nine month periods ended December 28, 2012 compared to \$235,000 and \$480,000 for the three and nine month periods ended December 30, 2011, respectively, as stock awards have been dramatically curtailed and prior grants become fully expensed.

Other Income (Expense), net

Interest income for the third quarter and first nine months of fiscal 2013 increased by \$6,000 and \$2,000 relative to the prior year periods due to interest received on delinquent tax refunds.

Interest expense in the third quarter and first nine months of fiscal 2013 decreased \$6,000 and \$34,000 over comparable prior year periods mostly due to the early retirement of the related party debt in fiscal 2012.

The fair value of the warrant liability discussed in Note 7 is determined using a Monte Carlo option pricing model, and is affected by changes in inputs to that model including our stock price, expected stock price volatility and contractual term. To the extent that the fair value of the warrant liability increases or decreases, we record an expense or income in our consolidated statements of operations. The income of \$13,000 for the current quarter and income of \$26,000 for the nine months ended December 28, 2012 are attributed to the change in fair value of the warrant liability. This is in contrast to income of \$84,000 and \$719,000 in the three and nine month periods of the prior year, respectively. This liability is sensitive to the change in the stock price, expected volatility, interest rates and contractual life of the warrants which are the primary assumptions applied to the Monte Carlo model used to calculate the fair value of the warrants.

We realized a net loss for the third quarter of fiscal 2013 of \$1,026,000 (\$0.03 per share), as compared to a net loss of \$812,000 (\$0.03 per share) in the third quarter of fiscal 2012, an increase in the loss of \$214,000. This increase in the loss for the fiscal 2013 quarter is primarily attributable to lower gross margin dollars realized of \$237,000 on \$684,000 lower revenues. Year to date we realized a net loss of \$3.3 million in fiscal 2013 relative to a net loss of \$1.0 million in fiscal 2012. The increase in net loss of \$2.3 million is attributable to lower gross margin due to lower revenues partially offset by operating expense reductions of \$1.3 million and \$0.7 million in less income from the change in warrant liability.

Fluctuation in Operating Results

Our operating results may fluctuate from period to period and will depend on numerous factors, including, but not limited to, customer demand and market acceptance of our products, new product introductions, product obsolescence, component price fluctuation, manufacturing inefficiencies, varying product mix, and other factors. If demand does not meet our expectations in any given quarter, the sales shortfall may result in an increased impact on operating results due to our inability to adjust operating expenditures quickly enough to compensate for such shortfall. Our result of operations could be materially adversely affected by changes in economic conditions, governmental or customer spending patterns for the markets we serve. The current turbulence in the global financial markets and its potential impact on global demand for our customers' products and their ability to finance capital expenditures could materially affect our operating results. In addition, any significant reduction in defense spending as a result of a change in governmental spending patterns could reduce demand for our product sold into the military market.

Liquidity and Capital Resources

At December 28, 2012, we had cash and cash equivalents of \$559,000, a decrease of \$2.7 million from the March 31, 2012 balance. The lower balance for the nine month period is attributable to cash used in operating activities of \$1.1 million, cash used in investing activities of \$414,000, and cash used in financing activities of \$1.1 million. Following the closing of the \$2.5 million secured debt offering with PFG, we expect to have cash and cash equivalents of over \$2.6 million. Combined with the newly agreed covenants with both SVB and PFG, expected cash flow from operations, and the current SVB line of credit, we believe that our existing cash and cash equivalents will be sufficient for the next twelve months. Positive cash flow from operations is highly dependent on increasing revenue levels. We have had and continue to experience supply limitations that has hampered our ability to achieve the levels of HSOR revenue and the related gross margin previously enjoyed. We may, need additional financing to fund our operations

in the future and there can be no assurance that additional funds will be available, especially if we experience operating results below expectations, or, if financing is available, there can be no assurance as to the terms on which funds might be available. If adequate financing is not available as required, or is not available on favorable terms, our business, financial position and results of operations will be adversely affected.

Operating Activities

The decrease of \$1.1 million in cash resulting from operating activities for the nine months ended December 28, 2012 was the result of funding ongoing losses. Cash used in operations of \$1.1 million resulted from the net loss of \$3.3 million less non-cash charges of \$1.6 million in depreciation, amortization, stock-based compensation and change in fair value of warrant liability plus the liquidation of \$619,000 of net working capital into cash.

Investing Activities

For the nine months ended December 28, 2012, we used \$414,000 in investing activities comprised of capital expenditures of \$316,000 and patent expenditures of \$98,000.

Financing Activities

For the nine months ended December 28, 2012, \$1.1 million was used in financing activities, due to repayment of principal on outstanding debts with SVB and MEDC.

Off-Balance Sheet Arrangements

We identify and disclose all significant off balance sheet arrangements and related party transactions. API does not utilize special purpose entities or have any known financial relationships with other companies' special purpose entities.

Operating Leases

We enter into operating leases where the economic climate is favorable. The liquidity impact of operating leases is not material.

Purchase Commitments

We have purchase commitments for materials, supplies, services, and property, plant and equipment as part of the normal course of business. Commitments to purchase inventory at above-market prices have been reserved. Certain supply contracts may contain penalty provisions for early termination. Based on current expectations, we do not believe that it is reasonably likely to incur any material amount of penalties under these contracts.

Other Contractual Obligations

We do not have material financial guarantees that are reasonably likely to affect liquidity.

Recent Pronouncements and Accounting Changes

In September 2011, the FASB issued updated guidance that modifies the manner in which the two-step impairment test of goodwill is applied. Under the amendments in this update, an entity has the option to first assess 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, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test prescribed by existing standards.

The adoption of this guidance did not impact our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

At December 28, 2012, most of our interest rate exposure is linked to the prime rate, subject to certain limitations, offset by cash which could be invested in short term instruments. As such, we are at risk to the extent of the spread between these two types of instruments. We do not believe that moderate changes in the prime rate will materially affect our operating results or financial condition.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officers (the Certifying Officers) are responsible for establishing and maintaining disclosure controls and procedures for the Company. The Certifying Officers have designed such disclosure controls and procedures to ensure that material information is made known to them, particularly during the period in which this report was prepared. The Certifying Officers have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Exchange Act Rule 13a-15(e) and 15d-15(e) (the Rules) under the Securities Exchange Act of 1934 (or Exchange Act)) as of the end of the period covered by this quarterly report and believe that our disclosure controls and procedures are effective based on the required evaluation.

There was no change in our internal control over financial reporting that occurred during the quarter ended December 28, 2012 that has materially affected or is reasonably likely to materially affect our internal controls.

Part II — OTHER INFORMATION

Item 1. Legal Proceedings

The information regarding litigation proceedings described in our Annual Report on Form 10-K for the year ended March 31, 2012 is incorporated herein by reference.

Item 1A. Risk Factors

The Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2012 includes a detailed discussion of its risk factors. This 10-Q should be read in conjunction with the risk factors and information disclosed in the Company's Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not Applicable

Item 3. Defaults upon Senior Securities

Not Applicable

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

Not Applicable

Item 6. Exhibits

The following documents are filed as Exhibits to this report:

Exhibit

No.

- 3.1 Amended By-Laws of Advanced Photonix, Inc. (as amended October 16, 2012) - incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K as filed with the Securities and Exchange Commission on October 18, 2012
- 10.1 First Amendment dated October 25, 2012 to Loan and Security Agreement by and among Silicon Valley Bank, Advanced Photonix Inc. and Picometrix, LLC - incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K as filed with the Securities and Exchange Commission on October 26, 2012
- 10.2 First Amendment dated October 25, 2012 to Loan and Security Agreement (EX-IM Loan Facility) dated as of January 31, 2012 by and among Silicon Valley Bank, Advanced Photonix Inc. and Picometrix, LLC - incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K as filed with the Securities and Exchange Commission on October 26, 2012
- 31.1 Certificate of the Registrant's Chief Executive Officer, and Director pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certificate of the Registrant's Chief Financial Officer, and Secretary pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.INS XBRL Instance
- 101.SCH XBRL Taxonomy Extension Schema
- 101.CAL XBRL Taxonomy Extension Calculation
- 101.DEF XBRL Taxonomy Extension Definition
- 101.LAB XBRL Taxonomy Extension Label
- 101.PRE XBRL Taxonomy Extension Presentation

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Advanced Photonix, Inc.
(Registrant)

February 11, 2013

/s/ Richard Kurtz
Richard Kurtz
Chief Executive Officer, President
and Director

/s/ Jeff Anderson
Jeff Anderson
Chief Financial Officer