ADVANCED PHOTONIX INC
Form 10-Q
November 10, 2014
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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 September 26, 2014

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	**33-0325826**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2925 Boardwalk Drive, 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 (Do not check if a smaller reporting company) 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 October 31, 2014, there were 37,381,413 shares of Class A Common Stock, $.001 par value, outstanding.

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Advanced Photonix, Inc.

Form 10-Q

For the Quarter Ended September 26, 2014

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PART I -- FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

Advanced Photonix, Inc.

Condensed Consolidated Balance Sheets

	September 26, 2014 (Unaudited)	**March 31, 2014**
ASSETS		
Current assets:		
Cash and cash equivalents	$1,146,000	$120,000
Receivables, net	4,462,000	5,085,000
Inventories	4,800,000	4,749,000
Prepaid expenses and other current assets	719,000	444,000
Total current assets	11,127,000	10,398,000
Equipment and leasehold improvements, net	1,815,000	2,144,000
Goodwill	4,579,000	4,579,000
Intangibles and patents, net	2,686,000	2,942,000
Other assets	179,000	138,000
Total Assets	$20,386,000	$20,201,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,198,000	$2,661,000
Accrued compensation	956,000	701,000
Accrued subcontracting costs	227,000	344,000
Other accrued expenses	771,000	1,108,000
Current portion of long-term debt, PFG	714,000	714,000
Current portion of long-term debt – MEDC/MSF	654,000	654,000
Current portion of capital lease	15,000	20,000
Current portion of long-term debt - bank line of credit	1,201,000	2,147,000
Current portion of long-term debt - bank term loan	167,000	306,000
Total current liabilities	6,903,000	8,655,000
Long-term debt, less current portion – PFG, net of discount	511,000	794,000
Long-term debt, capital lease	32,000	36,000
Warrant liability	318,000	409,000

Total liabilities	7,764,000	9,894,000
Commitments and contingencies		
Shareholders' equity:		
Class A Common Stock, $.001 par value, 100,000,000 authorized; 37,381,413 shares issued and outstanding as of September 26, 2014, and 31,203,213 shares issued and outstanding as of March 31, 2014	37,000	31,000
Additional paid-in capital	61,697,000	58,752,000
Accumulated deficit	(49,112,000)	(48,476,000)
Total shareholders' equity	12,622,000	10,307,000
Total Liabilities and Shareholders’ Equity	$20,386,000	$20,201,000

See notes to condensed consolidated financial statements.

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Advanced Photonix, Inc.

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended		Six Months Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
Sales, net	$7,789,000	$7,536,000	$15,452,000	$14,614,000
Cost of products sold	5,165,000	4,747,000	9,909,000	8,898,000
Gross profit	2,624,000	2,789,000	5,543,000	5,716,000
Operating expenses:				
Research, development and engineering	1,051,000	1,234,000	2,060,000	2,726,000
Sales and marketing	577,000	640,000	1,147,000	1,227,000
General and administrative	1,087,000	1,202,000	2,363,000	2,326,000
Amortization expense	181,000	259,000	386,000	509,000
Total operating expenses	2,896,000	3,335,000	5,956,000	6,788,000
Loss from operations	(272,000)	(546,000)	(413,000)	(1,072,000)
Other income (expense):				
Interest expense	(129,000)	(165,000)	(310,000)	(325,000)
Change in fair value of warrant liability	46,000	107,000	91,000	(89,000)
Other income (loss)	(13,000)	26,000	(4,000)	(17,000)
Total other expense	(96,000)	(32,000)	(223,000)	(431,000)
Loss before benefit for income taxes	(368,000)	(578,000)	(636,000)	(1,503,000)
Benefit for income taxes	--	--	--	--
Net loss	$(368,000)	$(578,000)	$(636,000)	$(1,503,000)
Basic & diluted loss per share	$(0.01)	$(0.02)	$(0.02)	$(0.05)
Weighted average common shares outstanding				
Basic & diluted shares	37,381,000	31,229,000	35,051,000	31,213,000

See notes to condensed consolidated financial statements.

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Advanced Photonix, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended	
	September 26,	September 27,
	2014	2013
Cash flows from operating activities:		
Net loss	$(636,000)	$(1,503,000)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	336,000	463,000
Amortization of intangible assets	386,000	509,000
Amortization of debt discount	74,000	96,000
Stock based compensation expense	37,000	70,000
Change in fair value of warrant liability	(91,000)	89,000
Changes in operating assets and liabilities:		
Accounts receivable – net	623,000	(674,000)
Inventories	(51,000)	(712,000)
Prepaid expenses and other assets	(316,000)	15,000
Accounts payable and accrued expenses	(662,000)	1,172,000
Net cash used in operating activities	(300,000)	(475,000)
Cash flows from investing activities:		
Capital expenditures	(132,000)	(93,000)
Proceeds from sale of equipment	125,000	‘--
Patent expenditures	(130,000)	(127,000)
Net cash used in investing activities	(137,000)	(220,000)
Cash flows from financing activities:		
Net proceeds or (payments) on bank line of credit	(946,000)	1,251,000
Payments on bank term loan	(139,000)	(167,000)
Payments on MEDC/MSF term loans	--	(276,000)
Payments on PFG term loan	(357,000)	(357,000)
Payments on capital lease	(9,000)	(3,000)
Taxes paid on net share settlement	--	(1,000)
Net proceeds from issuance of Class A Common Stock	2,914,000	--
Net cash provided by financing activities	1,463,000	447,000
Net increase (decrease) in cash and cash equivalents	1,026,000	(248,000)
Cash and cash equivalents at beginning of period	120,000	619,000
Cash and cash equivalents at end of period	$1,146,000	$371,000

	September 26, 2014	September 27, 2013
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 167,000	$ 193,000
Supplemental disclosure of non-cash investing and financing activities:		
Acquisition of equipment through-capital lease	$ --	$ 50,000

See notes to condensed consolidated financial statements.

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Advanced Photonix, Inc.

Notes to Condensed Consolidated Financial Statements
September 26, 2014

Note 1. Basis of Presentation

Business Description

General – Advanced Photonix, Inc. ® (the Company, we, us, our, or API), was incorporated under the laws of the State of Delaware in June 1988. API is a leading test and measurement company that packages optoelectronic semiconductors into high-speed optical receivers (HSOR products), custom optoelectronic subsystems (Optosolutions products) and Terahertz (THz products) instrumentation, serving the test and measurement, telecommunications, military/aerospace and medical 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. Picometrix®, LLC, and Advanced Photonix Canada, Inc.). 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 six-month period ended September 26, 2014 are not necessarily indicative of the results that may be expected for the balance of the fiscal year ending March 31, 2015.

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, 2014, filed with the SEC on June 30, 2014.

Recent Accounting Pronouncements- In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09 – *Revenue from Contracts with Customers* (ASU 2014-09), which supersedes nearly all existing revenue recognition guidance under U.S. Generally Accepted Accounting Principles (U.S. GAAP). The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required with the revenue recognition process than are required under existing U.S. GAAP.

The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is currently evaluating the impact of adopting ASU 2014-09 on the consolidated financial statement and has not yet determined the method by which the Company will adopt the standard in fiscal 2018.

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In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, which provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial are issued. An entity must provide certain disclosures if conditions or events raise substantial doubt about the entity's ability to continue as a going concern.

ASU 2014-15 is effective for annual periods ending after December 15, 2016, and for interim periods within annual periods beginning after December 15, 2016. The Company is currently evaluating the impact of adopting ASU 2014-15 on the consolidated financial statement and has not yet determined the impact the standard may have on the fiscal 2017 disclosures.

Note 2. 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 September 26, 2014, 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 262,095 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 six months ended September 27, 2013 and September 26, 2014, 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, 2013	**2,392**	**$ 1.66**	**2,142**	**$ 1.76**

Granted	24	$ 0.48		
Exercised	--	$ --		
Expired or forfeited	(114)	$ 1.03		
Balance as of June 28, 2013	**2,302**	**$ 1.68**	**2,099**	**$ 1.76**
Granted	--	$ --		
Exercised	(4)	$ 0.44		
Expired or forfeited	(19)	$ 1.80		
Balance as of September 27, 2013	**2,279**	**$ 1.68**	**2,117**	**$ 1.75**

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	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, 2014	**2,171**	**$ 1.66**	**2,017**	**$ 1.75**
Granted	--	$ --		
Exercised	--	$ --		
Expired or forfeited	(36)	$ 2.09		
Balance as of June 27, 2014	**2,135**	**$ 1.68**	**2,031**	**$ 1.70**
Granted	--	$ --		
Exercised	--	$ --		
Expired or forfeited	(16)	$ 1.39		
Balance as of September 26, 2014	**2,119**	**$ 1.66**	**2,055**	**$ 1.69**
Vested & expected to Vest, September 26, 2014	**2,103**	**$ 1.67**		

Information regarding stock options outstanding as of September 26, 2014 is as follows:

	Options Outstanding		
Price Range	**Shares (in 000s)**	**Weighted Average Exercise Price**	**Weighted Average Remaining Life**
$0.44 - $1.25	521	$0.71	7.00
$1.26 - $2.50	1,348	$1.81	2.69
$2.51 - $5.34	250	$2.83	0.92

	Options Exercisable		
Price Range	**Shares (in 000s)**	**Weighted Average Exercise Price**	**Weighted Average Remaining Life**
$0.44 - $1.25	457	$ 0.69	6.96
$1.26 - $2.50	1,348	$ 1.81	2.69
$2.51 - $5.34	250	$ 2.83	0.92

The intrinsic value of options exercised during each of the three and six month periods ended September 26, 2014 was zero. The intrinsic value of options exercised during both the three and six month periods ended September 27, 2013 was $600.

During the second quarter of fiscal 2015, no restricted shares were issued. There were 50,000 restricted shares issued during the second quarter of fiscal 2014. The restricted share transactions are summarized below:

	Shares (000's)	Weighted Average Grant Date Fair Value Per Share
Unvested, March 31, 2013	**128**	**$ 0.87**
Granted	40	$ 0.48
Vested	--	$ --
Expired or forfeited	(1)	$ 0.76
Unvested, June 28, 2013	**167**	**$ 0.78**
Granted	50	$ 0.66
Vested	(26)	$ 0.89
Expired or forfeited	(7)	$ 0.95
Unvested, September 27, 2013	184	**$ 0.72**

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	Shares (000's)	Weighted Average Grant Date Fair Value Per Share
Unvested, March 31, 2014	**84**	**$ 0.76**
Granted	--	$ --
Vested	--	$ --
Expired or forfeited	(16)	$ 0.50
Unvested, June 27, 2014	**68**	**$ 0.83**
Granted	--	$ --
Vested	(25)	$ 0.95
Expired or forfeited	--	$ --
Unvested, September 26, 2014	43	**$ 0.75**

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. The expected term assumption for awards issued during the six month periods ended September 26, 2014 and September 27, 2013 was 6.3 years.
2. The future volatility of the Company's stock has been estimated based on the weekly stock price during the expected term to the date of the latest stock option grant. The expected volatility assumption for awards issued during the six month periods ended September 26, 2014 and September 27, 2013 both averaged 68%.
3. A dividend yield of zero has been assumed for awards issued during six month periods ended September 26, 2014 and September 27, 2013, 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 six month periods ended September 26, 2014 and September 27, 2013 on the implied yield available on U.S. Treasury issues with an equivalent expected term, which both averaged 1.1% during each of the respective periods.
5. The forfeiture rate, for awards issued during the six month periods ended September 26, 2014 and September 27, 2013, was 26% and 22%, respectively, 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	Six months ended

	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
Cost of Products Sold	$2,000	$ 2,000	$3,000	$ 4,000
Research, development & engineering expense	3,000	7,000	7,000	12,000
General and Administrative expense	10,000	24,000	23,000	39,000
Sales and Marketing expense	1,000	8,000	4,000	15,000
Total Stock Based Compensation	**$16,000**	**$ 41,000**	**$37,000**	**$ 70,000**

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At September 26, 2014, 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 $49,000. This expense will be amortized on a straight-line basis over a weighted-average period of approximately 0.9 years and will be adjusted for subsequent changes in estimated forfeitures.

Note 3. 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. API has never experienced any losses related to these balances. At September 26, 2014, there was $868,000 cash held in excess of 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 September 26, 2014 two customers comprised 28% of accounts receivable. As of March 31, 2014, one customer individually comprised 19% of accounts receivable. The allowance for doubtful account balance was $20,000 on both September 26, 2014 and March 31, 2014.

Note 4. 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 September 26, 2014 and March 31,

2014:

	September 26, 2014	**March 31, 2014**
Raw material	$2,781,000	$3,093,000
Work-in-process	836,000	954,000
Finished products	1,183,000	702,000
Inventories, net	**$4,800,000**	**$4,749,000**

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.

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

	Weighted Average Lives in Years	September 26, 2014 Amortization Method	Carrying Value	Accumulated Amortization	Intangibles Net
Customer list	15	Straight Line	$190	$119	$71
Trademarks	15	Cash Flow	2,270	1,352	918
Technology	10	Cash Flow	10,950	10,791	159
Distribution Rights	7	Straight Line	148	33	115
Patents pending			642	--	642
Patents	10	Straight Line	1,391	610	781
Total Intangibles			**$15,591**	**$12,905**	**$2,686**

	Weighted Average Lives in Years	March 31, 2014 Amortization Method	Carrying Value	Accumulated Amortization	Intangibles Net
Customer list	15	Straight Line	$190	$113	$77
Trademarks	15	Cash Flow	2,270	1,267	1,003
Technology	10	Cash Flow	10,950	10,672	278
Distribution Rights	7	Straight Line	148	23	125
Patents pending			795	--	795
Patents	10	Straight Line	1,108	444	664
Total Intangibles			**$15,461**	**$12,519**	**$2,942**

Amortization expense for the three-month periods ended September 26, 2014 and September 27, 2013 was $181,000 and $259,000, respectively. The current patents held by the Company have remaining useful lives ranging from 2 years to 20 years. Amortization expense for the six-month periods ended September 26, 2014 and September 27, 2013 was $386,000 and $509,000, 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.

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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 2015	$304
2016	388
2017	343
2018	339
2019	330
2020 & after	340
Total	**$2,044**

Patent pending costs of $642,000 are not included in the future amortization chart above. These costs will be amortized beginning the month the patents are granted.

Note 5. Debt

Total outstanding debt of the Company as of September 26, 2014 and March 31, 2014 consisted of the following (*in thousands*):

	September 26, 2014	**March 31, 2014**
Bank term loan	$ 167	$306
Bank line of credit	1,201	2,147
MEDC/MSF loans	654	654
Partners for Growth (PFG) loan, net of debt discount	1,225	1,508
Capital leases	47	56
Total	**$ 3,294**	**$4,671**

Bank Debt

On January 31, 2012, API entered into a Loan and Security Agreement with Silicon Valley Bank ("SVB" and such agreement as amended from time to time, the "SVB Loan Agreement") and a related Loan and Security Agreement

(Ex-IM Loan Facility) with SVB (as amended from time to time, the "SVB Ex-Im Loan Agreement", and together with the SVB Loan Agreement, the "SVB Loan Agreements") that provided for a three-year $1 million term loan that, as amended through June 2014, expires in March 2015, and a $5 million line of credit with a $3 million export-import facility sublimit that, as amended through June 2014, expires in June 2016. Subsequent to the execution of the original SVB Loan Agreements, there have been eight amendments that have modified the financial covenants, allowed for the acquisition of substantially all of the operating assets of Silonex, Inc. ("Silonex"), allowed the Company to enter into the loan agreement with Partners for Growth III, L.P. ("PFG" and such agreement as amended from time to time as the "PFG Loan Agreement) as described below and extended the maturity date of the line of credit from January 2014 to June 2016.

The SVB Loan Agreements as amended contained December 2013 and January 2014 financial covenants that required the Company to maintain a minimum liquidity ratio of 2.25 to 1.00 and a minimum trailing three month adjusted EBITDA, measured monthly of (1) a negative $300,000 for each fiscal month during the period July through October 2013; and (2) $1 for each fiscal month during the period November 2013 through February 2014.

As of December 27, 2013 and January 24, 2014, the Company was not in compliance with the then existing minimum adjusted EBITDA covenant of $1 for the three months ended December 27, 2013 and January 31, 2014, respectively, and as of January 31, 2014, the Company was also not in compliance with the then existing minimum liquidity ratio of 2.25 to 1.00. In addition, the foregoing defaults triggered the cross-default provisions under each of the SVB Loan Agreements and the loan with PFG under the PFG Loan Agreement. Consequently, under the terms of each agreement, SVB and PFG were both entitled to proceed against the collateral provided as security for the loans issued thereunder upon an event of default subject, in PFG's case, to any rights that SVB may have in that same collateral.

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On February 10, 2014, API entered into separate Forbearance Agreements with SVB and PFG pursuant to which and subject to certain exceptions, each of SVB and PFG agreed not to proceed against the collateral securing their respective loans until February 28, 2014. On March 5, 2014, the Company entered into separate amendment agreements with SVB and PFG where, among other things, (i) SVB agreed to extend the maturity date of the Company's $5 million line of credit to May 31, 2014; (ii) the minimum trailing three month adjusted EBITDA covenant was reset to a negative $1.2 million for the fiscal month ended February 28, 2014, a negative $800,000 for the fiscal month ended March 31, 2014, a negative $600,000 for the fiscal month ended April 30, 2014 and a positive $1 for the fiscal month ending May 31, 2014; (iii) the existing minimum liquidity ratio covenant was reset to 1.30 to 1.00 as of February 28, 2014, and 2.25 to 1.00 for each month thereafter through May 2014; and (iv) each of SVB and PFG waived the existing defaults. In addition to the payment of an amendment fee, the Company agreed to pay each of SVB and PFG additional fees of up to $50,000 and $75,000, respectively, no later than May 31, 2014 (the "Tail Fees").

On April 30, 2014, API entered into separate amendment agreements with SVB and PFG where, among other things, (i) SVB agreed to extend the maturity date of the $5 million line of credit to July 31, 2014; (ii) the trailing three month adjusted EBITDA covenant was reset to a negative $800,000 for the fiscal month ended March 31, 2014, a negative $600,000 for the fiscal month ended April 30, 2014, a negative $250,000 for the fiscal months ending May 31, 2014 and June 30, 2014 and a positive $1 for the fiscal month ending July 31, 2014; and (iii) the existing minimum liquidity ratio covenant was reset to 1.30 to 1.00 as of March 31, 2014 through May 31, 2014, and 2.00 to 1.00 for each month thereafter through July 2014. In addition to the payment of an amendment fee, the Company agreed to pay each of SVB and PFG their respective Tail Fee and, commencing with the month ended May 31, 2014, an additional fee of $15,000 and $20,000, respectively, for each month that the liquidity ratio is less than 2.00 to 1.00 as of the last day of the month under measurement.

On June 6, 2014, API received approximately $2,657,000 in proceeds before expenses from a secondary placement of 5,391,304 shares of Class A Common Stock through a firm underwriting by B Riley & Co., LLC. On June 10, 2014, the underwriter exercised the option on an additional 808,696 shares of Class A Common Stock for proceeds before expenses of $398,606. The net proceeds were used to pay down the existing line of credit with SVB and certain related fees. On June 20, 2014, API signed separate amendments with SVB and PFG where, among other things, (i) SVB agreed to extend the maturity date of the Company's line of credit to June 2016, (ii) all parties agreed to a six month trailing adjusted EBTIDA covenant, measured at each fiscal month end, of negative $850,000 through June 2014, negative $300,000 for July through September 2014, a positive $1 for October through December 2014 and $100,000 each month thereafter subject to reset upon the submission of the fiscal 2016 budget but no lower than $100,000 on a rolling six month basis, (iii) all parties agreed to adjust the minimum liquidity ratio, as defined, to be 1.30 to 1.00 for months ending prior to June 2014 and 2.00 to 1.00 for all months on or after June 2014 as measured at each month end, and (iv) SVB restored an interest rate matrix based on the covenant performance that results in an interest rate on the line of credit to range from prime rate plus 50 basis points up to prime rate plus 400 basis points and an interest rate on the term loan to range from prime plus 100 basis points up to prime plus 450 basis points. The agreements confirmed the obligation to pay the previously agreed Tail fees of $50,000 and $75,000 to SVB and PFG respectively, associated attorney fees for the amendment, but waived the added fees for May 2014 of $15,000 and $20,000 respectively.

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On November 10, 2014, API signed separate amendments to the Loan Agreements with SVB and PFG where, among other things, (i) all parties agreed to a six month trailing adjusted EBITDA covenant, measured at each fiscal month end, of negative $800,000 through March of 2015, negative $300,000 for April through June of 2015, and $100,000 each month thereafter, (ii) all parties agreed to adjust the minimum liquidity ratio, as defined, to be 2.00 to 1.00 through February of 2015 with a reduction to 1.50 to 1.00 for each month thereafter, (iii) all parties agreed to continue the existing interest rate matrix. The amendments provided for a reimbursement of legal expenses and a modification fee of $10,000 with an additional $10,000 payable if the Company's March 2015 quarterly adjusted EBITDA is less than one dollar.

The interest rates on the SVB term loan and line of credit as of September 26, 2014 were 3.75% and 4.25%, respectively. The Company had approximately $1.2 million outstanding on the SVB line of credit with approximately $2.6 million in borrowing capacity as of September 26, 2014.

The EX-IM Loan Facility is guaranteed by the API's subsidiaries and all borrowings under the SVB Loan Agreements are secured by a first priority security interest granted to SVB over substantially all of the Company's respective assets. As of September 26, 2014, the Company is and expects to remain in compliance with the revised liquidity and adjusted EBITDA covenant with SVB.

Total interest payments made to the Company's bank lenders during the six months ended September 26, 2014 and September 27, 2013 were $54,000 and $36,000, respectively. Total interest payments made to the Company's bank lenders during the three months ended September 26, 2014 and September 27, 2013 were $16,000 and $25,000, respectively

Partners for Growth Secured Debt

On February 8, 2013, API entered into a $2.5 million secured Loan and Security Agreement with PFG that is subordinated to the SVB Loan Agreements. Pursuant to the terms of the agreement, the Company is obligated to make monthly principal payments of $59,524, plus accrued interest at 11.75% through maturity in August 2016. As part of the consideration for and as a closing condition to the PFG Loan Agreement, the Company agreed to grant PFG and certain of its affiliates warrants to purchase up to 1,195,000 shares of the Company's Class A Stock (the "Warrants") in a private placement pursuant to Section 4(a)(2) of the Securities Act. 995,000 of the shares issuable under the Warrants were granted at an initial strike price equal to $0.50 per share (the "Tier 1 Warrants"), and the remaining 200,000 shares issuable under the Warrants were granted at an initial strike price equal to $1.00 per share ("$1.00 Warrants").

The Warrants contain full-ratchet anti-dilution provisions that will result in proportional adjustments to the exercise price and the number of shares issuable under the PFG Warrant Agreements in the event that the Company conducts a stock split, subdivision, stock dividend or combination, or similar transaction. The PFG Warrant Agreements also

include a net exercise provision pursuant to which warrant holders will receive the number of shares equal to (x) 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 Stock (with fair value generally being equal to the highest closing price of the Company's Class A Stock during the 45 consecutive trading days prior to the date of exercise) and (2) the strike price of the Warrant, (y) divided by the fair market value of a share of Class A 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 Agreements as amended through December 2013 and January 2014, contained financial covenants that required the Company to maintain a minimum liquidity ratio of 2.25 to 1.00 and a minimum trailing three month adjusted EBITDA, measured monthly of (1) a negative $300,000 for each fiscal month during the period July through October 2013; and (2) $1 for each fiscal month during the period November 2013 through February 2014.

As of December 27, 2013 and January 24, 2014, API was not in compliance with then existing adjusted minimum EBITDA covenant of $1 for the three months ended December 27, 2013 and January 24, 2014, respectively, and as of January 24, 2014, API was also not in compliance with the then existing minimum liquidity ratio of 2.25 to 1.00. In addition, the foregoing defaults triggered the cross-default provisions under each of the SVB Loan Agreements and the loan with PFG. Consequently, under the terms of each agreement, SVB and PFG were both entitled to proceed against the collateral provided as security for the loans issued thereunder upon an event of default subject, in PFG's case, to any rights that SVB may have in that same collateral.

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On February 10, 2014, API entered into separate Forbearance Agreements with SVB and PFG pursuant to which and subject to certain exceptions, each of SVB and PFG agreed not to proceed against the collateral securing their respective loans until February 28, 2014. On March 5, 2014, the Company entered into separate amendment agreements with SVB and PFG where, among other things, the minimum trailing three month adjusted EBITDA covenant was reset to a negative $1.2 million for the fiscal month ended February 28, 2014, a negative $800,000 for the fiscal month ended March 31, 2014, a negative $600,000 for the fiscal month ended April 30, 2014 and a positive $1 for the fiscal month ending May 31, 2014; the existing minimum liquidity ratio covenant was reset to 1.30 to 1.00 as of February 28, 2014, and 2.25 to 1.00 for each month thereafter through May 2014; and each of SVB and PFG waived the existing defaults. In addition to the payment of an amendment fee, the Company agreed to pay each of SVB and PFG additional fees of up to $50,000 and $75,000, respectively, no later than May 31, 2014 (the “Tail Fees”).

On April 30, 2014, API entered into separate amendment agreements with SVB and PFG where, among other things the trailing minimum three month adjusted EBITDA covenant was reset to a negative $800,000 for the fiscal month ended March 31, 2014, a negative $600,000 for the fiscal month ended April 30, 2014, a negative $250,000 for the fiscal months ending May 31, 2014 and June 30, 2014 and a positive $1 for the fiscal month ending July 31, 2014; and the existing minimum liquidity ratio covenant was reset to 1.30 to 1.00 as of March 31, 2014 through May 31, 2014, and 2.00 to 1.00 for each month thereafter through July 2014. In addition to the payment of an amendment fee, the Company agreed to pay each of SVB and PFG their respective Tail Fee and, commencing with the month ended May 31, 2014, an additional fee of $15,000 and $20,000, respectively, for each month that the liquidity ratio is less than 2.00 to 1.00 as of the last day of the month under measurement.

On June 20, 2014, API signed separate amendments with SVB and PFG where, among other things, both parties agreed to a minimum six month trailing adjusted EBTIDA covenant, measured at each fiscal month end, of negative $850,000 through June 2014, negative $300,000 for July through September 2014, a positive $1 for October through December 2014 and $100,000 each month thereafter subject to reset upon the submission of the fiscal 2016 budget but no lower than $100,000 on a rolling six month basis, both parties agreed to adjust the minimum liquidity ratio, as defined, to be 1.30 to 1.00 for months ending prior to June 2014 and 2.00 to 1.00 for all months on or after June 2014 as measured at each month end. The agreements confirmed the obligation to pay the previously agreed Tail fees of $50,000 and $75,000 to SVB and PFG respectively, associated attorney fees for the amendment, but waived the added fees for May of $15,000 for SVB and $20,000 for PFG.

On November 10, 2014, API signed separate amendments to the Loan Agreements with SVB and PFG where, among other things, (i) all parties agreed to a six month trailing adjusted EBITDA covenant, measured at each fiscal month end, of negative $800,000 through March of 2015, negative $300,000 for April through June of 2015, and $100,000 each month thereafter, (ii) all parties agreed to adjust the minimum liquidity ratio, as defined, to be 2.00 to 1.00 through February of 2015 with a reduction to 1.50 to 1.00 for each month thereafter, (iii) all parties agreed to continue the existing interest rate matrix. The amendments provided for a reimbursement of legal expenses and a modification fee of $12,500 with an additional $12,500 payable if the Company’s March 2015 quarterly adjusted EBITDA is less than one dollar.

As of September 26, 2014, the Company is and expects to remain in compliance with the revised liquidity and adjusted EBITDA covenant with PFG, which were substantially the same as with SVB as of that date.

The Company determined the fair value of the warrant as of the issuance date to be $434,000. Pursuant to the accounting literature, a debt discount and a warrant liability were established as of the issuance date with the debt discount amortized over the life of the loan on an effective interest method. As of September 26, 2014, there was $144,000 in remaining unamortized debt discount offset against the PFG long term debt principal. See Note 6 to the Condensed Consolidated Financial Statements for additional information on the PFG warrants.

Interest payments made to PFG during the three and six month periods ended September 26, 2014 were $45,000 and $95,000, respectively. Interest payments made to PFG during the three and six month periods ended September 27, 2013 were $66,000 and $138,000, respectively.

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MEDC/MSF Loans

In fiscal years 2005 and 2006, we entered into two unsecured loan agreements that are currently held by the Michigan Economic Development Corporation ("MEDC" and such agreement the "MEDC Loan Agreement") and a MEDC affiliate, the Michigan Strategic Fund ("MSF" and such agreement the "MSF Loan Agreement") pursuant to which we borrowed an aggregate of amount of $2.2 million. As amended, payments on the approximately $327,000 in principal outstanding, as of September 26, 2014, under each of the MEDC Loan Agreement and MSF Loan Agreement are deferred until they mature on December 1, 2014 and November 1, 2014, respectively, at which time the entire remaining balance under each loan agreement becomes due and payable. The interest rate under both of the loans was 5.00% as of September 26, 2014. API has initiated discussions with the MEDC to revise the maturity dates of the loans. To date, a formal arrangement has not been finalized.

Interest payments made to the MEDC/MSF were $16,000 and $18,000 during the six months ended September 26, 2014 and September 27, 2013, respectively. Interest payments made to the MEDC/MSF were $8,000 during both the three months ended September 26, 2014 and September 27, 2013.

Capital Leases

During fiscal 2014, the Company purchased $82,000 of equipment through several capital leases with monthly principal payments of $1,700 plus interest with some maturities extending to 2019. The leases are collateralized by the associated equipment.

Interest payments made to the lessors for the three and six months ended September 26, 2014 were $1,000 and $2,000, respectively. Interest payments made to the lessors for the three and six months ended September 27, 2013 were $1,000 and zero, respectively.

Note 6. Stockholders' Equity

Warrants

At September 26, 2014 and March 31, 2014 the Company had the following warrants outstanding and exercisable:

	Shares (000's)	**Exercise Price**
2010 Warrants	267	$ 1.242
PFG Warrants	995	$ 0.500
PFG Warrants	200	$ 1.000
Total	1,462	

On November 29, 2010, 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 subject to adjustment, based on a formula in the warrant agreements, if Common Stock is issued in the future below $1.404. Future adjustments cannot reduce the exercise price below $1.17. Given the issuance in June 2014 of approximately 6.2 million shares at a price of $0.493 per share, a price reset was triggered to the 2010 Warrants and the new exercise price became $1.242. As a result of the exercise price reset feature, the fair values of the warrants are recorded as a liability with changes in values flowing through the Consolidated Statements of Operations.

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As described in Note 5, during February 2013, the Company issued warrants to PFG to purchase 1,195,000 shares of the Company's Class A Common Stock. The PFG warrants are exercisable over a five year period with 995,000 shares at strike price of $0.50 per share and another 200,000 shares with a strike price of $1.00 per share. The PFG warrant agreement contains a provision allowing the warrant to be put back to the Company under certain circumstances. Given this feature, the fair values of the warrants are recorded as a liability with changes in values flowing through the Consolidated Statements of Operations.

For the three and six months ended September 26, 2014, the Company recorded income of $46,000 and $91,000, respectively for the change in fair value of the warrant liability. For the three and six months ended September 27, 2013, the Company recorded income of $107,000 and expense of $89,000, respectively for the change in fair value of the warrant liability. The fair value of the warrant liability outstanding was approximately $318,000 and $409,000 as of September 26, 2014 and March 31, 2014, respectively.

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

	September 26, 2014		**March 31, 2014**	
	PFG Warrants	2010 Warrants	PFG Warrants	2010 Warrants
Contractual term in years	3.4	1.2	3.9	1.7
Volatility	66.7%	54.7%	65.6%	69.5%
Expected dividend	--	--	--	--
Risk-free interest rate	1.02%	0.19%	1.25%	0.34%

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 contractual term.

When a warrant may have different share exercise assumptions such as those issued in February 2013 to PFG and affiliates, the Company weighs various values based on the estimated probability of each outcome as of the valuation date.

The following chart represents the activity in the Company's Level 3 warrants during the three months ended June 27, 2014 and the year ended March 31, 2014.

	Six months Ended September 26, 2014	**Year Ended March 31, 2014**
Level 3 Warrants, beginning of period	$409,000	$292,000
Addition – PFG Warrants, initial fair value	--	--
Change in fair value of warrant liability	(91,000)	117,000
Level 3 Warrants, end of period	**$318,000**	**$409,000**

MEDC Put Option

In May 2010, the Company entered into a debt conversion agreement with the MEDC whereby the MEDC converted the accrued and unpaid interest as of November 30, 2009 totaling $562,336 into 1,041,363 unregistered shares of our Class A Common Stock at a price per share of $0.54 (market value of the stock on the day of conversion). In addition, the Company granted MEDC a put option to sell back the shares received pursuant to the debt conversion agreement in the event of a trigger event as defined in the debt conversion agreement. Given the conditions under which the put may be exercised are in the control of the Company, a liability for the fair value has not been recorded.

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Note 7. 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	
Basic and Diluted	**September 26,**	**September 27,**
	2014	**2013**
Weighted Average Basic Shares Outstanding	37,381,000	31,229,000
Dilutive effect of Stock Options and Warrants	--	--
Weighted Average Diluted Shares Outstanding	37,381,000	31,229,000
Net loss	$(368,000)	$(578,000)
Basic and Diluted loss per share	$(0.01)	$(0.02)

	Six months ended	
Basic and Diluted	**September 26,**	**September 27,**
	2014	**2013**
Weighted Average Basic Shares Outstanding	35,051,000	31,213,000
Dilutive effect of Stock Options and Warrants	--	--
Weighted Average Diluted Shares Outstanding	35,051,000	31,213,000
Net loss	$(636,000)	$(1,503,000)
Basic and Diluted loss per share	$(0.02)	$(0.05)

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.

Note 8. 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, MEDC/MSF debt and SVB bank debt) approximates the fair value

based upon the short-term nature of these instruments. In the case of the PFG debt, the carrying value approximates fair value based upon prevailing interest rates and terms available to the Company.

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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, 2014 (the 2014 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

API is a leading test and measurement company that packages optoelectronic semiconductors into high-speed optical receivers (HSOR products), custom optoelectronic subsystems (Optosolutions products) and Terahertz (THz products) instrumentation, serving a variety of global markets. Our HSOR transmission products are deployed in the internet infrastructure to enable the high-speed bandwidth necessary to support video and data for your TV, computer, tablet or smart phone anytime and anywhere. Our HSOR Comtest products are used to develop, manufacture and test optical communication equipment used in the telecom infrastructure. Our Optosolutions products are sold to a number of scientific instrumentation manufacturers for various applications such as metrology, currency validation, flame monitoring, solar panel quality, temperature sensing, particle detection, color sensing, infrared detection and many other applications that can only be done through optical sensing. Our T-Gauge® systems are used to measure and verify physical properties on-line and in real-time to reduce raw materials and rework costs in manufacturing processes as well as conduct quality control monitoring. Our established and growing patented Terahertz technology has allowed us to expand from the laboratory market into the 24/7 industrial process and quality control manufacturing, military and aerospace markets.

We support the customer from the initial concept and design of the semiconductor, hybridization of support electronics, packaging and signal conditioning or processing from prototype through full-scale production and validation testing. The target markets served by us are Test and Measurement, Military/Aerospace, Telecom Transmission, and Medical.

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.

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 cost adjustments, impairment costs, 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/or as areas most dependent on management's judgment and estimates.

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Revenue Recognition

Revenue is derived principally from the sales of our products. We recognize revenue when persuasive evidence of an arrangement exists, usually in the form of a purchase order, when shipment has occurred since title and risk of loss passes at that time, or when services have been rendered, 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) and distributors. Distributor and VAR sales represented approximately 15% of total revenue for the three months ended September 26, 2014. Significant terms and conditions of distributor agreements include transfer of title upon shipment, 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 Goodwill and Long-Lived Assets

As of September 26, 2014 and March 31, 2014, the consolidated balance sheet included $4.6 million of 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. In our annual assessment of goodwill impairment, we have 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 value before performing the two step quantitative impairment test. If after assessing the totality of events or circumstances, we determine 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 with the unit's carrying amount, including goodwill. Fair value of each reporting unit is determined by weighting fair values using a combination of a discounted cash flow approach, and observed enterprise values to revenue multiples and precedent sales transaction multiples for companies in the reporting unit's peer group. 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 goodwill exceeds its implied fair value, an impairment loss shall be recognized in an amount equal to that excess. We have selected March 31 as the date for the annual impairment test.

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We continue to meet the criteria to report as a single reportable segment. In fiscal 2013 and prior years, we had one reporting unit which was the aggregation of our three product lines. In fiscal 2014, as a result of the change from a shared manufacturing process for the three product lines and certain restructuring changes internally, we concluded we could no longer aggregate our three product lines into one reporting unit for goodwill impairment purposes but instead considered there to be two reporting units as photodiode production remains common for the HSOR and THZ products and the types and classes of customers are similar as well. We test our goodwill annually unless there are qualitative indications that it is more likely than not that the asset is impaired. Given our current market capitalization and the results in fiscal 2015, we concluded further impairment analysis on our goodwill was not necessary.

The carrying value of other long-lived assets, including amortizable intangibles, leasehold improvements, 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 (asset group) are less than the carrying value of the asset (asset group). 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 the specific asset or assets, in operations. The amount of the impairment loss recognized is equal to the excess of the carrying value of the asset, or asset group, over its then estimated fair value. Given the current fiscal year’s results, we have concluded that testing for impairment on our long lived assets was not necessary.

Accounting for Income Taxes

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 2014 Form 10-K, we have continued a full valuation allowance on our net Deferred Tax Assets as of September 26, 2014.

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.

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Warrant Valuations

We have warrants outstanding exercisable into 1,462,196 shares of Series A Common Stock with an estimated fair value of $318,000 as of September 26, 2014. We compute the fair value of the warrants using the Monte Carlo model, which is generally a preferred model when instruments contain non-standard features. When a warrant may have different share exercise assumptions such as those issued in February 2013 to Partners for Growth III, L.P. and affiliates, we weigh various values based on the estimated probability of each outcome as of the valuation date. The value derived from the model is therefore sensitive to changes in our weighting and also changes in the inputs regarding the current stock price, the contractual term, volatility, risk free interest rates and expected dividend rate.

RESULTS OF OPERATIONS

Revenues

We predominantly operate in one industry segment, light and radiation detection devices, and sell to four major markets including test and measurement, telecommunications, military and aerospace, and medical. Revenues by market consisted of the following (*in thousands*)*:*

Revenues	**Three months ended September 26, 2014**		**September 27, 2013**		**Six months ended September 26, 2014**		**September 27, 2013**	
Test and Measurement	$4,651	60 %	$4,681	62 %	$9,127	59 %	$9,120	63 %
Telecommunications	1,964	25 %	1,696	23 %	4,406	28 %	2,952	20 %
Military/Aerospace	832	11 %	711	9 %	1,476	10 %	1,758	12 %
Medical	342	4 %	448	6 %	443	3 %	784	5 %
Total Revenues	**$7,789**	**100 %**	**$7,536**	**100 %**	**$15,452**	**100 %**	**$14,614**	**100 %**

Our revenues for the quarter ended September 26, 2014 were $7.8 million, an increase of 3% (or $253,000) from revenues of $7.5 million for the quarter ended September 27, 2013. On a year to date basis, our revenues were $15.5 million, an increase of $838,000 or 6% from revenues of $14.6 million for the six months ended September 27, 2013. Sequentially, revenues increased 2% or $126,000 from the quarter ended June 27, 2014. We experienced revenue increases in two of four markets for the quarter and six months ending September 26, 2014 compared to the prior year period.

The Test and Measurement market revenue was approximately $4.7 million and $9.1 million in the second quarter and first half of fiscal 2015, similar to the related prior year periods. Improvements in Comtest revenues have been offset by lower Terahertz system and contract revenues. Sequentially, revenue increased approximately 4%, or $175,000, from the first quarter of fiscal 2015 on the strength of industrial product sales. Looking forward, we see the Comtest revenues slowing in the second half, which is causing us to revise our overall growth for the year.

Telecommunications revenues in the second quarter and first half of fiscal 2015 were $2.0 million and $4.4 million, respectively, an increase of 16% and 49% respectively from the prior year periods. The higher revenue was primarily due to the resolution of supply constraints in our 100G line side products and timing of orders and revenue on 40G line side products. Telecommunications revenue on a consecutive quarterly basis decreased 20%, or $478,000, from the first quarter of fiscal 2015. During the quarter North America and Europe carriers decreased their capital spending to fund near term merger and acquisition activity. This pause in the telecommunication market is leading us to revisit our total year growth forecast.

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Military/Aerospace market revenues in the second quarter and first half of fiscal 2015 were $832,000 and $1.5 million respectively, an increase of 17% from the comparable prior year second quarter and a 16% decrease over the prior year first half. The second quarter improved over the first quarter by 29% or $188,000. An Optosolutions military missile program has now begun to ramp back up in the current year explaining these revenue changes. Given Terahertz contract awards for the F-35 program expected to be awarded and contribute to revenue in our fiscal third quarter in addition to the fulfillment on existing missile orders, we would expect substantial growth in this market for the year. With the growth coming later than initially expected, this has caused us to revise our growth forecast for the year.

Medical market revenues in the second quarter and first half of fiscal 2015 were $342,000, and $443,000 respectively, a $106,000 and $341,000 decrease from the prior year periods. These reductions in revenue are mainly due to the timing of shipments related to one customer.

Given the slowing Comtest market, lower revenues and limited visibility provided us in the telecommunication market and delays in the development of Terahertz contract and product sales, we now expect the overall revenue growth to be flat for our fiscal year 2015.

Gross Profit

Gross profit for the second quarter of fiscal 2015 was $2.6 million compared to $2.8 million for the second quarter of fiscal 2014, a decrease of $165,000 on a revenue improvement of $253,000. Year to date fiscal 2015 gross profit was $5.5 million (36% of sales) down from $5.7 million (39% of sales) in the first half of fiscal 2014. The lower gross profit dollars has been driven by the growing mix of 100G HSOR product sales at competitively priced levels and a decline in Terahertz revenue.

Gross profit percentage was 34% for the second quarter of fiscal 2015 compared to 37% in the second quarter of fiscal 2014 and 38% in the first quarter of fiscal 2015. The fiscal 2015 second quarter gross margin rate declined year over year given the growing mix of 100G HSOR product sales at competitively priced levels. Sequentially, the lower mix of Terahertz revenue explained the rate decline.

Operating Expenses

Total operating expenses for the quarter and first half of fiscal 2015 were $2.9 million and $6.0 million respectively, a decrease of $439,000 and $832,000 over the comparable fiscal 2014 periods due to cost reduction efforts to lower our breakeven point and reduced intangible amortization. Total operating expenses for the second quarter of fiscal 2015

decreased by $164,000 when compared to the first quarter of fiscal 2015 given a reduction in G&A legal spend.

Research, Development and Engineering (RD&E) expenses decreased by $183,000 (or 15%) and $666,000 or 24% in the second quarter and first half of fiscal 2015 compared to the second quarter and first half of fiscal 2014 given lower headcount and outside contractor spend as we have completed several major projects.

Sales and Marketing (S&M) expenses decreased by $63,000 (or 10%) in the second quarter of fiscal 2015 and $80,000 (or 7%) for the first half of fiscal 2015 when compared to the prior year periods given lower headcount.

General and Administrative (G&A) expenses decreased $115,000 for the second quarter and increased $37,000 in the first half of fiscal 2015 when compared to prior year periods. The fluctuations were primarily attributable to the timing of outside legal expenses during the periods.

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Amortization expense decreased $78,000 to $181,000 compared to the second quarter of fiscal 2014 expense of $259,000. For the first half of fiscal 2015 versus the same period in fiscal 2014, the amortization expense declined by $123,000. 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 $16,000 and $37,000 for the three and six month periods ended September 26, 2014 compared to $41,000 and $70,000 for the three and six month periods ended September 27, 2013 as stock awards have been limited over the past year.

Other Income (Expense), net

Interest expense in the second quarter and first half of fiscal 2015 was $129,000 and $310,000 respectively. This decrease of $36,000 and $15,000 in expense relative to prior year periods is due to the decrease in total debt as equity proceeds of $2.9 million were primarily used to reduce the debt with SVB.

The fair value of the warrant liability discussed in Note 6 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 $46,000 for the current quarter and $91,000 for the first half of fiscal 2015 are driven primarily by the change in the stock price and remaining contractual term at quarter end. This is in contrast to $107,000 of income in the second quarter of fiscal 2014 and an expense of $89,000 for the first half of fiscal 2014.

Net Loss

We realized a net loss for the second quarter of fiscal 2015 of $368,000 ($0.01 per share), as compared to a net loss of $578,000 ($0.02 per share) in the second quarter of fiscal 2014, a reduction in net loss of $210,000. Year to date we realized a net loss of $636,000 in fiscal 2015 relative to a net loss of $1,503,000 in fiscal 2014. This decrease in net loss for the second quarter and first half of fiscal 2015 is primarily attributable to reduced operating expenses.

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 September 26, 2014, we had cash and cash equivalents of $1.1 million, an increase of approximately $1.0 million from the March 31, 2014 balance. The higher cash balance is attributable to cash used in operating activities of $300,000, cash used in investing activities of approximately $137,000, and cash provided by financing activities of $1.5 million primarily due to the recent receipt of $2.9 million in net proceeds from issuance of 6.2 million shares of our Class A Common Stock in June 2014.

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Operating Activities

The decrease of $300,000 in cash resulting from operating activities for the six months ended September 26, 2014 was primarily attributable to net cash provided by operations of $106,000, and net cash used to fund operating assets and liabilities of $406,000. Cash provided by operations of $106,000 resulted from the net loss of approximately $636,000 less non-cash charges of $742,000 mostly related to depreciation, amortization, stock-based compensation, and change in fair value of warrant liability. The bulk of the net cash used to fund operating assets came from the decrease in trade payables.

Investing Activities

For the six months ended September 26, 2014, we sold excess fabrication equipment for proceeds of $125,000 which netted against outflows for capital expenditures of $132,000 and patent expenditures of $130,000.

Financing Activities

For the six months ended September 26, 2014, approximately $1.5 million was provided by financing activities since we received the previously mentioned net proceeds of $2.9 million from our placement of 6.2 million shares of Class A Common Stock. This amount was offset by payments of principal on our loans with PFG, SVB and our capital lessors.

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.

Combined with the recently revised covenants with both SVB and PFG, expected cash flow (as measured by our bank EBITDA calculation), 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 may continue to experience supply limitations that could hamper our ability to achieve the levels of HSOR revenue and the related gross margin previously enjoyed. We may therefore 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.

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Recent Pronouncements and Accounting Changes

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09 – *Revenue from Contracts with Customers* (ASU 2014-09), which supersedes nearly all existing revenue recognition guidance under U.S. Generally Accepted Accounting Principles (U.S. GAAP). The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required with the revenue recognition process than are required under existing U.S. GAAP.

The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii)a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). We are currently evaluating the impact of adopting ASU 2014-09 on our consolidated financial statement and we have not yet determined the method by which we will adopt the standard in fiscal 2018.

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. The new standard requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial are issued. An entity must provide certain disclosures if conditions or events raise substantial doubt about the entity’s ability to continue as a going concern.

ASU 2014-15 is effective for annual periods ending after December 15, 2016, and for interim periods within annual periods beginning after December 15, 2016. We are currently evaluating the impact of adopting ASU 2014-15 on the consolidated financial statement and have not yet determined the impact the standard may have on our fiscal 2018 audit opinion.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

At September 26, 2014, most of our interest rate exposure is linked to the prime rate on our line of credit, 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 September 26, 2014 that has materially affected or is reasonably likely to materially affect our internal controls.

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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, 2014 is incorporated herein by reference.

Item 1A. Risk Factors

The risks, uncertainties and other factors described in Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2014 (the 2014 Form 10-K) are not the only ones facing the Company. Additional risks, uncertainties and other factors not presently known to us or that we currently deem immaterial may also have a material impact on our business operations, financial condition or operating results.

There have been no material changes in our risk factors from those disclosed in the 2014 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

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Item 6. Exhibits

The following documents are filed as Exhibits to this report:

Exhibit No.	
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

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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)

November 10, 2014

/s/ Richard Kurtz

Richard Kurtz

Chief Executive Officer, President

and Director

/s/ Jeff Anderson

Jeff Anderson

Chief Financial Officer