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ADVANCED PHOTONIX INC
Form 10QSB
November 10, 2004

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

FORM 10-QSB

(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, 2004

OR

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

Commission file no. 1-11056

ADVANCED PHOTONIX, INC.

Incorporated pursuant to the Laws of Delaware

IRS Employer Identification No. 33-0325826

1240 Avenida Acaso, Camarillo, CA 93012

(805) 987-0146

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

On November 5, 2004, 13,399,059 shares of Class A Common Stock, \$.001 par value, and 31,691 shares of Class B Common Stock, \$.001 par value, were outstanding.

ADVANCED PHOTONIX, INC.

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PART I FINANCIAL INFORMATION

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ADVANCED PHOTONIX, INC.

CONSOLIDATED BALANCE SHEET AT SEPTEMBER 26, 2004 (UNAUDITED)

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$
Short-term investments	
Accounts receivable, less allowance of \$39,000	
Inventories	
Prepaid expenses and other current assets	

Total Current Assets

EQUIPMENT AND LEASEHOLD IMPROVEMENTS, at cost
Less accumulated depreciation and amortization

Total Equipment and Leasehold Improvements

OTHER ASSETS

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Goodwill, net of accumulated amortization of \$353,000
 Patents, net of accumulated amortization of \$49,000
 Other

Total Other Assets

TOTAL ASSETS

 \$
 =====

See notes to consolidated financial statements.

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ADVANCED PHOTONIX, INC.

CONSOLIDATED BALANCE SHEET - Continued
 AT SEPTEMBER 26, 2004

(UNAUDITED)

 LIABILITIES AND SHAREHOLDERS' EQUITY
 CURRENT LIABILITIES

Accounts payable
 Accrued salaries, wages and benefits
 Current portion of capital lease payable
 Other accrued expenses

\$

Total Current Liabilities

Capital lease payable, net of current portion

COMMITMENTS AND CONTINGENCIES

Class A redeemable convertible preferred stock, \$.001 par value;
 780,000 shares authorized; 40,000 shares issued and outstanding

SHAREHOLDERS' EQUITY

Preferred stock, \$.001 par value; 10,000,000 shares authorized; 780,000
 shares designated Class A redeemable convertible;
 no shares issued and outstanding, other than Class A redeemable
 convertible
 Class A common stock, \$.001 par value; 50,000,000 shares authorized;
 13,399,059 shares issued and outstanding
 Class B common stock, \$.001 par value; 4,420,113 shares authorized;
 31,691 shares issued and outstanding

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Additional paid-in capital
Accumulated Deficit

Total Shareholders' Equity

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

\$

See notes to consolidated financial statements.

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ADVANCED PHOTONIX, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended		September 2003
	September 26, 2004	September 28, 2003	
SALES	\$3,709,000	\$3,256,000	\$6,000,000
Cost of goods sold	2,451,000	2,131,000	4,000,000
GROSS PROFIT	1,258,000	1,125,000	2,000,000
Research and development expenses	37,000	80,000	
Sales and marketing expenses	328,000	285,000	
General and administrative expenses	654,000	534,000	1,000,000
INCOME (LOSS) FROM OPERATIONS	239,000	226,000	
OTHER INCOME (EXPENSE)			
Interest income	7,000	5,000	
Interest expense	(1,000)	(8,000)	
Other, net	15,000	3,000	
TOTAL OTHER INCOME	21,000	--	
NET INCOME (LOSS)	\$ 260,000	\$ 226,000	\$ 2,000,000
Basic Income (Loss) Per Share	\$.02	\$.02	

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Diluted Income (Loss) Per Share	\$.02	\$.02	
Weighted Average Shares Outstanding	13,431,000	13,449,000	13,

See notes to consolidated financial statements.

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ADVANCED PHOTONIX, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

For the six month periods ended	September 26,

CASH FLOWS FROM OPERATING ACTIVITIES	
Net Income	\$ 608,000
Adjustments to reconcile net income to net cash provided by (used by) operating activities:	
Depreciation	181,000
Amortization	39,000
Disposal of fixed assets	20,000
Changes in operating assets and liabilities:	
Short-term investments	--
Accounts receivable	(166,000)
Inventories	(503,000)
Prepaid expenses and other current assets	(102,000)
Other assets	16,000
Accounts payable and accrued expenses	188,000
Net cash provided by (used by) operating activities	281,000

CASH FLOWS FROM INVESTING ACTIVITIES	
Capital expenditures	(71,000)
Net cash used by investing activities	(71,000)

CASH FLOWS FROM FINANCING ACTIVITIES	
Repayment of line of credit	(900,000)
Proceeds from exercise of stock options	1,000

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Net cash provided by (used by) financing activities	(899,000)
NET DECREASE IN CASH & CASH EQUIVALENTS	(689,000)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,299,000
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 610,000

See notes to consolidated financial statements.

ADVANCED PHOTONIX, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 September 28, 2003
 (Unaudited)

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of Advanced Photonix, Inc. ("the Company") and the Company's wholly owned subsidiaries, Silicon Sensors Inc. ("SSI") and Texas Optoelectronics, Inc. ("TOI"). These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-QSB and Article 10 of Regulation S-X and Regulation S-B. All significant intercompany accounts and transactions have been eliminated in consolidation. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation have been included. Operating results for the six month period ended September 26, 2004 are not necessarily indicative of the results that may be expected for the fiscal year ending March 27, 2005. For further information, refer to the financial statements and notes thereto included in the Advanced Photonix, Inc. Annual Report on Form 10-KSB for the fiscal year ended March 28, 2004.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Net Income (Loss) Per Share: Net income (loss) per share is based on the weighted average number of common shares outstanding. Such weighted average shares were approximately 13,431,000 at September 26, 2004 and 13,428,000 at September 28, 2003. Net income (loss) per share calculations are in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share" (SFAS 128). Accordingly, "basic" net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding for the year. The impact of Statement 128 on the calculation of earnings per share is as follows:

BASIC	Six Months Ended September 26, 2004	Six Months Ended September 28, 2003
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Average Shares Outstanding	13,431,000	13,428,000
Net Income	608,000	338,000
Basic Income Per Share	\$ 0.05	\$ 0.03

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NOTE 2 - Continued

DILUTED	Six Months Ended September 26, 2004	Six Months Ended September 28, 2003
Average Shares Outstanding	13,431,000	13,428,000
Net Effect of Dilutive Stock Options based on the treasury stock method using average market price	796,000	286,000
Total Shares	14,227,000	13,714,000
Net Income	608,000	338,000
Diluted Earnings Per Share	\$ 0.04	\$ 0.02
 Average Market Price of Common Stock	 \$ 2.17	 \$ 1.14
Ending Market Price of Common Stock	\$ 1.80	\$ 1.41

The following stock options granted to Company employees, directors, and former owners were excluded from the calculation of earnings per share in the financial statements because they were anti-dilutive for the periods reported:

Six Months Ended September 26, 2004		Six Months Ended September 28, 2003	
No. of Shares Underlying Options	Exercise Price Per Share	No. of Shares Underlying Options	Exercise Price Per Share
27,700	2.5000	14,900	1.1875
1,000	3.0940	58,300	1.2500
350,000	3.1875	4,000	1.6250
50,000	5.3440	88,000	1.8750
428,700		30,500	2.5000
		1,000	3.0940
		350,000	3.1875
		50,000	5.3440
		596,700	

Inventories: Inventories consist of the following:

	September 26, 2004
Raw materials	\$ 2,582,000
Work in progress	1,382,000
Finished products	188,000

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Total inventories	\$ 4,152,000
	=====
Less reserve	(942,000)
Progress bill and customer prepaid inventory	(484,000)

Inventories, net	\$ 2,726,000
	=====

NOTE 3 - NEW ACCOUNTING PRONOUNCEMENTS

In December 2003, the FASB issued Interpretation 46(r), ("FIN 46(r)") "Consolidation of Variable Interest Entities". The pronouncement amends Accounting Research Bulletin 51 to set standards to require financial statement consolidation of certain variable interest entities that meet specific characteristics if the company has a controlling financial interest. This interpretation shall be applied to all variable interest entities by the end of the first reporting period ending after December 15, 2004, for enterprises that are small business issuers. The Company adopted this Interpretation on October 1, 2004.

The Company does not believe that this accounting pronouncement will have a material impact on its financial position or results of operations.

NOTE 4 - SUBSEQUENT EVENT

On October 12, 2004, the Company announced that it had entered into a definitive agreement for the private placement to three institutional investors of \$5 million aggregate principal amount of its senior convertible notes. The notes are convertible at the option of the holder under certain circumstances into shares of the Company's Class A Common Stock at an initial conversion price of \$1.9393 per share, subject to adjustment. The notes will pay interest at an annual rate of prime plus 1% and will mature on September 30, 2007. In connection with the transaction, the Company has issued to the investors five-year warrants to purchase 850,822 shares of the Company's Class A Common Stock at an exercise price of \$2.1156 per share, subject to adjustment. The Company has agreed to register the shares of common stock issuable upon conversion of the notes and upon exercise of the warrants for resale under the Securities Act of 1933. The investors will have the option for a period of one year following effectiveness of the registration statement to acquire an additional \$5 million aggregate principal amount of the notes with an initial conversion price of \$2.1156 per share and five-year warrants to purchase an additional 850,822 shares of common stock. A copy of the agreement and all related documents were filed with the Securities and Exchange Commission on October 12, 2004 on Form 8-K.

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Item 2. Management's Discussion and Analysis

Application of Critical Accounting Policies

Application of our accounting policies requires management to make judgments and estimates about the amounts reflected in the financial statements. Management uses 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 allowances, restructuring costs, impairment costs, depreciation and amortization, sales discounts and returns, warranty costs, taxes and contingencies. Management has 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.

Revenue Recognition

We generally recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or readily determinable, and collectibility is probable; which is generally the date of shipment. Sales are recorded net of sales returns and discounts. We recognize revenue in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements."

Impairment of Long-Lived Assets

We continually review the recoverability of the carrying value of long-lived assets using the methodology prescribed in Statement of Financial Accounting Standards (SFAS) 144, "Accounting for the Impairment and Disposal of Long-Lived Assets." We also review long-lived assets and the related intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Upon such an occurrence, recoverability of these assets is determined by comparing the forecasted undiscounted net cash flows to which the assets relate, to the carrying amount. If the asset is determined to be unable to recover its carrying value, then intangible assets, if any, are written down first, followed by the other long-lived assets to fair value. Fair value is determined based on discounted cash flows, appraised values or management's estimates, depending on the nature of the assets.

Deferred Tax Asset Valuation Allowance

We record a deferred tax asset in jurisdictions where we generate a loss for income tax purposes. Due to our history of operating losses, we have recorded a full valuation allowance against these deferred tax assets in accordance with SFAS 109, "Accounting for Income Taxes," because, in management's judgment, the deferred tax assets may not be realized in the foreseeable future.

Inventories

Our inventories are stated at standard cost (which approximates the first-in, first-out method) or market. Slow moving and obsolete inventories are analyzed quarterly. To calculate a reserve for obsolescence, we compare the current on-hand quantities with both the projected usages for a two-year period and the actual usage over the past 12 months. On-hand quantities greater than projected usage are calculated at the standard unit cost. The production, engineering and purchasing departments review the initial list of slow-moving and obsolete items

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to identify items that have alternative uses in new or existing products. These items are then excluded from the analysis. The remaining amount of slow-moving and obsolete inventory is then reserved for. Additionally, non-cancelable open purchase orders for parts we are obligated to purchase where demand has been reduced may be reserved. Reserves for open purchase orders where the market price is lower than the purchase order price are also established.

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Accounts Receivable and Allowance for Doubtful Accounts

The Allowance for Doubtful Accounts is established by analyzing each account that has a balance over 90 days past due. Each account is individually assigned a probability of collection. The total amount determined to be uncollectible in the 90-days-past-due category is then reserved fully. The percentage of this reserve to the 90-days-past-due total is then established as a guideline and applied to the rest of the non-current accounts receivable balance where appropriate. When other circumstances suggest that a receivable may not be collectible, it is immediately reserved for, even if the receivable is not yet in the 90-days-past-due category.

RESULTS OF OPERATIONS

NET PRODUCT SALES

The Company's consolidated net product sales for the second quarter (Q2 05) and six month period (YTD 05) ended September 26, 2004, were \$3.709 million and \$6.962 million, respectively. Net sales increased by \$453,000, or 14%, as compared to the second quarter of the prior year (Q2 04) and by \$1.059 million, or 18% as compared to the same six month period of the prior year (YTD 04).

The increase in revenues for both the quarter and year to date periods is due in large part to increases in revenues to the industrial sensing and medical markets. Sales to customers in the industrial sensing markets increased by 36% in Q2 05 as compared to Q2 04 and sales to customers in the medical markets increased by 15% in the current quarter as compared to the prior year. In addition to the two markets noted above, we have also seen significant increases in year to date sales to customers in the military aerospace market. As compared to YTD 04, industrial sensing revenues have increased by 20%, sales to the medical markets have increased by 24% and sales to the military aerospace markets have increased by 18%. Stated as a percentage of total sales, industrial sensing makes up 40% of the Company's year to date revenues, military aerospace is 38% and medical revenues account for 16%. We continue to expect sales to increase in fiscal 2005 as compared to fiscal 2004; however, our shipment schedules are largely dependent on the requested delivery schedules of our customers. Thus the quarter to quarter comparisons often vary for both revenue and market analyses due to fluctuations in customer schedules which are beyond the control of the Company.

COSTS AND EXPENSES

Cost of product sales increased by \$320,000 (15%) during Q2 05 and by \$501,000 (13%) during YTD 05 as compared to Q2 04 and YTD 04, respectively. Stated as a percentage of net sales, cost of goods sold represented 66% in Q2 05, as compared to 65% in Q2 04, and 63% for YTD 05 as compared to 66% for YTD 04. Although gross margin decreased slightly in Q2 05 as compared to Q2 04 (34% vs. 35%, respectively, of total sales) our gross margins have increased year to date (37% in YTD 05 as compared to 34% in YTD 04). As our shipments in a given quarter are directly related to customer delivery requests, so is the resulting

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product mix for that quarter, and similar to revenues, our margins can also vary from quarter to quarter. The slight increase in cost of sales for Q2 05 is directly attributable to these fluctuations in product mix. The Company regards the year to date gross margin percentage as indicative of what can be expected for the remainder of the fiscal year and expects that year end gross margins will approximate 36%.

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Research and development (R & D) costs decreased by \$43,000 (54%) to \$37,000 in Q2 05 as compared to Q2 04, and by \$78,000 (50%) year to date. As stated in previous quarters, management's ongoing plan is to continue to focus the R & D department on those projects which offer higher commercial potential per dollar spent. Thus, R&D expenses for any given quarter are directly reflective of the specific projects currently underway and the costs incurred during that period. During the remainder of the fiscal year, we expect that R & D expenses will remain at or above the current level. The Company may incur increases in R & D spending, based on current customer project forecasts. However, there is no guarantee that certain milestones will be met within the projected timelines and, as such, R & D costs can vary significantly from quarter to quarter, depending on the level of activity associated with each customer's project.

Marketing and sales expenses increased by \$43,000 (15%) to \$328,000 in Q2 05 compared to Q2 04 and by \$84,000 (16%) to \$611,000 in YTD 05 compared to YTD 04. Stated as a percentage of sales, marketing and sales expenses remained constant at 9% of total revenue for the comparative periods of both years. The increases realized for both the quarter and year to date periods are primarily due to expansion of the sales department and include increased salary, commission and travel expenses as well as increases in advertising and marketing expenses over fiscal 2004. The Company believes that current marketing and sales expenses are indicative of what can be expected for the remainder of the fiscal year and anticipates they will continue to represent approximately 9% of total sales.

General and administrative (G & A) expenses increased by \$120,000 (22%) to \$654,000 in Q2 05 as compared to Q2 04. Year to date, general and administrative expenses increased by \$295,000 (30%) to \$1.272 million as compared to the same six month period of fiscal 2004. Approximately 50% of the increases for both the quarter and year to date periods are attributable to increased legal, consultant, bank fees and other costs associated with the Company's ongoing acquisition investigation activities. As with the sales department, the Company has added additional G & A personnel and, as a result, the remaining increase for both periods is due to increased salary and related expenses, including benefits, training and the accrual of bonus expenses. Expressed as a percentage of sales, general and administrative expenses represent 18% of total sales for both the quarterly and YTD periods in the current fiscal year, as compared to 16% for the same periods of the prior year. The Company expects that general and administrative expenses will continue to approximate 18% of total revenues for the remainder of the fiscal year.

The Company reported net income of \$260,000 and \$608,000 for Q2 05 and YTD 05, respectively, as compared to net income of \$226,000 and \$338,000 for Q2 04 and YTD 04, respectively.

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LIQUIDITY AND CAPITAL RESOURCES

At September 26, 2004, the Company had cash, cash equivalents and short term investments of \$2.3 million and working capital of \$6.6 million. The Company's cash and cash equivalents decreased by \$689,000 during the six months ended September 26, 2004. Cash generated through operating activities totaled \$281,000 and was significantly impacted by increases in accounts receivable and cash outlays for inventory and prepaid expenses. In addition, \$900,000 was used to pay off the Company's credit line balance and \$71,000 was used for capital expenditures, mainly manufacturing and computer equipment.

The Company is exposed to interest rate risk for marketable securities. Due to continually declining interest rates available to the Company pursuant to its investment policy, the Company was able to achieve the best yields on liquid money market and equity fund accounts and thus has held the majority of its available cash reserves in such accounts during the past year. At September 26, 2004, the Company held \$1.7 million in a highly liquid equity fund account which carries an average interest rate of 1.3%. During 2005, the Company will continue to monitor available interest rates and will attempt to utilize the best possible avenues of investment for its excess liquid assets.

Subsequent to the end of Q2 05, the Company announced on October 12, 2004 that it had entered into a material definitive agreement for the private placement of \$5 million aggregate principal amount of its senior convertible notes. (See Note 4 to the Consolidated Financial Statements - Subsequent Events for additional information.)

Item 3. Controls and Procedures

Our Chief Executive Officer, President, and Chief Financial Officer (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 the Company's disclosure controls and procedures as of the end of the period covered by this report and believe that the Company's disclosure controls and procedures are effective based on the required evaluation. There have been no significant changes in internal controls or in other factors that could significantly affect internal controls during the last fiscal quarter, including any corrective actions with regard to significant deficiencies and material weaknesses.

FORWARD LOOKING STATEMENTS

The information contained herein includes forward looking statements that are based on assumptions that management believes to be reasonable but are subject to inherent uncertainties and risks including, but not limited to, risks associated with the integration of newly acquired businesses, unforeseen technological obstacles which may prevent or slow the development and/or manufacture of new products, limited (or slower than anticipated) customer acceptance of new products which have been and are being developed by the Company, the availability of other competing technologies and a decline in the general demand for optoelectronic products. .

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PART II OTHER INFORMATION

Items 1 - 3
None.

Item 4 Submission of Matters to a Vote of Security Holders

The Company's Annual Stockholders Meeting was held on August 27, 2004. The following were considered and approved at the meeting by a majority of the shareholders eligible to vote in person or by proxy. The voting results for each proposal are listed below.

1. Election of Directors. The following persons were elected or re-elected to the Company's Board of Directors to serve until the next Annual Meeting of Stockholders and until their respective successors have been duly elected and qualified.

	FOR	WITHHELD
	-----	-----
Richard D. Kurtz	11,565,870	199,138
M. Scott Farese	11,562,845	202,163
Ward Harper	11,554,845	210,163
Paul D. Ludwig	11,557,778	207,230
Stephen P. Soltwedel	11,565,170	199,338

2. Amendment to 2000 Stock Option Plan. The Advanced Photonix, Inc. 2000 Stock Option Plan was amended by a majority of votes cast, increasing the number of shares of Class A Common Stock available for issuance from 1,500,000 to 2,500,000.

FOR: 2,861,876 AGAINST: 486,246 WITHHELD: 22,515 NOT VOTED: 8,394,371

Item 5 Other Information

None.

Item 6 Exhibits and Reports on Form 8-K

(a) Exhibits

- 31.1 Certification of the Registrant's Chairman, Chief Executive Officer, and Director pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of the Registrant's Chief Financial Officer and Secretary pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.3 Certification of the Registrant's President pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

The Company filed form 8-K on August 11, 2004 to report that it had issued a press release dated August 10, 2004 announcing financial results for the quarter ended June 27, 2004.

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)

Date: November 10, 2004

/s/ Richard Kurtz

Richard Kurtz
Chairman, Chief Executive Officer
and Director

/s/ Susan Schmidt

Susan Schmidt
Chief Financial Officer and Secretary

/s/ Paul Ludwig

Paul Ludwig
President

