ADVANCED PHOTONIX INC
Form 10-Q
February 09, 2015
Table Of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 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

1

Table Of Contents

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

YES NO

As of February 2, 2015, there were 37,381,413 shares of Class A Common Stock, $.001 par value, outstanding.

Table Of Contents

Advanced Photonix, Inc.

Form 10-Q

For the Quarter Ended December 26, 2014

Table of Contents

		Page
PART I	**FINANCIAL INFORMATION**	
Item 1.	Financial Statements	
	Condensed Consolidated Balance Sheets at December 26, 2014 and March 31, 2014	4
	Condensed Consolidated Statements of Operations for the three and nine-month periods ended December 26, 2014 and December 27, 2013 (unaudited)	5
	Condensed Consolidated Statements of Cash Flows for the nine-month periods ended December 26, 2014 and December 27, 2013 (unaudited)	6
	Notes to Condensed Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	30
Item 4.	Controls and Procedures	30
PART II	**OTHER INFORMATION**	
Item 1.	Legal Proceedings	31
Item 1A.	Risk Factors	31
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	31
Item 3.	Defaults Upon Senior Securities	31
Item 4.	Mine Safety Disclosures	31
Item 5.	Other Information	31
Item 6.	Exhibits	32
	Exhibit 10.1 Tenth Amendment to Loan and Security Agreement entered into February 5, 2015 by and between Silicon Valley Bank, Advanced Photonix, Inc., Picometrix, LLC and Advanced Photonix Canada, Inc.	

Exhibit 10.2 Eighth Amendment to Loan and Security Agreement (EX-IM Loan Facility) entered into as of February 5, 2015 by and between Silicon Valley Bank, Advanced Photonix, Inc., Picometrix, LLC and Advanced Photonix Canada, Inc.
Exhibit 10.3Modification No. 5 to Loan and Security Agreement executed as of February 5, 2015 by and among Partners For Growth III, L.P., Advanced Photonix, Inc. and Picometrix, LLC.
Exhibit 31.1 Section 302 Certification of Chief Executive Officer
Exhibit 31.2 Section 302 Certification of Chief Financial Officer
Exhibit 32.1 Section 906 Certification of Chief Executive Officer
Exhibit 32.2 Section 906 Certification of Chief Financial Officer

Table Of Contents

PART I -- FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

Advanced Photonix, Inc.

Condensed Consolidated Balance Sheets

	December 26, 2014 (Unaudited)	**March 31, 2014**
ASSETS		
Current assets:		
Cash and cash equivalents	$110,000	$120,000
Receivables, net	3,814,000	5,085,000
Inventories	4,987,000	4,749,000
Prepaid expenses and other current assets	725,000	444,000
Total current assets	9,636,000	10,398,000
Equipment and leasehold improvements, net	1,769,000	2,144,000
Goodwill	4,579,000	4,579,000
Intangibles and patents, net	2,678,000	2,942,000
Other assets	160,000	138,000
Total Assets	$18,822,000	$20,201,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,580,000	$2,661,000
Accrued compensation	790,000	701,000
Accrued subcontracting costs	226,000	344,000

Other accrued expenses	713,000	1,108,000
Current portion of long-term debt--PFG	714,000	714,000
Current portion of long-term debt – MEDC/MSF	116,000	654,000
Current portion of capital lease	8,000	20,000
Current portion of long-term debt - bank line of credit	1,546,000	2,147,000
Current portion of long-term debt - bank term loan	83,000	306,000
Total current liabilities	5,776,000	8,655,000
Long-term debt, less current portion – PFG, net of discount	365,000	794,000
Long-term debt, less current portion – MEDC/MSF	538,000	--
Long-term debt, capital lease	29,000	36,000
Warrant liability	178,000	409,000
Total liabilities	6,886,000	9,894,000
Commitments and contingencies		
Shareholders' equity:		
Class A Common Stock, $.001 par value, 100,000,000 authorized; December 26, 2014 – 37,381,413 shares issued and outstanding, March 31, 2014 – 31,203,213 shares issued and outstanding	37,000	31,000
Additional paid-in capital	61,712,000	58,752,000
Accumulated deficit	(49,813,000)	(48,476,000)
Total shareholders' equity	11,936,000	10,307,000
Total Liabilities and Shareholders’ Equity	$18,822,000	$20,201,000

See notes to condensed consolidated financial statements.

Table Of Contents

Advanced Photonix, Inc.

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended		**Nine Months Ended**	
	December 26, 2014	**December 27, 2013**	**December 26, 2014**	**December 27, 2013**
Sales, net	$5,805,000	$7,450,000	$21,257,000	$22,064,000
Cost of products sold	3,936,000	5,562,000	13,845,000	14,460,000
Gross profit	1,869,000	1,888,000	7,412,000	7,604,000
Operating expenses:				
Research, development and engineering	959,000	1,164,000	3,019,000	3,890,000
Sales and marketing	535,000	640,000	1,682,000	1,867,000
General and administrative	928,000	1,135,000	3,291,000	3,461,000
Amortization expense	153,000	260,000	539,000	769,000
Total operating expenses	2,575,000	3,199,000	8,531,000	9,987,000
Loss from operations	(706,000)	(1,311,000)	(1,119,000)	(2,383,000)
Other income (expense):				
Interest expense	(124,000)	(153,000)	(434,000)	(478,000)
Change in fair value of warrant liability	140,000	(124,000)	231,000	(213,000)
Other income (loss)	(11,000)	(30,000)	(15,000)	(47,000)
Total other expense	5,000	(307,000)	(218,000)	(738,000)
Loss before benefit for income taxes	(701,000)	(1,618,000)	(1,337,000)	(3,121,000)
Benefit for income taxes	--	--	--	--
Net loss	$(701,000)	$(1,618,000)	$(1,337,000)	$(3,121,000)
Basic & diluted loss per share	$(0.02)	$(0.05)	$(0.04)	$(0.10)
Weighted average common shares outstanding				
Basic & diluted	37,381,000	31,243,000	35,860,000	31,223,000

See notes to condensed consolidated financial statements.

Table Of Contents

Advanced Photonix, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended	
	December 26, 2014	December 27, 2013
Cash flows from operating activities:		
Net loss	$(1,337,000)	$(3,121,000)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	448,000	1,297,000
Amortization of intangible assets	539,000	769,000
Amortization of debt discount	107,000	143,000
Stock based compensation expense	52,000	110,000
Change in fair value of warrant liability	(231,000)	213,000
Changes in operating assets and liabilities:		
Accounts receivable – net	1,271,000	(389,000)
Inventories	(238,000)	(759,000)
Prepaid expenses and other assets	(303,000)	291,000
Accounts payable and accrued expenses	(1,505,000)	1,186,000
Net cash used in operating activities	(1,197,000)	(260,000)
Cash flows from investing activities:		
Capital expenditures	(198,000)	(109,000)
Proceeds from sale of equipment	125,000	--
Patent expenditures	(275,000)	(176,000)
Net cash used in investing activities	(348,000)	(285,000)
Cash flows from financing activities:		
Payments on bank term loan	(223,000)	(250,000)
Net proceeds (payments) on bank line of credit	(601,000)	1,128,000
Payments on MEDC/MSF term loans	--	(276,000)
Payments on PFG term loan	(536,000)	(537,000)
Payments on capital lease	(19,000)	(21,000)
Net proceeds from issuance of Class A Common Stock	2,914,000	--
Taxes paid on net share settlement	--	(2,000)
Net cash provided by financing activities	1,535,000	42,000
Net decrease in cash and cash equivalents	(10,000)	(503,000)
Cash and cash equivalents at beginning of period	120,000	619,000
Cash and cash equivalents at end of period	$110,000	$116,000

Supplemental disclosure of cash flow information:		
Cash paid for interest	$222,000	$283,000
Supplemental disclosure of non-cash investing and financing activities:		
Acquisition of equipment through capital lease	$--	$82,000

See notes to condensed consolidated financial statements.

Table Of Contents

Advanced Photonix, Inc.

Notes to Condensed Consolidated Financial Statements

December 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 nine-month period ended December 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 Events- On January 30, 2015, the Company entered into a merger agreement with Luna Innovations Incorporated (trading on the NASDAQ under the symbol of LUNA) (“Luna”) and API Merger Sub (“Merger Sub”) pursuant to which Merger Sub will merge with and into API and API will become a wholly-owned subsidiary of Luna ("the Merger"). On the effective time of the merger, the existing stockholders of API will receive 0.31782 of a share of Luna common stock for each share of API’s Class A common stock owned by them. The closing of the transaction is subject the approval of the stockholders of each of Luna and API and other customary closing conditions. The Company anticipates the transaction to close by late spring or early summer 2015. The proposed merger is expected to provide API's shareholders the ability to realize the value added associated with a larger company and to execute the Company's growth plans over the near term.

The merger agreement may be terminated by either Luna or API under certain circumstances, including if the merger has not been consummated on or before August 31, 2015, if the approval of the stockholders of either Luna or API is not obtained and for certain breaches of representations and warranties. If the merger agreement is terminated in certain specified circumstances, API must pay Luna, or Luna must pay API, as applicable, a termination fee of $750,000. In addition, if the merger agreement is terminated following a meeting of the stockholders of Luna or API at which the adoption of the merger agreement and approval of the transactions contemplated thereby, or the approval of the issuance of shares of Luna Common Stock to existing API stockholders as consideration for the merger is not approved, then Luna or API, as applicable, will be required to pay an amount up to $250,000 in reimbursement of the other party’s out-of-pocket expenses incurred in connection with the transaction.

See Note 5 regarding recent modifications to the Company's debt facilities.

Table Of Contents

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.

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 statements 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 December 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 266,095 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.

Table Of Contents

The following table summarizes information regarding options outstanding and options exercisable at each of the quarterly periods through the nine months ended December 27, 2013 and December 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**
Granted	--	$ --		
Exercised	--	$ --		
Expired or forfeited	(12)	$ 0.63		
Balance as of December 27, 2013	**2,267**	**$ 1.69**	**2,112**	**$ 1.75**
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**
Granted	--	$ --		
Exercised	--	$ --		
Expired or forfeited	(180)	$ 1.80		
Balance as of December 26, 2014	**1,939**	**$ 1.65**	**1,881**	**$ 1.67**
Vested & expected to Vest, December 26, 2014	**1,924**	**$ 1.65**		

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

Price Range	*Options Outstanding* Shares (in 000s)	Weighted Average Exercise Price	Weighted Average Remaining Life
$0.44-$1.25	521	$ 0.71	6.75
$1.26-$2.50	1,168	$ 1.81	2.83
$2.51-$5.34	250	$ 2.83	0.67

Price Range	*Options Exercisable* Shares (in 000s)	Weighted Average Exercise Price	Weighted Average Remaining Life
$0.44-$1.25	463	$ 0.69	6.70
$1.26-$2.50	1,168	$ 1.81	2.83
$2.51-$5.34	250	$ 2.83	0.67

Table Of Contents

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

During the third quarter of fiscal 2014, no restricted shares were issued. There were no restricted shares issued during the third quarter of fiscal 2015. 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**
Granted	--	$ --
Vested	(12)	$ 0.48
Expired or forfeited	(4)	$ 0.76
Unvested, December 27, 2013	168	**$ 0.74**

	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**
Granted	--	$ --
Vested	--	$ --
Expired or forfeited	--	$ --
Unvested, December 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 nine month periods ended December 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 nine month periods ended December 27, 2013 averaged 68%.

Table Of Contents

3. A dividend yield of zero has been assumed for awards issued during nine month periods ended December 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 nine month periods ended December 27, 2013 on the implied yield available on U.S. Treasury issues with an equivalent expected term, which averaged 1.1%.
5. The forfeiture rate, for awards issued during the nine month periods ended December 26, 2014 and December 27, 2013, was 30% and 23%, 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		**Nine months ended**	
	December 26, 2014	**December 27, 2013**	**December 26, 2014**	**December 27, 2013**
Cost of Products Sold	$1,000	$ 1,000	$4,000	$ 5,000
Research, development & engineering expense	3,000	4,000	10,000	16,000
General and Administrative expense	10,000	31,000	33,000	70,000
Sales and Marketing expense	1,000	4,000	5,000	19,000
Total Stock Based Compensation	**$15,000**	**$ 40,000**	**$52,000**	**$ 110,000**

At December 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 $33,000. This expense will be amortized on a straight-line basis over a weighted-average period of approximately 0.7 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 December 26, 2014, there was no 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 December 26, 2014 one customer comprised 13% of accounts receivable. As of March 31, 2014, one customer individually comprised 19% of accounts receivable. The allowance for doubtful account balance was $28,000 on December 26, 2014 and $20,000 on March 31, 2014.

Table Of Contents

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 December 26, 2014 and March 31, 2014:

	December 26, 2014	**March 31, 2014**
Raw material	$ 3,031,000	$3,093,000
Work-in-process	848,000	954,000
Finished products	1,108,000	702,000
Inventories, net	**$ 4,987,000**	**$4,749,000**

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

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

	Weighted Average Lives in Years	**December 26, 2014 Amortization Method**	**Carrying Value**	**Accumulated Amortization**	**Intangibles Net**

Customer list	15	Straight Line	$ 190	$ 122	$ 68
Trademarks	15	Cash Flow	2,270	1,394	876
Technology	10	Cash Flow	10,950	10,851	99
Distribution Rights	7	Straight Line	148	39	109
Patents pending			729	--	729
Patents	10	Straight Line	1,449	652	797
Total Intangibles			**$ 15,736**	**$ 13,058**	**$ 2,678**

Table Of Contents

	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 December 26, 2014 and December 27, 2013 was $153,000 and $260,000, respectively. The current patents held by the Company have remaining useful lives ranging from 2 years to 20 years. Amortization expense for the nine-month periods ended December 26, 2014 and December 27, 2013 was $539,000 and $769,000, 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.

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	$154
2016	396
2017	351
2018	347
2019	337
2020 & after	364
Total	**$1,949**

Patent pending costs of $729,000 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 December 26, 2014 and March 31, 2014 consisted of the following (*in thousands*):

	December 26, 2014	**March 31, 2014**
Bank term loan	$ 83	$306
Bank line of credit	1,546	2,147
MEDC/MSF loans	654	654
Partners for Growth (PFG) loan, net of debt discount	1,079	1,508
Capital leases	37	56
Total	**$ 3,399**	**$4,671**

13

Table Of Contents

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 expires in March 2015, and a $5 million line of credit with a $3 million export-import facility sublimit that expires in June 2016. Subsequent to the execution of the original SVB Loan Agreements, there have been ten 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.

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.

Table Of Contents

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.

On November 10, 2014, API signed separate amendments to the SVB Loan Agreements and PFG Loan Agreements 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, and (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 December 26, 2014 were 3.75% and 4.25%, respectively. The Company had approximately $1.5 million outstanding on the SVB line of credit with approximately $2.1 million in borrowing capacity as of December 26, 2014. However, given the liquidity covenant of 2.00 to 1.00 required by SVB, an additional advance in excess of $630,000 of the available line of credit would cause the Company to be in violation of the liquidity covenant with SVB.

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 in substantially all of the Company's respective assets.

Table Of Contents

As of December 26, 2014, the Company is in compliance with the November 10, 2014 revisions to the liquidity and adjusted EBITDA covenants with SVB. The Company experienced a $2.1 million dollar reduction in HSOR revenues in the third quarter relative to the second quarter which was more than anticipated in the November 2014 covenant reset. As a result, the Company obtained further covenant relief on February 5, 2015 from SVB by reducing the rolling six month adjusted EBITDA requirement for January through June 2015 to a negative $1,250,000, $1 of adjusted EBITDA required in July 2015 and $100,000 each month thereafter until maturity with up to $150,000 in transaction costs carved out of the calculation. The parties also agreed to reduce the minimum liquidity ratio to 1.30 to 1.00 for January 2015 until the maturity of the line of credit. Pursuant to this tenth amendment, the interest rate was changed to prime plus 5% or 8.25% per annum for the line of credit. The Company is required to pay a $10,000 bank fee plus associated legal costs for the amendment with an added $15,000 payable upon the maturity or payoff of the line of credit. Should the Company experience a reduction in revenue or an increase in expenses from its most recent forecast which was the basis of the February 5, 2015 covenants, the loan would be callable creating a liquidity issue.

Total interest payments made to the Company's bank lenders during the nine months ended December 26, 2014 and December 27, 2013 were $63,000 and $57,000, respectively. Total interest payments made to the Company's bank lenders during the three months ended December 26, 2014 and December 27, 2013 were $10,000 and $21,000, 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 subordinate to the SVB Loan Agreements. Pursuant to the terms of the PFG 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 Common 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 Common Stock (with fair value generally being equal to the highest closing price of the Company's Class A Common Stock during the 45 consecutive trading days prior to the date of exercise) and (2) the strike price of the Warrant, (y) divided by the fair market value of a share of Class A Common Stock. In addition, in the event the Company is acquired, liquidates, conducts a public offering, or the Warrants expire, each warrant holder will have the right to "put" its Warrants to the Company in exchange for a per share cash payment that varies with the number of shares issuable under each Warrant, but in the aggregate will not exceed $250,000.

The PFG Loan 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.

Table Of Contents

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 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.

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, and (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.

Table Of Contents

As of December 26, 2014, the Company is in compliance with the revised liquidity and adjusted EBITDA covenants with PFG, which were substantially the same as with SVB as of that date. The Company experienced a $2.1 million dollar reduction in HSOR revenues in the third quarter relative to the second quarter which was more than anticipated in the November 2014 covenant reset. As a result, the Company obtained further covenant relief on February 5, 2015 from PFG by reducing the rolling six month adjusted EBITDA requirement for January through June 2015 to a negative $1,250,000, $1 of adjusted EBITDA required in July 2015 and $100,000 each month thereafter until maturity with up to $150,000 in transaction costs carved out of the calculation. The parties also agreed to reduce the minimum liquidity ratio to 1.30 to 1.00 for January 2015 until the maturity of the term loan. Pursuant to the amendment, the interest rate remained at 11.75% per annum on the term loan. The Company is required to pay a $10,000 bank fee plus associated legal costs for the amendment with an added $15,000 payable upon the maturity or payoff of the term loan. Should the Company experience a reduction in revenue or an increase in expenses from its most recent forecast which was the basis of the February 5, 2015 covenants, the loan would be callable creating a liquidity issue.

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 December 26, 2014, there was $112,000 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 nine month periods ended December 26, 2014 were $39,000 and $134,000, respectively. Interest payments made to PFG during the three and nine month periods ended December 27, 2013 were $60,000 and $198,000, respectively.

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 $654,000 in remaining principal outstanding in aggregate under the MEDC Loan Agreement and MSF Loan Agreement are deferred along with accrued interest at a rate of 6% per annum. Beginning on November 1, 2015 and for 11 months thereafter, the total principal and accrued interest are to be paid in monthly installments along with each month’s earned interest at a 6% per annum rate.

Table Of Contents

Interest payments made to the MEDC/MSF were $22,000 and $25,000 during the 9 months ended December 26, 2014 and December 27, 2013, respectively. Interest payments made to the MEDC/MSF were $5,000 and $8,000 during both the three months ended December 26, 2014 and December 27, 2013, respectively.

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 nine months ended December 26, 2014 were $1,000 and $3,000, respectively. Interest payments made to the lessors for the three and nine months ended December 27, 2013 were $1,000 and $3,000, respectively.

Prior to the closing of the Merger described in Note 1, and absent such a closing, the Company's near-term liquidity is dependent on it meeting its debt covenants- which management expects it to do based on current forecasts. However, if the merger is not approved by stockholders or does not proceed in a timely closing and projected revenue increases do not occur as forecast, then the Company may need to seek additional funding sources to meet its obligations which would include the alternatives of raising more capital, restructuring existing debt, or exploring strategic options which could include the sale of a portion or all of the Company. There can be no assurances that additional capital, if needed, will be available to the Company or the terms under which capital would be available to the Company. If adequate financing is not available, or is not available on favorable terms, the Company’s business, financial position and results of operations will be adversely affected.

Note 6. Stockholders’ Equity

Warrants

At December 26, 2014 and March 31, 2014, the Company had the following warrants outstanding and exercisable which could be exchanged into shares of Class A Common Stock:

	Shares (000’s)	**Exercise Price**
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 of the PFG Warrants in February 2013, a price reset was triggered to the 2010 Warrants and the new exercise price became $1.376. 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.

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 a 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 warrants 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.

Table Of Contents

For the three and nine months ended December 26, 2014, the Company recorded income of $140,000 and $231,000, respectively for the change in fair value of the warrant liability. For the three and nine months ended December 27, 2013, the Company recorded expense of $124,000 and $213,000 respectively. The fair value of the warrant liability outstanding was approximately $178,000 and $409,000 as of December 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:

	December 26, 2014		**March 31, 2014**	
	PFG Warrants	2010 Warrants	PFG Warrants	2010 Warrants
Contractual term in years	3.1	0.9	3.9	1.7
Volatility	67.4%	55.2%	65.6%	69.5%
Expected dividend	--	--	--	--
Risk-free interest rate	1.21%	0.23%	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 nine months ended December 26, 2014 and the year ended March 31, 2014.

	Nine months Ended December 26, 2014	**Year Ended March 31, 2014**
Level 3 Warrants, beginning of period	$409,000	$292,000

Change in fair value of warrant liability	(231,000)	117,000
Level 3 Warrants, end of period	**$ 178,000**	**$ 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.

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:

Basic and Diluted	**Three months ended**	
	December 26, 2014	**December 27, 2013**
Weighted Average Basic Shares Outstanding	37,381,000	31,243,000
Dilutive effect of Stock Options and Warrants	--	--
Weighted Average Diluted Shares Outstanding	37,381,000	31,243,000
Net loss	$ (701,000)	$ (1,618,000)
Basic and Diluted loss per share	$ (0.02)	$ (0.05)

20

Table Of Contents

Basic and Diluted	Nine months ended December 26, 2014	December 27, 2013
Weighted Average Basic Shares Outstanding	35,860,000	31,223,000
Dilutive effect of Stock Options and Warrants	--	--
Weighted Average Diluted Shares Outstanding	35,860,000	31,223,000
Net loss	$(1,337,000)	$(3,121,000)
Basic and Diluted loss per share	$(0.04)	$(0.10)

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, and accounts payable) approximates the fair value based upon the short-term nature of these instruments. In the case of MEDC/MSF, PFG, and bank debt, the carrying value approximates fair value based upon prevailing interest rates available to the Company for debt of similar nature and maturity.

Note 9. Restructuring

During the quarter ended December 27, 2013, the Company made the decision to begin outsourcing the manufacturing of silicon photodiodes that are used in the Optosolutions production line to lower cost areas that were using larger production wafers. This opportunity became apparent with the acquisition and integration of the net assets of Silonex and we expect to save from $400,000 to $600,000 per year when fully implemented. To prepare for the transition, an inventory level was built up and the fabrication assets idled during the quarter ended December 27, 2013. API undertook a review of the alternative uses of the equipment and determined that an accelerated depreciation charge of approximately $608,000 was necessary in the quarter to state the net book value of the idled assets at amounts that could be obtained if the equipment was sold to independent third party buyers. Employees affected by the shutdown of this manufacturing activity were provided severance of approximately $59,000 of which $44,000 was accrued in the current quarter and $15,000 in the quarter ended September 27, 2013. The total restructuring costs of $652,000 and $667,000 are reflected in the cost of goods sold section of the Statement of Operations for the three months and nine months ended December 27, 2013.

21

Table Of Contents

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 communication test and measurement products (Comtest) 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/aerospace, and security markets.

We support our customers 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.

Pending Merger; Liquidity Concerns

On January 30, 2015, we entered into a merger agreement with Luna Innovations Incorporated (trading on NASDAQ under the symbol of LUNA) (“Luna) and API Merger Sub (“Merger Sub”) pursuant to which Merger Sub will merge with and into API and API will become a wholly-owned subsidiary of Luna ("the Merger"). On the effective time of the merger, the stockholders of API will receive 0.31782 of a share of Luna common stock for each share of API’s Class A common stock owned by them. The closing of the transaction is subject the approval of the shareholders of each of Luna and API and other customary closing conditions. We expect the transaction to close by late spring or early summer 2015. Prior to the closing, our liquidity is dependent on meeting bank covenants. The proposed merger is expected to provide API's shareholders the ability to realize the value added associated with a larger company and to execute the Company's growth plans over the near term.

Table Of Contents

The merger agreement may be terminated by either Luna or API in certain circumstances, including if the merger has not been consummated on or before August 31, 2015, if the approval of the stockholders of either Luna or API is not obtained and for certain breaches of representations and warranties. If the merger agreement is terminated in certain specified circumstances, API must pay Luna, or Luna must pay API, as applicable, a termination fee of $750,000. In addition, if the merger agreement is terminated following a meeting of the stockholders of Luna or API at which the adoption of the merger agreement and approval of the transactions contemplated thereby, or the approval of the issuance of shares of Luna Common Stock to existing API stockholders as consideration for the merger is not approved, then Luna or API, as applicable, will be required to pay an amount up to $250,000 in reimbursement of the other party's out-of-pocket expenses incurred in connection with the transaction.

Prior to the closing of the Merger, and absent such a closing, our near-term liquidity is dependent on us meeting our debt covenants- which we expect it to do based on our current forecasts. However, if the merger is not approved by stockholders or does not proceed in a timely closing and projected revenue increases do not occur as forecast, then we may need to seek additional funding sources to meet its our obligations which would include the alternatives of raising more capital, restructuring existing debt, or exploring strategic options which could include the sale of a portion or all of our product lines. There can be no assurances that additional capital, if needed, will be available to us or the terms under which capital would be available to us. If adequate financing is not available, or is not available on favorable terms, then our business, financial position and results of operations will be adversely affected.

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 judgments and estimates.

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.

Table Of Contents

We predominantly sell directly to original equipment manufacturers with a direct sales force with limited sales through representatives, value added resellers (VAR's) and distributors. Distributor and VAR sales represented approximately 19% of total revenue for the nine months ended December 26, 2014. Significant terms and conditions of distributor agreements include FOB source, net 30 days payment terms, with no return and limited exchange rights, and no price protection. Since the product transfers title to the distributor at the time of shipment by us, the products are not considered inventory on consignment.

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

Impairment of Long-Lived Assets

As of December 26, 2014 and March 31, 2014, our consolidated balance sheets included $4.6 million in goodwill. Goodwill represents the excess purchase price over amounts assigned to tangible or identifiable intangible assets acquired and liabilities assumed from our business acquisitions.

Goodwill and intangible assets that are not subject to amortization are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. 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.

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, the results in fiscal 2015 and the expected fair value of the upcoming merger with Luna Innovations Incorporated, 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 and the expected fair value of the upcoming merger with Luna, we have concluded that testing for impairment on our long lived assets was not necessary.

Deferred Tax Asset Valuation Allowance

We record deferred income taxes for the future tax consequences of events that were recognized in our financial statements or tax returns. We record a valuation allowance against deferred tax assets when, in management's judgment, it is more likely than not that the deferred income tax assets will not be realized in the foreseeable future. Consistent with the 2014 Form 10-K, we have continued a full valuation allowance on our net Deferred Tax Assets as of December 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 products sold.

Warrant Valuations

We have warrants outstanding exercisable into 1,462,196 shares of Series A Common Stock with an estimated fair value of $178,000 as of December 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**				**Nine months ended**			
	December 26, 2014		**December 27, 2013**		**December 26, 2014**		**December 27, 2013**	
Test and Measurement	$3,823	66 %	$5,191	70 %	$12,950	61 %	$14,311	65 %
Telecommunications	771	13 %	1,692	22 %	5,177	24 %	4,645	21 %
Military/Aerospace	905	16 %	439	6 %	2,381	11 %	2,196	10 %
Medical	306	5 %	128	2 %	749	4 %	912	4 %
Total Revenues	**$5,805**	**100 %**	**$7,450**	**100 %**	**$21,257**	**100 %**	**$22,064**	**100 %**

Table Of Contents

Our revenues for the quarter ended December 26, 2014 were $5.8 million, a decrease of 22% (or $1.6 million) from revenues of $7.4 million for the quarter ended December 27, 2013. On a year to date basis, our revenues were $21.3 million, a decrease of $807,000 or 4% from revenues of $22.1 million for the nine months ended December 27, 2013. Sequentially, revenues decreased 25% or $2.0 million from the quarter ended September 26, 2014. We experienced revenue increases in our Military/Aerospace and Medical markets for the quarter and revenue increases in the Military/Aerospace and Telecommunications markets for the nine months ending December 26, 2014 when compared to the prior year period.

The Test and Measurement market revenue was approximately $3.8 million and $13.0 million in the third quarter and first nine months of fiscal 2015, a decrease of $1.4 million over each of the related prior year periods. In the third quarter of fiscal 2015, Comtest customers significantly reduced their purchases relative to the last year comparable quarter and the second quarter of fiscal 2015 as major carriers pushed out capital spending in their infrastructures to direct some of the cash savings to finance significant merger and acquisition activity. These conditions appear to have also dampened the outlook for our quarter ending March 31, 2015.

Telecommunications revenues in the third quarter and nine months of fiscal 2015 were $771,000 and $5.2 million, respectively, a decrease of 54% from the prior year’s three months and an increase of 11% from the prior year’s nine month period. The lower three month revenue was primarily due to major carriers pushing out 100G capital spending in their infrastructures to direct some of the cash savings to finance significant merger and acquisition activity. From our second quarter of fiscal 2015 to the third quarter of fiscal 2015, we saw a $1.2 million drop in telecom sales mostly due to the timing of deliveries for 100G customers. We expect the 100G market to rebound starting late in our quarter ending March 31, 2015. These market conditions have caused us to lower our outlook for our quarter ending March 31, 2015 and as noted below, for the full year.

Military/Aerospace market revenues in the third quarter and first nine months of fiscal 2015 were $905,000 and $2.4 million respectively, an increase of 106% from the comparable prior year third quarter and a 8% increase over the prior year nine month activity. The third quarter improved by 9% over the second quarter of 2015. This is predominately due to long lived Optosolutions missile programs that have ramped up relative to prior periods.

Medical market revenues in the third quarter and first nine months of fiscal 2014 were $306,000, and $749,000 respectively, a $178,000 increase and a $163,000 decrease from the prior year periods. These fluctuations in revenue are mainly due to the timing of shipments related to one customer.

Given the pause in government spending experienced in the quarter that delayed expected Terahertz contract awards and the current capital spending approach of major carriers, we have revised our forecasted fiscal year 2015 revenues to be down by approximately 5% relative to the prior year. The proposed merger with Luna is expected to provide the liquidity needed for us to execute our growth plans over the next year.

26

Table Of Contents

Gross Profit

Gross profit for the third quarter of fiscal 2015 was $1.9 million similar to the third quarter of fiscal 2014 as the effect of the drop in volume in the current year's quarter was offset by the absence of $652,000 in restructuring costs incurred in last year's third quarter. Year to date gross profit was $7.4 million down from $7.6 million in the first nine months of fiscal 2014. The lower gross profit dollars has been driven by the decline in Terahertz contract revenue.

Gross profit percentage was 32% for the third quarter of fiscal 2015 compared to 25% in the third quarter of fiscal 2014 and 34% in the second quarter of fiscal 2015. The fiscal 2015 third quarter gross margin rate improved year over year given the absence of the silicon fabrication shutdown costs incurred in fiscal 2014 but declined sequentially given the large decline in HSOR volume in the quarter.

Operating Expenses

Total operating expenses for the quarter and first nine months of fiscal 2015 were $2.6 million and $8.5 million, a decrease of $624,000 and $1.5 million, respectively over the comparable fiscal 2014 periods. Total operating expenses for the third quarter of fiscal 2015 decreased by $321,000 when compared to the second quarter of fiscal 2015. Operating expenses in all categories have been trimmed to lower our breakeven point.

Research, Development and Engineering (RD&E) expenses decreased by $205,000 in the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014 given lower headcount and prototype part spend as we have completed several major projects. RD&E expenses decreased by $871,000 in the first nine months of fiscal 2015 relative to the first nine months of fiscal 2014 given lower headcount, prototype part spending and use of outside contractors on Terahertz development contracts.

Sales and Marketing (S&M) expenses decreased by $105,000 (or 16%) in the third quarter of fiscal 2015 compared to the prior year third quarter and decreased $185,000 (or 10%) in the first nine months of fiscal 2015 versus the same period in fiscal 2014. The decreases were primarily attributable to reduced headcount and commissions.

General and Administrative (G&A) expenses decreased $207,000 and $170,000 for the third quarter and first nine months of fiscal 2015 when compared to prior year periods. The decrease was primarily attributable to lower legal and personnel costs.

Amortization expense decreased $107,000 to $153,000 compared to the third quarter of fiscal 2014 expense of $260,000. For the first nine months of fiscal 2015 versus fiscal 2014, the amortization expense declined by $230,000. 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 $15,000 and $52,000 for the three and nine month period ended December 26, 2014 compared to $40,000 and $110,000 for the three and nine month period ended December 27, 2013 as stock awards have been limited over the past year.

Table Of Contents

Other Income (Expense), net

Interest expense in the third quarter and first nine months of fiscal 2015 was $124,000 and $434,000 respectively. This decrease of $29,000 and $44,000 in expense relative to prior year periods is due to the decrease in total debt as equity proceeds of $2.9 million received in June 2014 were used to pay down debt.

The fair value of the warrant liability discussed in Note 6 to the Condensed Consolidated Financial Statements 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 $140,000 for the current quarter and $231,000 for the nine months ended December 26, 2014 are attributed to the change in the warrant liability driven primarily by the change in the stock price at quarter end. This is in contrast to expense of $124,000 and $213,000 in the prior year quarter and year to date periods.

Net Loss

We realized a net loss for the third quarter of fiscal 2015 of $701,000 ($0.02 per share), as compared to a net loss of $1,618,000 ($0.05 per share) in the third quarter of fiscal 2014. Year to date we realized a net loss of $1,337,000 ($0.04 per share) in fiscal 2015 relative to a net loss of $3,121,000 ($0.10 per share) in fiscal 2014. The improvement is the result of, reduced operating expenses and favorable warrant liability adjustments for the comparable periods.

Fluctuation in Operating Results

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

Liquidity and Capital Resources

At December 26, 2014, we had cash and cash equivalents of $110,000, a decrease of $10,000 from the March 31, 2014 balance. The lower balance as of December 26, 2014, is attributable to cash used in operating activities of $1,197,000, cash used in investing activities of $348,000, and cash provided by financing activities of $1,535,000. Given the minimal cash on hand, we are dependent on our line of credit with SVB in order to maintain our liquidity and compliance with our debt covenants so that lenders do not demand payment on existing debt outstanding.

Table Of Contents

As of December 26, 2014, we were in compliance with the required liquidity and adjusted EBITDA covenant with our lenders, however we experienced a $2.1 million dollar reduction in HSOR revenues in the third quarter relative to the second quarter which was more than anticipated in November 2014 when we last reset our covenants with our major lenders. As a result, we sought and on February 5, 2015 obtained further covenant relief from our lenders by reducing the rolling six month adjusted EBITDA requirement for January through June 2015 to a negative $1,250,000, $1 of adjusted EBITDA required in July 2015 and $100,000 each month thereafter until maturity with up to $150,000 in transaction costs carved out of the calculation. The parties also agreed to reduce the minimum liquidity ratio to 1.30 to 1.00 from January 2015 until the maturity of each party's respective debt. The Company is required to pay in the aggregate $20,000 in fees plus associated legal costs for the amendments with an added $30,000 payable upon the maturity or payoff of the loans. Should the Company experience a reduction in revenue or an increase in expenses from its most recent forecast which was the basis of the February 5, 2015 covenants, the loan would be callable creating a liquidity issue.

Prior to the closing of the Merger, and absent such a closing, our near-term liquidity is dependent on us meeting our debt covenants- which we expect it to do based on our current forecasts. However, if the merger is not approved by stockholders or does not proceed in a timely closing and projected revenue increases do not occur as forecast, then we may need to seek additional funding sources to meet our obligations which would include the alternatives of raising more capital, restructuring existing debt, or exploring strategic options which could include the sale of a portion or all of our product lines. There can be no assurances that additional capital, if needed, will be available to us or the terms under which capital would be available to us. If adequate financing is not available, or is not available on favorable terms, then our business, financial position and results of operations will be adversely affected.

Operating Activities

The decrease of $1,197,000 in cash resulting from operating activities for the nine months ended December 26, 2014 was split between net cash used in operations of $422,000 and a use of net working capital of $775,000. The pause in revenue growth and the related drop in accounts payable in the current quarter explained much of the cash used for working capital. Cash used in operations of $422,000 resulted from the net loss of $1,337,000 less non-cash charges of $915,000 in depreciation, amortization, stock-based compensation and change in fair value of the warrant liability.

Investing Activities

For the nine months ended December 26, 2014, we used $348,000 in investing activities comprised of capital expenditures of $198,000, patent expenditures of $275,000 and $125,000 in proceeds from the sale of equipment.

Financing Activities

For the nine months ended December 26, 2014, approximately $1.5 million was provided by financing activities since we received net proceeds of $2.9 million from our placement of 6.2 million shares of Class A Common Stock in June

2014. This amount was offset by payments of principal on our loans with PFG, SVB and our capital lessors.

In summary, we funded operating losses of $.4 million, financed added working capital of $.8 million, spent $.3 million on patents and equipment and reduced term debt by $1.4 million with the $2.9 million in proceeds from our common stock placement.

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.

Table Of Contents

Purchase Commitments

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

Other Contractual Obligations

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

Recent Pronouncements and Accounting Changes

None.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

At December 26, 2014, most of our interest rate exposure is on our bank debt which is linked to the prime rate, subject to certain limitations, offset by cash which could be invested in short term instruments. As such, we are at risk to the extent of the spread between these two types of instruments. We do not believe that moderate changes in the prime rate will materially affect our operating results or financial condition.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

There was no change in our internal control over financial reporting that occurred during the quarter ended December 26, 2014 that has materially affected or is reasonably likely to materially affect our internal controls.

Table Of Contents

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

Table Of Contents

Item 6. Exhibits

The following documents are filed as Exhibits to this report:

Exhibit No.	
10.1	Tenth Amendment to Loan and Security Agreement entered into February 5, 2015 by and between Silicon Valley Bank, Advanced Photonix, Inc., Picometrix, LLC and Advanced Photonix Canada, Inc.
10.2	Eighth Amendment to Loan and Security Agreement (EX-IM Loan Facility) entered into as of February 5, 2 015 by and between Silicon Valley Bank, Advanced Photonix, Inc., Picometrix, LLC and Advanced Photonix Canada, Inc.
10.3	Modification No. 5 to Loan and Security Agreement executed as of February 5, 2015 by and among Partners For Growth III, L.P., Advanced Photonix, Inc. and Picometrix, LLC.
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

Table Of Contents

SIGNATURES

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

Advanced Photonix, Inc.

(Registrant)

February 9, 2015

/s/ Richard Kurtz

Richard Kurtz

Chief Executive Officer, President

and Director

/s/ Jeff Anderson

Jeff Anderson

Chief Financial Officer