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ADVANCED PHOTONIX INC
Form 10-K
June 24, 2005

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 27, 2005

OR

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

For the transition period from _____ to _____

Commission file number 1-11056

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

Delaware
(State or other jurisdiction of
incorporation or organization)

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

1240 Avenida Acaso, Camarillo, CA 93012
(Address of principal executive offices) (Zip Code)

(805) 987-0146
(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

Common Stock, \$.001 Par Value
Class A Common Stock

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in any definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

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Total revenues for registrant's fiscal year ended March 27, 2005 were \$14,802,761.

As of September 26, 2004, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$24,000,000.

As of June 17, 2005 there were 16,087,631 shares of Class A Common Stock and 31,691 shares of Class B Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting for 2005 are incorporated by reference in Part III.

PART I

ITEM 1. BUSINESS

GENERAL

Advanced Photonix, Inc.(R) (the "Company"), was incorporated under the laws of the State of Delaware in June 1988. The Company is engaged in the development and manufacture of custom optoelectronic solutions, serving a variety of global Original Equipment Manufacturer (OEM) markets. While the Company specializes in silicon-based custom photodiode assemblies, its product families range from custom light detection assemblies, including its patented Avalanche Photodiode technology, to light emitting diode (LED) assemblies. The Company supports the customer from the initial concept and design phase of the product, through to full-scale production and test. The Company has two manufacturing and wafer fabricating facilities; one in Camarillo, CA and one in Dodgeville, WI.

PRODUCTS & TECHNOLOGIES

The Company designs and manufactures silicon-based optoelectronic components and assemblies for a global OEM customer base. The core technology used in the majority of the Company's products is silicon-based photodiodes. Photodiodes sense light of varying wavelengths and intensity and convert that light into electrical signals. The Company manufactures photodiodes of varying complexity, from basic PIN (positive-intrinsic-negative) photodiodes to the more sophisticated avalanche photodiode (APD). The APD is a specialized silicon photodiode capable of detecting very low light levels due to an internal gain phenomenon known as avalanching. All devices are designed by the Company's experienced engineering staff, and fabricated in two state-of-the-art clean rooms. The Company's basic products and technologies include the following:

- o Silicon PIN photodetectors - spectrally enhanced, both single and multi-element
- o Silicon high resistivity p-type detectors
- o Silicon APDs - discrete, with and without thermoelectric coolers, and with integrated modules
- o Photodetector hybrids, which include signal amplification circuitry within the detector package
- o Custom LED assemblies and LED displays

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- o FILTRODE(R) - patented technology integrating optical filters directly on photodiode chips

MARKETS

These products serve customers in a variety of global markets, typically North America, Asia, Europe and Australia. The target markets and applications served by the Company are as follows:

Military & Aerospace:

- o Missile guidance
- o Laser range finders
- o Laser training systems
- o Heads-up displays
- o Satellite positioning

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Industrial & Commercial:

- o Optical encoders
- o Laboratory instrumentation
- o Baggage/Cargo scanners
- o Bar code scanners
- o Laser positioning systems

Medical:

- o Blood analysis, including pulse oximetry and glucometry
- o Bacteriology
- o Medical imaging

Automotive:

- o Laser detection
- o Adaptive cruise control
- o Automatic power windows
- o Drive-by-wire

Communications:

- o VCSEL monitor

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- o Pump laser monitor
- o Wireless communication

One of the key competitive advantages held by the Company is its ability to supply detector assemblies for high reliability (Hi-Rel) applications, including military and commercial aerospace. Hi-Rel devices are designed, manufactured and tested to function in severe environmental conditions. The Company has many years of experience in supplying Hi-Rel devices that demand modern wafer fabrication techniques, a dedicated assembly area, and a sophisticated test lab. These assembly and test capabilities meet several military approvals, including MIL-PRF-19500, MIL-STD-883 and MIL-STD-750. Hi-Rel products manufactured by the Company include:

- o Multi-element hybrid assemblies used on the U.S. Navy's Rolling Airframe Missile (RAM) developed by Raytheon
- o Narrow and wide field-of-view detectors used in Tube-launched Optically-tracked Wire-guided (TOW) missile tracking systems
- o LED arrays for use in thermal image displays in military night vision applications
- o Quadrant photodetectors used in the autocollimator for airborne navigation/FLIR (Forward Looking Infrared) pods and "smart bombs"
- o Opto assemblies for biological and blood analysis
- o Assemblies used in automotive distance control systems

RECENT DEVELOPMENTS

In March 2005, the Company formed a new subsidiary, Michigan Acquisition Sub, LLC ("Newco"), a Delaware limited liability company, for purposes of entering into an Agreement and Plan of Merger with Picotronix, Inc. (doing business as and referred to herein as "Picometrix"), a Michigan corporation, whereby Picometrix merged with and into Newco, with Newco being the surviving entity. The merger was completed in May 2005. The merger consideration was determined through arm's-length negotiations

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between the parties. (See Item 7. "Management's Discussion and Analysis of Financial Condition" and Results of Operations and Item 8. "Notes to the Consolidated Financial Statements" for more information on the transaction.)

RAW MATERIALS

The principal raw materials used by the Company in the manufacture of its semiconductor components and sensor assemblies are silicon wafers, chemicals and gases used in processing wafers, gold wire, lead frames, and a variety of packages and substrates, including metal, printed circuit board, flex circuits, ceramic and plastic packages. All of these raw materials can be obtained from several suppliers. From time to time, particularly during periods of increased industry-wide demand, silicon wafers and other materials have been in short supply. However, the Company has not been materially affected by such shortages. As is typical in the industry, the Company allows for a significant lead-time (2 months or greater) between order and delivery of raw materials.

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RESEARCH AND DEVELOPMENT

Since its inception in June 1988, the Company has incurred material research and development expenses, with the intent of commercializing these investments into profitable new standard and custom product offerings. During the fiscal years ended in 2005, 2004, and 2003, research and development expenses amounted to \$146,000, \$280,000, and \$511,000 respectively. The Company expects that continued research and development funding will be required for new projects as well as the continuing development of new derivatives of the Company's current product line, and for the commercialization of these products. The Company has in the past, and will continue to pursue customer funded, as well as internally funded, research and development projects when they are in support of the Company's development objectives.

During the last fiscal year, the Company shifted its primary research and development focus from overall APD development to those projects which have strong existing markets and can be transitioned to full commercialization in a relatively short period of time. As we begin the new fiscal year, the following research and development projects are currently underway:

- o APD performance enhancements - designed specifically for certain military and medical imaging applications
- o Silicon PIN photodiodes, which are being developed to meet unique customer requirements, such as higher speeds, lower electrical noise, and unique multi-element geometries.
- o Additional applications leveraging the Company's patented Filtrode(TM) family, integrating a variety of filters onto a detector chip
- o Position Sensitive Devices - the Company is broadening its offering of these devices with improved performance for industrial sensing markets

ENVIRONMENTAL REGULATIONS

The photonics industry, as well as the semiconductor industry in general, is subject to governmental regulations for the protection of the environment, including those relating to air and water quality, solid and hazardous waste handling, and the promotion of occupational safety. Various federal, state and local laws and regulations require that the Company maintain certain environmental permits. The Company believes that it

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has obtained all necessary environmental permits required to conduct its manufacturing processes. Changes in the aforementioned laws and regulations or the enactment of new laws, regulations or policies could require increases in operating costs and additional capital expenditures and could possibly entail delays or interruptions of operations.

BACKLOG AND CUSTOMERS

The Company's sales are made primarily pursuant to standard purchase orders for delivery of products. However, by industry practice, orders may be canceled or modified at any time. When a customer cancels an order, they are responsible for all finished goods, all costs, direct and indirect, incurred by the Company, as well as a reasonable allowance for anticipated profits. No assurance can be

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given that the Company will receive these amounts after cancellation. The current backlog contains only those orders for which the Company has received a confirmed purchase order and also includes contracts which have scheduled shipping dates beyond the upcoming fiscal year. As such, the current backlog represents only a portion of expected annual revenues for fiscal year 2006. The Company had approximately \$8.2 million in total backlog at the end of fiscal years 2005 and 2004.

Customers normally purchase the Company's products and incorporate them into products that they in turn sell in their own markets on an ongoing basis. As a result, the Company's sales are dependent upon the success of its customers' products and its future performance is dependent upon its success in finding new customers and receiving new orders from existing customers.

MARKETING

The Company markets its products in the United States and Canada through its own technical sales engineers and through independent sales representatives. International sales, including Europe, the Middle East and Pacific Rim, are conducted through foreign distributors (see Note 1 to the Financial Statements). The Company's products are primarily sold as components or assemblies to original equipment manufacturers (OEM's). The Company markets its products and capabilities through industry specific channels, both on the internet and in print through trade journals.

COMPETITION

The Company competes with a range of companies for the custom optoelectronic and silicon photodetector requirements of customers in its target markets. The Company believes that its principal competitors for sales of custom devices are small to medium size companies. Because the Company specializes in custom devices requiring a high degree of engineering expertise to meet the requirements of specific applications, it generally does not compete to any significant degree with other large United States, European or Pacific Rim manufacturers of standard "off the shelf" optoelectronic components or silicon photodetectors.

PROPRIETARY TECHNOLOGY

The Company utilizes proprietary design rules and processing steps in the development and fabrication of its PIN photodiodes and avalanche photodiodes. In addition, the Company owns the following patents:

US PATENT NO. -----	DESCRIPTION -----	DATE IS -----
6,111,299	Active Large Area Avalanche Photodiode Array	August
6,005,276	Solid State Photodetector with Light Responsive Rear Face	Decembe
5,801,430	Solid State Photodetector with Light Responsive Rear Face	Septemb
5,757,057	Large Area Avalanche Array	May 199

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5,477,075	Solid State Photodetector with Light Responsive Rear Face	December
5,311,044	Avalanche Photomultiplier Tube	May 199
5,146,296	Devices for Detecting and/or Imaging Single Photoelectron	September
5,057,892	Light Responsive Avalanche Diode	October
5,021,854	Silicon Avalanche Photodiode Array	June 19
4,782,382	High Quantum Efficiency Photodiode Devices	November
4,717,946	Thin Line Junction Photodiode	January

There can be no assurance that any issued patents will provide the Company with significant competitive advantages, or that challenges will not be instituted against the validity or enforceability of any patent owned by the Company, or, if instituted, that such challenges will not be successful. The cost of litigation to uphold the validity and to prevent the infringement of a patent could be substantial. Furthermore, there can be no assurance that the Company's APD technology will not infringe on patents or rights owned by others, licenses to which might not be available to the Company. Based on limited patent searches, contacts with others knowledgeable in the field of APD technology, and a review of the published materials, the Company believes that its competitors hold no patents, licenses or other rights to the APD technology which would preclude the Company from pursuing its intended operations.

In some cases, the Company may rely on trade secrets to protect its innovations. There can be no assurance that trade secrets will be established, that secrecy obligations will be honored or that others will not independently develop similar or superior technology. To the extent that consultants, key employees or other third parties apply technological information independently developed by them or by others to Company projects, disputes might arise as to the proprietary rights to such information which may not be resolved in favor of the Company.

EMPLOYEES

At June 17, 2005 (and subsequent to the merger with Picometrix) the Company had 156 employees, comprised of 147 full time employees (including 4 officers) and 9 part time employees. Included are 19 engineering and development personnel, 11 sales and marketing personnel, 111 operations personnel, and 15 general and administrative personnel (including 4 officers). The Company may, from time to time, engage personnel to perform consulting services and to perform research and development under third party funding. In certain cases, the cost of such personnel may be included in the direct cost of the contract rather than in payroll expense.

ITEM 2. PROPERTIES

The Company leases all of its executive offices, research, marketing and manufacturing facilities. At March 27, 2005, those leases consisted of primarily 45,000 square feet in two facilities. The facility located at 1240 Avenida Acaso in Camarillo, California is leased through February 2009. A second manufacturing

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facility is located at 305 County YZ, Dodgeville, Wisconsin, and is leased through November 2007. For a portion of the year, the Company also held a lease on the prior Photonic Detectors, Inc. facility in Simi Valley, California which was terminated effective April 30, 2005. The Company believes that its existing facilities are adequate to meet its needs for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's Class A Common Stock is traded on the American Stock Exchange (AMEX) under the symbol "API".

At June 17, 2005, the Company had 106 holders of record for the Class A Common Stock (including shares held in street name), representing approximately 6,000 beneficial owners of the Class A Common Stock. On the same date, there were 6 holders of record of the Class B Common Stock (none of which were held in street name).

The following table sets forth high and low closing prices by quarter for fiscal years 2005 and 2004.

	Quarterly Stock Market Data					
	1st Quarter		2nd Quarter		3rd Quarter	
	2005	2004	2005	2004	2005	2004
Common Stock(1)						
High	3.21	1.05	2.57	1.89	1.85	2.51
Low	2.02	.87	1.65	.88	1.57	1.37

(1) Price ranges on the American Stock Exchange

The Company has never paid any cash dividends on its capital stock. The Company intends to retain earnings, if any, for use in its business and does not anticipate that any funds will be available for the payment of cash dividends on its outstanding shares in the foreseeable future. The holders of Common Stock will not be entitled to receive dividends in any year until the holders of the Class A Redeemable Convertible Preferred Stock receive an annual non-cumulative dividend preference of \$.072 per share. To date, a total of 740,000 shares of Class A Redeemable Convertible Preferred Stock have been converted into 222,000 shares of Class

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A Common Stock, leaving outstanding 40,000 shares of Class A Redeemable Convertible Preferred Stock. The aggregate non-cumulative annual dividend preference of such Class A Redeemable Convertible Preferred Stock is \$2,880. There is no public market for the Company's Class A Redeemable Convertible Preferred Stock or Class B Common Stock; however, such stock is convertible into Class A Common Stock at the option of the holder and upon transfer by the holder of the Class A Redeemable Convertible Preferred Stock.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data for each of the five years presented below is derived from our audited consolidated financial statements and should be read in conjunction with the consolidated financial statements, the notes to the consolidated financial statements, and "Management's Discussion and Analysis of Financial Condition and Results of Operations", all of which are contained in this report on Form 10-K.

	(in thousands, except per share data)			
	2005	2004	2003	2002
Net Sales	\$ 14,803	\$ 12,401	\$ 9,147	\$ 6,931
Gross Profit	\$ 4,732	\$ 4,297	\$ 2,699	\$ 2,761
as a percentage of Sales	32%	35%	30%	40%
Net Income (Loss) from Continuing Operations	\$ 5,254	\$ 794	\$ (803)	\$ (284)
Earnings (Loss) Per Common Share - Basic	\$ 0.39	\$ 0.06	\$ (0.06)	\$ (0.02)
Earnings (Loss) Per Common Share - Diluted	\$ 0.34	\$ 0.06	\$ (0.06)	\$ (0.02)
Weighted Average Common Shares Outstanding	13,461	13,400	12,356	12,209
Total Assets	\$ 23,355	\$ 12,574	\$ 11,552	\$ 9,255
Current Liabilities	\$ 3,185	\$ 2,858	\$ 2,640	\$ 612
Long Term Liabilities	\$ 4,861	\$ 11	\$ 22	\$ --
Class A Redeemable Convertible Preferred Stock	\$ 32	\$ 32	\$ 32	\$ 32
Shareholders' Equity	\$ 15,277	\$ 9,673	\$ 8,858	\$ 8,611
Working Capital	\$ 11,261	\$ 5,802	\$ 4,811	\$ 7,461
Dividends declared on Capital Stock	\$ --	\$ --	\$ --	\$ --

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

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. Management uses historical experience and all available information to make these estimates and judgments, although differing amounts could be reported if there are changes in the assumptions and estimates. Estimates are used for, but not limited to, the accounting for the allowance for doubtful accounts, inventory allowances, impairment costs, depreciation and amortization, warranty

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costs, taxes and contingencies. Management has identified the following accounting policies as critical to an understanding of our financial statements and/or as areas most dependent on management's judgment and estimates.

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REVENUE RECOGNITION

In accordance with Staff Accounting Bulletin No. 104, we recognize revenue from the sale of products when the products are shipped to the customer. Revenues from the sale of services consist of non-recurring engineering charges, which are recognized when the services have been rendered. Historically, sales returns have amounted to less than 1% of net income and all sales are recorded net of sales returns and discounts.

IMPAIRMENT OF LONG-LIVED ASSETS

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

DEFERRED TAX ASSET VALUATION ALLOWANCE

We record a deferred tax asset in jurisdictions where we generate a loss for income tax purposes. For all years prior to fiscal 2005, due to our history of operating losses, we had recorded a full valuation allowance against these deferred tax assets in accordance with SFAS 109, "Accounting for Income Taxes," because, in management's judgment, the deferred tax assets would not be realized in the foreseeable future. In fiscal years 2004 and 2005, the Company returned to a position of continued profitability. Based on recent profit history and on anticipated future profits resulting from the Company's acquisition and merger with Picometrix, Inc. in May 2005, we reversed a portion of the valuation allowance for the year ended March 27, 2005, because, in our estimation, we believe that at least 50% of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible, and no assurance can be given that the Company will, in fact, generate future taxable income in amounts sufficient to fully realize the asset. We have considered the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making our assessment. The deferred tax assets are evaluated annually and the valuation allowance may be adjusted again in the future years if it is determined that any additional portion of the assets will or will not be realized.

INVENTORIES

Our inventories are stated at standard cost (which approximates the first-in, first-out method) or market. Slow moving and obsolete inventories are analyzed

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quarterly. To calculate a reserve for obsolescence, we begin with a review of our slow moving inventory. Any inventory which has not moved within the past 24 months is reserved for at 100% of book value; inventory which has not moved within the past 12 months is reserved for at 40%. The percentages applied to the reserve calculation are based on historical usage analyses. In addition, any residual inventory which is customer specific and remaining on hand at the time of contract completion is reserved for at the standard unit cost. 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 reserved for. Additionally, non-cancelable open purchase orders for parts we are obligated to purchase where demand has been reduced may be reserved. Reserves for open purchase orders where the market price is lower than the purchase order price are also established. If a product which had previously been reserved for is subsequently sold, the amount of reserve specific to that item is then reversed.

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ACCOUNTS RECEIVABLE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

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

TABLE OF CONTRACTUAL OBLIGATIONS

The following table sets forth the contractual obligations of the Company at March 27, 2005.

CONTRACTUAL OBLIGATIONS	PAYMENTS DUE BY PERIOD			
	Total	Less than 1 year	1 - 3 years	3 - 5 years
Long-term debt	5,000,000	--	5,000,000	--
Capital lease obligations	13,000	11,000	2,000	--
Operating lease obligations	1,488,000	434,000	1,054,000	--
Purchase Obligations	875,000	875,000	--	--
Other long-term liabilities reflected on the registrant's balance sheet under GAAP	--	--	--	--
Total	7,376,000	1,320,000	6,056,000	--

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RESULTS OF OPERATIONS

FISCAL YEAR 2005 COMPARED TO FISCAL YEAR 2004

REVENUES

The Company's revenues for the fiscal year ended March 27, 2005 (2005) were \$14.8 million, an increase of \$2.4 million, or 19% from revenues of \$12.4 million for the fiscal year ended March 28, 2004 (2004).

Approximately \$500,000 of the increase was attributable to revenues from Photonic Detectors, Inc. (PDI), which the Company acquired in December 2004. The remaining increase reflects an overall increase in shipments to customers in each of the Company's major market segments over the prior year. As has been the trend for most of the current fiscal year, the most significant revenue increases are coming from the medical and industrial sensing segments, which increased by 34% and 17% respectively over the prior year and account for \$1.5 million of the total increase. Similarly, sales to the military aerospace and automotive

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markets have also increased, by 5% and 17% respectively, and account for approximately \$400,000 of the remaining increase in net revenues. Stated as a percentage of net revenues, sales to the industrial sensing markets represent 44%, sales to the military aerospace markets represent 33%, medical is 17% and automotive is 5%.

As expected, the increased diversification and larger customer base achieved through the Company's previous acquisitions resulted in net revenues which fully met our expectations for the most recent fiscal year. During the upcoming year, we expect to see continued revenue growth in our core silicon business, as well as a significant revenue increase resulting from our acquisition of Picometrix, Inc. which occurred in May 2005. As such, in fiscal 2006, we expect total revenues to increase by 65%-85% over fiscal 2005.

COSTS AND EXPENSES

Cost of product sales increased to \$10.1 million in 2005 from \$8.1 million in 2004. Stated as percent of net sales, cost of product sales increased 3 percentage points to 68%, reducing our gross profit margin to 32% in 2005 as compared to 35% in fiscal year 2004. The reduction in gross margin is primarily attributable to manufacturing issues, including labor inefficiencies and a significant increase in material costs related to scrap, rework and assembly yields. Stated as a percentage of net sales, material costs rose to 28% in 2005 as compared to 25% in 2004. In 2005, we were again faced with heightened competitiveness in certain markets which caused us to absorb increases in certain material costs while maintaining or reducing existing pricing in our efforts to generate new business as well as retain existing business. Direct labor and other overhead expenses as a percentage of net sales remained flat at 8% and 32%, respectively, in 2005 as compared to 2004. While our gross margins fell slightly short of our expectations for 2005, we are continually seeking ways to improve our cost and margin structure, and have made margin improvement a continued priority for 2006.

Research and development (R&D) costs decreased by \$134,000 (48%) to \$146,000 during 2005 compared to \$280,000 in 2004. R & D costs decreased significantly

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over the past two years as we concentrated our efforts on projects offering the highest commercial potential per each dollar spent. We expect that R&D expenses will increase significantly in the upcoming fiscal year, as we focus on new opportunities brought to us as a result of the Picometrix acquisition.

Marketing and sales expenses increased by \$205,000 (20%) to \$1.2 million in 2005. Planned additions to the sales department staff during the year accounted for \$113,000 of increased salary, travel and related expenses. In addition, increased sales contributed to a \$68,000 increase in commission expense and overall advertising and marketing expenses increased by approximately \$24,000. We remain committed to insuring that our customers receive excellent service. To that end, we will continue to build our sales department and anticipate further increases in salary, commissions, travel and related expenses during fiscal 2006, as we plan for the successful integration of the Picometrix business.

Total general and administrative expenses increased by \$541,000 (25%) to \$2.7 million in 2005 as compared to \$2.2 million in 2003. Approximately 50% of the increase in general and administrative expenses is due to increased personnel and related expenses, including salaries, bonuses and benefits to support our growth objectives. In addition, total payroll was increased during the fourth quarter of fiscal 2005 as a direct result of the PDI acquisition, which was consummated on December 21, 2004. As part of our integration plan, selected PDI personnel were either offered a permanent position or requested to remain as an employee until a date specified by the Company. The net effect of the additional PDI personnel accounted for approximately \$160,000 of the year to date increase. The remaining increases in general and administrative expenses were primarily due to acquisition investigation and related expenses, including consultants, legal, financing and other related expenses, which amounted to approximately \$246,000 in total. In the upcoming year, general

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and administrative expenses will increase as needed to provide the infrastructure necessary to support the Company's growth objectives

Interest income for 2005 totaled \$43,000, an increase of \$23,000 over 2004, due primarily to capital financing activities which resulted in higher cash balances available for short-term investment. Interest expense for the year was \$154,000 as compared to \$30,000 in 2004, also a result of capital financing activities and the related interest liabilities.

At March 27, 2005, the Company reversed 50% of its deferred tax valuation allowance, in the amount of \$4,749,000. The deferred tax valuation allowance had previously been recorded at full value against its deferred tax assets, reducing the net value of the asset to zero. With the acquisition of both Photonic Detectors Inc. in December 2004 and Picometrix, Inc. in May 2005, the Company's management has projected that the Company will generate sufficient future taxable income to utilize at least a portion of its accumulated NOL's before they expire and has accordingly reduced the deferred tax asset valuation allowance to \$4.7 million against a deferred tax asset of \$9.5 million, bringing the net value of the deferred tax asset to \$4.7 million at March 27, 2005. The reduction in the valuation allowance has been recorded as a deferred tax benefit in the statement of operations.

Net income for fiscal year 2005 was \$5.3 million, including the \$4.7 million adjustment made to reduce the deferred tax valuation allowance, as compared to \$794,000 in 2004. Total acquisition-related expenses for fiscal year 2005 which were necessary to support our growth objectives amounted to \$560,000 (which

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includes interest expense of \$154,000, plus the \$406,000 increased general and administrative expenses associated with PDI and other acquisition investigation activities, as noted above). Thus, excluding the net impact of the deferred tax asset adjustment and acquisition-related expenses, net income for fiscal 2005 would have been \$1.1 million, or \$0.08 per share.

FISCAL YEAR 2004 COMPARED TO FISCAL YEAR 2003

REVENUES

The Company's revenues for the fiscal year ended March 28, 2004 (2004) were \$12.401 million, an increase of \$3.254 million, or 36%, from revenues of \$9.147 million for the fiscal year ended March 30, 2003 (2003).

The increase was primarily attributable to the Company's acquisitions of Silicon Sensors, Inc. and Texas Optoelectronics, Inc., both of which occurred during fiscal 2003. The increase in net product sales reflects significant increases in shipments to customers in each of the Company's major market segments, the most notable coming from the military/aerospace segments, which increased 41% over the prior year and represent 37% of total revenues, or \$4.64 million. Similarly, sales to the industrial sensing segments increased 28% over the prior year and represent 41% of total revenues, or \$5.13 million. Sales to the medical markets, representing 15% of total revenues, increased 22% to \$1.86 million, and sales to the automotive segment, which are directly attributable to the Texas Optoelectronics, Inc. acquisition, increased to \$717,000 and represent 6% of total revenues, as compared to \$203,000 representing 2% of total revenues in fiscal year 2003.

Revenues fell somewhat short of expectations because of changes in customer delivery schedules and other manufacturing issues. Nonetheless, we are pleased with the market stability and increased diversification that has been achieved as a result of our acquisitions and consolidation of the three companies.

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COSTS AND EXPENSES

Cost of product sales increased to \$8.10 million in 2004 from \$6.45 million in 2003. Stated as percent of net sales, cost of product sales decreased 5 percentage points to 65%, bringing gross profit margin to 35% in 2004 as compared to 30% in fiscal year 2003. The improvement in gross margin is primarily attributable to a reduction in material costs which decreased to 25% as compared to 30% in the prior year. In addition, margins benefited from the consolidation of the Company's acquired businesses and steps taken by the Company to maximize production efficiencies between its two facilities, including load and inventory sharing, inventory reduction plans, and other cost management techniques. Direct labor as a percentage of net sales remained relatively flat at 8% in 2004 as compared to 7% in 2003, as did other fixed and variable overhead expenses, which amounted to 32% for 2004 compared to 33% in 2003. The Company continually seeks ways to improve gross margin, and expects that the current margin of 35% is indicative of what can be expected in the future, given the current operational structure.

Research and development (R&D) costs decreased by \$231,000 (45%) to \$280,000 during 2004 compared to \$511,000 in 2003. R & D costs have fluctuated significantly over the past two years as we have restructured and refocused our efforts. During 2004, the Company discontinued projects which did not have a clearly identified customer demand in our current market segments. We expect R&D

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expenditures for fiscal year 2005 to be slightly higher than in 2004.

Marketing and sales expenses decreased slightly, by \$59,000 (5%) to \$1.026 million in 2004. During 2004, the Company focused on bringing more sales and marketing functions in-house and improving the effectiveness and utilization of its internal sales force, thereby decreasing the use of outside sales representatives and advertising/marketing services. As a result, decreases in bad debt expense (\$78,000) and advertising and marketing expenses (\$40,000) were offset by increases in travel, salary and benefit expenses. To insure that we can continue to provide excellent service to our consolidated customer base, we will continue to build our sales department and expect that marketing and sales expenses will increase in 2005, due primarily to planned additions to the sales department staff.

Total general and administrative expenses increased by \$174,000 (9%) to \$2.148 million in 2004 as compared to \$1.974 million in 2003. The net increase in general and administrative expenses is primarily due to increased software support and travel costs, representing approximately \$105,000. In addition, the Company posted increased consultant and non-compete expenses of \$40,000 as well as an increase to its Directors & Officers liability insurance of \$24,000. General and administrative expenses are expected to increase in fiscal year 2005, due to the addition of an in-house information technology specialist and the continued strengthening of the administrative infrastructure necessary to support the Company's growth.

Interest income for 2004 totaled \$20,000, a decrease of \$50,000 over 2003. Interest expense for the year was \$30,000 as compared to \$13,000 in 2004. The decrease in interest income is primarily due to consistently low interest rates available throughout the past year and the increase in interest expense is due to obligations assumed through the acquisition of Texas Optoelectronics, Inc. as well as expenses associated with the Company's secured line of credit. In addition, the Company reported a \$40,000 net loss on sale of fixed assets, due primarily to the disposal or sale of select assets acquired from Texas Optoelectronics, Inc. for which the Company had no useful application.

Net income for fiscal year 2004 was \$794,000, an improvement of \$1.597 million, or 199%, over the net loss of (\$803,000) reported in 2003.

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LIQUIDITY AND CAPITAL RESOURCES

On December 21, 2004, the Company purchased the business and all of the outstanding stock of Photonic Detectors, Inc., a privately owned manufacturer of optoelectronic components and assemblies, located in Simi Valley, California. In connection with the transaction, the Company acquired certain net assets, including \$44,000 cash, and assumed certain outstanding liabilities of Photonic Detectors, Inc. \$1,073,000 net cash was expended for the transaction, which included the agreed purchase price of \$1,075,000, plus additional expenses incurred of \$42,000, less the \$44,000 cash received.

In addition, in March 2005, approximately \$4.2 million was used to fund a pre-acquisition loan made to Picometrix, Inc. The loan was contributed to the capital of the newly formed limited liability company upon closing of the acquisition and merger transaction on May 2, 2005 (see Note 13 to the Consolidated Financial Statements for information concerning additional debt incurred by the Company in connection with the Picometrix acquisition).

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In July 2004, the Company established a revolving line of credit with a regional bank which provides for borrowings up to \$3,000,000, based on 80% of the Company's eligible accounts receivable and 40% of the Company's eligible inventory, subject to certain limitations as defined by the agreement. At March 27, 2005, the outstanding balance on the line was \$1.0 million. The line is secured by all business assets of the Company. Repayment is interest only, monthly, with principal due at maturity, July 20, 2005. Interest is computed at the Wall Street Journal Prime plus 1.00% which was 6.00% at March 27, 2005 (see Note 6 to the Consolidated Financial Statements).

At March 27, 2005, the Company had cash and cash equivalents of \$1.5 million and working capital of \$11.3 million. The Company's cash and cash equivalents increased by \$204,000 during the twelve months ended March 27, 2005, including \$1.7 million transferred from short-term investments into cash. \$5.0 million was obtained through private placement of a convertible note, of which \$1.25 million remained in a restricted cash collateral account subject to release upon satisfaction of certain conditions (which conditions were subsequently met) (see Note 7 to the Consolidated Financial Statements for further information concerning this debt), and the balance was available for working capital and other requirements. Cash provided by operating activities totaled \$228,000, which was net of significant outlays for inventories and prepaid capital finance expenses. \$30,000 was derived through net increases in accounts payable, accrued expenses, and customer deposit liabilities. \$193,000 was used for capital expenditures required primarily for necessary computer and manufacturing equipment upgrades or replacements.

The Company is exposed to interest rate risk for marketable securities. Due to anticipated cash needs during the year, the Company held funds in highly liquid income and money fund accounts, considered to be cash equivalents, which carried an average interest rate of 1.3%. At March 27, 2005, the Company did not hold any funds in either short-term or long term investment accounts. We continually monitor interest rates and will attempt to utilize the best possible avenues of investment as excess cash becomes available.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At March 27, 2005, all of our interest rate exposure is linked to the prime rate, subject to certain limitations. As such, we are at risk to the extent of changes in the prime rate and do not believe that moderate changes in the prime rate will materially affect our operating results or financial condition.

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FORWARD LOOKING STATEMENTS

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

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements of Advanced Photonix, Inc. are included in Item 8:

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM.

FINANCIAL STATEMENTS:

Consolidated Balance Sheet,
at March 27, 2005 and March 28, 2004

Consolidated Statements of Operations
for the Years Ended March 27, 2005, March 28, 2004
and March 30, 2003

Consolidated Statements of Shareholders' Equity
for the Years Ended March 27, 2005, March 28, 2004 and
March 30, 2003

Consolidated Statements of Cash Flows
for the Years Ended March 27, 2005, March 28, 2004 and
March 30, 2003

Notes to Consolidated Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
of Advanced Photonix, Inc.:

We have audited the accompanying consolidated balance sheets of Advanced Photonix, Inc. (the "Company") as of March 27, 2005 and March 28, 2004 and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years ended March 27, 2005, March 28, 2004 and March 30, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the Standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the

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consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company at March 27, 2005 and March 28, 2004 and the results of its operations and its cash flows for the years ended March 27, 2005, March 28, 2004 and March 30, 2003 in conformity with accounting principles generally accepted in the United States.

/s/ Farber & Hass LLP
May 27, 2005

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ADVANCED PHOTONIX, INC.
CONSOLIDATED BALANCE SHEET

	March 27, 2005	March 28, 2004
	-----	-----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,503,000	\$ 1,254,000
Restricted cash	1,254,000	--
Investments	--	--
Accounts receivable, less allowance of \$24,000 in 2005 and \$56,000 in 2004	2,610,000	4,228,000
Note receivable from Picometrix, Inc.	4,228,000	3,644,000
Inventories, less allowance of \$1,032,000 in 2005 and \$925,000 in 2004	3,644,000	644,000
Deferred tax asset, current portion	644,000	563,000
Prepaid expenses and other current assets	563,000	-----
Total current assets	14,446,000	-----
EQUIPMENT AND LEASEHOLD IMPROVEMENTS, at cost	5,118,000	(3,719,000)
Less accumulated depreciation and amortization	(3,719,000)	-----
Equipment and leasehold improvements, net	1,399,000	-----
OTHER ASSETS:		

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Deferred tax asset, net of current portion and valuation allowance of \$4,749,000	4,105,000	
Goodwill, net of accumulated amortization of \$353,000	2,421,000	
Patents, net of accumulated amortization of \$51,000 in 2005 and \$47,000 in 2004	13,000	
Non-compete agreement, net of current portion and accumulated amortization of \$150,000 in 2005 and \$119,000 in 2004	--	
Prepaid capital finance expenses, net of current portion and accumulated amortization of \$83,000 in 2005	315,000	
Customer list of acquired company, net of current portion and accumulated amortization of \$32,000 in 2005	481,000	
Security deposits and other assets	175,000	
	-----	-----
Total other assets	7,510,000	
	-----	-----
TOTAL ASSETS	\$ 23,355,000	\$
	=====	=====

(Continued)

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ADVANCED PHOTONIX, INC.
CONSOLIDATED BALANCE SHEET - CONTINUED

	March 27, 2005

LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Line of Credit	\$ 1,000,000
Accounts payable	1,053,000
Accrued salaries, wages and benefits	529,000
Current portion of capital lease payable	11,000
Customer deposits	271,000
Other accrued expenses	321,000

Total current liabilities	3,185,000

LONG TERM DEBT:	
Convertible note payable, net of discount of \$141,000	4,859,000
Capital lease payable, net of current portion	2,000

Total long term debt	4,861,000

COMMITMENTS AND CONTINGENCIES:	
Class A Redeemable Convertible Preferred Stock, \$.001 par value; 780,000 shares authorized; 2005 and 2004 - 40,000 shares issued and outstanding; liquidation preference \$25,000	32,000

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SHAREHOLDERS' EQUITY:

Preferred stock, \$.001 par value; 10,000,000 shares authorized; 780,000 shares designated Class A redeemable convertible;
 2005 and 2004 - no shares issued and outstanding
 Class A common stock, \$.001 par value; 50,000,000 shares authorized; 5,780,191 shares reserved for future issuance
 2005 - 13,512,631 shares issued and outstanding
 2004 - 13,397,059 shares issued and outstanding
 Class B common stock, \$.001 par value; 4,420,113 shares authorized;
 2005 and 2004 - 31,691 shares issued and outstanding
 Additional paid-in capital
 Accumulated deficit

Total shareholders' equity

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

 -
 13,000
 -
 27,995,000
 (12,731,000)

 15,277,000

 \$ 23,355,000
 =====

See notes to consolidated financial statements.

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ADVANCED PHOTONIX, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED MARCH 27, 2005 AND MARCH 28, 2004 AND MARCH 30, 2003

	2005	2004
	-----	-----
SALES	14,803,000	12,401,000
COST OF GOODS SOLD	10,071,000	8,104,000
	-----	-----
GROSS PROFIT	4,732,000	4,297,000
RESEARCH AND DEVELOPMENT EXPENSES	146,000	280,000
SELLING, GENERAL AND ADMINISTRATIVE EXPENSE	3,920,000	3,174,000
	-----	-----
INCOME (LOSS) FROM OPERATIONS	666,000	843,000
OTHER INCOME (EXPENSE)		
Interest income	43,000	20,000
Interest expense	(154,000)	(30,000)
Other, net	(35,000)	(34,000)
	-----	-----
TOTAL OTHER INCOME (EXPENSE)	(146,000)	(44,000)
INCOME (LOSS) BEFORE PROVISION (BENEFIT) FOR INCOME TAXES	520,000	799,000
PROVISION (BENEFIT) FOR INCOME TAXES		

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Provision (benefit) for income taxes - current	18,000	12,000
Provision (benefit) for income taxes - deferred	(4,752,000)	(7,000)
	-----	-----
TOTAL PROVISION (BENEFIT) FOR INCOME TAXES	(4,734,000)	5,000
	-----	-----
NET INCOME (LOSS)	5,254,000	794,000
	=====	=====
BASIC EARNINGS (LOSS) PER SHARE	.39	.0
DILUTED EARNINGS (LOSS) PER SHARE	.34	.0
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	13,461,000	13,400,000

See notes to consolidated financial statements.

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ADVANCED PHOTONIX, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For each of the three years in the period ended March 27, 2005	Class A Common Stock		Class B Common Stock		Additional Paid-in Capital
	Shares	Amount	Shares	Amount	

BALANCE AT					
MARCH 31, 2002	12,211,648	\$ 12,000	31,691	\$ --	\$ 26,576,000
Options issued to acquire SSI (below market price)	--	--	--	--	5,000
Exercise of Options	98,500	--	--	--	71,000
Shares issued to acquire TOI assets	1,059,110	1,000	--	--	973,000
Net loss	--	--	--	--	--

BALANCE AT					
MARCH 30, 2003	13,369,258	13,000	31,691	--	27,625,000
Exercise of Options	77,801	--	--	--	67,000
Return of shares issued to acquire TOI assets (Final settlement of shares held in escrow)	(50,000)	--	--	--	(46,000)
Net Income	--	--	--	--	--

BALANCE AT					
MARCH 28, 2004	13,397,059	13,000	31,691	--	27,646,000
Exercise of Options	2,000	--	--	--	1,000
Discount on note payable (fair value of detachable					

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warrants issued)	--	--	--	--	141,000
Shares issued to					
acquire PDI	113,572	--	--	--	207,000
Net Income	--	--	--	--	--

BALANCE AT					
MARCH 27, 2005	13,512,631	\$ 13,000	31,691	\$ --	\$ 27,995,000
=====					

See notes to consolidated financial statements.

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ADVANCED PHOTONIX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

For each of the three years in the period ended March 27, 2005	2005	2004

CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 5,254,000	\$ 794,000
Adjustment to reconcile net income (loss) to net cash provided by (used by) operating activities		
Depreciation	369,000	328,000
Amortization	198,000	78,000
Disposal of fixed assets	56,000	39,000
Provision for doubtful accounts	0	(36,000)
Provision for obsolete inventory	0	70,000
Provision for warranty expense	15,000	
Decrease in deferred tax valuation allowance	(4,749,000)	
Changes in operating assets and liabilities:		
Accounts receivable	71,000	(176,000)
Inventories	(291,000)	307,000
Prepaid expenses and other current assets	(193,000)	27,000
Prepaid acquisition costs	(134,000)	(17,000)
Prepaid capital finance expenses	(398,000)	--
Other assets	--	--
Accounts payable	428,000	(73,000)
Customer deposit liability	(477,000)	--
Accrued expenses	79,000	(125,000)
	-----	-----
Net cash provided by operating activities	228,000	1,216,000
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(193,000)	(298,000)
Short term investments	1,700,000	(300,000)
Increase in restricted cash	(1,254,000)	--
Cash acquired through acquisition of Photonic Detectors, Inc.	44,000	--
Purchase of outstanding shares of Photonic Detectors, Inc. common stock	(1,117,000)	--
Loan to Picometrix, Inc.	(4,228,000)	--

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Intangible assets acquired	--	(10,000)
Purchase of selected net assets of Silicon Sensors, LLC	--	--
	-----	-----
Net cash used by investing activities	(5,048,000)	(608,000)
	-----	-----

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ADVANCED PHOTONIX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

For each of the three years in the period ended March 27, 2005	2005	2004
-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of Photonic Detectors, Inc. line of credit	(78,000)	--
Advanced Photonix, Inc. secured line of credit	(900,000)	(300,000)
Advanced Photonix, Inc. revolving line of credit (asset-based)	1,000,000	--
Proceeds from private placement of convertible note	5,000,000	--
Proceeds from sale of fixed assets	--	23,000
Proceeds from issuance of stock options	--	--
Proceeds from exercise of stock options	2,000	66,000
	-----	-----
Net cash provided by (used by) financing activities	5,024,000	(211,000)
	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	204,000	397,000
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	1,299,000	902,000
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 1,503,000	\$ 1,299,000
	=====	=====

SUPPLEMENTAL DISCLOSURE OF CASH FLOW
INFORMATION:

	2005	2004
	-----	-----
Cash paid for interest	\$ 153,000	\$ 30,000
Cash paid for income taxes	\$ 19,000	\$ 5,000

In October 2004 the Company issued \$5,000,000 in secured debt to be used for future acquisition. In conjunction with that debt, the Company issued warrants convertible into 850,822 shares of the Company's common stock. The warrants issued were adjusted to present value. The adjustment was \$141,000 to additional paid-in capital.

In January 2003, the Company purchased all of the issued and outstanding shares of common stock of Texas Optoelectronics Inc. (see Note 2). In connection with the purchase, the Company incurred a secured debt of \$1,200,000 with an investment brokerage company, of which \$300,000 was repaid during fiscal year 2004. At March 28, 2004, the outstanding balance of the secured debt was

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\$900,000, the balance of which was repaid during fiscal 2005. On July 21, 2004, the Company entered into an asset-based revolving line of credit for up to \$3 million with a local financial institution to support working capital requirements, capital investments and potential investigation and integration costs related to future acquisitions. At March 27, 2005 the outstanding balance on the revolving line of credit was \$1 million.

See notes to consolidated financial statements.

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ADVANCED PHOTONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BUSINESS DESCRIPTION - Advanced Photonix, Inc. (the Company or API), is engaged in the development and manufacture of optoelectronic semiconductor based components, hybrid assemblies and other proprietary solid state light and radiation detection devices, including proprietary advanced solid state silicon photodetection devices which utilize Avalanche Photodiode (APD) technology. API is located in Camarillo, California.

The Company's wholly-owned subsidiary, Silicon Sensor, Inc. (SSI) (see Note 2 - Acquisitions), manufactures silicon photodiodes and optoelectronic devices in a manufacturing facility in Dodgeville, Wisconsin.

The Company's wholly-owned subsidiary, Texas Optoelectronics, Inc. (TOI) (see Note 2 - Acquisitions), manufactured optoelectronic devices in a facility in Garland, Texas. The Company shut down the Garland facility in May 2003 and relocated the TOI assets to the Company's facilities in Dodgeville, Wisconsin and Camarillo, California.

In December 2004 the Company acquired all of the outstanding shares of Photonic Detectors, Inc. (PDI) (see Note 2 - Acquisitions), PDI manufactured optoelectronic devices in a facility in Simi Valley, California. The acquired facility was shut down in March 2005 and all assets were merged into the operations in Dodgeville, Wisconsin and Camarillo, California.

PRINCIPLES OF CONSOLIDATION - The consolidated financial statements include the financial statements of the Company and its wholly-owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

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

FISCAL YEAR-END - The Company's fiscal year ends on the last Sunday in March. Fiscal years in the three-year period ended March 27, 2005 contain fifty-two weeks each.

OPERATING SEGMENT INFORMATION - The Company predominantly operates in one industry segment, light and radiation detection devices. Substantially all of the Company's assets and employees are located at

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the Company's facilities in Camarillo, California and Dodgeville, Wisconsin.

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In fiscal 2005, 2004 and 2003, the Company had export sales of approximately \$2,488,000, \$1,202,000 and \$1,848,000, respectively, made primarily to customers in North America, Asia and Europe. Sales to specific countries, stated as a percentage of total sales, consist of the following:

	2005	2004	2003
	-----	-----	-----
Canada	2%	--	--
Germany	--	--	4%
Japan	2%	--	2%
Spain	5%	--	2%
United Kingdom	2%	4%	4%
All other countries	6%	6%	8%
	-----	-----	-----
Total export sales	17%	10%	20%

FAIR VALUE OF FINANCIAL INSTRUMENTS - The carrying value of all financial instruments potentially subject to valuation risk (principally consisting of cash equivalents, accounts receivable, accounts payable, notes receivable and notes payable) approximates fair value based upon prevailing interest rates available to the Company.

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.

RESTRICTED CASH - As a condition of the Senior Convertible Note (see note 7), the Company established a cash collateral account with a bank and a control agreement with a collateral agent. The agreement grants the holder of the note a first priority perfected interest in the account. Conditioned upon certain defined events and permitted acquisitions, the collateral agent may release the funds to the Company. In May 2005 (see note 13) the Company concluded a permitted acquisition allowing for the release of the restricted funds.

SHORT-TERM AND LONG-TERM INVESTMENTS - Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities", requires that all debt and marketable equity securities be classified in one of three categories: trading, available-for-sale, or held-to-maturity. It is the Company's intent to maintain a diverse portfolio to take advantage of investment opportunities. The Company has classified all investments as current assets, which includes available-for-sale and held-to-maturity. Available-for-sale investments are redeemable within one year. Held-to-maturity securities are callable government issues; however, market rates make the call remote and the Company has the intent and

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ability to not redeem the issue.

Available-for-sale securities are recorded at market value. Unrealized holding gains and losses, net of the related income tax effect, are excluded from earnings and are reported as a separate component of shareholders' equity until realized. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion are included in interest income. At the time of sale, any realized gains or losses, calculated by the specific identification method, are recognized as a component of operating results.

Held-to-maturity securities are carried at amortized cost.

The Company held no short-term or long-term investments as of March 27, 2005.

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All of the Company's short-term investments as of March 28, 2004 were due within one year.

Short-term and long-term investments consist of the following as of March 28, 2004:

	Cost	Fair Value
	-----	-----
Equity securities	1,700,000	1,700,000
Totals	\$ 1,700,000	\$ 1,785,000
	=====	=====

CONCENTRATION OF CREDIT RISK - Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash equivalents and accounts receivable. The Company maintains cash balances at four financial institutions that are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000. As of March 27, 2005, the Company had cash at three financial institutions in excess of Federally insured amounts. As excess cash is available, the Company invests in short-term and long-term investments, primarily consisting of Government Securities and Money Market instruments. Accounts receivable are unsecured and the Company is at risk to the extent such amount becomes uncollectible. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. As of March 27, 2005, one customer comprised 22% of accounts receivable. As of March 28, 2004, two customers comprised 14% and 13%, respectively, of accounts receivable. For fiscal years 2005, 2004 and 2003, cash deposits held at financial institutions in excess of FDIC insured amounts were as follows:

2005	2004	2003
-----	-----	-----

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\$2,421,000 \$1,013,000 \$500,000

SIGNIFICANT CUSTOMER - During the fiscal year ended March 27, 2005, two customers represented 12% and 12% of the Company's net sales. During the fiscal years ended March 28, 2004 and March 30, 2003, no customer accounted for more than 10% of the Company's net sales.

INVENTORIES - Inventories, which include material, labor and manufacturing overhead, are stated at standard cost (which approximates the first in, first out method) or market.

Inventories consist of the following at March 27, 2005 and March 28, 2004

	2005 -----	2004 -----
Raw material	\$ 3,129,000	\$ 2,857,000
Work-in-process	1,245,000	880,000
Finished products	302,000	117,000
	-----	-----
Total inventories	4,676,000	3,854,000
Less reserve	(1,032,000)	(925,000)
	-----	-----
Inventories, net	\$ 3,644,000 =====	\$ 2,929,000 =====

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EQUIPMENT AND LEASEHOLD IMPROVEMENTS - Equipment and leasehold improvements are stated at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets or lease term ranging from three to nine years.

Equipment and leasehold improvements consist of the following at March 27, 2005 and March 28, 2004:

	2005 -----	2004 -----
Machinery and equipment	\$ 3,795,000	\$ 3,611,000
Furniture and fixtures	154,000	145,000
Leasehold improvements	294,000	267,000
Data processing equipment	322,000	284,000
Vehicles	26,000	26,000
Capitalized software	382,000	368,000
Construction-in-process	68,000	93,000
Assets held for sale or disposal	77,000	111,000

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	-----	-----
Total	\$5,118,000	\$ 4,905,000
	=====	=====

LONG-LIVED ASSETS - The Company recognizes impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. In such circumstances, those assets are written down to estimated fair value. Long-lived assets consist primarily of goodwill and fixed assets.

INTANGIBLE ASSETS - In October 2004 the Company entered into a definitive agreement for \$5,000,000 of senior convertible notes, (see note 7). In connection with the agreement costs of approximately \$597,000 were incurred which are being amortized over the 36 month term of the agreement. Monthly amortization is approximately \$16,500 per month over the life of the notes.

In December 2004 the Company acquired Photonic Detectors, Inc. (see note 2). The Company recorded an intangible asset of \$635,000 which represents the excess of cost over fair value of net assets. This intangible asset is associated with the value of the acquired customer list. The intangible asset is being amortized over a period of 60 months beginning January 2005. Monthly amortization is \$10,000 per month. Each year the Company evaluates the present value of future cash flows associated with the list. Any impairment would be recognized when the expected future operating cash flows from such intangible assets is less than their carrying value.

Assuming no impairment to the intangible value, future amortization expense for intangible assets is as follows:

2006	\$	326,000
2007		326,000
2008		243,000
2009		127,000
2010		95,000

Total	\$	1,117,000
		=====

PATENTS - Patents represent costs incurred in connection with patent applications. Such costs are amortized using the straight-line method over the useful life of the patent once issued, or expensed immediately if any specific application is unsuccessful. Amortization expense was approximately \$3,000 in fiscal 2005, 2004 and 2003, respectively. The current patents held by the Company have remaining useful lives ranging from 2 years to 10 years, with a weighted average remaining useful life of 3.5 years. Future amortization of patent expenses are as follows:

2006	\$	3,000
2007		3,000

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2008	2,000
2009	1,000
2010	--

Total	\$ 9,000
	=====

GOODWILL - The excess of cost over the purchase price of acquired net assets is amortized on a straight-line basis over a 25-year period. In accordance with SFAS 142, Goodwill and other Intangible Assets, the Company ceased amortizing goodwill on April 1, 2002. The Company annually evaluates the recoverability of goodwill by assessing whether the recorded value of the goodwill will be recovered through future expected operating results.

REVENUE RECOGNITION - Revenues from research and development cost reimbursement-type contracts are recorded as costs are incurred based upon the relationship between actual costs incurred, total estimated costs and the amount of the contract or grant award. Estimation of costs are reviewed periodically and any anticipated losses are recognized in the period in which they first become determinable.

The Company recognizes revenues upon shipment. Provision for estimated losses, if any, is made in the period in which such losses are determined.

SHIPPING AND HANDLING COSTS -- The Company's policy is to classify shipping and handling costs as a component of Costs of Goods Sold in the Statement of Operations.

ADVERTISING EXPENSE - Advertising costs are expensed as incurred. Advertising expense was approximately \$84,000, \$57,000 and \$106,000 in fiscal 2005, 2004 and 2003, respectively.

WARRANTIES - The Company typically warrants its products against defects in material and workmanship for a period of 90 days from the date of shipment. A provision for estimated future warranty costs are recorded when products are shipped. Warranty costs were approximately \$15,000, \$0 and \$15,000 in fiscal 2005, 2004 and 2003, respectively.

NET INCOME (LOSS) PER SHARE - Net income (loss) per share calculations are in accordance with SFAS No. 128, "Earnings per Share". Accordingly, basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding for each year. Diluted earnings (loss) per share has not been presented in 2004 or 2003 as the impact is immaterial. The impact of Statement 128 on the calculation of earnings per share is as follows:

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	2005	2004
BASIC		
Average Shares Outstanding	13,461,000	13,400,000
Net Income (Loss)	5,254,000	794,000
Basic Income (Loss) Per Share	\$ 0.39	\$ 0.06

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DILUTED		
Average Shares Outstanding	13,461,000	13,400,000
Net Effect of Shares Issuable pursuant to terms of convertible note, based on a weighted average	1,176,000	--
Net Effect of Dilutive Stock Options and Warrants based on the treasury stock method using average market price	962,000	562,000
Total Shares	15,599,000	13,962,000
Net Income, adjusted for interest expense on convertible note (net of tax)	5,304,000	794,000
Diluted Earnings Per Share	\$ 0.34	\$ 0.06
Average Market Price of Common Stock	\$ 2.18	\$ 1.57
Ending Market Price of Common Stock	\$ 2.11	\$ 2.05

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

2005		2004		20
Exercise Price per Share	No. Shares Underlying Options	Exercise Price per Share	No. Shares Underlying Options	Exercise Price per Share
2.2500	35,400	1.8750	64,000	1.1875
2.5000	27,700	2.5000	27,700	1.2500
3.0940	1,000	3.0940	1,000	1.6250
3.1875	350,000	3.1875	350,000	1.8750
5.3440	50,000	5.3440	50,000	2.5000
TOTAL	464,100	TOTAL	492,700	3.0940
	=====		=====	
				3.1875
				5.3440
				TOTAL

RESEARCH AND DEVELOPMENT COSTS - The Company charges all research and development costs, including costs associated with development contract revenues, to expense when incurred. Manufacturing costs associated with the development of a new fabrication process or a new product are expensed until such times as these processes or products are proven

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through final testing and initial acceptance by the customer. Costs related to revenues on non-recurring engineering services billed to customers are generally classified as cost of product sales.

PERVASIVENESS OF ESTIMATES - The preparation of 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.

ACCOUNTING FOR STOCK OPTION BASED COMPENSATION - SFAS No. 123, "Accounting for Stock Based Compensation", sets forth accounting and reporting standards for stock based employee compensation plans. As allowed by SFAS 123, the Company continues to measure compensation cost under Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees" and complies with the pro forma disclosure requirements of the standard (see Note 5).

NEW ACCOUNTING PRONOUNCEMENTS - In November 2004, the FASB issued FASB Statement No. 151, "Inventory Costs - An amendment of ARB No. 43, Chapter 4". Statement 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be expensed as incurred and not included in overhead. Further, Statement 151 requires that allocation of fixed production overheads to conversion costs should be based on normal capacity of the production facilities. The provisions in Statement 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Companies must apply the standard prospectively. The Company will adopt this standard on April 1, 2006.

In December 2004, the FASB issued FASB Statement No. 153, "Exchanges of Nonmonetary Assets" which is an amendment of APB Opinion No. 29. The amendments made by the Statement are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replaces it with a broader exception for exchanges of nonmonetary assets that do not have "commercial substance." Previously, Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. The provisions in Statement 153 are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Early application is permitted and companies must apply the standard prospectively. The Company will adopt this statement on July 1, 2005.

In December 2004 the FASB issued SFAS 123(R), "Share-Based Payment"--Statement 123, as originally issued, is effective until the provisions of Statement 123(R) are fully adopted. This statement will provide investors and other users of financial statements with more complete and neutral financial information by requiring the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair market value of the equity or liability instruments issued. The Company will adopt this Statement in July 2005.

The FASB issued SFAS 132(R), "Employers' Disclosures about Pensions and Other Postretirement Benefits--Statement 132", as originally issued, is effective until the provisions of Statement 132(R) are fully adopted. The provisions of FAS 132 did not change. FAS 132(r) identified new disclosures that are required. All new disclosure requirements for the domestic plans of publicly traded entities are effective for years ending after December 15, 2003. Estimated future benefit payments, and all other new disclosure requirements for foreign plans and nonpublic entities are effective for years ending after June 15, 2004.

In May 2005, the Financial Accounting Standards Board (FASB), issued Statement of Financial Accounting Standards 154 "Accounting Changes and Error Corrections" ("SFAS 154"). This Statement replaces APB Opinion No. 20, "Accounting Changes", and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements", and changes the requirements for the accounting for and reporting of a change in accounting principle. The accompanying audited consolidated financial statements do not have any accounting changes or error corrections.

The Company does not believe that any of these recent accounting pronouncements will have a material impact on its financial position or results of operations.

2. ACQUISITION

In August 2002, SSI, a newly formed wholly-owned subsidiary of the Company, purchased substantially all of the assets and selected liabilities of Silicon Sensors LLC, a closely-held manufacturer of opto-electronic semiconductor based components located in Dodgeville, Wisconsin. The financial purchase price was \$1,718,675 in cash, plus the assumption of the Seller's trade accounts payable and accrued liabilities, amounting to approximately \$282,000. The Company incurred \$79,000 of expenses in connection with this acquisition. In addition, the Company entered into a 3 year \$225,000 non-compete agreement with the majority member of Silicon Sensors, LLC and is recording monthly amortization expense of \$6,250.

In January 2003, the Company purchased all of the issued and outstanding shares of common stock of TOI, a privately owned custom manufacturer of opto-electronic components and assemblies. The purchase price was 1,009,110 shares of API Class A Common Stock (issued at \$0.92 per share) and repayment of a debt of TOI in the amount of \$1,200,000 representing principal and interest.

In December 2004, the Company purchased all of the issued and outstanding shares of common stock of PDI, a privately owned manufacturer of opto-electronic components and assemblies located in Simi Valley, California. The purchase price was 113,572 shares of API Class A Common Stock (issued at \$1.82 per share) plus \$1,075,000 in cash and the assumption of the seller's trade accounts payable, accrued liabilities, and bank line of credit amounting to approximately \$259,000. In addition, the purchase agreement contains a contingent purchase price during the five year contract period following the closing date upon which the Company shall pay the seller an amount equal to 20% of incremental sales as defined, subject to specific sales targets being met. The Company incurred \$42,000 of expenses in

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connection with this acquisition. The

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Company has closed the Simi Valley location and integrated its business into the Camarillo, California and Dodgeville, Wisconsin facilities. In connection with the transaction, the Company recorded a \$635,000 intangible asset ("Customer List") which it will amortize over a 5 year period, beginning January 2005. A summary of the assets and liabilities acquired at fair market value is as follows:

Assets Acquired	
Cash	\$ 44,000
Accounts receivable	239,000
Inventories	423,000
Prepaid & other current assets	3,000
Furniture and equipment	239,000
Customer list	635,000

Total Assets Acquired	\$ 1,583,000
	=====
Liabilities Assumed	
Accounts payable	\$ (159,000)
Accrued salaries & benefits	(22,000)
Bank line of credit	(78,000)

Total liabilities assumed	\$ (259,000)
	=====
Total Purchase Price	\$ 1,324,000
	=====

3. CAPITALIZATION

The Company's Certificate of Incorporation provides for two classes of common stock, a Class A for which 50,000,000 shares are authorized for issuance and a Class B for which 4,420,113 shares are authorized for issuance. The par value of each class is \$.001. Subject to certain limited exceptions, shares of Class B Common Stock are automatically converted into an equivalent number of Class A shares upon the sale or transfer of the Class B Common Stock by the original holder. The holder of each share of Class A and Class B Common Stock is entitled to one vote per share.

The Company has authorized 10,000,000 shares of Preferred Stock, of which 780,000 shares have been designated Class A Redeemable Convertible Preferred Stock with a par value of \$.001 per share. 40,000 shares of Class A Redeemable Convertible Preferred Stock ("Class A Preferred") were issued and outstanding at March 27, 2005. The Class A Preferred Stock has a liquidation preference equal to its issue price (\$.80 per share) and is convertible at any time, at the option of the holder, into .3 shares of Class B Common Stock for each share of Class A Preferred Stock converted. The Class A Preferred Stock is subject to redemption at the Company's option for \$.80 per share at any time. The Company would be required to pay approximately \$25,000 to redeem these shares. The holders of the Class A Preferred Stock are entitled to an

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annual non-cumulative dividend preference of \$.072 per share when the Company's net earnings per share of Class A Preferred Stock equals or exceeds \$.072. The Class A Preferred stockholders do not have voting rights except as required by applicable law.

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4. INCOME TAXES

At March 27, 2005, the Company had net operating loss carry forwards (NOL's) of approximately \$24 million for Federal income tax purposes and \$4 million for state income tax purposes that expire at various dates through fiscal year 2023. The tax laws related to the utilization of loss carry forwards are complex and the amount of the Company's loss carry forward that will ultimately be available to offset future taxable income may be subject to annual limitations under IRC Section 382 resulting from changes in the ownership of the Company's common stock.

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets at March 28, 2004 were substantially composed of the Company's net operating loss carry forwards, for which the Company had made a full valuation allowance. With the acquisition of both Photonic Detectors Inc. in December 2004 and Picometrix, Inc. in May 2005, the Company management has projected that the Company will generate sufficient future taxable income to utilize approximately 50% of the accumulated NOL's before they expire.

Realization of the deferred tax asset is dependent upon generating sufficient taxable income prior to expiration of any NOL's. Although realization is not assured, management believes it is more likely than not that the recorded deferred asset will be realized. Accordingly the Company has reduced the deferred tax asset valuation allowance to \$4.7 million at March 27, 2005.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment.

The tax provision for the year ended March 27, 2005 is composed of the minimum California franchise tax, Wisconsin state income tax and reversal of the deferred tax asset valuation allowance. The tax provisions for the years ended March 28, 2004 and March 30, 2003 were composed of Wisconsin state income tax and the minimum California franchise tax.

Below are reconciliations between the provision for income taxes compared with the amounts at the United States federal statutory rate:

YEARS ENDED	MARCH 27, 2005	MARCH 28, 2004
Federal income tax at statutory rates	177,000	(1,000,000)
State income TAXES, net of federal benefit	39,000	(1,000,000)
Amortization of Goodwill	--	(1,000,000)
Utilization of NOL Carryforwards	(211,000)	(1,000,000)
Change in valuation allowance	(4,749,000)	(1,000,000)

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Other	10,000
Effective federal income tax	(4,734,000)

Deferred Tax Assets at March 27, 2005 are as follows, at a projected tax rate of 34% for federal income tax purposes and 8.5% for state income tax purposes:

	Federal -----	State -----
Current	507,000	\$137,000
Long Term	8,395,000	460,000
	-----	-----
	8,902,000	597,000

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The Company's net deferred tax assets consist of the following components, for fiscal years 2005 and 2004:

	2005 -----	2004 -----
Sec. 263A Adjustment	59,000	40,000
Accrued Bonuses	63,000	2,000
Accrued Interest	--	6,000
Inventory Reserve	409,000	396,000
Utility Accruals	7,000	7,000
Warranty Reserve	13,000	8,000
A/R Allowance	9,000	24,000
Accrued Vacation	77,000	65,000
NOL Carryforwards	8,217,000	8,640,000
Accumulated Amortization	32,000	19,000
Accumulated Depreciation	(149,000)	(96,000)
R&D Credits	721,000	765,000
California Mfg. Credit	40,000	59,000
	-----	-----
Total	9,498,000	9,935,000
Valuation Allowance	(4,749,000)	(9,935,000)
	-----	-----
Net Deferred Tax Asset	4,749,000	--

At March 27, 2005 the Company's net operating loss carry forwards will expire on the following dates:

Federal -----		California -----	
Amount	Expiration	Amount	Expiration
-----	-----	-----	-----
\$ 1,073,430	March 31, 2006	\$ 2,181,725	March 31, 2007
3,171,670	March 31, 2007	82,141	March 31, 2013

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2,226,072	March 31, 2008	973,927	March 31, 2014
3,816,200	March 31, 2009	471,220	March 31, 2014

1,947,320	March 31, 2010		
30,267	March 31, 2011		
1,548,581	March 31, 2012		
599,421	March 31, 2013		
250,133	March 31, 2014		
6,096,005	March 31, 2015		
82,471	March 31, 2016		
1,868,504	March 31, 2022		
846,957	March 31, 2023		

\$23,557,031		\$ 3,709,013	
=====		=====	

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5. STOCK OPTIONS

The Company has four stock option plans: The 1990 Incentive Stock Option and Non-Qualified Stock Option Plan, the 1991 Directors' Stock Option Plan ("The Directors' Plan"), the 1997 Employee Stock Option Plan and the 2000 Stock Option Plan. The Company measures compensation for these plans under APB Opinion No. 25. No compensation cost has been recognized as all options were granted at the fair market value or the greater of the underlying stock at the date of grant. Had compensation expense for these plans been determined consistent with SFAS No. 123, the Company's net income (loss) and net income (loss) per share would be as follows:

	2005	2004
	-----	-----
Net income (loss), as reported	\$ 5,254,000	\$ 794,000
Net income (loss), pro forma	\$ 5,208,000	\$ 723,000
Basic income (loss) per share, as reported	\$ 0.39	\$ 0.00
Basic income (loss) per share, pro forma	\$ 0.39	\$ 0.00

Because the SFAS No. 123 method of accounting has not been applied to options granted prior to April 3, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2005, 2004 and 2003, respectively: risk-free interest rates of, 4%, 5% and 9.0%, expected volatility of 1%, 5% and 4% and expected lives of 10 years in all periods. No dividends were assumed in the calculations.

The Company's various stock option plans provide for the granting of non-qualified and incentive stock options to purchase up to 3,700,000 shares of common stock for periods not to exceed 10 years. Options typically vest at the rate of 25% per year over four years, except for options granted under The Directors' Plan, which typically vest at the rate of 50% per year over two years. Under these plans, the option exercise price equals the stock's market price on the date of grant.

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Options may be granted to employees, officers, directors and consultants. The Company has also granted options, under similar terms as above, under no specific shareholder approved plan.

Stock option transactions for fiscal years 2004 and 2005 are summarized as follows:

	Shares (000)	Weighted Average Exercise Price
	-----	-----
Outstanding, March 30, 2003	1,804	\$ 1.44
Granted	300	\$ 0.92
Exercised	(78)	\$ 0.86
Expired	(65)	\$ 1.21

Outstanding, March 28, 2004	1,961	\$ 1.39
	=====	=====
Exercisable, March 28, 2004	1,580	\$ 1.52
	=====	=====
Outstanding, March 28, 2004	1,961	\$ 1.39
Granted	401	\$ 1.88
Exercised	(2)	\$ 0.65
Expired	(5)	\$ 0.86

Outstanding, March 27, 2005	2,355	\$ 1.47
	=====	=====
Exercisable, March 27, 2005	1,776	\$ 1.48
	=====	=====

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Information regarding stock options outstanding as of March 27, 2005 is as follows:

Price Range	(in 000s) Shares	Options Outstanding	
		Weighted Average Exercise Price	Weighted Remainin
-----	-----	-----	-----
\$0.50 - \$1.25	1,445	\$ 0.77	
\$1.61 - \$2.50	509	\$ 1.91	
\$3.09 - \$5.34	401	\$ 3.46	

Options Exercisable

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Price Range Shares	(in 000s) Shares	Weighted Average Exercise Price	Weighted Remainin
\$0.50 - \$1.25	1,212	\$ 0.76	
\$1.61 - \$2.50	163	\$ 2.03	
\$3.09 - \$5.34	401	\$ 3.46	

6. LINE OF CREDIT/SHORT TERM DEBT

The Company has a revolving line of credit from a regional bank which provides for borrowings up to \$3,000,000. The line allows for borrowings on 80% of eligible accounts receivable and 40% on eligible inventory, as defined, limited to \$1,500,000. The line is secured by all business assets of the Company. Repayment is interest only, monthly, with principal due at maturity, July 20, 2005. Interest is computed at the Wall Street Journal Prime plus 1.00% which was 6.00% at March 27, 2005.

7. SENIOR CONVERTIBLE NOTE/LONG TERM DEBT AND RESTRICTED CASH

In October 2004, the Company entered into a definitive agreement for the private placement to four institutional investors of \$5 million aggregate principal amount of its senior convertible notes. The original Securities Purchase Agreement was filed with the Securities and Exchange Commission on October 12, 2004. The notes are convertible at the option of the holder under certain circumstances into shares of the Company's Class A Common Stock at an initial conversion price of \$1.9393 per share, subject to adjustment. The notes pay interest at an annual rate of prime plus 1% and will mature on October 12, 2007. At the time of the closing of the private placement, \$2.5 million of the purchase price for the notes was being held in a cash collateral account subject to release upon satisfaction of certain conditions specified in the purchase agreement. The original conditions of release provided for \$1,250,000 to be eligible for release if the Company had entered into a definitive agreement for a permitted acquisition on or before January 31, 2005. Subsequently, any balance remaining in the cash collateral account, up to the full \$2,500,000, would be released upon the Company's consummation of a permitted acquisition on or before March 31, 2005. The original terms were modified by letters of agreement between API and the investors dated March 9, 2005. The modified terms provide for \$1,250,000 to be released upon entry into a definitive agreement

for a permitted acquisition on or before March 11, 2005 and for the remaining funds to be released upon the consummation of that acquisition on or before May 1, 2005. A "permitted acquisition" is defined in the Securities Purchase Agreement as the purchase by the Company of an entity with (1) EBITDA of not less than \$750,000 during the twelve months immediately preceding the acquisition and (2) revenues of not less than \$4,000,000 during the twelve months immediately preceding the acquisition. Since Photonic Detectors, Inc. did not qualify as a "permitted acquisition" no funds were released as a result of completing that transaction. However, \$1,250,000 was released in March 2005, upon signing an Agreement and Plan of Merger

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with Picometrix, Inc. and \$1,250,000 remained as restricted cash in the cash collateral account at March 27, 2005. The remaining amount of restricted cash was released to the Company in May 2005, upon the completion of the acquisition of Picometrix, Inc.

In connection with the transaction, the Company had issued to the investors five-year warrants to purchase 850,822 shares of the Company's Class A Common Stock at an exercise price of \$2.1156 per share, subject to adjustment. The Company has agreed to register the shares of common stock issuable upon conversion of the notes and upon exercise of the warrants for resale under the Securities Act of 1933. The investors have the option for a period of one year following effectiveness of the registration statement to acquire an additional \$5 million aggregate principal amount of the notes with an initial conversion price of \$2.1156 per share and five-year warrants to purchase an additional 850,822 shares of common stock. The original terms of the warrants issued and, the additional warrants to be issued, in the private placement to the investors were also modified on March 9, 2005 to reduce the exercise price from \$2.1156 per share of Class A Common Stock of API to \$1.78 per share (see Note 13 "Subsequent Events"). Similarly, on March 9, 2005, the terms of the notes issued in connection with the private placement (the "Notes") were modified to (i) provide that the interest rate shall not be less than 6.5% at any time and (ii) increase the amount of "Permitted Indebtedness" (as such term is defined in the Notes) from \$3 million to \$6 million and (iii) decrease the amount of "Permitted Acquisition Indebtedness" (as such term is defined in the Notes) from \$6 million to \$3 million. In addition, the investors in the private placement agreed to subordinate, pursuant to a form of subordination agreement in form and substance reasonable satisfactory to them, (i) the principal and interest payments on the Notes to the "Permitted Bank Debt" (as such term is defined in the letters of agreement) and (ii) their liens on the Company's assets to any lien granted by the Company as security for the "Permitted Bank Debt".

In accordance with APB 14, the Company has recorded a discount to the note of \$141,000 to account for the fair value associated with the note's detachable warrants. Upon any exercise of the conversion feature, the notes will then be converted from debt to equity. A copy of the original agreement and all related documents were filed with the Securities and Exchange Commission on October 12, 2004 on Form 8-K, and the foregoing summary is qualified in its entirety by reference thereto.

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8. RELATED PARTY NOTE RECEIVABLE

In March 2005 the Company issued a cash advance to Picometrix, Inc. in the amount of \$4,228,000 in connection with the pending acquisition of Picometrix, Inc. by the Company. The loan was contributed to the capital of the newly formed limited liability company upon closing of the acquisition and merger transaction in May 2005 (see Note 13).

9. CAPITALIZED LEASE OBLIGATION

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The Company has a capitalized lease obligation which provides for monthly payments of \$889. The lease matures through fiscal 2006 and is collateralized by certain equipment with a net book amount of approximately \$27,000. Future payments on the lease obligations are as follows:

2005	\$ 11,000
2006	2,000

Total minimum lease payments	\$ 13,000
Less interest	(3,000)

Present value of net minimum lease payments	\$ 10,000
	=====

10. COMMITMENTS

The Company leases its manufacturing and office facility and certain office equipment under non-cancelable operating leases. Minimum future lease payments under all non-cancelable operating leases expiring at various dates through fiscal 2009 are as follows:

2006	\$ 434,000
2007	395,000
2008	349,000
2009	310,000

Total	\$1,488,000
	=====

Rent expense was approximately \$482,000, \$441,000 and \$362,000 in fiscal 2005, 2004 and 2003, respectively.

11. LEGAL

The Company is, from time to time, subject to legal and other matters in the normal course of its business. While the results of such matters cannot be predicted with certainty, management does not believe that the final outcome of any pending matters will have a material effect on the financial position and results of operations of the Company.

12. EMPLOYEES' RETIREMENT PLAN

The Company maintains a 401(k) Plan which is qualified under the Internal Revenue Code. All full-time employees are eligible to participate in the Plan. Employees may make voluntary contributions to the Plan which are matched by the Company at the rate of \$.50 for every \$1.00 of employee contribution, subject to certain limitations. The Company contributions and administration costs recognized as expense

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were approximately \$62,000, \$71,000 and \$64,000 in fiscal 2005, 2004 and 2003, respectively.

13. SUBSEQUENT EVENTS (UNAUDITED)

In May 2005 The Company entered into a term note with a regional bank which provides for borrowings up to \$2,700,000. The note is guaranteed by Advanced Photonix, Inc, Silicon Sensors, Inc. and Michigan Acquisition Sub, LLC, a newly formed limited liability company established for purposes of transacting the merger with Picotronix, Inc., a Michigan corporation (doing business as and referred to herein as "Picometrix") (see below). Repayment is principal of \$75,000 per month, plus interest, until maturity on May 2, 2008. Interest is computed at the Wall Street Journal Prime plus 1.00% with a ceiling of 7.75% and a floor of 6.00%.

On March 8, 2005, Advanced Photonix, Inc. and its newly formed subsidiary, Michigan Acquisition Sub, LLC ("Newco"), a Delaware limited liability company, entered into an Agreement and Plan of Merger (the "Agreement") with Picotronix, Inc., whereby Picometrix merged with and into Newco, with Newco being the surviving entity. The transaction was completed in May 2005. The merger consideration paid to the stockholders of Picometrix at the closing of the transaction consisted of \$3,500,000 in cash, four-year API promissory notes in the aggregate principal amount of \$2,900,500 (the "API Notes") and 2,575,000 shares of API's Class A Common Stock.

The API Notes are payable in four annual installments with the first being a payment of \$500,000, the second being a payment of \$550,000, the third being a payment of \$900,000 and the fourth being a payment of \$950,500. The API Notes bear an interest rate of prime plus 1.0% and are secured by all of the intellectual property of Picometrix. API has the option of prepaying the API Notes without penalty.

On June 15, 2005, one of the institutional investors associated with the private placement transaction (See Note 7 "Senior Convertible Note/Long Term Debt and Restricted Cash") exercised its warrant option to purchase 170,164 shares of Class A Common Stock at an exercise price of \$1.78 per share, resulting in proceeds to the Company of \$303,000.

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14. QUARTERLY FINANCIAL DATA (UNAUDITED)

The table below lists financial information (unaudited) by quarter for each of the three fiscal years ending March 27, 2005, March 28, 2004, and March 30, 2003.

	First -----	Second -----	Third -----	Fourth -----
2005				
Net Sales	\$ 3,253,000	\$ 3,709,000	\$ 3,852,000	\$ 3,852,000

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Cost of Sales	1,956,000	2,451,000	2,832,000	2,
Research & Development Expenses	42,000	37,000	33,000	
Selling, General & Administrative Expenses	902,000	982,000	870,000	1,
Net Income (Loss)	\$ 347,000	\$ 260,000	\$ 35,000	\$ 4,
Basic Income (Loss) per Common Share	\$ 0.03	\$ 0.02	\$ 0.00	\$
Diluted Income (Loss) per Common Share	\$ 0.02	\$ 0.02	\$ 0.00	\$
Weighted Average Common Shares Outstanding	13,431,000	13,431,000	13,437,000	13,
2004				
Net Sales	\$ 2,647,000	\$ 3,256,000	\$ 2,933,000	\$ 3,
Cost of Sales	1,774,000	2,131,000	1,895,000	2,
Research & Development Expenses	78,000	80,000	32,000	
Selling, General & Administrative Expenses	684,000	819,000	756,000	
Net Income (Loss)	\$ 113,000	\$ 225,000	\$ 255,000	\$
Basic & Diluted Income (Loss) per Common Share	\$ 0.01	\$ 0.02	\$ 0.02	\$
Weighted Average Common Shares Outstanding	12,247,000	13,449,000	13,458,000	13,
2003				
Net Sales	\$ 1,548,000	\$ 1,838,000	\$ 2,603,000	\$ 3,
Cost of Sales	916,000	1,307,000	1,737,000	2,
Research & Development Expenses	142,000	144,000	107,000	
Selling, General & Administrative Expenses	541,000	637,000	725,000	1,
Net Income (Loss)	\$ (23,000)	\$ (232,000)	\$ 61,000	\$ (
Basic & Diluted Income (Loss) per Common Share	\$ 0.00	\$ (0.02)	\$ 0.00	\$
Weighted Average Common Shares Outstanding	12,247,000	12,251,000	12,251,000	13,

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

In February 2005, Susan Schmidt resigned from her position as Chief Financial Officer, effective March 11, 2005, citing personal reasons. On March 11, 2005 Richard Kurtz, Chairman of the Board and Chief Executive Officer, assumed the position of interim principal financial officer until the appointment of Robin Risser as Chief Financial Officer on May 2, 2005. During the interim period and

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through the date of this report, Ms. Schmidt has continued on with the Company in the capacity of a consultant, assisting management in the evaluation and reporting of financial information and maintaining consistency in our disclosure and internal controls and procedures.

DISCLOSURE CONTROLS

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (or Exchange Act)). Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in alerting them in a timely manner to material information required to be disclosed in our periodic reports filed with the SEC.

CHANGES IN INTERNAL CONTROLS

During our most recent fiscal quarter, there has not occurred any change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

In accordance with General Instruction G(3), and except for certain of the information called for by Items 10 and 12 which is set forth below, the information called for by Items 10 through 13 of Part III is incorporated by reference from the Company's definitive proxy statement ("Proxy Statement") to be filed pursuant to Regulation 14A promulgated under the Securities Exchange Act of 1934 in connection with the Company's 2005 Annual Meeting of Stockholders.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS

CODE OF ETHICS

The Company has adopted a Code of Ethics for Senior Financial Officers, pursuant to the Sarbanes-Oxley Act of 2002. The Code of Ethics is published on the Company's web site, www.advancedphotonix.com on the Investor Relations page.

ITEM 11. EXECUTIVE COMPENSATION

The response to this item is incorporated by reference from the Company's Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

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The following table sets forth, as of March 27, 2005, the aggregated information pertaining to all securities authorized for issuance under the Company's equity compensation plans:

Plan Category -----	Number of Securities to be issued upon exercise of outstanding options, warrants and rights -----	Weighted-average exercise price of outstanding options, warrants and rights -----	Number of securities remaining available for future issuance -----
Equity compensation plans approved by shareholders	1,776,100	\$ 1.48	1,089,222
Equity compensation plans not approved by shareholders	--	--	--
Total	1,776,100	\$ 1.48	1,089,222

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The response to this item is incorporated by reference from the Company's Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The response to this item is incorporated by reference from the Company's Proxy Statement.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

The following is a list of the financial statements, schedules and exhibits filed herewith.

- (1) Financial Statements: No financial statements have been filed with this Form 10-K other than those listed in Item 8.
- (2) Financial Statement Schedules: Schedules for which provisions are made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions, or are disclosed in the accompanying consolidated financial statements, or are inapplicable and, therefore, have been omitted.

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(3) Exhibits:

Exhibit No. -----	Description -----
2.1	Stock Purchase Agreement dated December 21, 2004 between Advanced Photonix, Inc. and Photonic Detectors, Inc. - incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K, as filed with the Securities and Exchange Commission on December 23, 2004
2.2	Agreement and Plan of Merger between Advanced Photonix, Inc. and Michigan Acquisition Sub, LLC, Picotronix, Inc., Robin Risser and Steven Williamson, dated March 8, 2005 - incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K, as filed with the Securities and Exchange Commission on March 14, 2005
3.1	Certificate of Incorporation of the Registrant, as amended - incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on Form S-1, filed with the Securities and Exchange Commission on November 23, 1990
3.1.1	Amendment to Certificate of Incorporation of the Registrant, dated October 29, 1992-incorporated by reference to the Registrant's March 31, 1996 Annual Report on Form 10-K
3.1.2	Amendment to Certificate of Incorporation of the Registrant, dated September 9, 1992-incorporated by reference to the Registrant's March 31, 1996 Annual Report on Form 10-K
3.2	By-laws of the Registrant, as amended - incorporated by reference to Exhibit 3.(ii) to the Registrant's Form 8-K as filed with the Securities and Exchange Commission on June 8, 2005
4.1	Rights Agreement, by and between the Company and Continental Stock Transfer and Trust Company, as amended - incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on February 9, 2005
10.1*	Advanced Photonix, Inc. 1991 Special Directors Stock Option Plan - incorporated by reference to Exhibit 10.9 to the Registrant's March 31, 1991 Annual Report on Form 10-K
10.2*	Advanced Photonix, Inc. 1990 Incentive Stock Option and Non-Qualified Stock Option Plan - incorporated by reference to Exhibit No. 10.11 to the Registrant's Registration Statement on Form S-1, filed with the Securities and Exchange Commission on November 23, 1990
10.3*	Advanced Photonix, Inc. 1997 Employee Stock Option Plan - incorporated by reference to Exhibit 10.13 to the Registrant's March 30, 1997 Annual Report on Form 10-K

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- 10.4* Amendment No. 1 to 1997 Employee Stock Option Plan of Advanced Photonix, Inc. - incorporated by reference to Exhibit 10.14 to the Registrant's December 28, 1997 Quarterly report on Form 10-Q
- 10.5* Advanced Photonix, Inc. 2000 Stock Option Plan, as amended - incorporated by reference to Exhibit 99.1 to the Registrant's Form 8-K, as filed with the Securities and Exchange Commission on November 19, 2004
- 10.9 Lease Agreement dated February 23, 1998 between Advanced Photonix, Inc. and High Tech No. 1, Ltd. - incorporated by reference to Exhibit 10.9 to the Registrant's March 29, 1998 Annual Report on Form 10-K
- 10.10 Form of Indemnification Agreement provided to Directors and Principal Officers of Advanced Photonix, Inc. - incorporated by reference to Exhibit 10.15 to the Registrant's December 28, 1997 Quarterly report on Form 10-Q
- 10.11* Employment Agreement dated August 21, 2002 between Advanced Photonix, Inc. and Paul D. Ludwig - incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K as filed with the Securities and Exchange Commission on September 5, 2002

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- 10.12* Employment Agreement dated February 10, 2003 between Advanced Photonix, Inc. and Richard D. Kurtz - incorporated by reference to Exhibit 10.12 to the Registrant's March 30, 2003 Annual Report on Form 10-KSB
- 10.20 Securities Purchase Agreement, Registration Rights Agreement, Senior Subordinated Convertible Note, Warrant to Purchase Class A Common Stock, and Additional Investment Right dated October 12, 2004 between Advanced Photonix, Inc. and private investors - incorporated by reference to Exhibits 10.13 through 10.13.4 to the Registrant's Form 8-K, as filed with the Securities and Exchange Commission on October 12, 2004
- 10.20.1 Letters of Agreement amending the Securities Purchase Agreement and Warrant to Purchase Class A Common Stock, dated March 9, 2005, between Advanced Photonix, Inc. and private investors - incorporated by reference to Exhibits 10.2 through 10.5 to the Registrant's Form 8-K, as filed with the Securities and Exchange Commission on March 14, 2005
- 10.26.1 Promissory Note between Picotronics, Inc. and Advanced Photonix, Inc., dated March 10, 2005 - incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K, as filed with the Securities and Exchange Commission on March 14, 2005
- 10.26.2 Secured Promissory Note between Advanced Photonix, Inc. and Robin Risser, dated May 2, 2005 - incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K, as filed with the Securities and Exchange Commission on May 6, 2005
- 10.26.3 Secured Promissory Note between Advanced Photonix, Inc. and Steven Williamson, dated May 2, 2005 - incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K, as

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filed with the Securities and Exchange Commission on May 6, 2005

- 10.26.4* Employment Agreement between Advanced Photonix, Inc. and Robin Risser, dated May 2, 2005 - incorporated by reference to Exhibit 10.3 to the Registrant's Form 8-K, as filed with the Securities and Exchange Commission on May 6, 2005
- 10.26.5* Employment Agreement between Advanced Photonix, Inc. and Steven Williamson, dated May 2, 2005 - incorporated by reference to Exhibit 10.4 to the Registrant's Form 8-K, as filed with the Securities and Exchange Commission on May 6, 2005
- 21.1 List of Subsidiaries of Registrant - incorporated by reference to Exhibit 21.1 to the Registrant's March 30, 2003 Annual Report on Form 10-KSB
- 31.1 Certification of the Registrant's Chairman, Chief Executive Officer, Principal Financial Officer and Director pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

*Constitutes a compensation plan or arrangement required to be filed as part of this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

By: /s/ Paul D. Ludwig

Paul D. Ludwig, President

Date: June 24, 2005

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Signature

Title

/s/ Richard D. Kurtz

Richard D. Kurtz

Chairman of the Board, Chief Executive Officer and Acting Chief Financial Officer

