APA Enterprises, Inc.
Form 10-K
June 28, 2006

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

FORM 10-K

x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended March 31, 2006.

o 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 0-16106

APA ENTERPRISES, INC.
(Exact Name of Registrant as Specified in its Charter)

Minnesota	**41-1347235**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

2950 N.E. 84th Lane
Blaine, Minnesota 55449
(763) 784-4995
(Address, including ZIP code and telephone number, including area code, of registrant's principal executive office)

Securities registered pursuant to Section 12(b) of the Act:
NONE

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $.01 per share
(Title of class)

Series B Preferred Share Purchase Rights
(Title of class)

Indicate by check mark if the registrant is a well-seasoned issuer, as defined in Rule 405 of the Securities Act.

o YES x NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or section 15(d) of the Exchange Act.

o YES x NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months and (2) has been subject to the filing requirements for the past 90 days.

x YES o NO

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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 definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

x YES o NO

Indicate by check mark whether the registrant is a large accelerated filer, and accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

o YES x NO

The aggregate market value of the voting and non-voting equity held by non-affiliates of the registrant, as of the last business day of the registrant's most recently completed second fiscal quarter computed by reference to the price at which the common equity was last sold was approximately $15,196,584.

The number of shares of common stock outstanding as of June 17, 2006 was 11,872,331.

Documents Incorporated by Reference:

Portions of our proxy statement for the annual shareholders meeting to be held in August 2006 are incorporated by reference into Part III.

APA ENTERPRISES, INC.
ANNUAL REPORT ON FORM 10-K
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PART I

ITEM 1. BUSINESS.

General Development of Business.

APA Enterprises, Inc. ("APA" or the "Company"), formerly APA Optics, Inc., is a Minnesota corporation which was founded in 1979. Our corporate headquarters is located at 2950 84^{th} Lane N.E., Blaine, MN and our corporate website is www.apaenterprises.com. The information available on our website is not part of this Report.

Since the founding of the Company, we have focused on leading edge research in gallium nitride (GaN), sophisticated optoelectronics, and optical systems, with the primary goal of developing advanced products for subsequent fabrication and marketing. Based on this research we have developed multiple products including fiber optic components for metro and access communications networks, a range of GaN based devices, and precision optical products. We believe that gallium nitride based devices have significant potential markets and we have developed specific expertise and/or patent positions relevant to them. During fiscal year 2004 we ceased the design and manufacturing of precision optical components due to intense competition from Asian manufacturers primarily based on lower labor rates and sold this product line in April 2004 (see Note C to the Consolidated Financial Statements included in Item 8 of this Report). The Company acquired the assets of two companies in calendar 2004 and has deployed them in a wholly owned subsidiary of the Company known as APA Cables and Networks, Inc. ("APACN"). APACN is a manufacturer and seller of telecommunications equipment.

In fiscal year 2005 we formed a wholly-owned subsidiary in India, APA Optronics (India) Private Limited ("APA India"), to take advantage of lower manufacturing costs in India. While the prime focus of the subsidiary will be support of manufacturing activities across the Company's products, it will also support other business activities, including software development. The Company has already started the supporting activities in most of these areas. The Company plans to significantly increase its manufacturing activities once the construction of a larger facility in India is completed and manufacturing operations are located in the new facility some time during the calendar year 2006.

In fiscal year 2006 we sold certain equipment and intellectual property related to our research and development work surrounding gallium nitride based heterojunction field effect transistors. The sale to an unrelated third party for consideration including $1.9 million in cash enables us to focus our R&D efforts on power amplifiers built using GaN technology by using commercially available parts, rather than building our own transistors. This is expected to decrease our operating costs and shorten our time to market for power amplifiers.

In fiscal year 2006, the Company also terminated its manufacturing operations, mostly related to fiber optic communication components, in Aberdeen, South Dakota. The associated assets were designated as not being utilized in manufacturing. Most of the assets, if not utilized within the company, will potentially be sold in future.

The Company reports its operations activities in two segments, Optronics (comprising the activities in Blaine, Minnesota, Aberdeen, South Dakota and India) and APACN (comprising the activities in Plymouth, Minnesota).

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APACN focuses on custom-engineered products for telecommunications customers, primarily related to cabling management requirements of the Fiber-to-the-Home ("FTTH") marketplace and in designing and terminating custom cable assemblies for commercial and industrial original equipment manufacturers ("OEM's"). In June 2003, APACN purchased the assets of Americable, Inc. The Americable acquisition allowed APACN to add its own brand of fiber distribution equipment to its full-line of standard and custom copper and fiber optic cable assemblies for broadband service providers and OEM's. The Americable acquisition diversified our product offerings, expanded our opportunities for cross-selling our products to former Computer System Products (CSP) and Americable customers, and enabled us to offer a more complete technology solution to all of our customers. To date, APACN has been able to successfully establish itself as a value-added supplier to its target market of independent telephone companies and cable television operators as well as OEM's who value a high level of engineering services as part of their procurement process. APACN has expanded its product offerings and broadened its customer base since its inception two years ago.

APACN also invested in expanding its sales and engineering expenditures by 32% during fiscal 2006 to increase its potential revenues during fiscal year 2007 and beyond. APACN is already realizing the impact of these efforts in terms of increased sales, particularly during the last two quarters of the fiscal year 2006. The increase in revenues is due to additional customers and product acceptance, mainly in the Fiber-to-the-Premise market, as well as an increase in revenue generated from a new supply agreement to an existing customer serving the test equipment market.

Optronics continues to focus upon Gallium Nitride (GaN) related activities.

Additional information regarding operations in the segments is set forth in Note Q in the Notes to the Consolidated Financial Statements under Item 8 herein.

Description of Business -Optronics Segment

Optronics develops manufactures and markets advanced products for UV (ultraviolet) detection, nitride epitaxial layers and wide band-gap transistors. These operations began with the inception of the Company in 1979 and are located principally in our facility in Blaine, Minnesota. Certain products are purchased from contract manufacturers.

Products

Our current products are described below.

- Ultraviolet (UV) Detector-Based Products We currently manufacture value-added products built around UV detectors fabricated by Optronics and procured externally. These products are:

- SunUV® Personal UV Monitor The SunUV® Personal UV Monitor (formerly, SunUVWatch®) is a personal ultraviolet (UV) radiation monitor that also incorporates a time/day/date function. It detects UV radiation that is hazardous to human health. It keeps track of the total UV exposure of the user and estimates a maximum exposure time according to government guidelines based on skin type and widely-accepted research on UV exposure limits. The product has been introduced and is being sold through retail channels, catalogs and Internet sites in the USA and Europe.

In fiscal year 2006, we developed and introduced an attractive new PUVM plastic/metal model that offers two key advantages for the product line. This model, manufactured in-house by our off-shore supplier, potentially eliminates most of the manufacturing issue of some of the earlier models. The new model also can be color-matched to the *SunUVStation™* described below, which allows us to market the two products together in a pairing that retailers and other channels find attractive.

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The new SunUVStation consumer product complements the Personal UV Monitor, and together they give Optronics a product line in the sun protection area. The SunUVStation offers a larger display that indicates the UV Index on a colorful 7" diameter analog face for backyard, pool, patio, campground, or other locations where groups of people are exposed to the sun. This product, complementing the small format personalized UV monitor, will be manufactured at the new APA Optronics India facility and marketed in FY2007 through selected channels.

Industrial Products: Profiler M UV Meter Optronics' *Profiler M* radiometer was created for the printing and coating industries that use UV curing. The instrument measures the intensity and distribution of four UV bands inside curing chambers. Data from the instrument can be transferred to a computer for analysis using proprietary *CureControl* software supplied as part of the purchase. Periodic upgrades of the software will be offered, providing the potential for increased utility for the user and an ongoing revenue stream for Optronics. Marketing and sales activities for the Profiler M are now focused on expanding our group of domestic and international distributors. Currently, there are four companies distributing the product - 2 general UV industries suppliers, a UV equipment manufacturer, and a UV coatings and adhesives manufacturer and we are seeking additional representatives in all these areas. Supporting marketing activities include exhibiting at trade shows for the industry and participation in technical conferences and journals that can showcase the advantages of the *Profiler M*.

Research and development efforts at Optronics are described below.

- In the 4th quarter of fiscal year 2006 we completed the sale of our epitaxial foundry to an unrelated, third party for total consideration of $1.9 million in cash and a license back of the technology within a specified field of use. The transaction included sale of APA's multi-wafer metal organic chemical vapor deposition system, the technical know-how associated with the growth of state-of-the-art epitaxial layers, two heterojunction field effect transistor patents (United States patent 5,192,987 and United States patent 5,296,395), an additional pending patent (now allowed, United States patent application claiming priority of United States provisional application No. 60/428,856), and associated intellectual property. Terms of the transaction allow APA to market and sell products for applications greater than 1 GHz and provide revenue sharing based on future licensing agreements regarding these patents. The transaction allowed APA to terminate the lease of an off-site facility utilized by the epi foundry and resulted in termination of three employees associated with the development and growth of epi-layers.

- The sale described in the immediately preceding paragraph should decrease operating costs while enabling early entry into power amplifier markets utilizing GaN power transistors procured from outside sources. Such transistors have demonstrated impressive performance while maintaining excellent reliability. Our goal is to manufacture amplifiers that utilize these transistors - simplifying amplifier architecture, improving amplifier efficiency and increasing bandwidth and power. Such amplifiers will initially target test and measurement and later cellular base station applications.

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- Opportunities to team with companies offering complementary capabilities to our own are being evaluated based on relevance to our long term strategic interests.

Marketing and Distribution

We do not maintain a large internal sales force. We have one sales person dedicated to the SunUV(C) Personal UV Monitor and we also maintain product information on our website. Additionally we use manufacturer's representative and distributors domestically.

Competition

The optoelectronics and compound semiconductor electronic device markets are evolving rapidly and, therefore, the competitive landscape changes continually. The opportunities presented by these markets have fostered a highly competitive environment. This competition has resulted in price reductions and lower profit margins for the companies serving this market. Many of the companies engaged in these businesses are well financed and have significantly greater research, development, production, and marketing resources than we do. Some of these companies have long operating histories, well-established distribution channels, broad product offerings and extensive customer bases. Our ability to compete with these companies across our product lines will depend largely on the performance of our devices, our ability to innovate and develop competitive solutions for our customers, our intellectual property, our ability to convince customers to adopt our technology early in their design cycle, and our ability to control costs.

We are not aware of any companies currently marketing a personal UV monitor with a combination of features, style and packaging equivalent to ours, although there are other manufacturers of this type of product in the United States, Japan and Korea. Our SunUVStation product is unique to the best of our knowledge.

Electronic Instrumentation and Technology, Inc. ("EIT"), Apprise Technologies, UV Process Supply and International Light offer UV curing control instruments that perform similar functions to the Profiler M, although we believe that our product offers a very competitive combination of features and price.

There are no currently available GaN/AlGaN power amplifiers; however, we anticipate that there will be several US, Japanese and European firms announcing products in the next calendar year.

Description of Business - APACN

APACN offers a broad range of telecommunications equipment and products developed from over 20 years of product expertise acquired in each of the CSP and Americable acquisitions. Its broad range of product offerings include the design and manufacture of standard and custom connectivity products such as fiber distribution systems, optical components, Outside Plant (OSP) cabinets, and fiber and copper cable assemblies that serve the communication service provider including FTTH, large enterprise, and OEM markets. APACN maintains a range of engineering and technical knowledge in-house that works closely with customers to develop, customize and enhance products from design through production. Most products are produced at APACN's plant in Plymouth, Minnesota with support from a corporate network of global manufacturing partners. APACN produces these products on both a quick-turn and scheduled delivery basis.

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Products

· Fiber Distribution Central Office Frame Systems APACN Fiber Distribution Systems ("FDS") are high density, easy access fiber distribution panels and cable management systems that are designed to reduce installation time, guarantee bend radius protection and improve traceability. In the 144-port count configuration, APACN is the industry leader for density, saving the customer expensive real estate in the central office. The product line fully supports a wide range of panel configurations, densities, connectors, and adapters that can be utilized on a stand-alone basis or integrated into the panel system. The unique interchangeable building block design delivers feature rich solutions which are able to meet the needs of a broad range of network deployments.

· Fiber Distribution Outside Plant Cabinets APACN's Fiber Scalability Center ("FSC") is a modular and scalable fiber distribution platform designed for "grow-as-you-go cost containment" as fiber goes beyond the control of a central office and closer to the user. This allows rollout of FTTH services by communication service providers without a large initial expense. Each outside plant cabinet stores feeder and distribution splices, splitters, connectors and slack cable neatly and compactly, utilizing field-tested designs to maximize bend radius protection, connector access, ease of cable routing and physical protection, thereby minimizing the risk of fiber damage. The FSC product has been designed to scale with the application environment as demand requires and to reduce service turn-up time for the end-user.

· Optical Components APACN packages optical components for signal coupling, splitting, termination, multiplexing, demultiplexing and attenuation to seamlessly integrate with the APACN FDS. This value-added packaging allows the customer to source from a single supplier and reduce space requirements. The products are built and tested to meet the strictest industry standards ensuring customers trouble-free performance in extreme outside plant environments.

· Cable Assemblies APACN manufactures high quality fiber and copper assemblies with an industry-standard or customer-specified configuration. Industry-standard assemblies built include but are not limited to: single mode fiber, multimode fiber, multi-fiber, CATV node assembly, DS1 Telco, DS 3 (734/735) coax, Category 5e and 6, SCSI, Token Ring, and V.35. In addition, APACN's engineering services team works alongside the engineering design departments of our OEM customers to design and manufacturer custom solutions for both in-the-box as well as network connectivity assemblies specific to that customer's product line.

Marketing and Distribution

APACN markets its products in the United States through a direct sales team with limited support from a network of manufacturer representative organizations. In addition, during fiscal 2006, the company significantly expanded its use of a two-tier distribution channel allowing the product line to penetrate a broader field of broadband service providers. APACN works closely with its target customers to adapt the company's product platform to the client's unique requirements. APACN offers a high level of customer service and principally brings new products to markets based upon the specific requests of its customers.

Competition

Competitors for the APACN FDS and FSC include but are not limited to ADC Telecommunications, Inc., Corning Cabling Systems, Inc., OFS (Furukawa Electric North America, Inc.), Telect Inc., Fiber Optic Network Solutions (FONS) Corporation (acquired by ADC Telecommunications during fiscal 2006), Alcatel, Inc., and Tyco Electronics, Inc. Nearly all of these firms are substantially larger than APACN and as a result may be able to procure pricing for necessary components and labor at much lower prices. Competition for the custom fiber and copper termination services for cable assemblies is intense. Competitors range from small, family-run businesses to very large contract manufacturing facilities.

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Sources of Materials and Outsourced Labor

Numerous purchased materials, components, and labor, are used in the manufacturing of the Company's products. Most of these are readily available from multiple suppliers. However, some critical components and outsourced labor are purchased from a single or a limited number of suppliers. The loss of access to some components and outsourced labor would have a material adverse effect on our ability to deliver products on a timely basis and on our financial performance.

Patents and Intellectual Property

As of March 31, 2006, we had 14 patents issued in the United States and two pending patent applications inside and outside the United States. During the last fiscal year the following 2 patents and a patent in process were sold:
US Patent 5,192,987 "High electron mobility transistor with GaN/AlGaN heterojunction";
US Patent 5,2196,395 " Method of making a high electron mobility transistor";
US Patent application from provisional No. 60/428,856 (since allowed).
Terms of the sale of these patents allow APA to market and sell products for applications greater than 1 GHz
All of our patents relate to the business of our Optronics segment. We believe our success heavily depends upon technology we develop internally and we anticipate additional patent application filings this year. We have made significant progress toward improving the active, strategic management of our intellectual property portfolio. The markets for our products are characterized by rapid change and continual innovation that could render our technology and patents obsolete before their statutory protection expires. Several of the companies we compete with have greater research and development resources than we do and could develop technologies and products that are similar or even superior to ours without infringing on our intellectual property. It is possible that sale or license of part of our patent portfolio could be helpful to our business plans.

Environmental Compliance

Because we handle a number of chemicals in our operations, we must comply with federal, state and local laws and regulations regarding the handling and disposal of such chemicals. To date the cost of such compliance has not been material.

Major Customers

No single customer accounted for more than 10% of the Company's sales in fiscal 2006, 2005, or 2004.

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Backlog

Backlog reflects purchase order commitments for our products received from customers that have yet to be fulfilled. Backlog orders are generally shipped within three months. Optronics had no backlog as of March 31, 2006, a backlog of $7,200 as of March 31, 2005 and a backlog of $6,490 as of March 31, 2004. APACN had backlogs of $1,383,206 as of March 31, 2006, $429,180 as of March 31, 2005, and $856,700 as of March 31, 2004.

Research and Development

During the fiscal years ended March 31, 2006, 2005, and 2004, Optronics spent approximately $1,409,000, $1,104,000, and $949,000, respectively, on research and development, mainly for the development of compound semiconductor electronic devices. This segment had no research activities sponsored by customers in fiscal years 2006, 2005 or 2004. We operate in highly competitive and rapidly evolving markets and plan to commit significant resources for research and development for the foreseeable future. We could locate research and development facilities in locations other than our current facilities in Minnesota based on several factors, including accessibility to qualified personnel and facility costs. APACN has made no significant expenditures for research and development from its inception through March 31, 2006.

Employees

As of March 31, 2006, Optronics had 36 full-time employees in the combined locations of Blaine, MN, Aberdeen, SD, and India. As of March 31, 2006, APACN had 92 full-time employees, mainly in Plymouth, MN. Our future performance is dependent on our ability to attract, train, and retain highly qualified personnel. We have no employment agreements with our employees. The loss of one or more key employees could negatively impact the Company.

ITEM 1A. RISK FACTORS.

Factors That May Affect Future Results

The statements contained in this Report on Form 10-K that are not purely historical are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitations, statements regarding the Company’s expectations, hopes, beliefs, anticipations, commitments, intentions and strategies regarding the future. Forward-looking statements include, but are not limited to, statements contained in “Item 1. Business” and “Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.” Actual results could differ from those projected in any forward-looking statements for the reasons, among others, detailed below. We believe that many of the risks detailed here are part of doing business in the industry in which we compete and will likely be present in all periods reported. The fact that certain risks are characteristic to the industry does not lessen the significance of the risk. The forward-looking statements are made as of the date of this Report as Form 10-K and we assume no obligation to update the forward-looking statements or to update the reasons why actual results could differ from those projected in the forward-looking statements.

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Our Results of Operations

Unless we generate significant revenue growth, our expenses and negative cash flow will significantly harm our financial position.

We have not been profitable since fiscal 1990. As of March 31, 2006, we had an accumulated deficit of $36.5 million. We may incur operating losses for the foreseeable future, and these losses may be substantial. Further, we may continue to incur negative operating cash flow in the future. We have funded our operations primarily through the sale of equity securities and borrowings. We have significant fixed expenses and we expect to continue to incur significant and increasing manufacturing, sales and marketing, product development and administrative expenses. As a result, we will need to generate significantly higher revenues while containing costs and operating expenses if we are to achieve profitability.

Acquisitions or investments could have an adverse affect on our business.

We acquired the assets of Americable in June 2003 and integrated them with the assets of APACN. We acquired assets in India in March 2005 as part of a strategy to take advantage of lower manufacturing costs in India. We intend to continue reviewing acquisition and investment prospects. There are inherent risks associated with making acquisitions and investments including but not limited to:

- Challenges associated with integrating the operations, personnel, etc., of an acquired company;
- Potentially dilutive issuances of equity securities;
- Reduced cash balances and or increased debt and debt service costs;
- Large one-time write-offs of intangible assets;
- Risks associated with geographic or business markets different than those we are familiar with; and
- Diversion of management attention from current responsibilities.

Our Products and Introduction of New Products

We must introduce new products and product enhancements to increase revenue.

The successful operation of our business depends on our ability to anticipate market needs and develop and introduce new products and product enhancements that respond to technological changes or evolving industry standards on a timely and cost-effective basis. Our products are complex, and new products may take longer to develop than originally anticipated. These products may contain defects or have unacceptable manufacturing yields when first introduced or as new versions are released. Our products could quickly become obsolete as new technologies are introduced or as other firms introduce lower cost alternatives. We must continue to develop leading-edge products and introduce them to the commercial market quickly in order to be successful. Our failure to produce technologically competitive products in a cost-effective manner and on a timely basis will seriously harm our business, financial condition and results of operations.

Our products may infringe on the intellectual property rights of others.

Our products are sophisticated and rely on complicated manufacturing processes. We have received multiple patents on aspects of our design and manufacturing processes and we have applied for several more. Third parties may still assert claims that our products or processes infringe upon their intellectual property. Defending our interests against these claims, even if they lack merit, may be time consuming, result in expensive litigation and divert management attention from operational matters. If such a claim were successful, we could be prevented from manufacturing or selling our current products, be forced to redesign our products, or be forced to license the relevant intellectual property at a significant cost. Any of these actions could harm our business, financial condition or results of operations.

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We may make additional strategic changes in our product portfolio, but our strategic changes and restructuring programs may not yield the benefits that we expect.

In connection with the downturn in the communications industry we have divested or closed product lines and businesses that either were not profitable or did not match our new strategic focus. As necessary, we may make further divestitures or closures of product lines and businesses. We may also make strategic acquisitions.

The impact of potential changes to our product portfolio and the effect of such changes on our business, operating results and financial condition, are unknown at this time. If we acquire other businesses in our areas of strategic focus, we may have difficulty assimilating these businesses and their products, services, technologies and personnel into our operations. These difficulties could disrupt our ongoing business, distract our management and workforce, increase our expenses and adversely affect our operating results and financial condition. In addition to these integration risks, if we acquire new businesses, we may not realize all of the anticipated benefits of these acquisitions, and we may not be able to retain key management, technical and sales personnel after an acquisition. Divestitures or elimination of existing businesses or product lines could also have disruptive effects and may cause us to incur material expenses.

Manufacturing and Operations

Our dependence on outside manufacturers may result in product delivery delays.

We purchase components and labor that are incorporated into our products from outside vendors. In the case of the SunUV® Personal UV Monitor, we supply components to an outside assembler who delivers the completed product. If these vendors fail to supply us with components or completed assemblies on a timely basis, or if the quality of the supplied components or completed assemblies is not acceptable, we could experience significant delays in shipping our products. Any significant interruption in the supply or support of any components or completed assemblies could seriously harm our sales and our relationships with our customers. In addition, we have increased our reliance on the use of contract manufacturers to make our products. If these contract manufacturers do not fulfill their obligations or if we do not properly manage these relationships, our existing customer relationships may suffer.

We may be required to rapidly increase our manufacturing capacity to deliver our products to our customers in a timely manner.

Manufacturing of our products is a complex and precise process. We have limited experience in rapidly increasing our manufacturing capacity or in manufacturing products at high volumes. If demand for our products increases, we will be required to hire, train and manage additional manufacturing personnel and improve our production processes in order to increase our production capacity. There are numerous risks associated with rapidly increasing capacity, including:

- Difficulties in achieving adequate yields from new manufacturing lines,
- Difficulty maintaining the precise manufacturing processes required by our products while increasing capacity,

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- The inability to timely procure and install the necessary equipment, and
- Lack of availability of qualified manufacturing personnel.

If we apply our capital resources to expanding our manufacturing capacity in anticipation of increased customer orders, we run the risk that the projected increase in orders will not be realized. If anticipated levels of customer orders are not received, we will not be able to generate positive gross margins and profitability.

We are dependent upon skilled employees; if we lose the services of our key personnel our ability to execute our operating plan, and our operating results, may suffer.

Our future performance depends in part upon the continued service and contributions of key management, engineering, sales and marketing personnel, many of whom would be difficult to replace quickly. If we lose any of these key personnel, our business, operating results and financial condition could be materially adversely affected or delay the development or marketing of existing or future products. Competition for these personnel is intense and we may not be able to retain or attract such personnel. Our success will depend in part upon our ability to attract and retain additional personnel with the highly specialized expertise necessary to generate revenue and to engineer, design and support our products and services.

Markets and Market Conditions

Demand for our products is subject to significant fluctuation. Adverse market conditions in the communications equipment industry and any slowdown in the United States economy may harm our financial condition.

Demand for our products is dependent on several factors, including capital expenditures in the communications industry. Capital expenditures can be cyclical in nature and result in protracted periods of reduced demand for component parts. Similarly, periods of slow economic expansion or recession can result in periods of reduced demand for our products. Such periods of reduced demand will harm our business, financial condition and results of operations. Changes to the regulatory requirements of the telecommunications industry could also affect market conditions, which could also reduce demand for our products.

Our industry is highly competitive and subject to pricing pressure.

Competition in the communications equipment market is intense. We have experienced and anticipate experiencing increasing pricing pressures from current and future competitors as well as general pricing pressure from our customers as part of their cost containment efforts. Many of our competitors have more extensive engineering, manufacturing, marketing, financial and personnel resources than we do. As a result, these competitors may be able to respond more quickly to new or emerging technologies and changes.

Declining average selling prices for our fiber optic products will require us to reduce production costs to effectively compete and market these products.

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Since the time we first introduced our fiber optic components to the marketplace we have seen the average selling price of fiber optic components decline. We expect this trend to continue. To achieve profitability in this environment we must continually decrease our costs of production. In order to reduce our production costs, we will continue to pursue one or more of the following:

- Seek lower cost suppliers of raw materials or components.
- Work to further automate our assembly process.
- Develop value-added components based on integrated optics.
- Seek offshore sources for manufacturing and assembly services.

We will also seek to form strategic alliances with companies that can supply these services. Decreases in average selling prices also require that we increase unit sales to maintain or increase our revenue. There can be no guarantee that we will achieve these objectives. Our inability to decrease production costs or increase our unit sales could seriously harm our business, financial condition and results of operations.

Our markets are characterized by rapid technological changes and evolving standards.

The markets we serve are characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. In developing our products, we have made, and will continue to make, assumptions with respect to which standards will be adopted within our industry. If the standards that are actually adopted are different from those that we have chosen to support, our products may not achieve significant market acceptance.

Conditions in global markets could affect our operations.

We have acquired facilities in India which will support design and production of our products. We also source products and labor from off shore suppliers. We expect that our foreign operations and reliance on off shore sourcing will increase in the future. As such we are subject to the risks of conducting business internationally. Those risks include but are not limited to:

- local economic and market conditions;
- political and economic instability;
- fluctuations in foreign currency exchange rates;
- tariffs and other barriers and restrictions;
- geopolitical and environmental risks; and
- changes in diplomatic or trade relationships and natural disasters.

We cannot predict whether our business operations and reliance in these markets will be affected adversely by these conditions.

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Our Customers

Our sales could be negatively impacted if one or more of our key customers substantially reduce orders for our products.

If we lose a significant customer, our sales and gross margins would be negatively impacted. In addition, the loss of sales may require us to record impairment, restructuring charges or exit a particular business or product line.

Consolidation among our customers could result in our losing a customer or experiencing a slowdown as integration takes place.

It is likely that there will be increased consolidation among our customers in order for them to increase market share and achieve greater economies of scale. Consolidation is likely to impact our business as our customers focus on integrating their operations and choosing their equipment vendors. After a consolidation occurs, there can be no assurance that we will continue to supply the surviving entity.

Customer payment defaults could have an adverse effect on our financial condition and results of operations.

As a result of competitive conditions in the telecommunications market, some of our customers may experience financial difficulties. It is possible that customers from whom we expect to derive substantial revenue will default or that the level of defaults will increase. Any material payment defaults by our customers would have an adverse effect on our results of operations and financial condition.

Performance Requirements and Performance of our Products

Our products may have defects that are not detected before delivery to our customers.

Some of the Company’s products are designed to be deployed in large and complex networks and must be compatible with other components of the system, both current and future. Our customers may discover errors or defects in our products only after they have been fully deployed. In addition, our products may not operate as expected over long periods of time. In the case of the SunUV® Personal UV Monitor, a consumer product, customers could encounter a latent defect not detected in the quality inspection. If we are unable to fix errors or other problems, we could lose customers, lose revenues, suffer damage to our brand and reputation, and lose our ability to attract new customers or achieve market acceptance. Each of these factors would negatively impact cash flow and would seriously harm our business, financial condition and results of operations.

Product defects could cause us to lose customers and revenue or to incur unexpected expenses.

If our products do not meet our customers’ performance requirements, our customer relationships may suffer. Also, our products may contain defects. Any failure or poor performance of our products could result in:

- delayed market acceptance of our products;
- delays in product shipments;
- unexpected expenses and diversion of resources to replace defective products or identify the source of errors and correct them;
- damage to our reputation and our customer relationships;

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- delayed recognition of sales or reduced sales; and
- product liability claims or other claims for damages that may be caused by any product defects or performance failures.

Intellectual Property

If we are unable to adequately protect our intellectual property, third parties may be able to use our technology, which could adversely affect our ability to compete in the market.

Our success will depend in part on our ability to obtain patents and maintain adequate protection of the intellectual property related to our technologies and products. The patent positions of technology companies, including our patent position, are generally uncertain and involve complex legal and factual questions. We will be able to protect our intellectual property rights from unauthorized use by third parties only to the extent that our technologies are covered by valid and enforceable patents or are effectively maintained as trade secrets. The laws of some foreign countries do not protect intellectual property rights to the same extent as the laws of the U.S., and many companies have encountered significant problems in protecting and defending such rights in foreign jurisdictions. We will apply for patents covering our technologies and products as and when we deem appropriate. However, these applications may be challenged or may fail to result in issued patents. Our existing patents and any future patents we obtain may not be sufficiently broad to prevent others from practicing our technologies or from developing competing products. Furthermore, others may independently develop similar or alternative technologies or design around our patents. In addition, our patents may be challenged, invalidated or fail to provide us with any competitive advantages.

We rely on trade secret protection for our confidential and proprietary information. We have taken security measures to protect our proprietary information and trade secrets, but these measures may not provide adequate protection. While we seek to protect our proprietary information by entering into confidentiality agreements with employees, collaborators and consultants, we cannot assure you that our proprietary information will not be disclosed, or that we can meaningfully protect our trade secrets. In addition, our competitors may independently develop substantially equivalent proprietary information or may otherwise gain access to our trade secrets.

Our business will suffer if we are unable to protect our patents or our proprietary rights.

Our success depends to a significant degree upon our ability to develop proprietary products. However, patents may not be granted on any of our pending patent applications in the United States or in other countries. In addition, the scope of any of our issued patents may not be sufficiently broad to offer meaningful protection. Furthermore, our issued patents or patents licensed to us could potentially be successfully challenged, invalidated or circumvented so that our patent rights would not create an effective competitive barrier.

Intellectual property litigation could harm our business.

It is possible that we may have to defend our intellectual property rights in the future. In the event of an intellectual property dispute, we may be forced to litigate or otherwise defend our intellectual property assets. Disputes could involve litigation or proceedings declared by the United States Patent and Trademark Office or the International Trade Commission. Intellectual property litigation can be extremely expensive, and this expense, as well as the consequences should we not prevail, could seriously harm our business.

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If a third party claimed an intellectual property right to technology we use, we might be forced to discontinue an important product or product line, alter our products and processes, pay license fees or cease certain activities. We may not be able to obtain a license to such intellectual property on favorable terms, if at all.

Litigation or third party claims of intellectual property infringement could require us to spend substantial time and money and adversely affect our ability to develop and commercialize products.

Our commercial success depends in part on our ability to avoid infringing patents and proprietary rights of third parties, and not breaching any licenses that we have entered into with regard to our technologies. Other parties have filed, and in the future are likely to file, patent applications covering genes and gene fragments, techniques and methodologies relating to model systems, and products and technologies that we have developed or intend to develop. If patents covering technologies required by our operations are issued to others, we may have to rely on licenses from third parties, which may not be available on commercially reasonable terms, or at all.

Third parties may accuse us of employing their proprietary technology without authorization. In addition, third parties may obtain patents that relate to our technologies and claim that use of such technologies infringes these patents. Regardless of their merit, such claims could require us to incur substantial costs, including the diversion of management and technical personnel, in defending ourselves against any such claims or enforcing our patents. In the event that a successful claim of infringement is brought against us, we may be required to pay damages and obtain one or more licenses from third parties. We may not be able to obtain these licenses at a reasonable cost, or at all. Defense of any lawsuit or failure to obtain any of these licenses could adversely affect our ability to develop and commercialize products.

Executive Officers

The following is a list of our executive officers, their ages, positions and offices as of March 31, 2006.

Name	***Age***	***Position***
Dr. Anil K. Jain	60	Chief Executive Officer/President/Chief Financial Officer of APA Enterprises, Inc.
Cheri Beranek Podzimek	43	President, APACN

Dr. Anil K. Jain has been a Director, Chief Executive Officer and President since March 1979. He also currently serves as Chief Financial Officer. From 1973 until October 15, 1983, when Dr. Jain commenced full time employment with the Company, he was employed at the Systems and Research Center at Honeywell Inc. as a Senior Research Fellow, coordinating optics-related development.

Cheri Beranek Podzimek joined APACN in July 2003 as President. Ms. Podzimek was previously President of Americable, which was acquired by APACN in June 2003. She served as President of Americable from 2002 to 2003. From 2001 to 2002 Ms. Podzimek was Chief Operating Officer of Americable. Previously, Ms. Podzimek held a variety of lead marketing positions with emerging high-growth technology companies. She served as Vice President of Marketing from 1996-2001 at Transition Networks, a manufacturer of network connectivity products, Director of Marketing from 1992 to 1996 at Tricord Systems, an early stage multi-processor based super server manufacturer, and Director of Marketing from 1988 to 1992 at Digi International, a designer and manufacturer of connectivity products. Earlier in her career Ms. Podzimek held marketing positions for non-profit organizations, including the City of Fargo, the Metropolitan Planning Commission of Fargo/Moorhead and North Dakota State University.

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ITEM 1B. UNRESOLVED STAFF COMMENTS.

None

ITEM 2. PROPERTIES.

We have corporate offices, manufacturing facilities, and laboratories located in an industrial building at 2950 N.E. 84th Lane, Blaine, Minnesota. We currently lease 23,500 square feet of space under a lease from Jain-Olsen Properties, a partnership consisting of Anil K. Jain and Kenneth A. Olsen, the former being officer and director of the Company. See Note O of Notes to the Consolidated Financial Statements included under Item 8 of this Report. We own land directly west of the Blaine facility that may be used for future expansion.

We own a 24,000 square foot production facility in Aberdeen, South Dakota, which was used mainly for assembly of products for APACN customers and to a lesser extent for assembly of our DWDM components and UV detectors. During the fiscal year 2006 the Company terminated all the manufacturing activities at this facility and put the facility for potential lease or sale. The land upon which this facility is located (approximately 12 acres) was granted to us as part of a financing package from the city of Aberdeen. See Note I of Notes to the Consolidated Financial Statements included under Item 8 in this Report for further information regarding the financing of this facility. This land was sub-divided into two parcels of approximately 10 and 2 acres, and the latter was sold to Aberdeen Development Corporation. The Company contemplates further sub-dividing the balance 10 acre land in to two parts of approximately 5 acres each with the intention of selling or leasing the building along with 5 acre land and retaining the other 5 acre parcel for future use.

APA signed a lease agreement in June of 2004 with Veeco Compound Semiconductor, Inc. to locate APA's multi-wafer MOCVD unit, purchased in fiscal 2004, in Veeco's facilities in White Bear Lake, Minnesota, which is near APA's Blaine facility. The lease term commenced on December 1, 2004 and was terminated March 10, 2006 coinciding with the sale of the epi foundry operation to an unrelated third party.

APA India currently leases, on a month to month basis, a 500 square meter facility in a special export zone near New Delhi, India. The Company is planning to relocate in to its own 1,000 square meter facility, under construction at present in the same general location, some time in calendar year 2006.

APACN subleases a 37,000 square foot facility in Plymouth, Minnesota consisting of office, manufacturing and warehouse space. This lease runs through June, 2006. Subsequent to year end, the company has renewed the lease of this facility through November 2013 on 30,000 square feet.

ITEM 3. LEGAL PROCEEDINGS.

On May 23, 2005 APA Enterprises, Inc. ("APA") was served with a complaint filed in U.S. District Court, District of Virginia by Electronic Instrumentation and Technology, Inc. ("EIT"). EIT alleged that APA obtained certain confidential information from EIT and used such information for unauthorized purposes. EIT requested money damages of unspecified amount and equitable relief. This matter was tried to a jury in December 2005. APA defeated EIT's claims of fraud and misappropriation of trade secrets. APA was ordered to pay EIT $35,000 for breach of contract. EIT filed certain post-trial motions, all of which were denied by the court. EIT did not appeal the verdict and this matter is concluded.

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

No matter was submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this Report.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Our common stock is traded on The NASDAQ National Market under the symbol "APAT." The following table sets forth the quarterly high and low sales prices for our common stock for each quarter of the past two fiscal years as reported by NASDAQ.

Fiscal 2006	**High**	**Low**
Quarter ended June 30, 2005	$ 1.62	$ 1.20
Quarter ended September 30, 2005	1.48	1.18
Quarter ended December 31, 2005	1.35	1.10
Quarter ended March 31, 2006	2.01	1.17

Fiscal 2005	**High**	**Low**
Quarter ended June 30, 2004	$ 3.75	$ 2.22
Quarter ended September 30, 2004	2.28	1.37
Quarter ended December 31, 2004	2.48	1.37
Quarter ended March 31, 2005	2.21	1.36

There were approximately 329 holders of record of our common stock as of March 31, 2006.

We have never paid cash dividends on our common stock. The loan agreement relating to certain bonds issued by the South Dakota Economic Development Finance Authority restricts our ability to pay dividends.

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ITEM 6. SELECTED FINANCIAL DATA.

	2006	2005	2004	2003	2002
Statements of Operations Data:					
Revenues	$ 15,717,837	$ 13,886,486	$ 11,909,465	$ 436,157	$ 595,955
Net loss	(3,348,848)	(3,420,038)	(6,535,147)	(5,009,434)	(4,738,199)
Net loss per share, basic and diluted	(.28)	(.29)	(.55)	(.42)	(.40)
Weighted average number of shares, basic and diluted	11,872,331	11,872,331	11,872,331	11,873,914	11,896,976
Balance Sheet Data:					
Total assets	$ 19,593,571	$ 22,074,014	$ 26,083,516	$ 31,884,526	$ 36,396,410
Long-term obligations, including current portion	1,360,961	1,578,836	1,811,759	2,173,682	2,461,363
Shareholders' equity	15,579,442	18,922,161	22,363,061	28,918,943	33,504,917

The above selected financial data should be read in conjunction with the financial statements and related notes included under Item 8 of this Report and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing in Item 7 of this Report.

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

General

Optronics is, at present, engaged in designing, manufacturing, and marketing of various optoelectronic products, ultraviolet ("UV") detectors and related products. For the last several years our goal has been to manufacture and market products/components based on our technology developments. Previously, we focused on DWDM components for fiber optic communications and GaN based UV detectors (both components and integrated detector/electronic/display packages) because we believe that these two product areas have significant potential markets and because we have expertise and/or patent positions related to them. Optronics terminated the fiber optic communication activities at the end of fiscal year 2006.

APACN, which is a wholly owned subsidiary of APA Enterprises, is engaged in the design, manufacture, distribution, and marketing of a variety of fiber optics and copper components to the data communication and telecommunication industries. APACN's primary manufactured products include standard and custom fiber optic cable assemblies, copper cable assemblies, Outside Plant (OSP) cabinets, value-added fiber optics frames, panels and modules. APACN acquired certain assets of Americable on June 27, 2003. Several items discussed under the "Results of Operations" show significant changes from the comparable periods in the preceding fiscal year as a result of the acquisitions of Americable.

Application of Critical Accounting Policies

In preparing our consolidated financial statements, we make estimates, assumptions and judgments that can have a significant impact on our revenues, loss from operations and net loss, as well as on the value of certain assets and liabilities on our consolidated balance sheet. We believe that there are several accounting policies that are critical to an understanding of our historical and future performance, as these policies affect the reported amounts of revenues, expenses and significant estimates and judgments applied by management. While there are a number of accounting policies, methods and estimates affecting our consolidated financial statements, areas that are particularly significant include:

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- Accounting for income taxes; and
- Valuation and evaluating impairment of long-lived assets and goodwill.

Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income tax liability in each of the jurisdictions in which we do business. This process involves estimating our actual current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. We must then assess the likelihood that these deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not more likely than not or unknown, we must establish a valuation allowance.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our deferred tax assets. At March 31, 2006, we have recorded a full valuation allowance of $13,390,433 against our deferred tax assets, due to uncertainties related to our ability to utilize our deferred tax assets, consisting principally of certain net operating losses carried forward. The valuation allowance is based on our estimates of taxable income by jurisdiction and the period over which our deferred tax assets will be recoverable. The Company had U.S. federal and state net operating loss (NOL) carry forwards of approximately $33,782,000 which expire in fiscal years 2007 to 2026. To date the Company has not completed a section 382 analysis. If certain ownership changes occurred under section 382, there may be further limitations on the usage of the net operating loss carry forwards.

During the fourth quarter of fiscal year 2006, the Company recorded a deferred income tax liability of $272,000 for the book and income tax basis difference in goodwill on acquisitions.

Realization of the NOL carry forwards and other deferred tax temporary differences are contingent on future taxable earnings. The deferred tax asset was reviewed for expected utilization using a "more likely than not" approach as required by SFAS No. 109, "Accounting for Income Taxes," by assessing the available positive and negative evidence surrounding its recoverability.

We will continue to assess and evaluate strategies that will enable the deferred tax asset, or portion thereof, to be utilized, and will reduce the valuation allowance appropriately at such time when it is determined that the "more likely than not" approach is satisfied.

Valuation and evaluating impairment of long-lived assets and goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired. Goodwill is not amortized, but reviewed for impairment annually or whenever conditions exist that indicate an impairment could exist. The Company performed the annual impairment test in fiscal years 2006, 2005 and 2004 and concluded that no impairment had occurred.

The Company evaluates the recoverability of its long-lived assets in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 requires recognition of impairment of long-lived assets in the event that events or circumstances indicate an impairment may have occurred and when the net book value of such assets exceeds the future undiscounted cash flows attributed to such assets. We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. No impairment of long-lived assets has occurred through the year ended March 31, 2006.

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New Accounting Pronouncement

In December 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004)(SFAS 123R), *Share-Based Payment*. This statement requires the compensation cost relating to share-based payment transactions to be recognized in a company's financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Statement 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The Company will be required to apply Statement 123(R) effective April 1, 2006. For fiscal year 2007, management estimates the expense to be approximately $103,000.

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Contractual Obligations

Our contractual obligations and commitments are summarized in the table below (in 000's):

		Total		Less than 1 Year		1-3 years		4-5 years		After 5 years
Long-term debt (1)	$	1,361	$	1,343	$	18	$	0	$	0
Operating leases		568		193		261		89		25
Total Contractual Cash Obligations	$	1,929	$	1,536	$	279	$	89	$	25

(1) Includes fixed interest ranging from 0.62 to 10.00%.

Results of Operations

2006 Compared to 2005

REVENUES

Consolidated revenues for the fiscal year ended 2006 increased 13% to $15,718,000 from sales of $13,886,000 in 2005. Consolidated cost of sales decreased from 81% in 2005 to 78% in 2006 resulting in improved gross margin of $3,517,000 in 2006 as compared to $2,688,000 in 2005, an increase of 31%. Consolidated operating losses, however increased to $4,655,000 in 2006 compared to $3,795,000 in 2005. Consolidated net losses, however, decreased somewhat to $3,349,000 in 2006 or $.28 per diluted share compared to $3,420,000 or $.29 in 2005. The losses in fiscal 2006 were impacted by significantly increased legal expenses and non-operating activities related to the sale of Metal Organic Chemical Vapor Deposition (MOCVD) operations and a non-cash deferred tax liability related to goodwill on acquisitions. Increased legal expenses related to the defense of a lawsuit brought by EIT, a Virginia corporation, and a non-cash tax expense accrual related to goodwill were offset by a gain on the sale of Metal Organic Chemical Vapor Deposition (MOCVD) operations.

APACN's revenues for the year ended 2006 were $15,641,000 versus $13,801,000 in the year ended 2005, an increase of 13%. The increase is primarily attributable to an increased acceptance of the Company's products within the FTTH market resulting from increased sales and marketing activities during the fiscal year 2006. Sales to broadband service providers and commercial data networks, which include APACN custom fiber distribution systems, associated cable assemblies and optical components, were $10,488,000 or 67% of revenue. Sales to OEM's, consisting primarily of fiber optic and copper cable assemblies produced to customer design specifications, were $5,152,000, or 33% of revenue. This compares to 69% for broadband and commercial data networks and 31% for OEM's in the prior year. APACN's revenue growth is dependent upon capital expenditures in the communications equipment industry, our ability to develop and introduce new products, and our ability to acquire and retain business in a competitive industry. We expect sales at APACN in fiscal 2007 to continue to increase as a result of our investment in market development activities and the acceptance of the product line within our target customers.

Gross revenues at Optronics for the year ended 2006 were $400,000, compared to $489,000 in 2005, a decrease of 24%. Gross revenues reflect approximately $323,000 of sales to APACN for fiber optics products and subcontracted labor versus $404,000 last year. These sales are eliminated as intercompany sales in the consolidated financial statements. Sales of UV monitors were $39,000 versus $29,000 in the prior year period, and sales of foundry services were $60,000 in 2006 versus $41,000 in 2005. Optronics' revenue growth is dependent upon our ability to successfully establish manufacturing reliability for our GaN products and successful selling into our targeted market segments.

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COST OF SALES AND GROSS PROFIT

APACN’s gross profit for the year ended in 2006 was $4,195,000 as compared to $3,821,000 in 2005. Gross profit percent for APACN for the year ended March 31, 2006 was 27% versus 28% in the prior year. The decrease in margin percentage reflects continued downward price pressure. The company expects to experience continued downward price pressure throughout fiscal 2007 and is continuing on its ongoing program to reduce the cost of its products through a combination of product re-design, process improvement and global sourcing of components and outside manufacturing. We expect gross margin percentage for APACN in fiscal 2007 to be about the same as in fiscal 2006.

Optronic’s net cost of sales for the year ended 2006 were $755,000 as compared to $1,218,000 in 2005. Personnel related expenses decreased approximately $250,000 due to staff reductions in our GaN product line and the termination of our Aberdeen manufacturing facility.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development (“R&D”) expenses consist solely of the research and development expense at Optronics. There have been no research and development expenses at APACN. R&D expenses increased by approximately $305,000, to $1,409,000 for the year ended March 31, 2006 as compared to $1,104,000 for the year ended March 31, 2005. This represents an increase of 28% from 2005. The majority of the increase reflects additional rental and depreciation costs associated with operating a semiconductor machine for the entire year fiscal year of 2006 as compared to only the last two quarters in fiscal 2005. We expect these R&D expenses to reduce significantly during fiscal 2007 due mainly to the sale of the operations of the semiconductor machine.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administration (“S, G & A”) expenses increased approximately $1,384,000, or 26%, to $6,763,000 in 2006 from $5,379,000 in 2005.

S, G & A expenses at APACN were $4,248,000 for the year ending March 31, 2006 as compared to $3,487,000 in 2005, an increase of $761,000 or 22% mainly due to increased sales and marketing activities. As a percentage of revenue, we expect S, G & A expenses to be comparable in fiscal year 2007 to fiscal year 2006.

S, G & A expenses at Optronics increased $626,000 to $2,519,000 for the year ending March 31, 2006, from $1,893,000 in the prior period. The increase is mainly due to $443,000 increased legal costs primarily associated with the defense of a law suit from Electronic Instrumentation and Technology, Inc. (EIT), a Virginia corporation. We expect S, G, & A in fiscal 2007 to decrease significantly as compared to S, G & A in fiscal 2006.

GAIN ON DISPOSAL OF ASSETS (net)

Gains on disposal of assets at APACN were $4,000 in fiscal year ending March 31, 2006. There were no gains in the prior fiscal year.

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Gains on disposal of assets at Optronics were $1,195,000 in fiscal year ended March 31, 2006 as compared to $209,000 in fiscal year ended March 31, 2005. A gain of approximately $1,163,000 was recognized on the sale of the MOCVD equipment and licensing of two patents during March 2006. In the prior fiscal year, the company realized a gain of approximately $196,000 on the sale of the optics product line in April 2004

OTHER INCOME AND EXPENSE

Other income at APACN increased approximately $114,000 to $122,000 in fiscal 2006 as compared to $8,000 in fiscal 2005. The difference is due mainly to significant contingent goodwill earn out of approximately $119,000, during fiscal year 2006, from Crescent Electric during the 3rd and final year of agreement acquired as a direct result of CSP acquisition. Other expense at APACN increased $83,000 to $386,000 for the year ending March 31, 2006 versus $303,000 in the prior year period. Interest expense increased $83,000 due to a higher debt balance outstanding and increasing interest rates over the year.

Other income at Optronics increased approximately $251,000 to $808,000 in fiscal 2006 from $557,000 in 2005. Interest income increased approximately $183,000 due mainly to higher interest income earned on cash equivalents. Other expenses increased approximately $69,000 to $160,000 from $91,000 in 2005, due mainly to the expenses related to the EIT judgment and write-down of fiber optic assets during the fiscal year 2006.

NET LOSS

Consolidated net loss decreased $71,000 to $3,349,000, or $.28 cents per share in fiscal 2006, as compared to a net loss of $3,420,000, or $.29 cents per share, in fiscal 2005.

Net loss for APACN for the year ending 2006 was $588,000 versus a profit of $36,000 in fiscal 2005. The increased losses during the fiscal 2006 were mainly due to the expansion of its sales and marketing activities and an accrual for taxes on goodwill.

Net loss for Optronics for the year ending 2006 was $2,760,000, a decrease of $696,000, or 20%, from $3,456,000 in 2005. The decreased losses are primarily the result of sale of its MOCVD operations and licensing of two patents.

2005 Compared to 2004

REVENUES

Consolidated revenues for the fiscal year ended 2005 increased 17% to $13,886,000 from sales of $11,909,000 in 2004. Consolidated cost of sales decreased to $11,198,000 in 2005 from $11,914,000 in 2004. Consolidated operating losses decreased to $3,795,000 in 2005 compared to $6,558,000 in 2004. Consolidated net losses decreased to $3,420,000 in 2005 or $.29 per diluted share compared to $6,535,000 or $.55 in 2004.

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APACN's revenues for the year ended 2005 were $13,801,000 versus $11,691,000 in the year ended 2004, an increase of 18%. The increase is primarily attributable to higher revenues in the first quarter of fiscal 2005 generated by the acquisition of Americable, Inc., which occurred at the end of the first quarter of fiscal 2004. The Americable assets contributed no corresponding revenues for the first quarter of fiscal 2004. Sales to broadband service providers and commercial data networks, which include APACN custom fiber distribution systems, associated cable assemblies and optical components, were $9,483,000 or 69% of revenue. Sales to OEM's, consisting primarily of fiber optic and copper cable assemblies produced to customer design specifications, were $4,317,000, or 31% of revenue. This compares to 60% for broadband and commercial data networks and 40% for OEM's in the prior year. The change in mix is partially a result of an increased acceptance of the Company's products within the FTTH market, offset by lower demand from some OEM customers. APACN's revenue growth is dependent upon capital expenditures in the communications equipment industry, our ability to develop and introduce new products, and our ability to acquire and retain business in a competitive industry.

Gross revenues at Optronics for the year ended 2005 were $490,000, compared to $409,000 in 2004, an increase of 20%. Gross revenues reflect approximately $404,000 of sales to APACN for fiber optics products and subcontracted labor versus $191,000 last year. These sales are eliminated as intercompany sales in the consolidated financial statements. The Company had no sales of its optics products in 2005 versus $92,000 in the prior year due to the sale of that product line in April 2004. Sales of UV monitors were $28,000 versus $23,000 in the prior year period, and sales of foundry services were $41,000 in 2005. Optronics' revenue growth is dependent upon our ability to successfully establish manufacturing reliability for our GaN products and successful selling into our targeted market segments.

COST OF SALES AND GROSS PROFIT

APACN's gross profit for the year ended in 2005 was $3,821,000 as compared to $2,660,000 in 2004. The increase is due mainly to higher margins generated in the first quarter of fiscal 2005 generated by the acquisition of Americable assets. Gross profit percent for APACN for the year ended March 31, 2005 was 28% versus 23% in the prior year. The increase in margin percentage reflects reduced production costs, resulting from consolidating multiple facilities, and a focus on selling higher margin products.

Optronic's net cost of sales for the year ended 2005 were $1,218,000 as compared to $2,883,000 in 2004. Personnel related costs decreased approximately $780,000 due to staff reductions in response to demand and the sale of the optics product line in April 2004. In addition, inventory writeoffs decreased approximately $125,000 and other production expenses decreased approximately $140,000 due to cost reductions implemented in fiscal 2004 and 2005 in the optics and GaN product lines.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development ("R&D") expenses consist solely of the research and development expense at Optronics. There have been no research and development expenses at APACN. R&D expenses increased by approximately $155,000, to $1,104,000 for the year ended March 31, 2005 as compared to $949,000 for the year ended March 31, 2004. This represents an increase of 16% from 2004. The majority of the increase reflects additional rental and depreciation costs associated with operating a semiconductor machine, beginning in the third quarter of fiscal 2005, as well as personnel costs associated with this start up and HFET development.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Consolidated selling, general and administration ("S, G & A") expenses decreased approximately $226,000, or 4%, to $5,379,000 in 2005 from $5,605,000 in 2004.

S, G & A expenses at APACN were $3,487,000 for the year ending March 31, 2005 as compared to $3,615,000 in 2004. The majority of the difference is attributable to expenses generated by the assets acquired from Americable which occurred at the end of the first quarter of fiscal 2004. Consolidation of facilities beginning in fiscal 2004 also contributed to lower costs in fiscal 2005.

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S, G & A expenses at Optronics decreased $97,000 to $1,893,000 for the year ending March 31, 2005, from $1,990,000 in the prior period. The decrease is attributable to a reduction in personnel expense of $260,000 in 2005, which was offset in part by higher outside services in 2005 related to India development expenses, along with higher facility expenses in 2005 (which consists of facility expenses included in cost of sales in 2004 but reclassified as S, G, & A in 2005) as this portion of the facility is no longer used for manufacturing operations.

GAIN ON DISPOSAL OF ASSETS (net)

Gains on disposal of assets were only recognized at Optronics. These gains were $209,000 in fiscal year ended March 31, 2005. There were no gains recognized in the prior fiscal year. The company realized a gain of approximately $196,000 on the sale of the optics product line in April 2004.

OTHER INCOME AND EXPENSE

Other income at APACN decreased approximately $15,000 to $8,000 in fiscal 2005 as compared to $23,000 in fiscal 2004. The difference is due mainly to higher income for management fees earned in fiscal 2004 related to the CSP acquisition. Other expense at APACN decreased $9,000 to $303,000 for the year ending March 31, 2005 versus $312,000 in the prior year period. Interest expense increased $64,000 due to a higher debt balance outstanding over the year. That was offset by a reduction of $77,000 in asset disposal charges absorbed in the prior year.

Other income at Optronics increased approximately $127,000 to $557,000 in fiscal 2005 from $430,000 in 2004. Interest income increased approximately $100,000 due mainly to higher interest income earned on cash equivalents. In addition $39,000 in facility related rental was also generated due to the sale of the fiber optics product line in April 2004. Other expenses decreased approximately $24,000 to $91,000 from $115,000 in 2004, due mainly to the absence of expenses related to assets disposed of in the prior year.

NET LOSS

Consolidated net loss decreased $3,115,000 to $3,420,000, or $.29 cents per share, as compared to a net loss of $6,535,000, or $.55 cents per share, in fiscal 2004.

Net income for APACN for the year ending 2005 was $36,000 versus a loss of $1,245,000 in fiscal 2004. The income is due mainly to increased revenue, reduced duplicate and one time expenses, lower personnel costs and more efficient operations achieved in the consolidation of the CSP and Americable assets.

Net loss for Optronics for the year ending 2005 was $3,456,000, a decrease of $1,834,000, or 35%, from $5,290,000 in 2004. The decreased losses are primarily the result of lower personnel and production expenses from cost reduction efforts implemented in fiscal 2004 and 2005, combined with the gain on sale of the optics business and the related savings of expense related to that product line.

Liquidity and Capital Resources

As of March 31, 2006, our principal source of liquidity was our cash, cash equivalents and short-term investments, which totaled $8,948,000 compared to $10,813,000 at March 31, 2005.

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We used $3,276,000 to fund operating activities during fiscal 2006 compared to $2,247,000 in fiscal 2005, and $5,596,000 in fiscal 2004. In all three years the largest use of cash in operating activities was the funding of the net losses. The net loss for fiscal 2006 decreased to $3,349,000 from $3,420,000 in fiscal 2005. The primary factor contributing to the decreased loss from fiscal 2005 to 2006 was the sale of the MOCVD equipment and licensing of two patents which was mostly negated by increased S, G&A costs. The primary factors contributing to the decreased loss from fiscal 2004 to 2005 were the profitable operations at APACN and reduced expenses at Optronics.

In fiscal 2006 we netted approximately $1,629,000 in positive cash flows from investing activities after accounting for the purchase of property and equipment of $428,000 and $2,057,000 proceeds from the sale of assets, including proceed of $1,900,000 of MOCVD equipment and licensing of two patents. In fiscal 2005 we used $249,000 in investing activities, including $49,000 used to purchase assets through APA Optronics (India) Private Limited (See Note B of Notes to the Consolidated Financial Statements included under Item 8 of this Report). We also invested $429,000 to purchase property and equipment, mainly for production equipment at Optronics. In fiscal 2004 we used $2,753,000 in investing activities including $1,960,000 used to purchase the assets of Americable. We also invested $786,000 to purchase property and equipment, mainly for the purchase of the MOCVD system

In fiscal 2006, we used $219,000 in financing activities, primarily to pay down long-term debt relating to our facility in Aberdeen, South Dakota. In fiscal 2005, we used $235,000 in financing activities, primarily to pay down long-term debt relating to our facility in Aberdeen, South Dakota. In fiscal 2004, we used $342,000 in financing activities primarily to pay down long-term debt relating to our facility in Aberdeen, South Dakota.

Construction of our manufacturing facility in Aberdeen utilized certain economic incentive programs offered by the State of South Dakota and the City of Aberdeen. At March 31, 2006, the total principal outstanding under bonds issued by the State of South Dakota was $1,320,000. Interest on the bonds ranges from 5.8% to 6.75%, and the bonds are due in various installments between 2005 and 2016. These bonds require compliance with certain financial covenants. We were out of compliance with these covenants during all of fiscal 2004, 2005 and 2006. For further information regarding these bonds, see Note I of Notes to the Consolidated Financial Statements included under Item 8 of this Report. On April 14, 2004 the Company sold its optics manufacturing operations, as discussed in Note C to the Consolidated Financial Statements included under Item 8 of this Report, to PNE, Inc. dba IRD. The terms of the sale required the Company to prepay $89,000 of a loan with the Aberdeen Development Corporation ("ADC") in South Dakota and to accelerate the loan payment schedule to maturity in fiscal 2011 from 2016. In June 2005, the Company sold a portion of the land in Aberdeen acquired from ADC back to ADC in consideration of cancellation of the remaining $120,000 due on the loan. Accordingly, the loan from ADC is fully satisfied. See Note D to the Consolidated Financial Statements included under Item 8 of this Report.

Our capital requirements are dependent upon several factors, including market acceptance of our products, the timing and extent of new product introductions and delivery, and the costs of marketing and supporting our products on a worldwide basis. See "Item 1. Business." Although we believe that our current cash, cash equivalents, and short-term investments will be sufficient to fund our operations for more than the next 12 months, we cannot assure you that we will not seek additional funds through public or private equity or debt financing or from other sources within this time frame, or that additional funding, if needed, will be available on terms acceptable to us, or at all. We may also consider the acquisition of, or evaluate investments in, products and businesses complementary to our business. Any acquisition or investment may require additional capital.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Our exposure to market risk for changes in interest rates relates primarily to our cash equivalents. The portfolio includes only marketable securities with active secondary or resale markets to ensure liquidity. We have no investments denominated in foreign country currencies and, therefore, our investments are not subject to foreign exchange risk. See “Cash and Equivalents” under Note A of the Consolidated Financial Statements.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Quarterly Results of Operations. The following tables present our unaudited quarterly operating results for the eight quarters ended March 31, 2006:

	Quarter Ended			
Statement of Operations Data	June 30, 2004(1)	September 30, 2004	December 31, 2004	March 31, 2005
Net revenue	$ 3,687,718	$ 3,668,068	$ 3,305,299	$ 3,225,401
Gross profit	600,875	782,264	601,140	704,031
Net loss	(702,836)	(883,047)	(928,510)	(905,645)
Net loss per share, basic and diluted	$ (0.06)	$ (0.07)	$ (0.08)	$ (0.08)

	Quarter Ended			
Statement of Operations Data	June 30, 2005	September 30, 2005	December 31, 2005	March 31, 2006(2)
Net revenue	$ 3,512,563	$ 4,069,367	$ 4,379,192	$ 3,756,715
Gross profit	725,110	904,070	1,024,333	863,591
Net loss	(891,006)	(1,063,628)	(1,275,786)	(118,428)
Net loss per share, basic and diluted	$ (0.08)	$ (0.09)	$ (0.11)	$ (0.01)

(1) In January, 2004 the Company announced the discontinuance of optics manufacturing at its Blaine, Minnesota facility. The closure was the result of aggressive off-shore pricing and continued lower demand for this product line. The Company sold its optics manufacturing operations on April 14, 2004 for $220,000.

(2) During the fourth quarter of fiscal year 2006, the Company recorded a deferred income tax liability of $272,000 related to goodwill from acquisitions.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
APA Enterprises, Inc.

We have audited the accompanying consolidated balance sheets of APA Enterprises, Inc. and subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended March 31, 2006. These consolidated financial state-ments are the responsibility of the Com-pany's management. Our responsibility is to express an opinion on these consolidated financial state-ments 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 audit to obtain reasonable assur-ance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting. Our audit included consideration of internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion of the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above pre-sent fairly, in all material respects, the consolidated financial position of APA Enterprises, Inc. and subsidiaries as of March 31, 2006 and 2005 and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended March 31, 2006, in con-formity with accounting principles generally accepted in the United States of America.

/s/ Grant Thornton LLP

Minneapolis, Minnesota
May 12, 2006

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APA Enterprises, Inc.

CONSOLIDATED BALANCE SHEETS

March 31,

ASSETS	2006	2005
CURRENT ASSETS		
Cash and cash equivalents	$ 8,947,777	$ 10,813,492
Accounts receivable, net of allowance for uncollectible accounts of $77,831 and $57,107 at March 31, 2006 and 2005	1,892,483	1,446,248
Inventories	1,836,843	1,270,653
Prepaid expenses	173,040	264,372
Bond reserve funds	126,385	131,548
Total current assets	12,976,528	13,926,313
PROPERTY, PLANT AND EQUIPMENT, net	2,623,412	3,946,998
OTHER ASSETS		
Bond reserve funds	343,241	337,091
Goodwill	3,422,511	3,422,511
Other	227,879	441,101
	3,993,631	4,200,703
	$ 19,593,571	$ 22,074,014

The accompanying notes are an integral part of these financial statements.

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APA Enterprises, Inc.

CONSOLIDATED BALANCE SHEETS - Continued

March 31,

LIABILITIES AND SHAREHOLDERS' EQUITY		2006		2005
CURRENT LIABILITIES				
Current maturities of long-term debt	$	1,342,481	$	1,471,036
Accounts payable		1,353,828		814,005
Accrued compensation		815,046		568,950
Accrued expenses		211,840		190,062
Total current liabilities		3,723,195		3,044,053
LONG-TERM DEBT, net of current maturities		18,480		107,800
DEFERRED INCOME TAXES		272,454		-
Total liabilities		4,014,129		3,151,853
COMMITMENTS AND CONTINGENCIES		-		-
SHAREHOLDERS' EQUITY				
Undesignated shares, 4,999,500 authorized shares; no shares issued and outstanding		-		-
Preferred stock, $.01 par value; 500 authorized shares; no shares issued and outstanding		-		-
Common stock, $.01 par value; 50,000,000 authorized shares; 11,872,331 shares issued and outstanding at March 31, 2006 and 2005		118,723		118,723
Additional paid-in capital		51,966,213		51,960,084
Accumulated deficit		(36,505,494)		(33,156,646)
Total shareholders equity		15,579,442		18,922,161
	$	19,593,571	$	22,074,014

The accompanying notes are an integral part of these financial statements.

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APA Enterprises, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

Years ended March 31,

	2006	2005	2004
Revenues	$ 15,717,837	$ 13,886,486	$ 11,909,465
Cost of sales	12,200,733	11,198,176	11,914,050
Gross profit (loss)	3,517,104	2,688,310	(4,585)
Operating expenses			
Research and development	1,408,778	1,103,972	948,737
Selling, general and administrative	6,763,068	5,379,483	5,605,177
Gain on sale of assets (net)	(1,198,295)	(208,837)	-
	6,973,551	6,274,618	6,553,914
Loss from operations	(3,456,447)	(3,586,308)	(6,558,499)
Other income	547,878	275,661	225,719
Other expense	(164,708)	(105,253)	(200,314)
	383,170	170,408	25,405
Loss before income taxes			