

ADVANCED POWER TECHNOLOGY INC  
Form 10-Q  
May 13, 2003

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2003**

**OR**

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

**Commission file number 001-16047**

**Advanced Power Technology, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other Jurisdiction of  
Incorporation or Organization)

**93-0875072**

(I.R.S. Employer  
Identification Number)

**405 SW Columbia Street, Bend, Oregon 97702**

(Address of principal executive offices and Zip Code)

**(541) 382-8028**

(Registrant's telephone number)

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 the filing requirements for the past 90 days. Yes  No

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

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The number of shares of the Registrant's Common Stock outstanding as of April 30, 2003 was 10,402,737 shares.

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**ADVANCED POWER TECHNOLOGY, INC.**

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## ITEM 1. FINANCIAL STATEMENTS

## ADVANCED POWER TECHNOLOGY, INC.

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	March 31, 2003 (unaudited)	December 31, 2002
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 7,990	\$ 6,708
Short-term investments in available-for-sale securities	8,073	10,452
Accounts receivable, net of allowance of \$161 (2003) and \$70 (2002)	7,195	6,899
Inventories, net	11,728	11,949
Prepaid expenses and other current assets	2,329	2,521
Total current assets	37,315	38,529
Property and equipment, net of accumulated amortization and depreciation of \$12,197 (2003) and \$11,410 (2002)	10,501	10,617
Long-term investments in available-for-sale securities	2,000	2,000
Other assets	181	109
Technology rights, net of accumulated amortization of \$1,146 (2002) and \$876 (2002)	9,618	9,887
Goodwill	15,570	15,806
Total assets	\$ 75,185	\$ 76,948
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 2,782	\$ 2,873
Accrued expenses	1,735	2,475
Total current liabilities	4,517	5,348
Other long term liabilities	423	428
Total liabilities	4,940	5,776
Stockholders equity:		
Preferred stock, par value \$.001, 1,000,000 shares authorized; no shares issued and outstanding		
Common stock, par value \$.01, 19,000,000 shares authorized; 10,511,594 issued and 10,402,737 shares outstanding in 2003; 10,503,219 shares issued and 10,394,362 shares outstanding in 2002	105	105
Additional paid-in capital	88,502	88,490
Treasury stock, at cost, 108,857 shares	(1,700)	(1,700)
Deferred stock compensation	(124)	(171)

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Accumulated other comprehensive income	189	166
Accumulated deficit	(16,727)	(15,718)
Total stockholders' equity	70,245	71,172
Total liabilities and stockholders' equity	\$ 75,185	\$ 76,948

See accompanying notes to consolidated financial statements.

**ADVANCED POWER TECHNOLOGY, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31,	
	2003	2002
Revenues, net	\$ 11,159	\$ 8,239
Cost of goods sold	7,752	5,612
Amortization of technology rights and other charges	284	392
Total cost of goods sold	8,036	6,004
Gross profit	3,123	2,235
Operating expenses:		
Research and development	833	1,021
Selling, general and administrative	3,931	2,510
In-process research and development		1,897
Total operating expenses	4,764	5,428
Loss from operations	(1,641)	(3,193)
Interest income, net	56	219
Other income, net	11	39
Loss before income tax benefit	(1,574)	(2,935)
Income tax benefit	(565)	(370)
Net loss	\$ (1,009)	\$ (2,565)
Net loss per share:		
Basic	\$ (0.10)	\$ (0.26)
Diluted	(0.10)	(0.26)
Weighted average number of shares used in the computation of net loss per share:		
Basic	10,400	9,859
Diluted	10,400	9,859

See accompanying notes to consolidated financial statements.

## ADVANCED POWER TECHNOLOGY, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31,	
	2003	2002
Cash flows from operating activities:		
Net loss	\$ (1,009)	\$ (2,565)
Adjustments to reconcile net loss to net cash (used) provided by operating activities:		
Depreciation and amortization	1,063	625
Inventory provisions	(142)	
Amortization of deferred stock compensation	47	146
Amortization of investment premium	13	36
Deferred gain on sale-leaseback	(4)	(5)
Non-cash charge for in-process research & development		1,897
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(273)	(765)
Inventories	388	849
Prepaid expenses and other assets	(214)	1,781
Accounts payable and accrued expenses	(272)	(301)
Net cash (used) provided by operating activities	(403)	1,698
Cash flows from investing activities:		
Purchases of available-for-sale securities	(1,000)	(1,000)
Proceeds from sale of available-for-sale securities	3,363	3,736
Payment for acquisitions, net of cash acquired		(14,085)
Proceeds from sale of property and equipment	97	72
Purchase of property and equipment	(773)	(259)
Net cash (used) provided by investing activities	1,687	(11,536)
Cash flows from financing activities:		
Payments on capital lease obligations	(20)	(18)
Proceeds from exercise of stock options	12	94
Net cash (used) provided by financing activities	(8)	76
Effects of exchange rate changes on cash	6	5
Net change in cash and cash equivalents	1,282	(9,757)
Cash and cash equivalents at beginning of period	6,708	16,102
Cash and cash equivalents at end of period	\$ 7,990	\$ 6,345
Supplemental disclosure of cash flow information:		
Cash received (paid) during the period for: Interest	\$ (14)	\$ (29)
Income taxes	225	1,395
Supplemental disclosure of noncash activities:		
Unrealized gain (loss) on short-term and long-term investments	\$ (2)	\$ (35)

Issuance of stock and options for acquisition of business

20,313

See accompanying notes to consolidated financial statements.



**ADVANCED POWER TECHNOLOGY, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share amounts)**

**(unaudited)**

**Note 1. Basis of Presentation**

The accompanying unaudited consolidated financial statements include normal recurring adjustments necessary for a fair presentation of Advanced Power Technology, Inc.'s (APT) interim results. The consolidated financial statements and notes in this Form 10-Q are presented as permitted by Regulation S-X, and as such, they do not contain certain information included in APT's 2002 annual consolidated financial statements and notes. This Form 10-Q should be read in conjunction with APT's consolidated financial statements and notes included in its Annual Report on Form 10-K for the year ended December 31, 2002. The financial information as of December 31, 2002 is derived from the audited consolidated financial statements as filed with APT's Annual Report on Form 10-K for the year ended December 31, 2002. The results of operations for the three months ended March 31, 2003 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2003.

APT's financial quarters are 13 week periods. The first quarter of 2003 ended on March 30 and the first quarter of 2002 ended on March 31. For convenience, the first quarters of 2003 and 2002 are shown as ended on March 31.

**Note 2. Summary of Significant Accounting Policies**

*(a) Revenue Recognition, Sales Returns and Allowances*

The balances and changes in reserve for warranties and sales returns for the three months ended March 31, 2003 and 2002 are as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2003</b>	<b>2002</b>
Balance beginning of period	\$ 351	\$ 365
Fair value of acquisition related balance		58
Provisions	244	287
Charge offs	(306)	(191)
Balance end of period	\$ 289	\$ 519

*(d) Stock-Based Compensation*

APT has elected to continue to apply the prescribed accounting in Opinion 25 and provide the required disclosures per SFAS 123 and SFAS 148. APT accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS 123 and Emerging Issues Task Force consensus on Issue No. 96-18, Accounting for Equity Instruments that are Issued to Other than Employees, for Acquiring or in Conjunction with Selling Goods or Services.

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Had APT determined compensation cost based on the fair value at the grant date for its stock options under SFAS 123, APT's net income (loss) would have been the pro forma amounts indicated in the table below.

	Three Months Ended March 31,	
	2003	2002
<b>Net income (loss):</b>		
As reported	\$ (1,009)	\$ (2,565)
Add: Stock based compensation included in reported net income (loss), net of related tax effects	47	146
Deduct: Stock based compensation determined under fair value based method for all awards, net of related tax effects	(438)	(554)
Pro forma net income (loss)	\$ (1,400)	\$ (2,973)
<b>Earnings (loss) per share:</b>		
Basic and Diluted as reported	\$ (0.10)	\$ (0.26)
Basic and Diluted pro forma	\$ (0.13)	\$ (0.30)

**(e) Net Income (Loss) Per Share**

Basic net income (loss) per share is computed using the weighted average number of shares of common stock outstanding for the period. Diluted net income per share is computed using the weighted average number of shares of common stock and dilutive potential common shares related to stock options and warrants outstanding during the period. Anti-dilutive potential common shares are excluded from the diluted net income share calculation. Dilutive net (loss) per share excludes all potential common shares from the calculation as the impact would be anti-dilutive.

Incremental dilutive shares included in the calculation of diluted net income (loss) per share and incremental anti-dilutive shares that were excluded from the calculation of diluted net income (loss) per share for the three months ended March 31, 2003 and 2002 are summarized in the following table.

	Three Months Ended March 31	
	2003	2002
Incremental dilutive shares included in diluted net income per share calculation		
Anti-dilutive shares excluded from diluted net income (loss) per share calculation	1,179,000	902,000

**Note 3. Comprehensive Income (loss)**

Comprehensive income (loss) is the total of net income (loss) and all other non-owner changes in equity. Comprehensive income (loss) includes foreign currency translations and unrealized gains and losses from investments, as presented in the following table.

	Three Months Ended March 31,	
	2003	2002
Net loss	\$ (1,009)	\$ (2,565)
Other comprehensive income (loss), net of tax		
Foreign currency translation adjustment	25	(9)
Unrealized loss on available for sale securities	(2)	(35)
Comprehensive loss	\$ (986)	\$ (2,609)

**Note 4. Inventories, net**

	March 31, 2003	December 31, 2002
Raw materials	\$ 2,786	\$ 2,806
Work in process	6,421	6,705
Finished goods	4,063	4,128
	13,270	13,639
Valuation reserve	(1,542)	(1,690)
	\$ 11,728	\$ 11,949

**Note 5. Acquisitions**

(a) ***GHz Technology, Inc.***

On January 25, 2002, APT acquired all of the outstanding shares and stock options of GHz Technology, Inc. (GHz), in exchange for cash, APT common stock, and APT stock options. The company was renamed Advanced Power Technology RF, Inc. (APTRF). The GHz assets acquired included approximately \$205 in cash and \$7,656 in marketable securities. The transaction was accounted for by the purchase method of accounting, in accordance with SFAS 141, Business Combinations and SFAS 142. APT obtained a third party valuation study to estimate the fair value of the acquired intangible assets. APT began to consolidate the financial results of GHz on January 25, 2002 and forward.

(b) *Microsemi RF Products, Inc.*

On May 24, 2002, APT acquired the product lines and certain assets of Microsemi RF Products, Inc. (MSC RF), a wholly-owned subsidiary of Microsemi Corporation, for \$12,200 in cash. The company was renamed Advanced Power Technology RF Pennsylvania, Inc. (APTRF-PA). The transaction was accounted for by the purchase method of accounting, in accordance with SFAS 141 and SFAS 142. APT obtained a third party valuation study to estimate the fair value of the acquired intangible assets. APT began to consolidate the financial results of the acquired business on May 24, 2002 and forward

**(c) Pro Forma Condensed Consolidated Results**

The following table reflects the unaudited combined results of APT, GHZ, and MSC RF as if the acquisitions had taken place as of January 1, 2002. The pro forma information includes non-cash charges for amortization of technology rights, inventory fair value adjustments, depreciation and deferred compensation related to the acquisitions, consistent with generally accepted accounting principles. The period excludes a charge of \$1,897 for in-process research and development expense. The pro forma information does not necessarily reflect the actual results that would have occurred if the companies had been combined during the period nor is it necessarily indicative of future results of operations for the combined companies.

	<b>Three Months Ended March 31,</b>	
	<b>2003</b>	<b>2002</b>
Revenues, net	\$ 11,159	\$ 11,033
Net loss	(1,009)	(1,325)
Net loss per share:		
Basic	\$ (0.10)	\$ (0.13)
Diluted	(0.10)	(0.13)
Weighted average number of shares used in the computation of net loss per share:		
Basic	10,400	10,277
Diluted	10,400	10,277

**Note 8. SEGMENT INFORMATION**

APT operates in one segment and is engaged in the manufacture and marketing of high-performance power semiconductors and modules for switching and RF applications.

**Note 9. COMMITMENTS AND CONTINGENCIES**

From time to time the Company is involved in various legal matters that arise out of the ordinary conduct of our business, including those related to litigation over intellectual property rights, commercial transactions, contracts and environmental matters. The Company is currently involved in various legal proceedings. The Company does not believe that the ultimate resolution of such litigation will have a material adverse effect on the Company's financial position, results of operations or cash flows. The Company accrues loss contingencies in connection with its litigation when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This discussion and analysis is intended to be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in our Annual Report on Form 10-K for the year ended December 31, 2002.

### **Forward-looking Statements and Risk Factors Affecting Business and Results of Operations**

All statements and trend analyses contained in this item and elsewhere in this report on Form 10-Q relative to the future constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-statements are subject to the business and economic risks faced by us and our actual results of operations may differ materially from those contained in the forward-looking statements. In addition, results of operations for the periods discussed below should not be considered indicative of the results to be expected in any future period and fluctuations in operating results might result in fluctuations in the market price of our common stock. Our quarterly and annual operating results may vary significantly depending on many factors, including but not limited to, the cost and liability associated with patent infringement litigation, the ability of subcontractors to meet their delivery commitments; unfavorable changes in industry and competitive conditions; our mix of product shipments; the accuracy of our customer's forecasts; the effectiveness of our efforts to control and reduce costs; and other risks detailed in Management's Discussion and Analysis of Financial Condition and Results of Operations - Risk Factors Affecting Business and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2002, filed with the Securities and Exchange Commission.

### **Overview**

We are a leading designer, manufacturer and marketer of high-performance power semiconductors and modules for both switching and RF applications. Power semiconductors manage and regulate electrical power by converting electricity into a form required by electrical and electronic products. Our power semiconductors increase system efficiency, permit the design of more compact end products and improve features and functionality. We are primarily focused on the high power, high frequency segment of the power semiconductor market. High power refers to the ability to dissipate above one kilowatt, and high frequency refers to the ability to switch on and off at rates above 100 kilohertz. In addition we are strengthening our portfolio of RF products that operate at frequencies ranging from 1 megahertz to 100 megahertz. RF generally refers to the ability to operate at frequencies above 1 megahertz. We sell our products primarily in North America, Europe, and Asia, through a network of independent sales representatives and distributors.

To further our penetration in RF markets, we completed the acquisition of GHz Technology, Inc. and the business of Microsemi RF Products, Inc. in January 2002 and May 2002, respectively. These acquisitions are part of the Company's ongoing strategy to expand its product and technology portfolio in the RF power arena through both internal development and acquisitions. We believe that these acquisitions serve to position APT as an emerging, dominant supplier in bipolar RF power transistors for avionics, radar and non-cellular communications applications. These acquisitions have added valuable RF technology and substantial RF engineering, manufacturing and marketing capability to the Company.

In August 2000, we completed an initial public offering, or IPO, of 4,025,000 shares of our common stock, including the underwriters over-allotment, at an offering price of \$15.00 per share. The IPO included 2,830,000 shares sold by APT and 1,195,000 shares sold by shareholders of APT, and resulted in net proceeds to APT of approximately \$38.3 million. The net remaining proceeds are currently held in various investments and will be used for general corporate purposes, including research and development and possible acquisitions. Our

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common stock is listed on the Nasdaq National Market under the symbol APTI.

The following discussion should be read in conjunction with the consolidated financial statements provided under Part II, Item 8 of this Annual Report on Form 10-K. Certain statements contained herein may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These



statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially, as discussed more fully herein.

### **Critical Accounting Policies and Estimates**

Advanced Power Technology's discussion and analysis of its financial condition and results of operations are based upon consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires APT to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, APT evaluates its estimates, including those related to product returns and warranty obligations, allowance for doubtful accounts, excess and obsolete inventories, income taxes, valuation of intangible assets including goodwill, valuation of long-lived assets, contingencies and litigation, and excess component order cancellation costs. APT bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

APT believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

### ***Product Returns and Warranty Obligations***

Standard product revenue is recognized upon shipment of product. APT recognizes revenue on customer-specific products or services based on the terms of customer contracts which are generally based on customer acceptance. In general, APT provides for a one-year repair or replacement warranty on its products. Upon shipment, APT also provides for the estimated cost that may be incurred for product warranty and sales returns based on historical experience. APT uses independent distributors to sell its products. Distributors can return up to 5% of the dollar value of products purchased during the prior six months upon a 30 days notice and receive certain price protections on purchased products. Sales to distributors are recognized upon shipment, less an allowance for estimated returns based on historical experience.

While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, APT's warranty obligation is affected by product non-conformance rates, material usage and service delivery costs incurred in correcting a product non-conformance. Should actual product non-conformance rates, material usage, service delivery costs, or distributor returns differ from APT's estimates, revisions to the estimated warranty liability would be required.

### ***Allowance for Doubtful Accounts***

APT maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management regularly reviews the adequacy of the allowance after considering the size of the accounts receivable balance, historical bad debts, the customer's expected ability to pay and our collection history with each customer. Management reviews significant individual accounts that are past due to determine whether an allowance should be made based on these factors. If the financial condition of our customers were to

deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

*Excess and Obsolete Inventories*

Inventories are stated at the lower of standard cost (approximates actual cost on a first-in, first-out basis) or market (net realizable value). APT establishes reserves for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated net realizable value based upon assumptions about future demand and market conditions. APT evaluates historical usage of the product, current customer demand, and forecasted usage of the product. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

### ***Income Taxes***

APT records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. While APT considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event APT were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should APT determine that it would not be able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

### ***Valuation of Goodwill and Intangible Assets with Indefinite Lives***

APT values goodwill and intangible assets with indefinite lives in accordance with Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets ( SFAS No. 142 ). Currently APT carries a goodwill balance in connection with acquisitions made in 2002, but has no other intangible assets with indefinite lives. We annually review goodwill and other intangible assets that have indefinite lives for impairment and when events or circumstances indicate the carrying value of these assets might exceed their current fair values. We determine fair value using discounted cash flow analysis and other acceptable valuation methodologies, which requires us to make certain assumptions and estimates regarding industry economic factors and future profitability. It is our policy to conduct impairment testing based on our most current business plans, which reflect changes we anticipate in the economy and industry. If actual results are not consistent with our assumptions and judgments, we could be exposed to a material impairment charge.

### ***Valuation of Long-Lived Assets***

APT values goodwill and intangible assets with indefinite lives in accordance with Statement of Financial Accounting Standards No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets ( SFAS No. 144 ). We evaluate our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. We determine the potential impairment using undiscounted cash flow analysis, which requires us to make certain assumptions and estimates regarding industry economic factors and future profitability. It is our policy to conduct impairment testing based on our most current business plans, which reflect changes we anticipate in the economy and industry. If actual results are not consistent with our assumptions and judgments, we could be exposed to a material impairment charge.

### ***Contingencies and Litigation***

APT is subject to the possibility of various loss contingencies arising in the ordinary course of business. We consider the likelihood of loss or impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals should be adjusted.



**Results of Operations**

The following table presents our consolidated statement of operations data for the periods indicated as a percentage of net revenue:

	<b>Three Months Ended March 31,</b>	
	<b>2003</b>	<b>2002</b>
Revenues, net	100.0%	100.0%
Cost of goods sold	69.5	68.1
Amortization of technology rights and other charges	2.5	4.8
Total cost of goods sold	72.0	72.9
Gross profit	28.0	27.1
Operating expenses:		
Research and development	7.5	12.4
Selling, general and administrative	35.2	30.5
In-process research and development		23.0
Total operating expenses	42.7	65.9
Loss from operations	(14.7)	(38.8)
Interest and other income, net	0.6	3.1
Loss before income tax benefit	(14.1)	(35.7)
Income tax benefit	(5.1)	(4.5)
Net loss	(9.0)%	(31.2)%

*Revenues.* Revenues for the first quarter of 2003 were \$11.2 million, up 35.4% from \$8.2 million in the first quarter of 2002, and down 2.5% from \$11.4 million for the fourth quarter 2002. Excluding the acquisitions of GHz Technology Inc. (GHz) and the business of Microsemi RF Products, Inc., which were completed on January 25, 2002 and May 24, 2002, respectively, first quarter 2003 revenues were up 10.9% over the year ago quarter. On a before acquisition basis, the increase in revenues over the prior year quarter is attributable to higher sales to the industrial/medical and semiconductor capital equipment markets. APT's sales into the semiconductor capital equipment and industrial/medical markets hit a trough in the second half of 2001, and then strengthened in the second half of 2002 and first quarter of 2003, although with significant quarter to quarter variability.

Including the impact of the companies acquired, the 35.4% increase in revenues over the prior year quarter is a result of growth across all of the markets we serve, which include: communications/data processing, semiconductor capital equipment, industrial/medical and military/aerospace. Compared to the fourth quarter of 2002, we saw sequential increases in the communications/data processing and semiconductor capital equipment markets, offset by a sequential decline in the industrial/medical segment. This decrease was driven primarily by lower sales to one customer in medical imaging applications as a result of reduced end customer demand and by the impact of a last time buy shipment made in the fourth quarter of 2002.

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Sales to distributors were approximately 25% of revenues in the first quarter of 2003, compared to our 2002/2001 average of 21%. We monitor inventory levels at our distributors on a monthly basis. During the first quarter of 2003, inventories at our US distributors decreased and sales to end customers increased sequentially by 16% from the fourth quarter of 2002.

Sales of our higher margin RF products represented approximately 47.8% in the first quarter of 2003 compared to 36.2% in the first quarter of 2002.

*Gross Profit.* Gross profit for the first quarter of 2003 was 28.0% compared to 27.1% in the first quarter of 2002 and 26.6% in the fourth quarter of 2002. Excluding the non-cash purchase accounting adjustments for the fair value of inventory acquired and the amortization of the technology rights asset, gross profit was 30.5% for the first

quarter of 2003 compared to 31.9% in the first quarter of 2002 and 30.6% in the fourth quarter of 2002. Although our revenues increased by 35.4% in the first quarter of 2003 compared to the first quarter of 2002, when excluding the non-cash purchase accounting adjustments, our gross margin percentage declined in the first quarter of 2003 compared to the first quarter of 2002. The decline in gross margin percentage is due to slightly more unfavorable product mix and low fixed cost absorption at the Microsemi RF Products Inc business we acquired on May 24, 2002, which contributed gross margin at a lower percentage rate than our overall business. The company is pursuing actions to reduce our production costs, which we expect will lower our overall breakeven point. These include the consolidation of internal wafer fabrication operations at our Bend facility and greater utilization of low cost offshore assembly subcontractors associated with corresponding downsizing of internally assembly operations.

*Research and Development Expense.* First quarter of 2003 research and development expenses were \$833,000 or 7.5% of revenues, compared to \$1.0 million in the first quarter of 2002 or 12.4% of revenues. The decrease in spending over the prior year quarter is primarily due to lower expenditures for supplies and materials used in research and development expenses which were high in the first quarter of 2002 in order to support the introduction of a number of new products, especially in our Power MOS7© technology. The lower spending was partially offset by additional research and development expenses contributed by the companies we acquired in 2002. The Company plans to continue its research and development programs leading to the introduction of new products for use in both switching and RF applications.

*Selling, General and Administrative Expense.* First quarter of 2003 selling, general and administrative expenses were \$3.9 million or 35.2% of revenues, compared to \$2.5 million in the first quarter of 2003 or 30.5% of revenues and \$3.4 million in the fourth quarter of 2002 or 30.1% of revenues. The increase in selling, general and administrative expenses over the prior year quarter is partially due to \$527,000 of incremental spending at the subsidiaries we acquired at the end of January and May of 2002. This amount includes a \$240,000 severance charge in the first quarter of 2003 due to an organizational restructuring. The remaining \$894,000 increase over the prior year quarter is partially due to increased legal expenses in connection with the ongoing patent litigation, as more fully explained in Part II, Item 1 to this filing. We have denied infringement of the IXYS patents and have asserted affirmative defenses to our claims. However, the length of time and legal fees associated with the patent litigation with IXYS may be significant. The remaining increase over the prior year quarter is due to higher payroll expenses, as the graduated pay reductions implemented in 2001 were discontinued in the third quarter of 2002, higher insurance costs and additional depreciation charges due to capital additions for technology infrastructure. The increase in selling, general and administrative expenses over the fourth quarter of 2002 is primarily due to the increased legal expenses and a severance charge in the first quarter of 2003 as mentioned above.

*Stock Compensation Expense.* Stock compensation expense includes costs relating to stock-based employee compensation arrangements, and is based on the difference between the fair market value of our common stock on the date of grant of options and the exercise price of options to purchase that stock. Stock compensation expense is recognized over the vesting periods of the related options, typically five years. On a consolidated basis, stock compensation expense of \$47,000 was recorded in the first quarter of 2003. Of this amount, \$14,000 was recorded in cost of goods sold and \$33,000 was recorded in selling, general and administrative expense. Stock compensation expense of \$146,000 was recorded in the first quarter of 2002. Of this amount, \$64,000 was recorded in cost of goods sold, \$22,000 was recorded in research and development expense and \$60,000 was recorded in selling, general and administrative expense. We expect to record stock compensation expense of \$39,000 in the second quarter of 2003.

*Interest and other income, net.* Interest and other income, net, which includes interest income, interest expense and other expense, was \$67,000 in the first quarter of 2003 compared to \$258,000 in the first quarter of 2002. The primary component is interest income earned on our cash and marketable securities. Net interest income was \$56,000 in the first quarter of 2003 compared to \$219,000 in the first quarter of 2002. The decline in interest income is primarily due to lower interest rates available in the current investment market and a lower investment balance due to cash used for the acquisitions we made in 2002.

*Income Tax Expense (Benefit).* We recorded a tax benefit in the first quarter of 2003, at an effective tax rate of 35.9%. The first quarter tax rate benefit is lower than the expected tax rate primarily due to a foreign net operating loss in the quarter which carries a full valuation allowance. Our effective tax rate in the first quarter of



2002 was 12.6%. The effective tax rate in the first quarter of 2002 was lower than the federal statutory rate primarily due to the in process research and development expenses, which are not deductible for tax purposes and the benefit of a reduction in the valuation allowance due to the realization of foreign net operating loss carry forwards.

*Valuation of Goodwill and Intangible Assets with Finite Lives.* Due to recent stock market and economic conditions, the Company will perform an interim impairment analysis in the second quarter of 2003. The Company has engaged the services of an outside valuation specialist for this project. The results of this analysis might require that the Company record a non-cash charge for the amount of any impairment deemed to have occurred.

### **Liquidity and Capital Resources**

In the first three months of 2003, we used approximately \$403,000 in operating activities. This primarily resulted from our net loss of \$1.0 million and a negative cash flow from operating assets and liabilities of \$371,000, offset by non-cash charges for depreciation and amortization of \$1.1 million.

In the first three months of 2003, we generated \$1.7 million from investing activities, which consisted mainly of net proceeds from the sale of available-for-sale securities of \$2.4 million, offset by purchases of \$773,000 of fixed assets. Our purchases of fixed assets were for technology infrastructure and facility and equipment expenditures at our Bend facility in support of the consolidation of wafer fab operations from our Pennsylvania facility to Bend.

In the first three months of 2003, we used approximately \$8,000 in financing activities, which primarily consisted of the payment of capital lease obligations of \$20,000 offset by the net proceeds of \$12,000 from the exercise of stock options.

As of March 31, 2003 APT had \$32.8 million in working capital. Our trade accounts receivable balance was \$7.2 million reflecting a days sales outstanding ratio of 58 days, compared to trade accounts receivable of \$6.9 million at December 31, 2002, reflecting a days sales outstanding ratio of 63 days. Our inventory balance was \$11.7 million reflecting inventory turns of 2.7 times per year, compared to an inventory balance of \$11.9 million at December 31, 2002, reflecting inventory turns of 2.8 times per year. The calculations above are based on quarterly average balances of trade accounts receivable and inventory and annualized quarterly sales and cost of goods sold.

APT currently expects to fund expenditures for capital requirements as well as liquidity needs from a combination of available cash balances, internally generated funds and financing arrangements if needed. As of March 31, 2003, APT had \$18.1 million in cash and cash equivalents and available-for-sale securities. APT's investment policy is to invest in short term, high-grade liquid investments with the goal of capital preservation. APT's ability to generate positive cash flow from operations may be affected by market conditions as well as other risk factors as described in our Annual Report on Form 10-K for the year ended December 31, 2002. We expect from time to time to evaluate potential acquisitions and equity investments complementary to our market strategy. To the extent we pursue such transactions, we could require additional equity or debt financing to fund such activities or to fund our working capital requirements in the event of an industry downturn or an unexpected adverse change in our business operations. To the extent we require additional capital, we cannot assure you that we will be able to obtain such financing on terms favorable to us, or at all.



### **Recent Accounting Pronouncements**

In June 2002, the FASB issued SFAS 146 - Accounting for Costs Associated with Exit or Disposal Activities. SFAS 146 addresses accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring). SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value when the liability is incurred. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of the new rule is not expected to have a material impact on the Company's statements of position, operations or cash flows.

In November, 2002, the FASB issued FASB Interpretation No. 45 - Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). This interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued and requires that they be recorded at fair value. The initial recognition and measurement provisions of this interpretation are to be applied only on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements of this interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of the new rule is not expected to have a material impact on the Company's statements of position, operations or cash flows.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

We do not use derivative financial instruments in our investment portfolio. Due to the short duration and conservative nature of our cash equivalents, and the high quality and conservative nature of our long-term investments, we do not expect any material loss with respect to our investment portfolio.

Currently less than 2% of our sales are transacted in local currencies, primarily Euros. As a result, our international results of operations have limited exposure to foreign exchange rate fluctuations. We do not currently hedge against foreign currency rate fluctuations. Most of our export sales and sales by APT Europe are in U.S. dollars, and most of our foreign currency sales are from operations with significant expenses in the same currency. As a result, gains and losses from such fluctuations have not been material to our consolidated results of operations.

### **ITEM 4. CONTROLS AND PROCEDURES**

*(a) Evaluation of disclosure controls and procedures.*

As required by new Rule 13a-15 under the Securities Exchange Act of 1934, within the 90 days prior to the date of this report, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange

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Commission's rules and forms. In connection with the new rules, we currently are in the process of further reviewing and documenting our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

Based on our most recent evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures, the Company did not discover:

(a) any significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data nor any material weaknesses in internal controls;

(b) any instances of fraud, whether or not material, that involved management or other employees who have a significant role in the registrant's internal controls.

*(b) Changes in internal controls*

None.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

On August 15, 2002, IXYS Corporation filed a patent infringement lawsuit against APT with the United States District Court, Northern District of California. The claim filed by IXYS alleges that APT infringes on their United States Patent No. 5,486,715 and 5,801,419. The IXYS claim also requested that damages be determined at trial and that such damages be trebled. On October 1, 2002, APT filed its answers to the IXYS allegations of patent infringement. In addition, APT filed a patent infringement counterclaim against IXYS, alleging that IXYS infringes on APT United States Patent No. 5,283,202, entitled "IGBT Device With Platinum Lifetime Control Having Gradient Or Profile Tailored Platinum Diffusion Regions." APT has filed with the court several affirmative defenses related to the validity of the IXYS patents. In addition, APT does not believe that it infringes upon the IXYS patents cited in the claim. APT plans to vigorously defend itself in this lawsuit.

### **ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) The exhibits filed as part of this report are listed below:

#### **Exhibit No.**

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

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended March 31, 2003.



**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized this 12<sup>th</sup> day of May, 2003

ADVANCED POWER TECHNOLOGY, INC.

By: /s/ GREG M. HAUGEN

Greg M. Haugen  
Vice President, Finance and Administration,  
Chief Financial Officer and Secretary  
(Principal Financial Officer)

**CERTIFICATION PURSUANT TO**  
**RULE 13a-14 AND 15d-14 OF THE SECURITIES AND EXCHANGE ACT OF 1934**  
**AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Patrick Sireta, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Advanced Power Technology;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of this registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard



to significant deficiencies and material weaknesses.

By: /s/ PATRICK SIRETA  
President and Chief Executive Officer  
May 12, 2003

**CERTIFICATION PURSUANT TO**  
**RULE 13a-14 AND 15d-14 OF THE SECURITIES AND EXCHANGE ACT OF 1934**  
**AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Greg Haugen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Advanced Power Technology;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of this registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard

to significant deficiencies and material weaknesses.

By: /s/ GREG HAUGEN  
Vice President, Finance and Administration,  
Chief Financial Officer and Secretary  
(Principal Financial Officer)  
May 12, 2003