PHOTONIC PRODUCTS GROUP INC
Form 10-K/A
September 29, 2006

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

FORM 10-K/A

(Amendment No. 1)

(Mark One)

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

For the fiscal year ended: December 31, 2005

OR

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: 0-11668

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Photonic Products Group, Inc.
(Exact name of registrant as specified in its charter)

New Jersey	**22-2003247**
State or other jurisdiction of incorporation or organization	(I. R. S. Employer Identification No.)

181 Legrand Avenue, Northvale, NJ	**07647**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code **201-767-1910**

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

Title of each class	**Name of each exchange on which registered**

Securities registered pursuant to section 12(g) of the Act:
Common stock, par value $.01 Per Share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o. No x.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o. No x.

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b2 of the Exchange Act. (Check one):

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

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

Yes o No x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter. $3,657,500

Note. If a determination as to whether a particular person or entity is an affiliate cannot be made without involving unreasonable effort and expense, the aggregate market value of the common stock held by non-affiliates may be calculated on the basis of assumptions reasonable under the circumstances, provided that the assumptions are set forth in this Form.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

Common Shares outstanding as of March 25, 2006
[7,433,634]

Photonic Products Group, Inc.

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Note: Page F-1 follows Page 48.

** Section amended from Original Filing

*** See Note 2 on Page F-11

Explanatory Note

This Amendment No. 1 on Form 10-K/A (Form 10-K/A) to our Annual Report on Form 10-K for the year ended December 31, 2005, initially filed with the U.S. Securities and Exchange Commission (SEC) on March 31, 2006 (Original Filing), reflects the disclosure of events unknown to the Company at the time of the original filing. In the Company s Form 10-Q filed on May 15, 2006 the Company reported that its internal controls for monitoring the use and reporting of charges on the Company s debit card were not adequate and it was taking steps to remedy that inadequacy, including limiting the use of the debit card. The Company stated that it did not believe that this internal control issue had any material impact on the Company s financial statements based upon what had been uncovered.

The Audit Committee of the Company s Board of Directors followed the discovery with respect to internal control inadequacies by conducting an internal investigation through an independent forensic accounting specialist. On May 16, 2006, William Miraglia stepped down as the Company s chief financial officer, following the appointment of William Foote as new chief financial officer, but remained employed in a non-officer capacity. From that time, Mr. Miraglia was restricted from using the Company debit card which had previously been under his direct control. In the course of its investigations, the Audit Committee discovered that Mr. Miraglia s use of the Company s debit card for unauthorized and personal charges was more widespread than initially discovered. On May 18, 2006, Mr. Miraglia was suspended with pay and barred from access to the Company s facilities and records while the investigation proceeded.

The investigation revealed that over a period of approximately six years, Mr. Miraglia had used the Company s debit card for unauthorized and personal transactions, and had, also, initiated and signed for other unapproved personal expenditures by company check. In total, unauthorized and unapproved expenses of a personal nature, from June 2000 to May 2006, were approximately $860,000. As a result of this information, Mr. Miraglia was terminated for cause from employment with the Company on June 14, 2006.

On June 26, 2006, the Company filed Form 8-K to provide an update on these events. The Company has reviewed the results of the investigation and performed an additional review of the transactions and concluded that all material charges, although unapproved and unauthorized, had been reflected as part of the Company s expenses in the appropriate periods. Based on its investigation and findings, the Company has concluded that none of the payments described above, either individually or in total, require a restatement to the Company s previously reported net income or earnings per share in any of the affected periods.

The Company has filed a claim to recover a portion of these losses under its employee dishonesty insurance policy, to the extent permitted as a result of policy limits on time and amounts of coverage. This claim has been settled and the company has recovered $300,000 from our insurance carrier, which is the policy limit. In addition, Mr. Miraglia has signed an agreement to make restitution to the Company. To date, he has repaid $5,000. In light of a number of factors, the Company does not believe that any significant further recoveries from Mr. Miraglia are likely in the foreseeable future. The Company is considering pursuing other remedies.

This Amendment No. 1 on Form 10-K/A is provided to update Part I Risk Factors, Part II- Item 9A Controls and Procedures, and include additional information and disclosure about the final results of the Audit Committee s investigation, including the amount of these expenditures in the respective periods, discussed herein in Note 2 of the Notes to the Financial Statements.

For the convenience of the reader, this Form 10-K/A sets forth the entire Form 10-K which was originally prepared and relates to the Company as of December 31, 2005. However, this Form 10-K/A only amends and restates the Original Filing for the Items described above, and for other related information. No attempt has been made to modify or update other disclosures presented in our Original Filing of Form 10-K, including the Financial Statements, except as indicated in the foregoing discussion. Accordingly, except for the foregoing amended information, this Form 10-K/A continues to speak as of March 31, 2006 (the Original Filing date of the Form 10-K), and does not reflect any events occurring after the filing of our Form 10-K and does not modify or update those disclosures affected by other subsequent events. Unless otherwise stated, the information in this Form 10-K/A not affected by such current amendments is unchanged and reflects the disclosures made at the time of the Original Filing.

PART I

Caution Regarding Forward Looking Statements

This Annual Report contains forward-looking statements as that term is defined in the federal securities laws. The Company wishes to insure that any forward-looking statements are accompanied by meaningful cautionary statements in order to comply with the terms of the safe harbor provided by the Private Securities Litigation Reform Act of 1995. The events described in the forward-looking statements contained in this Annual Report may not occur. Generally, these statements relate to business plans or strategies, projected or anticipated benefits or other consequences of the Company s plans or strategies, projected or anticipated benefits of acquisitions made by the Company, projections involving anticipated revenues, earnings, or other aspects of the Company s operating results. The words may , will , expect , believe , anticipate , proj plan , intend , estimate , and continue , and their opposites and similar expressions are intended to identify forward-looking statements. The Company cautions you that these statements are not guarantees of future performance or events and are subject to a number of uncertainties, risks, and other influences, many of which are beyond the Company s control, that may influence the accuracy of the statements and the projections upon which the statements are based. Factors which may affect the Company s results include, but are not limited to, the risks and uncertainties discussed in Items 1A, 7 and 7A. Any one or more of these uncertainties, risks, and other influences could materially affect the Company s results of operations and whether forward-looking statements made by the Company ultimately prove to be accurate. Readers are further cautioned that the Company s financial results can vary from quarter to quarter, and the financial results for any period may not necessarily be indicative of future results. The foregoing is not intended to be an exhaustive list of all factors that could cause actual results to differ materially from those expressed in forward-looking statements made by the Company. The Company s actual results, performance and achievements could differ materially from those expressed or implied in these forward-looking statements. The Company undertakes no obligation to publicly update or revise any forward looking statements, whether from new information, future events, or otherwise.

The following discussion and analysis should be read in conjunction with the Company s consolidated financial statements and the notes thereto presented elsewhere herein. The discussion of results should not be construed to imply any conclusion that such results will necessarily continue in the future.

Item 1. Business

Photonic Products Group, Inc. (the Company or PPGI), incorporated in 1973, develops, manufactures and markets products and services for use in diverse Photonics industry sectors via its multiple business units. Prior to its name change in September, 2003, PPGI was named and did business solely as Inrad, Inc.

The Company had announced in 2002 that it was implementing its plan to transform the Company from a single business unit into a portfolio of businesses serving the Photonics industry. Company management, the Board of Directors, and shareholders approved the name change in 2003, reinforcing the transformation of the Company s business model into that of a portfolio of business units whose branded products conform to the paradigm: Products Enabling Photonics™.

In November 2003, the Company concluded its first acquisition, that of the assets and certain liabilities of Laser Optics, Inc. of Bethel, CT. Laser Optics, Inc. was a custom optics and optical coating services provider, in business since 1966. PPGI integrated the Bethel team and their operations into the Company s Northvale, NJ operations in mid-2004, combining them with Inrad s custom optics and optical coating product lines under the Laser Optics name.

In October 2004 the Company completed its second acquisition of a complementary business with the purchase of 100% of the stock of MRC Precision Metal Optics, Inc. of Sarasota, FL. MRC Optics, now a wholly-owned subsidiary of PPGI, is a fully integrated precision metal optics and diamond-turned aspheric optics manufacturer, specializing in CNC and single point diamond machining, optical polishing, plating, beryllium machining, and opto-mechanical design and assembly services.

PPGI s business units products continue, at present, to fall into two product categories: optical components (including standard and custom optical components and assemblies, crystals, and crystal components), and laser accessories (including wavelength conversion products and Pockel s Cells (optical shutters) that employ nonlinear crystals to perform the function of wavelength conversion). Currently, its optical components product lines and services are brought to market via three PPGI business units: INRAD, Laser Optics, and MRC Optics. Laser accessories are brought to market by INRAD.

In summary, the Company is at present an optical component, subassembly, and sub-system supplier to major original equipment manufacturers and researchers in the Photonics industry. PPGI expects that in the future its products may also include other product categories.

Administrative, engineering and manufacturing operations are housed at present in a 42,000 square foot building located in Northvale, New Jersey, about 15 miles northeast of New York City, and in a 25,000 square foot building located in Sarasota, FL. The headquarters of the Company are located within its Northvale, NJ facility.

Custom optic manufacturing is at present a major product area for PPGI. The Company specializes in high-end precision components. It develops, manufactures and delivers precision custom optics and thin film optical coating services via its Laser Optics and MRC Precision Optics branded business units. Glass, metal, and crystal substrates are processed using modern manufacturing equipment and techniques to prepare and polish substrates, deposit optical thin films, and assemble sub-components, thereby producing optical components used in advanced Photonic systems of many kinds. The majority of custom optical components and optical coating services supplied are used in inspection and process control systems, in defense and aerospace electro-optical systems, in laser system applications, in industrial scanners, and in medical system applications.

The Company also currently develops, manufactures, and delivers synthetic optical crystals, optical crystal components, and laser accessories via its INRAD brand. It grows synthetic crystals with electro-optic (EO), non-linear and optical properties for use in both its standard products and custom products. The majority of crystals, crystal components and laser accessories supplied are used in laser systems, defense EO systems, and in R&D applications by researchers within corporations, universities, and national laboratories.

The Company has been implementing its plan to assemble a portfolio of businesses serving the Photonics industry, and is engaged from time to time in exploratory strategic merger and acquisition discussions. The Company is also engaged from time to time in discussions regarding the raising of capital to finance its growth. The Company s policy is to not comment on such exploratory discussions, due to their indefinite nature.

The following table summarizes the Company s product sales by product categories during the past three years:

	Years Ended December 31,					
	2005		**2004**		**2003**	
Category	**Sales**	**%**	**Sales**	**%**	**Sales**	**%**
Optical Components*	$ 12,279,000	89	$ 7,877,000	85	$ 4,469,000	83
Laser Accessories	1,506,000	11	1,345,000	15	893,000	17
TOTAL**	$ 13,785,000	100	$ 9,222,000	100	$ 5,362,000	100

* a) 2003 Optical Component sales included $78,000 from operations acquired from Laser Optics, Inc.

b) 2004 Optical Component sales include $901,000 from the Company s new MRC Optics subsidiary.

** Not included above are (non-product) contract R&D sales of approximately $26,000 in 2003.

Products Manufactured by the Company

Optical Components

b) Custom Optics and Optical Coating Services

Manufacturing of high-performance custom optics is at present a major product area for PPGI, and is addressed in the marketplace principally via its Laser Optics and its MRC Optics business units.

The Laser Optics business unit was formed in 2003 via the combination of INRAD s Northvale, NJ based custom optics and optical coating services operations and those of the former Laser Optics, Inc. of Bethel, CT. The Company had been active in the field since 1973, and Laser Optics, Inc. since 1966.

The new Laser Optics provides custom products. It specializes in the manufacture of optical components, optical coatings (ultra-violet wavelengths through infra-red wavelengths) and subassemblies for military, industrial, process control, photonic instrument, and medical end-use. Planar, prismatic and spherical components are fabricated from glasses of all kinds and crystals of most kinds, including fused silica, quartz, infra-red materials (including germanium, zinc selenide and zinc sulfide), calcite, magnesium fluoride and silicon. Component types include mirrors, lenses, prisms, waveplates, polarizing optics, monochrometers, x-ray mirrors, and cavity optics for lasers.

To meet performance requirements, most optical components and sub-assemblies require thin film coatings on their surfaces. Depending on the design, optical coatings can refract, reflect, or transmit specific wavelengths. Laser Optics coating service specialties include high laser damage resistance, infra-red, polarizing, high reflective, anti-reflective, and coating to complex custom

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requirements on a wide range of substrate materials. Laser Optics both coats customer furnished components and components it manufactures. Coating deposition process technologies employed included electron beam, thermal, and ion assist.

MRC Optics, established in 1983 is a fully integrated precision metal optics and optical assembly manufacturer. The Company provides high quality precision CNC and diamond machining, polishing, plating, beryllium machining, and opto-mechanical design and assembly services. MRC has developed custom processes to support prototypes through high rate production quantities of large flat mirrors, thermally stable optical mirrors, reflective porro prisms, low RMS surface finish polished mirrors, diamond machined and precision aspheric and plano mirrors, and arc-second accuracy polygons and motor assemblies. Optical plating specialties include void-free gold and electroless nickel.

c) Crystals and Crystal Components

PPGI produces and brings to market crystals and crystal components via its INRAD business unit. Certain synthetic crystals, because of their internal structure, have unique optical, non-linear, or electro-optical properties. Electro-optic and nonlinear crystal devices can alter the intensity, polarization or wavelength of a laser beam. Developing growth processes for high quality synthetic crystals and manufacturing and design processes for crystal components lies at the heart of the INRAD product line. Synthetic crystals currently in production include Nickel Sulfate, Lithium Niobate, Beta Barium Borate, Alpha Barium Borate, KDP, deuterated KDP and Zinc Germanium Phosphide, among others.

The INRAD crystals and crystal components product lines also include crystalline filter materials, including patent protected materials, that have unique transmission and absorption characteristics that enable them to be used in critical applications in defense systems such as missile warning sensors. Other crystal components, both standard and custom, are used in laser applications research and in commercial laser systems to change the wavelength of laser light.

INRAD has developed and manufactures a line of Q-switches, Pockels Cells (optical shutters) and associated electronics, and has been active in this field since 1973. Pockels cells are used in applications that require the fast switching of the polarization direction of a beam of light. These uses include Q-switching of laser cavities (i.e., to generate laser output pulses), coupling light into and out from regenerative amplifiers, and light intensity modulation. These devices are sold on an OEM basis to laser manufacturers and individually to researchers.

INRAD Pockels Cell products include the following:

- Single crystal and dual crystal KD*P Pockels Cells
- PKC-21 and PKC-02
- 9 mm through 50 mm apertures
- Single crystal Lithium Niobate Pockels Cells
- PLC-01
- 8.5 mm through 10.5 mm apertures
- Single crystal and dual crystal BBO Pockels Cells
- PBC-03
- 2.5 mm x 2.5 mm through 2.5 mm x 7 mm sizes
- Electronic drivers
- Gimbal mounts

Laser Accessories

PPGI designs, manufactures, and brings to market a line of harmonic generation laser accessories via its INRAD business unit.

a) Harmonic Generation Systems

Harmonic generation systems enable the users of lasers to convert the fundamental frequency of the laser to another frequency required for a specific end use. Harmonic generators are currently used in spectroscopy, semiconductor processing, medical lasers, optical data storage and scientific research.

Many commercial lasers have automatic tuning features, allowing them to produce a range of frequencies. The INRAD Autotracker, when used in conjunction with these lasers, automatically generates tunable ultraviolet light or infrared light for use in spectroscopic applications.

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Products offered for such nano-second laser systems include the following:

- AT-III an Autotracker with servo controlled tuning
- 5-304 temperature-stabilized crystals
- Harmonic separators for ultra-violet (UV), infra-red (IR), and second frequency mixing (SFM)

The Company produces a Harmonic Generator, the 5-050, for use with ultra-fast lasers having pulsewidths in the femtosecond and picosecond regime. This product is sold on an OEM basis to manufacturers of ultra fast lasers and to researchers in the scientific community.

b) Laser Pulse Measurement Instruments

The Company marketed, through December 31, 2005, a line of Autocorrelators that measure extremely short laser pulses. Autocorrelators are used for measuring laser pulses from ultrafast lasers, with pulse durations in the picosecond and femtosecond ranges. INRAD had pioneered the design, manufacture, and introduction of autocorrelators as accessories for the emerging field of ultrafast lasers back in 1979. In 2000, INRAD joined forces with Angewandte Physik & Electronik, GmbH of Berlin, Germany, (A.P.E.) and became the source for supply of products manufactured by A.P.E. to customers in the Americas, Israel, and selected other markets. Effective January 1, 2006, the Company and A.P.E. ended their alliance in this field. At the present time the Company does not offer Autocorrelators for sale in the market place.

Research and Development

Company-funded research expenditures during the years ended December 31, 2005, 2004, and 2003 were $20,000, $98,000, and $154,000, 0.4%, 1.1%, and 2.9% of net product sales, respectively.

During 2005 and 2004, the Company narrowed its focus of internal research and development efforts onto improving certain crystal growth processes, and on improving manufacturing process technologies for optical components. Technical resources were focused on supporting the integration of Laser Optics into Northvale operations and ramp-up of production rates within Northvale operations and Sarasota operations. As a result, internal R&D expenditures were at historically low levels in 2005 and 2004.

Markets

In 2005, 2004 and 2003 the Company s product sales were made to customers in the following market areas:

Market	2005		2004		2003	
Defense/Aerospace	$ 8,352,000	(60)%	$ 4,127,000	(45)%	$ 2,321,000	(43)%
Process control & metrology	3,259,000	(24)%	1,817,000	(20)%	844,000	(16)%
Laser systems (non-military)	1,044,000	(8)%	1,753,000	(19)%	1,066,000	(20)%
Universities & National laboratories	522,000	(4)%	763,000	(8)%	641,000	(11)%
Other	608,000	(4)%	662,000	(8)%	516,000	(9)%
Total	$ 13,785,000	(100)%	$ 9,222,000	(100)%	$ 5,388,000	(100)%

Major market sectors served by the Company include defense/aerospace, process control & metrology, laser systems (non-military), telecomm, universities and national laboratories, and various other markets not separately classified. The defense/aerospace area consists of sales to OEM defense systems and subsystems manufacturers, manufacturers of non-military satellite-based systems and subsystems, and direct sales to governments where the products have the same end-use. The process control and metrology area consists of customers who are OEM manufacturers of capital equipment used in manufacturing and quality assurance, such as in semiconductor (i.e., chip) fabrication and testing. The laser systems market area consists principally of customers who are OEM manufacturers of industrial, medical, and R&D lasers. Universities and National Laboratories consists of product sales to researchers. The Other category represents sales to market areas that, while they may be the object of penetration plans by the Company, are not currently large enough to list individually, and as well sales through third parties for whom the end-use sector is not known.

The Company is a provider of optical components, both specialty crystal components and high precision custom optical components for customers in the aerospace and defense electro-optical systems sector. End-use applications include military laser systems, military electro-optical systems, satellite-based systems, and missile warning sensors and systems intended to protect aircraft. The dollar volume of shipments of product within this sector depends in large measure on the U.S. Defense Department budget and its priorities, that of foreign governments, the timing of their release of contracts to their prime equipment and systems contractors, and

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the timing of competitive awards from this customer community to the Company. In the post-9/11 era, government spending priorities for such systems have risen sharply and deployment of new systems has been accelerated, as has refurbishment of fielded systems. The Company s sales of products to this customer sector continued their upward trend in 2005, increasing by 102% in dollar terms in 2005 from 2004, to 60% of total Company sales. The defense and aerospace sector offers continued opportunities for the Company s capabilities in precision optics.

Demand in the Process Control and Metrology (semiconductor tools) market for the Company s products rebounded in 2004 from a protracted and deep cyclical downturn in capital spending for new tools and instruments in 2002 and 2003. Sales in 2005 increased 79% over sales in 2004, representing 24% of total Company sales. The optical and x-ray inspection segment of the semiconductor industry offers continued opportunities for the Company s capabilities in precision optics, crystal products, and monochrometers.

The Company serves the laser industry as an OEM supplier of standard and custom optical components and laser accessories. Within the Laser Systems customer sector, sales in 2005 declined 40% from sales in 2004, representing 8% of total revenues and reflecting a return to 2003 sales levels. Sales in 2004 had been up 64% from the prior year on a surge of demand from both old and new customers for the Company s laser accessory products. The Company continues to seek to acquire complementary products to broaden its laser accessory and laser optical components product lines.

Sales to customers within the University and National Laboratories market sector decreased in 2005, now representing 4% of total revenues. Sales to this sector have been in the $500,000 to $750,000 range historically, now representing a smaller percentage of total revenues.

Export sales, primarily to customers in countries within Europe, the Near East and Japan, amounted to 14%, 12%, 19% of product sales in 2005, 2004 and 2003, respectively. No foreign customer accounted for more than 10% of product sales in 2005, 2004, or 2003.

In 2005, two U.S. customers accounted for 13% and 14%, respectively, of sales. The two customers are each divisions of defense industry prime contractors who manufacture electro-optical systems under multi-year production contracts for the U.S. and allied foreign governments. In 2004, the two U.S. customers each accounted for 12% of sales, and one customer accounted for 10% of sales. The latter customer manufactures process control and metrology systems. In the short-term the loss of any of these customers would have a significant negative impact on the company and its business units. In 2003, one U.S. customer accounted for 16% of total sales, and one U.S. customer accounted for 10% of total sales. Both customers are defense industry prime contractors who manufacture electro-optical systems under multi-year production contracts for the U.S. and foreign governments.

Long-Term Contracts

Certain of the Company s orders from customers provide for periodic deliveries at fixed prices over a period that may be greater than one year. In such cases, as in most other cases as well, the Company attempts to obtain firm price commitments from its suppliers for the materials necessary to fulfill the order.

Marketing and Business Development

The Company s two Northvale, NJ-based business units market their products domestically through their own sales and marketing teams, led by the Vice President - Marketing and Sales. Independent sales agents are used in countries in major non-U.S. markets, including Canada, Europe, the Near East and Japan and domestically in the west coast region of the USA.

The Company s MRC Optics subsidiary markets its products domestically through their own sales and marketing team, led by the MRC Vice President of Marketing and Business Development

Trade show participation and Internet-based marketing and promotion are coordinated at the Corporate level.

Backlog

The Company s order backlog as of December 31, 2005 was $7,857,000, more than 95% of which is shippable during fiscal year 2006. The Company s order backlog as of December 31, 2004 was $6,433,000. The Company s order backlog as of December 31, 2003 was $2,286,000.

Competition

Within each product category in which the Company s business units are active, there is competition.

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b) Laser Pulse Measurement Instruments

Changes in the Photonics industry have had an effect on suppliers of custom optics. As end users have introduced products requiring large volumes of optical components, suppliers have responded either by carving out niche product areas or by ramping up their own manufacturing capacity and modernizing their manufacturing methods to meet higher volume run rates. Many custom optics manufacturers lack in-house thin film coating capability. As a result, there are fewer well-rounded competitors in the custom optics arena, but they are equipped with modern facilities and progressive manufacturing methods. The Company has judiciously deployed capital towards modernizing its facility, and has staffed the manufacturing group with individuals with comprehensive experience in manufacturing management, manufacturing engineering, advanced finishing processes, thin-film coating processes, and capacity expansion. The Company competes on the basis of providing consistently high quality products, establishing strong customer relations, and continuously improving its labor productivity, cost structure, and product cycle times.

Competition for the Company s systems is limited, but competitors products are generally lower priced. The Company s systems are considered to be high end and generally offer a combination of features not available elsewhere. Because of the Company s in-house crystal growth capability, the Company s staff is knowledgeable about matching appropriate crystals to given applications.

For the crystal product area, price, quality, delivery, and customer service are market drivers. Many of the Company s competitors are overseas and can offer significantly reduced pricing for some crystal species. The Company has been able to retain and grow its customer base by providing the quality and customer service needed by OEM customers. On many occasions, the quality of the crystal component drives the ultimate performance of the component or instrument into which it is installed. Thus, quality and technical support are considered to be valuable attributes for a crystal supplier by many, but not all, OEM customers.

Although price is the principal factor in many product categories, competition is also based on product design, product performance, customer confidence, quality, delivery, and customer service. The Company is a sole-source supplier of products to many major customers. Based on its performance to date, the Company believes that it can continue to compete successfully, although no assurances can be given in this regard.

Employees

As of December 31, 2005, the Company had 102 full-time employees.

Patents and Licenses

The Company relies on its manufacturing and technological expertise, rather than on patents, to maintain its competitive position in the industry. The Company takes precautionary and protective measures to safeguard its design and technical and manufacturing data, and relies on nondisclosure agreements with its employees to protect its proprietary information.

Regulation

Foreign sales of certain of the Company s products may require export licenses from the United States Department of Commerce or Department of State. Such licenses are generally available to all but a limited number of countries and are obtained when necessary. One product, representing less than 1% of Company sales in 2005 and 2004, and less than 4% of Company sales in 2003, required U.S. State Department export approval and the required approvals were granted.

There are no federal regulations nor any unusual state regulations that directly affect the sale of the Company s products other than those environmental compliance regulations that generally affect companies engaged in manufacturing operations in New Jersey and Florida.

Item 1A. Risk Factors

a) Many of the Company s customer s industries are cyclical

The Company s business is significantly dependent on the demand its customers experience for their products. Many of their end users are in industries that historically have experienced a cyclical demand for their products, The industries include but are not limited to, the defense electro-optics industry and the manufacturers of process control capital equipment for the semiconductor tools industry, As a result, demand for the Company s products and its financial results of operations are subject to cyclical fluctuations.

b) **The Company faces competition**

The Company encounters substantial competition from other companies positioned to serve the same market sectors that the Company serves. Some competitors may have financial, technical, capacity, marketing or other resources more extensive than ours,

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or may be able to respond more quickly than the Company can to new or emerging technologies and other competitive pressures. Some competitors have manufacturing operations in low-cost labor regions such as the far-east and eastern-Europe and can offer products at lower price than the Company. The Company may not be successful in winning orders against the Company s present or future competitors.

c) As general economic conditions deteriorate, the Company s financial results suffer

Significant economic downturns or recessions in the United States or Europe could adversely affect the Company s business, by causing a temporary or longer term decline in demand for the Company s goods and services. Additionally, the Company s revenues and earnings may be affected by general economic factors, such as excessive inflation, currency fluctuations and employment levels.

d) The Company s business success depends on its ability to recruit and retain key personnel

The Company s existing business and its expansion plans depend on the expertise, experience, and continuing services of certain scientists, engineers, production and management personnel, and on the Company s ability to recruit additional personnel. There is competition for the services of these personnel, and there is no assurance that the Company will be able to retain or attract the personnel necessary for its success, despite the Company s effort to do so. The loss of the services of the Company s key personnel could have a material adverse affect on its business, on its results of operations, or on its financial results.

e) The Company has incurred operating losses for two of the past three years and net losses for each of the past three years

The Company had income from operations of $358,000 in 2005 but had sustained operating losses of $(410,000) in 2004, and $(1,654,000) in 2003. Net losses for the 3 years were $(11,000) in 2005, $(673,000) in 2004 and $(1,777,000) in 2003. The Company has been following a strategy of growing via acquisition into a portfolio of Photonics businesses, and in this period had required capital both to fund working capital needs and to acquire businesses. The Company borrowed $1,000,000 via a subordinated convertible note to a major investor in December 2002 providing working capital during this period, and borrowed $2,500,000 million via a subordinated convertible note to finance acquisitions. Additionally, the Company has long-term debt in the form of a secured promissory note in the amount of $1,700,000 as well to a major investor, and the Company raised over $1,170,000 via a private placement of stock in 2004. The Company cannot establish lending lines from banking institutions at this time due to its prior net losses, absent a longer recent history of profitable fiscal quarters. In December 2005, the Company initiated a financing arrangement with a major shareholder and debt holder in the amount of $700,000 to fund acquisition of capital assets needed to absorb growth opportunities. The funds were received in February 2006.

If the Company continues to sustain losses, the Company would be put at risk, since there are no assurances that the Company would be able to obtain additional financing it would require to continue to implement growth-by-acquisition or to supply the working capital needs of its existing operations.

f) The Company may not succeed in acquiring complementary businesses or in integrating acquired businesses

The Company s business strategy includes expanding its production capacities, product lines and market reach through both internal growth and acquisition of complementary businesses. The Company may not succeed in finding or completing acquisitions of such businesses, nor can the

Company be assured that it will be able to raise the financial capital needed for such acquisitions. Acquisitions may result in substantial per share financial dilution of the Company s Common Stock from the issuance of equity securities. They may also result in the taking on of debt and contingent liabilities, and amortization expenses related to intangible assets acquired, any of which could have a material adverse affect on the Company s business, financial condition or results of operations. Also, acquired businesses may be experiencing operating losses. Any acquisition will involve numerous risks, including difficulties in the assimilation of the acquired company s people, operations and products, uncertainties associated with operating in new markets and working with new customers, and the potential loss of the acquired company s key employees. To date, the Company has had limited experience in acquiring or integrating businesses.

g) The Company depends on, but may not succeed in, developing and acquiring new products and processes

In order to meet the Company s strategic objectives, the Company must continue to develop, manufacture and market new products, and to develop new processes and to improve existing processes. As a result, the Company expects to continue to make investments in research and development and to continue to consider from time to time the strategic acquisition of businesses, products, or technologies complementary to the Company s business. There can be no assurance that the Company will be able to develop and introduce new products or enhancements to its existing products and processes in a way that achieves market acceptance or other pertinent targeted results. Nor can the Company be sure that it will be successful in acquiring complementary businesses, products, or technologies. Nor can there be assurance that the Company will have the human or financial resources to pursue or succeed in such activitites.

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h) The Company s operations may be adversely affected if it fails to keep pace with industry developments

The Company serves industries and market sectors which will be affected by future technological developments. The introduction of products or processes utilizing new developments could render the Company s existing products or processes obsolete or unmarketable. The Company s continued success will depend upon its ability to develop and introduce on a timely and cost-effective basis new products, processes, and manufacturing capabilities that keep pace with developments and address increasingly sophisticated customer requirements.

i) The Company s manufacturing processes require products from limited sources of supply

The Company utilizes many relatively uncommon materials and compounds to manufacture its products. Examples include optical grade quartz, specialty optical glasses, scarce natural and manmade crystals, and high purity chemical compounds. Failure of the Company s suppliers to deliver sufficient quantities of these necessary materials on a timely basis, or to deliver contaminated or inferior quality materials, or to markedly increase their prices could have an adverse effect on the Company s business, despite its efforts to secure long term commitments from the Company s suppliers. Adverse results might include reducing the Company s ability to meet commitments to its customers, compromising the Company s relationship with its customers, adversely affecting the Company s ability to meet expanding demand for its products, or causing the Company s financial results to deteriorate.

j) Product yield problems and product defects that are not detected until products are in service could increase the Company s costs and/or reduce its revenues

Changes in the Company s own or in its suppliers manufacturing processes, or the use of defective or contaminated materials by the Company, could result in an adverse effect on its ability to achieve acceptable manufacturing yields, delivery performance, and product reliability. To the extent that the Company does not achieve such yields, delivery performance or product reliability, its business, operating results, financial condition and customer relationships could be adversely affected. Additionally, the Company s customers may discover defects in the Company s products after the products have been put into service in their systems. In addition, some of the Company s products are combined by the Company s customers with products from other vendors, which may contain defects, making it difficult and costly to ascertain whose product carries liability. Any of the foregoing developments could result in increased costs and warranty expenses, loss of customers, diversion of technical resources, legal action by the Company s customers, or damage to the Company s reputation.

k) International sales account for a significant portion of revenues

Sales to customers in countries other than the United States accounted for approximately 14%, 12% and 19% of revenues during the years ended December 31, 2005, 2004, and 2003, respectively. The Company anticipates that international sales will continue to account for a significant portion of the Company s revenues for the foreseeable future. In particular, although the Company s international sales are denominated in U.S. dollars, currency exchange fluctuations in countries where the Company does business could have a material adverse effect on its business, financial condition or results of operations, by making the Company less price-competitive than foreign manufacturers.

l) The Company may not be able to fully protect its intellectual property

The Company does not currently hold any material patents applicable to its most important products or manufacturing processes. The Company relies on a combination of trade secret and employee non-competition and nondisclosure agreements to protect its intellectual property rights. There can be no assurance that the steps the Company takes will be adequate to prevent misappropriation of the Company s technology. In addition, there can be no assurance that, in the future, third parties will not assert infringement claims against the Company. Asserting the Company s rights or defending against third-party claims could involve substantial expense, thus materially and adversely affecting the Company s business, results of operations or financial condition.

m) The Company s stock price may fluctuate widely

Many factors, including, but not limited to, future announcements concerning the Company, its competitors or customers, as well as quarterly variations in operating results, announcements of technological innovations, seasonal or other variations in anticipated or actual results of operations, changes in earnings estimates by analysts or reports regarding the Company s industries in the financial press or investment advisory publications, could cause the market price of the Company s stock to fluctuate substantially. In addition, the Company s stock price may fluctuate widely for reasons which may be unrelated to operating results. These fluctuations, as well as general economic, political and market conditions such as recessions, military conflicts, or market or market-sector declines, may materially and adversely affect the market price of the Company s Common Stock. In addition, any information concerning the Company, including projections of future operating results, appearing in investment advisory publications or on-line bulletin boards or otherwise emanating from a source other than the Company could in the future contribute to volatility in the market price of the Company s Common Stock.

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n) The Company has experienced certain material weaknesses in our internal control over financial reporting

Subsequent to the preparation of our consolidated financial statements for the year ended December 31, 2005, certain material weaknesses became evident to our management with the discovery that our former Chief Financial Officer had incurred and paid for unauthorized and personal expenses through the Company. This discovery showed that internal controls for monitoring the use and reporting of charges on the Company s debit card and with respect to the Company s handling of disbursements by check were inadequate. A material weakness is a significant deficiency in one or more of the internal control components that alone or in the aggregate precludes our internal controls from reducing to an appropriately low level the risk that material misstatements in our financial statements will not be prevented or detected on a timely basis.

In light of the foregoing discoveries resulting from the investigation and from management s review of its internal control procedures, the Audit Committee directed the Company to take a number of steps to strengthen its internal controls, including (a) recall and cancellation of the corporate debit card and (b) implementation of a policy requiring two authorized signatures on all checks in amounts of $5,000 or more. These changes have been implemented. The Company has extended this policy to all wire transfers initiated from its bank. In addition, a joint meeting with the accounting staff, the Chief Executive Officer and the new Chief Financial Officer was conducted to review internal controls and procedures, to promote a control environment that emphasizes appropriate judgment, skepticism and objectivity and to reinforce each employee s responsibility to report unusual or suspicious financial transactions to an independent officer or member of the Audit Committee.

Other initiatives to further strengthen internal controls are currently being assessed and implemented by the Company. These include but are not limited to: (i) establishing a written ethics policy to cover all employees which supplements the existing policy that covers senior financial executives and members of the Board of Directors, (ii) improving internal procedures for reporting suspected ethics violations, (iii) extending the requirement for written approval of business expenses to all corporate officers expense reports and, (iv) identification and documentation of all critical internal controls within an Internal Control Policies and Procedures Manual.

We believe that these corrective steps enable us to conclude that the material weaknesses in internal controls over financial reporting, as identified above, have been remediated.

Item 1B. Unresolved Staff Comments

There were no unresolved Staff comments as of March 15, 2006.

Item 2. Properties

Administrative, engineering and manufacturing operations are housed at present in a 42,000 square foot building located in Northvale and in a 25,000 square foot building located in Sarasota, FL. The headquarters of the Company are located within its Northvale, NJ facility.

PPGI, INRAD and Laser Optics occupy approximately 42,000 square feet of space located at 181 Legrand Avenue, Northvale, New Jersey pursuant to a net lease expiring on October 31, 2006. PPGI has an option to renew the Northvale lease for an additional term of five years. In November 2003, the Company exercised its option to lease 11,000 square feet of additional adjoining space in the same building, which brought the total square feet of leased space occupied by PPGI in Northvale, New Jersey to its present 42,000 square feet. In 2003, Laser Optics Holdings, Inc., a Subsidiary of the Company, acquired the rights to the lease of 8,000 square feet of space in Bethel, CT, formerly occupied by Laser Optics, Inc., upon purchase of the assets of Laser Optics, Inc. This lease expired in May of 2004 coincident with the Company s vacating that facility and relocating the assets of Laser Optics, Inc. to its Northvale operations center.

PPGI s MRC Optics subsidiary occupies approximately 25,000 square feet of space located at 6405 Parkland Drive, Sarasota, FL pursuant to a net lease expiring on August 31, 2006. MRC Optics has negotiated terms for renewal of that lease, an offer from the landlord is in-hand and is under management review.

The facilities are adequate to meet current and future projected production requirements.

The total rent in 2005 for these leases was approximately $525,000. The Company also paid real estate taxes and insurance premiums that totaled approximately $95,000 in 2005.

Item 3. Legal Proceedings

There are no legal proceedings involving the Company as of the date hereof.

Item 4. **Submission of Matters to a Vote of Security Holders**

Not Applicable.

PART II

Item 5. **Market for Registrant s Common Equity and Related Stockholder Matters**

a) **Market Information**

The Company s Common Stock, par value $0.01 per share, is traded on the OTC Bulletin Board under the symbol PHPG.

The following table sets forth the range of closing prices for the Company s Common Stock in each fiscal quarter from the quarter ended March 31, 2004 through the quarter ended December 31, 2005, as reported by the National Association of Securities Dealers NASDAQ System. Such over-the-counter quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

	Price High	Low
Quarter ended December 31, 2005	1.45	.90
Quarter ended September 30, 2005	0.98	.75
Quarter ended June 30, 2005	1.00	.65
Quarter ended March 31, 2005	1.40	1.05
Quarter ended December 31, 2004	1.60	.70
Quarter ended September 30, 2004	1.50	.65
Quarter ended June 30, 2004	2.00	.46
Quarter ended March 31, 2004	.65	.37

As of March 21, 2006 the Company s stock price was $1.25 per share.

b) **Shareholders**

As of March 24, 2006, there were approximately 230 owners of record of the Common Stock. The number of record owners of common stock was approximated based upon the Shareholders Listing provided by the Company s Transfer Agent.

c) **Dividends**

The Company did not pay any cash dividends on its Common Stock during the years ended December 31, 2005, 2004 and 2003. The Company paid a dividend of 134,000 shares of Common Stock on its Series A and Series B convertible preferred stock in 2005, valued at $134,000. The Company paid a dividend of 134,000 shares of Common Stock on its Series A and Series B convertible preferred stock in 2004, valued at $165,000. The Company paid a dividend of 134,000 shares of Common Stock on its Series A and Series B convertible preferred stock in 2003, valued at $54,000. Payment of cash dividends will be at the discretion of the Company s Board of Directors and will depend, among other factors, upon the earnings, capital requirements, operations and financial condition of the Company. The Company does not anticipate paying cash dividends in the immediate future.

d) Recent Sales of Unregistered Securities and Registration of Securities

There were no sales of unregistered securities, nor were any sales of securities registered during 2005.

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Item 6. **Selected Financial Data**

The following data is qualified in its entirety by the financial statements presented elsewhere in this Annual Report on Form 10-K.

	As of December 31, or For the Year Ended December 31, 2005	2004	2003	2002	2001
Revenues	$ 13,785,057	$ 9,221,857	$ 5,388,184	$ 5,569,118	$ 8,075,205
Net (loss) profit	(11,398)	(672,937)	(1,777,309)	(1,715,972)	43,634
Net (loss) profit applicable to common shareholders					
Basic	(.02)	(.15)	(.35)	(.35)	(.02)
Diluted	(.02)	(.15)	(.35)	(.35)	(.02)