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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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.

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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)
Weighted average shares					
Basic	7,218,244	5,710,354	5,287,849	5,210,322	5,046,666
Diluted	7,218,244	5,710,354	5,287,849	5,210,322	5,046,666
Dividends paid	134,000	164,820	53,600	120,600	155,000
Total assets	13,481,021	13,526,634	8,851,121	8,508,925	8,599,072
Long-term obligations	5,963,411	6,459,088	4,405,576	1,188,512	287,170
Shareholders equity	3,929,407	3,965,129	3,284,439	5,049,879	6,745,489

The Company completed the acquisition of the stock of MRC Precision Metal Optics, Inc. in mid-October 2004. Also, the Company completed the acquisition of Laser Optics, Inc. s assets and liabilities at the end of November 2003. The comparability of information in the selected financial data is aided by details provided in the management discussion, which attribute certain portions of revenue growth in 2004 to these two acquisitions.

Item 7. **Management s Discussion and Analysis of Financial Condition and Results of Operation**

Critical Accounting Policies

The Company s significant accounting polices are described in Note 1 of the consolidated financial statements, that were prepared in accordance with accounting principles generally accepted in the United States of America. In preparing the Company s financial statements, the Company made estimates and judgments that affect the results of its operations and the value of assets and liabilities the Company reports. The Company s actual results may differ from these estimates.

The Company believes that the following summarizes critical accounting polices that require significant judgments and estimates in the preparation of the Company s consolidated financial statements.

Revenue Recognition

The Company records revenue when a product is shipped. Losses on contracts are recorded when identified. The Company, from time to time, may recognize revenue using the percentage of completion method for certain long term manufacturing projects. No revenues in 2005 were accounted for using the percentage of completion method.

Accounts Receivable

The Company records an allowance for doubtful accounts receivable as a charge against earnings for revenue for items that have been reviewed and carry a risk of non-collection in the future. The Company has not experienced a non-collection of accounts receivable materially affecting the results of operations.

Inventory

The Company records a reserve for slow moving inventory as a charge against earnings for all products on hand that have not been sold to customers in the past twelve months. An additional reserve is recorded for product on hand that may not be sold to customers within the upcoming twelve months.

From time to time, estimated costs are recorded as a charge against earnings based on known circumstances where it is probable that a manufacturing cost over run has been incurred or is expected to be incurred and the amount can be reasonably estimated.

Results of Operations

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	898,000	17
TOTAL**	$ 13,785,000	100	$ 9,222,000	100	$ 5,367,000	100

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* 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.

The following table sets forth, for the past three years, the percentage relationship of statement of operations categories to total revenues.

	Years ended December 31,		
	2005	**2004**	**2003**
Revenues:			
Product sales	100.0 %	100.0 %	100.0 %
Costs and expenses:			
Cost of goods sold	72.2 %	71.9 %	72.7 %
Gross profit margin	27.8 %	28.1 %	27.3 %
Selling, general and administrative expenses	25.0 %	31.5 %	44.3 %
Internal research and development	0.1 %	1.1 %	2.9 %
Special charges	0 %	0 %	10.8 %
Profit/(Loss) from operations	3.0 %	(4.5)%	(30.6)%
Net Loss	(0.1)%	(7.3)%	(32.9)%

Revenues

Total revenues were approximately $13,785,000, $9,222,000, and $5,388,000 in 2005, 2004 and 2003, respectively. Revenues increased 49% in 2005 to $13,785,000, from $9,222,000 in 2004, aided by strong ending backlog in 2004 and strong new order intake throughout 2005. Additionally, sales in 2005 included a second year of twelve full months of revenues from legacy Laser Optics, Inc. lines of business acquired in November of 2003, synergies from the combination and integration of Laser Optics and Inrad custom optics operations in 2004, and twelve full months of revenues from the Company s MRC Optics subsidiary, acquired in October of 2004. 2004 sales had been up 71% from 2003 sales.

Examining these results by customer industry sector:

Sales to the Defense/Aerospace sector continued their three year upward trend in 2005, increasing by 102% in dollar terms in 2005 from 2004, to 60% of total Company sales. A majority of sales at the Company s MRC Optics subsidiary are to customers in this sector, and 2005 represented a full twelve months of revenue contribution from that subsidiary. 2005 sales to the sector were $8,352,000 as compared with $4,127,000 in 2004. Sales in 2003 were $2,321,000, up 34% from 2002. Increased military spending on electro-optical systems and R&D in the post-9/11 era combined with strategic re-positioning by the Company has boosted demand for the Company s products. Sales to this sector accounted for 60%, 45%, and 43%, of total sales in 2005, 2004, and 2003, respectively.

Revenues from customers in the Process Control and Metrology (ie. semiconductor tools, instruments) sector in 2005 increased 79% over sales in 2004, to $3,259,000 from $1,817,000, now representing 24% of total Company sales. A large fraction of this growth is due to inclusion of a full twelve months of sales to this sector by the Company s MRC Optics subsidiary. Sales in the sector had rebounded in 2004 from a protracted and deep cyclical downturn in capital spending for new tools and instruments in 2002 and 2003. Revenues rose to $1,817,000 in 2004 from $844,000 in 2003, up 115%. 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. Sales to this sector accounted for 24%, 20%, and 16% of total sales in 2005, 2004, and 2003, respectively.

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Revenues decreased in the non-military Laser Systems sector, declining 40% in 2005 to $1,044,000 from $1,753,000 in 2004, and now representing 8% of total revenues. Sales here in 2005 reflect a return to 2003 sales levels. The similar sales level in 2003 then represented 20% of sales and now represent 8% of sales, as total Company sales have grown by 155% since 2003. Sales in 2004 had been up 64% from the prior year on a surge of demand from customers for the Company s laser accessory products and certain optical components. This demand declined in 2005 to pre 2004 levels. Reasons included decline in sales of one customer s product line, acquisition of another customer by a larger corporation with in-house resources for the production of the product, and a general decline in demand for harmonic generators. . Sales to this sector accounted for 8%, 19%, 20%, of total sales in 2005, 2004, and 2003, respectively.

Sales to customers within the University and National Laboratories market sector decreased in 2005, 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.

Sales to customers in Other (i.e. non-separately classified) sectors were $608,000 in 2005 as compared with $659,000 in 2004. Sales in 2004 were up 4% from $458,000 in 2003. Sales in these sectors have accounted for 4%, 8%, and 9% of total sales in 2005, 2004, and 2003, respectively.

New orders in 2005 were $15,308,000, as compared with $11,240,000 in 2004. 2005 results include a full year of new orders from the Company s MRC Optics subsidiary, as compared with only partial year contributions from newly acquired MRC Optics of $530,000 in 2004. New orders in 2004 had increased to $11,240,000 from $6,018,000 in 2003, up 85% from those in 2003. Order intake in 2005 was especially strong in 2005 from customers in the Defense/Aerospace, and Process Control and Metrology sectors.

The annualized product book-to-bill ratio for 2005 was 1.11 as compared with 1.22 in 2004.. The annualized product book-to-bill ratio for 2004 net of the MRC Optics acquisition, was 1.28. The annualized product book to bill ratio in 2003 had been greater than 1.0 for the first time in three years at 1.1, reflecting a positive change overall across all market sectors served.

The Company s backlog of product orders as of December 31, 2005 was approximately $7,876,000, up 22% from December 31, 2004. The Company s end of year backlogs in 2004 and 2003 were $6,433,000 and$2,286,000, respectively.

Cost of Goods Sold and Gross Profit Margin

As a percentage of product sales, cost of goods sold was 72.2%, 71.9%, and 72.7% for the years ended December 31, 2005, 2004 and 2003, respectively. Gross profit margin as a percentage of product sales was 27.8%, 28.1%, and 27.3%, for 2005, 2004, and 2003, respectively.

In 2005, the cost of goods sold remained relatively constant, as a percentage, to 2004 levels. Sales increased by 49%, while cost of goods sold increased by 51%. The increase in the total cost of goods sold in 2005 in comparison to 2004 was the result of increased costs for material and personnel associated with the increased sales volumes and the inclusion of MRC Optics costs as well as sales.

Gross margins for the Company in 2005 represent the combined results from its two centers of operation: Northvale, NJ (site of INRAD and Laser Optics) and Sarasota, FL, site of MRC Optics.

Gross margins from the Company s Northvale operations continued their year-over-year improvement in 2005, the second year following the integration of the acquired operations of Connecticut-based Laser Optics into Northvale. During the period, labor productivity rose, economies of scale, and cost controls there resulted in increases in gross profit margin during 2005.

2005 represented the first full year of fiscal contribution from operations at the Company s Sarasota-based MRC Optics subsidiary, where gross margins in 2005 lagged those in Northvale significantly. Negative gross margins at our new MRC Optics subsidiary during the first quarter, were followed by improved margins during the remainder of the year, as sales volumes there rose by 35% year over year. Problem vendors were replaced with qualified new suppliers, and capacity constraints were eased with the addition of these new vendors, new personnel and new equipment resources that were brought on line, and key manufacturing processes were re-optimized for use of higher productivity methods.

In 2004, the cost of goods sold remained relatively constant, as a percentage, to 2003 levels. Sales increased by over 71%. However, fixed costs for facilities related expenditures and depreciation also increased and along with increases in variable costs for labor and material created a situation in which cost of sales remained at the same relative percentage for the year.

Fixed costs are a major component of the Company s total cost structure. Management and the Board of Directors decided to reduce such costs in 2002 only up to the point where further reductions would impede the Company s ability to perform for its current customers or to rebound in the future when macroeconomic conditions improved, and to invest in new operations and lines of

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business. This philosophy continued throughout 2003 and 2004, and enabled the Company to be well-positioned with its operations to manufacture and deliver the goods that are behind the growth that has characterized 2004 and 2005.

Costs of most purchased components have been relatively stable in 2005, 2004, and 2003. However, unit costs of certain raw materials such as crystal quartz, high grade optical glasses, nickel and gold plating solutions have increased significantly in the past year.

Selling, General and Administrative Expenses

Selling, general and administrative expenses as a percentage of sales were 25.0%, 31.5%, and 44.3% in 2005, 2004, and 2003, respectively.

Selling, general and administrative expenses in 2005 increased in dollar terms from those in 2004 by $534,000, or 18.3%, while sales increased by 49%, resulting in a drop in the SG&A cost as a percentage of sales. The increase in SG&A expenditures reflected the first full year of costs from the Company s MRC Optics subsidiary, acquired in October of 2004.

Selling, general and administrative expenses in 2004 increased $526,000, or 22% compared to 2003, while revenues increased 71%, resulting in a drop in the SG&A cost as a percentage of sales. The increase in SG&A costs in 2004 was attributable to a full year of costs for the newly acquired Laser Optics operations and two and one half months of costs incurred as a result of the MRC acquisition. Also adding to the increase were the restoration of salaries for executive personnel to pre-2002 levels and increased costs for commissions that resulted from the higher sales volume in 2004.

Internal Research and Development Expenses

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.

Special Charges

During 2003, the Company acquired the assets and liabilities of Laser Optics, Inc. A strategic decision was made at that time to relocate the assets and employees from Bethel, CT to Northvale, NJ and to combine the Laser Optics, Inc. business lines with the Custom Optics business line. The entity created by this combination is now a PPGI business unit called Laser Optics. The assets acquired and employees were relocated to Northvale, NJ into consolidated operations during the spring of 2004. The costs of relocating employees included relocation costs, stay on bonuses and relocation bonuses, that were accrued in 2003. The accrual amounted to $107,000 ($0.02 per share on a basic and diluted basis) and has been included in the consolidated statement of operations as a special charge.

During 2003 the Company determined that there was excess inventory, relative to forecasted future needs, of certain crystals and solutions. Based on this determination, a reserve was taken in the amount of $475,000 ($0.09 per share on a basic and diluted basis) in order to recognize the diminished future economic benefit of the inventory. The increased reserve has been included in the consolidated statement of operations as a special charge.

Operating Income

The profit from operations in 2005 was $358,000 compared to an operating loss of $(410,000) in 2004 and $(1,654,000) in 2003. The improved performance was a direct result of the success of management s acquisition program and an overall strengthening of business from existing and new customers.

Losses in 2003 were due to slackened and continuing weak demand in major market sectors served by the Company and its products. These losses occurred despite strict cost containment measures, and they were absorbed. The cost containment program implemented by management and the Board stopped short, by design, of impeding the ability of the Company s operations to perform again in the future, or of impeding the Company s ability to find new customers for its products. Management s efforts to restore profitability to operations through 2005 have been focused on building the Company s top line, driving improvements in operations, and through continued focus on business development and selling activities.

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Other Income and Expenses

Interest expense increased over prior periods due to the assumption of MRC debt. The Company s average borrowings in 2005 and 2004 were approximately $6,500,000 versus $4,500,000 in 2003. In 2003, borrowing needs increased due principally to obtaining the capital needed for the acquisition made during 2003. A subordinated convertible note was placed for acquisition purposes. Interest on the secured and convertible notes is accrued, and payment is due upon the maturity of the notes. Also during 2003, a secured note replaced all of the Company s prior bank debt.

During 2005, the Company sold approximately 60% of platinum inventory, deemed to be non-productive and in excess, for net proceeds of $314,000. The transaction resulted in a gain of $136,000. The proceeds were used to augment cash reserves that were required to support working capital needs at mid-year.

Liquidity and Capital Resources

In December of 2005, a major shareholder and debt holder agreed to provide the Company with $700,000 in financing to fund the acquisition of certain capital assets required for expanded capabilities to meet customer demand. The Note was executed and the funds received in February 2006. The terms for the Note call for the amount to be repaid in equal monthly installments, including interest & principal, commencing March 2006, until maturity in March 2013. The Note bears an annual interest rate of 6.75%.

At the end of the fourth quarter of 2002, the Company received $1,000,000 in proceeds from the issuance of a Subordinated Convertible Promissory Note. The Note, originally due in January 2006, has been extended to December 31, 2008 and bears an interest rate of 6%. Interest accrues yearly and along with principal may be converted into Common Stock, (and/or securities convertible into common shares). The note is convertible into 1,000,000 Units consisting of 1,000,000 shares of Common Stock and Warrants to acquire 750,000 shares of Common Stock at a price of $1.35 per share. The Holder of the Note is a related party to a major shareholder of the Company.

In the second quarter of 2002, the Company secured an asset loan from Wachovia Bank. In January 2003 the Company was in violation of certain financial covenants required under the loan agreements. As a result Wachovia Bank sold both the asset based loan and working capital revolver to APC Investments. In June of 2003, the Company paid off the loan held by APC with $1,700,000 in proceeds received from the issuance of a Secured Promissory Note that is held by a major investor in the Company. The Secured Promissory Note was for a period of 36 months and bears interest at the rate of 6% per annum. The Company s Board of Directors approved the issuance of 200,000 warrants to Clarex, Ltd. as a fee for the issuance of the Note and in the 2nd quarter of 2004 approved the issuance of an additional 200,000 warrants as a fee for extending the note to September 30, 2007. The note was subsequently extended to December 31, 2008 without issuance of warrants or any other consideration. The warrants are exercisable at $0.425 per share and $1.08 per share, respectively, approximately a 20% discount to market, and expire in March 2008 and May 2008. The Note is secured by all assets of the Company.

At the end of the fourth quarter of 2003, the Company received $1,500,000 in proceeds from the issuance of a Subordinated Convertible Promissory Note. The Note, originally due in January 2006, has been extended to December 31, 2008 and bears an interest rate of 6%. Interest accrues yearly and along with principal may be converted into Common Stock, and/or securities convertible into Common Stock. The note is convertible into 1,500,000 Units consisting of 1,500,000 shares of Common Stock and Warrants to acquire 1,125,000 shares of Common stock at a price of $1.35 per share. The Holder of the Note is a major shareholder of the Company. The proceeds from the Note were used in the Company s acquisition program.

In April 2004, the Company received $1,000,000 in proceeds from the issuance of a Subordinated Convertible Promissory Note. The Note is due in March 2007 and bears an interest rate of 6%. Interest accrues yearly and along with principal may be converted into Common Stock, (and/or securities convertible into common shares). The note is convertible into 1,000,000 Units consisting of 1,000,000 shares of Common Stock and Warrants to acquire 750,000 shares of Common Stock at a price of $1.35 per share. The Holder of the Note is a major shareholder of the Company.

During the 2nd quarter of 2004, the Company entered into an agreement with an investment banking firm to raise equity via a private placement accordance with Regulation D that was not registered with the Securities and Exchange Commission. In July 2004 the Company issued 1,581,000 Units consisting of 1,581,000 shares and warrants to acquire an additional 1,185,750 shares at $1.35 per share. In addition, 262,276 Warrants were issued to Casimir Capital, LP, the placement agent for the private placement. Casimir Capital earned commissions of $142,391 as the underwriter of this private placement. This private placement resulted in net proceeds to the Company of approximately $1,173,000. The funds were utilized in the furtherance to the company s M&A program, capital equipment purchases and to meet general working capital requirements. The issued shares and shares underlying warrants were subsequently registered under an S-1 Registration filing.

Capital expenditures, including internal labor and overhead charges, for the years ended December 31, 2005, 2004 and 2003 were approximately $454,000, $1,014,000, and $101,000, respectively. Capital expenditures in 2005 were used for the build up of

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tooling for new customer requirements and for the acquisition of equipment. A major portion of the 2004 capital expenditures were for the relocation and integration of the Laser Optics Bethel operations into the Northvale facility. Approximately $600,000 was used in this facility rearrangement and expansion, including $190,000 of capitalized internal labor and overhead. Additional large capital expenditures for the year included a certain production-critical machine tool, upgraded coating equipment in the Laser Optics business unit, and metrology equipment and computer hardware and software upgrades. Capital expenditures in 2003 were used for expansion and renovation of facilities and for the acquisition of equipment. The expenditures were financed in part from capital raised in the 2000 private offering of Series B convertible preferred stock and in part by the asset loan secured in the second quarter of 2002.

A summary of the Company s contractual cash obligations at December 31, 2005 is as follows:

Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**Greater Than 5 Years**
Notes payable	$ 1,700,000	$	$ 1,700,000	$	
Convertible notes payable	3,500,000		3,500,000		
Note payable-other	779,483	260,697	168,612	20,385	329,789
Operating leases	418,312	418,312			
Capital leases including interest	565,468	293,224	272,244		
Total contractual cash obligations	$ 6,963,263	$ 972,233	$ 5,640,856	$ 20,385	$ 329,789

Overview of Financial Condition

As shown in the accompanying financial statements, the Company reported a net loss of approximately ($11,000) in 2005, ($673,000) in 2004, and ($1,777,000) in the year ended December 31, 2003. During the past three years, the Company s working capital requirements were met by additional borrowings from a major shareholder, the issuance of secured and subordinated convertible notes and the issuance of common and preferred stock to shareowners.

Net cash provided by operations was $360,000 in 2005. The positive operating cash flow for 2005 and the positive operating cash flow of $632,000 in 2004 resulted from the sharply higher level of sales, which resulted in lower operating losses than in prior years, and availability of customer milestone payments on certain long term contracts. Operating cash flow in 2005 was lower than in the prior year due to, in part, the need to fund increases in accounts receivable resulting from the higher sales levels and to low gross margins at its new MRC Optics subsidiary during the first half of 2005. Net cash used in operations was ($283,000) in 2003. In 2003, $3,200,000 of secured and convertible notes were issued to both replace bank debt and for use in the Company s acquisition program. In June of 2003, demand was made by a lender to pay approximately $1,700,000 in settlement of bank debts that were in technical default due to a violation of certain financial covenants. The Company issued a Secured Note, payable to an affiliate of a major shareholder and used the proceeds to satisfy the demand for payment.

In April 2004, the Company issued a $1,000,000 Subordinated Convertible Promissory Note to a major shareholder. In July 2004 the Company raised approximately $1,173,000, net, via a private equity offering. Proceeds from this note and the private equity placement were used in the furtherance of the Company s merger and acquisition program.

In October of 2003, the Company issued a $1,500,000 Subordinated Convertible Promissory Note to a major shareholder. Proceeds from this note were used in the furtherance of the Company s merger and acquisition program.

In December 2002, the Company received $1,000,000 in proceeds from the issuance of a Subordinated Convertible Promissory Note to a related party of a major shareholder. The Company did so anticipating continued distressed market conditions during 2003 and it used the proceeds from the note to meet its working capital needs in 2003.

The Company has made progress in transforming itself into a portfolio of businesses serving the Photonics industry. The Company assesses merger and acquisition opportunities from time to time, and seeks financing from time to time in the private equity and public equity financial markets. The Company s first acquisition was completed in November 2003 and the necessary capital was raised in-part via a $1,500,000 subordinated convertible note. Additional financing was obtained in 2004 via placement of a $1,000,000 convertible note proceeds of approximately $1,173,000 from a private placement of units consisting of the Company s common stock and warrants. These funds were earmarked for acquisitions and capital expenditures, and were partially used to complete its second acquisition in 2004.

Where possible, the Company will continue to increase sales, and reduce expenses and cash requirements to improve future operating results and cash flows. Management expects that cash flow from operations and use of available cash reserves will provide adequate liquidity for the Company s operations in 2006.

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No assurances can be given that the Company will be able to identify and acquire appropriate targets for acquisition or merger, or to raise the capital required for any such acquisition. Additional capital from financings would be needed if it were to make further acquisitions.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The Company believes that it has limited exposure to changes in interest rates from investments in certain money market accounts. The Company does not utilize derivative instruments or other market risk sensitive instruments to manage exposure to interest rate changes. The Company believes that a hypothetical 100 basis point adverse move in interest rates along the entire interest rate yield curve would not materially affect the fair value of the Company s interest sensitive money market accounts at December 31, 2005.

Item 8. Financial Statements and Supplementary Data

The financial statements and supplementary financial information required to be filed under this Item are presented commencing on page F-1 of the Annual Report on Form 10-K, and are incorporated herein by reference.

Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Background to Matters related to Controls and Procedures Resulting in Filing of 10-K/A

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 that it was taking steps to remedy that inadequacy, including limiting use of that 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.

On June 26, 2006, the Company filed Form 8-K which provided additional information and an update on the situation, including some of the items discussed below.

On May 16, 2006, William Miraglia stepped down as the Company s chief financial officer, preceding the appointment of William Foote as new chief financial officer, but remained employed as controller of the Company in a non-officer capacity. From that time, Mr. Miraglia no longer had access to the use of the Company s debit card, which had previously been under his direct control. Meanwhile, the Audit Committee of the Company s Board of Directors followed the discovery with respect to internal control inadequacies by conducting an internal investigation via an independent forensic accounting specialist. As a result, the Company discovered more widespread use by William Miraglia of its debit card for unauthorized and personal charges, several instances of unauthorized payments by check for non-business personal expenses, and other unauthorized transactions. Mr. Miraglia was suspended with pay and barred from access to the Company s facilities and records while the investigation proceeded.

The internal investigation was completed and a final report was presented by the independent forensic accounting specialist to the audit committee on July 26, 2006. The investigation discovered that over a period of approximately six years, from the second quarter of 2000 through the second quarter of 2006, Mr. Miraglia had engaged in unauthorized and personal transactions totaling $860,000. This included unauthorized charges on the Company s debit card of approximately $711,000.

In addition, the investigation by the audit committee revealed inadequate internal controls with respect to the Company s handling of disbursements by check. It discovered that Mr. Miraglia made payments totaling $94,500, by check, to the IRS with respect to a personal tax levy against him over a period of approximately two years (third quarter 2004 through second quarter 2006), in addition to, other unapproved payments and misappropriation of funds totaling approximately $36,000. As a result of the foregoing discoveries, Mr. Miraglia was terminated for cause from his employment with the Company on June 14, 2006.

The investigation concluded that Mr. Miraglia acted alone and there was no evidence implicating any other employees in these or any other unauthorized and personal transactions. The results of this investigation have been reviewed with our Company auditors

It was also discovered that Mr. Miraglia had created a control environment that contributed to the failure of Company employees charged with certain financial and accounting duties to exercise appropriate judgment, skepticism and objectivity in detecting and preventing these unauthorized personal transactions by Mr. Miraglia.

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.

Disclosure controls and procedures

The Company carried out an evaluation, with the participation of the Company s management, including the Company s Chief Executive Officer and the current Chief Financial Officer, of the effectiveness of the Company s disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-15, as of the end of the period covered by this Annual Report on Form 10-K/A. Disclosure controls and procedures are designed to ensure that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported on a timely basis and that such information is accumulated and reported to management, including our CEO and CFO, as appropriate.

At the time of the filing our Annual Report on Form 10-K (Original Filing for the year ended December 31, 2005, our Chief Executive Officer and former Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2005. Subsequent to that evaluation, our Chief Executive Officer and current CFO concluded that our disclosure controls were not effective in ensuring that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms, as of December 31, 2005, because of the internal control inadequacies discussed below. Based upon the substantial work performed during the period after the date of the Original Filing and through the investigation process , management has concluded that the Company s consolidated financial statements for the periods covered by and included in this Annual Report on Form 10-K/A are fairly stated in all material respects.

Changes in internal controls over financial reporting

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 the written approval of business expenses to corporate officers expense reports and, (iv) identification and documentation of all critical internal controls within an Internal Control Policies and Procedures Manual.

Except as stated above, there were no other changes in our internal control over financial reporting that occurred during our last fiscal year to which this Annual Report on Form 10-K/A relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B **Other Information**

None.

PART III

Item 10. **Directors and Executive Officers of the Registrant**

Directors of the Registrant

The following table sets forth the name and age of each director of the Company, the period during which each such person has served as a director and the positions and business experience of each such person:

Name and Age	Since	Positions; Business Experience
John C. Rich, 68	2000	Chairman of the Board of Directors (September 2004 to Present) Director (2000 to August 2004) Vice President/General Manager (1999-2002) Power Electronics Division, C&D technologies President (1990-1999), Raytheon/GM Hughes Optical Systems Vice President (1983-1989), Perkin Elmer Microlithography, Electro-Optics, and Systems Colonel, Commander, Air Force Avionics Laboratory and Air Force Weapons Laboratory
Daniel Lehrfeld, 62	1999	Director President and Chief Executive Officer (2000-present), President and Chief Operating Officer (1999-2000), Vice President/General Manager (1995-1999) Raytheon/GM Hughes Electro-Optics Center, President (1989-1991) New England Research Center, (subsidiary) Deputy General Manager (1989-1995) & Director, Business Development, International Business, Operations, Cryogenic Products Magnavox Electronic Systems E. Coast Div., Deputy Sector Director & Program Director Philips Laboratories Briarcliff North American Philips subs. Philips Electronics NV, Group Leader/Project Leader Grumman Aerospace Corporation
Luke P. LaValle, Jr. 63	2006	Director President and CEO, American Capital Management Inc. Past senior investment officer, United States Trust Company of NY Lt. Colonel, US Army Reserve (Ret.)
Thomas H. Lenagh, 80	1998	Director (September 2004 to Present) Chairman of the Board of Directors (May 2000 August 2004). Management Consultant (1990 - Present) Past Chairman and CEO, Systems Planning Corporation Financial Vice President, the Aspen Institute Treasurer and Chief Investment Officer, The Ford Foundation Captain, US Navy Reserve (ret.)
Jan M. Winston 69	2000	Director Principal (1997-Present) Winston Consulting, Division Director/General Manager (1981-1997) IBM Corporation. Executive positions held in Development, Finance and Marketing.

The directors hold office for staggered terms of three years.

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Executive Officers of the Registrant

The following table sets forth the name and age of each executive officer of the Company, the period during which each such person has served as an executive officer and the positions with the Company held by each such person:

Name and Age	Since	Position With the Company
Daniel Lehrfeld, 62	1999	President and Chief Executive Officer
William S. Miraglia, 56	1999	Vice President, Chief Financial Officer and Secretary
Devaunshi Sampat, 53	1999	Vice President Marketing Communication

Daniel Lehrfeld has served as Chief Executive Officer and President since May 2000. He joined the Company in 1999 as President and Chief Operating Officer. Prior to joining the Company, Mr. Lehrfeld held the position of Vice President and General Manager of Electro-Optic Systems, a division, successively, of the Raytheon, GM/Hughes Electronics and Magnavox Electronic Systems Corporations. He has also held executive positions with Philips Laboratories Briarcliff and Grumman Aerospace Corporation. Mr. Lehrfeld holds B.S. and M.S. degrees from Columbia University School of Engineering and Applied Science and an M.B.A. degree from the Columbia Graduate School of Business.

William S. Miraglia joined the Company as Secretary and Chief Financial Officer in June 1999. Previously, he held the position of Vice President of Finance for a division of UNC, Inc., a New York Stock Exchange aviation company. Prior to his last position, Mr. Miraglia has held management positions in the aerospace industry and in public accounting. He holds a B.B. A. from Pace University and an M.B.A. from Long Island University.

Devaunshi Sampat joined the Company in 1998. In 1999 she was appointed Vice President of Marketing and Sales. In 2003 she also assumed the title of Vice President for Marketing Communications for PPGI. Prior to joining the Company, Ms. Sampat held sales management positions within the Photonics industry with Princeton Instruments and Oriel Instruments. Ms. Sampat holds a B.S. in Medical Technology from the University of Bridgeport.

Each of the executive officers has been elected by the Board of Directors to serve as an officer of the Company until the next election of officers, as provided by the Company s by-laws.

Committees of the Board of Directors

Composition of the Board of Directors. In October of 2005, the Board agreed unanimously to discontinue the Executive Committee, for reasons of the small size of the Board and the frequent number of Board meetings customarily held. At the same time the Board agreed to make each outside director a member of each Committee.

Since the adoption of the Sarbanes-Oxley Act in July 2002, there has been a growing public and regulatory focus on the independence of directors. Requirements relating to independence are imposed by the Sarbanes-Oxley Act with respect to members of the Audit Committee. The Board of Directors has determined that the members of the Audit Committee satisfy all such definitions of independence.

Audit Committee. Thomas Lenagh, Chairman. The Audit Committee is empowered by the Board of Directors to, among other things, serve as an independent and objective party to monitor the Company s financial reporting process, internal control system and disclosure control system, review and appraise the audit efforts of the Company s independent accountants, assume direct responsibility for the appointment, compensation, retention and oversight of the work of the outside auditors and for the resolution of disputes between the outside auditors and the Company s management regarding financial reporting issues, and provide an open avenue of communication among the independent accountants, financial and senior management, and the Company s Board of Directors.

Audit Committee Financial Expert. The Board of Directors of the Company has determined that Mr. John Rich is an audit committee financial expert , as such term is defined by the SEC. Mr. Rich, as well as Mr. Thomas Lenagh, Mr. Luke P. LaValle and Mr. Jan Winston, have been determined to be independent within the meaning of SEC regulations.

Compensation Committee. Mr. Jan Winston, Chairman. The Compensation Committee reviews, approves and makes recommendations to the Board of Directors on matters regarding the compensation of the executives of the Company.

Nominating Committee. Mr. Frank Wiedeman through August 1, 2005, Chairman, Mr. John Rich, Chairman (acting). The Nominating Committee makes recommendations to the Board of Directors for the selection of individuals to be nominated to the Board of Directors.

Executive Committee. Discontinued during 2005.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company s directors and officers, and persons who own more than 10% of a registered class of the Company s equity securities, to file initial reports of ownership and reports of changes in ownership with the Securities and Exchange Commission. These persons are required by the Securities and Exchange Commission to furnish the Company with copies of all Section 16(a) reports that they file. Based solely on the Company s review of these reports and written representations furnished to the Company, the Company believes that in 2005 each of the reporting persons complied with these filing requirements.

Code of Ethics

The Company has adopted a Code of Ethics that applies to the Company s principal executive officer, principal financial officer, principal accounting officer or controller (or persons performing similar functions). A copy of such Code of Ethics has been filed as Exhibit 14.1 to this Annual Report on Form 10-K.

Item 11. Executive Compensation

Summary of Cash and Certain Other Compensation

The following table sets forth, for the years ended December 31, 2005, 2004 and 2003, the cash compensation paid by the Company and its Subsidiaries, with respect to the Company s Chief Executive Officer and other officer, whose total annual salary and bonus exceeded $100,000, for services rendered in all capacities as an executive officer during such period:

Summary Compensation Table

Name and Principal Position	Year	Salary		Bonus	Securities Underlying Stock Options
Daniel Lehrfeld,	2005	$	183,000	N/A	0
President and	2004	$	183,000	N/A	200,000
Chief Executive Officer	2003	$	156,000	N/A	85,000
Devaunshi Sampat,	2005	$	165,000	N/A	20,000
Vice President,	2004	$	171,000	N/A	20,000
Marketing Comm.	2003	$	105,000	N/A	50,000
William Miraglia	2005	$	126,000	N/A	15,000
Vice President,	2004	$	126,000	N/A	25,000
Chief Financial Officer and Secretary	2003	$	101,000	N/A	40,000

The Company is party to an employment agreement with Mr. Dan Lehrfeld, President and CEO, that provides for a minimum annual salary during its term, and severance benefits under certain conditions that include a change of control of the Company.

The aggregate minimum commitment under this agreement is as follows:

Year Ending **December 31,**	
2006	$185,000
2007	$185,000

2008	$185,000
2009	$185,000

Should Mr. Lehrfeld be terminated without cause during this contract period, he would be entitled to one year s salary payable in one lump sum within 30 days of termination.

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There is an SEC requirement to report officer received perquisites or other personal benefits in excess of the lesser of $50,000 or 10% of such individual s reported salary and bonus. During fiscal years 2005, 2004 and 2003, respectively, no officer received any such perquisites or other personal benefits, nor were any granted.

Compensation of Directors

Fees for non-employee directors were $500 during fiscal year 2005 and fiscal year 2004 for each board meeting attended, and $250 during 2005 and 2004 for each conference call meeting in which they participated. The board agreed to defer payment of fees to its directors after October, 2005 in the interest of conserving cash. The total deferral amounted to $5,500 that is expected to be paid in 2006. Each non-employee director received 11,000 stock options, exercisable at $1.03, in 2005 and 20,000 stock options, exercisable at $.50 in 2004.

Compensation Committee Interlocks and Insider Participation

The following directors of the Company served as members of the Compensation Committee of the Company s Board of Directors during 2005: Mr. Frank Wiedeman, through August 1, 2005, Mr. Jan Winston, Mr. Luke LaValle and Mr. John Rich. None of these individuals are officers or employees of the Company. Officer s compensation is guided by overall job performance and the market salaries for those positions for companies of the same relative size and within industries similar to the Company s industry, as well as relativity to other salaries within the Company.

Option Exercises and Holdings

The following table provides information concerning options exercised during 2005 and the value of unexercised options held by each of the executive officers named in the Summary Compensation Table at December 31, 2005.

Option Grants in Last Fiscal Year

Shown below is information on grants of stock options pursuant to the 2000 Equity Compensation plan during the Fiscal year ended December 31, 2005 to the officers named below:

	Individual Grants					Alternative to Grant Date Value (a)
Name	Number of Securities Underlying Options Granted	% of Total Options Granted to Employees in Fiscal Year		Expiration or Base Price ($/Sh)	Expiration Date	Grant Date Payment Value ($)
Dan Lehrfeld	0	0	%			$ 0
Devaunshi Sampat	20,000	14.3	%	$ 1.03	Jan 2015	$ 20,600
William Miraglia	15,000	10.8	%	$ 1.03	Jan 2015	$ 15,450

(a) Based on a grant date present value of $1.03, derived using the Black-Scholes option pricing model with the following assumptions: Volatility of 210.54%, Risk free rate of return of 5.20%, Dividend Yield of 0% and a 10 year option life.

Aggregated Option Exercises in Last fiscal Year and Fiscal Year end Option Values

Name	Shares Acquired on Exercise (# shares)	Value Realized	Number of Securities Underlying Unexercised Options at December 31, 2005 (# of shares) Exercisable	Unexercisable	Value of In-the-Money Options at December 31, 2005 ($)(1) Exercisable	Unexercisable
Daniel Lehrfeld	0	0	731,550	73,450	363,275	36,725
Devaunshi Sampat	0	0	159,580	41,420	119,165	20,710

William Miraglia	0	0	119,280	34,720	81,890	17,360

(1) Based on $1.50 per share, the closing price of the Company s Common Stock, as reported by the OTC Bulletin Board, on December 31, 2005

No stock appreciation rights were granted during the fiscal year ended December 31, 2005.

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Item 12. **Security Ownership of Certain Beneficial Owners and Management**

The following table presents certain information with respect to the security ownership of the directors and named executive officers of the Company and the security ownership of each individual or entity known by the Company to be the beneficial owner of more than 5% of the Company s Common Stock outstanding (7,282,898 shares) as of March 23, 2006. Percentages that include ownership of options or convertible securities are calculated assuming exercise or conversion by each individual or entity of the options, (including out-of-the-money options), or convertible securities owned by each individual or entity separately without considering the dilutive effect of option exercises and security conversions by any other individual or entity. The Company has been advised that all individuals, or entities, listed have the sole power to vote and dispose of the number of shares set opposite their names in the table. Unless otherwise indicated, the address of each beneficial owner is c/o Photonic Products Group, Inc., 181 Legrand Avenue, Northvale, New Jersey 07674.

Name and Address of Beneficial Owner	Number of shares		Percent of Common Stock	
Clarex, Ltd. & Welland Ltd. Scotia House 404 East Bay Street Nassau, Bahamas	9,971,914	(1)	67.8	%
The estate of Warren Ruderman 45 Duane Lane Demarest, NJ 07627	1,172,000		16.1	%
Daniel Lehrfeld	896,350	(2)	11.1	%
Thomas Lenagh	209,540	(3)	2.8	%
The estate of Frank Wiedeman	168,400	(4)	2.3	%
John Rich	63,840	(5)	0.9	%
Jan Winston	53,440	(6)	0.7	%
William Miraglia	129,720	(7)	1.8	%
Devaunshi Sampat	171,180	(8)	2.3	%
Directors and Executive Officers as a group (7 persons)	1,692,470	(9)	19.5	%

(1) Including 900,000 shares issuable within 60 days on conversion of convertible preferred stock, 3,500,000 shares subject to convertible promissory notes at a conversion of $1.00, and 3,025,000 warrants exercisable as follows: 2,625,000 at $1.35, 200,000 at $1.08 and 200,000 at $.425.

(2) Including 731,550 shares subject to options exercisable within 60 days and 48,000 shares issuable within 60 days on conversion of convertible preferred stock

(3) Including 122,640 shares subject to options exercisable within 60 days.

(4) Including 90,000 shares subject to options exercisable or convertible within 60 days.

(5) Including 12,000 shares issuable within 60 days on conversion of convertible preferred stock and 47,640 shares subject to options exercisable within 60 days.

(6) Including 4,000 shares issuable within 60 days on conversion of convertible preferred stock and 47,640 shares subject to options exercisable within 60 days.

(7) Including 7,200 shares issuable within 60 days on conversion of convertible preferred stock and 119,280 shares subject to options exercisable within 60 days.

(8) Including 8,000 shares issuable within 60 days on conversion of convertible preferred stock and 159,850 shares subject to options exercisable within 60 days.

(9) Including 79,200 shares issuable within 60 days on conversion of convertible preferred stock and 1,318,330 shares subject to options exercisable within 60 days.

Equity Compensation Plan Information

The following table gives information about the Company s Common Stock that may be issued upon the exercise of options, warrants and rights under the Company s Key Employee Compensation Plan and the Company s 2000 Equity Compensation Program, as of December 31, 2005. These plans were the Company s only equity compensation plans in existence as of December 31, 2005.

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Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)
Equity Compensation Plans Approved by Shareholders	2,577,860	$ 1.18	3,422,140
Equity Compensation Plans Not Approved by Shareholders			
Total	2,577,860	$ 1.18	3,422,140

Item 13. Certain Relationships and Related Transactions

During the years ended December 31, 2005, 2004 and 2003, approximately 1%, 3%, and 3%, respectively of the Company s net product sales were through a foreign agent, in which the estate of Warren Ruderman, a principal shareholder has an investment. Terms of sales to this foreign agent were substantially the same as to unrelated foreign agents.

In December 2005 the Company initiated a financing arrangement with Clarex, Ltd. 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.

During 2005 two notes due to Clarex, Ltd., a shareowner and debt holder had their maturity dates extended from January 31, 2006 to December 31, 2008.

Item 14. Principal Accounting Fees and Services

In accordance with the requirements of the Sarbanes-Oxley Act of 2002 and the Audit Committee s charter, all audit and audit-related work and all non-audit work performed by the Company s independent accountants is approved in advance by the Audit Committee, including the proposed fees for such work. The Audit Committee is informed of each service actually rendered.

Audit Fees. Audit fees billed or expected to be billed to the Company by the Company s principal accountant for the audit of the financial statements included in the Company s Annual Reports on Form 10-K, and reviews of the financial statements included in the Company s Quarterly Reports on Form 10-Q, for the years ended December 31, 2005 and 2004 totaled approximately $110,000 and $98,500, respectively.

Audit-Related Fees. The Company was billed $0 and $0 by the Company s principal accountant for the fiscal years ended December 31, 2005 and 2004, respectively, for assurance and related services that are reasonably related to the performance of the audit or review of the Company s financial statements and are not reported under the caption *Audit Fees* above.

Tax Fees. The Company was billed an aggregate of $10,000 and $8,500 by the Company s principal accountant for the fiscal years ended December 31, 2005 and 2004, respectively, for tax services, principally the preparation of income tax returns.

All Other Fees. In 2004 the Company incurred approximately $125,000 in fees in connection with activities related to the MRC acquisition due diligence, audit of MRC, 8-K filing, S-8 registration and S-1 registration for resale of common stock issued as a result of the private equity offering.

Applicable law and regulations provide an exemption that permits certain services to be provided by the Company s outside auditors even if they are not pre-approved. The Company has not relied on this exemption at any time since the Sarbanes-Oxley Act was enacted. All other fees have been pre-approved by the Audit Committee of the Board of Directors.

PART IV

Item 15. **Exhibits and Financial Statement Schedules**

(a) (1) Financial Statements.

Reference is made to the Index to Financial Statements and Financial Statement Schedule on Page F-1.

(a) (2) Financial Statement Schedule.

Reference is made to the Index to Financial Statements and Financial Statement Schedule on Page F-1.

All other schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Financial Statements or Notes thereto.

(a) (3) Exhibits.

Exhibit No.	**Description of Exhibit**
2.1	Stock Purchase Agreement between Photonic Products Group, Inc., MRC Precision Metal Optics and Frank E. Montone (incorporated by reference to Exhibit 2.1 to the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on October 25, 2004)**
3.1	Restated Certificate of Incorporation of Photonics Products Group, Inc. (incorporated by reference to Exhibit 3.1 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
3.2	By-Laws of Photonic Products Group, Inc. (incorporated by reference to Exhibit 3.2 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
4.2	Form of Warrants issued pursuant to June 2004 Private Placement (incorporated by reference to Exhibit 4.2 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
4.3	Form of Placement Agent Warrants issued pursuant to June 2004 Private Placement (incorporated by reference to Exhibit 4.3 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
4.4	Promissory Note Dated June 30, 2003 held by Clarex, Ltd. (incorporated by reference to Exhibit 4.4 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
4.5	Subordinated Convertible Promissory Note dated April 1, 2004 held by Clarex, Ltd. (incorporated by reference to Exhibit 4.5 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
4.6	Subordinated Convertible Promissory Note dated October 31, 2003 held by Clarex, Ltd. (incorporated by reference to Exhibit 4.6 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
4.7	Subordinated Convertible Promissory Note dated December 31, 2002 held by Welland, Ltd. (incorporated by reference to Exhibit 4.7 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
4.8	Warrant dated March 31, 2004 issued to Clarex, Ltd. (incorporated by reference to Exhibit 10.2 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
4.9	Warrant dated May 19, 2004 issued to Clarex, Ltd. (incorporated by reference to Exhibit 10.3 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
10.1	2000 Equity Compensation Program (incorporated by reference to Exhibit 10.1 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
10.2	Daniel Lehrfeld Employment Contract, dated October 20, 1999 (incorporated by reference to Exhibit 10.4 to the Company s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on August 25, 2004)**
14.1	Code of Ethics**
21.1	List of Subsidiaries**
23.1	Consent of Holtz Rubenstein Reminick LLP Independent Auditors
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

** Previously filed with Original Filing

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PHOTONIC PRODUCTS GROUP, INC.

By: /s/ Daniel Lehrfeld
Daniel Lehrfeld
Chief Executive Officer

Dated: September 29, 2006

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

Signature	Title	Date
/s/ John Rich John Rich	Chairman of the Board of Directors	September 29, 2006
/s/ Daniel Lehrfeld Daniel Lehrfeld	President, Chief Executive Officer and Director	September 29, 2006
/s/ Luke P. Lavalle Luke P. Lavalle	Director	September 29, 2006
/s/ Thomas Lenagh Thomas Lenagh	Director	September 29, 2006
/s/ Jan Winston Jan Winston	Director	September 29, 2006
/s/ William J. Foote William J. Foote	Chief Financial Officer and Secretary	September 29, 2006

PHOTONIC PRODUCTS GROUP , INC. AND SUBSIDIARIES

REPORT ON AUDITS OF CONSOLIDATED FINANCIAL STATEMENTS

THREE YEARS ENDED DECEMBER 31, 2005

CONTENTS

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Photonic Products Group, Inc. and Subsidiaries
Northvale, New Jersey

We have audited the accompanying consolidated balance sheets of Photonic Products Group, Inc. and Subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders equity and cash flows for the three years ended December 31, 2005. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Photonic Products Group, Inc. and Subsidiaries as of December 31, 2005 and 2004 and the results of their operations and their cash flows for the three years ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

HOLTZ RUBENSTEIN REMINICK LLP

Melville, New York
February 24, 2006, except for Note 2, as to which the date is September 29, 2006.

PHOTONIC PRODUCTS GROUP, INC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2005	2004
Assets		
Current assets:		
Cash and cash equivalents	$ 1,156,563	$ 1,393,507
Accounts receivable (after allowance for doubtful accounts of $15,000 in 2005 and $88,000 in 2004)	2,265,934	1,447,994
Inventories	2,423,879	2,479,074
Other current assets	153,723	87,540
Total Current Assets	6,000,099	5,408,115
Plant and equipment:		
Plant and equipment at cost	12,472,480	12,018,865
Less: Accumulated depreciation and amortization	(8,143,592)	(7,255,427)
Total plant and equipment	4,328,888	4,763,438
Precious Metals	130,732	309,565
Goodwill	1,869,646	1,727,971
Intangible Assets, net of accumulated amortization of $112,602 and $32,425, respectively	987,272	1,067,449
Other Assets	164,384	250,096
Total Assets	$ 13,481,021	$ 13,526,634
Liabilities and Shareholders Equity		
Current Liabilities:		
Current portion of notes payable -Other	$ 260,697	$ 226,146
Accounts payable and accrued liabilities	2,426,692	2,189,744
Customer advances	652,264	385,714
Current obligations under capital leases	248,550	300,813
Total Current Liabilities	3,588,203	3,102,417
Related Party Convertible and Secured Notes Payable	5,200,000	5,200,000
Notes Payable Other, net of current portion	518,786	794,379
Capital Lease Obligations, Net of Current Obligation	244,625	464,709
Total Liabilities	9,551,614	9,561,505
Commitments		
Shareholders equity:		
10% convertible preferred stock, Series A no par value; 500 shares issued and outstanding	500,000	500,000
10% convertible preferred stock, Series B no par value; 2,100 shares issued and outstanding	2,100,000	2,100,000
Common stock: $.01 par value; 60,000,000 authorized shares 7,287,398 issued at December 31, 2005 and 7,186,794 issued at December 31, 2004	72,862	71,868
Capital in excess of par value	11,145,243	11,036,561
Accumulated deficit	(9,873,748)	(9,728,350)
	3,944,357	3,980,079
Less Common stock in treasury, at cost (4,600 shares)	(14,950)	(14,950)
Total Shareholders Equity	3,929,407	3,965,129

Total Liabilities & Shareholders Equity	$	13,481,021	$	13,526,634

See Notes to Consolidated Financial Statements

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PHOTONIC PRODUCTS GROUP, INC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31, 2005	2004	2003
REVENUES			
Net sales	$ 13,785,057	$ 9,221,857	$ 5,388,184
COST AND EXPENSES			
Cost of goods sold	9,956,125	6,618,506	3,917,123
Selling, general and administrative expense	3,450,224	2,916,056	2,389,547
Internal research and development expense	20,279	97,685	153,843
Special charges			582,000
	13,426,628	9,632,247	7,042,513
OPERATING PROFIT (LOSS)	358,429	(410,390)	(1,654,329)
OTHER INCOME (EXPENSE)			
Interest expense	(504,509)	(358,940)	(266,165)
Gain on sale of precious metals	135,931		
Other	(1,249)	49	8,950
	(369,827)	(358,891)	(257,215)
LOSS BEFORE INCOME TAX BENEFIT (PROVISION) AND PREFERRED STOCK DIVIDENDS	(11,398)	(769,281)	(1,911,544)
INCOME TAX BENEFIT (PROVISION)		96,344	134,235
NET (LOSS)	(11,398)	(672,937)	(1,777,309)
PREFERRED STOCK DIVIDENDS	(134,000)	(164,820)	(53,600)
NET LOSS APPLICABLE TO COMMMON SHAREHOLDERS	$ (145,398)	$ (837,757)	$ (1,830,909)
NET LOSS PER COMMON SHARE-BASIC	$ (0.02)	$ (0.15)	$ (0.35)
NET LOSS PER COMMON SHARE-DILUTED	$ (0.02)	$ (0.15)	$ (0.35)
WEIGHTED AVERAGE SHARES OUTSTANDING BASIC AND DILUTED	7,218,244	5,710,354	5,287,849

See notes to consolidated financial statements

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PHOTONIC PRODUCTS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

	Common Stock		Preferred Stock (Series A)		Preferred Stock (Series B)		Capital in excess of		Treasury	Total Shareholders
	Shares	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**	**par value**	**Deficit**	**Stock**	**Equity**
Balance, December 31, 2002	**5,283,640**	**$ 52,836**	**500**	**$ 500,000**	**2,100**	**$ 2,100,000**	**$ 9,471,676**	**$ (7,059,684)**	**$ (14,950)**	**$ 5,048,878**
401K contribution	28,263	283					11,587			11,870
Dividend on Preferred Stock	134,000	1,340					52,260	(53,600)		
Net loss for the year								(1,777,309)		(1,777,309)
Balance, December 31, 2003	**5,445,903**	**54,459**	**500**	**500,000**	**2,100**	**2,100,000**	**9,535,523**	**(8,890,593)**	**(14,950)**	**3,283,439**
401K contribution	25,891	259					12,686			12,945
Dividend on Preferred Stock	134,000	1,340					163,480	(164,820)		0
Common stock private placement	1,581,000	15,810					1,157,174			1,172,984
Warrants issued to lender							167,698			167,698
Net loss for the period								(672,937)		(672,937)
Balance, December 31, 2004	**7,186,794**	**71,868**	**500**	**500,000**	**2,100**	**2,100,000**	**$ 11,036,561**	**(9,728,350)**	**(14,950)**	**3,964,129**
Dividend on preferred stock	39,200	380					38,808	(134,000)		(94,812)
Accelerated stock options							21,398			21,398
Common stock private placement							(19,690)			(19,690)
401K contribution	61,404	614					68,166			68,780
Net loss for the period								(11,398)		(11,398)
Balance, December 31, 2005	**7,287,398**	**$ 72,862**	**500**	**$ 500,000**	**2,100**	**$ 2,100,000**	**$ 11,145,243**	**$ (9,873,748)**	**$ (14,950)**	**$ 3,928,407**

See notes to consolidated financial statements

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PHOTONIC PRODUCTS GROUP, INC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2005	2004	2003
Cash flows from operating activities:			
Net (loss)	$ (11,398)	$ (672,937)	$ (1,777,309)
Adjustments to reconcile net loss to cash used in operating activities:			
Depreciation and amortization	1,025,074	713,080	566,764
Gain on sale of precious metal	(135,931)		
401K common stock contribution	68,780	12,945	11,870
Stock option acceleration expense	21,398		
Change in allowance for doubtful accounts	73,000		
Inventory reserve	(254,526)	372,106	475,000
Changes in assets and liabilities:			
Accounts receivable	(744,939)	(10,756)	244,670
Inventories	309,720	(486,535)	(319,892)
Unbilled contract costs		191,767	149,774
Other current assets	(66,184)	(10,599)	7,656
Other assets	28,981	28,133	102,097
Accounts payable and accrued liabilities	81,740	599,590	255,987
Customer advances	110,546	(105,291)	
Total adjustments	371,659	1, 304,440	1,493,926
Net cash provided by (used in) operating activities	360,261	631,503	(283,383)
Cash flows from investing activities:			
Capital expenditures	(453,615)	(1,013,569)	(101,045)
Proceeds from sale of precious metals	314,764		
Cash used for business acquisition, net		(732,000)	(183,780)
Net cash used in investing activities	(138,851)	(1,745,569)	(284,825)
Cash flows from financing activities:			
Net (uses) proceeds from issuance of common stock	(19,492)	1,172,984	
Proceeds from secured notes payable			1,700,000
Proceeds from senior convertible debentures		1,000,000	1,500,000
Principal payments of notes payable	(166,515)	(847,907)	(727,425)
Principal payments of bank debt			(1,678,623)
Principal payments of capital lease obligations	(272,347)	(99,664)	(98,658)
Net cash (used in) provided by financing activities	(458,354)	1,225,413	695,294
Net (decrease) increase in cash and cash equivalents	(236,944)	111,347	127,086
Cash and cash equivalents at beginning of the year	1,393,507	1,282,160	1,155,074
Cash and cash equivalents at end of the year	$ 1,156,563	$ 1,393,507	$ 1,282,160

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PHOTONIC PRODUCTS GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

THREE YEARS ENDED DECEMBER 31, 2005

1. Nature of Business and Summary of Significant Accounting Policies

b. Nature of Operations

PHOTONIC PRODUCTS GROUP, Inc. and Subsidiaries (the Company , formerly known as Inrad, Inc.) is a manufacturer of crystals, crystal devices, electro-optic and optical components, and sophisticated laser subsystems and instruments. The Company s principal customers include commercial instrumentation companies and OEM laser manufacturers, research laboratories, government agencies, and defense contractors. The Company s products are sold domestically using its own sales staff, and in major overseas markets, principally Europe and the Far East, using independent sales agents.

c. Principles of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned Subsidiaries. Upon consolidation, all intercompany accounts and transactions are eliminated.

d. Allowance for doubtful accounts

Management must make estimates of the collectability of accounts receivable. Management specifically analyzes accounts receivable and analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in customer payment terms when evaluating the adequacy of the allowance for doubtful accounts.

e. Depreciation and amortization

Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Amortization of leasehold improvements is computed using the straight-line method over the estimated useful lives of the related assets, 3-7 years, or the remaining term of the lease, 10 years, whichever is shorter. Maintenance and repairs of property and equipment are charged to operations and major improvements are capitalized. Upon retirement, sale or other disposition of property and equipment, the cost and accumulated depreciation are eliminated from the accounts and gain or loss is included in operations.

f. Inventories

Inventories, including certain precious metals consumed in the manufacturing process, are stated at the lower of cost (first-in, first-out method) or market.

g. Income taxes

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

h. Impairment of long-lived assets

In accordance with SFAS No. 144, long-lived assets, such as property, plant and equipment and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimate undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the assets. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Goodwill and intangible assets not subject to amortization are tested in December of each year for impairment and are tested for impairment more frequently if events and circumstances indicate that the assets might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value.

i. Acquired Goodwill and Intangible assets

Acquired intangible assets and goodwill consists of goodwill approximating $1,870,000 and other intangible assets, principally of non-contractual customer relationships that approximated $987,000. The intangible assets are amortized on a straight-line basis over the assets estimated useful life up to 14 years. The Company periodically evaluates whether events or circumstances have occurred indicating the carrying amount of intangible assets may not be recoverable. When factors indicate that intangible assets should be evaluated for possible impairment, the Company uses an estimate of the associated undiscounted future cash flows compared to the related carrying amount of assets to determine if an impairment loss should be recognized.

The gross carrying amount of intangible assets as of December 31, 2005 and as of December 31, 2004 was $1,100,000. Accumulated amortization related to intangible assets approximates $113,000 as of December 31, 2005 and $32,000 as of December 31, 2004. Amortization expense was approximately $81,000 for the year ended December 31, 2005 and $32,000 for the year ended December 31, 2004. Aggregate amortization for the five succeeding years ending December 31, 2006 through December 31, 2011 approximates $405,000, accumulating at the rate of $81,000 per year. The weighted average lives of the Company s intangible assets is 14 years.

The changes in the carrying amounts of goodwill, by acquisition, for the year ended December 31, 2004, are as follows:

	Balance Jan. 1, 2005	Goodwill Additions	Purchase Price Adjustment	Balance Dec. 31, 2005
Laser Optics	$ 311,572			$ 311,572
MRC	$ 1,416,399		$ 141,675	$ 1,558,074
Total	$ 1,727,971		$ 141,675	$ 1,869,646

The following schedule details the Company s intangible asset balance by major asset class.

	At December 31, 2005 Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer-related	$ 549,937	$ (56,301)	$ 493,636
Completed technology	362,958	(37,159)	325,799
Trademarks	186,979	(19,142)	167,837
Total	$ 1,099,874	$ (112,602)	$ 987,272

	At December 31, 2004 Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer-related	$ 549,937	$ (16,213)	$ 533,725
Completed technology	362,958	(10,700)	352,258
Trademarks	186,979	(5,512)	181,466
Total	$ 1,099,874	$ (32,425)	$ 1,067,449

j. Stock-based compensation

The Company accounts for stock-based compensation arrangements in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and accounts for stock issued for services provided by other than employees in accordance with and complies with the disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation. Under APB No. 25, compensation expense is based on the difference, if any, on the date of the grant, between the fair value of the Company s stock and the exercise price. A new measurement date for purposes of determining compensation is established when there is a substantive change to the terms of an underlying option.

(ii) The Company has elected the disclosure-only provisions of Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation (FASB 123) in accounting for its employee stock options. Accordingly, no compensation expense has been recognized. Had the Company recorded compensation expense for the stock options based on the fair

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value at the grant date for awards, consistent with the provisions of FASB 123, the Company s net income (loss) and net income (loss) per share applicable to common shareholders would have changed to the following pro forma amounts:

	Years Ended December 31, 2005	2004	2003
Net Loss:			
As reported	$ (11,398)	$ (672,937)	$ (1,777,309)
Add: tock-based employee Compensation included in reported net income, net of related tax effects	S 21,398		
Less: Stock based employee compensation expense determined under fair value based method, net of related tax effects	(140,630)	(237,565)	(76,555)
Pro forma	$ (130,630)	$ (910,502)	$ (1,853,864)
Loss per share:			
Basic:			
As reported	$ (.02)	$ (.15)	$ (.35)
Pro forma	$ (.02)	$ (.19)	$ (.36)
Diluted:			
As reported	$ (.02)	$ (.15)	$ (.35)
Pro forma	$ (.02)	$ (.19)	$ (.36)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following range of weighted-average assumptions were used for grants during the years ended December 31, 2005, 2004 and 2003:

	Years Ended December 31, 2005	2004	2003
Dividend yield	0.00 %	0.00 %	0.00 %
Volatility	210.54 %	166.32 %	127.16 %
Risk-free interest rate	5.2 %	5.2 %	5.2 %
Expected life	10 years	10 years	10 years

k. Revenue recognition

The Company records revenue, other than on contractual type work, when a product is shipped. Revenue on contractual type work is accounted for using the percentage-of-completion method, whereby revenue and profits are recognized throughout the performance of the contracts. Percentage-of-completion is determined by relating the actual cost of work performed to date to the estimated total cost for each contract. Losses on contracts are recorded when identified.

l. Internal research and development costs

Internal research and development costs are charged to expense as incurred.

m. Precious metals

Precious metals not consumed in the manufacturing process are valued at cost, cost being determined on the first-in, first-out basis.

n. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

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o. Advertising costs

Advertising costs are charged to operations when the advertising first takes place. Included in selling, general and administrative expenses are advertising costs of $34,000, $28,000 and $32,000 for the years ended December 31, 2005, 2004 and 2003.

p. Statements of cash flows

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Interest paid during the years ended December 31, 2005, 2004 and 2003 was $183,000, $194,000 and $63,000, respectively.

Income taxes paid were $7,000 in 2005, $1,200 in 2004, $580 in 2003.

In 2005, non- cash transactions resulting from the exchange of debt for stock amounted to $59,200.

In 2005, non- cash transactions resulting from goodwill adjustments amounted to $141,675.

q. Concentration of risk

The Company invests its excess cash in deposits and money market accounts with major financial institutions and in commercial paper of companies with strong credit ratings. Generally, the investments mature within ninety days, and therefore, are subject to little risk. The Company has not experienced losses related to these investments.

The concentration of credit risk in the Company s accounts receivable is mitigated by the Company s credit evaluation process, reasonably short collection terms and the geographical dispersion of revenue. The Company generally does not require collateral.

The Company utilizes many relatively uncommon materials and compounds to manufacture its products. Therefore, any failure by its suppliers to deliver materials of an adequate quality and quantity could have an adverse effect on the Company s ability to meet the commitments of its customers.

r. Net Loss per common share

The basic net loss per share is computed using weighted average number of common shares outstanding for the applicable period. The diluted loss per share is computed using the weighted average number of common shares plus common equivalent shares outstanding, except if the effect on the per share amounts, including equivalents, would be anti-dilutive. The weighted average number of common shares plus common equivalent shares outstanding was 9,565,564.

s. Shipping and handling costs

The Company has included freight out as a component of selling, general and administrative expenses that amounted to $32,000 in 2005, $31,000 in 2004 and $27,000 in 2003. When applicable the Company bills its customers for freight costs.

t. Recently issued accounting pronouncements

In June 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3, (SFAS 154). SFAS 154 replaces APB Opinion No. 20, Accounting Changes (APB 20), and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements . SFAS 154 requires retrospective application to prior periods financial statements of a voluntary change in accounting principle unless it is impracticable to determine either the period-specific effects or the cumulative effects of the change. APB 20 previously required that most voluntary changes in accounting principle be recognized by including in net income in the period of the change the cumulative effect of changing to the new accounting principle. This standard generally will not apply with respect to the adoption of new accounting standards, as new accounting standards usually include specific transition provisions, and will not override transition provisions contained in new or existing accounting literature. SFAS 154 is effective for fiscal years beginning after December 15, 2005, and early adoption is permitted for accounting changes and error corrections made in years beginning after the date that SFAS 154 was issued. The Company does not expect that the adoption of SFAS 154 on January 1, 2006 will have a significant effect on its financial condition or results of operations.

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On December 21, 2004, the Financial Accounting Standards Board (FSAB) issued FASB Staff Position No. FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 (FSP No 109-1), and FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 (FSP No. 109-2). These staff positions provide accounting guidance on how companies should account for the effects of the American Jobs Creation Act of 2004 that was signed into law on October 22, 2004. FSP No. 109-1 states that the tax deduction for domestic manufacturing activities from this legislation should be accounted for as a special deduction and reduce tax expense in the period(s) the amounts are deductible on the tax returns, not as an adjustment of recorded deferred tax assets and liabilities. FSP No. 109-2 gives a company additional time to evaluate the effects of the legislation on any plan for reinvestment or repatriation of foreign earnings for purposes of applying FASB Statement No. 109. The Company has determined that it will not repatriate any undistributed foreign earnings under the new tax legislation and, therefore, the legislation as it relates to the undistributed foreign earnings will not have an effect on the Company s consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment. This statement replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB No. 25. Accounting for Stock Issued to Employees. SFAS 123(R) requires all stock-based compensation to be recognized as an expense in the financial statements and that such cost be measured according to the grant-date fair value of the stock options or other equity instruments. SFAS 123(R) will be effective for the first annual period beginning after June 15, 2005. Additionally, in March 2005, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 107, Share-Based Payment (SAB No. 107), which provides additional guidance on certain implementation issues with respect to SFAS No. 123(R). While the Company currently provides the pro forma disclosures required by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, on a quarterly basis (see Note 1 - Accounting for Stock-Based Compensation), it is currently evaluating the impact this statement will have on its consolidated financial statements. Unrecognized stock-based compensation expense related to unvested options as of December 31, 2005 was $131,000.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs - an amendment of ARB No. 43, Chapter 4 (SFAS No. 151). SFAS No. 151 requires all companies to recognize a current-period charge for abnormal amounts of idle facility expense, freight, handling costs and wasted materials. This statement also requires that the allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for fiscal years beginning after June 15, 2005. The Company is currently evaluating the effect that this statement will have on its consolidated financial statements.

u. Comprehensive income (loss)

Comprehensive income (loss) refers to revenue, expenses, gains and losses that under generally accepted accounting principles are included in comprehensive income but are excluded from net income as these amounts are recorded directly as an adjustment to stockholders equity. At December 31, 2005 and 2004, there were no such adjustments.

2. Impact of Unauthorized Personal Transactions by Former CFO

As discussed in the Explanatory Note to Form 10-K/A and in Item 9a Controls and Procedures, the results of an investigation by our Audit Committee through an independent forensic accounting specialist revealed that over a period of approximately six years, from the second quarter of 2000 through the second quarter of 2006, the Company s former Chief Financial Officer, William Miraglia, had engaged in unauthorized and personal transactions totaling $860,000. This included unauthorized charges on the Company s debit card of approximately $711,000. In addition, the investigation discovered that Mr. Miraglia made payments totaling $94,500, by check to the IRS with respect to a personal tax levy against him over a period of approximately two years (third quarter 2004 through second quarter 2006), in addition to, other unapproved payments and misappropriation of funds totaling approximately $36,000. As a result of the foregoing discoveries, Mr. Miraglia was terminated for cause from his employment with the Company on June 14, 2006.

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A summary of unauthorized personal transactions which occurred from approximately the second quarter of 2000 through the second quarter of 2006, follows:

	QUARTER ENDED March 31	June 30	September 30	December 31	TOTAL
From the second quarter 2000 to December 31, 2000	$ n/a	$ 1,000	$ 24,000	$ 25,000	$ 50,000
From January 1, 2001 to December 31, 2001	31,000	50,000	17,000	15,000	113,000
From January 1, 2002 to December 31, 2002	20,000	21,000	8,000	16,000	66,000
From January 1, 2003 to December 31, 2003	15,000	32,000	54,000	29,000	130,000
From January 1, 2004 to December 31, 2004	44,000	43,000	67,000	81,000	235,000
From January 1, 2005 to December 31, 2005	39,000	62,000	52,000	55,000	209,000
Total through December 31, 2005					$ 803,000
From January 1, 2006 to June 30, 2006	47,000	10,000	n/a	n/a	57,000
Total Unauthorized Personal Transactions					$ 860,000

Mr. Miraglia recorded these transactions primarily through journal entries prepared and entered by himself into the Company s accounts. The transactions were reflected as Selling, General and Administrative expenses. Although the transactions were unauthorized and personal in nature, based upon a review of the accounting treatment of individual transactions, the Company has concluded that all material charges have been reflected as part of the reported expenses, reported net income, earnings per share and cash flows in the appropriate periods.

3. Inventories

Inventories are comprised of the following:

	December 31, 2005	2004
Raw materials	$ 616,000	$ 579,000
Work in process, including manufactured parts and components	1,350,000	1,420,000
Finished goods	458,000	480,000
	$ 2,424,000	$ 2,479,000

4. Property and Equipment

Property and equipment are comprised of the following:

	December 31, 2005	2004
Office and computer equipment	$ 1,067,000	$ 985,000
Machinery and equipment	9,505,000	9,161,000
Leasehold improvements	1,900,000	1,873,000
	12,472,000	12,019,000
Less accumulated depreciation and amortization	8,143,000	7,255,000
	$ 4,329,000	$ 4,764,000

5. Subordinated Convertible Promissory Notes

In April 2004, the Company received $1,000,000 in proceeds from the issuance of a Subordinated Convertible Promissory Note. The Note is due in March 2007 and bears an interest rate of 6%. Interest accrues yearly and along with principal may be converted into Common Stock, (and/or securities convertible into common shares). As a result of the June 2004 private placement, the note is convertible into 1,000,000 Units consisting of 1,000,000 shares of Common Stock and Warrants to acquire 750,000 shares of Common Stock at a price of $1.35 per share. The

Holder of the Note is a major shareholder of the Company.

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In 2003, the Company issued a Subordinated Convertible Promissory Note for proceeds of $1,500,000. The note was amended in 2004 to clarify its conversion features. The Holder of the Note is a major Shareholder and Debt Holder of the Company. The note bears interest at the rate of 6% per annum and has a maturity date of December 31, 2008. The note was extended from its original maturity date of January 31, 2006. The note is convertible into common shares (and/or securities convertible into common shares) of the Company. As a result of the June 2004 private placement, the note is convertible into 1,500,000 Units consisting of 1,500,000 shares of Common Stock and Warrants to acquire 1,125,000 shares of Common Stock at a price of $1.35 per share. The Holder of the Note is a major shareholder of the Company. The proceeds from the Note are intended for use in the Company s acquisition program.

In June 2003, the Company received $1,700,000 from a major Shareholder and Debt Holder of the Company. The proceeds of the note were used to pay outstanding bank debt. The note is secured by the assets of the Company. The note bears interest at the rate of 6% per annum and is due December 2008.

In 2002, the Company issued a Subordinated Convertible Promissory Note for proceeds of $1,000,000. The note was amended in 2004 to clarify its conversion features. The note bears interest at the rate of 6% per annum and has a maturity date of December 31, 2008. The note was extended from its original maturity date of January 31, 2006. The note is convertible into common shares (and/or securities convertible into common shares) of the Company. As a result of the June 2004 private placement, the note is convertible into 1,000,000 Units consisting of 1,000,000 shares of Common Stock and Warrants to acquire 750,000 shares of Common Stock at a price of $1.35 per share. The Holder of the Note is a related party to a major Shareholder of the Company.

6. Notes Payable Other

As part of the purchase price of MRC on October 19, 2004, a $175,000 Note was issued to the sole shareholder of the company. The note bears interest at the rate of 6% per annum and is payable annually on the anniversary of the closing date. On the second anniversary of the Closing Date, $50,000 of the Note amount shall be due and payable. The remaining portion of the Note along with any accrued unpaid interest shall be paid in full on October 19, 2009. Three notes, totaling $295,725, were assumed from note holders of MRC. The notes bear interest rates from 6.0% to 10.5% and are payable from 2 to 4 years. During FY 2005 two of the notes totaling $199,525 were exchanged for two notes totaling $125,000, 80,000 shares of common stock of the Company and 60,000 warrants convertible into 60,000 shares of common stock at $1.35 per share. A Note payable to the SBA was also assumed. The Note in the amount of $390,497 bears interest at the rate of 4.0% and is due in 2032.

At the time of the purchase of Laser Optics, Inc., the Company converted certain liabilities to notes payable. Notes totaling $100,728 were issued to former officers of Laser Optics, Inc. for back pay and unreimbursed business expenses. These notes are for a three year period and carry an interest rate defined as the prime rate in the United States as published in the Wall Street Journal. A note in the amount of $86,777 was issued to the former landlord for back rent. It is a 36-month note with an interest rate of 2% per annum. At the time of the closing a former officer of Laser Optics, Inc. received a $15,000 prepayment on his note. All note balances are payable monthly commencing January 2004.

Notes payable other consist of the following:

	December 31, 2005	2004
Notes payable other, payable in aggregate including interest at monthly installments of $20,000 rates ranging from 2.0% to 10.5% expiring in April 2032, and a once yearly payment including interest of $60,500	$ 779,483	$ 1,020,525
Less current portion	260,697	226,146
Long-term debt, excluding current portion	$ 518,786	$ 794,379

Notes payable other, mature as follows:

2006	$ 260,697
2007	15,182
2008	15,916
2009	137,514
2010	9,998
Thereafter	340,176
	$ 779,483

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7. <u>Accounts Payable and Accrued Expenses</u>

Accounts payable and accrued expenses are comprised of the following:

	December 31, 2005	2004
Trade accounts payable and accrued purchases	$ 668,352	$ 837,830
Accrued vacation	335,153	347,357
Accrued payroll	217,653	197,639
Accrued interest	748,048	433,433
Accrued relocation costs		179,825
Accrued bonus	53,990	
Accrued common stock payable	155,200	
Accrued 401K common stock contribution	140,689	60,659
Accrued expenses other	107,607	133,001
	$ 2,426,692	$ 2,189,744

8. <u>Capital Lease Obligations</u>

Capital lease obligations consist of the following:

	December 31, 2005	2004
Capital leases, payable in aggregate monthly installments of $23,000, including interest at rates ranging from 11.0% to 11.6% expiring through October 2008	$ 493,175	$ 765,522
Less current portion	248,550	300,813
Long-term debt, excluding current portion	$ 244,625	$ 464,709

Maturities of capital leases are as follows:

Year Ending **December 31,**	
2006	293,224
2007	223,100
2008	49,144
Total minimum payments	565,468
Less amounts representing interest	72,293
Present value of minimum payments	$493,175

Capital lease obligations are collateralized by property and equipment with cost and related accumulated depreciation approximating $858,000 and $139,000 at December 31, 2005.

9. <u>Income Taxes</u>

A reconciliation of the income tax provision (benefit) computed at the statutory Federal income tax rate to the reported amount follows:

Year Ended

	December 31, 2005			2004			2003		
Federal statutory rate	34		%	34		%	34		%
Tax provision (benefit) at Federal statutory rates	$	(3,876	)	$	(228,797	)	$	(604,255	)
Loss in excess of available benefit	3,876			228,797			604,255		
State taxes	0			(96,344		)	(134,235		)
	$	0		$	(96,344	)	$	(134,235	)

At December 31, 2005, the Company has Federal and State net operating loss carry forwards for tax purposes of approximately $9,805,000 and $1,002,000, respectively. The tax loss carry forwards expire at various dates through 2025.

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The State of New Jersey has enacted a program that allows new or emerging technology and biotechnology businesses to sell their unused Net Operating Loss (NOL) carryover to any corporation for at least 75% of the value of the tax benefits. In 2004, the Company sold $1,550,800 of their NOL for $96,344.

Internal Revenue Code Section 382 places a limitation on the utilization of Federal net operating loss and other credit carryforwards when an ownership change, as defined by the tax law, occurs. Generally, this occurs when a greater than 50 percentage point change in ownership occurs. Accordingly, the actual utilization of the net operating loss and carryfowards for tax purposes may be limited annually to a percentage (approximately 6%) of the fair market value of the Company at the time of any such ownership change.

The benefit (provision) for income taxes consists of the following:

	Years Ended December 31, 2005	**2004**	**2003**
Current:			
State	$	$ 96,344	$ 134,235
Deferred:			
Federal			
State			
Total	$ 0	$ 96,344	$ 134,235

Deferred tax assets (liabilities) comprise the following:

December 31,		**2005**	**2004**
Inventory reserves	283,000	$ (79,000)	$ 332,000
Vacation liabilities	127,000	(2,000)	118,000
Section 263A adjustment	19,000	14,000	116,000
Depreciation	(83,000)	51,000	102,000
Loss carry forwards	3,424,000	2,993,000	2,992,000
Gross deferred tax assets	3,936,000	2,977,000	3,660,000
Valuation allowance	(3,936,000)	(2,977,000)	(3,660,000)
	$	$	$

10. <u>Related Party Transactions</u>

During the years ended December 31, 2005, 2004 and 2003, approximately 1%, 3%, and 3%, respectively of the Company s net product sales were through a foreign agent, in which Warren Ruderman, a principal shareholder has an investment. Terms of sales to this foreign agent were substantially the same as to unrelated foreign agents.

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.

During 2005 two notes due to Clarex, LTD., a shareowner and debt holder had their maturity dates extended from January 31, 2006 to December 31, 2008.

During 2004, Clarex, LTD., a shareowner and debt holder received a 6% Convertible Promissory Note for $1,000,000 due March 2007. In March 2004, Clarex, LTD received 200,000 warrants for offering the 2003 $1,700,000 secured promissory note and an additional 200,000 warrants for extending the maturity date of the Note to December 2008.

During 2003, Clarex, LTD. a shareowner and debt holder received a 6% Secured Promissory Note for $1,700,000 due December 2005, that was subsequently extended to December 31, 2008. In October 2003, Clarex, LTD received a $1,500,000, 6% Convertible Promissory Note due January 2006. that was subsequently extended to December 31, 2008.

During 2002, Welland Ltd., a related party to Clarex, Ltd., received a 6% Subordinated Convertible Promissory Note due January 31, 2006, that was subsequently extended to December 31, 2008, resulting in proceeds to the Company of $1,000,000.

11. Commitments

a. Lease commitment

The Company occupies 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. The Company has an option to renew the Northvale lease for an additional term of five years.

The Company 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 preliminary terms for a renewal of that lease, but does not currently have an option in place to renew the lease.

Rental expense was approximately $525,000, $370,000 and $238,000 in 2005, 2004 and 2003, respectively, and real estate taxes were $95,000, $64,000 and $41,000 in 2005, 2004 and 2003, respectively.

Future minimum annual rentals are payable as follows:

Year Ending **December 31,**	
2006	$418,000

b. Retirement plans

The Company maintains a 401(k) savings plan for all eligible employees (as defined in the plan). The 401(k) plan allows employees to contribute from 1% to 15% of their compensation on a salary reduction, pre-tax basis. The 401(k) plan also provides that the Company, at the discretion of the Board of Directors, may match employee contributions. The Company contributed $141,519 in the form of 144,836 shares of the Company s common stock in 2005, distributed in March 2006. The Company contributed $68,166 in the form of 61,404 shares of the Company s common stock in 2004, distributed in March 2005.

c. Employment agreements

The Company is party to an employment agreement with an officer that provides for a minimum annual salary. The aggregate minimum commitment under this agreement is as follows:

Year Ending **December 31,**		
2006	$	175,000
2007	$	175,000
2008	$	175,000
2009	$	175,000

Should the agreement be terminated without cause during the term of the contract, the officer would be entitled to one year s salary.

12. Product Sales, Foreign Sales and Sales to Major Customers

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

Year Ended December 31,	**2005**		**2004**		**2003**	
Category	**Sales**	**%**	**Sales**	**%**	**Sales**	**%**
Optical Components*	$ 12,279,000	89	$ 7,860,000	85	$ 4,469,000	83
Laser Accessories	1,506,000	11	1,362,000	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.

Export sales, primarily to approximately sixteen customers in six countries within Europe, Asia and Canada, amounted to 14%, 12% and 19% of net product sales in 2005, 2004 and 2003, respectively.

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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% of total product sales. In 2004, three U.S. customers accounted for 12%, 12%, and 10% of total product sales. In 2003, two U.S. customers accounted for 16.0% and 10.0% of total sales.

13. Shareholders Equity

a. Common shares reserved at December 31, 2005, are as follows:

Common Shares Preferred	
1991 Stock option plan	302,500
2000 Stock option plan	6,000,000
Convertible preferred stock	1,340,000
Subordinated convertible notes	3,500,000
Warrants	4,473,026

b. Preferred stock

The Company has authorized 1,000,000 shares of preferred stock, no par value, which the Board of Directors has the authority to issue from time to time in a series. The Board of Directors also has the authority to fix, before the issuance of each series, the number of shares in each series and the designation, preferences, rights and limitations of each series. Series A consist of 500 shares at a stated value of $1,000 per share convertible into common shares at the rate of $1.00 per share. Series B consist of 2,100 shares at a stated value of $1,000 per share convertible into common shares at the rate of $2.50 per share.

For the years ended December 31, 2005, 2004 and 2003, the Company paid a common stock dividend on preferred stock equal to $134,000, $165,000 and $54,000, respectively.

c. Stock options

The Company has adopted two stock option plans that provide for the granting of options to employees, officers, directors, and others who render services to the Company. Under these plans in the aggregate, options to purchase no more than 6,000,000 shares of common stock may be granted, at a price that may not be less than the fair market value per share.

The Equity Compensation Program authorizes the issuance of incentive stock options. At the annual Shareholders meeting held in 2004, shareholders approved a recommendation by the Board to increase the number of options to be granted under the 2000 Equity Compensation Program, from 4,000,000 to 6,000,000. The 2000 equity compensation plan expires in August 2010.

A summary of the status of the Company s stock option program as of December 31, 2005, 2004 and 2003, and changes during the years then ended is presented below:

	Years Ended December 31, 2005		**2004**		**2003**	
Fixed Stock Options	**Shares**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**
Outstanding, beginning of year	2,121,600	$ 1.21	1,449,100	$ 1.42	1,173,800	$ 1.69
Granted	139,500	1.03	680,000	0.74	299,900	0.50
Exercised						
Expired	(2000)	1.25				

Forfeited	(68,800)	1.18	(7,500)	.50	(24,600)	2.26
Outstanding, end of year	2,190,300	1.18	2,121,600	1.21	1,449,100	1.42
Options exercisable, end of year	1,666,124	1.43	1,301,047	1.53	881,424	1.88
Weighted-average fair values of options granted during year		$ 1.03		$ .67		$ .48

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Warrants outstanding expire from March 2008 to July 2009 as per the below schedule:

Shares	**Exercisable through**	**Exercise Price**	**Fair Value**
1,448,026	July 2009	$ 1.35	$ 1.29
200,000	May 2008	$ 1.08	$ .42
200,000	March 2008	$ .425	$ .42
80,000	July 2009	$ 1.35	$ 1.31

The following table summarizes information about stock options outstanding at December 31, 2005:

	Options Outstanding			**Options Exercisable**	
Range of Exercise Price	**Number Outstanding**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Number Outstanding**	**Weighted Average Exercise Price**
$0.50 - $2.00	2,049,200	6.99 yrs.	$ 1.01	2,073,610	$ 1.27
$3.00 - $5.00	141,100	4.95 yrs.	$ 3.57	504,250	$ 3.70

14. <u>Fair Value of Financial Instruments</u>

The methods and assumptions used to estimate the fair value of the following classes of financial instruments were:

Current Assets and Current Liabilities: The carrying amount of cash, current receivables and payables and certain other short-term financial instruments approximate their fair value.

Long-Term Debt: The fair value of the Company s long-term debt, including the current portion, for notes payable and subordinated convertible debentures, was estimated using a discounted cash flow analysis, based on the Company s assumed incremental borrowing rates for similar types of borrowing arrangements. The carrying amount of variable and fixed rate debt at December 31, 2005 approximates fair value.

15 <u>Quarterly Data</u> (Unaudited)

Summary quarterly results were as follows:

Year 2005	**First**	**Second**	**Third**	**Fourth**
Net sales	$ 3,233,846	$ 3,107,079	$ 3,581,339	$ 3,862,793
Gross profit	597,601	745,376	1,105,767	1,380,188
Net Income (loss)	(374,884)	(286,248)	307,524	342,210
Net Income (loss) per share Basic (a)	(0.05)	(0.06)	.04	.05
Net Income (loss) per share Diluted (a)	(0.05)	(0.06)	.03	.03

Year 2004	**First**	**Second**	**Third**	**Fourth**
Net sales	$ 1,805,802	$ 1,917,221	$ 2,582,372	$ 2,916,372
Gross profit	277,393	532,589	846,991	946,377
Net Income (loss)	(489,393)	(264,722)	95,167	(13,430)
Net Income (loss) per share Basic (a)	(0.09)	(0.08)	.01	(0.2)
Net Income (loss) per share Diluted (a)	(0.09)	(0.08)	.01	(0.2)

Year 2003		First	Second	Third	Fourth
Net sales		$ 1,200,853	$ 1,147,117	$ 1,405,663	$ 1,634,551
Gross profit		279,963	201,856	285,690	228,552
Net loss		(357,857)	(438,187)	(380,473)	(600,792)
Net loss per share	Basic (a)	(0.07)	(0.09)	(0.07)	(0.04)
Net loss per share	Diluted (a)	(0.07)	(0.09)	(0.07)	(0.04)

16. Special Charges

During 2003, the Company accrued certain expenses related to the relocation of 17 employees from Bethel, CT to its facility in Northvale, NJ. The special charges accrued amounted to $107,000 ($.02 per share on a basic and diluted basis) and included the costs for permanent relocation, stay on bonuses and relocation bonuses, anticipated to be expended in the next fiscal year.

During 2003, the Company determined that there was excess inventory, relative to forecasted future needs, of certain crystals and solutions. Based on this determination, a reserve was taken in the amount of $475,000 ($.09 per share on a basic and diluted basis) in order to recognize the diminished future economic benefit of the inventory.

REPORT OF INDEPENDENT REGISTERED CERTIFIED PUBLIC ACCOUNTANTS ON SUPPLEMENTAL SCHEDULE

The audits referred to in our report dated February 24, 2006, except for Note 2, as to which the date is September 29, 2006 relating to the consolidated financial statements of Photonic Products Group, Inc. and subsidiaries, which is contained in Item 8 in the Form 10-K/A, include the audits of the financial statement schedule listed in the accompanying Schedule II for the years ended December 31, 2005, 2004 and 2003. This financial statement schedule is the responsibility of the Company s management. Our responsibility is to express an opinion on this financial statement schedule based upon our audits.

It is our opinion such financial statement schedule presents fairly, in all material respects, the information set forth therein.

Holtz Rubenstein Reminick LLP
Melville, NY

September 29, 2006

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Schedule II Valuation and Qualifying Accounts

PHOTONIC PRODUCTS GROUP, INC.

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

(in thousands)

	Balance at Beginning of Period	Charged (Credited) to Cost and Expenses	Acquired Balance	Deductions	Balance at End of Period
Allowance for Doubtful Accounts					
Year ended December 31, 2005	$ 40,000			$ 25,000	$ 15,000
Year ended December 31, 2004	$ 40,000				$ 40,000
Year Ended December 31, 2003	$ 40,000				$ 40,000
Reserve for Inventory Obsolescence					
Year ended December 31, 2005	$ 807,000	$ (61,000)			$ 746,000
Year ended December 31, 2004	$ 992,000	$ (185,000)			$ 807,000
Year ended December 31, 2003	$ 600,000	$ 392,000			$ 992,000

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