APOGEE TECHNOLOGY INC
Form 10QSB
May 15, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended March 31, 2006

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

For the transition period from to

Commission file number 000-30656

APOGEE TECHNOLOGY, INC.

(Exact name of small business issuer as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	**04-3005815** (I.R.S. Employer Identification No.)

129 MORGAN DRIVE, NORWOOD, MASSACHUSETTS 02062
(Address of principal executive offices)

(781) 551-9450
(Issuer s telephone number, including area code)

NOT APPLICABLE
(Former name, former address and former fiscal year,
if changed since last report)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 ý No o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes ý No

State the number of shares outstanding of each of the Issuer s classes of common equity, as of the latest practicable date: As of April 24, 2006, there were 11,968,332 shares of Common Stock, $.01 par value per share, outstanding.

Transitional Small Business Disclosure Format (Check one): Yes o No ý

APOGEE TECHNOLOGY, INC.

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QUARTER ENDED MARCH 31, 2006 AND MARCH 31, 2005

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PART II - OTHER INFORMATION

PART I **FINANCIAL INFORMATION**

Item 1. **Financial Statements**

APOGEE TECHNOLOGY, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

		MARCH 31, 2006 (Unaudited)		DECEMBER 31, 2005
ASSETS				
Current assets				
Cash and cash equivalents	$	4,673,581	$	5,512,974
Accounts receivable, net of allowance for doubtful accounts of $88,074 and $145,000, in 2006 and 2005 respectively		119,291		152,837
Inventories, net		613,585		1,327,964
Prepaid expenses and other current assets		92,529		123,462
Total current assets		5,498,986		7,117,237
Property and equipment, net		47,687		39,932
Other assets				
Escrow account		411,924		409,480
Patents, net of accumulated amortization of $-0- and $-0-, in 2006 and 2005 respectively		154,044		149,536
	$	6,112,641	$	7,716,185
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities				
Accounts payable and accrued expenses	$	529,299	$	766,930
Deferred distributor revenue		625,521		1,337,022
Deferred contract revenue		72,686		72,686
Total current liabilities		1,227,506		2,176,638
Commitments and Contingencies				
Stockholders equity				
Common stock, $.01 par value; 20,000,000 shares authorized, 11,968,332 and 11,968,332 issued and outstanding at March 31, 2006 and December 31, 2005		119,683		119,683
Additional paid-in capital		18,104,423		18,104,423
Deferred stock compensation		74,590		
Accumulated deficit		(13,413,561)		(12,684,559)
Total stockholders equity		4,885,135		5,539,547
	$	6,112,641	$	7,716,185

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

APOGEE TECHNOLOGY, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

	THREE MONTHS ENDED MARCH 31, 2006			2005
Revenues				
Product sales	**$**	**985,398**	$	1,013,787
Royalties				100,953
		985,398		1,114,740
Costs and expenses				
Product sales		**725,244**		967,342
Research and development		**394,576**		790,140
Selling, general and administrative		**626,709**		799,939
		1,746,529		2,557,421
Operating loss		**(761,131)**		(1,442,681)
Other income (expense)				
Interest/other income		**53,715**		4,397
Interest/other expense		**(21,586)**		
		32,129		4,397
Net income (loss)	**$**	**(729,002)**	$	(1,438,284)
Basic and diluted loss per common share	**$**	**(0.06)**	$	(0.12)
Weighted average common shares outstanding - basic and diluted		**11,968,332**		11,838,332

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

APOGEE TECHNOLOGY, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	THREE MONTHS ENDED MARCH 31, 2006	2005
Cash flows from operations		
Net income (loss)	**$ (729,002)**	$ (1,438,285)
Adjustments to reconcile net income (loss)to net cash used in operating activities:		
Provision for doubtful accounts	**(56,926)**	15,000
Provision for slow moving, excess and obsolete inventory	**32,270**	243,229
Depreciation and amortization	**(2,873)**	20,891
Stock compensation expense	**74,590**	
Changes in operating assets and liabilities:		
Accounts receivable	**68,949**	172,574
Inventories	**682,108**	100,103
Prepaid expenses and other current assets	**30,934**	56,529
Accounts payable and accrued expenses	**(218,551)**	(47,465)
Deferred distributor revenue	**(711,501)**	(214,237)
Deferred contract revenue		(23,102)
Net cash (used) in operating activities	**(830,002)**	(1,114,763)
Cash flows from investing activities		
Purchases of property and equipment	**(4,882)**	(4,894)
Patent costs	**(4,509)**	(18,426)
Net cash provided by (used in) investing activities	**(9,391)**	(23,320)
Cash flows from financing activities		
Net cash provided by financing activities		
Incease (decrease) in cash and cash equivalents	**(839,393)**	(1,138,083)
Cash and cash equivalents - beginning	**5,512,974**	1,886,883
Cash and cash equivalents - ending	**$ 4,673,581**	$ 748,800

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

APOGEE TECHNOLOGY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2006 AND MARCH 31, 2005 (UNAUDITED)

1. The Company and Basis of Presentation

The Company

Apogee Technology, Inc. and Subsidiary (the Company or Apogee , we , us , or our) has historically designed, developed, and marketed integrated circuit (IC) products incorporating our proprietary DDX® audio amplifier technology to the consumer market. In addition, under licensing agreements with third parties, we granted rights to our intellectual property for use in royalty bearing audio IC products. Apogee is currently in the final stages of the process of evolving from an audio focused enterprise to a provider of sensors and medical device products based upon our acquired Micro-Electromechanical Systems (MEMS) Nanotechnologies. We released our first sensor products in December 2005 targeted for the consumer, automotive and industrial markets and we are currently developing a MEMS based device for transdermal drug delivery for the medical market.

On October 5, 2005, Apogee completed a transaction with SigmaTel, Inc. (SigmaTel), whereby certain assets of the audio division were sold, including the DDX technology and the associated royalties from its license agreement with STMicroelectronics (ST), to SigmaTel for approximately $9.4 million, resulting in a gain of approximately $8.9 million plus a one-year earn-out of potentially up to $4.5 million (the SigmaTel Transaction). No assurance can be given that any of this earn-out will be realized. The Company and certain of its principal stockholders also entered into an Indemnification Agreement if certain terms of the Agreement are violated. The Company is authorized to indemnify the principal stockholders in the event any one or more of them has to satisfy any obligations thereunder. In addition, the Company s engineering and marketing staff related to the audio division were offered positions at SigmaTel as a part of the Transaction.

Although the Company retained some of its audio division related agreements (with the exception of the royalty rights from the license agreement with ST) and its audio IC inventory, the Company intends to cease the operations of its audio division upon completion of the sale of these remaining assets.

Subsequent to the sale of the audio division, we organized our MEMS division into two business groups, the Sensor Products Group and the Medical Products Group. The Sensor Products Group will focus on the design, development and marketing of proprietary MEMS/Nanotechnology based sensors for the consumer, industrial and automotive markets. In December 2005, we introduced our first sensor products, a family of miniature pressure sensors, trademarked under the Sensilica brand name. These sensors are presently being sampled to potential customers. We intend to sell these sensor devices as stand-alone die and as packaged solutions in a similar manner as employed in the marketing and sale of our former audio IC products. The Medical Products Group is currently focused on the design, development and marketing of MEMS based devices to provide enhanced delivery of a range of therapies through the skin, or transdermally. We have demonstrated the feasibility of our solution by performing efficacy tests with model drugs and have performed related testing to support the commercialization of our transdermal delivery device. Depending upon the results of our technology and product development activities, we may: (i) license our technology to third party medical device or pharmaceutical companies, (ii) develop, have made and market through distributors our own medical products, or (iii) partner with third party pharmaceutical companies to commercialize our products.

Since the scope of operations covered by the Medical Products Group is currently considered immaterial, we have not implemented disclosures encompassed under SFAS 131, Disclosures about Segments of an Enterprise and Related Information . We will, however, continue to evaluate the materiality of this business Group.

Basis of Presentation

Consolidated Financial Statements

The financial statements include the accounts of Apogee Technology, Inc., and its wholly owned inactive subsidiary, DUBLA, Inc. All significant intercompany transactions and accounts have been eliminated.

In the opinion of the Company s management, all adjustments, consisting of normal recurring accruals considered necessary for a fair presentation, have been included in the accompanying unaudited financial statements. Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2006.

Going Concern

The accompanying consolidated financial statements have been prepared on a going concern basis which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. As shown in the consolidated financial statements, we have incurred continuing losses and negative cash flows from operations. Net losses were approximately $729,000 and negative cash flows from operations were approximately $830,000 for the three months ended March 31, 2006. This raises substantial doubt about the Company s ability to continue as a going concern.

The Company sold certain tangible and intangible assets associated with its audio business in 2005 and has approximately $4.7 million of cash at March 31, 2006. The Company has reduced, in the short-term, its operating expenses for payroll and related costs, rents and professional fees amongst others. The Company believes that its current working capital will be sufficient to fund its capital and operational requirements at least through March 31, 2007.

The long term success of the Company is dependent upon its ability to successfully develop and market its sensor and medical device products based upon its MEMS technology, to attain profitable operations and/or raise additional funds as needed for such purpose. There can be no assurance, however, that the Company will be able to become profitable or raise the funds that it needs or that additional funds will be available to the Company on acceptable terms, if at all.

Use of Estimates in Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and such differences could affect the results of operations reported in future periods and such differences could be material.

2. **Summary of Significant Accounting Policies**

Revenue Recognition

The Company recognizes revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104 (SAB 104), Revenue Recognition in Financial Statements: Revenue Recognition , which states that revenue should be recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) the product has been shipped and the customer takes ownership and assumes the risk of loss; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. The following policies apply to the Company s major product sales categories for revenue recognition.

Sales to OEM Customers: Revenue is recognized under the Company s standard terms and conditions of sale, title and risk of loss transfer to the customer at the time products are shipped to the customer or the customers representative/freight forwarder (shipping terms Ex Works). The Company has experienced minimal warranty or other returns and based upon historical experience has recorded a $10,000 provision for such returns.

Sales to Distributors: At times the Company provides incentives such as stock rotation, price protection and other incentives to its distributors. Therefore, under the sell through method of revenue recognition the Company defers recognition of revenue until such time that the distributor sells products to its customers based upon receipt of point-of-sale reports from the distributors. Distributor payments received before revenue is recognized are recorded as deferred revenue. Unsold inventory held at distributors is included as a component of finished goods inventory.

The Company records royalty revenue when earned in accordance with the underlying agreement. Royalties are based upon sales of products commercialized from the Company s licensed technology. Consulting revenue is recognized as services are performed in accordance with the terms of the underlying consulting agreements.

Loss Per Share

Basic loss per share is computed by dividing the net loss attributable to common stockholders for the period by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is computed based on the weighted average number of shares of common stock and shares of common stock issuable upon the exercise of stock options and common stock warrants.

Research and Development

Costs for research and development are expensed as incurred.

Inventories

Inventories, including inventory held at distributors (See Note 4) are stated at the lower of cost on a first-in, first-out basis or market. This policy requires the Company to make estimates regarding the market value of the Company s inventory, including an assessment of excess or obsolete inventory. The Company determines excess and obsolete inventory based on an estimate of the future demand and estimated selling prices for the Company s products within a specified time horizon, generally 12 to 24 months. The estimates the Company uses for expected demand are also used for near-term capacity planning and inventory purchasing and are consistent with the Company s revenue forecasts. Actual demand and market conditions may differ from those projected by the Company s management.

If the Company s unit demand forecast is less than the Company s current inventory value, the Company will record additional excess inventory charges or write-downs to net realizable value which will decrease the Company s gross margin and net operating results in the future. Accordingly, during the three months ended March 31, 2006, the Company recorded a provision of approximately $32,000 for slow moving, excess and obsolete inventory.

Purchase commitment losses

The Company accrues for estimated losses on non-cancelable purchase orders of products, which may occur if the future sale price declines below the committed purchase price. There are no outstanding purchase commitments of product inventory and therefore no provision was required at March 31, 2006.

Property and Equipment

Major replacements and betterments of equipment are capitalized. Cost of normal maintenance and repairs is charged to expense as incurred. Depreciation is provided over the estimated useful lives of the assets using accelerated methods. Leasehold improvements are amortized over either the term of lease or the estimated useful life of the improvement.

Patents

Costs incurred to register and obtain patents are capitalized and amortized on a straight-line basis over five years, their estimated useful lives.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Substantially all of the Company s cash is held in high quality money market funds comprised of short-term, fixed income securities earning interest at 4.23% at March 31, 2006.

Accounts Receivable

The Company carries its trade receivables from direct customers less an allowance for doubtful accounts to ensure that trade receivables are carried at net realizable value. On a periodic basis, the Company evaluates the collectibility of its accounts receivable on a variety of factors, including length of time receivables are past due, indication of customer willingness to pay, significant one-time events and historical experience. An additional reserve for individual accounts is recorded when the Company becomes aware of a customer s inability to meet its financial obligations, such as in the case of bankruptcy filings or substantial deterioration in the customer s operating results or financial position.

If the financial condition of the Company s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Accounts receivable are generally considered past due if any portion of the receivable balance is outstanding for more than 90 days. If circumstances related to the Company s customers change, estimates of the recoverability of receivables would be further adjusted.

Fair value of financial instruments

Carrying amounts of certain of the Company s financial instruments, including cash and cash equivalents, accounts receivable and notes and accounts payable, approximate their fair values due to their relative short maturities and based upon comparable market information available at the respective balance sheet dates. The Company does not hold or issue financial instruments for trading purposes.

Stock Based Compensation

The Company has one stock-based compensation plan, the 1997 Employee, Director and Consultant Stock Option Plan (Plan) which is described below. Prior to fiscal 2006, the Company accounted for the plan under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees , and related Interpretations, as permitted by Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation , (SFAS 123). Compensation costs related to stock options granted at fair value under those plans were not recognized in the consolidated statements of income.

In December 2004, FASB issued SFAS 124 (revised 2004), Share-Based Payments , (SFAS 123(R)). Under the new standard, companies are no longer able to account for stock-based compensation transactions using the intrinsic value method in accordance with APB Opinion No. 25. Instead companies are required to account for such transactions using a fair-value method and recognize the expense in the consolidated statement of income.

Prior to January 1, 2006, the Company had adopted only the disclosure provisions of Financial Accounting Standard No. 123(R), Accounting For Stock-Based Compensation (SFAS 123(R)). It applied APB Opinion No. 25, Accounting For Stock Issued To Employees , and related interpretations in accounting for its plan and did not recognize compensation expense for its stock-based compensation plan.

Effective January 1, 2006, the Company adopted SFAS 123(R) using the modified-prospective-transition method. Under this transition method, stock compensation costs recognized beginning January 1, 2006 includes (a) compensation cost for all stock-based compensation payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all stock-based payments granted on or subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

Stock Based Compensation

The Company s net loss for the three months ended March 31, 2006 was larger by approximately $75,000 more than if the Company had continued to account for share-based compensation under APB Opinion No. 25. Basic and diluted loss per share for the same period was $0.01 higher, due to the Company s adopting SFAS 123(R).

1997 Employee, Director and Consultant Stock Option Plan

In May 1997, the Company adopted an incentive stock option plan for employees, directors and consultants. The Company s board of directors authorized a maximum of 600,000 shares of common stock for issuance under the plan, which in 2001 was increased to 2,100,000 shares, increased in 2002 to 3,100,000 shares and further increased in 2003 to 4,100,000 shares. Pursuant to the plan, the board may grant options to employees, directors, or consultants at its discretion. Options granted under the plan to individuals with less than 10% ownership are to be for 100% of the fair value of the common stock on the date of grant and expire 10 years from the date of grant. Options granted under the plan to individuals with greater than 10% ownership are to be for 110% of the fair value of the common stock on the date of grant and expire five years from the date of grant.

Accounting for Stock Compensation

Stock-based compensation costs are generally based on the fair value calculated from the Black-Scholes option-pricing model on the date of grant for stock options. RSU fair values generally equal their intrinsic value on the date of grant.

The fair values of stock grants are amortized as compensation expense over the options vesting period. Compensation expense recognized is shown in the operating activities section of the consolidated statements of cash flow.

In anticipation of adopting SFAS 123(R), the Company evaluated the assumptions used in the Black-Scholes model. The Company continues to calculate the expected volatility based solely on historical volatility. The Company believes the historical volatility provides the best estimate of future stock price volatility.

The expected term was previously and is currently calculated based on an analysis of vesting periods and contractual life. The Company believes that this analysis provides a better estimate of option term periods.

The Company continues to base the estimate of risk-free rate on the U.S. Treasury yield curve in effect at the time of grant. The Company has never paid cash dividends and does not currently intend to pay cash dividends, and thus has assumed a 0% dividend yield.

Stock Based Compensation

As part of the requirements of SFAS 123(R), the Company is required to estimate potential forfeitures of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods.

A summary of the Company s stock compensation activity with respect to the fiscal quarter ended March 31, 2006 follows:

Stock Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2005	2,495,060	$ 5.4939		
Granted	106,500	0.9799		
Exercised	-0-			
Cancelled or expired	(25,000)	5.2000		
Outstanding at March 31, 2006	2,576,560	$ 5.3102	6.6881	$ 56,930.00

Vested at March 31, 2006	2,269,560	$	5.8648	6.3239	$	56,930.00
Exercisable at March 31, 2006	2,269,560	$	5.8648	6.3239	$	56,930.00

The weighted average fair value per share of stock-based payments granted to employees during the three months ended March 31, 2006 was $0.78. Although no options were exercised during the three months ended March 31, 2006, the total intrinsic value of exercisable stock options was $56,930 during the same period. In addition, since no options vested in the first quarter ended March 31, 2006, no fair value of vested options was calculated. Had we implemented SFAS 123(R), our stock-based compensation expense for the three months ended March 31, 2005 would have been approximately $532,000.

During the three months ended March 31, 2006, the Company issued 106,500 options to purchase shares under the Company s Plan. No options were exercised for the three months ended March 31, 2006.

3. Accounts Receivable

Accounts Receivable at March 31, 2006 and December 31, 2005 are comprised of the following:

		2006		**2005 (Audited)**
Distributor	**$**	**75,163**	$	190,202
Direct customers		**132,202**		107,635
	$	**207,365**	$	297,837
Less allowance for doubtful accounts	**$**	**(88,074)**		(145,000)
Net accounts receivable	**$**	**119,291**	$	152,837

4. Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. The major classifications of inventories are as follows:

		March 31, 2006		**December 31, 2005 (Audited)**
Raw materials	**$**	**-0-**	$	-0-
Finished goods held by Apogee		**2,111,007**		2,297,795
Finished goods held by distributors		**448,103**		943,423
	$	**2,559,110**	$	3,241,218
Less allowance for slow moving, excess And obsolete inventory		**(1,945,525)**		(1,913,254)
Inventory - net	**$**	**613,585**	$	1,327,964

5. Property and Equipment

Property and equipment at March 31, 2006 and December 31, 2005 are comprised of the following:

	March 31, 2006	December 31, 2005 (Audited)
Equipment	**$ 55,544**	$ 48,091
Software	**32,943**	32,943
Furniture and fixtures	**19,943**	22,515
Leasehold improvements	**22,954**	22,954
	$ 131,384	$ 126,503
Less accumulated depreciation	**(83,697)**	(86,570)
	$ 47,687	$ 39,933

Depreciation expense was $4,882 for the three months ended March 31, 2006.

The estimated useful lives of the classes of physical assets were as follows:

Description	**Depreciable Lives**
Equipment	5 years
Software	3 years
Furniture and fixtures	7 years
Leasehold improvements	Term of lease

6. Accrued Expenses

	March 31, 2006	December 31, 2005 (Audited)
Accrued audit expenses	**$ 40,000**	$ 69,000
Accrued legal expenses	**67,000**	86,000
Accrued taxes	**20,000**	20,000
Other accrued expenses	**31,000**	39,000
	$ 158,000	$ 214,000

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7. Deferred Contract Revenue

During September 2004, the Company entered into a funding agreement with United Binational Industrial Research and Development (BIRD) Foundation of Israel. This agreement will provide funds to the Company for industrial research and development activities. The agreement will provide up to a maximum of $560,000 of which the Company may receive $280,000, and another partner in the agreement will receive the remainder. The Company has recorded $101,379 in deferred contract revenue and for the twelve months ended December 31, 2004 recorded $23,101 as an offset to research and development expenses. There was no revenue recorded under this agreement for the fiscal year ended December 31, 2005 or the three months ended March 31, 2006.

8. Stockholders Equity

Stock Options

During the three months ended March 31, 2006, the Board of Directors awarded to certain employees options to purchase 106,500 shares at exercise prices ranging from $.77 to $1.30 per share. These options were granted under the 1997 Employee, Director and Consultant Stock Option Plan. The options vest over five years beginning at the first anniversary of the date of grant.

9. Related Party Transactions

The Company rents its facility from an entity controlled by a stockholder for $4,400 per month pursuant to a lease that expired December 31, 2005. Currently, the Company is renting the facility on a month-to-month basis.

10. License Agreement

On February 7, 2001, the Company signed a license agreement with ST Microelectronics NV (ST). The agreement granted ST the exclusive rights to develop, manufacture, and sell products incorporating certain intellectual property rights owned or controlled by the Company. In consideration for this license, ST paid to the Company a one-time license fee of $1.6 million in cash, a $400,000 credit for future design services and royalties based upon the sale of ST products that incorporate the licensed technology.

Royalty income was recognized during the period in which the royalties were earned. Royalties were reported to us by ST on a quarterly Royalty Schedule, which was received within 30 days of quarter end. Royalties were determined based upon either a percentage of selling prices or a flat rate depending on the particular product item sold in the reporting quarter. The license agreement has no expiration date; however, either party may cancel the agreement upon certain advance notices as defined in the agreement. In conjunction with the SigmaTel

Transaction, Apogee sold the rights to the royalties received under the license agreement to SigmaTel, as well as, all the rights title and interest in the related intellectual property.

11. Concentrations

During the three months ended March 31, 2006, the Company derived approximately 76% of its revenue as a result of sell through by three distributors.

During the three months ended March 31, 2005, the Company derived approximately 72% of its total revenue and 79% of product revenue from three distributors.

Three of the Company s customers accounted for approximately 91% of the total accounts receivable balance at March 31, 2006.

Four of the Company s customers accounted for approximately 87% of the total accounts receivable balance at March 31, 2005.

During the three months ended March 31, 2006, the Company derived approximately 97% of its revenue from distributors located in Asia and Europe.

During the three months ended March 31, 2005, the Company derived approximately 91% of its total and product revenue from distributors located in Asia and Europe.

The Company maintains its cash accounts with high quality financial institutions. Balances usually exceed the maximum coverage ($100,000) provided by the Federal Deposit Insurance Corporation on insured depositor accounts.

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

GENERAL

The following Management s Discussion and Analysis of the Company s Financial Condition and Results of Operations for the three-month periods ended March 31, 2006 and March 31, 2005 should be read in conjunction with the Company s Financial Statements and related Notes included elsewhere in this Quarterly Report on Form 10-QSB. This discussion contains, in addition to historical statements, forward-looking statements that involve risks and uncertainties. The Company s actual results could differ significantly from the results discussed in the forward-looking statements. Factors that could cause or contribute to such differences include the factors discussed in the section titled Certain Risk Factors That May Affect Future Results of Operations And Our Common Stock Price as well as other factors described in the Company s Annual Report on Form 10-KSB for the year ended December 31, 2005. The Company does not intend to update any such forward-looking statements.

OVERVIEW

Apogee has historically designed, developed, and marketed integrated circuit (IC) products incorporating our proprietary DDX® audio amplifier technology to the consumer market. In addition, under licensing agreements with third parties, we granted rights to our intellectual property for use in royalty bearing audio IC products. Apogee is currently in the final stages of the process of evolving from an audio focused enterprise to a provider of sensors and medical device products based upon its acquired Micro-Electromechanical Systems (MEMS) MEMS/Nanotechnologies. We released our first sensor products in December 2005 targeted for the consumer, automotive and industrial markets and we are currently developing a MEMS based device for transdermal drug delivery for the medical market.

From 1981 until 1995, Apogee was in the business of engineering, manufacturing and marketing high quality, high-end patented ribbon loudspeaker systems for use in home audio and video entertainment systems. Since 1995, we have focused on the development and commercialization of our proprietary all-digital, high efficiency audio amplifier technology, known as DDX®. Our DDX development efforts were directed toward the licensing of our technology and the design and development of DDX based IC s. Apogee signed an exclusive licensing agreement for audio applications with STMicroelectronics NV (ST) in February 2001, which was subsequently transitioned to a non-exclusive license in 2005. Under this licensing agreement with ST, Apogee developed and provided intellectual property to be used in royalty bearing products produced by ST. Apogee started the development of DDX-based IC products in 1996. The first IC product was released in late 2000 and since that time we have released over 20 additional IC products. Apogee marketed and sold its semiconductor products to audio manufacturers using a worldwide sales and distribution network. We utilized ST and another third party supplier to produce our semiconductor products.

As set forth in our Current Report on Form 8-K as filed on October 11, 2005, we completed a transaction with SigmaTel, Inc. (SigmaTel) on October 5, 2006, whereby certain assets of our audio division were sold, including the DDX technology and the associated royalties from our license agreement with ST, to SigmaTel for approximately $9.4 million plus a one-year earn-out of potentially up to $4.5 million. No assurance can be given that this earn-out will be realized, and based on our reports received to date, the revenue generated from this earn-out is likely to be minimal, if anything at all. As part of the transition a significant portion of Apogee s engineering and marketing staff related to the audio division left the Company after they were offered positions at SigmaTel. We have chosen to exit the audio business and by the terms of a non-compete with SigmaTel, signed in connection with our sale of assets to them, we can no longer compete in the Class D audio/amplifier business for a period of two years.

Subsequent to the sale of the audio division, we reorganized the Company s remaining MEMS division into two business groups, the Sensor Products Group and the Medical Products Group. The Sensor Products Group will focus on the design, development and marketing of proprietary MEMS/Nanotechnology based sensors for the consumer, industrial and automotive markets. In December 2005, we introduced our first sensor products, a family of miniature pressure sensors, trademarked under the Sensilica brand name. These sensors are presently being sampled to potential customers. We intend to sell these sensor devices as stand-alone die and as packaged solutions in a similar manner as employed in the marketing and sale of our former audio IC products. The Medical Products Group is currently focused on the design, development and marketing of MEMS based devices to provide enhanced delivery of a range of therapies through the skin, or transdermally. We have demonstrated the feasibility of our solution by performing efficacy tests with model drugs and have performed related testing to support the commercialization of our transdermal delivery device. Depending upon the results of our technology and product development activities, we may: (i) license our technology to third party medical device or pharmaceutical companies, (ii) develop, have made and market through distributors our own medical products, or (iii) partner with third party pharmaceutical companies to commercialize our products.

For the immediate future a meaningful portion of our revenue will result from the sale our remaining audio inventory. We expect that future revenue will initially be the result of sensor sales, potential licensing revenues resulting from the grant rights to its intellectual property, and consulting work from product or intellectual property development for third parties. It is likely that our MEMS-based medical products will take longer to commercialize, but the same business model will likely apply. Although the sales and marketing staff is not the same, we plan to leverage our past experience with a worldwide network of direct sales staff, independent sales representatives and distributors to support our Sensor Products Group and in conjunction with this we also intend to add new sales channels for our emerging medical products as appropriate.

In our former business, we outsourced the manufacturing, assembly and preliminary testing of our products. We intend to follow the same business model with respect to our sensor and medical products businesses. Our cost of revenue includes the third-party manufacturing, testing and assembly costs as well as costs associated with shipping. Research and development expenses consist primarily of salaries and related overhead costs associated with engineering activities as well as other materials and related services used in the development of our semi-conductor chips. Selling, general and administrative expenses consist primarily of employee compensation and overhead charges as well as expenses directly associated with the marketing of our past and potential products. We expect our business structure to remain largely the same.

At March 31, 2006, we had an accumulated deficit of approximately $13.4 million, as compared to a deficit of $12.7 million as of December 31, 2005. Our historical net losses and accumulated deficit (since 1995) result primarily from the costs associated with our efforts to design, develop and market its DDX technology as well as costs associated with our efforts to develop new products using our analog and digital circuit designs and MEMS technology.

As of March 31, 2006, we had 14 employees compared to 36 employees for the same period in 2005. This reduction in employees is a direct result of the audio business sale to SigmaTel, Inc. in October 2005.

During the three-month period ended March 31, 2006, we derived approximately 76% of our revenue as a result of sell through by three of our distributors. As of March 31, 2006, Apogee recognized substantially all of the deferred revenue, approximately $252,000, related to one of our former distributors. At December 31, 2005, we had formally terminated this distributor contract. At March 31, 2006 it was determined that we would have no continuing involvement with this distributor as it related to the audio business. All of the revenue was attributable to the audio division. Prior to the SigmaTel transaction, we utilized a network of sales representatives and distributors, as well as sales offices in China, Hong Kong, Japan and Taiwan, to support our worldwide sales and marketing activities. Subsequent to the selling of the audio business in October 2005, we closed our locations in China, Hong Kong and Taiwan. In addition, in January 2006, we closed the Long Island, New York office.

SELECTED CONSOLIDATED FINANCIAL DATA

The following selected financial data for the three-month periods ended March 31, 2006 and 2005 have been derived from our unaudited financial statements. Any trends reflected by the following table may not be indicative of future results.

	For the Three Months ended March 31,