INFINITE GROUP INC
Form 10KSB/A
August 01, 2002

FORM 10-KSB/A
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

(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, 2001

OR

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

Commission File Number 0-21816

INFINITE GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	52-1490422 (I.R.S. Employer Identification No.)
2364 Post Road, Warwick, RI (Address of principal executive offices)	02886 (Zip Code)
Issuer's telephone number	(401) 738-5777

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
None	None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, $.001 par value
(Title of class)

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 |_|

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B 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-KSB or any amendment to this Form 10-KSB. |_|

The registrant's revenues for the year ended December 31, 2001 were $8,507,648. As of March 27, 2002, there were 5,577,086 outstanding shares of common stock, par value $0.001 per share. The aggregate market value of the voting stock of

the registrant held by non-affiliates of the registrant on March 27, 2002, based on the average bid and asked price on such date was $11,711,881.

DOCUMENTS INCORPORATED BY REFERENCE:

None.

Transitional Small Business Disclosure Format: Yes |_| No |X|

INFINITE GROUP, INC.

Form 10-KSB

TABLE OF CONTENTS

FORWARD LOOKING STATEMENT INFORMATION

Various statements made in this Annual Report on Form 10-KSB are "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995) regarding the plans and objectives of management for future operations. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these "forward-looking statements." The "forward-looking statements" included in this report are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving judgments about, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of these assumptions could prove inaccurate and, therefore, we cannot assure you that the forward-looking statements included in this report will prove to be

accurate. In light of the significant uncertainties inherent in the forward-looking statements included in this report, the inclusion of these statements should not be interpreted by anyone that our objectives and plans will be achieved. Factors that could cause actual results to differ materially from those expressed or implied by forward-looking statements include, but are not limited to, the factors set forth elsewhere in this Report under the headings "Business," "Factors That May Affect Future Growth," and Management's Discussion and Analysis of Financial Condition and Results of Operations."

PART I

BUSINESS

We operate through two business segments, our Laser Group and our Photonics Group.

Revenues from our Laser Group for the quarter ended March 31, 2002 were $1,529,046 (69.3% of total quarterly continuing revenues) compared to $1,961,200 for the quarter ended March 31, 2001. Revenues related to the Photonics Group in the quarter ended March 31, 2002 were $678,077 (30.7% of total quarterly continuing revenues) compared to $108,013. Each business segment is essential to our overall growth. The Laser Group has been in business for over twenty years, while the Photonics Group started just over one year ago. Research and development performed in the Laser Group led to the original patent on the diode technology that became the core business of the Photonics Group. We expect the Laser Group to grow at the rate of the general economy, and for the Photonics Group to grow from approximately $1.2 million in annual revenues in 2001 to in excess of approximately $5.7 million of revenues from the DARPA contract in 2002. We anticipate developing diode lasers for defense, telecommunications, materials processing, laser printers, and medical applications and anticipate that the Photonics Group will continue to grow much more rapidly than the Laser Group. In general, we expect most commercial and governmental customers to pay for contract research and development in order to design diodes specific to their application in terms of wattage output needed and other characteristics.

During 2001, we also had a Plastics Group, which consisted of two subsidiaries, Express Pattern, Inc. (EP) and Osley & Whitney, Inc. (O&W). Our Plastics Group provided rapid prototyping services and proprietary mold building services. In November 2001 and December 2001, our board of directors determined to dispose of O&W and EP. Our plan consisted of shutting down the operations of O&W and selling the assets of EP. The O&W equipment was sold at auction in March 2002. The O&W land and building were sold at auction on July 16, 2002 for $650,000. A closing of this sale is scheduled for August 8, 2002. This closing will complete the liquidation of the O&W assets, resulting in a net obligation to the secured lender, including accrued interest and closing expenses, of approximately $200,000. The obligation of O&W to the secured lender was guaranteed by Infinite. Accordingly, we will assume that remaining outstanding balance. The secured lender has tentatively agreed with us to convert the balance into a term loan amortizing monthly based upon a seven year amortization schedule, with a balloon payment due eighteen months from issuance. It is anticipated that this note will be executed and delivered following the closing of the sale of the land and building.

On March 14, 2002, we sold the net assets of our Express Pattern subsidiary for $725,000, consisting of $575,000 in cash (of which $300,000 was paid to O&W's secured lender) and a five-year 8% subordinated $150,000 note, due upon maturity with quarterly interest payments. The purchasers included a former employee of Express Pattern and Thomas J. Mueller, our chief operating officer, who is a

passive investor in the purchasing entity. The sale was negotiated at "arm's length" by disinterested management with the former employee and his financier.

The Laser Group

Our Laser Group provides comprehensive laser-based materials and processing services (cutting, welding, drilling and assembly) to aerospace, power generation and medical device customers. As to the Laser Group, the majority of revenues are derived from one-time purchase orders, usually from repeat customers such as General Electric, United Technologies, Barnes Aerospace, Dey Laboratories, etc. Work begins when materials arrive from the customer (our inventories are minimal and the customer is responsible for the quality of the materials), and we cut, weld, drill and assemble the parts according to engineering drawings and specifications provided by the customer or determined by our engineers with customer approval. Upon completion of the parts, they are inspected by quality control personnel, compared to the engineering specifications, packaged and delivered to the customer. The customer is billed for the number of parts delivered.

The Laser Group uses 26 laser workstations to process parts ranging in size from very large (jet engine or gas turbine parts) to very small medical products, such as stents (stents are medical implants used to open veins for better blood flow). Substantially all of our laser workstations employ multi-axis lasers, commonly used for industrial component fabrication. One of our laser workstations uses a new system developed with and licensed from Sandia National Laboratories (Sandia). This workstation uses a process called Laser Engineered Net Shaping (LENS(R)), which was developed cooperatively at Sandia by Sandia and a consortium that included our Laser Group, Ford, Motorola, Lockheed Martin and others. The LENS(R) workstation is used to make parts or resurface parts directly in metal by introducing powdered metals through a feeder system, melting the airborne powdered metals as they pass through a small tube with a laser beam, and depositing the metal on to a surface. This process is computer controlled and the systems deposit metals based on information provided from three-dimensional engineering files, such as AutoCad(R). LENS(R) workstations are useful for the overhaul and repair of expensive aerospace parts that would otherwise be discarded, and for depositing rare metals, such as titanium, in complex structures used in medical devices. Lockheed Martin, Barnes Aerospace, United States Government military overhaul depots and Triton Systems are our primary customers to date for these services.

To meet aerospace customer needs, our Laser Fare subsidiary is certified for overhaul and repair of jet engine and aerospace parts by the FAA. We maintain the overhaul and repair license in order to perform laser material processing services on jet engine parts (cutting, welding, drilling) and to use the LENS process to repair or deposit titanium or other metals to aerospace components. To become FAA certified for overhaul and repair of jet engine and aerospace parts, Laser Fare contacted the FAA and submitted a quality manual and the required procedures for the parts involved. After the FAA staff reviewed the documentation, FAA inspectors visited the facility and performed an inspection. Thereafter, they require an inspection if procedures are changed. Our last change was in 2000, for which we passed inspection. We are subject to audit by the FAA at any time, either on a scheduled or periodic basis, or at our request if we change procedures. Loss of the license could impair our ability to conduct overhaul and repair of jet engine and aerospace parts.

Additionally, we are registered with the FDA as a Contract Manufacturer of medical devices to produce products such as asthma testing devices for Dey Laboratories (in which some of the components are cut using laser workstations).

We are subject to quality control audits by the

FDA at any time.We have never been audited by their inspectors. However, our medical customers are responsible for the inspection, sale and distribution of their products and devices and we do not believe we have liability to end-users. The process for registration as a contract manufacturer involves completion of an application Form FDA 2891A, which Laser Fare completed in 1995, and renewal forms every two years thereafter. Loss of the registration could impair our ability to perform contract manufacturing of medical devices or components.

Our Laser Group also provides laser-related contract research and development. We are both a prime contractor and subcontractor on several projects sponsored by the Defense Advanced Research Projects Agency (DARPA). We are a subcontractor on all four of DARPA's Mesoscopic Integrated Conformal Electronics (or MICE) programs. Mesoscopic refers to "handheld", and MICE programs are aimed at providing a series of sophisticated handheld devices for military, industrial and consumer use based on very small electronic components, many of which may be manufactured using lasers. Other research and development projects include research for the United States Naval Underwater Warfare Center, the Electric Boat division of General Dynamics, and the United States Air Force Research Laboratory (AFRL).

The Laser Group employs 68 full-time technical and engineering personnel in Smithfield and Narragansett, RI in 16,800 square feet of facilities that we own and 8,326 square feet of facilities that we lease.

The Photonics Group

Our Photonics Group develops and markets diode lasers for source and pump lasers and semiconductor optical amplifiers. Diode lasers and amplifiers are small semiconductor products (as small as one millimeter). The structure of a diode laser is much the same as a basic laser, with two specially designed slabs of semiconductor material on top of each other, with another material in between them forming the "active layer." An electrical current is sent through the device in order to excite electrons, which can then fall back to the non-excited ground state and give out photons ("particles" of light). Depending on the power generated (as measured in watts) and other characteristics, the laser energy generated can be used as the light source for a wide variety of products ranging from being the light source for fiber optic cable to the energy source to cut metals in materials processing equipment. Just as light bulbs can be designed with different shapes, characteristics and wattage for different applications, we can design diodes to provide different characteristics and wattages to meet specific customer needs.

An amplifier couples two or more of these diode lasers in such a fashion that the output of the second or third diode in terms of wattage is much greater than one diode laser alone.

Photonics is the science of generating and harnessing light to do useful work. Lasers and fiber optics are the best-known expressions of photonics technology. We believe photonics technology will be as important to the 21st century as electronics was to the 20th century.

The basic unit of light is the photon, while in electronics it is the electron. Because photons are massless and travel faster than electrons, photonic devices can be smaller and significantly faster than electronic devices. For example, replacing electronics (copper wire) with photonics (fiber optic cable) boosts the capacity of telecommunications transmission lines by a factor of 10,000.

Photonic components are the "enabling technology" in many familiar consumer products including CD-ROM players, digital cameras, displays on laptop computers and calculators, fiber optic cable for telephones, cable television and networked computer systems. In industry, photonic "eyes" enable robots to "see." Photonics is also found in semiconductor manufacturing as well as analytical and process-monitoring applications. In medicine, photonics is at the core of diagnostic instrumentation, laser microsurgery, and filmless real-time imaging.

In April 2001, we organized Infinite Photonics, Inc. to develop and market laser diodes based on our proprietary, patented and patent pending grating coupled surface emitting lasers (GCSEL) diode technology platform developed by our Laser Group's research and development unit over the last four years. In addition to our staff researchers, we also engaged researchers at the Photonics Research Center at the University of Connecticut, the Ioffe Institute in St. Petersburg, Russia and the Center for Research and Education in Optics and Lasers at the University of Central Florida in Orlando to develop applications of our GCSEL's. To date we have obtained one patent (expiring in 2018), have nineteen patents pending for GCSEL and related technologies. We own the intellectual property, which in addition to patents and patent applications, includes the trade secrets and processing techniques used to manufacture these diodes.

Our diode lasers are produced from two to four inch semiconductor wafer material, usually indium phosphide (InP), gallium arsenide (GaAs), or gallium nitride (GaN). The semiconductor wafer material chosen determines the wavelength of the laser beam, such as 980 nanometers for GaAs, 1550 nanometers for InP, and 1480 nanometers for GaN. A nanometer is one billionth of a meter. The semiconductor diode wafers we currently use in the manufacture of GCSEL's are processed at Industrial Microphotonics Company (a TRW subsidiary). We are currently qualifying a second wafer-manufacturing source, as required by most larger telecommunications equipment manufacturers.

A three-inch semiconductor wafer has the potential to produce substantially more than 2,000 individual diode lasers as small as a millimeter by one and one-half millimeters. Each diode can emit laser energy (lase) with continuous power of greater than one watt. Each individual diode has two sections, active and passive. The passive area of each diode on the wafer is etched with one of a variety of grating patterns. It is through this grating on the surface of the diode that the laser beam emits, hence the name, Grating Coupled Surface Emitting Laser. At the opposite end of the diode from the grating, a contact is placed on the diode to provide electrical power, and a thermo-electric cooler or heat sink may be used to cool the diode during operation. When electrical power is applied to the contact, lasing begins in the semiconductor material, and laser energy is emitted through the grating. The device is packaged to protect the diode, along with a very small focusing lens, and that lens is used to focus the laser beam into the end of the fiber optic cable.

Our competitors produce diode lasers that can either emit from the edge of the wafer material, such as processes known as Fabry-Perot or Distributed Feedback diode lasers, or through the surface, such as through a surface emitting technology different from ours, known as Vertically Coupled Surface Emitting Lasers. Each technology has different characteristics in terms of cost, power output and laser beam quality. We believe that our GCSEL diodes produce the best

overall combination of cost, power and beam quality of emitted light for high power (0.5 to 8 watts) applications used in defense, telecommunications, materials processing, laser printers and medical device equipment. Because the beam comes out of the grating in a cylindrical shape (low beam spreading), our diodes require lower cost focusing optics. Emitting the beam from the wide surface of the wafer (as opposed to the narrow edge of the wafer) allows our diodes to be tested on the wafer, which provides lower test, burn-in and packaging costs. Finally, the very narrow line width of the beam allows for tunability over a greater number of available channels. The qualities of our diode lasers in comparison to competitive diodes include:

- Power of up to eight watts compared to currently commercially available power of under one watt;
- Beam spreading of less than one degree as compared to 12 to 30 degrees for edge emitted laser energy (which reduces the cost and complexity of the optics needed to focus to the fiber); and
- Relatively narrow line width of emitted laser energy (which allows for more than 50 communication channels on a single fiber optic cable).

We have many of the same disadvantages of most emerging technology start-ups, which includes among others: market acceptance of a new technology; customer commitment to engineer or re-engineer their products to incorporate our technology; the need to expand rapidly and attract talented personnel; and the need to raise capital to fund that expansion.

On January 23, 2002, Infinite Photonics, Inc. signed and commenced a $12.0 million research and development contract with DARPA, which is scheduled to conclude by the end of 2003. Payments under this contract will be received as services are rendered and billed for. As of May 31, 2002, approximately $1.4 million has been billed under this contract in the current year. Of the remaining contract balance we believe that an additional $4.3 million will be billed during 2002 with the balance billed during 2003. If we fail to meet technical milestones and defense contract audit requirements, DARPA may terminate the contract which could result in less than $12 million of revenue to us under this contract. The purpose of the contract is to provide DARPA with pump and source laser diodes and grating coupled semiconductor optical amplifiers with powers much higher than the current industry standard of about 0.3 watts (more than one watt with a goal as high as ten watts), high repetition rates (up to 20,000 laser pulses per second), and high beam quality (minimum beam spreading of the laser). We will own the intellectual property developed under the contract.

In March 2002, we signed a one-year lease with the Central Florida Research Park in Orlando, Florida for a 6,750 square foot laboratory and manufacturing facility. This facility replaces laboratory and office space we were leasing on a short-term basis from the University of Central Florida. Depending on market acceptance of our products once we achieve full production, we may require more space in the foreseeable future.

Our Photonics Group employs ten full-time personnel. We expect to grow our Photonics Group staff to approximately 30 to 40 full-time employees by the end of 2002. We currently have subcontractors producing raw material (semiconductor wafers), electrical drivers, power supplies and devices to control the heat produced by our diodes (thermal management). The proprietary grating patterns etched into the semiconductor wafers for different applications are accomplished at our current facilities in Orlando, FL and in St. Petersburg, Russia at the Ioffe Institute.

We expect to acquire a minimum of approximately $1.2 million in capital equipment over the next year through equipment operating leases that will be negotiated under terms available at the time of acquisition. Additionally, we currently have semiconductor steppers and other relatively high cost equipment available to us on a per hour basis from the University of Central Florida, as well as from other commercial facilities. We estimate that our current and proposed leased and rented equipment will support up to $10.0 million in annual revenue capacity. Our Florida facility is certified for exemption by the Governor's Office from sales and use taxes under Florida's Semiconductor, Defense and Space Technology Facilities Program.

Dey Laboratories, Inc. accounted for 12% and 7% of our revenues during the year ended December 31, 2000 and 2001, respectively. DARPA accounted for 12 % of our revenues for 2001 and we expect DARPA to account for over 40% of our consolidated revenues for the year ending December 31, 2002.

We intend to continue to use a combination of direct sales to customers, contract research and development for new and existing customer applications and early stage prototype assistance to foster our Photonics Group's growth.

We were incorporated under the laws of the state of Delaware on October 14, 1986. On January 7, 1998, we changed our name from Infinite Machines Corp. to Infinite Group, Inc. Our principal executive offices are located at 2364 Post Road, Warwick, RI 02886 and our facsimile number is (401) 738-6180. Our subsidiaries are located in Rhode Island and Florida. We maintain sites on the World Wide Web at www.infinite-group.com, www.laserfare.com, and www.infinitephotonics.com. Information contained on any of our websites do not constitute a part of this Report on Form 10-KSB.

Factors that may affect future growth.

In addition to the other information provided in our reports, you should consider the following factors carefully in evaluating our business and us. Additional risks and uncertainties not presently known to us, that we currently deem immaterial or that are similar to those faced by other companies in our industry or business in general, such as competitive conditions, may also impair our business operations. If any of the following risks occur, our business, financial condition, or results of operations could be materially adversely affected.

We have experienced losses in the current and prior years and we anticipate that we will continue to generate operating losses for at least the first quarter of 2002.

Our operations to date have not been profitable. As of December 31, 2001 we had an accumulated deficit of approximately $23.5 million. We expect to continue operating at a loss during the first quarter of 2002. The majority of the operating losses during 2001 were primarily attributable to discontinued injection molding operations at our former Osley & Whitney, Inc. subsidiary and start up costs at our Infinite Photonics, Inc. subsidiary. Other factors that could adversely affect our operating results in the future include:

- the cost of manufacturing scale-up and production at our Photonics Group;

- introduction of new products and product enhancements by us or our competitors;
- changes in applied photonics technologies; and
- changes in general economic conditions.

We cannot assure you that our revenues will increase sufficiently to offset our operating costs or that, even if they do, that our operations will ever be profitable.

We are highly leveraged, which increases our operating deficit and makes it difficult for us to grow.

At December 31, 2001 we had current liabilities, including trade payables, of $6.2 million, and long-term liabilities of $2.6 million and a working capital deficit of $1.7 million. We continue to experience working capital shortages that impair our business operations and growth strategy. If we continue to incur operating losses and experience working capital limitations, our business, operations and financial condition will be materially adversely affected.

We have been dependent on our chief executive officer to fund working capital needs and provide equipment.

Mr. Brockmyre, our chief executive officer, lent us $974,000 and $150,000 during 2000 and 2001, respectively. He converted $974,000 and $100,000 of this amount into shares of our common stock during 2000 and 2001, respectively. In addition, Mr. Brockmyre has purchased and leased to us equipment necessary for our operations. There is no assurance that he will be willing or able to fund future working capital needs.

We may require additional financing in the future, which may not be available on acceptable terms.

Depending on the amount of money we raise under our existing credit facilities, we may require additional funds to expand our production capability, continue to develop new applications for our diode technology and for working capital and general corporate purposes. At this time, we cannot assure you that cash flow from product sales will reach the level required to sustain our operations and growth plans in the near term. Further, we cannot assure you that adequate additional financing will be available or, if available, will be offered on acceptable terms. Our existing credit facilities limit our ability to raise capital through the sale of our securities. Accordingly, if we need additional capital but are unable to access it under our existing facilities, our access to capital may be limited. In addition, any additional equity financing may be dilutive to stockholders, and debt financings, if available, may involve restrictive covenants that further limit our ability to make decisions that we believe will be in our best interests. In the event we

cannot obtain additional financing on terms acceptable to us when required, our operations will be materially adversely affected and we may have to cease or substantially reduce operations.

Some of our products and services are at an early stage of development and may not achieve market acceptance.

Our primary focus is to develop new commercial applications for our diode laser and laser-driven technologies. Many of the benefits of our diode laser and laser

technologies are not widely known. Therefore, we anticipate that we will need to educate our target markets to generate demand for our products and services and, as a result of market feedback, we may be required to further refine these services. In order to persuade potential customers to purchase our services, we will need to overcome industry resistance to, and suspicion of, new technologies. In addition, developing new applications for these technologies and other new technologies may require significant further research, development, testing and marketing prior to commercialization. We cannot assure you that commercial applications of these technologies can be successfully developed, marketed or produced.

Some of our current products and services have not been commercially successful.

Our laser materials processing services have not generated a significant amount of revenue, even though they have been available for some time. In addition, since the number of jet engine, aerospace and medical device manufacturers is relatively small, most of our revenue from these businesses is generated from a limited number of customers. We cannot assure you that these customers will continue to purchase these products and services or that we will be able to expand the market for these products and services. Therefore, any material delay, retooling, cancellation or reduction in orders from the customers who purchase these products and services could have a material adverse affect on our business, operations and financial condition.

We have limited marketing and sales capabilities and must make sales in fragmented markets.

Our future success depends, to a great extent, on our ability to successfully market our products and services. We currently have limited sales and marketing capabilities and experience at our Photonics Group (generally limited to technical trade conferences, technical publications, and direct customer inquiry) and we will need to hire qualified sales and marketing personnel, develop additional sales and marketing programs and establish sales distribution channels in order to achieve and sustain commercial sales of our products. In addition, our ability to successfully market our products and services is further complicated by the fact that our principal markets, laser photonics, telecommunications, aerospace and medical components, are highly fragmented. Consequently, we will need to identify and successfully target particular market segments in which we believe we will have the most success. These efforts will require a substantial amount of effort and resources. We cannot assure you that any marketing and sales efforts undertaken by us will be successful or will result in any significant product sales.

We depend on the aerospace, laser photonic, telecommunications and medical device industries, which continually produce technologically advanced products.

A majority of our sales in our Laser Group are to companies in the aerospace, laser photonic, telecommunications and medical device industries, which are subject to rapid technological change and product obsolescence. If our customers are unable to create products that keep pace with the changing technological environment and market demand, their products could become obsolete and the demand for our services could decline significantly. If we are unable to offer cost-effective, quick-response manufacturing services to customers, demand for our services will also decline. This would have a material adverse affect on our business, operations and financial condition.

We depend on government research and development contracts to support our Photonics Group.

Substantially all of our Photonics Group revenue has been derived from governmental research programs. Any reduction in spending on these programs would have a material adverse affect on our business, operations and financial condition.

Our industry is intensely competitive, which may adversely affect our operations and financial results.

All our markets are intensely competitive and numerous companies offer conventional and laser driven products and services that compete with our products and services. We anticipate that competition for our products and services will continue to increase. Most of our competitors have substantially greater capital resources, research and development staffs, manufacturing capabilities, sales and marketing resources, facilities and experience. These companies, or others, could undertake extensive research and development in laser technology and related fields that could result in technological changes. Many of these companies also are primary customers for various components, and therefore have significant control over certain markets that we have targeted. In addition, we may not be able to offer prices as low as some of our competitors because those competitors may have lower cost structures. Our inability to provide comparable or better products and services at a lower cost than our competitors could adversely effect demand for our products and services. We cannot assure you that our competitors will not succeed in developing technologies in these fields which will enable them to offer laser services more advanced and less costly than those we offer or which could render our technologies obsolete.

Our products and services are subject to industry standards, which increases their cost and could delay or bar their commercial acceptance.

Since some of our products and services in development are used in the telecommunications industry, they must comply with the Bellcore Testing standards for traditional equipment and/or Bluetooth standards for wireless devices. These standards govern the design, manufacture and marketing of these items. If we fail to comply with these standards, we will not be able to sell

our products. We may encounter significant delays or incur additional costs in our efforts to comply with these industry standards.

We depend on our relationship with third parties to develop and commercialize new products.

Our strategy for research and development and for the commercialization of our products contemplates a continuing relationship with various publicly and privately funded consortia and our existing relationships will continue with strategic partners, original equipment manufacturers (OEMs), potential licensees and others. We depend on these associations and relationships not only to underwrite our research and development efforts, but also for product testing and to create markets for our products and services. The majority of our product research has been funded by customers or potential customers. We cannot assure you that our existing relationships will continue or the extent to which the parties to such arrangements will continue to allocate time of resources to these strategic alliances. Similarly, we cannot assure you that we will be able to enter into new arrangements in the future. In addition, we cannot assure you that any agreement will progress to a production phase or, if production commences, that we will receive significant revenues as a result of these relationships. The majority of our relationships for product development or

contract research is for one to two years in duration, and is generally cancelable based on attaining or not attaining the customers' milestones.

We have only limited manufacturing capabilities and our inability to continuously manufacture products on a cost-effective basis would harm our business.

We have limited production facilities and limited experience in manufacturing our product offerings. To the extent any of our existing or future products must be produced in commercially reasonable quantities, we will have to either develop that expertise quickly or outsource that function. Developing manufacturing capability is an expensive and time-consuming endeavor and we do not have the resources that are required for a full-scale manufacturing capability. Therefore, in all likelihood we will have to engage a third party to manufacture our products for us. In that event, we will depend on the manufacturer to produce high-quality products based on our specifications, on time and within budget. If we are unable to manufacture products in sufficient quantities and in a timely manner to meet customer demand ourselves or by others, our business, financial condition and results of operations will be materially adversely affected.

We depend on our intellectual property rights to provide us with a competitive advantage.

Our ability to compete successfully depends, in part, on our ability to protect our products and technologies under United States and foreign patent laws, to preserve trade secrets and other proprietary information and technologies, and to operate without infringing the proprietary rights of others. We cannot assure you that patent applications relating to our products or potential products will result in patents being issued, that any issued patents will afford adequate protection or not be challenged, invalidated, infringed or circumvented, or that any rights granted will give us a competitive advantage. Furthermore, we cannot assure you that others have not independently developed, or will not independently develop, similar products and/or technologies, duplicate any of our product or technologies, or, if patents are issued to, or licensed by, us, design around those patents. We cannot assure you that patents owned or licensed and

issued in one jurisdiction will also be issued in any other jurisdiction. In addition, we cannot assure you that we can adequately protect our proprietary technology and processes that we maintain as trade secrets. If we are unable to develop and adequately protect our proprietary technology and other assets, our business, financial condition and results of operations will be materially adversely affected.

We depend on the continued services of our key personnel.

Our future success depends, in part, on the continuing efforts of our senior executive officers, Clifford G. Brockmyre II, Thomas Mueller, Bruce J. Garreau, and Jeff Bullington who conceived our strategic plan and who are responsible for executing that plan. The loss of any of these key employees may adversely affect our business. At this time we do not have any term "key man" insurance on any of these executives other than a $1.7 million policy on Clifford G. Brockmyre II. If we lose the services of any of these senior executives, our business, operations and financial condition could be materially adversely affected.

We may have difficulties in managing our growth.

Our future growth depends, in part, on our ability to implement and expand our financial control systems and to expand, train and manage our employee base and provide support to an expanded customer base. If we cannot manage growth effectively, it could have material adverse effect on our results of operations, business and financial condition. Acquisitions and expansion involve substantial infrastructure and working capital costs. We cannot assure you that we will be able to integrate our acquisitions and expansions efficiently. Similarly, we cannot assure you that we will continue to expand or that any expansion will enhance our profitability. If we do not achieve sufficient revenue growth to offset increased expenses associated with our expansion, our results will be adversely affected.

We must attract, hire and retain qualified personnel.

As we continue to develop new products and as our business grows, significant demands will be placed on our managerial, technical, financial and other resources. One of the keys to our future success will be our ability to attract, hire and retain highly qualified scientific, engineering, marketing, sales and administrative personnel. Competition for qualified personnel in these areas is intense and we will be competing for their services with companies that have substantially greater resources than we do. We cannot assure you that we will be able to identify, attract and retain employees with skills and experience necessary and relevant to the future operations of our business. Our inability to retain or attract qualified personnel in these areas could have a material adverse effect on our business and results of operations.

We face potential product liability claims.

The sale of our telecommunications, aerospace and medical products and services will involve the inherent risk of product liability claims by others. We maintain product liability insurance coverage. However, we cannot assure that the amount and scope of our existing coverage is adequate to protect us in the event that a product liability claim is successfully asserted.

Moreover, we cannot assure you that we will continue to maintain the coverage we currently have. Product liability insurance is expensive, subject to various coverage exclusions and may not always be obtainable on terms acceptable to us.

Our stock price is volatile and could be further affected by events not within our control.

The trading price of our common stock has been volatile and will continue to be subject to:

- volatility in the trading markets generally;
- significant fluctuations in our quarterly operating results;
- announcements regarding our business or the business of our competitors;
- changes in prices of our or our competitors' products and services;
- changes in product mix; and
- changes in revenue and revenue growth rates for us as a whole or for geographic areas, and other events or factors.

Statements or changes in opinions, ratings or earnings estimates made by brokerage firms or industry analysts relating to the markets in which we operate or expect to operate could also have an adverse effect on the market price of our common stock. In addition, the stock market as a whole has from time to time experienced extreme price and volume fluctuations which have particularly affected the market price for the securities of many small cap companies and which often have been unrelated to the operating performance of these companies.

The price of our common stock may be adversely affected by the possible issuance of shares under our credit facilities and as a result of the exercise of outstanding warrants and options.

In addition to the shares that may be issuable under our credit facilities, as of December 31, 2001 we have granted options to employees and directors covering 1,036,037 shares of our common stock under our stock option plans. In addition, we have issued warrants covering 1,083,375 shares of common stock. As a result of the actual or potential sale of these shares into the market, our common stock price may decrease.

Concentration of ownership

As of March 27, 2002, our chief executive officer, Clifford G. Brockmyre II, is our largest stockholder, owning approximately 26% of the issued and outstanding shares of our common stock. Mr. Brockmyre, as a result, effectively controls all our affairs, including the election of directors and any proposals regarding a sale of the Company or its assets or a merger.

Some provisions in our charter documents and bylaws may have anti-takeover effects.

Our certificate of incorporation and bylaws contain provisions that may make it more difficult for a third party to acquire us, with the result that it may deter potential suitors. For example, our board of directors is authorized, without action of the stockholders, to issue authorized but unissued common stock and preferred stock. The existence of undesignated preferred stock and

authorized but unissued common stock enables us to discourage or to make it more difficult to obtain control of us by means of a merger, tender offer, proxy contest or otherwise.

Absence of dividends to shareholders.

We have never declared a dividend on our common stock. We do not anticipate paying dividends on the common stock in the foreseeable future. We anticipate that earnings, if any, will be reinvested in the expansion of our business and debt reduction.

We have agreed to limitations on the potential liability of our directors.

Our certificate of incorporation provides that, in general, directors will not be personally liable for monetary damages to the company or our stockholders for a breach of fiduciary duty. Although this limitation of liability does not affect the availability of equitable remedies such as injunctive relief or rescission, the presence of these provisions in the certificate of incorporation could prevent us from recovering monetary damages.

We must maintain compliance with certain criteria in order to maintain listing of our shares on the Nasdaq market.

Our common stock is traded on the Nasdaq SmallCap Market. In order to maintain this listing, we are required to meet certain requirements relating to our stock price and net tangible assets of $2.0 million (stockholders' equity, less unamortized goodwill). If we fail to meet these requirements, our stock could be delisted. If our stock is delisted, it will trade on the OTC Bulletin Board or in the "pink sheets" maintained by the National Quotation Bureau Incorporated. As a consequence of such delisting, an investor could find it more difficult to dispose of or to obtain accurate quotations as to the market value of our securities. Among other consequences, delisting from Nasdaq may cause a decline in our stock price and difficulty in obtaining future financing.

The liquidity of our stock could be severely reduced if it becomes classified as "penny stock".

The Securities and Exchange Commission has adopted regulations which generally define a "penny stock" to be any non-Nasdaq equity security that has a market price (as therein defined) of less than $5.00 per share or with an exercise price of less than $5.00 per share. If our securities were subject to the existing rules on penny stocks, the market liquidity for our securities could be severely adversely affected. For any transaction involving a penny stock, unless exempt, the rules require substantial additional disclosure obligations and sales practice obligations on broker-dealers where the sale is to persons other than established customers and accredited investors (generally, those persons with assets in excess of $1,000,000 or annual income exceeding $200,000, or $300,000 together with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of the common stock and have received the purchaser's written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the rules require the delivery, prior to the transaction, of a risk disclosure document mandated by the Commission relating to the penny stock market. The broker-dealer also must disclose the

commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Consequently, the "penny stock" rules may restrict the ability of broker-dealers to sell the common stock and accordingly the market for our common stock.

Customer concentration

Both our Laser Group and our Photonics Group have experienced significant customer concentration. The Laser Group sells laser services to over 100 customers for jet engine and aerospace parts including: General Electric; United Technologies; Rolls Royce Allison; Barnes Aerospace; and Orenta. Medical laser services are sold to over 20 customers, including Dey Laboratories (a Merck Germany unit), Stryker Medical, and Johnson & Johnson. In our Photonics Group, over 90% of our revenues are derived from sales to the United States Government, including DARPA and AFRL. Dey Laboratories, Inc. accounted for 12% and 7% of revenues during the year ended December 31, 2000 and 2001, respectively. DARPA accounted for 12 % of revenues for 2001 and we expect DARPA to account for over 40% of the consolidated revenues for the year ending December 31, 2002. Due to the concentration of revenues in both groups, loss of any of these customers could have a significant detrimental effect on that group's business and financial results.

Government regulation

To meet aerospace customer needs, our Laser Fare subsidiary is certified for overhaul and repair of jet engine and aerospace parts by the FAA. We maintain the overhaul and repair license in order to perform laser material processing services on jet engine parts (cutting, welding, drilling) and to use the LENS process to repair or deposit titanium or other metals to aerospace components. To become FAA certified for overhaul and repair of jet engine and aerospace parts, Laser Fare contacted the FAA and submitted a quality manual and the required procedures for the parts involved. After the FAA staff reviewed the documentation, FAA inspectors visited the facility and performed an inspection. Thereafter, they require an inspection if procedures are changed. Our last change was in 2000, for which we passed inspection. We are subject to audit by the FAA at any time, either on a scheduled or periodic basis, at our request if we change procedures. Loss of the license could impair our ability to conduct overhaul and repair of jet engine and aerospace parts.

Additionally, we are registered with the FDA as a Contract Manufacturer of medical devices to produce products such as asthma testing devices for Dey Laboratories (in which some of the components are cut using laser workstations). We are subject to quality control audits by the FDA at any time. We have never been audited by their inspectors. However, our medical customers are responsible for the inspection, sale and distribution of their products and devices and we do not believe we have liability to end-users. The process for registration as a contract manufacturer involves completion of an application Form FDA 2891A, which Laser Fare completed in 1995, and renewal forms every two years thereafter. Loss of the registration could impair our ability to perform contract manufacturing of medical devices or components.

As we perform government defense contracts in both our Laser and Photonics Groups, a number of our employees have received National Security Clearance by the appropriate agencies, and we are responsible for compliance with Federal Acquisition Regulations, or "FAR's." In addition, we are audited by the Defense Contract Audit Agency (DCAA), who must periodically approve our hourly billing rates for direct labor charged to our federal contracts.

Patents and intellectual property

Our patents and patent applications relate to diode grating structure, design and processes to produce the diode; thermal management devices to control the heat of the diode and other manufacturing processes; titanium processes for the LENS application, and other manufacturable product discovered or acquired in the course of our research. The majority of our intellectual property is employed directly in the development and manufacture of laser diodes, products using the LENS process or processes used to provide laser processing services. A patent on our GCSEL technology was awarded on April 17, 2001. Presently, this is our only material issued patent. Additionally, we have nineteen patent applications pending, including twelve related to our GCSEL technology and seven related to thermal management applications to disperse the heat created by diode lasers and for other uses. All patents have a duration of seventeen years from the date of issuance.

For intellectual property that we discover or develop that is not related to our core businesses, we intend to seek to license or sell this technology to unaffiliated third parties.

Competition

Our Laser Group's materials processing business competes with laser and traditional job shops. We principally compete with universities and large corporations for some of our laser research services. Our proprietary technology allows us to compete in these markets.

Our Photonics Group competes in the laser diode market. Laser diodes are produced for a large number of consumer, industrial and government purposes. We are focused on three of the larger components of those markets: telecommunications; materials processing; and medical products. We compete against a large global market of component manufacturers, and against many large, well-funded diode manufacturers including industry leaders, such as JDS Uniphase, Nortel, Coherent and Novalux. Much of the industry addresses low to mid-range power applications under 0.5 watts, such as edge emitting diode and vertically coupled surface emitting laser manufacturers. Our product development program is concentrated on applications requiring mid to high power (greater than 1.0 watts), relatively high beam quality (beam spreading less than 1%), and narrow line width (for greater than 50 channel applications). We believe that such applications are and will be important to current and future telecommunications requirements for optical amplification (Raman and EDFA); materials processing applications for ablation (low heat effected zone), and medical applications (low heat effected zone).

We compete with different manufacturers, depending on the type of service or product we provide and the geographic locale of our different operations. Most of our competitors have greater manufacturing, financial, research and development and/or marketing resources than we have. In addition, we may not be able to offer prices as low as some of our competitors because those competitors may have lower cost structures as a result of their geographic location,

economies of scale, or the services they provide. Our inability to provide comparable or better manufacturing services at a lower cost than our competitors could cause our net sales to decline.

Employees

As of March 29, 2002, we had 78 full-time employees including 38 production personnel, 26 engineering and research personnel, three sales personnel and 11 general and administrative personnel. Our ability to develop, manufacture and market our products and service, and to establish and maintain a competitive position in our businesses will depend, in large part, upon our ability to attract and retain qualified technical, marketing and managerial personnel, of which there can be no assurance. We believe that our relations with our employees are good. None of our employees are covered by a collective bargaining agreement.

Properties

The table below lists our manufacturing and administrative office locations and square feet owned or leased. The Orlando, Florida rent includes electric power, water and high speed internet.

	Square feet			
Location	Owned	Leased	Annual Rent	Termination Dat

Warwick, RI	--	2,223	$	35,568	2002
Smithfield, RI	16,800	8,000	$	28,800	Month to Month
Narragansett, RI	--	326	$	6,850	2002
Orlando, FL	--	6,750	$	104,123	2003

We anticipate the need for additional manufacturing facilities in the foreseeable future that we believe will be available on commercially reasonable terms. We believe all properties are in good operating condition. We do not expect to renew the leases for our Warwick and Narragansett facilities in our continuing effort to reduce general and administrative costs, and to further consolidate functions and personnel either in Smithfield, RI or Orlando, FL.

Legal proceedings

We are a defendant in an action commenced in the Circuit Court for the Sixteenth Judicial Circuit, Kane County, Illinois, by Craftsman Tool & Mold Co. in which the plaintiff alleges that we guaranteed an obligation of O&W in the approximate amount of $130,000. We intend to vigorously defend this action, and believe the plaintiff's position is without merit.

We are the plaintiff in a lawsuit filed in the Rhode Island Superior Court on August 13, 1999 captioned Infinite Group, Inc. vs. Spectra Science Corporation ("Spectra") and Nabil Lawandy. In the action we assert that by fraud and in breach of fiduciary duties owed, Spectra and its president Nabil Lawandy, caused us to sell to Spectra shares of Spectra's Series A Preferred Stock at a substantial discount to fair market value. We allege that in entering into the transaction we relied on various representations made by Spectra and Mr. Lawandy, which were

untrue at the time they were made. In the action we seek compensatory damages in the amount of $500,000 plus punitive damages as well as an award of attorney's fees and costs. In its response to the complaint, Spectra asserted counterclaims against us which we believe are without merit. The first counterclaim alleges that Infinite, through Laser Fare, breached a contract to sell four lasers to Spectra for a total price of $30,000. Spectra asserted that the lasers did not meet its specifications or operate satisfactorily and, thus, seeks a refund of the purchase price. The second counterclaim alleges that Infinite, by bringing suit against Spectra, has breached a fiduciary duty to Spectra and has intentionally interfered with advantageous relations.

Our motion to dismiss the counterclaims was denied. We are currently engaged in the discovery stage of the proceedings and believe that the matter will be placed on the trial calendar during the fourth quarter of 2002 or first quarter of 2003. We intend to vigorously prosecute this proceeding.

Other than the foregoing proceeding, we are not a party to any material legal proceeding.

Submission of matters to a vote of security holders

None.

PART II

Market for common equity and related matters

Our common stock is quoted on the Nasdaq SmallCap Market System ("Nasdaq") under the symbol "IMCI". The following table sets forth the high and low bid prices of the common stock for the past two fiscal years by quarter as reported by Nasdaq. Quotations represent interdealer prices without an adjustment for retail markups, markdowns or commissions and may not represent actual transactions.

Period	High	Low
2001		
First Quarter	$4.234	$1.500
Second Quarter	3.990	1.688
Third Quarter	3.320	1.600
Fourth Quarter	4.170	1.500
2000		
First Quarter	$18.375	$ 1.063
Second Quarter	4.938	1.531
Third Quarter	6.125	2.000
Fourth Quarter	4.000	1.375

As of March 27, 2002, we believe that we had approximately 1,650 beneficial stockholders.

Dividend policy

We do not expect to declare or pay any dividends in the foreseeable future. Instead, we intend to retain all earnings, if any, in order to expand our operations. The payment of dividends, if any, in the future is within the discretion of our board of directors and will depend upon our earnings, if any, our capital requirements and financial condition and other relevant factors. Under the terms of our credit facilities, we are prohibited from paying dividends or making other cash distributions.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary statement identifying important factors that could cause our actual results to differ from those projected in forward-looking statements.

Pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, readers of this report are advised that this document contains both statements of historical facts and forward-looking statements. Forward-looking statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those indicated by the forward-looking statements. Examples of forward looking statements include, but are not limited to (i) projections of revenues, income or loss, earnings per share, capital expenditures, dividends, capital structure and other financial items, (ii) statements of our plans and objectives, including product enhancements, or estimates or predictions of actions by customers, suppliers, competitors or regulatory authorities, (iii) statements of future economic performance, and (iv) statements of assumptions underlying other statements and statements about is and our business.

This report also identifies important factors, which could cause our actual

results to differ materially from those indicated by the forward-looking statements. These risks and uncertainties include the factors discussed under the heading "Certain Factors That May Affect Future Growth" beginning at page 7 of this report.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our consolidated financial statements and the notes thereto appearing elsewhere in this report.

Overview

Our business has two segments; our Laser Group and our Photonics Groups. During 2001, we sold or discontinued operations of our Plastics Group.

Our Laser Group, comprised of Laser Fare, Inc. (LF -Smithfield, RI) and Mound Laser & Photonics Center, Inc. (MLPC- Miamisburg, OH) provides comprehensive laser-based materials processing services to leading manufacturers. Our Photonics Group, includes Infinite Photonics, Inc., (Orlando, FL) and the Advanced Technology Group (Narragansett, RI) manufactures and markets our proprietary grating coupleted surface emitting laser (GCSEL) diodes. MetaTek, Inc. of Albuquerque, NM was merged into Infinite Photonics, Inc.

Our Plastics Group, which had been comprised of Osley & Whitney, Inc. (Westfield, MA), Materials & Manufacturing Technologies, Inc. (West Kingston, RI) and Express Pattern, Inc. (Buffalo Grove, IL), provided rapid prototyping services and proprietary mold building services, which were discontinued or sold.

During 2001, we continued to experience operating losses, due primarily to losses in the discontinued Plastics Group attributed to falling demand for our injection molds, and start-up costs for our Photonics Group. These losses resulted in reductions in cash flow and a negative

working capital position. We are currently focused on our two primary lines of business and we are actively pursuing additional capital through the equity line of credit agreement, private equity sources, strategic alliances, venture capital and investment banking sources.

Our financial statements included in this report have been prepared in conformity with accounting principles generally accepted in the United States. During 2001, there were a number of new accounting standards issued by the Financial Accounting Standards Board, which we have determined, did not have any effect on our financial statements in 2001 and we anticipate they will not have a material effect on our financial statements in 2002. We believe that our operations, as currently structured, together with our current financial resources, will result in improved financial performance in fiscal 2002.

Forward looking strategy

Our business plan for 2002 includes the completion of our plan to dispose of the Plastics Group commenced in November 2001 and the ramp up of research, engineering, manufacturing, marketing and administrative capability for our Photonics Group.

In cooperation with O&W's secured lender, the majority of O&W's equipment and furnishings were sold at public auction on March 12, 2002, and accounts receivable are being remitted to the secured lender as paid. The Osley & Whitney land and building were sold at auction on July 22, 2002 for $650,000. A closing

of this sale is scheduled for August 8, 2002. This transaction will complete the liquidation the Osley & Whitney's assets, resulting in a net obligation to the secured lender, including accrued interest and closing expenses, of approximately $200,000. The obligation of Osley & Whitney to the secured lender was guaranteed by Infinite. Accordingly, Infinite will assume that remaining outstanding balance. The secured lender has tentatively agreed to convert the balance into a term loan amortizing monthly based upon a seven year amortization schedule, with a balloon payment due eighteen months from issuance. It is anticipated that this note will be executed and delivered following the closing of the sale of the land and building.

On March 14, 2002 we closed on the sale of the assets of Express Pattern, Inc. for $725,000, consisting of $575,000 in cash (of which $300,000 was paid to O&W's secured lender) and a five year 8% subordinated $150,000 note, due upon maturity with quarterly interest payments.

Our Photonics Group is completing leasehold improvements to its semiconductor laser diode manufacturing facilities in Orlando, Florida, which will be completed during the second quarter of 2002. We have hired or transferred ten research and administrative personnel who are working on the DARPA contract and we are actively interviewing for additional engineering, quality control, manufacturing and administrative personnel. Equipment has started arriving at the facility, and we expect to complete about $1.2 million in capital equipment expansion by the end of 2002, primarily funded through operating leases. As a result of these steps, we expect that our Photonics Group will significantly increase capacity by year-end. In addition, we closed on a $1.0 convertible note with Laurus Master Fund, which has been used to fund salaries and other costs billable under our DARPA contract. We have completed the first technical review with

DARPA and believe we are on schedule to meet their timetable for completion of that contract by the end of 2003.

Our Photonics Group is actively engaged in discussions with a number of potential commercial customers to incorporate our technology in their next major product updates planned for late 2002 or early 2003. Our marketing efforts are aimed at customer education and in that regard our staff members have recently presented papers at technical trade shows, such as the recent Photonics West and Optical Fiber conferences, which are attended by representatives of leading companies using diode devices. Additionally, we are actively exploring financing alternatives for our Photonics Group, including through venture capital firms with, in many cases, portfolio companies that could be end users of our products.

Finally, we are completing steps to further reduce corporate overhead including facilities consolidation and other cost reduction measures. We believe that the successful implementation of this plan will result in profitable operations during 2002.

Liquidity and capital resources

We have financed our product development activities and operations through a series of private placements of debt and equity securities. As of December 31, 2001, we had cash and cash equivalents of approximately $130,242 available for our working capital needs and planned capital asset expenditures. In addition, on February 5, 2002, we closed on a $1.0 million, two year convertible note (see below).

The December 31, 2001 financial statements reflect a decrease in accounts receivable from December 31, 2000 of approximately $328,000, or 18%. Approximately $873,000 of the accounts receivable at December 31, 2000 is related to the continuing operations. These receivables have increased by approximately $626,000 to $1,498,463, or 72% at December 31, 2001. This increase is primarily related to an increase of approximately $500,000 in accounts receivable due under a $1 million DARPA contract at the Photonics Group. This contract was new in the second quarter of 2001 and accounted for approximately $986,000 in new revenues for 2001. Accounts receivable from continuing operations, excluding this amount have increased approximately 15%. The total increase in revenues from the Photonics Group for 2001 of approximately $860,000 coupled with approximately $1.0 million (16%) increase in revenues from the Laser Segment provided for the overall increase in revenues from 2000 of approximately $1,880,000, or 28%. The balance of the accounts receivable at December 31, 2000 of approximately $954,000 relate to the discontinued operations of the Plastics Group. Theses accounts receivable balances have been reduced to approximately $355,000 at December 31, 2001 and are included in the balance sheet as "assets of discontinued operations". This reduction reflects the shut down of the O& W operations in November 2001.

The December 31, 2001 financial statements also reflect a reduction in inventory levels from December 31, 2000 of approximately $352,000, or 73%. A reduction of approximately $329,000 relates to inventories of the discontinued Plastics Group that existed at December 31, 2000,

which have been included in the balance sheet as "assets of discontinued operations" at December 31, 2001. The remaining marginal reduction of approximately $23,000 from continuing operations relates to the timing of inventory purchases at year-end for the Laser Group.

Property and equipment purchases at our Laser Fare subsidiary amounted to approximately $360,000 of which $308,000 related to the LENS process. The majority of the remaining increase occurred at our Infinite Photonics subsidiary (approximately $30,000) and consisted of furniture and fixtures at the new Orlando facility. Cash flows for intangible assets increased from the development and acquisition of patents pending and other intellectual property relating to the GCSEL technology used at the Photonics Group. We anticipate that increased equipment needs in the Photonics Group during 2002 will be obtained through operating leases.

During 2000 and 2001, our president and chief executive officer loaned us an aggregate of $1,124,000 evidenced by a series of short-term notes, which bore interest at various interest rates ranging from 10% to 11%. In addition, at December 31, 1999, a $40,000 loan from our president and chief executive officer was outstanding. The proceeds of these loans were used for working capital purposes. In consideration for these loans, our president and chief executive officer was issued warrants to purchase 153,000 shares of common stock at exercise prices ranging from $1.03125 to $2.73 per share. As of December 31, 2001, approximately $50,000 of the loans, along with $4,375 of unpaid interest remained outstanding, and approximately $1,126,000 (including interest of $12,000 which accrued during 2000) had been repaid through the issuance of shares of common stock and the application of portions of the loan balance to satisfy the exercise price of outstanding options and warrants. During 2000, $1,026,000 of principal and interest were repaid through (a) the issuance of 294,649 shares of common stock issued at a weighted average price of $2.22; (b) the application of $199,471 in satisfaction of the exercise price of outstanding options; and (c) the application of $172,750 in satisfaction of the exercise price of outstanding warrants. During 2001, $100,000 of principal was repaid

through the issuance of 39,526 shares of common stock issued at a price of $2.53. All share issuances were valued at fair market value on the date of conversion, which was determined based upon price of the common stock on the twenty trading days preceding the conversion.

While the majority of the revenues realized as of December 31, 2001 were attributed to our Laser Group operations, we anticipate improved revenue from our Photonics Group and positive results from additional expense containment measures that have been implemented. We anticipate that our existing credit facilities, together with our other strategies for raising additional working capital through debt and/or equity transactions will provide adequate liquidity to fund our operations. Subsequent to year-end, additional private placements of our common stock yielded gross proceeds of $150,000.

At December 31, 2001 we had a working capital deficit of approximately $1.7 million, ($1.3 million after eliminating the assets and liabilities of our discontinued operations). The working capital deficit was primarily caused by recurring losses at the former Plastics Group resulting in slow payments to the Company's vendors.

A going concern qualification was included in the opinion issued by our auditors on our 2000 financial statements as a result of one of the Company's primary lenders not having issued its waiver for certain loan covenant violations that existed at December 31, 2000 at our Laser Fare subsidiary. The loan covenants are measured annually at December 31. The loan covenant violations which existed at December 31, 2000 related to failure to meet certain levels of working capital, debt to tangible net worth ratio and exceeding capital expenditure limits. Due to the acquisition of LENS equipment in a non-monetary transaction and acquisition of stent equipment, we exceeded the capital expenditure limitations to support the growth of our Laser Group. Subsequent to the issuance of the financial statements and the repayment of a certain portion of the related debt, the bank issued a waiver letter for the violations.

At December 31, 2001, the Company was in violation of certain covenants related to its failure to meet certain levels of debt to tangible net worth ratio and exceeding the capital expenditure limits. We completed acquisition of the LENS equipment in a non-monetary transaction in 2001, which also caused us to exceed our capital limitation requirements. The covenant violations were waived by the bank prior to the issuance of the financial statements.

During the year ended December 31, 2001, the Company adopted a plan to discontinue the operations of its former Plastics Group, which was suffering recurring losses and required significant levels of cash flows to operate. In addition, during the first quarter of 2002 the Company sold its Express Pattern and Mound subsidiaries. These events provided an infusion of approximately $845,000 in cash, which has been used to pay down existing bank debt, as well as for working capital needs.

As a result of the above transactions, the Company currently operates under two business segments. The Laser Group is expected to have positive income from operations and cash flow based on its current and budgeted revenue levels from its existing customer base. The Photonics Group was awarded a $12.0 million DARPA contract, for which work began during the first quarter of 2002. The Photonics Group should be able to sustain break even or better operating performance. In addition, during the first quarter of 2002, the Company closed on a $1.0 million convertible debt financing with the Laurus Fund, the proceeds of which will be used to finance the working capital needs of the Photonics Group for 2002. The Company has also reduced its corporate overhead costs by

reducing personnel and reallocating personnel resources to the Photonics Group, who will generate revenues under the DARPA contract. These factors have led to our improved liquidity in 2002 and the absence of a going concern qualification on our 2001 financial statements.

In conjunction with our on-going business expansion program, we are pursuing alternative sources of funding. We have put several agreements in place to potentially provide future liquidity and are exploring several additional arrangements including private placements, direct investment by strategic alliance partners, and venture capital sources. To date we have arranged an asset based convertible note that is available to fund sales volume increases and working capital needs at our Photonics Group.

On July 23,2002 we terminated the equity line of credit agreement which we had entered into with Cockfield Holdings Limited (Cockfield) on November 30, 2000. As a result, we were released, and released Cockfield, from any further obligation thereunder.

As consideration for establishing the equity line of credit, we granted Cockfield warrants to purchase up to 200,000 shares of our common stock. As consideration for the services rendered by Jesup & Lamont as placement agent in connection with the equity line of credit, we granted

Jesup & Lamont warrants to purchase up to 100,000 shares of our common stock. These warrants, covering 300,000 shares of our common stock, are exercisable at any time prior to November 20, 2003, for $3.135 per share and survived the termination of the agreement.

Our asset based convertible note

On February 8, 2002, we completed a transaction with Laurus Master Fund, Ltd., a New York based hedge fund, (Laurus) for $1.0 Million in cash in exchange for a $100,000 two-year note bearing interest at 15%, with interest payable quarterly. If we allow Laurus to convert the Note into shares of common stock at $2.25 per share, we will receive an interest rebate from Laurus equal to one percent per $100,000 converted. The Note is secured by a deposit account and by the accounts receivable of our Infinite Photonics subsidiary. Our use of the proceeds of this note is limited to funding expenses under our DARPA contract, and the growth of accounts receivable with commercial customers.

In connection with the transaction, we issued five-year warrants to Laurus to purchase 50,000 shares of common stock at $2.65 per share, paid a $50,000 origination fee at closing and paid legal and closing expenses of $37,500.

There is no assurance, that our current resources will be adequate to fund our current operations and business expansion or that we will be successful in raising additional working capital. Our failure to raise necessary working capital could force us to curtail operations, which would have a material adverse effect on our financial condition and results of operations.

Results of operations

Laser Group

Revenues from our Laser Group for the years ended December 31, 2001 and 2000 were $7,305,574 and $6,285,882, respectively, with a net operating loss of $140,742 and $239,704, respectively. The increase in revenues was due primarily to increased services performed for General Electric (approximately $411,000)

and Barnes Aerospace (approximately $436,000) on gas turbine parts and the remainder from medical device manufacturers. The reduced operating loss resulted from economies of scale.

Photonics Group

Revenues from our Photonics Group for the years ended December 31, 2001 and 2000 were $1,202,074 and $341,688, respectively. Net operating loss for the 2001 period was $332,245 as compared to net income of $84,727 for the 2000 period. The 2001 operating loss was due to start-up costs at Infinite Photonics. The increased revenue in 2001 of approximately $860,000 was attributable to work performed and billed under the DARPA contract during the period."

Plastics Group

The loss from our discontinued Plastics Group for the year ended December 31, 2001 was $1,774,085 compared to a loss of $775,827 for the year ended December 31, 2000. The increased loss during 2001 was attributable to a general reduction in revenues at O&W primarily attributable to loss of business from key customers and a $622,000 loss on the disposal of assets divested in connection with these discontinued operations.

Comparison of the years ended December 31, 2001 and 2000

In 2001, consolidated revenues were $8,507,648 on cost of goods sold of $5,897,511 resulting in a gross profit of $ 2,610,137 from continuing operations for the year. Consolidated revenues from continuing operations in 2000 were $6,627,570 on cost of sales of $ 4,720,649, resulting in a gross profit of $1,906,921. The increase of $ 1,880,078 or 28.4% in consolidated revenues for the year ended December 31, 2001 compared to the year ended December 31, 2000 was primarily due to a $1.3 Million DARPA contract in 2001 awarded to our Photonics Group, and increases in sales in our Laser Group to GE Gas Turbine and Barnes Aerospace for gas turbine parts and to medical device manufacturers. Gross profit margin increased in 2001 to 30.7% from 28.8% in 2000. This increase was due to slightly higher margins in both gas turbine and medical devices. We signed a large $12.0 million DARPA contract on January 23, 2002 where net margins are limited to approximately 6.7% for government research which historically has been approximately eight percent. As a result, we expect revenues to increase significantly in 2002, but at lower net margins.

As to the Laser Group, the majority of revenues are derived from one-time purchase orders, usually from repeat customers such as General Electric, United Technologies, Barnes Aerospace, Dey Laboratories, etc. Work begins when materials arrive from the customer (our inventories are minimal and the customer is responsible for the quality and quantity of the materials), and we cut, weld, drill and assemble the parts according to engineering drawings and specifications provided by the customer or determined by our engineers with customer approval. Upon completion, the parts are inspected by quality control personnel, compared to the engineering specifications, packaged and delivered to the customer. The customer is billed for the number of parts delivered.

As to the Photonics Group, the majority of revenues are derived from contract research and development. We expect to complete approximately $5.7 million of effort in 2002 under the current DARPA contract totaling $12.0 million, with the remainder to be completed in 2003. The work is subject to periodic technical reviews and government audit, and is cancelable if we fail to meet technical and financial milestones. We completed both a technical DARPA review and a Defense Contract Audit Agency review in May 2002, and we believe we are on schedule

technically and in audit compliance.

Research and development expenses were $94,665 for the year ended December 31, 2001. Because we are in the contract research and development business and mark up our services to reflect an anticipated profit on such services, the majority of our research revenues and related costs are reflected in sales and cost of goods sold, respectively. Research and development reflects internal costs associated with new product development efforts. We anticipate that internal research and development expenses will increase in 2002, based on expected GCSEL

product development efforts in our Photonics Group based upon customer demand and discretionary cash flows.

General and administrative expenses were $2,735,782 for the year ended December 31, 2001 as compared to $1,775,596 for the year ended December 31, 2000. The increase of $960,186, or 54.1%, is primarily due to Infinite Photonics start-up expenses, the hiring of our new chief operating officer in 2001, reinstatement in 2001 of a 20% salary reductions and increased legal, investment banking and other fees related to our capital raising activities. The Chief Operating Officer was hired in January 2001 at an annual salary of $160,000, of which $156,651 was paid during 2001. The CEO, CFO and Secretary took salary reductions of 20% of their base salaries of $175,000, $135,000, and $110,000, respectively for approximately half of 1999, all of 2000, and the first quarter of 2001. During the last three quarters of 2001, salaries were paid at the normal rate resulting in an increase of approximately $63,000 over the period ended December 31, 2000. Increased legal and accounting expenses of approximately $30,000 and $63,000, respectively, resulted from general corporate matters. The new Infinite Photonics subsidiary, which began operations in 2001, resulted in increased general and administrative costs of approximately $383,000. Finally, public company costs for our stock transfer agent, share listing costs, etc. increased by approximately $52,000.

Selling expenses were $307,030 for the year ended December 31, 2001 as compared to $433,845 for the year ended December 31, 2000. The decrease of $126,815, or 29.2%, was primarily attributed to decreased sales salaries and commissions in our Laser Group due to better utilization of cross selling to existing customers, and other efficiencies.

Depreciation and amortization expense totaled $775,924 for the year ended December 31, 2001 as compared to $755,052 for the year ended December 31, 2000. The increase was primarily due to depreciation expense for new lasers acquired for stent production at our Laser Group.

Interest expense was $456,179 during 2001 as compared to $580,239 during 2000, or a decrease of $124,060, or 21.4%. Interest expense to stockholders was $128,567 during 2001 as compared to $173,694 during 2000. The decrease of $45,127, or 26.0% was due primarily to the satisfaction of a capital lease obligation to the president/principal stockholder in exchange for the issuance of common stock during 2001. The decrease is also due to reduced interest expense caused by the general reduction of amounts outstanding, in accordance with the terms of the debt. Other interest expense was $327,612 during 2001 as compared to $406,545 during 2000. The decrease of $78,933, or 19.4% was due primarily to a reduction of short-term borrowings in our Laser Group and the reduction in the prime interest rate during 2001.

Interest income for the year ended December 31, 2001 was $18,508 as compared to $21,003 for the year ended December 31, 2000 due to comparatively lower interest rates in 2001.

The loss from the disposition of assets in 2001 was $11,856, as compared to $60,587 in 2000. The 2001 amount relates to a gain on the sale of a laser in our Laser Group in the amount of $9,500 offset by the disposal of an asset no longer used, resulting in a loss of $21,356. The 2000 amount relates to the sale of an obsolete laser in our Laser Group. Each year as we complete our capital budget, assets at or approaching the end of their useful lives are reviewed for upgrade, disposal or replacement.

28

In November 2001 and December 2001, the Company's Board of Directors resolved to dispose of Osley & Whitney and Express Pattern. The formal plan consisted of shutting down the operations of the O&W subsidiary and selling the net assets of the EP subsidiary. Effective November 30, 2001, the Company shut down the operations of O&W and terminated all of the employees. The loss from the operations of the discontinued business segment amounted to $372,055 as compared to $383,665 during 2000. The loss on disposal of discontinued operations in the amount of $622,000 for the year ending December 31, 2001, represents the writedown of property, plant and equipment and inventory at O&W to their net realizable value ($472,000), and an allowance for doubtful accounts receivable of $150,000.

On March 13, 2002, the Company sold the net assets of Express Pattern to certain officers/employees of the Company.

We had a consolidated net loss from continuing operations of $1,788,459 for the year ended December 31, 2001 as compared to $1,710,582 in 2000. The loss from discontinued operations was $994,055 for the year ended December 31, 2001 as compared to $383,665 for the period ended December 31, 2000. Disappointing results, offshore Asian competition in the mold business, and a weak market after the tragedies of September 11, 2001 lead to the discontinuance of our Plastics Group.

Critical Accounting Policies

Revenue Recognition

The Company generates substantially all of its revenue from two sources. The first source represents services performed relating to contracted research and development. These services are performed based upon terms specified and agreed upon by both parties prior to commencement of the project. Revenues relating to these services are recognized at the point that the services are performed. There may or may not be a product delivered at the end of the project. The second area relates to traditional laser services, which include welding, machining, cutting, drilling and engraving. These services relate to processes performed on the customers' parts. The services are performed based upon terms specified and agreed upon by both parties prior to commencement. Revenues relating to these services are recognized at the point that the completed product is delivered to the customer. Generally there is little judgment or uncertainty that goes into the recognition of revenue from both revenue sources that would impact the reporting

Accounts Receivable Provisions

As part of the financial reporting process, management estimates and establishes reserves for potential credit losses relating to the collection of certain receivables. This analysis involves a degree of judgment regarding customers' ability and willingness to satisfy its obligations to us. These estimates are based on past history with customers and current circumstances. Management's

estimates of doubtful accounts historically have been within reasonable limits of actual bad debts. Management's failure to identify all factors involved in determining the collectability of an account receivable could result in bad debts in excess of reserves established.

Deferred Tax Asset Valuation

Management calculates the future tax benefit relating to certain tax timing differences and available net operating losses and credits available to offset future taxable income. This deferred tax asset is then reduced by a valuation allowance if management believes it is more likely than not that all or some portion of the asset will not be realized. This estimate is based on historical profitability results, expected future performance and the expiration of certain tax attributes which give rise to the deferred tax asset. As of the balance sheet date, a reserve has been established for the entire amount of the deferred tax asset. In the event, we generate future taxable income we will be able to utilize the net operating loss carry forwards. This will result in the realization of the deferred tax asset, which has been fully reserved. As a result, we would have to revise its estimates of future profitability and determine if its valuation reserve requires downward adjustment.

Stock-Based Compensation

We disclose the pro forma compensation cost relating to stock options granted under employee stock option plans, based on the fair value of those options at the date of grant. This valuation is determined utilizing the Black- Scholes, option-pricing model, which takes into account certain assumptions, including the expected life of the option and the expected stock volatility and dividend yield over this life. These assumptions are made based on past experience and expected future results. In the event the actual performance varies from the estimated amounts, the value of these options may be misstated."

Effect of new accounting pronouncements

In June 2001, the FASB issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." Under these new standards, all acquisitions subsequent to June 30, 2001 must be accounted for under the purchase method of accounting.

SFAS No. 142 requires that goodwill be tested annually for impairment using a two-step process. The first step was to identify a potential impairment and, in transition, this step must be measured as of the beginning of the fiscal year. The second step of the goodwill impairment test measures the amount of the impairment loss (measured as of the beginning of the year of the adoption), if any, and must be completed by the end of the Company's fiscal year. Any impairment loss resulting from the transitional impairment tests are reflected as the cumulative effect of a change in accounting principle.

The Company adopted the provisions of SFAS No. 142 in its first quarter ended March 31, 2002. The Company's goodwill in the amount of approximately $88,769 at December 31, 2001, relates to the Laser Fare and Mound subsidiaries. Subsequent to December 31, 2001, the assets of Mound were disposed of and operations were ceased, resulting in the write-down of goodwill amounting to $17,584. The remaining goodwill, amounting to $71,185, relates to Laser Fare, which will be a reporting unit by itself for purposes of determining any impairment of goodwill. The Company will no longer record $28,612 of annual amortization expense related to its existing goodwill at December 31, 2001. The Company has allocated its intangible assets to its

30

reporting units. The remaining useful lives of the intangibles have been evaluated and no changes will be made.

SFAS No. 141 also requires that upon adoption of SFAS No. 142, the company reclassify the carrying amounts of certain intangibles assets into or out of goodwill, based upon certain criteria. The Company does not anticipate any reclassifications. SFAS No. 142 supersedes APB No. 17, "Intangible Assets," and is effective for fiscal years beginning after December 15, 2001. SFAS No. 142 primarily addresses the accounting for goodwill and intangible assets subsequent to their initial recognition. The provisions of SFAS No. 142 prohibit the amortization of goodwill and indefinite-lived intangible assets; require that goodwill and indefinite-lived intangible assets be tested annually for impairment, and in interim periods if certain events occur indicating that the carrying value of goodwill and / or indefinite-lived intangible assets may be impaired; require that reporting units be identified for the purpose of assessing potential future impairments of goodwill; and removes the 40-year limitation on the amortization period of intangible assets that have finite lives.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). SFAS 143 establishes accounting standards for recognition and measurement of a liability for the costs of asset retirement obligations. Under SFAS 143, the costs of retiring an asset will be recorded as a liability when the retirement obligation arises, and will be amortized to expense over the life of the asset.

On January 1, 2002, the Financial Accounting Standards Board issued Statement No. 144 (SFAS 144), "Accounting for the Impairment or Disposal of Long-Lived Assets", which provides guidance in the accounting for impairment of disposal of long-lived assets. For long-lived asset to be held and used, the new rules are similar to previous guidance, which required the recognition of impairment when the undiscounted cash flows will not recover the carrying amount. The computation of fair value now removes goodwill from consideration and incorporates a probability-weighted cash flow estimation approach. Additionally, assets qualifying for discontinued operations treatment have been expanded beyond the former major line of business or class of customer approach. The Registrant adopted the provisions of SFAS 144 in fiscal 2001 and utilized this guidance for the disposal of the Plastics Group. Accordingly, the assets and liabilities of the discontinued operations are reflected as gross amounts, rather than net, in the accompanying balance sheet in accordance with SFAS 144. There was no impact from the adoption of this standard on its impairment tests of long lived assets nor its accounting for discontinued operations.

Financial statements

Reference is made to the financial statements, the report thereon and notes thereto, beginning on page F-1 of this report.

Changes in and disagreements with accountants on accounting and financial disclosure

31

During the third quarter of 2001 we filed a current report on Form 8-K regarding a change in our certified public accountants. On August 2, 2001, we were

notified that the firm of Freed Maxick Sachs & Murphy, PC, which had previously merged with McGladrey & Pullen, LLP on November 1, 2000, elected to demerge from McGladrey & Pullen, LLP effective August 1, 2001 and that McGladrey & Pullen, LLP would no longer be our auditors. The demerged firm, which is newly named Freed Maxick & Battaglia, CPAs, Pc, was appointed as our new auditors by our board of directors. We had no disagreements with McGladrey & Pullen, LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope of procedure.

PART III

MANAGEMENT DIRECTORS AND EXECUTIVE OFFICERS

Set forth below are the names, ages and positions of the our directors and executive officers.

Name	Age	Position	Affiliate Since
Clifford G. Brockmyre II(1)	60	Chairman of the board, president and chief executive officer	1994
Thomas J. Mueller	50	Chief operating officer	2000
Bruce J. Garreau	51	Chief financial and accounting officer	1999
Daniel T. Landi	59	Corporate controller and secretary	1994
J. Terence Feeley	51	Director	1994
Michael S. Smith (2)	47	Director	1995
Brian C. Corridan (2)	53	Director	2000

---

(1) This person may be deemed a parent and/or promoter as those terms are defined in the Rules and Regulations promulgated under the Securities Act of 1933, as amended.

(2) Member of the audit and compensation committees.

Each director is elected for a period of one year and serves until his successor is duly elected by our stockholders. Officers are elected by and serve at the will of our board of directors.

Background

The principal occupation of each of our directors and executive officers for at least the past five years is as follows:

Clifford G. Brockmyre II has been a director since October 1994, our president since October 1995 and our chief executive officer since January 1998. For over 27 years, Mr. Brockmyre has been involved in the tooling, machining and manufacturing industries and was the 1992 chairman of the 3000+ corporation

member National Tooling and Machining Association. He developed the laser manufacturing liaison to the National Laboratories at Los Alamos, Sandia and Oak Ridge for Laser Fare. The Department of Energy has set up Laser Fare as a model for technology transfer under its Small Business Initiative. Mr. Brockmyre serves on the Rhode Island State Economic Advisory Council, a position he was appointed to by the Governor of Rhode Island.

Thomas J. Mueller became our Chief Operating Officer in December 2000. He joined us in April 1999 as founder and president of our Express Pattern, an Infinite Group subsidiary. He has a long history in rapid prototyping, previously founding Prototype Express, an early rapid prototyping service bureau. Mr. Mueller held engineering and management positions at Baxter Healthcare and Caterpillar. He received BS and MS degrees in mechanical engineering from the University of Illinois and an MS in Management from the Sloan School of Management at MIT.

Bruce J. Garreau became our chief financial officer in July 1999. Prior thereto, he served as a consulting principal with the Corporate Financial Group (CFG), which provided financial, merger and acquisition, planning and strategy services to venture capital funded technology and other start-ups, as well as product and other development services to larger companies. Prior to CFG he was executive vice president and controller of Northeast Savings, FA, Hartford, CT, then the largest publicly traded thrift institution in New England (subsequently acquired by Fleet Bank). He served nine years as senior manager and senior computer specialist at KPMG. Mr. Garreau received a BS in public accountancy from State University of new York at Albany and is a certified public accountant in New York and Connecticut.

Daniel T. Landi is our corporate controller and secretary and was our chief financial officer from August 1994 to July 1999. Prior thereto, from January 1993 to June 1994 he was the chief financial officer of a privately held aerospace research and development company. From June 1991 through 1992, Mr. Landi was a principal of Focused Management Consulting Group, a firm concentrating on acquisitions, mergers, joint ventures and start-up operations, including private placements and initial public offerings. Mr. Landi has extensive domestic and international experience in finance, accounting and information systems with his twenty-six years of progressive growth in overall business and senior financial management with IBM. Mr. Landi received a BS in Finance and an MBA from the University of Connecticut.

J. Terence Feeley has been the president of the Laser Fare -- Advanced Technology Group since 1994. He became a director in March 1999. He was the co-founder, president and chief executive officer of Laser Fare prior to its acquisition by us. Mr. Feeley is the past President of the Laser Institute of America, the author of over 50 papers on laser technology and the co-editor of three books in the area of laser based rapid manufacturing. Mr. Feeley received a BA from the University of Rhode Island.

Michael S. Smith became a director in 1995 and is a member of our audit and compensation committees. He is the president and chief executive officer of Micropub Systems International Inc., a brewery system manufacturer. From October 1992 through January 1997, Mr. Smith was the managing director of corporate finance of H.J. Meyers & Co., an investment-banking firm and was general counsel of that firm from May 1991 through May 1995. Mr. Smith was associated with the law firm of Harter, Secrest & Emery from 1987 until 1991. Mr. Smith received a BA from Cornell University and a JD from Cornell University School of Law.

Brian Q. Corridan became director in November 2000 and is a member of our audit

and compensation committees. Since 1994 he has been president of Corridan & Co., an independent financial services firm, an OSJ (Office of Supervisory Jurisdiction) of Raymond James Financial Services. He has served as a Registered Representative with Prudential Securities, Tucker

Anthony & R.L. Day, and Kidder Peabody & Co. where he participated in brokerage services as well as corporate and municipal financings with these firms. Mr. Corridan received a BA from Stonehill College, and is a former Naval Officer. He serves as a trustee of a number of civic and educational organizations including chairman of the Springfield Technical Community College Technology Park. He serves on the finance committee of Baystate Health System, Inc., is a trustee of Our Lady of the Elms College and was a director of Health New England a mid sized HMO.

Our board of directors has an audit committee and a compensation committee. The audit committee reviews the scope and results of the audit and other services provided by our independent accountants and our internal controls. The compensation committee is responsible for the approval of compensation arrangements for our officers and the review of our compensation plans and policies.

Section 16(a) beneficial ownership reporting compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our officers and directors, and persons who own more than ten percent of a registered class of our equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission ("SEC"). Officers, directors and greater than ten-percent shareholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file. Based solely on review of the copies of such forms furnished to us, or written representations that no Forms 5 were required, we believe that all Section 16(a) filing requirements applicable to its officers and directors were complied with except as follows: Thomas J. Mueller - Form 4 two transactions; J. Terence Feeley -- Form 4 two transactions; Bruce J. Garreau - Form 4 one transaction; Clifford G. Brockmyre, II - Form 4 one transaction.

Directors' compensation

Our directors do not receive any cash consideration for serving as directors. All directors are reimbursed for out-of-pocket expenses incurred in connection with their attendance at board meetings. In addition, pursuant to our non-discretionary, non-employee directors' stock option plan, each non-employee director is granted options to purchase 5,000 shares of common stock upon becoming a director and at the end of each fiscal year during which he served as a director.

Limitation of directors' liability and indemnification

The Delaware General Corporation Law (DGCL) authorizes corporations to limit or eliminate the personal liability of directors to corporations and their shareholders for monetary damages for breach of directors' fiduciary duty of care. Our certificate of incorporation limits the liability of our directors to the company or its shareholders to the fullest extent permitted by Delaware law.

Our certificate of incorporation provides mandatory indemnification rights to any officer or director who, by reason of the fact that he or she is an officer or director, is involved in a legal proceeding of any nature. Such indemnification rights include reimbursement for expenses incurred by such

officer or director in advance of the final disposition of such proceeding in accordance with the applicable provisions of the DGCL. Insofar as indemnification for liabilities

under the Securities Act may be provided to officers and directors or persons controlling the company, we have been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

There is no pending litigation or proceeding involving any of our directors, officers, employees or agents in which indemnification by us will be required or permitted. We are not aware of any threatened litigation or proceeding that may result in a claim for such indemnification.

Executive compensation

Summary Compensation. The following table sets forth certain information concerning compensation for services in all capacities awarded to, earned by or paid to our chief executive officer and the other four most highly compensated executive officers ("Named Executives") during 2001, 2000 and 1999 whose aggregate compensation exceeded $100,000.

	Annual compensation			Long-term com	
					S
Name and principal position	Salary	Bonus	Other annual compensation*	Restricted stock awards(1)	u
Clifford G. Brockmyre President and chief executive officer					
2001	$ 99,836	$ --	$ --	$ --	
2000	132,966	--	--	--	
1999	163,096	--	--	--	
Thomas J. Mueller Chief operating officer					
2001	124,326	--	10,500	--	
2000	125,643	--	--	--	
1999	71,876	--	--	--	
J. Terrence Feeley President -- Advanced Technology Group					
2001	139,861	--	10,298	--	
2000	140,297	--	9,288	--	
1999	151,603	--	9,652	--	
Bruce J. Garreau Chief financial officer					
2001	81,027	--	6,750	--	
2000	94,868	--	8,308	--	
1999	51,714	--	--	--	

Daniel T. Landi Corporate controller and secretary				
2001	75,944	--	--	--
2000	87,966	--	--	--
1999	101,539	--	--	--

---

* Reflects executive's Contribution to our 401k plan.

** Reflects application of accrued and unpaid salary to satisfy stock option exercise price.

Employment Agreements

We have an employment agreement dated June 30, 2001 with Clifford G. Brockmyre II, our president and chief executive officer, for a term expiring on June 30, 2003, which provides for an annual salary of $175,000 and various benefits. In addition to the compensation provided under the agreement, Mr. Brockmyre is eligible to participate in our bonus plan and is eligible for other bonuses as determined in the sole direction of the board of directors. The agreement also provides, among other things, that, if Mr. Brockmyre is terminated other than for cause (which is defined to include conviction of a crime involving moral turpitude, engaging in activities competitive with us, divulging confidential information, dishonesty or misconduct detrimental to us or breach of a material term of the agreement), we will pay to him a lump sum payment equal to the product of the sum of (i) the highest annual rate of salary paid to Mr. Brockmyre, and (ii) the highest annual bonus paid to or accrued to the benefit of Mr. Brockmyre during the employment term multiplied by 2.99. The agreement also provides for payments to Mr. Brockmyre, or his estate, in the event of his death or permanent disability.

We have an employment agreement dated July 1, 1999 with Mr. J. Terence Feeley, president of the Advanced Technology Group, for a term expiring on July 1, 2002, which provides for an annual salary of $150,000 and various benefits. In addition to the compensation provided under the agreement, Mr. Feeley is eligible to participate in our bonus plan and is eligible for other bonuses as determined in the sole direction of the board of directors. This agreement also provides, among other things, that, if Mr. Feeley is terminated other than for Cause, we will pay to him a lump sum payment equal to the product of the sum of (i) the highest annual rate of salary paid to Mr. Feeley, and (ii) the highest annual bonus paid to or accrued to the benefit of Mr. Feeley during the employment term multiplied by two. The agreement also provided for payments to Mr. Feeley, or his estate, in the event of his death or permanent disability.

We entered into an employment agreement dated October 1, 1999 with Bruce J. Garreau, our chief financial and accounting officer, for a term expiring on October 1, 2002, which provides for an annual salary of $135,000 and various benefits including the grant of 10,000 shares of our common stock and 75,000 stock options exercisable at $1.00 per share. The 10,000 shares had a value of $7,312 upon issuance. The options vest in three equal installments of 25,000 shares over an eighteen-month period. In addition to the compensation provided under the agreement, Mr. Garreau is eligible to participate in our bonus plan and is eligible for other bonuses as determined in the sole direction of the board of directors. The agreement also provides, among other things, that if Mr. Garreau is terminated other than for Cause, we will pay to him a lump sum

payment equal to the product of the sum of (i) the highest annual rate of salary paid to Mr. Garreau and (ii) the highest annual bonus paid to or accrued to the benefit of Mr. Garreau during the employment term multiplied by two. The agreement also provides for payments to Mr. Garreau, or his estate, in the event of his death or permanent disability.

Stock options

Option grants

The following table sets forth certain information regarding options granted by us in 2001 to each of the Named Executives.

	Option Grants in Last Fiscal Year				
	Individual Grants				Pote Va A
Name	Number of Shares Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price ($/share)	Expiration Date	Ap O 5%
Clifford G. Brockmyre ...	--	--	--	--	-
Thomas J. Mueller	50,000	28.6	$ 2.04	8/30/11	$ 5,1
J. Terrence Feeley	125,000	71.4	2.01	9/15/11	12,5
Bruce J. Garreau	--	--	--	--	
Daniel T. Landi	--		--	--	

---

(1) Potential realizable values are net of exercise price but before taxes, and are based on the assumption that our common stock appreciates at the annual rate shown (compounded annually) from the date of grant until the expiration date of the options. These numbers are calculated based on Securities and Exchange Commission requirements and do not reflect our projection or estimate of future stock price growth. Actual gains, if any, on stock option exercises are dependent on our future financial performance, overall market conditions and the option holder's continued employment through the besting period. This table does not take into account any appreciation in the price of the common stock from the date of grant to the date of this Form 10KSB.

Option exercises and year-end option values

The following table provides information with respect to options exercised by the Named Executives during 2001 and the number and value of unexercised options held by the Named Executives as of December 31, 2001.

Aggregated option exercises in last fiscal year and year-end option values

Name	Shares Acquired on Exercise (#)	Value Realized(1)	Number of Shares Underlying Unexercised Options at Fiscal Year-End		I
			Exercisable	Unexercisable	
Clifford G. Brockmyre ...	--	--	7,337	--	$
Thomas J. Mueller	21,550	$ 22,197	22,200	137,500	$
J. Terrence Feeley		--	184,953	278,333	$
Bruce J. Garreau	59,300	58,845	4,733	66,667	$
Daniel T. Landi	3,438	2,486	13,284	--	$

---

(1) For the purposes of this calculation, value is based upon the difference between the exercise price of the options and the stock price at date of exercise.

(2) For the purpose of this calculation value is based upon the difference between the exercise price of the exercisable and unexercisable options and the stock price at December 31, 2001 of $2.53 per share

38

Stock Option Plans

We have stock option plans, which were adopted by our board and approved by our shareholders covering an aggregate of 2,003,226 unexercised shares of our common stock, consisting of both incentive stock options within the meaning of Section 422 of the United States Internal Revenue Code of 1986 (the "Code") and non-qualified options. The option plans are intended to qualify under Rule 16b-3 of the Securities Exchange Act of 1934. incentive stock options are issuable only to our employees, while non-qualified options may be issued to non-employees, consultants, and others, as well as to employees.

The option plans are administered by the compensation committee of the board of directors, which determines those individuals who shall receive options, the time period during which the options may be partially or fully exercised, the number of share of common stock that may be purchased under each option, and the option price.

The per share exercise price of an incentive or non-qualified stock option may not be less than the fair market value of the common stock on the date the option is granted. The aggregate fair market value (determined as of the date the option is granted) of the shares of common stock for which incentive stock options are first exercisable by any individual during any calendar year may not exceed $100,000. No person who owns, directly or indirectly, at the time of the granting of an incentive stock option to him or her, more than 10% of the total combined voting power of all classes of stock of the company shall be eligible to receive any incentive stock option under the option plans unless the option price is at least $110% of the fair market value of our common stock subject to the option, determined on the date of grant. Non-qualified options are not subject to this limitation.

An optionee may not transfer an incentive stock option, other than by will or the laws of descent and distribution, and during the lifetime of an optionee, the option will be exercisable only by him or her. In the event of termination of employment other than by death or disability, the optionee will have three

months after such termination during which to exercise the option. Upon termination of employment of an optionee by reason of death or permanent total disability, the option remains exercisable for one year thereafter to the extent it was exercisable on the date of such termination. No similar limitation applies to non-qualified options.

Pursuant to our option plans, each new non-employee director is automatically granted, upon becoming a director, an option to purchase 5,000 shares of our common stock at the fair market value of such shares on the grant date. In addition, each non-employee director is automatically granted an option to purchase 5,000 shares at the fair market value of such shares on the date of grant, on the date of our annual meeting of stockholders. These options vest 1/3 upon grant and 1/3 at the end of each subsequent year of service.

Options under the option plans must be granted within 10 years from the effective date of each respective plan. Incentive stock options granted under the plan cannot be exercised more than 10 years from the date of grant, except that incentive stock options issued to greater than 10% stockholders are limited to four-year terms. All options granted under the plans provide for the payment of the exercise price in cash or by delivery of shares of common stock already owned

by the optionee having a fair market value equal to the exercise price of the options being exercised, or by a combination of such methods of payment. Therefore, an optionee may be able to tender shares of common stock to purchase additional shares of common stock and may theoretically exercise all of his stock options without making any additional cash investment.

Any unexercised options that expire or that terminate upon an optionee's ceasing to be affiliated with the company become available once again for issuance. As of January 31, 2001, we had outstanding stock options to purchase 1,161,037 shares under our option plans, including 22,000 shares to Michael S. Smith and 12,500 shares to Brian Q. Corridan under the our non-employee directors' plan. These options are exercisable at prices ranging from $1.375 to $9.40 per share.

Compensation committee interlocks and insider participation in compensation decisions

None of the directors serving on the compensation committee of our board of directors is employed by us. In addition, none of our directors or executive officers is a director or executive officer of any other corporation that has a director or executive officer who is also a member of our board of directors.

Security ownership of certain beneficial owners and management

The following table sets forth information regarding the beneficial ownership of our common stock as of February 28, 2001 by:

- each person known to us to be the beneficial owner of more than 5% of our outstanding shares;
- each of our directors;
- each executive officer named in the Summary Compensation Table above;
- all of our directors and executive officers as a group.

Except as otherwise indicated, the persons listed below have sole voting and investment power