

UNIVERSAL DISPLAY CORP \PA\  
Form 10-Q  
November 08, 2007

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

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended September 30, 2007**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 1-12031**

**UNIVERSAL DISPLAY CORPORATION**  
(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

**23-2372688**  
(I.R.S. Employer Identification No.)

**375 Phillips Boulevard**  
**Ewing, New Jersey**  
(Address of principal executive offices)

**08618**  
(Zip Code)

**Registrant's telephone number, including area code: (609) 671-0980**

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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer” and “large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer

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

As of November 1, 2007, the registrant had outstanding 35,267,456 shares of common stock.

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**PART I – FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****UNIVERSAL DISPLAY CORPORATION AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)**

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 60,605,836	\$ 31,097,533
Short-term investments	23,057,973	17,957,752
Accounts receivable	2,489,838	2,113,263
Inventory	2,209	30,598
Other current assets	745,936	606,267
<b>Total current assets</b>	<b>86,901,792</b>	<b>51,805,413</b>
PROPERTY AND EQUIPMENT, net	13,388,135	14,074,093
ACQUIRED TECHNOLOGY, net	5,048,184	6,319,488
INVESTMENTS	—	42,770
OTHER ASSETS	82,272	89,772
<b>TOTAL ASSETS</b>	<b>\$ 105,420,383</b>	<b>\$ 72,331,536</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 1,233,927	\$ 1,808,869
Accrued expenses	3,703,177	5,245,536
Deferred license fees	7,178,268	7,178,268
Deferred revenue	550,000	150,000
<b>Total current liabilities</b>	<b>12,665,372</b>	<b>14,382,673</b>
DEFERRED LICENSE FEES	2,582,800	2,966,500
DEFERRED REVENUE	552,554	600,000
<b>Total liabilities</b>	<b>15,800,726</b>	<b>17,949,173</b>
<b>COMMITMENTS AND CONTINGENCIES (Note 9)</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred Stock, par value \$.01 per share, 5,000,000 shares authorized, 200,000 shares of Series A Nonconvertible Preferred Stock issued and outstanding (liquidation value of \$7.50 per share or \$1,500,000), 300,000 shares of Series B Convertible Preferred Stock authorized and none outstanding, 5,000 shares of Series C-1 Convertible Preferred Stock authorized and none outstanding, 5,000 shares of Series D Convertible Preferred Stock authorized and none outstanding	2,000	2,000
	351,176	313,854

Common Stock, par value \$0.01 per share, 50,000,000 shares authorized, 35,117,615 and 31,385,408 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively		
Additional paid-in-capital	247,359,526	199,505,981
Unrealized loss on available for sale securities	(16,682)	(82,846)
Accumulated deficit	(158,076,363)	(145,356,626)
Total shareholders' equity	89,619,657	54,382,363
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 105,420,383	\$ 72,331,536

The accompanying notes are an integral part of these statements.

## UNIVERSAL DISPLAY CORPORATION AND SUBSIDIARY

**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	<b>Three Months</b>	
	<b>Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>REVENUE:</b>		
Contract research revenue	\$ 1,229,306	\$ 1,328,109
Development chemical revenue	229,774	492,173
Commercial chemical revenue	1,185,050	201,227
Royalty and license revenue	183,151	534,248
Technology development revenue	250,000	540,531
<b>Total revenue</b>	<b>3,077,281</b>	<b>3,096,288</b>
<b>OPERATING EXPENSES:</b>		
Cost of chemicals sold	281,062	136,393
Research and development	4,568,299	4,331,512
General and administrative	2,209,537	1,965,921
Royalty and license expense	91,132	169,035
<b>Total operating expenses</b>	<b>7,150,030</b>	<b>6,602,861</b>
Operating loss	(4,072,749)	(3,506,573)
<b>INTEREST INCOME</b>	<b>1,114,769</b>	<b>565,262</b>
<b>INTEREST EXPENSE</b>	<b>(2,585)</b>	<b>(1,976)</b>
<b>NET LOSS</b>	<b>\$ (2,960,565)</b>	<b>\$ (2,943,287)</b>
<b>BASIC AND DILUTED NET LOSS PER COMMON SHARE</b>	<b>\$ (0.08)</b>	<b>\$ (0.09)</b>
<b>WEIGHTED AVERAGE SHARES USED IN COMPUTING BASIC AND DILUTED NET LOSS PER COMMON SHARE</b>	<b>34,985,918</b>	<b>31,151,052</b>

The accompanying notes are an integral part of these statements.

**UNIVERSAL DISPLAY CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)**

	<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>REVENUE:</b>		
Contract research revenue	\$ 3,649,076	\$ 2,765,699
Development chemical revenue	805,978	1,464,703
Commercial chemical revenue	2,727,681	936,071
Royalty and license revenue	474,346	2,272,279
Technology development revenue	750,000	1,938,258
<b>Total revenue</b>	<b>8,407,081</b>	<b>9,377,010</b>
<b>OPERATING EXPENSES:</b>		
Cost of chemicals sold	727,650	445,203
Research and development	15,565,452	14,563,374
General and administrative	7,131,268	6,198,148
Royalty and license expense	222,725	522,354
<b>Total operating expenses</b>	<b>23,647,095</b>	<b>21,729,079</b>
Operating loss	(15,240,014)	(12,352,069)
<b>INTEREST INCOME</b>	<b>2,523,467</b>	<b>1,584,278</b>
<b>INTEREST EXPENSE</b>	<b>(3,190)</b>	<b>(10,187)</b>
<b>NET LOSS</b>	<b>\$ (12,719,737)</b>	<b>\$ (10,777,978)</b>
<b>BASIC AND DILUTED NET LOSS PER COMMON SHARE</b>	<b>\$ (0.38)</b>	<b>\$ (0.35)</b>
<b>WEIGHTED AVERAGE SHARES USED IN COMPUTING BASIC AND DILUTED NET LOSS PER COMMON SHARE</b>	<b>33,230,574</b>	<b>30,725,351</b>

The accompanying notes are an integral part of these statements.

## UNIVERSAL DISPLAY CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Nine months ended September 30,	
	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (12,719,737)	\$ (10,777,978)
Non-cash charges to statement of operations:		
Depreciation	1,347,549	1,364,378
Amortization of intangibles	1,271,304	1,271,303
Amortization of premium and discount on investments	(189,306)	(115,156)
Stock-based employee compensation	803,693	696,135
Stock-based non-employee compensation	9,497	105,011
Non-cash expense under a Development Agreement	745,453	2,550,392
Stock-based compensation to Board of Directors and Scientific Advisory Board	318,997	—
(Increase) decrease in assets:		
Accounts receivable	(376,575)	(1,797,022)
Inventory	28,389	5,833
Other current assets	(139,669)	(173,632)
Other assets	7,500	(2,500)
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	(526,381)	(28,319)
Deferred license fees	(383,700)	3,066,301
Deferred revenue	352,554	(1,850,758)
Net cash used in operating activities	(9,450,432)	(5,686,012)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(661,591)	(2,015,804)
Purchases of investments	(27,344,981)	(15,136,785)
Proceeds from sale of investments	22,543,000	16,139,000
Net cash used in investing activities	(5,463,572)	(1,013,589)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from the issuance of common stock	38,000,023	—
Proceeds from the exercise of common stock options and warrants	6,422,284	5,505,298
Net cash provided by financing activities	44,422,307	5,505,298
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	29,508,303	(1,194,303)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	31,097,533	30,654,249
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 60,605,836	\$ 29,459,946

The following non-cash activities occurred:



Unrealized gain on available-for-sale securities	\$	66,164	\$	60,022
Common stock issued to Board of Directors and Scientific Advisory Board that was earned in a previous period		260,000		588,200
Common stock issued to employees that was earned in a previous period		951,321		838,854
Common stock issued for royalties that was earned in a previous period		499,993		—
Common stock issued under a Development Agreement that was earned in a previous period		21,915		22,515

The accompanying notes are an integral part of these statements.

**UNIVERSAL DISPLAY CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**1. BACKGROUND**

Universal Display Corporation (the “Company”) is engaged in the research, development and commercialization of organic light emitting diode (“OLED”) technologies and materials for use in flat panel display, solid-state lighting and other product applications. The Company’s primary business strategy is to develop and license its proprietary OLED technologies to product manufacturers for use in these applications. In support of this objective, the Company also develops new OLED materials and sells those materials to product manufacturers. Through internal research and development efforts and relationships with entities such as Princeton University (“Princeton”), the University of Southern California (“USC”), the University of Michigan (“Michigan”), Motorola, Inc. (“Motorola”) and PPG Industries, Inc. (“PPG”), the Company has established a significant portfolio of proprietary OLED technologies and materials (Note 4, 5 and 6).

The Company conducts a substantial portion of its OLED technology and material development activities at its technology development and transfer facility in Ewing, New Jersey.

**2. BASIS OF PRESENTATION**

**Interim Financial Information**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position as of September 30, 2007, the results of operations for the three and nine months ended September 30, 2007 and 2006, and cash flows for the nine months ended September 30, 2007 and 2006. While management believes that the disclosures presented are adequate to make the information not misleading, these unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto in the Company’s latest year-end financial statements, which are included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2006.

**Management’s Use of Estimates**

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

**Recent Accounting Pronouncements**

In June 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”), an interpretation of Statement of Financial Accounting Standards (“SFAS”) No. 109, *Accounting for Income Taxes* (“SFAS 109”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS 109. FIN 48 prescribes a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon examination. If the tax position is deemed “more-likely-than-not” to be sustained, the tax position is then measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50% likely of being

realized upon ultimate settlement. FIN 48 was adopted by the Company on January 1, 2007. The adoption of FIN 48 has not had an impact on the Company's results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value and expands disclosures on fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS 157 to have a material impact on its results of operations and financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS 159"). SFAS 159 permits entities to measure many financial instruments and certain other items at fair value at specified election dates. Under SFAS 159, any unrealized holding gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. If elected, the fair value option (1) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (2) is irrevocable (unless a new election date occurs); and (3) is applied only to entire instruments and not to portions of instruments. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS 159 to have a material impact on its results of operations and financial position.

In June 2007, the FASB approved Emerging Issues Task Force Issue No. 07-03 (“Issue No. 07-03”), *Accounting for Nonrefundable Advance Payments for Goods or Services to be Used in Future Research and Development Activities*. Issue No. 07-03 requires that nonrefundable advance payments for future research and development activities be deferred and capitalized. Such amounts should be recognized as an expense as goods are delivered or the related services are performed. Issue No. 07-03 is effective for fiscal years beginning after December 15, 2007. The Company does not expect the adoption of Issue No. 07-03 to have a material impact on its results of operations and financial position.

### Adjustment to Prior Year Consolidated Financials Statements

Certain prior year amounts have been adjusted to conform to the current year presentation. The adjustment results in an increase in reported cost of chemicals sold and a reduction in research and development expenses by \$54,756 and \$240,192 for the three and nine months ended September 30, 2006, respectively. In addition, an adjustment was made from accounts payable and accrued expenses to the non-cash expense under a Development Agreement in the Company’s Consolidated Statement of Cash Flows. These adjustments had no impact on the Company’s balance sheet, reported net loss or cash flows.

### 3. CASH, CASH EQUIVALENTS, SHORT-TERM AND LONG-TERM INVESTMENTS

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. The Company classifies its existing marketable securities as available-for-sale. These securities are carried at fair market value, with unrealized gains and losses reported in shareholders’ equity. Gains or losses on securities sold are based on the specific identification method.

Investments at September 30, 2007 and December 31, 2006 consist of the following:

Investment Classification	Cost	Unrealized		Market Value Aggregate Fair
		Gains	(Losses)	
September 30, 2007-				
Certificates of deposit	\$ 12,464,000	\$ —	\$(17,923)	\$ 12,446,077
US Government bonds	10,610,655	5,966	(4,725)	10,611,896
	\$ 23,074,655	\$ 5,966	\$(22,648)	\$ 23,057,973
December 31, 2006-				
Certificates of deposit	\$ 11,243,000	\$ —	\$(79,070)	\$ 11,163,930
US Government bonds	6,840,368	668	(4,444)	6,836,592
	\$ 18,083,368	\$ 668	\$(83,514)	\$ 18,000,522

### 4. RESEARCH AND LICENSE AGREEMENTS WITH PRINCETON, USC AND MICHIGAN

The Company has funded OLED technology research at Princeton and, on a subcontractor basis, at USC, under a Research Agreement executed with Princeton in August 1997 (as amended, the “1997 Research Agreement”). In April 2002, the 1997 Research Agreement was amended to provide for, among other things, an additional five-year term, which expired July 31, 2007. Payments to Princeton under this agreement are charged to research and development expenses as they become due. The Company has paid \$3,571,226 to Princeton under the 1997 Research

Agreement. Although the payments were charged to expense when they became due, the actual work performed by Princeton and USC did not always equate to the fixed amounts actually paid for each period. In the third quarter of 2006, Princeton refunded \$1,011,358 to the Company for cumulative amounts overpaid under the 1997 Research Agreement. The Company recorded the refund as an offset to research and development expenses.

On October 9, 1997, the Company, Princeton and USC entered into an Amended License Agreement under which Princeton and USC granted the Company worldwide, exclusive license rights, with rights to sublicense, to make, have made, use, lease and/or sell products and to practice processes based on patent applications and issued patents arising out of work performed by Princeton and USC under the 1997 Research Agreement (as amended, the “1997 Amended License Agreement”). Under this agreement, the Company is required to pay Princeton royalties for licensed products sold by the Company or its sublicensees. For licensed products sold by the Company, the Company is required to pay Princeton 3% of the net sales price of these products. For licensed products sold by the Company’s sublicensees, the Company is required to pay Princeton 3% of the revenues received by the Company from these sublicensees. These royalty rates are subject to renegotiation for products not reasonably conceivable as arising out of the 1997 Research Agreement if Princeton reasonably determines that the royalty rates payable with respect to these products are not fair and competitive. The Company is obligated under the 1997 Amended License Agreement to pay to Princeton minimum annual royalties. The minimum royalty payment is \$100,000 per year. The Company accrued \$119,166 of royalty expense in connection with the agreement for the nine months ended September 30, 2007.

The Company also is required under the 1997 Amended License Agreement to use commercially reasonable efforts to bring the licensed OLED technology to market. However, this requirement is deemed satisfied provided the Company performs its obligations under the 1997 Research Agreement and, when that agreement ends, the Company invests a minimum of \$800,000 per year in research, development, commercialization or patenting efforts respecting the patent rights licensed to the Company.

In January 2006, the Principal Investigator conducting research at Princeton under the 1997 Research Agreement transferred to Michigan. As a result of this transfer, the Company has entered into a new Sponsored Research Agreement with USC to sponsor OLED technology research at USC and, on a subcontractor basis, Michigan. This new Research Agreement (the “2006 Research Agreement”) was effective as of May 1, 2006, and has a term of three years. The 2006 Research Agreement supersedes the 1997 Research Agreement with respect to all work being performed at USC and Michigan. Under the 2006 Research Agreement, the Company is obligated to pay USC up to \$4,636,296 for work actually performed during the period from May 1, 2006 through April 30, 2009. Amounts paid to Princeton under the 1997 Research Agreement offset any amounts the Company was obligated to pay USC under the 2006 Research Agreement. Payments under the 2006 Research Agreement are made to USC on a quarterly basis as actual expenses are incurred. Through the period ended September 30, 2007, the Company had incurred \$790,029 in research and development expense under the 2006 Research Agreement.

In connection with entering into the 2006 Research Agreement, the Company amended the 1997 Amended License Agreement to include Michigan as a party to that agreement effective as of January 1, 2006. Under this amendment, Princeton, USC and Michigan have granted the Company a worldwide exclusive license, with rights to sublicense, to make, have made, use, lease and/or sell products and to practice processes based on patent applications and issued patents arising out of work performed under the 2006 Research Agreement. The financial terms of the 1997 Amended License Agreement were not impacted by this amendment.

## 5. ACQUIRED TECHNOLOGY

Acquired technology consists of acquired license rights for patents and know-how obtained from PD-LD, Inc. (“PD-LD”) and Motorola. These intangible assets consist of the following:

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
PD-LD, Inc.	\$ 1,481,250	\$ 1,481,250
Motorola, Inc.	15,469,468	15,469,468
	16,950,718	16,950,718

Less: Accumulated amortization	(11,902,534)	(10,631,230)
Acquired technology, net	\$ 5,048,184	\$ 6,319,488

On July 19, 2000, the Company, PD-LD, its president Dr. Vladimir Ban and Princeton entered into a Termination, Amendment and License Agreement whereby the Company acquired all PD-LD's rights to certain issued and pending OLED technology patents in exchange for 50,000 shares of the Company's common stock. Pursuant to this transaction, these patents were included in the patent rights exclusively licensed to the Company by Princeton under the 1997 Amended License Agreement. The acquisition of these patents had a fair value of \$1,481,250.

On September 29, 2000, the Company entered into a License Agreement with Motorola. Pursuant to this agreement, the Company licensed from Motorola what are now 74 issued U.S. patents and corresponding foreign patents relating to OLED technologies. These patents expire between 2012 and 2018. The Company has the sole right to sublicense these patents to OLED product manufacturers. As consideration for this license, the Company issued to Motorola 200,000 shares of the Company's common stock (valued at \$4,412,500), 300,000 shares of the Company's Series B Convertible Preferred Stock (valued at \$6,618,750) and a warrant to purchase 150,000 shares of the Company's common stock at \$21.60 per share. The warrant was recorded at a fair market value of \$2,206,234 based on the Black-Scholes option-pricing model, and was recorded as a component of the cost of the acquired technology. The warrant expired on September 29, 2007, without having been exercised by Motorola.

The Company also issued a warrant to an unaffiliated third party to acquire 150,000 shares of the Company's common stock as a finder's fee in connection with the Motorola transaction. The original exercise price of this warrant was \$21.60 per share and the exercise period was seven years. This warrant was accounted for at its fair value based on the Black-Scholes option pricing model and \$2,206,234 was recorded as a component of the cost of the acquired technology. The Company used the following assumptions in the Black-Scholes option pricing model for the 300,000 warrants issued in connection with this transaction: (1) 6.3% risk-free interest rate, (2) expected life of 7 years, (3) 60% volatility and (4) zero expected dividend yield. Based on anti-dilution adjustments, the number of warrant shares was adjusted to 191,028 shares, and the exercise price was adjusted to \$16.96 per share. The warrant was exercised on a cashless basis on August 13, 2007.

In total, the Company recorded an intangible asset of \$15,469,468 for the technology acquired from Motorola. This includes \$25,750 of direct cash transaction costs.

Amortization expense was \$1,271,304 for the nine months ended September 30, 2007 and \$1,271,303 for the same period in 2006. For each of the years 2007 through 2009, amortization expense will be \$1,695,072 and for 2010 amortization expense will be \$1,234,272.

The Company is required under the License Agreement to pay Motorola based on gross revenues earned by the Company from its sales of OLED products or components, or from its sublicensees for their sales of OLED products or components, whether or not these products or components are based on inventions claimed in the patent rights licensed from Motorola. All royalty payments are payable, at the Company's discretion, in either all cash or up to 50% in shares of the Company's common stock and the remainder in cash. The number of shares of common stock used to pay the stock portion of the royalty payment is calculated by dividing the amount to be paid in stock by the average daily closing price per share of the Company's common stock over the 10 trading days ending two business days prior to the date the stock is issued.

The Company was required to pay Motorola minimum royalties of \$1,000,000 for the two-year period ended on December 31, 2006. In satisfaction of this obligation, in March 2007, the Company issued to Motorola 37,075 shares of the Company's common stock, valued at \$499,993, and paid Motorola \$500,007 in cash. For the nine months ended September 30, 2007, the Company accrued \$96,058 of royalty expense in connection with the License Agreement with Motorola. The Company is no longer subject to a minimum royalty obligation under this agreement.

## **6. EQUITY AND CASH COMPENSATION UNDER THE PPG AGREEMENTS**

On October 1, 2000, the Company entered into a five-year Development and License Agreement ("Development Agreement") and a seven-year Supply Agreement ("Supply Agreement") with PPG. Under the Development Agreement, a team of PPG scientists and engineers assisted the Company in developing its proprietary OLED materials and supplied the Company with these materials for evaluation purposes. Under the Supply Agreement, PPG supplied the Company with its proprietary OLED materials that were intended for resale to customers for commercial purposes.



For the period from inception of the Development Agreement through December 2004, the Company issued shares of its common stock and warrants to acquire its common stock to PPG on an annual basis in consideration of the services provided under the agreement. The consideration to PPG for these services was determined by reference to an agreed-upon annual budget and was subject to adjustment based on costs actually incurred for work performed during the budget period. The specific number of shares of common stock and warrants issued to PPG was determined based on the average closing price of the Company's common stock during a specified period prior to the start of the budget period. In January 2003, the Company and PPG amended the Development Agreement, providing for additional consideration to PPG for additional services to be provided under that agreement, which services were paid for in cash. All materials provided by PPG under the Supply Agreement were also paid for in cash.

In December 2004 and again in March 2005, the Company and PPG amended both the Development Agreement and the Supply Agreement to alter the charges and method of payment for services and materials provided by PPG under both agreements during 2005. Under the amended Development Agreement, the Company compensated PPG on a cost-plus basis for the services provided during each calendar quarter. The Company was required to pay for some of these services in cash and for other of the services in common stock. Payment for up to 50% of the remaining services was able to be paid, at the Company's sole discretion, in cash or shares of common stock, with the balance payable in all cash. The actual number of shares of common stock issuable to PPG was determined based on the average closing price for the Company's common stock during a specified period prior to the end of that quarter. If, however, this average closing price was less than \$6.00, the Company was required to compensate PPG in all cash. The Company recorded these expenses to research and development as they were incurred. Under the amended Development Agreement, the Company was no longer required to issue warrants to PPG.

Under the amended Supply Agreement, the Company also compensated PPG on a cost-plus basis for services and materials provided during each calendar quarter of 2005. The Company was required to pay for all materials and for some of these services in cash. Payment for up to 50% of the remaining services was able to be paid, at the Company's sole discretion, in cash or shares of common stock, with the balance payable in all cash. Again, the specific number of shares of common stock issuable to PPG was determined based on the average closing price for the Company's common stock during a specified period prior to the end of that quarter. If, however, this average closing price was less than \$6.00, the Company was required to compensate PPG in all cash.

On July 29, 2005, the Company entered into an OLED Materials Supply and Service Agreement with PPG. This Agreement superseded and replaced in their entirety the amended Development and Supply Agreements effective as of January 1, 2006, and extended the term of the Company's existing relationship with PPG through December 31, 2008. Under the new agreement, PPG has continued to assist the Company in developing its proprietary OLED materials and supplying the Company with those materials for evaluation purposes and for resale to its customers. The financial terms of the new agreement are substantially similar to those of the amended Development and Supply Agreements, and include a requirement that the Company pay PPG in a combination of cash and the Company's common stock.

The Company issued to PPG 50,477 and 176,205 shares of the Company's common stock as consideration for services provided by PPG under the OLED Materials Supply and Service Agreement during the nine months ended September 30, 2007 and 2006, respectively. Of these shares, 8,250 shares were issued on October 22, 2007, 39,624 shares were issued on April 16, 2007, 59,624 shares were issued on October 19, 2006 and 119,184 shares were issued on April 19, 2006. For these shares, the Company recorded a charge of \$745,453 and \$2,281,459 to research and development expense for the nine months ended September 30, 2007 and 2006, respectively. The Company also recorded \$746,715 and \$773,890 to research and development expense for the cash portion of the work performed by PPG during the nine months ended September 30, 2007 and 2006, respectively.

Also, in accordance with the OLED Materials Supply and Service Agreement, the Company is required to reimburse PPG for its raw materials and conversion costs for all development chemicals produced on behalf of the Company. The Company recorded \$162,132 and \$199,873 to research and development expense for this activity during the nine months ended September 30, 2007 and 2006, respectively.

Through the end of 2006, the Company was required under its agreements with PPG to grant options to purchase the Company's common stock to PPG employees performing development services for the Company, in a manner consistent with that for issuing options to its own employees. Subject to certain contingencies, these options were to vest one year following the date of grant and will expire 10 years from the date of grant. However, in connection with a transition to the Company in 2006 of all work being performed by the PPG development team, all outstanding options granted to PPG employees became vested as of December 31, 2006.

On December 30, 2005, the Company granted to PPG employees performing development services under the Development Agreement options to purchase 31,500 shares of the Company's common stock at an exercise price of \$10.51. In April 2006, the Company hired several PPG employees as full-time employees of the Company. As a result of these hirings, the Company accelerated the vesting of 18,500 of the options granted on December 30, 2005. Accordingly, the Company recorded \$225,882 in research and development costs related to these options for the period ended September 30, 2006. The Company also recorded \$43,051 in research and development costs for the remaining 13,000 options for the period ended September 30, 2006. The Company determined the fair value of the options earned during the period ended September 30, 2006 using the Black-Scholes option-pricing model with the following assumptions: (1) risk free interest rate of 4.39-4.62%, (2) no expected dividend yield, (3) contractual life of 3.25 years and (4) expected volatility of 48.75-77.59%.

In lieu of stock options, and consistent with awards made to the Company's own employees, shares of stock were granted to certain PPG employees performing development services on the Company's behalf during 2006. On

January 9, 2007, the Company issued 1,500 shares of its common stock as a bonus to these PPG research and development team members for the year ended December 31, 2006. Accordingly, the Company accrued \$21,915 as of December 31, 2006 in research and development costs relating to the issuance. The Company has no obligation to issue options or shares of stock to any PPG employees in 2007 or thereafter.

## 7. SHAREHOLDERS' EQUITY

	Preferred Stock,		Common Stock		Additional Paid-In Capital	Unrealized Loss on Available for Sale Securities		Accumulated Deficit	Total Equity
	Series A	Shares	Amount	Shares		Amount			
BALANCE, JANUARY 1, 2007	200,000	2,000	31,385,408	3,854	\$ 199,505,981	\$ (82,846)	\$ (145,356,626)	\$ 54,382,363	
Issuance of common stock through public offering, net of expenses of \$2,599,977(A)	—	—	2,800,000	28,000	37,972,023	—	—	38,000,023	
Exercise of common stock options and warrants(B)	—	—	748,870	7,488	6,414,796	—	—	6,422,284	
Stock-based employee compensation (C)	—	—	69,738	698	1,747,110	—	—	1,747,808	
Stock-based non-employee compensation					9,497			9,497	
Issuance of common stock to Board of Directors and Scientific Advisory Board (D)	—	—	32,796	328	578,669	—	—	578,997	
Issuance of common stock in connection with Development and License Agreements (E)	—	—	80,803	808	1,131,450	—	—	1,132,258	
Unrealized gain on available-for-sales securities	—	—	—	—	—	66,164	—	66,164	
Net loss	—	—	—	—	—	—	(12,719,737)	(12,719,737)	
Comprehensive loss	—	—	—	—	—	—	—	(12,653,573)	
BALANCE, SEPTEMBER 30, 2007	200,000	2,000	35,117,685	351,876	\$ 247,359,526	\$ (16,682)	\$ (158,076,363)	\$ 89,619,657	

- (A) In May 2007, the Company sold 2,800,000 shares of common stock through a public offering at \$14.50 per share. The offering resulted in net proceeds to the Company of \$38,000,023, net of \$2,599,977 in associated costs.
- (B) During the nine months ended September 30, 2007, the Company issued 748,870 shares of common stock upon the exercise of common stock options and warrants, resulting in cash proceeds of \$6,422,284.
- (C) Includes \$951,321 that was earned in a previous period and charged to expense when earned, but issued in 2007.
- (D) Includes \$260,000 that was earned in a previous period and charged to expense when earned, but issued in 2007.
- (E) Includes \$521,908 that was earned in a previous period and charged to expense when earned, but issued in 2007 (see Notes 5 and 6).

## 8. STOCK-BASED COMPENSATION

On January 1, 2006, the Company adopted SFAS No. 123R utilizing the modified prospective transition method. SFAS No. 123R requires employee stock options to be valued at fair value on the date of grant and charged to expense over the applicable vesting period. Under the modified prospective method, compensation expense is recognized for all share based payments issued on or after January 1, 2006, and for all share payments issued to employees prior to January 1, 2006 that remain unvested. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123R. The adoption of SFAS No. 123R did not change the Company's accounting for stock-based payments issued to non-employees.

### Equity Compensation Plan

In 1995, the Board of Directors of the Company adopted a Stock Option Plan (the "1995 Plan"), under which options to purchase a maximum of 500,000 shares of the Company's common stock were authorized to be granted at prices not less than the fair market value of the common stock on the date of the grant, as determined by the Compensation Committee of the Board of Directors. Through September 30, 2007, the Company's shareholders approved increases in the number of shares reserved for issuance under the 1995 Plan to 7,000,000, and extended the term of the plan through 2015. The 1995 Plan was also amended and restated in 2003, and is now called the Equity Compensation Plan. The Equity Compensation Plan provides for the granting of incentive and nonqualified stock options, stock, stock appreciation rights and performance units to employees, directors and consultants of the Company. Stock options are exercisable over periods determined by the Compensation Committee, but for no longer than 10 years from the grant date.

During the nine months ended September 30, 2007, the Company granted 4,750 common stock options to employees. These stock options vested immediately and had exercise prices equal to the market price of the Company's common stock on the date of grant. The fair value of the options granted during the nine months ended September 30, 2007 was \$35,650. For the nine months ended September 30, 2007 and 2006, compensation expense related to all outstanding common stock options was \$426,985 and \$607,591, respectively.

In addition, during the nine months ended September 30, 2007, the Company granted a total of 115,026 shares of restricted stock to employees and members of the Scientific Advisory Board. These shares of restricted stock had a value of \$1,705,001 on the date of grant and will vest in equal increments over three years from the date of grant. For the nine months ended September 30, 2007, the Company recorded as compensation charges related to all restricted stock awards a general and administrative expense of \$243,393 and a research and development expense of \$262,282.

On each of March 31, 2007, June 30, 2007 and September 30, 2007, the Company issued 5,000 shares of fully vested common stock to members of its Board of Directors as partial payment for services performed for the three-month periods ended on such dates. The fair value of the shares issued was \$190,030, which was recorded as a compensation charge in general and administrative expense for the nine months ended September 30, 2007.

### **Net Loss Per Common Share**

Basic net loss per common share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding for the period. Diluted net loss per common share reflects the potential dilution from the exercise or conversion of securities into common stock. For the nine months ended September 30, 2007 and 2006, the effects of the exercise of the combined outstanding stock options and warrants of 5,681,359 and 6,938,651, respectively, were excluded from the calculation of diluted EPS as the impact would have been antidilutive.

## **9. COMMITMENTS AND CONTINGENCIES**

### **Commitments**

Under the 2006 Research Agreement with USC, the Company is obligated to make certain payments to USC. See Note 4 for further explanation.

Under the terms of the 1997 Amended License Agreement, the Company is required to make minimum royalty payments to Princeton. See Note 4 for further explanation.

### **Patent Interference Concerning U.S. Patent No. 6,734,457**

In June 2006, Patent Interference No. 105,461 was declared by the United States Patent and Trademark Office (the "USPTO") between Semiconductor Energy Laboratory Co., Ltd. ("SEL"), and Princeton and USC (the "Universities"). The dispute concerned U.S. Patent No. 6,734,457, which had been issued to SEL. The SEL patent claimed aspects of the Company's phosphorescent OLED technology that the Company believes were disclosed and claimed in U.S. Application Serial No.10/913,211, which the Company exclusively licenses from the Universities. The Universities sought a ruling by the USPTO that they should be granted a patent to the claimed invention and that the SEL patent is invalid because the Universities were first-to-invent and their invention was made prior to that of SEL. Under the Company's agreement with the Universities, it was required to pay all legal costs and fees associated with the interference proceeding.

An oral hearing in the matter was held before the Board of Patent Appeals and Interferences (the "BPAI") of the USPTO on April 25, 2007. The following day, the BPAI issued a decision in favor of the Universities. The BPAI decision confirmed that the Universities were first-to-invent the subject matter of the interference and that the Universities' invention is prior art to SEL's patent. As a result, all claims of the SEL patent were canceled. SEL did not appeal the BPAI decision and the proceeding is effectively terminated.

### **Notice of Opposition to European Patent No. 0946958**

On December 8, 2006, Cambridge Display Technology, Ltd. ("CDT") filed a Notice of Opposition to European Patent No. 0946958 (the "EP '958 patent"). The EP '958 patent, which was issued on March 8, 2006, is a European counterpart patent to U.S. patents 5,844,363, 6,602,540 and 6,888,306, and to pending U.S. patent application 10/966,417, filed on October 15, 2004. These patents and patent applications relate to the Company's flexible OLED technology. They are exclusively licensed to the Company by Princeton, and under the license agreement the Company is required to pay all legal costs and fees associated with this proceeding.

The European Patent Office (the "EPO") set a date of May 12, 2007 for the Company to file a response to the facts and arguments presented by CDT in its Notice of Opposition. The response was timely filed and the Company is awaiting the opponent's response, which is expected in November 2007, although no firm date has been set. Since the proceeding is still in a relatively early stage, Company management cannot make any prediction as to the probable outcome of this opposition. However, based on a preliminary analysis of the evidence presented, Company management believes there is a substantial likelihood that the patent being challenged will be declared valid, and that all or a significant portion of its claims will be upheld.

### **Notices of Opposition to European Patent No. 1449238**

On March 8, 2007, Sumation Company Limited (“Sumation”), a joint venture between Sumitomo Chemical Company and CDT, filed a first Notice of Opposition to European Patent No. 1449238 (the “EP ‘238 patent”). The EP ‘238 patent, which was issued on November 2, 2006, is a European counterpart patent, in part, to U.S. patents 6,830,828, 6,902,830 and 7,001,536, and to pending U.S. patent application 11/233,605, filed on September 22, 2005. These patents and patent application relate to the Company’s PHOLED technology. They are exclusively licensed to the Company by Princeton, and under the license agreement the Company is required to pay all legal costs and fees associated with this proceeding.

Two other parties filed additional oppositions to the EP ‘238 patent just prior to the August 2, 2007 expiration date for such filings. On July 24, 2007, Merck Patent GmbH, of Darmstadt, Germany, filed a second Notice of Opposition to the EP ‘238 patent, and on July 27, 2007, BASF Aktiengesellschaft, of Mannheim, Germany, filed a third Notice of Opposition to the EP ‘238 patent.

The EPO set a January 6, 2008 due date for the Company to file its responses to the three oppositions. The Company is in the process of reviewing each Notice of Opposition and preparing its response to each. There is considerable overlap in the prior art evidence relied upon in each opposition. The three oppositions will be handled in a single proceeding. At this time, Company management cannot make any prediction as to the probable outcome of the oppositions. However, based on a preliminary analysis of the evidence presented, Company management believes there is a substantial likelihood that the patent being challenged will be declared valid, and that all or a significant portion of its claims will be upheld.

### **10. CONCENTRATION OF RISK**

All contract research revenue has been derived from contracts with United States government agencies. Two non-government customers accounted for 46% and 15% of consolidated revenue for the nine months ended September 30, 2007 and 2006, respectively. Accounts receivable from these customers were \$902,363 at September 30, 2007. Revenues from outside of North America represented 54% and 68% of consolidated revenue for the nine months ended September 30, 2007 and 2006, respectively.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes above.

#### **CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS**

This discussion and analysis contains some “forward-looking statements.” Forward-looking statements concern our possible or assumed future results of operations, including descriptions of our business strategies and customer relationships. These statements often include words such as “believe,” “expect,” “anticipate,” “intend,” “plan,” “estimate,” “se,” “will,” “may” or similar expressions. These statements are based on assumptions that we have made in light of our experience in the industry, as well as our perceptions of historical trends, current conditions, expected future developments and other factors we believe are appropriate in these circumstances.

As you read and consider this discussion and analysis, you should not place undue reliance on any forward-looking statements. You should understand that these statements involve substantial risk and uncertainty and are not guarantees of future performance or results. They depend on many factors that are discussed further in the section entitled “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2006, as supplemented by



any disclosures in Item 1A of Part II of our Quarterly Report for the quarters ended March 31 and June 30, 2007 and in Item 1A of Part II below. Changes or developments in any of these areas could affect our financial results or results of operations, and could cause actual results to differ materially from those contemplated in the forward-looking statements.

All forward-looking statements speak only as of the date of this report or the documents incorporated by reference, as the case may be. We do not undertake any duty to update any of these forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

## **OVERVIEW**

We are a leader in the research, development and commercialization of organic light emitting diode, or OLED, technologies for use in flat panel display, solid-state lighting and other applications. Since 1994, we have been exclusively engaged, and expect to continue to be exclusively engaged, in funding and performing research and development activities relating to OLED technologies and materials, and in attempting to commercialize these technologies and materials. Our revenues are generated through contract research, sales of development and commercial chemicals, technology development and evaluation, and intellectual property licensing arrangements. We anticipate that in the future revenues from licensing our intellectual property will become a more significant part of our revenue stream.

While we have made significant progress over the past few years developing and commercializing our family of OLED technologies (PHOLED, TOLED, FOLED, etc.) and materials, we have incurred significant losses and will likely continue to do so until our OLED technologies and materials become more widely incorporated into commercial OLED products. We have incurred significant losses since our inception, resulting in an accumulated deficit of \$158,076,363 as of September 30, 2007.

We anticipate fluctuations in our annual and quarterly results of operations due to uncertainty regarding, among other factors:

- § the timing of our receipt of license fees and royalties, as well as fees for future contract research and technology development and evaluation;
- § the timing and volume of sales of our OLED materials for both commercial usage and evaluation purposes;
- § the timing of our customers' introduction and discontinuance of OLED products incorporating our technologies and materials;
- § the timing and magnitude of expenditures we may incur in connection with our ongoing research and development activities; and
- § the timing and financial consequences of our formation of new business relationships and alliances.

## **RESULTS OF OPERATIONS**

### **Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006**

We had a net loss of \$2,960,565 (or \$0.08 per diluted share) for the quarter ended September 30, 2007, compared to a net loss of \$2,943,287 (or \$0.09 per diluted share) for the same period in 2006. The increase in net loss was primarily due to decreased revenues and increased operating expenses, as described below.

Our revenues were \$3,077,281 for the quarter ended September 30, 2007, compared to \$3,096,288 for the same period in 2006.

We earned \$1,229,306 in contract research revenue from the U.S. government for the quarter ended September 30, 2007, compared to \$1,328,109 for the same period in 2006. The decrease was mainly due to the timing of revenue recognition in connection with several new government programs that commenced during the second and third quarters of 2006, as well as our continuing work under existing government programs.

We earned \$229,774 from sales of developmental chemicals during the quarter ended September 30, 2007, compared to \$492,173 for the same period in 2006. The decrease was mainly due to a decreased volume of material purchases by an OLED product manufacturer that transitioned from exclusively development chemical purchases in 2006 to primarily commercial chemical purchases in 2007. We cannot accurately predict the timing and frequency of development chemical purchases by our customers due to participants in the OLED industry having differing OLED technology development and product launch strategies.

Our commercial chemical and royalty and license revenues for the quarter ended September 30, 2007 were \$1,185,050 and \$183,151, respectively, compared to \$201,227 and \$534,248, respectively, for the corresponding period in 2006.

Almost all of our commercial chemical revenue for the quarter ended September 30, 2007 was from sales of our materials to Samsung SDI Co., Ltd. ("Samsung SDI"). During the same period in 2006, we recorded most of our commercial chemical revenue, as well as our license revenues, from sales of our materials to AU Optronics Corporation ("AUO"). AUO discontinued manufacturing the product for which it ordered our materials in the third quarter of 2006, and we have not sold any commercial chemicals to AUO since that time. AUO's discontinuation of

material purchases is also the primary reason for the decrease in our license revenues. We cannot accurately predict the timing and frequency of such purchases by our customers due to the early stage of the OLED industry.

During the quarter ended June 30, 2007, we entered into new commercial supply agreements with two OLED display manufacturers, Chi Mei EL Corporation (“CMEL”) and LG.Philips LCD Co., Ltd. (“LPL”). These agreements are similar to the commercial supply agreement we had entered into with AUO, in that we will record both commercial chemical and license revenues from sales of our materials under the agreements. A small portion of our commercial chemical and license revenues for the quarter ended September 30, 2007 were from sales of our materials to CMEL and LPL. We cannot accurately predict the timing and frequency of such purchases by our customers due to the early stage of the OLED industry.

We recorded royalty revenue of \$16,051 from Samsung SDI for the quarter ended September 30, 2007, with no corresponding revenues for the same period of 2006. This revenue represents royalties received under our patent license agreement with Samsung SDI, which we entered into in April 2005. Under that agreement, we receive royalty reports a specified period of time after the end of the quarter during which royalty-bearing products are sold by Samsung SDI. Consequently, the royalty revenue from Samsung SDI for the three months ended September 30, 2007 represents only royalties earned during the second quarter of 2007.

Our royalty and license revenue for each of the quarters ended September 30, 2007 and 2006 also included license fees of \$127,900. These revenues were from our patent license agreement with Samsung SDI, as well as the cross-license agreement we executed with DuPont Displays, Inc. ("DuPont") in December 2002. In connection with each of these agreements, we received upfront payments that have been classified as deferred license fees and deferred revenue. The deferred license fees are being recognized as license revenue over the term of the agreement with Samsung SDI and over 10 years with DuPont. In addition, during the third quarter of 2006 we received a non-refundable payment for granting a license to one of our ink jet printing patents and certain related patent filings, which payment is creditable against future amounts payable under a broader license agreement covering other aspects of our OLED patent portfolio, if one is executed by a specified date. Therefore, we have recorded this payment as a deferred license fee rather than recognizing it as current license fee revenue.

We recognized \$250,000 in technology development revenue for the quarter ended September 30, 2007 in connection with the renewal of a technology development and evaluation agreements. This compares to \$540,531 in technology development revenue for the same period in 2006, which was in connection with our work under three such agreements. The decrease was due to our completion of work under two of these technology development agreements. Also, in the third quarter of 2006 we received a non-refundable payment for the continuation of one of these technology development agreements, which payment is creditable against future amounts payable under a commercial license agreement, if one is executed by a specified date. Therefore, we have recorded this payment as a deferred license fee rather than technology development revenue. The amount and timing of our receipt of fees for technology development and similar services is difficult to predict due to participants in the OLED industry having differing technology development strategies.

We incurred research and development expenses of \$4,568,299 for the quarter ended September 30, 2007, compared to \$4,331,512 for the same period in 2006. The increase was mainly due to increased operating costs resulting from the expansion of our New Jersey facility and increased sponsored research expenses, offset to some extent by a decrease in amounts payable to PPG for development work.

General and administrative expenses were \$2,209,537 for the quarter ended September 30, 2007, compared to \$1,965,921 for the same period in 2006. The increase in general and administrative expenses was mainly due to increased personnel costs and a change in the timing of payments to independent members of our Board of Directors.

Interest income increased to \$1,114,769 for the quarter ended September 30, 2007, compared to \$565,262 for the same period in 2006. The increase resulted mainly from higher rates of return on investments during the second quarter of 2007, as well as an increase in investment purchases due to funds received from a common stock offering we completed in May 2007.

#### **Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006**

We had a net loss of \$12,719,737 (or \$0.38 per diluted share) for the nine months ended September 30, 2007, compared to a net loss of \$10,777,978 (or \$0.35 per diluted share) for the same period in 2006. The increase in net loss was primarily due to decreased revenues and increased operating expenses, as described below.

Our revenues were \$8,407,081 for the nine months ended September 30, 2007, compared to \$9,377,010 for the same period in 2006.

We earned \$3,649,076 in contract research revenue from the U.S. government for the nine months ended September 30, 2007, compared to \$2,765,699 for the same period in 2006. The increase was mainly due to the recognition of revenue on several new government programs that commenced during the second and third quarters of 2006, as well as our continuing work under existing government programs.

We earned \$805,978 from sales of developmental chemicals during the nine months ended September 30, 2007, compared to \$1,464,703 for the same period in 2006. The decrease was mainly due to a decreased volume of material purchases by an OLED product manufacturer that transitioned from exclusively development chemical purchases in 2006 to primarily commercial chemical purchases in 2007. We cannot accurately predict the timing and frequency of development chemical purchases by our customers due to participants in the OLED industry having differing OLED technology development and product launch strategies.

Our commercial chemical and royalty and license revenues for the nine months ended September 30, 2007 were \$2,727,681 and \$474,346, respectively, compared to \$936,071 and \$2,272,279, respectively, for the corresponding period in 2006.

Almost all of our commercial chemical revenue for the nine months ended September 30, 2007 was from sales of our materials to Samsung SDI. During the same period in 2006, we recorded most of our commercial chemical revenue, as well as our license revenues, from sales of our materials to AUO. As previously indicated, we have not sold any commercial chemicals to AUO since the third quarter of 2006. AUO's discontinuation of material purchases is also the primary reason for the decrease in our license revenues. We cannot accurately predict the timing and frequency of such purchases by our customers due to the early stage of the OLED industry.

We recorded royalty revenue of \$47,446 from Samsung SDI for the nine months ended September 30, 2007, with no corresponding revenues for the same period of 2006. As previously indicated, this revenue represents royalties received under our patent license agreement with Samsung SDI, which we entered into in April 2005. Under that agreement, we receive royalty reports a specified period of time after the end of the quarter during which royalty-bearing products are sold by Samsung SDI. Consequently, the royalty revenue from Samsung SDI for the nine months ended September 30, 2007 represents only royalties earned during the first two quarters of 2007.

Our royalty and license revenue for each of the nine-month periods ended September 30, 2007 and 2006 also included license fees of \$383,700. These revenues were from our patent license agreement with Samsung SDI and our cross-license agreement with DuPont. In addition, during the third quarter of 2006 we received a non-refundable payment for granting a license to one of our ink jet printing patents and certain related patent filings, which payment is creditable against future amounts payable under a broader license agreement covering other aspects of our OLED patent portfolio, if one is executed by a specified date. Therefore, we have recorded this payment as a deferred license fee rather than recognizing it as current license fee revenue.

We recognized \$750,000 in technology development revenue for the nine months ended September 30, 2007 in connection with the renewal of a technology development and evaluation agreements. This compares to \$1,938,258 in technology development revenue for the same period in 2006, which was in connection with our work under four such agreements. The decrease was due to our completion of work under three of these technology development agreements. Also, in the third quarter of 2006 we received a non-refundable payment for the continuation of one of these technology development agreements, which payment is creditable against future amounts payable under a commercial license agreement, if one is executed by a specified date. Therefore, we have recorded this payment as a deferred license fee rather than technology development revenue. The amount and timing of our receipt of fees for technology development and similar services is difficult to predict due to participants in the OLED industry having differing technology development strategies.

We incurred research and development expenses of \$15,565,452 for the nine months ended September 30, 2007, compared to \$14,563,374 for the same period in 2006. The increase was mainly due to increased personnel costs, increased direct materials and subcontract costs resulting from efforts on our government programs, increased operating costs resulting from the expansion of our New Jersey facility and increased legal expenses associated with patent application, prosecution, maintenance and defense costs, offset to some extent by a decrease in amounts payable to PPG as a result of our hiring certain PPG employees (see Note 6 to the Notes to Consolidated Financial Statements).

General and administrative expenses were \$7,131,268 for the nine months ended September 30, 2007, compared to \$6,198,148 for the same period in 2006. The increase was mainly due to increased personnel costs and a change in the timing of payments to independent members of our Board of Directors.

Interest income increased to \$2,523,467 for the nine months ended September 30, 2007, compared to \$1,584,278 for the same period in 2006. The increase resulted mainly from higher rates of return on investments during the second quarter of 2007, as well as an increase in investment purchases due to funds received from a common stock offering we completed in May 2007.

## **Liquidity and Capital Resources**

As of September 30, 2007, we had cash and cash equivalents of \$60,605,836, and short-term investments of \$23,057,973, for a total of \$83,663,809. This compares to cash and cash equivalents of \$31,097,533, short-term investments of \$17,957,752 and investments in certificates of deposit and other liquid instruments with an original maturity of more than one year of \$42,770, for a total of \$49,098,055, as of December 31, 2006. The overall increase in cash and cash equivalents and short-term and long-term investments of \$34,565,754 was primarily due to proceeds received from the common stock offering we completed in May 2007, as described below.

Cash used in operating activities was \$9,450,432 for the nine months ended September 30, 2007, compared to \$5,686,012 for the same period in 2006. The increase was mainly due to an increase in operating expenses and a decrease in the receipt of deferred license fees and deferred revenue.

Cash used in investing activities was \$5,463,572 for the nine months ended September 30, 2007, compared to \$1,013,589 for the same period in 2006. The increase was mainly due to increased investment purchases due to an increase in funds received from the common stock offering we completed in May 2007, as described below.

Cash provided by financing activities was \$44,422,307 for the nine months ended September 30, 2007, compared to \$5,505,298 for the same period in 2006. The increase was mainly due to the completion of our common stock offering. In May 2007, we completed a public offering of 2,800,000 shares of our common stock at a price of \$14.50 per share. The offering resulted in proceeds to us of \$38,000,023, net of \$2,599,977 in underwriting discounts and commissions and other costs associated with completion of the offering.

Working capital increased to \$74,236,420 as of September 30, 2007, from working capital of \$37,422,740 as of December 31, 2006. Again, this increase was mainly due to proceeds from the common stock offering we completed in May 2007.

We anticipate, based on our internal forecasts and assumptions relating to our operations (including, among others, assumptions regarding our working capital requirements, the progress of our research and development efforts, the availability of sources of funding for our research and development work, and the timing and costs associated with the preparation, filing, prosecution, maintenance, defense and enforcement of our patents and patent applications), that we have sufficient cash, cash equivalents and short-term investments to meet our obligations through at least the end of 2008.

We believe that potential additional financing sources for us include long-term and short-term borrowings, public and private sales of our equity and debt securities and the receipt of cash upon the exercise of warrants and options. It should be noted, however, that additional funding may be required in the future for research, development and commercialization of our OLED technologies and materials, to obtain, maintain and enforce patents respecting these technologies and materials, and for working capital and other purposes, the timing and amount of which are difficult to ascertain. There can be no assurance that additional funds will be available to us when needed, on commercially reasonable terms or at all.

### **Critical Accounting Policies**

Refer to our Annual Report on Form 10-K for the year ended December 31, 2006 for a discussion of our critical accounting policies. There have been no changes in critical accounting policies to date in 2007.

### **Contractual Obligations**

Refer to our Annual Report on Form 10-K for the year ended December 31, 2006 for a discussion of our contractual obligations. There have been no significant changes in contractual obligations to date in 2007.

### **Off-Balance Sheet Arrangements**

Refer to our Annual Report on Form 10-K for the year ended December 31, 2006 for a discussion of off-balance sheet arrangements. As of September 30, 2007, we had no off-balance sheet arrangements.

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

We do not utilize financial instruments for trading purposes and hold no derivative financial instruments, other financial instruments or derivative commodity instruments that could expose us to significant market risk. Our primary market risk exposure with regard to financial instruments is to changes in interest rates, which would impact interest income earned on investments.

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

### **Evaluation of Disclosure Controls and Procedures**



Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2007. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures, as of the end of the period covered by this report, are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed or submitted under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. However, a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

## **Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II – OTHER INFORMATION**

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

#### **Patent Interference Concerning U.S. Patent No. 6,734,457**

In June 2006, Patent Interference No. 105,461 was declared by the United States Patent and Trademark Office (the “USPTO”) between Semiconductor Energy Laboratory Co., Ltd. (“SEL”), and Princeton and USC (the “Universities”). The dispute concerned U.S. Patent No. 6,734,457, which had been issued to SEL. The SEL patent claimed aspects of our phosphorescent OLED technology that we believe were disclosed and claimed in U.S. Application Serial No.10/913,211, which we exclusively license from the Universities. The Universities sought a ruling by the USPTO that they should be granted a patent to the claimed invention and that the SEL patent is invalid because the Universities were first-to-invent and their invention was made prior to that of SEL. Under our agreement with the Universities, we were required to pay all legal costs and fees associated with the interference proceeding.

An oral hearing in the matter was held before the Board of Patent Appeals and Interferences (the “BPAI”) of the USPTO on April 25, 2007. The following day, the BPAI issued a decision in favor of the Universities. The BPAI decision confirmed that the Universities were first-to-invent the subject matter of the interference and that the Universities’ invention is prior art to SEL’s patent. As a result, all claims of the SEL patent were canceled. SEL did not appeal the BPAI decision and the proceeding is effectively terminated.

#### **Notice of Opposition to European Patent No. 0946958**

On December 8, 2006, Cambridge Display Technology, Ltd. (“CDT”) filed a Notice of Opposition to European Patent No. 0946958 (the “EP ‘958 patent”). The EP ‘958 patent, which was issued on March 8, 2006, is a European counterpart patent to U.S. patents 5,844,363, 6,602,540 and 6,888,306, and to pending U.S. patent application 10/966,417, filed on October 15, 2004. These patents and patent applications relate to our flexible OLED technology. They are exclusively licensed to us by Princeton, and under the license agreement we are required to pay all legal costs and fees associated with this proceeding.

The European Patent Office (the “EPO”) set a date of May 12, 2007 for us to file a response to the facts and arguments presented by CDT in its Notice of Opposition. The response was timely filed and we are awaiting the opponent’s response, which is expected in November 2007, although no firm date has been set. Since the proceeding is still in a relatively early stage, we cannot make any prediction as to the probable outcome of this opposition. However, based on a preliminary analysis of the evidence presented, we believe there is a substantial likelihood that the patent being challenged will be declared valid, and that all or a significant portion of its claims will be upheld.

#### **Notices of Opposition to European Patent No. 1449238**

On March 8, 2007, Sumation Company Limited (“Sumation”), a joint venture between Sumitomo Chemical Company and CDT, filed a first Notice of Opposition to European Patent No. 1449238 (the “EP ‘238 patent”). The EP ‘238 patent, which was issued on November 2, 2006, is a European counterpart patent, in part, to U.S. patents 6,830,828, 6,902,830 and 7,001,536, and to pending U.S. patent application 11/233,605, filed on September 22, 2005. These patents and patent application relate to our PHOLED technology. They are exclusively licensed to us by Princeton, and under the license agreement we are required to pay all legal costs and fees associated with this proceeding.

Two other parties filed additional oppositions to the EP '238 patent just prior to the August 2, 2007 expiration date for such filings. On July 24, 2007, Merck Patent GmbH, of Darmstadt, Germany, filed a second Notice of Opposition to the EP '238 patent, and on July 27, 2007, BASF Aktiengesellschaft, of Mannheim, Germany, filed a third Notice of Opposition to the EP '238 patent.

The EPO set a January 6, 2008 due date for us to file our responses to the three oppositions. We are in the process of reviewing each Notice of Opposition and preparing our response to each. There is considerable overlap in the prior art evidence relied upon in each opposition. The three oppositions will be handled in a single proceeding. At this time, we cannot make any prediction as to the probable outcome of the oppositions. However, based on a preliminary analysis of the evidence presented, we believe there is a substantial likelihood that the patent being challenged will be declared valid, and that all or a significant portion of its claims will be upheld.

## ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors previously discussed in Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2006, as supplemented by our Quarterly Report on Form 10-Q for the quarters ended March 31 and June 30, 2007.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the quarter ended September 30, 2007, we issued an aggregate of 159,722 unregistered shares of our common stock. All of these shares were issued upon the exercise of outstanding warrants. The warrants had a weighted average exercise price of \$10.28 per share. All of the shares were issued in reliance on the exemption from registration contained in Section 4(2) of the Securities Act of 1933, as amended.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

## ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

The following is a list of the exhibits included as part of this report. Where so indicated by footnote, exhibits that were previously included are incorporated by reference. For exhibits incorporated by reference, the location of the exhibit in the previous filing is indicated parenthetically, together with a reference to the filing indicated by footnote.

<b>Exhibit Number</b>	<b>Description</b>
31.1*	Certifications of Sherwin I. Seligsohn, Chief Executive Officer, as required by Rule 13a-14(a) or Rule 15d-14(a)
31.2*	Certifications of Sidney D. Rosenblatt, Chief Financial Officer, as required by Rule 13a-14(a) or Rule 15d-14(a)
32.1**	Certifications of Sherwin I. Seligsohn, Chief Executive Officer, as required by Rule 13a-14(b) or Rule 15d-14(b), and by 18 U.S.C. Section 1350. (This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.)
32.2**	

Certifications of Sidney D. Rosenblatt, Chief Financial Officer, as required by Rule 13a-14(b) or Rule 15d-14(b), and by 18 U.S.C. Section 1350. (This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Further, this exhibit shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.)

- \* Filed herewith.
- \*\* Furnished herewith.

Note: Any of the exhibits listed in the foregoing index not included with this report may be obtained, without charge, by writing to Mr. Sidney D. Rosenblatt, Corporate Secretary, Universal Display Corporation, 375 Phillips Boulevard, Ewing, New Jersey 08618.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**UNIVERSAL DISPLAY CORPORATION**

Date: November 8, 2007

By: /s/ Sidney D.

Rosenblatt

Sidney D. Rosenblatt

Executive Vice President and Chief Financial Officer