

LIQUIDMETAL TECHNOLOGIES INC  
Form S-1/A  
July 20, 2006

As filed with the Securities and Exchange Commission on July 20, 2006

Registration No. 333-130251

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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Amendment No. 2 to

## FORM S-1

REGISTRATION STATEMENT

Under

THE SECURITIES ACT OF 1933

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## LIQUIDMETAL TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

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

**3399**  
(Primary Standard Industrial Classification Code  
Number)

**33-0264467**  
(I.R.S. Employer  
Identification No.)

**Liquidmetal Technologies, Inc.**

**25800 Commercentre Drive, Suite 100**

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**Lake Forest, California 92630**

**(949) 206-8000**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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**Ricardo A. Salas**

**President and Chief Executive Officer**

**Liquidmetal Technologies, Inc.**

**25800 Commercentre Drive, Suite 100**

**Lake Forest, California 92630**

**Phone: (949) 206-8000**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

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with a copy to:

**Curt P. Creely**

**Foley & Lardner LLP**

**100 North Tampa Street, Suite 2700**

**Tampa, Florida 33602**

**Phone: (813) 229-2300/Fax: (813) 221-4210**

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**Approximate date of commencement of proposed sale to the public:** From time to time after the effective date of this Registration Statement, as determined by the selling stockholders.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box.

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If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

### CALCULATION OF REGISTRATION FEE

| Title of Each Class of Securities to Be Registered   | Amount to Be Registered      | Proposed Maximum Offering Price Per Share | Proposed Maximum Aggregate Offering Price(5) | Amount of Registration Fee |
|--|------------------------------|---|--|----------------------------|
| Common Stock issuable upon conversion of 6% Senior Secured Notes Due July 2007               | 2,356,002 shares             | \$ 1.18(1)                                | \$ 2,780,083                                 | \$ 298                     |
| Common Stock issuable upon conversion of 7% Senior Secured Convertible Notes Due August 2007 | 4,938,936 shares             | \$ 2.00(2)                                | \$ 9,877,872                                 | \$ 1,057                   |
| Common Stock issuable upon exercise of warrants  | 3,943,039 shares             | \$ 2.00(3)                                | \$ 7,886,078                                 | \$ 844                     |
| Common Stock issuable upon exercise of non-qualified stock options                           | 376,345 shares               | \$ 1.18(1)                                | \$ 444,088                                   | \$ 48                      |
| <b>TOTAL</b>   | <b>11,614,322 shares (4)</b> | <b>\$</b>                                 | <b>20,988,121</b>                            | <b>\$ 2,247(6)</b>         |

(1) The price is estimated, solely for the purpose of calculating the registration fee, in accordance with Rules 457(g) and 457(c) under the Securities Act, based on the average of the high and low prices of the Registrant's Common Stock as of December 6, 2005 on the OTC Bulletin Board.

(2) The price is estimated in accordance with Rule 457(g) under the Securities Act, solely for the purpose of calculating the registration fee and is \$2.00, the conversion price of the 7% Senior Secured Convertible Notes Due August 2007.

(3) The price is estimated in accordance with Rule 457(g) under the Securities Act, solely for the purpose of calculating the registration fee and is \$2.00, the exercise price of the warrants issued in June 2005 and August 2005.

(4) Pursuant to Rule 416 under the Securities Act, this registration statement also covers such number of additional shares of common stock to prevent dilution resulting from stock splits, stock dividends, or similar transactions.

(5) Estimated solely for calculating the registration fee pursuant to Rule 457(a).

(6) Previously paid.

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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**PROSPECTUS**

**LIQUIDMETAL TECHNOLOGIES, INC.**

**11,614,322 Shares**

**Common Stock**

This prospectus covers a total aggregate of up to 11,614,322 shares of our common stock, par value \$.001 per share, that may be offered from time to time by the selling stockholders identified on pages 22-27 of this prospectus. The shares being offered by this prospectus consist of:

up to 2,356,002 shares issuable upon the conversion of principal and accrued but unpaid interest under our 6% Senior Secured Notes Due July 2007;

up to 4,938,936 shares issuable upon the conversion of principal and accrued but unpaid interest under our 7% Senior Secured Convertible Notes Due August 2007;

up to 3,943,039 shares issuable upon the exercise of common stock purchase warrants issued by us in connection with previous private placements; and

up to 376,345 shares issuable upon the exercise of a non-qualified stock option agreement granted to one individual.

This prospectus also covers such number of additional shares of common stock to prevent dilution resulting from stock splits, stock dividends, or similar transactions.

We are registering these shares of our common stock for resale by the selling stockholders named in this prospectus, or their transferees, pledgees, donees or successors. We will not receive any proceeds from the sale of these shares by the selling stockholders. These shares are being registered to permit the selling stockholders to sell shares from time to time in the public market, in amounts, at prices and on terms determined at the time of offering. The selling stockholders may sell this common stock through ordinary brokerage transactions, directly to market makers of our shares or through any other means described in the section entitled "Plan of Distribution" beginning on page 85.

**Before purchasing any of the shares covered by this prospectus, carefully read and consider the risk factors in the section entitled Risk Factors beginning on page 7.**

Our common stock is quoted on the OTC Bulletin Board under the symbol LQMT.OB. On July 13, 2006, the last reported sales price of our common stock was \$1.90 per share.

Our principal executive offices are located at 25800 Commercentre Drive, Suite 100, Lake Forest, California 92630, and our telephone number at that address is (949) 206-8000.

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**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved the sale of this common stock or determined that the information in this prospectus is accurate and complete. Any representation to the contrary is a criminal offense.**

The date of this prospectus is July 20, 2006.

The information in this prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

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This prospectus is a part of the registration statement that we filed with the Securities and Exchange Commission. The selling stockholders named in this prospectus may from time to time sell the securities described in this prospectus.

**You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. The common stock is not being offered in any jurisdiction where the offer is not permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or any sale of the common stock.**

## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

We have registered the following trademark, which is used in this prospectus: Liquidmetal. In this prospectus, we use the terms company, we, us and our to refer to Liquidmetal Technologies, Inc. In this prospectus Liquidmetal or Liquidmetal Technologies refer to Liquidmetal Technologies, Inc.

**PROSPECTUS SUMMARY**



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*This summary highlights information contained elsewhere in this prospectus. Because this is a summary, it is not complete and does not contain all of the information that may be important to you. For a more complete understanding of us and this offering of our common stock, we encourage you to read this prospectus in its entirety, especially the risks of investing in our common stock discussed under Risk Factors and our consolidated financial statements, including the notes thereto, appearing elsewhere in this prospectus.*

### **Liquidmetal Technologies, Inc.**

We are a materials technology company that develops and commercializes products made from amorphous alloys. Our Liquidmetal® family of alloys consists of a variety of proprietary coatings, powders, bulk alloys, and composites that utilize the advantages offered by amorphous alloy technology. We develop, manufacture, and sell products and components from bulk amorphous alloys to customers in various industries, and we also partner with third-party licensees such as Rawlings, Head, SAGA and Socket Communications and distributors such as Matech and LLPG to develop and commercialize bulk Liquidmetal alloy products. We believe that our proprietary bulk alloys are the only commercially viable bulk amorphous alloys currently available in the marketplace. In addition to our bulk alloys, we market and sell a line of proprietary amorphous alloy-based industrial coatings under the Liquidmetal® Armacor™ coatings brand.

Amorphous alloys are unique materials that are distinguished by their ability to retain a random atomic structure when they solidify, in contrast to the crystalline atomic structure that forms in other metals and alloys when they solidify. Liquidmetal alloys possess a combination of performance, processing, and potential cost advantages that we believe will make them preferable to other materials in a variety of applications. The amorphous atomic structure of our alloys enables them to overcome certain performance limitations caused by inherent weaknesses in crystalline atomic structures, thus facilitating performance and processing characteristics superior in many ways to those of their crystalline counterparts. For example, our zirconium-titanium Liquidmetal alloys are approximately 250% stronger than commonly used titanium alloys such as Ti-6Al-4V, but they also have some of the beneficial processing characteristics more commonly associated with plastics. We believe these advantages could result in Liquidmetal alloys supplanting high-performance alloys, such as titanium and stainless steel, and other incumbent materials in a wide variety of applications. Moreover, we believe these advantages could enable the introduction of entirely new products and applications that are not possible or commercially viable with other materials.

### **Our Strategy**



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Our goal is to develop and commercialize a wide variety of products made from Liquidmetal alloys. The key elements of our strategy include:

Identifying and developing new applications for our Liquidmetal alloy technology;

Focusing our marketing and internal manufacturing activities on select products with expected higher gross margins;

Further developing our manufacturing processes, capabilities, and efficiencies for bulk Liquidmetal alloy;

Pursuing strategic partnerships in order to more rapidly develop and commercialize products; and

Advancing and further developing the Liquidmetal® brand to increase awareness of our company and technology.

### **Applications for Liquidmetal Alloys**

We have focused our commercialization efforts for Liquidmetal alloys on five identified product areas. We believe that these areas are consistent with our strategy in terms of market size, building brand recognition, and providing an opportunity to develop and refine our processing capabilities. Although we believe that strategic partnering transactions could create valuable opportunities beyond the parameters of these target markets, we anticipate continuing to pursue these markets both internally and in conjunction with partners.

*Components for electronic products.* We produce components for electronic devices using our bulk Liquidmetal alloys and believe that our alloys offer enhanced performance and design benefits for these components in certain applications. Specifically, we currently produce internal hinge housings for certain Samsung cellular phone models and casings for certain SanDisk flash memory drives.

*Sporting goods and leisure products.* We are developing a variety of applications for Liquidmetal alloys in the sporting goods and leisure products area. In 2003, Rawlings Sporting Goods Company launched a new line of baseball and softball bats that utilize a Liquidmetal alloy coating, and HEAD NV Sport launched a new line of HEAD® Liquidmetal® tennis racquets that incorporates Liquidmetal alloy in composite form in their racquet design. In 2005, we also launched goods that utilize Liquidmetal alloy including skis. Other potential applications for our alloys in this industry include golf clubs, eyewear, fishing, hunting, and other sport products.

*Medical devices.* We are engaged in product development efforts relating to various medical devices that could be made from Liquidmetal alloys. We believe that the unique properties of bulk Liquidmetal alloys provide a combination of performance and cost benefits that could make them a desirable replacement to incumbent materials, such as stainless steel and titanium, currently used in various medical device applications.

*Industrial coatings and powders.* We continue to market and sell amorphous alloy industrial coatings and powders under the Liquidmetal® Armacor™ coatings brand name. Liquidmetal alloy coatings are used primarily as a protective coating for industrial machinery and equipment.

*Defense applications.* We are working with the U.S. Department of Defense, as well as a variety of defense-related research and development agencies and large defense contractors, to develop various defense-related applications for Liquidmetal alloys. For example, we are currently developing prototype kinetic energy penetrator rods for use in armor-piercing ammunition systems.

**Risk Factors / Going Concern**





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We are subject to a number of risks that you should be aware of before you decide to buy our common stock. These risks are discussed more fully in the **RISK FACTORS** section of this prospectus.

We have experienced significant operating losses since our inception. Our net loss for the fiscal years ended December 31, 2005 and 2004 was \$7.1 million and \$14.9 million, respectively, and \$6.0 million and \$3.3 million for the three months ended March 31, 2006 and 2005, respectively. In the audit report on our financial statements for our fiscal years ended December 31, 2005 and 2004, our auditors included a going-concern qualification indicating that our significant operating losses and working capital deficit cause substantial doubt about our ability to continue as a going concern. By issuing an opinion stating that there is substantial doubt about our ability to continue as a going concern, our auditors have indicated that they are uncertain as to whether we have the capability to continue our operations without additional funding. Accordingly, we anticipate that we will need additional funding during the next 12 months, and we plan to seek to raise such funds through public or private equity financing, bank debt financing, or from other sources. Specifically, we anticipate that we could need \$1 million to \$5 million over the next twelve months to pursue our current operating plan, although this amount may be lower depending on the orders we receive for our products. The amount of funding that we plan to seek and the timing of such fundraising efforts will depend on the extent to which we are able to increase revenues through obtaining additional purchase orders for our products, particularly components for cellular phones and flash memory drive casings, and our ability to continue to improve our manufacturing processes. However, adequate funds may not be available when needed, and if we raise additional funds by issuing equity securities, existing stockholders may be diluted. If we don't receive sufficient funding to operate under our current plan, we intend to reduce operations and expenses and shift our focus to the pursuit of licensing transactions and other strategic transactions that are less capital intensive.

### **Corporate Information**



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We were originally incorporated in California in 1987, and we reincorporated in Delaware in May 2003. Our principal executive offices are located at 25800 Commercentre Dr., Suite 100, Lake Forest, California 92630. Our telephone number at that address is (949) 206-8000. Our Internet website address is [www.liquidmetal.com](http://www.liquidmetal.com) and all of our filings with the Securities and Exchange Commission are available free of charge on our website. Any information that is included on or linked to our Internet site is not a part of this prospectus.

**The Offering**

|                                       |  |
|---------------------------------------|--|
| Common stock offered                  | <p>Up to 11,614,322 shares are being offered by the selling stockholders. Of these shares:</p> <p style="padding-left: 40px;">up to 2,356,002 shares are issuable to various selling stockholders upon the conversion of principal and accrued but unpaid interest under our 6% Senior Secured Notes Due July 2007 (the July 2007 Notes ), which notes were issued by us to such selling stockholders on July 29, 2004;</p> <p style="padding-left: 40px;">up to 4,938,936 shares are issuable to various selling stockholders upon the conversion of principal and accrued but unpaid interest under our 7% Senior Secured Convertible Notes Due August 2007 (the August 2007 Notes ), which notes were issued by us to such selling stockholders on August 2, 2005;</p> <p style="padding-left: 40px;">up to 165,324 shares are issuable to various selling stockholders upon the exercise of outstanding common stock purchase warrants issued by us on March 1, 2004 and having an adjusted exercise price of \$2.72 per share;</p> <p style="padding-left: 40px;">up to 893,750 shares are issuable to various selling stockholders upon the exercise of outstanding common stock purchase warrants issued by us on June 13, 2005 and having an exercise price of \$2.00 per share;</p> <p style="padding-left: 40px;">up to 2,883,965 shares are issuable to various selling stockholders upon the exercise of outstanding common stock purchase warrants issued by us on August 2, 2005 and having an exercise price of \$2.00 per share; and</p> <p style="padding-left: 40px;">up to 376,345 shares are issuable to one individual upon the exercise of an outstanding non-qualified stock option agreement issued by us on January 1, 2001 and having an exercise price of \$1.16 per share.</p> |
| Shares outstanding after the offering | 55,699,340 shares  |
| Use of proceeds                       | We will not receive any proceeds from the sale of the shares offered by the selling stockholders. Any proceeds we receive from the selling stockholders upon their exercise of the warrants or option to purchase the shares included in the shares that are being offered by them hereunder will be used for general working capital.   |
| Risk factors                          | See RISK FACTORS and other information included in this prospectus for a discussion of factors you should carefully consider before deciding to invest in the shares.  |
| OTC Bulletin Board symbol             | LQMT.OB  |

The number of shares of common stock that will be outstanding immediately after this offering is based on 44,085,018 shares outstanding as of July 3, 2006 and assumes the full conversion of the convertible promissory notes and the full exercise of the warrants and option identified above. There is no guarantee that all or any of such notes, warrants, or option will be converted or exercised. The number of shares of common stock to be outstanding after this offering does not include 8,483,223 shares issuable pursuant to common stock options outstanding as of July 3, 2006 under our equity incentive plans, of which options to purchase 6,238,040 shares were exercisable as of such date at a weighted-average exercise price of \$4.94 per share, and 7,995,550 additional shares of common stock reserved for future grants under our equity compensation

plans.

The convertible notes identified above are convertible into such number of shares of our common stock as is determined by dividing the outstanding principal balance of such notes plus any accrued but unpaid interest by the conversion price then in effect. As of July 3, 2006, approximately \$2.3 million in aggregate principal amount of July 2007 Notes were outstanding at a conversion price of \$1.00 per share, and approximately \$9.9 million in aggregate principal amount of August 2007 Notes were outstanding at a conversion price of \$2.00 per share. The warrants and option identified above are exercisable at the price per share indicated above. However, the above-described notes and warrants contain anti-dilution provisions that may result in a reduction of these conversion and exercise prices if we issue shares in the future for consideration below the existing conversion or exercise prices. Such anti-dilution provisions may cause a decrease in the voting power and value of your investment in our shares. See DESCRIPTION OF CAPITAL STOCK Anti-Dilution Provisions in Notes and Warrants.

In this prospectus, unless otherwise stated or the context otherwise requires, references to Liquidmetal, we, us, our, our company, the Company, and similar references refer to Liquidmetal Technologies, Inc. and its subsidiaries.

**Summary Consolidated Financial Data**

The following summary consolidated financial data as of and for our years ended December 31, 2005, 2004, 2003, 2002 and 2001 have been derived from our audited consolidated financial statements. The following summary consolidated financial data as of and for the three months ended March 31, 2006 and 2005 have been derived from our unaudited consolidated financial statements included elsewhere in this prospectus. Such unaudited interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( generally accepted accounting principles ). Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for any future periods or the year ending December 31, 2006. In the opinion of management, all adjustments (consisting of only of normal recurring accruals) considered necessary for a fair presentation have been included. The following information should be read together with MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS and our Consolidated Financial Statements and Notes thereto included elsewhere in this prospectus. The historical results presented below are not necessarily indicative of future results. The summary consolidated financial data should be read in conjunction with restatement footnote 2 in the notes to the fiscal year 2005 consolidated financial statements included in the INDEX TO THE FINANCIAL STATEMENTS of this prospectus and in the fiscal 2003 annual report on Form 10-K filed on November 10, 2004, which reflects the restatements of prior year transactions.



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|   | Three Months<br>Ended March 31, |            | Years Ended December 31, |             | Years Ended December 31, |             | Years Ended December 31, |            |
|---|---------------------------------|------------|--------------------------|-------------|--------------------------|-------------|--------------------------|------------|
|   | 2006                            | 2005       | 2005                     | 2004        | 2003                     | 2002        | 2001                     | 2001       |
|   | (Restated)                      | (Restated) | (Restated)               | (Restated)  | (Restated)               | (Restated)  | (Restated)               | (Restated) |
|   | (Unaudited)                     |            |                          |             |                          |             |                          |            |
| (In thousands, except per share data)   |                                 |            |                          |             |                          |             |                          |            |
| <b>Consolidated Statements Of Operation Data:</b>   |                                 |            |                          |             |                          |             |                          |            |
| Revenue   | \$ 6,555                        | \$ 2,843   | \$ 16,365                | \$ 17,429   | \$ 13,658                | \$ 9,138    | \$ 3,882                 |            |
| Cost of sales   | 5,324                           | 2,835      | 15,129                   | 12,168      | 18,162                   | 5,656       | 1,924                    |            |
| Gross profit  | 1,231                           | 8          | 1,236                    | 5,261       | (4,504)                  | 3,482       | 1,958                    |            |
| Operating expenses:   |                                 |            |                          |             |                          |             |                          |            |
| Selling, general, and administrative expenses   | 2,705                           | 2,590      | 8,534                    | 11,591      | 17,729                   | 13,099      | 5,239                    |            |
| Research and development expenses   | 203                             | 397        | 1,120                    | 1,467       | 8,780                    | 11,825      | 1,726                    |            |
| Impairment of Goodwill  |                                 |            |                          |             | 184                      |             |                          |            |
| Impairment of long lived assets   |                                 |            | 4,487                    |             | 2,684                    |             |                          |            |
| Total operating expenses  | 2,908                           | 2,987      | 14,141                   | 13,058      | 29,377                   | 24,924      | 6,965                    |            |
| Loss before interest, other income, income taxes, minority interest and discontinued operations | (1,677)                         | (2,979)    | (12,905)                 | (7,797)     | (33,881)                 | (21,442)    | (5,007)                  |            |
| Loss from extinguishments of debt   |                                 |            | (1,247)                  | (2,941)     |                          |             |                          |            |
| Change in value of warrants, (loss) gain  | (1,289)                         | 133        | 3,985                    | 747         |                          |             |                          |            |
| Change in value of conversion feature, (loss) gain  | (1,783)                         | 1,115      | 9,118                    | 2,093       |                          |             |                          |            |
| Other income  | 480                             |            | 302                      |             |                          |             |                          |            |
| Interest expense  | (1,782)                         | (1,537)    | (6,021)                  | (6,577)     | (390)                    | (1,109)     | (1,103)                  |            |
| Interest income   | 2                               | 6          | 17                       | 37          | 304                      | 506         | 8                        |            |
| Gain on sale of marketable securities held for sale   |                                 |            |                          |             | 1,178                    | 832         |                          |            |
| Loss before minority interest and discontinued operations                                       | (6,049)                         | (3,262)    | (7,053)                  | (14,136)    | (32,789)                 | (21,213)    | (6,102)                  |            |
| Minority interest in loss of consolidated subsidiary  |                                 |            |                          |             | 21                       | 118         |                          |            |
| Loss from continuing operations   | (6,049)                         | (3,262)    | (7,053)                  | (14,136)    | (32,768)                 | (21,095)    | (6,102)                  |            |
| Discontinued Operations:  |                                 |            |                          |             |                          |             |                          |            |
| Income (loss) from discontinued operations, net   |                                 |            |                          | (749)       | (964)                    | 83          | (5,973)                  |            |
| Gain (loss) from disposal of discontinued operations, net                                       |                                 |            |                          |             | 127                      | 1,556       | (11,949)                 |            |
| Net loss  | \$ (6,049)                      | \$ (3,262) | \$ (7,053)               | \$ (14,885) | \$ (33,605)              | \$ (19,456) | \$ (24,024)              |            |
| Loss per share from continuing operations   | \$ (0.14)                       | \$ (0.08)  | \$ (0.17)                | \$ (0.34)   | \$ (0.79)                | \$ (0.54)   | \$ (0.18)                |            |
| Gain (Loss) per share from discontinued operations  | \$                              | \$         | \$                       | \$ (0.02)   | \$ (0.02)                | \$ 0.04     | \$ (0.54)                |            |
| Net loss per share  | \$ (0.14)                       | \$ (0.08)  | \$ (0.17)                | \$ (0.36)   | \$ (0.81)                | \$ (0.50)   | \$ (0.72)                |            |
| Weighted average shares - basic and diluted   | 42,817                          | 41,610     | 41,833                   | 41,610      | 41,505                   | 38,714      | 33,323                   |            |

As of March 31, 2006  
(Restated)

(Unaudited)  
(In thousands)

**Consolidated Balance Sheet Data:**

|  |    |          |
|--|----|----------|
| Cash and cash equivalents  | \$ | 1,263    |
| Working deficit  |    | (11,986) |
| Total assets   |    | 22,336   |
| Long-term obligations, including current portion, net of discount of \$7,004 |    | 7,750    |
| Stockholders deficit   |    | (3,494)  |



**RISK FACTORS**



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*An investment in our common stock involves risk. You should carefully consider the risks we describe below before deciding to invest in our common stock. The market price of our common stock could decline due to any of these risks, in which case you could lose all or part of your investment. In assessing these risks, you should also refer to the other information included in this prospectus, including our consolidated financial statements, including the notes thereto, and appearing elsewhere in this prospectus. This discussion contains forward-looking statements. See *Forward-Looking Statements* for a discussion of uncertainties, risks and assumptions associated with these statements.*

### **We have incurred significant operating losses in the past and may not be able to achieve or sustain profitability in the future.**

We have experienced significant operating losses since our inception. Our net loss for the fiscal years ended December 31, 2005, 2004, and 2003 was \$7.1 million, \$14.9 million and \$33.6 million, respectively, and our net loss for the three months ended March 31, 2006 and 2005 was \$6.0 million and \$3.3 million, respectively. We had an accumulated deficit of approximately \$140.6 million at March 31, 2006. Of this accumulated deficit, \$44.5 million was attributable to losses generated by our discontinued equipment manufacturing and retail golf businesses through March 31, 2006. We anticipate that we may continue to incur operating losses for the foreseeable future. Consequently, it is possible that we may never achieve positive earnings and, if we do achieve positive earnings, we may not be able to achieve them on a sustainable basis.

### **We may require additional funding, which may not be available on favorable terms or at all.**

Our future capital requirements will depend on the amount of cash generated by our operations. Our projections of cash flows from operations and, consequently, future cash needs are subject to substantial uncertainty. In addition, in our audit report on our financial statements for our fiscal years ended December 31, 2005 and 2004, our auditors included a going-concern qualification indicating that our significant operating losses and working capital deficit cause substantial doubt about our ability to continue as a going concern. By issuing an opinion stating that there is substantial doubt about our ability to continue as a going concern, our auditors have indicated that they are uncertain as to whether we have the capability to continue our operations without additional funding. Accordingly, we anticipate that we will need additional funding during the next 12 months, and we plan to seek to raise such funds through public or private equity financing, bank debt financing, or from other sources. Specifically, we anticipate that we could need \$1 million to \$5 million over the next twelve months to pursue our current operating plan, although this amount may be lower depending on the orders we receive for our products. The amount of funding that we plan to seek and the timing of such fundraising efforts will depend on the extent to which we are able to increase revenues through obtaining additional purchase orders for our products, particularly components for cellular phones and flash memory drive casings, and our ability to continue to improve our manufacturing processes. However, adequate funds may not be available when needed, and if we raise additional funds by issuing equity securities, existing stockholders may be diluted. In addition, if shares of our common stock or securities convertible into or exercisable for our common stock are issued in consideration of such funds at an effective per share price lower than the conversion and exercise prices of our currently outstanding convertible notes and warrants, then anti-dilution provisions in such convertible notes and warrants would be triggered, thus possibly causing even greater dilution to our then-existing stockholders if the notes are converted or the warrants are exercised. See **RISK FACTORS** Our convertible notes and warrants contain anti-dilution provisions that, if triggered, could cause substantial dilution to our then-existing stockholders.

### **We have a limited history of developing, manufacturing, and selling products made from our bulk amorphous alloys.**

We have marketed and sold industrial coatings to distributors in the coatings industry since 1987. Prior to the third quarter of 2002, our experience selling products made from bulk amorphous alloys has been limited to our discontinued retail golf business, which had a different marketing strategy than the one we are currently employing. Therefore, we have a relatively limited history of producing bulk amorphous alloy components and products on a mass-production basis. Furthermore, our ability to produce our products in desired quantities and at commercially reasonable prices is uncertain and is dependent on a variety of factors that are outside of our control, including the nature and design of the component, the customer's specifications, and required delivery timelines.



**We rely on assumptions about the markets for our products and components that, if incorrect, may adversely affect our profitability.**

We have a relatively short history producing bulk amorphous alloy components on a mass-production basis. We have made assumptions regarding the market size for, and the manufacturing requirements of, our products and components based in part on information we received from third parties and also from our limited history. If these assumptions prove to be incorrect, we may not achieve anticipated revenue targets or profitability.

**If we cannot establish and maintain relationships with customers that incorporate our components and products into their finished goods, we will not be able to increase our revenue and commercialize our products.**

Our business is based upon the commercialization of a new and unique materials technology. Our ability to increase our revenues will depend on our ability to successfully maintain and establish relationships with customers who are willing to incorporate our proprietary alloys and technology into their finished products. However, we believe that the size of our company and the newness of our technology and manufacturing process may continue to make it challenging to maintain and establish such relationships. In addition, we rely and will continue to rely to a large extent on the manufacturing, research, and development capabilities, as well as the marketing and distribution capabilities, of our customers in order to commercialize our products. Our future growth and success will depend in large part on our ability to enter into these relationships and the subsequent success of these relationships. If our products are selected for use in a customer's products, we still may not realize significant revenue from that customer if that customer's products are not commercially successful.

**It may take significant time and cost for us to develop new customer relationships, which may delay our ability to generate additional revenue or achieve profitability.**

Our ability to generate revenue from new customers is generally affected by the amount of time it takes for us to, among other things:

identify a potential customer and introduce the customer to Liquidmetal alloys;

work with the customer to select and design the parts to be fabricated from Liquidmetal alloys;

make the molds and tooling to be used to produce the selected part;

make prototypes and samples for customer testing;

work with our customers to test and analyze prototypes and samples; and



with respect to some types of products, such as medical devices, to obtain regulatory approval.

We currently do not have a sufficient history of selling products made from our bulk amorphous alloys to predict accurately the length of our average sales cycle. We believe that our average sales cycle from the time we deliver an active proposal to a customer until the time our customer fully integrates our bulk amorphous alloys into its product could be a significant period of time. Our history to date has demonstrated that the sales cycle could extend significantly longer than we anticipate. The time it takes to transition a customer from limited production to full-scale production runs will depend upon the nature of the processes and products into which our alloys are integrated. Moreover, we have found that customers often proceed very cautiously and slowly before incorporating a fundamentally new and unique type of material into their products.

**After we develop a customer relationship, it may take a significant amount of time for that customer to develop, manufacture, and sell finished goods that incorporate our components and products.**

Our experience has shown that our customers will perform numerous tests and extensively evaluate our components and products before incorporating them into their finished products. The time required for testing, evaluating, and designing our components and products into a customer's products, and in some cases, obtaining regulatory approval,

can take a significant amount of time, with an additional period of time before a customer commences volume production of products incorporating our components and products, if ever. Moreover, because of this lengthy development cycle, we may experience a delay between the time we accrue expenses for research and development and sales and marketing efforts and the time when we generate revenue, if any. We may incur substantial costs in an attempt to transition a customer from initial testing to prototype and from prototype to final product. If we are unable to minimize these transition costs, or to recover the costs of these transitions from our customers, our operating results will be adversely affected.

**A limited number of our customers generate a significant portion of our revenue.**

For the near future, we expect that a significant portion of our revenue will be concentrated in a limited number of customers. For example, for the three months ended March 31, 2006, revenues from one customer Samsung, represented approximately 13% of total revenues from operations, and for the year ended December 31, 2005, revenues from one customer, Samsung, represented approximately 10% of total revenue from continuing operations, and for the year ended December 31, 2004, revenue from two customers represented approximately 62% of total revenue from continuing operations, and for the year ended December 31, 2003, revenue from two customers represented approximately 26% of total revenue from continuing operations. Revenues from direct suppliers to Samsung represented approximately 14% and 62% of total revenues from continuing operations for the year ended December 31, 2005 and 2004, respectively. Revenues from direct suppliers to Samsung for the three months ended March 31, 2006 was less than 10% of total revenues. Also, revenues from defense related contracts with the United States of America represented 10%, and Growell Metal represented 12%, of revenue from continuing operations for the year ended 2004. A reduction, delay, or cancellation of orders from one or more of these customers or the loss of one or more customer relationships could significantly reduce our revenue. Unless we establish long-term sales arrangements with these customers, they will have the ability to reduce or discontinue their purchases of our products on short notice.

**We expect to rely on our customers to market and sell finished goods that incorporate our products and components, a process over which we will have little control.**

Our future revenue growth and ultimate profitability will depend in part on the ability of our customers to successfully market and sell their finished goods that incorporate our products. We will have little control over our customers' marketing and sales efforts. These marketing and sales efforts may be unsuccessful for various reasons, any of which could hinder our ability to increase revenue or achieve profitability. For example, our customers may not have or devote sufficient resources to develop, market, and sell their finished goods that incorporate our products. Because we typically will not have exclusive sales arrangements with our customers, they will not be precluded from exploring and adopting competing technologies. Also, products incorporating competing technologies may be more successful for reasons unrelated to the performance of our customers' products or the marketing efforts of our customers.

**Our growth depends on our ability to identify, develop, and commercialize new applications for our technology.**

Our future growth and success will depend in part on our ability to identify, develop, and commercialize, either alone or in conjunction with our customers, new applications and uses for Liquidmetal alloys. If we are unable to identify and develop new applications, we may be unable to develop new products or generate additional revenue. Successful development of new applications for our products may require additional investment, including costs associated with research and development and the identification of new customers. In addition, difficulties in developing and achieving market acceptance of new products would harm our business.

**We may not be able to effectively compete with current suppliers of incumbent materials or producers of competing products.**

The future growth and success of our bulk amorphous alloy business will depend in part on our ability to establish and retain a technological advantage over other materials for our targeted applications. For many of our targeted applications, we will compete with manufacturers of similar products that use different materials. These different materials may include plastics, titanium alloys, or stainless steel, among others. For example, we have targeted the cellular phone component market as an application for bulk Liquidmetal alloys. In this market, we believe we will compete with other manufacturers of cellular phone components who use plastics or metal to construct their components. These other manufacturers may be able to manufacture their cellular phone components, particularly those made from plastics, at significantly less cost than our alloys. In other markets, we will compete directly with suppliers of the incumbent material.

In addition, in each of our targeted markets, our success will depend in part on the ability of our customers to compete successfully in their respective markets. Thus, even if we are successful in replacing an incumbent material in a finished product, we will remain subject to the risk that our customer will not compete successfully in its own market.

**Our bulk amorphous alloy technology is still at an early stage of commercialization relative to many other materials.**

Our bulk amorphous alloy technology is a relatively new technology as compared to many other material technologies, such as plastics and widely-used high-performance crystalline alloys. Historically, the successful commercialization of a new materials technology has required the persistent improvement and refining of the technology over a sometimes lengthy period of time. Accordingly, we believe that our Company's future success will be dependent on our ability to continue expanding and improving our technology platform by, among other things, constantly refining and improving our manufacturing processes, optimizing our existing amorphous alloy compositions for various applications, and developing and improving new bulk amorphous alloy compositions. Our failure to further expand our technology base could limit our growth opportunities and hamper our commercialization efforts.

**Future advances in materials science could render Liquidmetal alloys obsolete.**

Academic institutions and business enterprises frequently engage in the research and testing of new materials, including alloys and plastics. Advances in materials science could lead to new materials that have a more favorable combination of performance, processing, and cost characteristics than our alloys. The future development of any such new materials could render our alloys obsolete and unmarketable or may impair our ability to compete effectively.

**Our growth depends upon our ability to retain and attract a sufficient number of qualified employees.**

Our business is based upon the commercialization of a new and unique materials technology. Our future growth and success will depend in part on our ability to retain key members of our management and scientific staff, who are familiar with this technology and the potential applications and markets for it. For example, as a result of their experience and knowledge of our alloy technology, we believe that our future growth and success will depend in large part on the efforts of John Kang, our Chairman of the board of directors, and Dr. Atakan Peker, our Vice President of Technology. We do not have key man or similar insurance on any of these individuals. If we lose their services or the services of other key personnel, our financial results or business prospects may be harmed. Additionally, our future growth and success will depend in part on our ability to attract, train, and retain scientific engineering, manufacturing, sales, marketing, and management personnel. We cannot be certain that we will be able to attract and retain the personnel necessary to manage our operations effectively. Competition for experienced executives and scientists from numerous companies and academic and other research institutions may limit our ability to hire or retain personnel on acceptable terms. In addition, many of the companies with which we compete for experienced personnel have greater financial and other resources than we do. Moreover, the employment of non-citizens may be restricted by applicable immigration laws.

On December 15, 2005, an indictment naming as defendants ten former officers and directors of Medical Manager Corporation, including our Chairman, John Kang, was filed in the United States District Court for the District of South Carolina (Beaufort Division). Medical Manager Corporation was a publicly traded company in which Mr. Kang was formerly the President and Chief Executive Officer. Mr. Kang was charged in counts for conspiracy to commit securities fraud, conspiracy to commit mail fraud and conspiracy to launder money instruments relating to a series of acquisitions that were made by Medical Manager during the years 1996 through 2003, the accounting practices of Medical Manager during that time frame, and the filing of various financial statements during that time frame. Although the indictment is unrelated to Mr. Kang's service as a director and officer of our company, Mr. Kang resigned as our President and Chief Executive Officer on December 30, 2005;

however, he continues to serve as Chairman of the Board of our company and continues to work for the company on a full-time basis. Mr. Kang has pled not guilty to the indictment and plans to contest the charges vigorously. At this time, however, we cannot estimate the potential impact on our company, if any, that might result from these charges.

**We may not be able to successfully identify, consummate, or integrate strategic partnerships.**

As a part of our business strategy, we intend to pursue strategic partnering transactions that provide access to new technologies, products, markets, and manufacturing capabilities. These transactions could include licensing

agreements, joint ventures, or even business combinations. We believe that these transactions will be particularly important to our future growth and success due to the size and resources of our company and the newness of our technology. For example, we may determine that we may need to license our technology to a larger manufacturer in order to penetrate a particular market. In addition, we may pursue transactions that will give us access to new technologies that are useful in connection with the composition, processing, or application of Liquidmetal alloys. We may not be able to successfully identify any potential strategic partnerships. Even if we do identify one or more potentially beneficial strategic partnering, we may not be able to consummate these transactions on favorable terms or obtain the benefits we anticipate from such a transaction.

**We may encounter manufacturing problems or delays or may be unable to produce high-quality products at acceptable costs.**

We have relatively limited experience in manufacturing our products and may be required to manufacture a range of products in high volumes while ensuring high quality and consistency. Although we currently own and operate a 166,000 square feet and a 14,400 square feet manufacturing facilities in South Korea and China, respectively, we cannot guarantee that these facilities will be able to produce the intended products with production yields, quality controls, and production costs that provide us with acceptable margins or profitability or satisfy the requirements of our customers.

**We expect to derive a substantial portion of our revenue from sales outside the United States, and problems associated with international business operations could affect our ability to manufacture and sell our products.**

We expect that we will continue to manufacture a substantial portion of our initial bulk Liquidmetal alloy products in our South Korean facility and derive a material portion of our revenues from customers in South Korea. For our fiscal years ended December 31, 2005, 2004, and 2003, approximately 31%, 54%, and 34% of our revenues came from customers located in South Korea, respectively. For the three months ended March 31, 2006 and 2005, approximately 47% and 33% of our revenues came from customers located in South Korea, respectively. As a result, our manufacturing operations and financial results are subject to risks of political instability, including the risk of conflict between North Korea and South Korea and tensions between the United States and North Korea. In addition, we anticipate that the trend of foreign customers accounting for a significant portion of our total revenues may continue. Specifically, we expect to continue to derive a significant amount of revenue from sales to customers located in Asia. A downturn in the economies of Asian countries where our products will be sold, particularly South Korea's economy, could materially harm our business.

Consequently, our operations and revenue likely will be subject to a number of risks associated with foreign commerce, including:

staffing and managing our manufacturing facility located in South Korea and post-processing facility located in China;

product or material transportation delays or disruption, including the availability and costs of air and other transportation between our South Korean and Chinese facilities and the United States;

political and economic instability, including instability involving China and North Korea that may disrupt our operations in China and South Korea;

potentially adverse tax consequences, which may reduce the profitability of products manufactured overseas or sold to overseas customers;

burden of complying with complex foreign laws and treaties, which could limit our ability to conduct our business as contemplated in South Korea and China; and

trade protection laws, policies, and measures and other regulatory requirements affecting trade and investment that could adversely affect the profitability of our South Korean and Chinese Operations, including loss or modification of exemptions for taxes and tariffs.

Moreover, customers may sell finished goods that incorporate our components and products outside of the United States, which exposes us indirectly to additional foreign commerce risks.

**A substantial increase in the price or interruption in the supply of raw materials for our alloys could have an adverse effect on our profitability.**

Our proprietary alloy compositions are comprised of many elements, all of which are available commodity products. Although we believe that each of these raw materials is currently readily available in sufficient quantities from multiple sources on commercially acceptable terms, if the prices of these materials substantially increases or there is an interruption in the supply of these materials, such increase or interruption could adversely affect our profitability. For example, if the price of one of the elements included in our alloys substantially increases, we may not be able to pass the price increase on to our customers.

**Our business is subject to the potential adverse consequences of exchange rate fluctuations.**

We expect to conduct business in various foreign currencies and will be exposed to market risk from changes in foreign currency exchange rates and interest rates. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on our business, results of operations, and financial condition and could specifically result in foreign exchange gains and losses. The impact of future exchange rate fluctuations on our operations cannot be accurately predicted. To the extent that the percentage of our non-U.S. dollar revenue derived from international sales increases in the future, our exposure to risks associated with fluctuations in foreign exchange rates will increase further. Moreover, as a result of operating a manufacturing facility in South Korea, a substantial portion of our costs are and will continue to be denominated in the South Korean won. Adverse changes in the exchange rates of the South Korean won to the U.S. dollar will affect our costs of goods sold and operating margins and could result in exchange losses. The average foreign exchange rates for the years ended December 31, 2005, 2004, and 2003 were 1,028, 1,151, and 1,195 South Korean Won to the U.S. dollar, respectively. The average foreign exchange rates for the three months ended March 31, 2006 and 2005 were 993 and 1,027 South Korean Won to the U.S. dollar, respectively. The fluctuations in the exchange rates resulted in foreign currency translation gains of \$0.3 million, \$1.7 million, and \$0.2 million for the years ended December 31, 2005, 2004, and 2003, respectively, and \$0.1 million and \$0.3 million for the three months ended March 31, 2006 and 2005, respectively.

**Our inability to protect our licenses, patents, and proprietary rights in the United States and foreign countries could harm our business because third parties may take advantage of our research and development efforts.**

We have an exclusive license from Caltech to several patents and patent applications relating to amorphous alloy technology, and we have obtained several of our own patents. We also have the exclusive right to Caltech's inventions, proprietary information, know-how, and other technology relating to bulk amorphous alloys existing as of September 1, 2001. Our success depends in part on our ability to obtain and maintain patent and other proprietary right protection for our technologies and products in the United States and other countries. If we are unable to obtain or maintain these protections, we may not be able to prevent third parties from using our proprietary rights. Specifically, we must:

protect and enforce our license agreement with Caltech and our own patents and intellectual property;



exploit our license of the patented technology under our license agreement with Caltech as well as our own patents; and

operate our business without infringing on the intellectual property rights of third parties.

Caltech owns several issued United States patents covering the composition and method of manufacturing of the family of Liquidmetal alloys. We also hold several United States and corresponding foreign patents covering the manufacturing processes of Liquidmetal alloys and their use. The patents relating to our coatings expire on various dates between 2005 and 2022, and those relating to our bulk amorphous alloys between 2013 and 2025. If we are unable to protect our proprietary rights prior to the expiration of these patents, we may lose the advantage we have established as being the first to market bulk amorphous alloy products. In addition, the laws of some foreign countries do not protect proprietary

rights to the same extent as the laws of the United States, and we may encounter significant problems and costs in protecting our proprietary rights in these foreign countries.

Patent law is still evolving relative to the scope and enforceability of claims in the fields in which we operate. Our patent protection involves complex legal and technical questions. Our patents and those patents for which we have license rights may be challenged, narrowed, invalidated, or circumvented. We may be able to protect our proprietary rights from infringement by third parties only to the extent that our proprietary technologies are covered by valid and enforceable patents or are effectively maintained as trade secrets. Furthermore, others may independently develop similar or alternative technologies or design around our patented technologies. Litigation or other proceedings to defend or enforce our intellectual property rights could require us to spend significant time and money and could otherwise adversely affect our business.

**Other companies may claim that we infringe their intellectual property rights, which could cause us to incur significant expenses or prevent us from selling our products.**

Our success depends, in part, on our ability to operate without infringing on valid, enforceable patents or proprietary rights of third parties and not breaching any licenses that may relate to our technology and products. Future patents issued to third parties may contain claims that conflict with our patents and that compete with our products and technologies, and third parties could assert infringement claims against us. Any litigation or interference proceedings, regardless of their outcome, may be costly and may require significant time and attention of our management and technical personnel. Litigation or interference proceedings could also force us to:

stop or delay using our technology;

stop or delay our customers from selling, manufacturing or using products that incorporate the challenged intellectual property;

pay damages; or

enter into licensing or royalty agreements that may be unavailable on acceptable terms.

**Our level of indebtedness reduces our financial flexibility and could impede our ability to operate.**

As of March 31, 2006, our long-term debt was \$14.8 million, including the current portion of such debt. Our long-term debt (including the current portion) includes the following:

\$2.6 million in principal outstanding under our Korean subsidiary's loan from Kookmin Bank of South Korea;

\$2.3 million in principal outstanding under convertible notes issued in our August 19, 2004 private exchange;  
and

\$9.9 million in principal outstanding under convertible notes issued in our August 2, 2005 private placement.

Under our loan from Kookmin Bank, we are obligated to make equal monthly payments of principal and interest of \$0.11 million each through the period ending in September 2007. Under our 6% Senior Secured Notes due July 2007 and 7% Senior Secured Notes due August 2007, we are required to make cash interest payments to the noteholders of \$0.22 million per quarter until such notes are converted or paid. Unless such notes are converted, the \$2.3 million in aggregate principal amount under our 6% Senior Secured Notes due July 2007 will become due in July 2007, provided that the holders of such notes may demand payment thereunder in July 2006. The \$9.9 million in aggregate principal amount under our 7% Senior Secured Notes due August 2007 will become due in August 2007.

As of March 31, 2006, our short-term debt was \$2.3 million. Our short-term debt includes the following:

\$1.3 million in outstanding advances received under a factoring, loan, and security agreement executed in April 2005 with a financing company; and

\$1.0 million in principal outstanding under unsecured subordinated promissory notes issued in a March 17, 2006 private placement.

Our level of debt affects our operations in several important ways, including the following:

a significant portion of our cash flow from operations is likely to be dedicated to the payment of the principal of and interest on our indebtedness;

we may be unable to refinance our indebtedness on terms acceptable to us or at all;

our cash flow may be insufficient to meet our required principal and interest payments; and

we may be unable to obtain additional loans as a result of covenants and agreements with existing debt holders.

In addition, our convertible notes and related documents contain restrictive covenants pursuant to which we generally may not (i) incur any indebtedness that would be senior to, or on the same rank as, the convertible notes with respect to payment or security, (ii) grant any liens or security interests in any of our assets which serve as collateral for the convertible notes (which collateral consists of substantially all of our assets), (iii) with certain exceptions, sell any of the assets that constitute collateral for the notes, (iv) become a guarantor for a third-party's obligation (other than guarantees in the ordinary course of business not in excess of \$0.5 million in the aggregate), (v) acquire any shares or securities of any other person or entity in excess of an aggregate of \$1.0 million over any rolling 12-month period, (vi) purchase or otherwise acquire any assets in excess of an aggregate of \$3.0 million over any rolling 12-month period, (vii) engage in any transaction resulting in the issuance to any person of more than 40% of the equity of our company, or (viii) engage in any merger or sale of all or substantially all of our business assets. These covenants may curtail our ability to raise capital in the future or otherwise restrict our ability to enter into a transaction that we believe would be in the best interest of our stockholders.

**If we default on the convertible notes that we have issued, the noteholders may accelerate the amounts due under such notes and may foreclose on the security interests that secure the notes.**

As of July 3, 2006, we had approximately \$12.2 million in principal amount of convertible notes outstanding. Approximately \$2.3 million in principal amount of convertible notes will become due in July 2007, with the balance becoming due in August 2007. Interest on our convertible notes is payable quarterly in cash. These notes are secured by substantially all of the assets of our company. We will be deemed to be in default under these notes if we fail to pay any principal or interest when it becomes due, and we will also be deemed to be in default if we breach any other material provision of our other agreements with the noteholders and we fail to cure such breach within thirty days of notice of default. Upon a default under these notes, the noteholders have the right to accelerate the maturity date of the notes and demand that they be immediately repaid by us. If we fail to pay such notes, either at maturity or upon acceleration, then the noteholders may elect to foreclose upon the assets securing the notes.

On May 12, 2006, we received a letter from one holder holding \$0.5 million of the August 2007 Notes demanding immediate payment of late filing fees and late registration fees for the period following October 31, 2005 through May 3, 2006. As a result of the late fee provisions of the restated registration rights agreement, we are obligated to pay late filing and late registration fees accrued through July 3, 2006 of up to \$1.4 million to all of the noteholders. In addition, the letter purported to constitute a notice of default under the August 2007 Notes and July 2007 Notes ( Notes ) as a result of our failure to pay the late filing and late registration fees. Under the terms of Notes, if a default is not cured by us within thirty (30) days of notice thereof, the holder has the right to accelerate all principal and interest due under the Notes. As of July 3, 2006, \$9.9 million in aggregate principal amount of August 2007 Notes was still outstanding with accrued but unpaid interest in the amount of approximately \$175 thousand. In addition, \$2.3 million in aggregate principal amount of July 2007 Notes was also outstanding with accrued but unpaid interest in the amount of approximately \$35 thousand. As of July 14, 2006, we have not paid any amounts under the demand letter and we are currently in negotiations with the holder regarding the matters set forth in the letter with the goal of preventing any acceleration of amounts due under the Notes.

**We have not complied with Section 404 of the Sarbanes-Oxley Act of 2002 for our fiscal years ended December 31, 2005 and 2004.**

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, or SOX, the SEC has adopted rules requiring a public company to include a report of management on the company's internal controls over financial reporting in its annual report on Form 10-K. In addition, the public accounting firm auditing a public company's financial statements must attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting. Although these requirements were first applicable to our annual report on Form 10-K for our fiscal year ended December 31, 2004, for the reasons described below, we were unable to comply with these requirements for our 2004 and 2005 fiscal years. As a result, investors may not be able to rely on our financial statements for the fiscal years ended December 31, 2004 and 2005.

Our inability to comply with the requirements of Section 404 of SOX for our 2004 fiscal year resulted primarily from a restatement of pre-2004 financial results that consumed substantially all of the time and resources of our finance staff during the second half of 2004. As a result of this restatement process, our Form 10-K for our 2003 fiscal year was not filed until November 2004, and our former auditor determined that it would not be possible to complete management's assessment of, and our auditor's audit of, our internal controls over financial reporting as of December 31, 2004. Accordingly, our former auditor issued a disclaimer of opinion with respect to our internal controls over financial reporting as of December 31, 2004, and such disclaimer of opinion was filed with our amended Form 10-K filed on May 10, 2005. Subsequently, our former auditor resigned in November 2005, and we did not engage our current auditor until January 20, 2006, and as a result, our current auditor was not able to conduct an audit of our internal controls over financial reporting as of December 31, 2005. Therefore, our current auditor issued a disclaimer of opinion with respect to our internal controls over financial reporting as of December 31, 2005, and such disclaimer of opinion was filed with our Form 10-K for our 2005 fiscal year.

The filing of these disclaimers does not comply with the SEC's rules and regulations under Section 404, and this noncompliance has resulted in us being in violation of Section 13(a) under the Securities Exchange Act of 1934. Section 13(a) establishes the general requirement that public companies must file with the SEC, in accordance with such rules and regulations as the SEC may prescribe, such information, documents, and reports as the SEC may from time to time require for the protection of investors, including Form 10-Ks and 10-Qs.

In general, the SEC has broad authority under the Securities Exchange Act of 1934 to institute investigations, to seek injunctions, to seek monetary penalties, and to otherwise pursue enforcement actions for violations of Section 13(a), including a failure to file a Form 10-K or for the omission of necessary statements in a Form 10-K. Therefore, a violation under Section 404 of SOX or Section 13(a) of the Securities Exchange Act of 1934 could potentially subject an issuer to these same investigations and penalties. Section 404 of SOX is a relatively new legal requirement, and there is very little precedent establishing the consequences or appropriate response to a public company's failure to comply with Section 404. Accordingly, although we have discussed our Section 404 noncompliance with the SEC, we cannot predict what action, if any, the SEC may take against our company as a result of a failure to be compliant with our obligations under Section 404 of SOX or Section 13(a) of the Securities Exchange Act of 1934.

Effective December 27, 2005, the SEC announced final rulings on revisions to accelerated filer definition and deadlines for periodic reports. The ruling revised the definition of the term "accelerated filer" to permit an accelerated filer that has voting and non-voting common equity held by non-affiliates of less than \$50 million to exit accelerated filer status at the end of the fiscal year in which its equity falls below \$50 million and to file its annual report for that year and subsequent periodic reports on a non-accelerated basis. As of the fiscal year ended December 31, 2005, we were still considered an accelerated filer and were required to comply with SOX 404 requirements for the 2005 fiscal year.

In addition to the foregoing, although our common stock was admitted to the OTC Bulletin Board for quotation on June 15, 2005, as a result of our noncompliance with Section 404 for our 2005 fiscal year, it may not have been appropriate for the OTC Bulletin Board to admit our common stock for quotation on June 15, 2005. Consequently, there is no assurance that our common stock will remain eligible for quotation on

the OTC Bulletin Board.

**We have identified material weaknesses in our internal control over financial reporting and have determined that our disclosure controls and procedures are not effective.**

Our former independent auditors, Stonefield Josephson, Inc., have notified the Audit Committee of our Board of Directors that they believed there were reportable conditions during 2004 and 2005 which constituted material weaknesses in our internal controls. The following material weaknesses have been identified:

Lack of adequate segregation of duties in our South Korean operations in accounts receivable involving cash receipts, shipping, delivery of products and customer invoice reconciliations.

Lack of adequate segregation of duties in our Coatings Division in Texas in order processing and invoicing.

Lack of adequate controls and documentation in our South Korean operations to evidence proper customer invoicing and revenue recognition in the proper period.

Lack of progress in documenting, assessing and evaluating our internal controls in our South Korean operations.

Lack of controls over internal access to our SAP system of reporting by unauthorized users.

Manual performance of numerous procedures that could be automated using current reporting systems.

In addition to the foregoing, after a review of our operating results for the fiscal year ended December 31, 2004 and for the quarters ended March 31, 2005, June 30, 2005, and September 30, 2005, and pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act), our Chief Executive Officer and our Chief Financial Officer have determined that, as of each such date, our disclosure controls and procedures were not effective to provide reasonable assurance that information that we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. Management's conclusion regarding our effectiveness of our disclosure control procedures as of December 31, 2004 was based on the above described material weaknesses. Management's conclusion regarding our effectiveness of our disclosure control procedures as of December 31, 2005 was based on the Company's determination that it had previously failed to properly account for the senior convertible notes issued by the Company. In particular, the Company had previously failed to identify and properly account for the derivative feature of such convertible notes in accordance with applicable accounting standards.

Effective internal control over financial reporting and disclosure controls and procedures are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. We have in the past discovered, as described above, and



may in the future discover, areas of our disclosure and internal controls that need improvement. We are in the process of addressing these issues to ensure that our internal control over financial reporting and disclosure controls and procedures are improved so as to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. If, however, we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed.

We cannot be certain that our efforts to improve the material weaknesses in our internal control over financial reporting and the ineffectiveness of our disclosure controls and procedures will be successful or that we will be able to maintain adequate controls over our financial processes and reporting in the future. We will need to commit substantial resources, including substantial time from our management team's accounting personnel and from external consultants, to implement and integrate into our organization improved disclosure controls and additional procedures generally and to improve systems to report financial information on a timely basis. Any failure or delay to develop or maintain effective controls, or difficulties encountered in their implementation or in other effective improvement of our internal and disclosure controls could materially harm our operating results or cause us to fail to meet our reporting obligations. Ineffective internal and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a significant negative effect on the trading price of our securities.

**The restatement of our 2003 and 2002 consolidated financial statements has had a material adverse impact on us.**

We previously determined that our consolidated financial statements for the years ended December 31, 2003 and 2002, as described in more detail in Note 2 to our consolidated financial statements included in the form 10-K for

the year ended December 31, 2003, filed on November 10, 2004, should be restated. As a result of this restatement, we have become subject to a number of additional risks and uncertainties, including the following.

We incurred substantial unanticipated costs for accounting and legal fees in 2004 in connection with the restatement.

Due to the time and resources necessary to complete the restatement, we and our independent auditor determined that it was not possible to complete the management's assessment and auditor's audit of our internal controls over financial reporting as of December 31, 2004, as required by Section 404 of the Sarbanes-Oxley Act of 2002, and, accordingly, our independent auditor issued a disclaimer of opinion with respect to our internal control over financial reporting for such year. Our failure to comply with these requirements has resulted in us being in violation of Section 13(a) of the Securities Exchange Act of 1934.

The restatement resulted in a series of stockholder class action and derivative lawsuits against us (although we have reached agreements in principal for the settlement of these transactions).

**We have received a demand for the payment of late fees under a registration rights agreement with our noteholders.**

On May 12, 2006, we received a letter from one holder holding \$0.5 million of the August 2007 Notes demanding immediate payment of late filing fees and late registration fees for the period following October 31, 2005 through May 3, 2006. As a result of the late fee provisions of the amended and restated registration rights agreement between us and our noteholders, we may be obligated to pay late filing and late registration fees accrued through July 3, 2006 of up to \$1.4 million to all of the noteholders. In addition, the May 12 letter purported to constitute a notice of default under the August 2007 Notes and July 2007 Notes as a result of our failure to pay the late filing and late registration fees. Under the terms of such notes, if a default is not cured by us within thirty (30) days of notice thereof, the holder has the right to accelerate all principal and interest due under the notes. As of July 3, 2006, \$9.9 million in aggregate principal amount of August 2007 Notes was still outstanding with accrued but unpaid interest in the amount of approximately \$175 thousand. In addition, \$2.3 million in aggregate principal amount of July 2007 Notes was also outstanding with accrued but unpaid interest in the amount of approximately \$35 thousand. As of July 14, 2006, we have not paid any amounts under the demand letter and we are currently in negotiations with the holder regarding the matters set forth in the May 12 letter with the goal of preventing any acceleration of amounts due under the notes. However, we cannot predict the outcome of the negotiations, and the resolution of this issue may harm our business and have a material adverse impact on our financial condition.

**Evolving regulation of corporate governance and public disclosure may result in additional expenses and continuing uncertainty.**

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002 and new SEC regulations, are creating uncertainty for public companies. As a result of these new rules and the size and limited resources of our company, we will incur additional costs associated with our public company reporting requirements, and we may not be able to comply with some of these new rules. For example, we were not able to comply with Section 404 of the Sarbanes-Oxley Act of 2002 for our 2005 and 2004 fiscal years. In addition, these new rules could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and this could make it difficult for us to attract and retain qualified persons to serve on our board of directors.

We are presently evaluating and monitoring developments with respect to new and proposed rules and cannot predict or estimate the amount of the additional costs we may incur or the timing of such costs. These new or changed laws, regulations, and standards are subject to varying interpretations, in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices.

We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we intend to invest resources to comply with evolving laws, regulations, and standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new or changed laws, regulations, and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, regulatory authorities may initiate legal proceedings against us and we may be harmed.

**The time and cost associated with complying with government regulations to which we could become subject could have a material adverse effect on our business.**

Some of the applications that we have identified or may identify in the future may be subject to government regulations. For example, any medical devices such as precision ophthalmic instruments and orthopedic devices made from our alloys likely will be subject to extensive government regulation in the United States by the Food and Drug Administration, or FDA. Any medical device manufacturers to whom we sell Liquidmetal alloy products may need to comply with FDA requirements, including premarket approval or clearance under Section 510(k) of the Food Drug and Cosmetic Act before marketing in the United States Liquidmetal alloy medical device products. These medical device manufacturers may be required to obtain similar approvals before marketing these medical devices in foreign countries. Any medical device manufacturers with which we jointly develop and sell medical device products may not provide significant assistance to us in obtaining required regulatory approvals. The process of obtaining and maintaining required FDA and foreign regulatory approvals could be lengthy, expensive, and uncertain. Additionally, regulatory agencies can delay or prevent product introductions. The failure to comply with applicable regulatory requirements can result in substantial fines, civil and criminal penalties, stop sale orders, loss or denial of approvals, recalls of products, and product seizures.

In addition, the processing of beryllium, a minor constituent element of some of our alloys, can result in the release of beryllium into the workplace and the environment and in the creation of beryllium oxide as a by-product. Beryllium is classified as a hazardous air pollutant, a toxic substance, a hazardous substance, and a probable human carcinogen under environmental, safety, and health laws, and various acute and chronic health effects may result from exposure to beryllium. We are required to comply with certain regulatory requirements and to obtain a permit from the U.S. Environmental Protection Agency or other government agencies to process beryllium. Our failure to comply with present or future governmental regulations related to the processing of beryllium could result in suspension of manufacturing operations and substantial fines or criminal penalties.

To the extent that our products have the potential for dual use, such as military and non-military applications, they may be subject to import and export restrictions of the U.S. government, as well as other countries. The

process of obtaining any required U.S. or foreign licenses or approvals could be time-consuming, costly, and uncertain. Failure to comply with import and export regulatory requirements can lead to substantial fines, civil and criminal penalties, and the loss of government contracting and export privileges.

**The existence of minority stockholders in our Liquidmetal Golf subsidiary creates potential for conflicts of interest.**

We directly own 79% of the outstanding capital stock of Liquidmetal Golf, our subsidiary that has the exclusive right to commercialize our technology in the golf market. The remaining 21% of Liquidmetal Golf stock is owned by approximately 95 stockholders of record. As a result, conflicts of interest may develop between us and the minority stockholders of Liquidmetal Golf. To the extent that our officers and directors are also officers or directors of Liquidmetal Golf, matters may arise that place the fiduciary duties of these individuals in conflicting positions. John Kang, our Chairman, is also director of Liquidmetal Golf. In addition, James Kang, Founder and Director, is also a director of Liquidmetal Golf.

**Our stock price has experienced volatility and may continue to experience volatility.**

During the first six months in 2006, the highest bid price for our common stock was \$2.34 per share, while the lowest bid price during that period was \$0.87 per share. The trading price of our common stock could continue to fluctuate widely due to:

quarter-to-quarter variations in results of operations;

loss of a major customer;

announcements of technological innovations by us or our potential competitors;

changes in, or our failure to meet, the expectations of securities analysts;

new products offered by us or our competitors;

announcements of strategic relationships or strategic partnerships; or

other events or factors that may be beyond our control.

In addition, the securities markets in general have experienced extreme price and trading volume volatility in the past. The trading prices of securities of many companies at our stage of growth have fluctuated broadly, often for reasons unrelated to the operating performance of the specific companies. These general market and industry factors may adversely affect the trading price of our common stock, regardless of our actual operating performance. If our stock price is volatile, we could face securities class action litigation, which could result in substantial costs and a diversion of management's attention and resources and could cause our stock price to fall.

**Our convertible notes and warrants contain anti-dilution provisions that, if triggered, could cause substantial dilution to our then-existing stockholders.**

As of July 3, 2006, we had outstanding approximately \$2.3 million in aggregate principal amount of July 2007 Notes with a conversion price of \$1.00 per share and \$9.9 million in aggregate principal amount of August 2007 Notes with a conversion price of \$2.00 per share. We also had outstanding warrants to purchase 3,777,715 shares at an exercise price of \$2.00 per share and 165,324 shares at an adjusted exercise price of \$2.72 per share issued to holders of the convertible notes. Additionally, we had outstanding warrants to purchase 125,000 shares at an exercise price of \$2.00 per share issued to holders of our 10% unsecured subordinated promissory notes in March 2006 and 773,741 shares at an exercise price of \$2.58 per share issued to holders of our 8% unsecured subordinated notes in May 2006. Each of these notes and warrants contain weighted-average anti-dilution provisions whereby, if we issue shares in the future for consideration below such conversion or exercise prices, then (with certain exceptions, including the issuance of stock options) the conversion price for our convertible notes would automatically be reduced (allowing the holders of the notes to receive additional shares of common stock upon conversion) and the exercise price of the warrants would automatically be

reduced. If our available funds and cash generated from operations are insufficient to satisfy our liquidity requirements in the future, then we may need to raise substantial additional funds in the future to support our working capital requirements and for other purposes. If shares of our common stock or securities convertible into or exercisable for our common stock are issued in consideration of such funds at an effective per share price lower than the conversion and exercise prices of our convertible notes and warrants, then these anti-dilution provisions would be triggered, thus possibly causing substantial dilution to our then-existing stockholders if the notes are converted or the warrants are exercised. Further, subsequent sales of the shares in the public market could depress the market price of our stock by creating an excess in supply of shares for sale. To illustrate the potential impact of these anti-dilution provisions, the degree of which would be determined by the amount of future funding as well as its conversion price, if we were to raise funds of \$1.0 million by issuing convertible notes with a conversion price of \$1.50, we estimate that our current noteholders could potentially receive approximately 1.0 million additional shares upon the conversion or exercise of their notes and warrants held as of July 3, 2006. Further, if we were to raise funds of \$5.0 million of convertible debt with a conversion price of \$1.00, we estimate that our current noteholders could potentially receive approximately 1.4 million shares upon the conversion or exercise of their notes and warrants held as of July 3, 2006.

**We have never paid dividends on our common stock, and we do not anticipate paying any cash dividends in the foreseeable future.**

We have paid no cash dividends on our common stock to date. We currently intend to retain our future earnings, if any, to fund the development and growth of our businesses, and upon the completion of this offering, we do not anticipate paying any cash dividends on our capital stock for the foreseeable future. In addition, the terms of existing or any future debts may preclude us from paying dividends on our stock. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future.

**Antitakeover provisions of our certificate of incorporation and bylaws and provisions of applicable corporate law could delay or prevent a change of control that you may favor.**

Provisions in our certificate of incorporation, our bylaws, and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. These provisions could discourage potential takeover attempts and could adversely affect the market price of our shares. Because of these provisions, you might not be able to receive a premium on your investment. These provisions:

authorize our board of directors, without stockholder approval, to issue up to 10,000,000 shares of blank check preferred stock that could be issued by our board of directors to increase the number of outstanding shares and prevent a takeover attempt;

limit stockholders' ability to call a special meeting of our stockholders;

provide for a classified board of directors; and

establish advance notice requirements to nominate directors for election to our board of directors or to propose matters that can be acted on by stockholders at stockholder meetings.

The provisions described above could delay or make more difficult transactions involving a change in control of us or our management.



**FORWARD-LOOKING STATEMENTS**



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This prospectus may contain forward-looking statements that relate to our management's current expectations, estimates, forecasts, and projections about our company and its business. Any statement in this prospectus that is not a statement of historical fact is a forward-looking statement, and in some cases, words such as believe, estimate, project, expect, intend, may, anticipate, plans, seeks, and similar words identify forward-looking statements. Forward-looking statements involve risks and uncertainties that could cause actual outcomes and results to differ materially from the anticipated outcomes or result. These statements are not guarantees of future performance. It is important to note that our actual results could differ materially from what is expressed in our forward-looking statements due to, among other things, the matters discussed in the RISK FACTORS section of this prospectus, as well as the following risks and uncertainties:

Our history of losses and uncertainty surrounding our ability to achieve profitability;

Our limited history of manufacturing products from bulk amorphous alloys;

Lengthy customer adoption cycles and unpredictable customer adoption practices;

Our ability to identify, develop, and commercialize new product applications;

Competition from other materials;

Our ability to consummate strategic partnerships in the future;

The potential for manufacturing problems or delays;

Potential difficulties associated with protecting or expanding our intellectual property position; and

Pending stockholder litigation against our company.

We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

**SELLING STOCKHOLDERS**



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On behalf of the selling stockholders named in the table below (including their donees, pledgees, transferees or other successors-in-interest who receive any of the shares covered by this prospectus), we are registering, pursuant to the registration statement of which this prospectus is a part, all 11,614,322 shares of our common stock which will become issuable upon:

the conversion of 6% Senior Secured Notes Due July 2007 (the July 2007 Notes ), which notes were issued by us to such selling stockholders on July 29, 2004;

the conversion of 7% Senior Secured Convertible Notes Due August 2007 (the August 2007 Notes ), which notes were issued by us to such selling stockholders on August 2, 2005;

the exercise of outstanding common stock purchase warrants issued by us on March 1, 2004 and having an adjusted exercise price of \$2.72 per share;

the exercise of outstanding common stock purchase warrants issued by us on June 13, 2005 and having an exercise price of \$2.00 per share;

the exercise of outstanding common stock purchase warrants issued by us on August 2, 2005 and having an exercise price of \$2.00 per share; and

the exercise of an outstanding non-qualified stock option issued by us to one individual, Paul Azinger, on January 1, 2001 and having an exercise price of \$1.16 per share.

Other than Mr. Azinger, the selling stockholders are investors that provided financing to us or are those that acted as placement agents in our private placement financings. We are registering the shares to permit the selling stockholders to offer these shares for resale from time to time. The selling stockholders may sell all, some or none of the shares covered by this prospectus. All information with respect to beneficial ownership has been furnished to us by the respective selling stockholders. For more information, see Plan of Distribution. None of the selling stockholders, other than Ricardo A. Salas and CK Cho, has had any material relationship with us within the past three years other than as a result of the ownership of shares of our common stock. Ricardo A. Salas was elected as President, Chief Executive Officer, and a director of our company as of December 30, 2005. CK Cho was appointed as a director of our company in December of 2004.

The table below lists the selling stockholders and information regarding their ownership of common stock as of July 3, 2006:

| SELLING STOCKHOLDER | NUMBER OF<br>SHARES<br>BENEFICIALLY<br>OWNED PRIOR<br>TO THIS<br>OFFERING | NUMBER OF<br>SHARES<br>BEING OFFERED<br>HEREBY(3) | SHARES OWNED AFTER<br>OFFERING(3)<br>NUMBER | PERCENTAGE(4) |
|---------------------|---|---|---|---------------|
|                     |   |   |   |               |

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|  |              |           |         |    |
|--|--------------|-----------|---------|----|
| Jess S. Morgan & Co., Inc. (7)   | 2,832,535(1) | 2,261,960 | 570,575 | 1% |
| Prana, LLC. (8)  | 211,000(1)   | 211,000   | 0       | *  |
| Rodd Friedman  | 212,156(1)   | 212,156   | 0       | *  |
| Bear Stearns f/b/o Rosen Capital LP M/P/P<br>Plan and Bruce Rosen TTEE(6)(9) | 49,500(1)    | 49,500    | 0       | *  |
| Caydal, LLC(10)  | 93,000(1)    | 50,000    | 43,000  | *  |
| Marlin Fund, LP (11)   | 290,251(1)   | 290,251   | 0       | *  |

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| SELLING STOCKHOLDER   | NUMBER OF<br>SHARES<br>BENEFICIALLY<br>OWNED PRIOR<br>TO THIS<br>OFFERING | NUMBER OF<br>SHARES<br>BEING OFFERED<br>HEREBY(3) | SHARES OWNED AFTER<br>OFFERING(3)<br>NUMBER | PERCENTAGE(4) |
|---|---|---|---|---------------|
| Marlin Fund II, LP(11)  | 54,000(1)   | 54,000  | 0   | *             |
| Marlin Fund Offshore, Ltd. c/o Hemisphere Management (B.V.I.) Limited(12) | 330,751(1)  | 330,751   | 0   | *             |
| Larry Bouts   | 25,000(1)   | 25,000  | 0   | *             |
| Really Cool Group Ltd.(13)  | 135,000(1)  | 100,000   | 35,000                                      | *             |
| Myron Neugeboren  | 90,000(1)   | 42,000  | 48,000                                      | *             |
| Jonas Brachfeld   | 12,000(1)   | 12,000  | 0   | *             |
| Greg Osborn(6)  | 91,008(1)   | 91,008  | 0   | *             |
| Richard Molinsky  | 30,000(1)   | 30,000  | 0   | *             |
| Richard and Joanne Kane   | 20,000(1)   | 20,000  | 0   | *             |
| Ricardo Salas   | 1,200,978(1)  | 263,876   | 937,102                                     | 2%            |
| Wry Ltd.(14)  | 30,000(1)   | 30,000  | 0   | *             |
| Keith Barksdale(6)  | 104,113(1)  | 104,113   | 0   | *             |
| CK Cho  | 712,853(1)  | 527,751   | 185,102                                     | *             |
| Eric Brachfeld(6)   | 85,808(1)   | 85,808  | 0   | *             |
| Edward Neugeboren(6)(15)  | 106,634(1)  | 100,834   | 5,800                                       | *             |
| Dolphin Direct Equity Partners, L.P.(16)                                  | 62,500(1)   | 62,500  | 0   | *             |
| Dolphin Offshore Partners, L.P.(16)                                       | 375,000(1)  | 375,000   | 0   | *             |
| Harvard Developments Inc.(17)   | 481,826(1)  | 481,826   | 0   | *             |
| Echo Capital Growth Corporation(18)                                       | 300,000(1)  | 300,000   | 0   | *             |
| Terrence L. Mealy   | 265,913(1)  | 265,913   | 0   | *             |
| Shinnston Enterprises Ltd.(19)  | 100,000(1)  | 100,000   | 0   | *             |
| Shea Diversified Investments, Inc.(20)                                    | 1,125,000(1)  | 1,125,000   | 0   | *             |
| Commonwealth Associates, L.P.(5)(21)                                      | 150,000(1)  | 150,000   | 0   | *             |
| Neal I. Goldman   | 225,000(1)  | 225,000   | 0   | *             |
| LBJ Holdings, LLC(22)   | 112,500(1)  | 112,500   | 0   | *             |





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| SELLING STOCKHOLDER                                   | NUMBER OF<br>SHARES<br>BENEFICIALLY<br>OWNED PRIOR<br>TO THIS<br>OFFERING | NUMBER OF<br>SHARES<br>BEING OFFERED<br>HEREBY(3) | SHARES OWNED AFTER |                              |
|---|---|---|--------------------|------------------------------|
|   |   |   | NUMBER             | OFFERING(3)<br>PERCENTAGE(4) |
| John Stout(23)  | 466,142(1)  | 75,000  | 391,142            | *                            |
| MicroCapital Fund Ltd.(24)                            | 375,000(1)  | 375,000   | 0                  | *                            |
| MicroCapital Fund L.P.(24)                            | 750,000(1)  | 750,000   | 0                  | *                            |
| Journeys End Partners, LLC(25)                        | 225,000(1)  | 225,000   | 0                  | *                            |
| Wynnefield Partners Small Cap Value LP(26)            | 537,330(1)  | 315,000   | 222,330            | *                            |
| Wynnefield Partners Small Cap Value LP I(26)          | 727,420(1)  | 412,500   | 314,920            | *                            |
| Wynnefield Small Cap Value Offshore Fund,<br>Ltd.(26) | 709,420(1)  | 397,500   | 311,920            | *                            |
| Min Capital Corp Retirement Trust(27)                 | 112,500(1)  | 112,500   | 0                  | *                            |
| Indigo Securities, LLC(5)(28)                         | 34,500(1)   | 34,500  | 0                  | *                            |
| Michael Falk  | 100,694   | 100,694   | 0                  | *                            |
| Robert O Sullivan(6)                                  | 100,694   | 100,694   | 0                  | *                            |
| Shea Ventures, LLC(29)                                | 31,826  | 31,826  | 0                  | *                            |
| Ed Shea   | 4,551   | 4,551   | 0                  | *                            |
| Billy Walters   | 16,136  | 16,136  | 0                  | *                            |
| Amos Investments, LLC(30)                             | 15,913  | 15,913  | 0                  | *                            |
| Keith Rosenbloom                                      | 7,468   | 7,468   | 0                  | *                            |
| Carl Kleidman   | 22,468  | 22,468  | 0                  | *                            |
| Joseph Pallotta                                       | 16,019  | 16,019  | 0                  | *                            |
| Inder Tallur  | 2,886   | 2,886   | 0                  | *                            |
| Daniel Parker Living Trust(31)                        | 1,994   | 1,994   | 0                  | *                            |
| Douglas Levine  | 976   | 976   | 0                  | *                            |
| Greg Manocherian                                      | 106   | 106   | 0                  | *                            |
| Jeffrey Frank   | 46,125  | 46,125  | 0                  | *                            |
| Valiant Enterprises, LLC(32)                          | 36,900  | 36,900  | 0                  | *                            |
| Bonnie Giusto   | 1,500   | 1,500   | 0                  | *                            |



| SELLING STOCKHOLDER         | NUMBER OF<br>SHARES<br>BENEFICIALLY<br>OWNED PRIOR<br>TO THIS<br>OFFERING | NUMBER OF<br>SHARES<br>BEING OFFERED<br>HEREBY(3) | SHARES OWNED AFTER<br>OFFERING(3) |               |
|-----------------------------|---|---|-----------------------------------|---------------|
|                             |   |   | NUMBER                            | PERCENTAGE(4) |
| Scott Lee                   | 2,500   | 2,500   | 0                                 | *             |
| Tom Hodges                  | 250   | 250   | 0                                 | *             |
| Vicki Johannes              | 1,000   | 1,000   | 0                                 | *             |
| Cecilio Rodriguez           | 3,500   | 3,500   | 0                                 | *             |
| Philip E. McMorrow IRA (33) | 21,362  | 18,862  | 2,500                             | *             |
| John P. McMorrow IRA (34)   | 18,862  | 18,862  | 0                                 | *             |
| Paul Azinger                | 376,345(2)  | 376,345   | 0                                 | *             |

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\* Less than 1.0%.

(1) Includes the number of shares of common stock issuable pursuant to the July 2007 Notes, August 2007 Notes, and/or the above-described common stock purchase warrants.

(2) Represents the number of shares issuable pursuant to Mr. Azinger's non-qualified stock option agreement dated January 1, 2001.

(3) Assumes that the stockholders dispose of all the shares of common stock covered by this prospectus and do not acquire or dispose of any additional shares of common stock. The selling stockholders are not representing, however, that any of the shares covered by this prospectus will be offered for sale, and the selling stockholders reserve the right to accept or reject, in whole or in part, any proposed sale of shares. On August 2, 2005, we entered into an amended and restated registration rights agreement with the selling stockholders listed above (other than Mr. Azinger). See the section of this prospectus entitled "DESCRIPTION OF CAPITAL STOCK - Registration Rights". Under the amended and restated registration rights agreement, we are required to file a resale registration statement for the shares underlying all of our outstanding convertible notes and warrants to enable the resale of such shares by the selling stockholders on a delayed or continuous basis under Rule 415 of the Securities Act.

(4) The percentage of common stock beneficially owned is based on 44,085,018 shares of common stock outstanding on July 3, 2006.

(5) These selling stockholders are broker-dealers who acquired their notes and warrants as compensation for serving as placement agents in the private placements in which the notes and warrants were issued.

(6) These selling stockholders (or their ultimate beneficial owners) have represented to us that they are affiliates of broker-dealers and that they each acquired the notes, warrants, or underlying shares to be resold in the ordinary course of business and that, at the time of acquisition, each had no agreements or understandings, directly or indirectly, with any person to distribute the securities.

(7) **Mr. Gary N. Levenstein, President of the Investment Division of Jess S. Morgan & Co., Inc., exercises sole voting and investment power over such shares.**

(8) **Mr. Renee Vallese, Managing Partner of Prana, LLC, exercises sole voting and investment power over such shares.**

(9) **Mr. Bruce Rosen, the Managing Director of Rosen Capital L.P. M/P/P, exercises sole voting and investment power over such shares.**

(10) **Mr. Kevin Daly, Managing Member of Caydal, LLC, exercises sole voting and investment power over such shares.**

(11) **Mr. Michael W. Masters, the Managing Member of Masters Capital Management, the General Partner of the selling stockholder, exercises sole voting and investment power over such shares.**

(12) **Mr. Michael W. Masters, the Managing Member of Masters Capital Management, the Investment Manager of the selling stockholder, exercises sole voting and investment power over such shares.**

(13) **Includes 35,000 shares held in a trust for which Really Cool Group Ltd. has voting and investment power. Really Cool Group Ltd. disclaims beneficial ownership of these shares. Mr. Jonathan Segal, director of Really Cool Group Ltd., exercises sole voting and investment power over such shares.**

(14) **Mr. Jonathan Segal, director of Wry Ltd., exercises sole voting and investment power over such shares.**

(15) **Includes 5,800 shares held in a trust for which Edward Neugeboren has voting and investment power. Edward Neugeboren disclaims beneficial ownership of these shares.**

(16) **Mr. Peter E. Salas, General Partner and authorized signatory of the selling stockholder, exercises sole voting and investment power over such shares.**

(17) **Mr. Paul J. Hill, President and Chief Operating Officer of Harvard Developments Inc., exercises sole voting and investment power over such shares.**

(17) Mr. Paul J. Hill, President and Chief Operating Officer of Harvard Developments Inc., exercises

(18) **Mr. Paul J. Hill, President of Echo Capital Growth Corporation, exercises sole voting and investment power over such shares.**

(19) **Mr. James K. Murray, Jr., Chairman of Shinnston Enterprises Ltd., exercises sole voting and investment power over such shares.**

(20) **Voting and investment power over the shares is held by: Edmund H. Shea, Jr. (Secretary), John C. Morrissey (Vice President), John Shea (President), Peter Shea (Vice President and Treasurer) and Ron Lakey (Assistant Secretary).**

(21) **Mr. Robert O Sullivan, President and Chief Executive Officer of Commonwealth Associates, L.P., exercises sole voting and investment power over such shares.**

(22) **Voting and investment power over the shares is held by: Brian Potiker (Vice President of HSP Group, Inc., Manager of LBJ Holdings, LLC), Jori Potiker (Vice President of HSP Group, Inc.), Lowell Potiker (Vice President of HSP Group, Inc.), and HSP**

(22) **Voting and investment power over the shares is held by: Brian Potiker (Vice President of HSP**



**Group, Inc. (Sheila Potiker, owner of 100% of the stock of HSP Group, Inc.).**

**(23) Includes 4,600 shares held by John Stout's spouse or children.**

**(24) Ian P. Ellis, Portfolio Manager for MicroCapital Fund, exercises sole voting and investment power over such shares.**

(25) **Mr. Gerald Cramer, Manager of Journeys End Partners, LLC, exercises sole voting and investment power over such shares.**

(26) **Nelson Obus, Managing Member of the selling stockholder, exercises sole voting and investment power over such shares.**

(27) **Mr. Robert Friedman, Trustee, exercises sole voting and investment power over such shares.**

(28) **Mr. Eric Brachfeld, Managing Partner of Indigo Securities, LLC, exercises sole voting and investment power over such shares.**

(29) **Voting and investment power over the shares is held by: Edmund H. Shea, Jr. (Manager), John C. Morrissey (Vice President), John Shea (Manager), Peter Shea (Manager) and Ron Lakey (Manager).**

(30) **Mr. James K. Murray, Jr., Managing Member of Amos Investments, LLC, exercises sole voting and investment power over such shares.**

(30) Mr. James K. Murray, Jr., Managing Member of Amos Investments, LLC, exercises sole voting

(31) **Mr. Henry Fuldner, Trustee, exercises sole voting and investment power over such shares.**

(32) **Jerry Apodaca, Member of Valiant Enterprises, LLC, exercises sole voting and investment power over such shares.**

(33) **Philip E. McMorrow exercises sole voting and investment power over such shares.**

(34) **John P. McMorrow exercises sole voting and investment power over such shares.**



**USE OF PROCEEDS**



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The selling stockholders will receive all of the proceeds from the sale of the common stock offered by this prospectus. We will not receive any of the proceeds from the sale of common stock by the selling stockholders, although we may receive proceeds from the exercise of warrants by the selling stockholders or the exercise of Mr. Azinger's stock option, if exercised. We cannot guarantee that the warrants or the option will be exercised by the selling stockholders.

### **DIVIDEND POLICY**





## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

Historically, we have not paid any dividends on our common stock, and we do not anticipate paying any dividends on our common stock in the foreseeable future. We expect to retain any earnings generated from our operations for use in our business. Any future determination as to the payment of dividends will be at the discretion of our Board of Directors and will depend upon our future operating results, financial condition and capital requirements, general business conditions and such other factors as our Board of Directors deems relevant.



**MARKET FOR AND PRICE RANGE OF THE COMMON STOCK**



## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

Our common stock is currently quoted on the Nasdaq OTC Bulletin Board under the symbol LQMT.OB. From the period July 16, 2004 through June 14, 2005, we were delisted from the Nasdaq Stock Market and our common stock was quoted on the pink sheets. We were admitted for quotation on the Nasdaq's OTC Bulletin Board on June 15, 2005. On July 13, 2006, the last reported sales price of our common stock was \$1.90 per share. As of July 13, 2006, we had 257 record holders of our common stock.

The following table sets forth, on a per share basis, the range of high and low bid information for the shares of our common stock for each full quarterly period within the two most recent fiscal years and any subsequent interim period for which financial statements are included. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

| <b>2006</b>    | <b>High</b> | <b>Low</b> |
|----------------|-------------|------------|
| Second Quarter | \$ 2.34     | \$ 1.31    |
| First Quarter  | \$ 1.75     | \$ 0.87    |
| <br>           |             |            |
| <b>2005</b>    | <b>High</b> | <b>Low</b> |
| Fourth Quarter | \$ 1.76     | \$ 0.64    |
| Third Quarter  | \$ 2.15     | \$ 1.52    |
| Second Quarter | \$ 2.25     | \$ 1.28    |
| First Quarter  | \$ 2.85     | \$ 1.10    |
| <br>           |             |            |
| <b>2004</b>    | <b>High</b> | <b>Low</b> |
| Fourth Quarter | \$ 4.00     | \$ 1.75    |
| Third Quarter  | \$ 2.33     | \$ 0.71    |
| Second Quarter | \$ 3.68     | \$ 0.55    |
| First Quarter  | \$ 4.52     | \$ 2.50    |

**SELECTED FINANCIAL DATA**

The following table shows our selected consolidated financial data as of and for the years ended December 31, 2001 through 2005. The selected consolidated financial data as of and for the years ended December 31, 2003 2004, and 2005 are derived from our audited consolidated financial statements included elsewhere in this prospectus. The summary consolidated financial data as of and for the three months ended March 31, 2006 and 2005 have been derived from our unaudited consolidated financial statements included elsewhere in this prospectus. Such unaudited interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( generally accepted accounting principles ). Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for any future periods or the year ending December 31, 2006. In the opinion of management, all adjustments (consisting of only of normal recurring accruals) considered necessary for a fair presentation have been included. The following information should be read with MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS and our Consolidated Financial Statements and Notes thereto included elsewhere in this prospectus.

These statements should be read in conjunction with restatement footnote 2 in the notes to the fiscal year 2005 consolidated financial statements included in the INDEX TO THE FINANCIAL STATEMENTS of this prospectus and in the fiscal 2003 annual report on Form 10-K filed on November 10, 2004, which reflects the restatements of prior year transactions.

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|   | Three Months<br>Ended March 31,   |            | Years Ended December 31, |                    |             |                    |                    |
|---|-----------------------------------|------------|--------------------------|--------------------|-------------|--------------------|--------------------|
|   | 2006<br>(Restated)<br>(Unaudited) | 2005       | 2005<br>(Restated)       | 2004<br>(Restated) | 2003        | 2002<br>(Restated) | 2001<br>(Restated) |
| (In thousands, except per share data)   |                                   |            |                          |                    |             |                    |                    |
| <b>Consolidated Statements Of Operation Data:</b>   |                                   |            |                          |                    |             |                    |                    |
| Revenue   | \$ 6,555                          | \$ 2,843   | \$ 16,365                | \$ 17,429          | \$ 13,658   | \$ 9,138           | \$ 3,882           |
| Cost of sales   | 5,324                             | 2,835      | 15,129                   | 12,168             | 18,162      | 5,656              | 1,924              |
| Gross profit  | 1,231                             | 8          | 1,236                    | 5,261              | (4,504)     | 3,482              | 1,958              |
| Operating expenses:   |                                   |            |                          |                    |             |                    |                    |
| Selling, general, and administrative expenses   | 2,705                             | 2,590      | 8,534                    | 11,591             | 17,729      | 13,099             | 5,239              |
| Research and development expenses   | 203                               | 397        | 1,120                    | 1,467              | 8,780       | 11,825             | 1,726              |
| Impairment of Goodwill  |                                   |            |                          |                    | 184         |                    |                    |
| Impairment of long lived assets   |                                   |            | 4,487                    |                    | 2,684       |                    |                    |
| Total operating expenses  | 2,908                             | 2,987      | 14,141                   | 13,058             | 29,377      | 24,924             | 6,965              |
| Loss before interest, other income, income taxes, minority interest and discontinued operations | (1,677)                           | (2,979)    | (12,905)                 | (7,797)            | (33,881)    | (21,442)           | (5,007)            |
| Loss from extinguishments of debt   |                                   |            | (1,247)                  | (2,941)            |             |                    |                    |
| Change in value of warrants, (loss) gain  | (1,289)                           | 133        | 3,985                    | 747                |             |                    |                    |
| Change in value of conversion feature, (loss) gain  | (1,783)                           | 1,115      | 9,118                    | 2,093              |             |                    |                    |
| Other income  | 480                               |            |                          | 302                |             |                    |                    |
| Interest expense  | (1,782)                           | (1,537)    | (6,021)                  | (6,577)            | (390)       | (1,109)            | (1,103)            |
| Interest income   | 2                                 | 6          | 17                       | 37                 | 304         | 506                | 8                  |
| Gain on sale of marketable securities held for sale   |                                   |            |                          |                    | 1,178       | 832                |                    |
| Loss before minority interest and discontinued operations                                       | (6,049)                           | (3,262)    | (7,053)                  | (14,136)           | (32,789)    | (21,213)           | (6,102)            |
| Minority interest in loss of consolidated subsidiary  |                                   |            |                          |                    | 21          | 118                |                    |
| Loss from continuing operations   | (6,049)                           | (3,262)    | (7,053)                  | (14,136)           | (32,768)    | (21,095)           | (6,102)            |
| Discontinued Operations:  |                                   |            |                          |                    |             |                    |                    |
| Income (loss) from discontinued operations, net   |                                   |            |                          | (749)              | (964)       | 83                 | (5,973)            |
| Gain (loss) from disposal of discontinued operations, net                                       |                                   |            |                          |                    | 127         | 1,556              | (11,949)           |
| Net loss  | \$ (6,049)                        | \$ (3,262) | \$ (7,053)               | \$ (14,885)        | \$ (33,605) | \$ (19,456)        | \$ (24,024)        |
| Loss per share from continuing operations   | \$ (0.14)                         | \$ (0.08)  | \$ (0.17)                | \$ (0.34)          | \$ (0.79)   | \$ (0.54)          | \$ (0.18)          |
| Gain (Loss) per share from discontinued operations  | \$                                | \$         | \$                       | \$ (0.02)          | \$ (0.02)   | \$ 0.04            | \$ (0.54)          |
| Net loss per share  | \$ (0.14)                         | \$ (0.08)  | \$ (0.17)                | \$ (0.36)          | \$ (0.81)   | \$ (0.50)          | \$ (0.72)          |
| Weighted average shares - basic and diluted   | 42,817                            | 41,610     | 41,833                   | 41,610             | 41,505      | 38,714             | 33,323             |

|  | As of March 31,<br>2006<br>(Restated)<br>(Unaudited) | 2005<br>(Restated) | 2004<br>(Restated) | As of December 31,<br>2003<br>(In thousands) | 2002<br>(Restated) | 2001<br>(Restated) |
|--|--|--------------------|--------------------|--|--------------------|--------------------|
| <b>Consolidated Balance Sheet Data:</b>                    |  |                    |                    |  |                    |                    |
| Cash and cash equivalents                                  | \$ 1,263   | \$ 1,392           | \$ 742             | \$ 3,127                                     | \$ 25,058          | \$ 2,230           |
| Working capital (deficit)                                  | (11,986)   | (10,993)           | (14,910)           | (698)  | 25,812             | (9,573)            |
| Total assets   | 22,336   | 21,563             | 28,508             | 30,852                                       | 24,845             | 6,680              |
| Long-term debt, including current portion, net of discount | 7,750  | 6,776              | 6,628              | 4,047  |                    | 2,988              |
| Shareholders' equity (deficiency)                          | (3,494)  | (1,320)            | 4,191              | 16,163                                       | 50,599             | (7,504)            |



**SUPPLEMENTARY FINANCIAL INFORMATION**

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The following information presents our unaudited quarterly operating results for 2006, 2005 and 2004. The data has been prepared by Liquidmetal Technologies, Inc. on a basis consistent with the Consolidated Financial Statements included elsewhere in this registration statement, and includes all adjustments, consisting of normal recurring accruals, that we consider necessary for a fair presentation thereof. These operating results are not necessarily indicative of our future performance.

We have restated our quarterly results for the 2004 and 2005 fiscal years and for the first quarter of 2006 to properly account for the conversion feature of our senior convertible notes. The restatement adjustments resulted in a cumulative net reduction of shareholders' equity by \$4.7 million and \$0.1 million for the fiscal years ended 2004 and 2005, respectively, and an increase in previously reported net loss by \$2.2 million and a decrease in net loss by \$4.2 million for the fiscal years ended 2004 and 2005, respectively. For the first quarter of 2006, the restatement adjustments resulted in a cumulative net reduction of shareholders' equity by \$0.9 million and an increase in previously reported net loss by \$1.0 million.

During the first quarter of 2006, we had an increase in revenues of \$3.7 million compared to the first quarter of 2005 due to increase in orders from our consumer electronics casings used in cellular phone components and other consumer electronics casings and increases in demand for Liquidmetal coatings products from the oil drilling industry. The increases were a result of our continued expanded sales and marketing efforts into various electronic components including sliding hinges, brackets and antenna. The Company experienced an increase gross profit of \$1.2 million for the first quarter of 2006 from the first quarter due to increase in mix of higher margin products compared to the first quarter of 2005 from increases in mix of higher margin products. Significant portion of our manufacturing costs continue to remain fixed. We believe that higher manufacturing volumes and greater mix of higher margin products in the future will cause the gross profit to improve over time.

During the fourth quarter of 2005, although annual revenues decreased relative to 2004, we had an increase in revenue of \$1.1 million compared to the third quarter due to increases in orders from our consumer electronics casings customers for Liquidmetal bulk alloy parts for cellular phone components and other consumer electronics casings, and increases in demand for Liquidmetal coatings products from the oil drilling industry. The increases in were a result of expanded sales and marketing efforts into various electronic components including sliding hinges, brackets and antenna. The Company experienced an increase gross profit of \$0.3 million for the fourth quarter of 2005 from the third quarter due to increase in mix of higher margin products. Significant portion of our manufacturing costs continue to remain fixed. We believe that higher manufacturing volumes and greater mix of higher margin products in the future will cause the gross profit to improve over time. In addition, the company wrote-down \$0.3 million of primarily raw material inventory considered to be long term as the carrying value of the inventory held as an impairment charge. While we may use the excess raw materials beyond one year to fulfill future demand, we did not foresee use of this inventory in the foreseeable future.

In the third quarter of 2005, the company wrote-down \$0.8 million of primarily raw material inventory considered to be long term as the carrying value of the inventory held as an impairment charge. While we may use the excess raw materials beyond one year to fulfill future demand, we did not foresee use of this inventory in the foreseeable future.

Included in the second quarter of 2005 was an impairment charge for long lived assets of \$3.4 million. Impairment charge represents write-down of \$1.7 million of raw materials considered to be long term inventory and \$1.7 million of idle equipment. While we may use the excess raw materials beyond one year to fulfill future demand, we did not foresee use of this inventory in the foreseeable future. Further, while we have marketed the idle equipment for ultimate sale since early 2004, we were unable to sell this equipment.

During the fourth quarter of 2004, although our revenues were comparable to prior year, we had a decrease in revenue of \$2.1 million compared to the third quarter due to an unanticipated and temporary decrease in orders from one of our customers, Samsung. In addition, included in our fourth quarter cost of sales is a \$0.4 million charge related to certain hinge finished goods used in Samsung's cell phone models which were nearing its end of life. The



Company experienced a gross loss of \$0.4 million for the fourth quarter due to the one time charge of cost of sales and also due to the fact that our cost of sales from our Liquidmetal bulk alloy segment includes primarily fixed costs from our labor and equipment expenses.

Pursuant to Accounting Principles Board Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, we reclassified our consolidated financial statements to reflect the discontinuation of our equipment manufacturing operations and retail golf business. The revenue, costs and expenses, assets and liabilities, and cash flows of the equipment manufacturing and our retail golf businesses were segregated in our accompanying Consolidated Balance Sheets, Consolidated Statements of Operations and Comprehensive Loss, and Consolidated Statements of Cash Flows. The net operating results, net assets, and net cash flows of the equipment manufacturing and retail golf businesses were reported as discontinued operations in our annual consolidated financial statements and in the condensed consolidated financial statements included in this report.

### Consolidated Statements of Operations Data:

**For the Three Months Ended**  
**3/31/06**  
**(Restated)**  
**(In thousands, except per share data)**  
**(Unaudited)**

|   |    |         |
|---|----|---------|
| Revenue   | \$ | 6,555   |
| Cost of sales   |    | 5,324   |
| Gross profit  |    | 1,231   |
| Operating expenses  |    |         |
| Selling, general, and administrative  |    | 2,705   |
| Research and development  |    | 203     |
| Total operating expenses  |    | 2,908   |
| Loss from operations  |    | (1,677) |
| Change in value of warrants, (loss)   |    | (1,289) |
| Change in value of conversion feature, (loss)   |    | (1,783) |
| Other income  |    | 480     |
| Interest expense, net   |    | (1,780) |
| Loss from operation before income taxes   |    | (6,049) |
| Income taxes  |    | (6,049) |
| Net Loss  | \$ | (6,049) |
| Loss per share from operations - basic and diluted  |    | (0.14)  |
| Weighted average common shares used to compute loss per share from operations - basic and diluted |    | 42,817  |

**Consolidated Statements of Operations Data:**

|   | 12/31/05<br>(Restated)                               | For the Three Months Ended |                       | 3/31/05<br>(Restated) |
|---|--|----------------------------|-----------------------|-----------------------|
|   |  | 9/30/05<br>(Restated)      | 6/30/05<br>(Restated) |                       |
|   | (In thousands, except per share data)<br>(Unaudited) |                            |                       |                       |
| Revenue   | \$ 5,453   | \$ 4,342                   | \$ 3,727              | \$ 2,843              |
| Cost of sales   | 4,576  | 3,756                      | 3,962                 | 2,835                 |
| Gross (loss) profit   | 877  | 586                        | (235)                 | 8                     |
| Operating expenses  |  |                            |                       |                       |
| Selling, general, and administrative  | 2,013  | 2,364                      | 1,567                 | 2,590                 |
| Research and development  | 314  | 196                        | 213                   | 397                   |
| Impairment of long lived assets   | 260  | 833                        | 3,394                 |                       |
| Total operating expenses  | 2,587  | 3,393                      | 5,174                 | 2,987                 |
| Loss from operations  | (1,710)  | (2,807)                    | (5,409)               | (2,979)               |
| Loss from extinguishments of debt   |  | (1,247)                    |                       |                       |
| Change in value of warrants, gain (loss)  | 2,840  | 1,112                      | (100)                 | 133                   |
| Change in value of conversion feature, gain   | 4,621  | 2,215                      | 1,167                 | 1,115                 |
| Interest expense, net   | (1,641)  | (1,652)                    | (1,180)               | (1,531)               |
| Income (loss) from operation before income taxes and discontinued operations  | 4,110  | (2,379)                    | (5,522)               | (3,262)               |
| Income taxes  |  |                            |                       |                       |
| Net income (loss)   | \$ 4,110   | \$ (2,379)                 | \$ (5,522)            | \$ (3,262)            |
| Income (loss) per share from continuing operations - basic and diluted  | \$ 0.10  | \$ (0.06)                  | \$ (0.13)             | \$ (0.08)             |
| Weighted average common shares used to compute income (loss) per share from continuing operations - basic and diluted | 42,180   | 41,933                     | 41,610                | 41,610                |

**Consolidated Statements of Operations Data:**

|   | 12/31/04<br>(Restated) | For the Three Months Ended                           |                       | 3/31/04<br>(Restated) |
|---|------------------------|--|-----------------------|-----------------------|
|   |                        | 9/30/04<br>(Restated)                                | 6/30/04<br>(Restated) |                       |
|   |                        | (In thousands, except per share data)<br>(Unaudited) |                       |                       |
| Revenue   | \$ 2,471               | \$ 4,615   | \$ 4,055              | \$ 6,288              |
| Cost of sales   | 2,895                  | 3,241  | 2,475                 | 3,557                 |
| Gross profit (loss)   | (424)                  | 1,374  | 1,580                 | 2,731                 |
| Operating expense:  |                        |  |                       |                       |
| Selling, general, and administrative  | 2,413                  | 3,569  | 2,544                 | 3,065                 |
| Research and development  | 407                    | 374  | 345                   | 341                   |
| Total operating expenses  | 2,820                  | 3,943  | 2,889                 | 3,406                 |
| Loss from operations  | (3,244)                | (2,569)  | (1,309)               | (675)                 |
| Loss on extinguishments of debt   |                        | (2,941)  |                       |                       |
| Change in value of warrants, (loss) gain  | (99)                   | (434)  | 694                   | 586                   |
| Change in value of conversion feature, gain (loss)  | (1,183)                | (2,338)  | 3,904                 | 1,710                 |
| Other income (expense), net   |                        | 302  |                       |                       |
| Interest income (expense), net  | (640)                  | (3,283)  | (2,233)               | (384)                 |
| Income (loss) from operation before income taxes and discontinued operations  | (5,166)                | (11,263)   | 1,056                 | 1,237                 |
| Income taxes  |                        |  |                       |                       |
| Income (loss) from continuing operations  | (5,166)                | (11,263)   | 1,056                 | 1,237                 |
| Loss from discontinued operations, net of tax   |                        |  | (356)                 | (393)                 |
| Net income (loss)   | \$ (5,166)             | \$ (11,263)  | \$ 700                | \$ 844                |
| Income (loss) per share from continuing operations basic and diluted  | \$ (0.12)              | \$ (0.27)  | \$ 0.03               | \$ 0.03               |
| Weighted average common shares used to compute income (loss) per share from continuing operations basic and diluted | 41,610                 | 41,610   | 41,610                | 41,610                |

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





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*The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements included elsewhere in this prospectus. This discussion contains forward-looking statements. See Forward-Looking Statements for a discussion of uncertainties, risks and assumptions associated with these statements.*

### **Overview**



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Our revenues are derived from two principal operating segments: Liquidmetal alloy industrial coatings and bulk Liquidmetal alloy products. Liquidmetal alloy industrial coatings are used primarily as a protective coating for industrial machinery and equipment, such as drill pipe used by the oil drilling industry and boiler tubes used in coal-burning power plants. Bulk Liquidmetal alloy segment revenue includes sales of parts or components of electronic devices, medical products, and sports and leisure goods; tooling and prototype parts (including demonstration parts and test samples) for customers with products in development, product licensing and arrangements, and research and development revenue relating primarily to defense and medical applications. We expect that these sources of revenue will continue to significantly change the character of our revenue mix.

The cost of sales for our Liquidmetal coatings segment consists primarily of the costs of outsourcing our manufacturing to third parties. Consistent with our expectations, our cost of sales has been increasing over historical results as we further build our bulk Liquidmetal alloy business. Although we plan to continue outsourcing the manufacturing of our coatings, we will internally manufacture many products derived from our bulk Liquidmetal alloys.

Selling, general, and administrative expenses currently consist primarily of salaries and related benefits, severance costs, travel, consulting and professional fees, depreciation and amortization, insurance, office and administrative expenses, and other expenses related to our operations.

Research and development expenses represent salaries, related benefits expense, stock-based compensation, depreciation of research equipment, consulting and contract services, expenses incurred for the design and testing of new processing methods, expenses for the development of sample and prototype products, and other expenses related to the research and development of Liquidmetal alloys. Costs associated with research and development activities are expensed as incurred. We plan to enhance our competitive position by improving our existing technologies and developing advances in amorphous alloy technologies. We believe that our research and development efforts will focus on the discovery of new alloy compositions, the development of improved processing technology, and the identification of new applications for our alloys.

We maintain certain of our raw material inventories in amounts in excess of our operating cycle of one year due to the nature of our manufacturing process, production lead time, and the recyclability of our raw material. These inventories were classified as long-term inventory as of December 31, 2004. We have determined that its current and projected raw material requirements are not sufficient enough to warrant the use of such raw materials in the foreseeable future. As a result, we determined that the carrying value of raw materials held by its subsidiary, Liquidmetal Korea, exceeded its fair value in the amount of \$2.7 million during the fiscal year 2005.

Idle equipment consists of certain equipment held by the Company for use in expansion of bulk alloy parts manufacturing. Due to excess manufacturing capacity, the Company classified the equipment as idle equipment as of December 31, 2005 and 2004. While the equipment may be used internally to meet future capacity requirements, considering our current revenue and foreseeable production requirements, we do not anticipate utilizing this equipment internally in the near future. As a result, we determined that the carrying value of idle equipment held by its subsidiary, Liquidmetal Korea, exceeded its fair value in the amount of \$1.7 million during the second quarter of fiscal year 2005.

On August 4, 2004, we established a sub-assembly plant in the city of Weihai in Shandong province of China under Weihai Liquidmetal Company Limited, which is 100 percent owned by Liquidmetal Korea, to facilitate our bulk alloy manufacturing business. Weihai Liquidmetal is consolidated into Liquidmetal Technologies with all intercompany transactions eliminated.

In conjunction with the divestiture of our Dongyang and Taesung subsidiaries in March and June 2004, respectively, we decided to discontinue our equipment manufacturing business in order to conform our operations to our broader corporate business strategy. Pursuant to Accounting Principles Board Opinion No. 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, we reclassified our consolidated financial statements to reflect the discontinuation of our equipment manufacturing operations. The revenue, costs and expenses, assets and liabilities, and cash flows of the equipment manufacturing business were segregated in our financial statements.

Impairment of goodwill represents the write-down of the goodwill balance of Dongyang Yudoro ( Dongyang ), our 51% owned subsidiary in South Korea. During 2003, Dongyang experienced net losses as a result of a continuing economic downturn in markets for its machinery products. These events, along with Dongyang's operating cash flow losses and uncertainty surrounding its future cash flows, led us to evaluate our investment for recoverability as of December 31, 2003. As a result, we determined that the carrying value of our investment in Dongyang exceeded its fair value as of December 31, 2003 in the amount of \$0.2 million. In March 2004, we sold our 51% investment in Dongyang to the 49% minority stockholder.

Impairment of Long-Lived Assets consists of a write-down of the building of our manufacturing facility in South Korea on the basis that the fair value of this building was determined to be less than the book value as of December 31, 2003. Our significant operational difficulties in 2003 along with our history of operating or cash flow losses and uncertainty surrounding our future cash flows, led us to evaluate our long-lived assets for recoverability as of December 31, 2003. As a result, we determined that the carrying value of our manufacturing plant in Pyongtaek, South Korea exceeded its fair value as of December 31, 2003 in the amount of \$2.7 million. The fair value of the building was based on the average of two independent appraisals of the building obtained in the first quarter of 2004.

We have restated our previously issued financial statements for the fiscal years ended December 31, 2004 and 2005, and for the quarter ended March 31, 2006 due to an error related to our accounting for the embedded convertible feature of the senior convertible notes issued in March 2004, which were exchanged in August 2004, in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, (SFAS 133).

The correction of the error to properly state the fair value of the embedded conversion feature of the senior convertible notes in accordance with SFAS 133 resulted in recognition of \$7.6 million as a conversion feature liability as of the issuance of the senior convertible notes in March 2004 as the convertible notes are considered a non-conventional convertible debt instrument. The correction resulted in recognition of the change in fair value of the embedded convertible feature in our earnings as a gain (loss) of \$2.1 million, \$5.3 million, and (\$0.8 million) for the years ended December 31, 2004 and 2005, and the quarter ended March 31, 2006, respectively, as well as adjustments to amortization of debt discount as interest expense of \$3.0 million, \$1.1 million, and \$0.2 million for the years ended December 31, 2004 and 2005, and the quarter ended March 31, 2006, respectively, and an additional loss on extinguishment of debt of \$1.3 million for the year ended December 31, 2004. Additionally, we recognized \$0.9 million, \$0.5 million, and \$27 thousand in additional paid in capital from redemption and conversion of convertible notes as of December 31, 2004, December 31, 2005, and March 31, 2006, respectively.

Change in Value of Warrants consists of changes to the fair value of warrants outstanding at each period. The warrants have been accounted for as a liability in accordance with Emerging Issues Task Force Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, with the change in fair values reported in earnings. The fair values are determined using a Black-Scholes pricing model and fluctuations in our stock price have had the greatest impact on the valuation of outstanding warrants.

Change in Value of Conversion Feature consists of changes to the fair value of the embedded conversion feature of our senior convertible notes. The embedded conversion feature has been accounted for as a separate derivative instrument in accordance with SFAS 133. The change in fair values are determined using a Black-Scholes pricing model and fluctuations in our stock price have had the greatest impact on the valuation of

the conversion features.

On May 21, 2003, we completed a reincorporation by transitioning from a California corporation to a Delaware corporation. The reincorporation was effected through the merger of the former California entity into a newly

created wholly owned Delaware subsidiary. The reincorporation changed the legal domicile of our company but did not result in any change to our business, management, employees, fiscal year, assets or liabilities, or location of facilities. As part of the reincorporation, each share of the California corporation was automatically converted into one share of the Delaware corporation. In addition, total authorized shares decreased from 200,000,000 shares to 100,000,000 shares.

**Results of Operations**



*Comparison of the three months ended March 31, 2006 and 2005*

*Revenue.* Revenue increased \$3.8 million to \$6.6 million for the three months ended March 31, 2006 from \$2.8 million for the three months ended March 31, 2005. The increase consisted of an increase of \$2.2 million from the sales and prototyping of parts manufactured from bulk Liquidmetal alloys to consumer electronics customers as a result of increased demand from electronic casings applications, an increase of \$0.3 million from our research and development contracts, and an increase of \$1.3 million from sales of our coatings products as a result of increase in demand from oil drilling applications.

*Cost of Sales.* Cost of sales increased to \$5.3 million, or 81% of revenue, for the three months ended March 31, 2006 from \$2.8 million, or 100% of revenue, for the three months ended March 31, 2005. The decrease in cost of sales as a percentage of revenue was a result of continued maturing of our manufacturing process, which represents the Company's efforts to manage costs and focus on our core business, and an increase in revenues generated from our higher margin coatings products. Significant portions of our manufacturing costs continue to remain fixed. We believe that higher manufacturing volumes and greater mix of higher-margin products in the future will cause the gross profit to improve over time. The cost to manufacture parts from our bulk Liquidmetal alloys is variable and differs based on the unique design of each product. However, the cost of sales for the products sold by the coatings business segment is generally consistent because the Liquidmetal coatings products are produced by third parties and sold wholesale to various industries.

*Selling, General, and Administrative Expenses.* Selling, general, and administrative expenses increased to \$2.7 million, or 41% of revenue, for the three months ended March 31, 2006 from \$2.6 million, or 91% of revenue, for the three months ended March 31, 2005. This increase was primarily a result of increase wages and compensation of \$0.7 million primarily from recognition of stock based compensation expense during the quarter and increases in employees, advertising and promotions costs of \$0.1 million primarily from higher commissions costs, travel expenses of \$0.1 million, offset by decreases in professional services by \$0.2 million, decrease in insurance costs of \$0.4 million, and decrease in depreciation expenses of \$0.1 million.

*Research and Development Expenses.* Research and development expenses decreased to \$0.2 million, or 3% of revenue, for the three months ended March 31, 2006 from \$0.4 million, or 14% of revenue, for the three months ended March 31, 2005. The Company continues to perform research and development of new Liquidmetal alloys and related processing capabilities, develop new manufacturing techniques, and contract with consultants to advance the development of Liquidmetal alloys. The decrease was primarily due to decreases in salaries, wages and related costs of \$0.2 million

*Change in Value of Warrants.* Change in value of warrants decreased to a net loss of \$1.3 million, or 20% of revenue, for the three months ended March 31, 2006 from a net gain of \$0.1 million, or 5% of revenue, for the three months ended March 31, 2005. The change in value of warrant consisted of warrants issued from the senior convertible notes issued in March 2004 and exchanged in August 2004, convertible debt funded in June 2005, senior convertible debt funded in August 2005, and subordinated promissory note funded in March 2006 primarily as a result of fluctuations in our stock price.



*Change in Value of Conversion Feature.* Change in the value of our conversion feature liability from our senior convertible notes issued in March 2004 and exchanged in August 2004 and August 2005 resulted in a change in value of conversion feature net loss of \$1.8 million, or 27% of revenue, during the three months ended March 31, 2006 and a gain of \$1.1 million, or 39% of revenue, for the three months ended March 31, 2005, primarily due to fluctuations in our stock price.

*Other Income.* Other income was \$480, or 7% of revenue, for the three months ended March 31, 2006 from net gain recognized from termination of a distribution agreement with a Japanese sporting goods distributor originally entered into in March 1996. There were no amounts recognized as other income during the three months ended March 31, 2005.

*Interest Expense.* Interest expense was \$1.8 million, or 27% of revenue, for the three months ended March 31, 2006 and was \$1.5 million, or 54% of revenue, for the three months ended March 31, 2005. Interest expense consists primarily of interest accrued on the Kookmin Bank loan funded in February 2003, senior convertible debt funded in March 2004 and exchanged in August 2004, senior convertible debt funded in August 2005, subordinated promissory note funded in March 2006, fees charged from short-term borrowings under the April 2005 factoring, loan, and security agreement, as well as amortization of debt issuance costs and discount on the convertible debt. The increase was primarily due to additional amortization of debt issuance costs and discount on debt funded in June 2005 and August 2005 as well as fees from borrowings made under the April 2005 factoring, loan, and security agreement.

*Interest Income.* Interest income was \$2 thousand for the three months ended March 31, 2006 and was \$6 thousand for the three months ended March 31, 2005 from interest earned on cash deposits.

***Comparison of the years ended December 31, 2005 and 2004***

*Revenue.* Revenue decreased to \$16.4 million in the twelve months ended December 31, 2005 from \$17.4 million in the twelve months ended December 31, 2004. The decrease included a \$2.6 million decrease from restatement of revenues from 2003 to 2004 as part of our 2003 financial statement restatement which resulted in one-time recognition of revenues during the first quarter of 2004, and \$0.9 million decrease from our research and development services related primarily to reduced activity from defense, leisure, and luxury goods applications during 2005. The decreases were offset by a \$0.4 million increase in bulk alloy parts primarily to increased sales to sporting goods manufacturers and \$1.9 million increase from sale of our coatings products from increased demand for drill pipe coatings during 2005.

*Cost of Sales.* Cost of sales increased to \$15.1 million, or 92% of revenue, during the twelve months ended December 31, 2005 from \$12.2 million, or 70% of revenue, in the twelve months ended December 31, 2004. The increase was a result of decreases in bulk Liquidmetal alloy business. Cost of sales as a percentage of revenue has increased as a result of ramp up of lower margin electronic casing and prototypes during the year. Further, significant portion of our manufacturing costs continue to remain fixed. We believe that higher manufacturing volumes and greater mix of higher margin products in the future will cause the gross profit to improve over time. The cost to manufacture parts from our bulk Liquidmetal alloys is variable and differs based on the unique design of each product. However, the cost of sales for the products sold by the coatings business segment is generally consistent because the Liquidmetal coatings products are produced by third parties and sold wholesale to various industries.

*Selling, General, and Administrative Expenses.* Selling, general, and administrative expenses decreased to \$8.5 million, or 52% of revenue, in the twelve months ended December 31, 2005 from \$11.6 million, or 67% of revenue, in the twelve months ended December 31, 2004. This decrease was primarily a result of decrease in professional and contracted services of \$1.8 million, decrease in advertising and promotions expense of \$0.2 million, decrease in bad debt expenses of \$0.1 million, decrease in product warranty expense of \$0.2 million, decrease in insurance costs of \$0.6 million, and decrease in amortization and depreciation costs of \$0.2 million. These and other decreases in selling,

general and administrative expenses represent the Company's efforts to manage costs and focus on our core business while continuing to build our corporate infrastructure required to prepare for and support the anticipated growth of our bulk Liquidmetal alloy business.

*Research and Development Expenses.* Research and development expenses decreased to \$1.1 million, or 7% of revenue, in the twelve months ended December 31, 2005 from \$1.5 million, or 8% of revenue, in the twelve months ended December 31, 2004. The decrease was primarily a result of decreases in salaries, wages and related expenses by \$0.3 million and decrease in laboratory and prototyping expenses by \$0.1 million. The decreases were a result of the Company focusing primarily on our core business associated with our bulk Liquidmetal alloy business while managing our costs. The Company continues to perform research and development efforts on new Liquidmetal alloys and related processing capabilities, develop new manufacturing techniques, and contract with consultants and provide research grants to various institutions to advance the development of Liquidmetal alloys.

*Impairment of Long Lived Assets.* Impairment of long lived assets increased to \$4.5 million, or 27% of revenue, for the twelve months ended December 31, 2005 from \$0 for the twelve months ended December 31, 2004.

Impairment expense represents primarily write-down of \$2.7 million of raw materials considered to be long term inventory and \$1.7 million of idle equipment. While we may use the excess raw materials beyond one year to fulfill future customer order, we have determined that our current capacity was not significant enough to warrant holding this inventory as a long term asset. Further, while we have actively marketed the idle equipment for ultimate sale since early 2004, we were unable to sell this equipment. In addition, while the equipment may be used internally to meet future capacity requirements, considering our current revenue, we do not anticipate utilizing this equipment internally in the near future. As such, we have reduced the carrying values of the excess raw material and idle equipment.

*Loss from Extinguishments of Debt.* Loss from extinguishments of debt decreased to \$1.2 million, or 8% of revenue, for the twelve months ended December 31, 2005 from \$2.9 million, or 17% of revenue, for the twelve months ended December 31, 2004. The \$1.2 million loss from extinguishments of debt was recognized from the exchange of our 6% Convertible Notes due 2006 in August 2005. The \$1.7 million loss from extinguishments of debt was recognized from exchange of our 6% Senior Convertible Notes due March 2007 in August 2004.

*Change in Value of Warrants.* Change in value of warrants was a net gain of \$4.0 million, or 24% of revenue, and \$0.7 million, or 4.3% of revenue, during the twelve months ended December 31, 2005 and 2004, respectively from the change in value of warrants issued from the senior convertible notes issued in March 2004 and exchanged in August 2004, convertible debt funded in June 2005, and senior convertible debt funded in August 2005 primarily as a result of fluctuations in our stock price.

*Change in Value of Conversion feature.* Change in the value of our conversion feature liability from our senior convertible notes issued in March 2004 and exchanged in August 2004 and August 2005 resulted in a change in value of conversion feature gain of \$9.1 million, or 56% of revenue, and a gain of \$2.1 million, or 12% of revenue, for the twelve months ended December 31, 2005 and 2004, respectively, primarily due to fluctuations in our stock price.

*Other Income.* Other income was \$0.3 million, or 2% of revenue, during the twelve months ended December 31, 2004 from certain stock transactions with John Kang, our Chairman, President, and Chief Executive Officer during 2002 (see CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS ). There were no amounts recorded as other income for the twelve months ended December 31, 2005.

*Interest Expense.* Interest expense was \$6.0 million, or 37% of revenue, for the twelve months ended December 31, 2005 and was \$6.6 million, or 38% of revenue, for the twelve months ended December 31, 2004. During each of the twelve months ended December 31, 2005 and 2004, the interest expense was primarily due to the interest accrued on the Kookmin Bank loan funded on February 4, 2003, senior convertible debt funded on March 3, 2004 and exchanged in August 2004, convertible debt funded on June 13, 2005, and senior convertible debt funded in August 9, 2005, as well as amortization of debt issuance costs and discount on the convertible debt. During 2005, \$0.1 million of interest expense was accrued from default interest rates applied to the senior convertible notes effective April 1, 2005 from non-payment of quarterly scheduled interest payments and \$1.0 million of late registration penalty fee of our senior convertible debt was accrued as interest expense. The default interest and late registration penalty were paid as of December 31, 2005.

*Interest Income.* Interest income was \$17 thousand for the twelve months ended December 31, 2005, and \$37 thousand for the twelve months ended December 31, 2004 from interest earned on cash deposits.

*Comparison of the years ended December 31, 2004 and 2003*

*Revenue.* Revenue increased to \$17.4 million in the twelve months ended December 31, 2004 from \$13.7 million in the twelve months ended December 31, 2003. The increase was due to increases in revenue earned by our bulk Liquidmetal alloy and coatings segments in the twelve months ended December 31, 2004. This increase in revenue consisted of \$3.8 million from the sale and prototyping of parts manufactured from bulk Liquidmetal alloys, offset by a decrease of \$1.9 million from research and development services related primarily from reduced activity from defense and medical applications. Our coatings business contributed \$1.0 million to the increase in revenues as compared to the twelve months ended December 31, 2003 from increased demand for drill pipe coatings.

*Cost of Sales.* Cost of sales decreased to \$12.2 million, or 70% of revenue, during the twelve months ended December 31, 2004 from \$18.2 million, or 133% of revenue, in the twelve months ended December 31, 2003. This

decrease was a result of the continued maturing of our manufacturing process and represents the Company's efforts to manage costs and focus on our core business while continuing to build production pipeline and manufacturing infrastructure required to prepare for and support the anticipated growth of our bulk Liquidmetal alloy business. The cost of sales for the products sold by the coatings business segment is generally consistent from year to year because the Liquidmetal coatings products are produced by third parties and sold wholesale to various industries.

*Selling, General, and Administrative Expenses.* Selling, general, and administrative expenses decreased to \$11.6 million, or 66% of revenue, in the twelve months ended December 31, 2004 from \$17.7 million, or 130% of revenue, in the twelve months ended December 31, 2003. This decrease was primarily a result of decrease in wages and related expense by \$5.0 million, decreases in travel and communication expenses by \$0.8 million, decreases in rent by \$0.8 million, decrease in relocation expenses by \$0.7 million, offset by an increase in professional fees, consultant fees, and contract services by \$0.8 million, and an increase in insurance costs by \$0.4 million. These and other decreases in selling, general and administrative expenses represent the Company's efforts to manage costs and focus on our core business while continuing to build our corporate infrastructure required to prepare for and support the anticipated growth of our bulk Liquidmetal alloy business.

*Research and Development Expenses.* Research and development expenses decreased to \$1.5 million, or 8% of revenue, in the twelve months ended December 31, 2004 from \$8.8 million, or 64% of revenue, in the twelve months ended December 31, 2003. The decrease was primarily a result of decreases in salaries, wages and the related expenses by \$3.0 million, decrease in laboratory and prototyping expenses by \$2.0 million, decrease in depreciation expense by \$0.7 million, decrease in professional fees, consultant fees, and contract services by \$0.6 million, decrease in research grants by \$0.3 million, and decrease in travel related expenses by \$0.2 million. The decreases were a result of the Company focusing primarily on our core business associated with our bulk Liquidmetal alloy business while managing our costs. The Company continues to perform research and development efforts on new Liquidmetal alloys and related processing capabilities, develop new manufacturing techniques, and contract with consultants and provide research grants to various institutions to advance the development of Liquidmetal alloys.

*Impairment of Goodwill.* Impairment of goodwill was \$0.2 million, or 1% of revenue, in the twelve months ended December 31, 2003. Impairment of goodwill represents the write-down of the goodwill balance of Dongyang Yudoro (Dongyang), our 51% owned subsidiary in South Korea. During 2003, Dongyang experienced net losses as a result of a continuing economic downturn in the market for its machinery products. These events along with Dongyang's operating, and cash flow losses, and uncertainty surrounding its future cash flows, led us to evaluate our investment for recoverability as of December 31, 2003. As a result, we determined that the carrying value of our investment in Dongyang exceeded its fair value as of December 31, 2003 in the amount of \$0.2 million. In March 2004, we sold our 51% investment in Dongyang to the 49% minority shareholder (see Note 18 to the consolidated financial statements included in this prospectus). There was no impairment charge to goodwill in the twelve months ended December 31, 2004.

*Impairment of Long Lived Assets.* Impairment of long lived assets was \$2.7 million, or 20% of revenue, in the twelve months ended December 31, 2003. Impairment expense represents a write-down of the building of our manufacturing facility in South Korea. Due to the decreased production and usage of our Pyongtaek manufacturing operation, we decided to obtain independent appraisals as to the fair value of this building. Accordingly, the fair value of the

building as determined by the average of the two independent appraisals was less than the carrying value of the building as of December 31, 2003. There was no impairment charge to long lived assets in the twelve months ended December 31, 2004.

*Loss from Extinguishment of Debt.* Loss from extinguishment of debt was \$2.9 million, or 17% of revenue, during the twelve months ended December 31, 2004 due to the extinguishment of our March Notes as it relates to the exchange in August 2004. There was no such loss recorded during twelve months ended December 31, 2003.

*Change in Value of Warrants.* Change in value of warrants was a net gain of \$0.7 million, or 4% of revenue, during the twelve months ended December 31, 2004 from the change in valuation of warrant payable issued related to the senior convertible notes issued in March 2004, which was exchanged in August 2004 (see Note 15 to the consolidated financial statements included in this prospectus). There were no such amounts recorded for the twelve months ended December 31, 2003.

*Change in Value of Conversion Feature.* Change in the value of our conversion feature liability from our senior convertible notes issued in March 2004 and exchanged in August 2004 resulted in a change in value of conversion feature gain of \$2.1 million, or 12% of revenue, during the twelve months ended December 31, 2004, primarily due to fluctuations in our stock price. There were no such amounts recorded for the twelve months ended December 31, 2003.

*Other Income.* Other income was \$0.3 million, or 2% of revenue, during the twelve months ended December 31, 2004 from certain stock transactions with John Kang, our Chairman, President, and Chief Executive Officer during 2002 (see CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS ). There were no amounts recorded as other income for the twelve months ended December 31, 2003.

*Interest Expense.* Interest expense was \$6.6 million, or 38% of revenue, in the twelve months ended December 31, 2004 and was \$0.4 million, or 3% of revenue, in the twelve months ended December 31, 2003. During the twelve months ended December 31, 2004, the interest expense was primarily due to the interest accrued, amortization of debt discount and deferred issuance costs on new senior convertible debt originally sold on March 3, 2004 and exchanged in August 2004, and interest accrued on Kookmin Bank loan funded on February 4, 2003. During the twelve months ended December 31, 2003, interest expense was primarily due to interest accrued on the Kookmin Bank loan to our South Korean subsidiary made on February 4, 2003.

*Interest Income.* Interest income was \$37 thousand for the twelve months ended December 31, 2004 for interest earned on certificate of deposits. Interest income was \$0.3 million or 2% of revenue for the twelve months ended December 31, 2003 for interest earned on short-term, investment grade, interest-bearing securities.

*Gain from Sale of Investment.* In April 2003 we sold our remaining shares of Growell Metal Co., Ltd. that were purchased in July 2002. We recognized a \$1.2 million gain on the sale of these shares during the twelve months ended December 31, 2003. There were no such gains in the twelve months ended December 31, 2004.

## **Liquidity and Capital Resources**

Since our inception, we have funded our operations through the sale of equity securities in private placements and our initial public offering, the sale of convertible notes and warrants in private placements, debt financing, and cash generated from operations.

Our cash used for operating activities was \$1.2 million for the three months ended March 31, 2006 and \$1.1 million for the three months ended March 31, 2005. Our working deficit increased from \$11.0 million at December 31, 2005 to \$12.0 million at March 31, 2006. The Company's working deficit increase of \$1.0 million was primarily attributable to increase in accounts payable and accrued liability of \$1.4 million, increase in short term debt of \$1.7 million, increase in warrant liabilities of \$1.4 million, increase in conversion feature liability of \$1.8 million, offset by increase in trade accounts receivable of \$1.1 million, decrease in settlement payable of \$3.3 million, and decrease in deferred revenue of \$0.9 million.



Our cash used in investing activities was \$0.2 million for the three months ended March 31, 2006 for the acquisition of property and equipment and investments in patents and trademarks.

Our cash provided by financing activities was \$1.4 million for the three months ended March 31, 2006, which consists of \$1.0 million in proceeds from borrowings from our subordinated promissory note executed in March 2006 and \$3.0 million in proceeds from factoring agreement executed in April 2005, offset by \$2.6 million on repayment of borrowings. The proceeds from borrowings have been used to meet working capital requirements.

We anticipate that our capital expenditures will be less than \$0.5 million for the full year 2006 for the acquisition of furniture, fixtures, and other business equipment. This amount is subject to change, however, depending upon the nature and the amount of the product orders that we actually receive from customers.

Our capital requirements during the next twelve months will depend on numerous factors, including the success of existing products either in manufacturing or development, the development of new applications for Liquidmetal

alloys, the resources we devote to develop and support our Liquidmetal alloy products, the success of pursuing strategic licensing and funded product development relationships with external partners.

We have experienced significant operating losses since our inception. Our net loss for the fiscal years ended December 31, 2005 and 2004 was \$7.1 million and \$14.9 million, respectively, and our net loss for the three months ended March 31, 2006 and 2005 was \$6.0 million and \$3.3 million, respectively. In the audit report on our financial statements for our fiscal years ended December 31, 2005 and 2004, our auditors included a going-concern qualification indicating that our significant operating losses and working capital deficit cause substantial doubt about our ability to continue as a going concern. By issuing an opinion stating that there is substantial doubt about our ability to continue as a going concern, our auditors have indicated that they are uncertain as to whether we have the capability to continue our operations without additional funding. Accordingly, we anticipate that we will need additional funding during the next 12 months, and we plan to seek to raise such funds through public or private equity financing, bank debt financing, or from other sources. Specifically, we anticipate that we could need \$1 million to \$5 million over the next twelve months to pursue our current operating plan, although this amount may be lower depending on the orders we receive for our products. The amount of funding that we plan to seek and the timing of such fundraising efforts will depend on the extent to which we are able to increase revenues through obtaining additional purchase orders for our products, particularly components for cellular phones and flash memory drive casings, and our ability to continue to improve our manufacturing processes. We evaluate our working capital needs and operating plan assumptions on a monthly basis to determine whether any adjustment to our cash and liquidity outlook is warranted, and we also review potential sources of financing on an ongoing basis. However, adequate funds may not be available when needed, and if we raise additional funds by issuing equity securities, existing stockholders may be diluted. If we don't receive sufficient funding to operate under our current plan, we intend to reduce operations and expenses and shift our focus to the pursuit of licensing transactions and other strategic transactions that are less capital intensive.

On May 12, 2006, we received a letter from one holder holding \$0.5 million of the August 2007 Notes demanding immediate payment of late filing fees and late registration fees for the period following October 31, 2005 through May 3, 2006. As a result of the late fee provisions of the restated registration rights agreement, we are obligated to pay late filing and late registration fees accrued through July 3, 2006 of up to \$1.4 million to all of the noteholders. In addition, the letter purported to constitute a notice of default under the August 2007 Notes and July 2007 Notes ( Notes ) as a result of our failure to pay the late filing and late registration fees. Under the terms of Notes, if a default is not cured by us within thirty (30) days of notice thereof, the holder has the right to accelerate all principal and interest due under the Notes. As of July 3, 2006, \$9.9 million in aggregate principal amount of August 2007 Notes was still outstanding with accrued but unpaid interest in the amount of approximately \$175 thousand. In addition, \$2.3 million in aggregate principal amount of July 2007 Notes was also outstanding with accrued but unpaid interest in the amount of approximately \$35 thousand. As of July 14, 2006, we have not paid any amounts under the demand letter and we are currently in negotiations with the holder regarding the matters set forth in the letter with the goal of preventing any acceleration of amounts due under the Notes.

*Initial Public Offering Proceeds*



## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

Pursuant to our Registration Statement on Form S-1 (Registration No. 333-73716), as amended, initially filed with the Securities and Exchange Commission on November 20, 2001 and declared effective May 21, 2002, we closed an initial public offering of 5,000,000 shares of common stock on May 28, 2002, plus an additional 229,000 shares on June 10, 2002 pursuant to an over allotment option, at a price of \$15.00 per share (which sale is referred to herein as the Offering ). The Offering generated aggregate cash proceeds during the second quarter 2002 of \$78.4 million. The net proceeds were \$70.7 million after deducting underwriting commissions of \$5.5 million and other transaction fees of \$2.2 million. The managing underwriters for the Offering were Merrill Lynch & Co., UBS Warburg, and Robert W. Baird & Co.

As of December 31, 2003, we used \$70.7 million of net proceeds from the Offering. In 2002, we used approximately \$7.8 million of the net proceeds from the Offering to repay all outstanding promissory notes and accrued interest, \$11.1 million to fund the construction of our manufacturing facility in South Korea, \$14.3 million to purchase equipment used to manufacture Liquidmetal parts, \$0.4 million to purchase assets related to production and sale of equipment used in the production process of Liquidmetal alloy products, and \$0.3 million to purchase the 51% interest in our majority owned Dongyang subsidiary. During the third quarter of 2002, we used \$2.0 million to invest in the common

stock of Growell Metal, which supplied a portion of the Liquidmetal alloy ingots used in our manufacturing operations in Korea. We have since sold such stock, realizing a gain on the sale. We used the remaining proceeds of \$32.7 million for working capital in 2002 and 2003, excluding \$2.1 million paid to Paul Azinger in 2002 and 2003 for amounts due under the terms of his terminated endorsement agreement with our discontinued retail golf operations.

*Private Placements of Convertible Notes*



## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

On March 3, 2004, we sold \$9.9 million of 6.0% senior convertible notes due 2007 (the March Notes ) to investor groups in a transaction led by Michigan Venture Capital Co., Ltd, a South Korea-based institutional investment firm, and IndiGo Ventures LLC, a New York-based investment firm that served as a financial advisor to our company for the transaction. The notes were convertible at any time into our common stock at a price of \$3.00 per share. Investors in the private placement received warrants to purchase an aggregate amount of up to approximately 1.2 million shares of common stock, originally exercisable at \$3.00 per share for varying periods but no later than 100 days following the effectiveness of a registration statement covering the resale of shares issuable upon exercise of the warrants. In addition, the investors had the right to call for repayment of the notes prior to maturity at any time after the second anniversary of the closing of the transaction.

On August 19, 2004, we completed a private exchange offer for our March Notes. Under terms of the exchange offer, approximately \$5.46 million in aggregate principal amount of the March Notes were exchanged for an aggregate of (i) \$2.73 million of 6% Senior Secured Notes Due 2007 (the July 2007 Notes ) and (ii) \$2.73 million of 10% Senior Secured Notes Due 2005 (the July 2005 Notes ), collectively referred to as Exchange Notes . In addition, we redeemed approximately \$4.5 million of the March Notes in cash. The Exchange Notes were collateralized by certain patents owned by our company and a second priority mortgage interest in plant facilities and certain equipment at our plant in South Korea. The July 2005 Notes had a maturity date of July 29, 2005, and a conversion price of \$2.00 per share (compared to a conversion price of \$3.00 per share under the March Notes). The July 2007 Notes have a maturity date of July 29, 2007, and a conversion price of \$1.00 per share. Further, the exchange notes are convertible into Common Stock, at the option of our company, if at any time after the issuance of the notes, the closing per share price of the Common Stock exceeded \$4.00 (as adjusted for stock splits, reverse splits, stock dividends, and recapitalizations) for 30 consecutive trading days, and further provided that there has been effective registration during such period. Holders of the July 2007 Notes also have the right to call for repayment of the July 2007 Notes prior to maturity at any time after the second anniversary of the completion of the exchange offer. A total of 563,151 warrants to purchase our common stock at an exercise price of \$3.00 per share all of which were previously issued in connection with the purchase of the March Notes were amended to provide for an extended expiration date of March 1, 2006. The warrants issued to placement agents are to expire the later of March 1, 2006 or 100 days after the effectiveness of registration of shares issuable under the warrants and senior convertible debt. The warrant exercise price is subject to price adjustment for anti-dilution purposes. As of March 31, 2006, there were 165,324 warrants outstanding and the exercise price of the warrants was \$2.72 per share. The warrant exercise price is subject to price adjustment for anti-dilution purposes.

On June 13, 2005, we completed a private placement (the June 2005 Private Placement ) of 10% Convertible Unsecured Notes Due June 13, 2006 in the aggregate principal amount of \$3.25 million (the June 2006 Notes ), together with warrants to purchase up to an aggregate of 893,750 shares of our company s common stock (the Warrants ). The June 2006 Notes were unsecured and were due on the earlier of June 13, 2006 or the consummation of a follow-on equity or debt offering or restructuring transaction pursuant to which our company receives gross proceeds of at least \$4.0 million. Prior to maturity, the June 2006 Notes were interest-only, with interest payments due quarterly, at the rate of 10% per year. If, within 120 days following the issue date of the June 2006 Notes, our company either failed to redeem the notes for the principal amount and accrued interest thereon or failed to close a Qualified Financing, then the June 2006 Notes would have been convertible at a conversion price equal to seventy five percent (75%) of the closing price of our company s common stock on the first trading day immediately preceding the conversion date. A Qualified Financing was defined in the June 2006 Notes as any debt or equity financing of our company resulting in aggregate gross proceeds to our company of at least \$5.0 million and in which the holders of at least sixty percent (60%) of the aggregate principal amount of our company s Long-Term Notes either (i) agree that the equity or debt securities to be issued in such financing shall be pari passu in order of payment to the July 2007 Notes held by them or (ii) exchange their July 2007 Notes for new securities in the financing transaction. We successfully completed a Qualified Financing on August 9, 2005, and the June 2006 Notes never became convertible.

On August 9, 2005, we completed a private placement (the August 2005 Private Placement) of \$9.9 million in principal amount of new 7% Convertible Secured Promissory Notes due August 2007 (the Senior Notes). The issuance consisted of \$5.0 million cash, exchange of \$1.3 million in principal amount of the July 2005 Notes, the exchange of \$3.0 million in principal amount of the June 2006 Notes, satisfaction of accrued interest and late registration fees in the amount of \$0.6 million on the July 2005 Notes, and satisfaction of accrued interest of \$9 thousand on the previously issued June 2006 Notes. The Senior Notes were issued pursuant to a Securities Purchase Agreement dated effective as of August 2, 2005 among the our company, the purchasers of the Senior Notes, and the holders of previously issued July 2005 Notes and June 2006 Notes. Interest payments on the Senior Notes are due quarterly, and failure to make timely interest payments will result in increase in interest rates to 14% per annum on the Senior Notes (Default Rates). As of September 30, 2005, we have made timely interest payments. The Senior Notes are convertible into shares of our common stock at \$2.00 per share Pursuant to an Amended and Restated Security Agreement. The Senior Notes are secured by substantially all of our assets and rank senior to all other obligations of our company, other than the our loan with Kookmin Bank of South Korea (or any refinancing of such loan), the July 2007 Notes, purchase-money asset financing, trade creditors in the ordinary course of business, and any inventory or receivables-based credit facility that we may obtain in the future, provided that the amount of the credit facility does not exceed 50% of eligible inventory and 80% of eligible receivables. The Senior Notes will automatically convert into shares of our common stock if the common stock has an average closing price of more than \$5.00 per share during 30 consecutive trading days. We also issued warrants to the purchasers of the Senior Notes and placement agents giving them the right to purchase up to 2,469,470 and 414,495 shares of our common stock, respectively, with an exercise price of \$2.00 per share. The warrants will expire on August 2, 2010.

In connection with the August 2005 Private Placement, we entered into an amended and restated registration rights agreement with the holders of the July 2007 Notes, the holders of the August 2007 Notes, and the holders of the above-described outstanding warrants. This amended and restated registration rights agreement replaced all other registration rights agreements previously entered into by us in connection with the private sale by us of convertible notes and warrants. Under the amended and restated registration rights agreement, we are required to file a resale registration statement for the shares underlying all of our outstanding convertible notes and warrants, as described above, by October 31, 2005, to enable the resale of such shares by the selling stockholders on a delayed or continuous basis under Rule 415 of the Securities Act. We are then required to cause such registration statement to become effective within 60 days after we receive the first written comments on the registration statement from the SEC, or if the SEC notifies us that it will not review the registration statement, within five days after such notification. We will be subject to certain monetary penalties, as set forth in the registration rights agreement, if the registration statement is not filed or does not become effective on a timely basis. Specifically, if we do not file the registration statement on a timely basis, we will be obligated to pay a late filing fee to the selling stockholders in the amount of 3% of the warrant exercise price on each of the warrants held by them plus 3% of the principal amount of the outstanding notes held by them. This fee will be payable for each period of 30 business days that the filing of the registration statement is made past the required filing date, and the payments will be due 10 business days following the end of each 30-day period. If the registration statement has not been declared effective by the required effective date, we will be obligated to pay a monthly late registration fee to the selling stockholders in the amount of 2% of the aggregate warrant exercise prices and aggregate note principal amounts for the first 30 business days after the required effective date, and 1% for each 30-business day period thereafter until the registration statement is declared effective. Notwithstanding the foregoing, the late filing fees and late registration fees will not exceed 18% of the aggregate warrant exercise prices and aggregate note principal amounts.

Our convertible notes and related documents contain restrictive covenants pursuant to which we generally may not (i) incur any indebtedness that would be senior to, or on the same rank as, the convertible notes with respect to payment or security, (ii) grant any liens or security interests in any of our assets which serve as collateral for the convertible notes (which collateral consists of substantially all of our assets), (iii) with certain exceptions, sell any of the assets that constitute collateral for the notes, (iv) become a guarantor for a third-party's obligation (other than guarantees in the ordinary course of business not in excess of \$0.5 million in the aggregate), (v) acquire any shares or securities of any other person or entity in excess of an aggregate of \$1.0 million over any rolling 12-month period, (vi) purchase or otherwise acquire any assets in excess of an aggregate of \$3.0 million over any rolling 12-month period, (vii) engage in any transaction resulting in the issuance to any person of more than 40% of the equity of our company, or (viii) engage in any merger or sale of all or substantially all of our business assets. These covenants may curtail our ability to raise capital in the future or otherwise restrict our ability to enter into a transaction that we believe would be in the best interest of our stockholders. We believe that we are currently in compliance with all such covenants. While there can be no assurances that we will be able to maintain compliance with these restrictive covenants in the future, if we violate these covenants and do



not cure such violations within 30 days of written notice from the noteholders, the noteholders may demand payment in full our convertible notes, collect penalty interest, and exercise other remedies that are available under notes.

On May 12, 2006, we received a letter from one holder holding \$0.5 million of the August 2007 Notes demanding immediate payment of late filing fees and late registration fees for the period following October 31, 2005 through May 3, 2006. As a result of the late fee provisions of the restated registration rights agreement, we are obligated to pay late filing and late registration fees accrued through July 3, 2006 of up to \$1.4 million to all of the noteholders. In addition, the letter purported to constitute a notice of default under the August 2007 Notes and July 2007 Notes ( Notes ) as a result of our failure to pay the late filing and late registration fees. Under the terms of Notes, if a default is not cured by us within thirty (30) days of notice thereof, the holder has the right to accelerate all principal and interest due under the Notes. As of July 3, 2006, \$9.9 million in aggregate principal amount of August 2007 Notes was still outstanding with accrued but unpaid interest in the amount of approximately \$175 thousand. In addition, \$2.3 million in aggregate principal amount of July 2007 Notes was also outstanding with accrued but unpaid interest in the amount of approximately \$35 thousand. As of July 14, 2006, we have not paid any amounts under the demand letter and we are currently in negotiations with the holder regarding the matters set forth in the letter with the goal of preventing any acceleration of amounts due under the Notes.

***Debt Financing***



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On March 17, 2006, in exchange for a \$1.0 million loan, we issued a \$1.0 million 10% subordinated promissory note due October 16, 2006 (the March 2006 Note ) to Atlantic Realty Group, Inc., a company controlled by Jack Chitayat, a former director of our company. The March 2006 Note is unsecured and subordinated to all prior indebtedness of the company. All accrued interest and unpaid principal are due October 16, 2006. The proceeds from the March 2006 Note is to be used solely for working capital purposes. In connection with the March 2006 Note, we issued warrants to Atlantic Realty to purchase an aggregate amount of up to 125,000 shares of common stock exercisable at \$2.00 per share. The warrants will expire on March 17, 2009 and include price adjustment provisions for anti-dilution purposes. There are no registration rights of the shares issuable from the exercise of the warrants. Further, cashless exercise of the warrants is permitted.

On May 17, 2006, we completed a private placement (the Private Placement ) of 8% Unsecured Subordinated Notes in the aggregate principal amount of \$3.625 million (the Notes ), together with warrants to purchase up to an aggregate of 705,233 shares of the Company's common stock (the Warrants ). Indigo Securities, LLC, served as placement agent in the transaction. The Private Placement, which was made solely to accredited investors including Ricardo A. Salas, President and CEO, pursuant to the exemption under Rule 506 under the Securities Act of 1933, resulted in gross proceeds of \$3.625 million before placement agent fees and expenses associated with the transaction. Mr. Salas holds \$0.1 million of the Notes.

The Notes issued in the Private Placement are unsecured and will become due on the earlier of August 17, 2007 or the consummation of a follow-on equity or debt offering pursuant to which the Company receives gross proceeds of at least \$6.0 million to be used for working capital purposes and repayment of debt, but excluding financings for the purpose of purchasing capital assets (a Follow-On Financing ). Interest on the unpaid principal balance of each Note accrues at the rate of 8% per annum from May 17, 2006 until the maturity date. The Notes can be prepaid by the Company at any time without penalty.

The Notes are subordinate in right of payment and in all other respects to the previously issued 6% Senior Secured Notes Due July 29, 2007 (the July 2007 Notes ), the previously issued 7% Senior Secured Convertible Notes Due August 2007 (the August 2007 Notes ), and any other notes that may be issued by the Company after May 17, 2006 in exchange for or in satisfaction of any July 2007 Notes or August 2007 Notes (collectively, the Senior Notes ). Notwithstanding the maturity date of the Notes, the Company will not make any payments of principal, interest or otherwise under the Notes until all amounts due and payable under the Senior Notes have been satisfied in full (whether through cash payment or conversion).

The Notes also give the investors the opportunity to participate in a Follow-On Financing at a discounted rate. If a holder of a Note elects to participate in a Follow-On Financing, then the holder of the Note will be entitled to purchase the securities being offered in the Follow-On Financing at a discount of 7% of the gross per share purchase price

(in the case of an offering of common stock or preferred stock) or 7% of the face amount of the security being sold (in the case of an offering of debt securities).

As a part of the Private Placement, the Company issued Warrants to the purchasers of the Notes giving them the right to purchase up to an aggregate of 705,233 shares of the Company's common stock. In addition, Warrants to purchase 68,508 shares of the Company's common stock were issued to the placement agent in the transaction. The Warrants have an exercise price of \$2.58 per share. The Warrants will expire on May 17, 2011.

The Company entered into a registration rights agreement with the holders of the Warrants (the "Warrant Holders") relating to the resale of the shares of Company common stock issuable upon exercise of the Warrants (the "Warrant Shares"). Under the registration rights agreement, the Company must file a registration statement with the Securities and Exchange Commission covering the resale of the Warrant Shares, if, following the 180<sup>th</sup> day after the date of the registration rights agreement, the Company receives a written request to do so from the holders of fifty percent or more of the Warrant Shares then outstanding. The Warrant Holders also have "piggyback" registration rights under the registration rights agreement, which requires the Company to register, upon request by a Warrant Holder, the Warrant Shares held by that Warrant Holder in any registration statement filed in connection with the public offering of the Company's common stock.

Our Liquidmetal Korea Co., Ltd. subsidiary also has an outstanding loan from Kookmin Bank in the Republic of Korea. As of March 31, 2006, the outstanding balance under this loan was \$2.6 million. The loan is payable in monthly installments of \$0.11 million per month through September 2007.

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



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An off-balance sheet arrangement is any transaction, agreement or other contractual arrangement involving an unconsolidated entity under which a company has (1) made guarantees, (2) a retained or a contingent interest in transferred assets, (3) an obligation under derivative instruments classified as equity, or (4) any obligation arising out of a material variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the company, or that engages in leasing, hedging, or research and development arrangements with the company.

We have made no arrangements of the types described in any of the categories that may have a material current or future effect on our financial condition, liquidity or results of operations.

### **Contractual Obligations**

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The following table summarizes our company's obligations and commitments as of March 31, 2006:

| Contractual Obligations (1)  | Total     | Payments Due by Period (in thousands) |           |           |               |
|------------------------------|-----------|---------------------------------------|-----------|-----------|---------------|
|                              |           | > 1 year                              | 1-3 Years | 3-5 Years | After 5 years |
| Long-term debt (2)           | \$ 14,756 | \$ 1,391                              | \$ 13,365 | \$        | \$            |
| Short-term debt (3)          | 2,286     | 2,286                                 |           |           |               |
| Capital lease obligation (4) | 42        | 42                                    | 7         |           |               |
| Operating leases and rents   | 1,009     | 492                                   | 516       | 1         |               |
| Consulting services payable  | 86        | 86                                    |           |           |               |
| Dongyang payable             | 11        | 11                                    |           |           |               |
| Nichimen                     | 350       | 350                                   |           |           |               |
|                              | \$ 18,540 | \$ 4,658                              | \$ 13,881 | \$ 1      | \$            |

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- (1) Contractual cash obligations include Long-Term Debt comprised of \$2,310 of Senior Convertible Notes issued in 2004, \$9,878 of Convertible Notes issued in 2005, and \$2,568 of Kookmin Notes, Short-Term Debt comprised of \$1,286 advances received under factoring, loan, and security agreement, \$1,000 of unsecured subordinated promissory note issued in 2006, future minimum lease payments under capital and operating leases, purchase commitments from a consultant, payments due from our discontinued equipment manufacturing business (Dongyang), and minimum payments due under a distribution agreement (Nichimen).
  - (2) Does not include interest payments of \$1,342, un-amortized discounts for conversion feature and warrants, deferred issuance costs of \$7,004 of our convertible notes.
  - (3) Does not include minimum interest and fee payments of \$30.
  - (4) Includes imputed interest of \$1.

**Critical Accounting Policies and Estimates**





The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect 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. These estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions.

We believe that the following accounting policies are the most critical to our consolidated financial statements since these policies require significant judgment or involve complex estimates that are important to the portrayal of our financial condition and operating results:

Our earnings and cash flows are subject to fluctuations due to changes in non-U.S. currency exchange rates. We are exposed to non-U.S. exchange rate fluctuations as the financial results of non-U.S. subsidiaries, Korea and China, are translated into U.S. dollars. As exchange rates vary, those results, when translated, may vary from expectations and adversely impact overall expected profitability. The cumulative translation effects for subsidiaries using functional currencies other than the U.S. dollar are included in accumulated foreign exchange translation in stockholders' equity. Movements in non-U.S. currency exchange rates may affect our competitive position, as exchange rate changes may affect business practices and/or pricing strategies of non-U.S. based competitors.

We record an accrual for potential product warranty costs. Due to the lack of historical information for warranty expense related to bulk alloy products, management estimates product warranties as a percentage of bulk alloy product sales earned during the period. In the event in future periods the actual product warranty costs consistently exceed the estimate for product warranty costs, an adjustment would be made and income would decrease in the period of such determination. Likewise, in the event we determine that actual product warranty costs are consistently lower than the estimate for product warranty costs, an adjustment would be made and income would increase in the period of such determination.

We record an allowance for doubtful accounts as a contra-asset to our trade receivables for estimated uncollectible accounts. Management estimates the amount of potentially uncollectible accounts by reviewing significantly past due customer balances relative to historical information available for those customers. In the event, in future periods, actual uncollectible accounts exceed the estimate for uncollectible accounts, an adjustment would be made and income would decrease in the period of such determination. Likewise, in the event, in future periods, actual uncollectible accounts are lower than the estimate for uncollectible accounts, an adjustment would be made and income would increase in the period of such determination.

We value inventories at lower of cost or net realizable value. Management has determined net realizable value to be equal to the selling price of the products to be produced and sold less the cost of disposal. In the event, in future periods, the actual selling prices exceed the estimate for

selling prices less cost to sell, an adjustment would be made and income would increase in the period of such determination. Likewise, in the event, in future periods, actual selling prices are lower than the estimate for selling prices, an adjustment would be made and income would decrease in the period of such determination.

We value our assets at lower of cost or fair market value. Management has determined fair market to be equal to the selling price of the assets to be sold less the cost of disposal. In the event, in future periods, actual selling prices are lower than the estimate for selling prices, an adjustment would be made and income would decrease in the period of such determination.

We record valuation allowances to reduce the deferred tax assets to the amounts estimated to be realized. While we consider taxable income in assessing the need for a valuation allowance, in the event we determine we would be able to realize our deferred tax assets in the future in excess of the net recorded amount, an adjustment would be made and income increased in the period of such determination. Likewise, in the event we determine we would not be able to realize all or part of our deferred tax assets in the future, an adjustment would be made and charged to income in the period of such determination.

We account for the warrants and the embedded conversion feature of our senior convertible notes as derivatives in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, and Emerging Issues Task Force Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock. Fair values of warrants and embedded conversion features are measured at each period end using Black-Scholes pricing models and changes in fair value during the period are reported in our earnings.

We adopted Statement of Financial Accounting Standards No. 123, Share-Based Payment ( SFAS 123R ), on January 1, 2006. This new standard requires companies to expense the fair value of employee stock options and similar awards. We adopted SFAS 123R using the modified prospective transition method. Therefore, stock based compensation expense measured in accordance with SFAS 123R was recorded during the first quarter of 2006, but the prior year consolidated statement of income was not restated. The adoption of SFAS 123R resulted in incremental expense in the first quarter of 2006 of \$0.2 million.

#### **Compliance with Section 404 of the Sarbanes-Oxley Act of 2002**

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, or SOX, the SEC has adopted rules requiring public companies to include a report of management on the company's internal controls over financial reporting in their annual reports on Form 10-K. In addition, the public accounting firm auditing a public company's financial statements must attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting. Although these requirements were first applicable to our annual report on Form 10-K for our fiscal year ending December 31, 2004, we were unable to comply with these requirements for such fiscal year. As disclosed in our amended Form 10-K filed with the SEC on May 10, 2005, the time and resources necessary to complete the restatement of prior periods' financial statements delayed our ability to complete the internal documentation, assessment and evaluation of internal control over financial reporting, all of which are required to be undertaken to comply with Section 404 of SOX. This delay prevented our independent auditor from being able to satisfactorily complete a timely audit of our internal control over financial reporting as of December 31, 2004.

Due to these delays, we and our independent auditor determined that it would not be possible to complete the management's assessment and auditor's audit of our internal controls over financial reporting as of December 31, 2004, and accordingly our independent auditor issued a disclaimer of opinion with respect to our internal control over financial reporting as of December 31, 2004, and such disclaimer was filed with our amended Form 10-K filed on May 10, 2005. The filing of this disclaimer does not comply with the SEC's rules and regulations under Section 404, and this noncompliance has resulted in us being in violation of Section 13(a) under the Securities Exchange Act of 1934. Section 13(a) establishes

the general requirement that public companies must file with the SEC, in accordance with such rules and regulations as the SEC may prescribe, such information, documents, and reports as the SEC may from time to time require for the protection of investors, including Form 10-Ks and 10-Qs.

In general, the SEC has broad authority under the Securities Exchange Act of 1934 to institute investigations, to seek injunctions, to seek monetary penalties, and to otherwise pursue enforcement actions for violations of Section 13(a), including a failure to file a Form 10-K or for the omission of necessary statements in a Form 10-K. Therefore, a violation under Section 404 of SOX or Section 13(a) of the Securities Exchange Act of 1934 could potentially subject an issuer to these same investigations and penalties. Section 404 of SOX is a relatively new legal requirement, and there is very little precedent establishing the consequences or appropriate response to a public company's failure to comply with Section 404. Accordingly, although we have discussed our Section 404 noncompliance with the SEC, we cannot predict what action, if any, the SEC may take against our company as a result of a failure to be compliant with our obligations under Section 404 of SOX or Section 13(a) of the Securities Exchange Act of 1934.

Effective December 27, 2005, the SEC announced final rulings on revisions to accelerated filer definition and deadlines for periodic reports. The ruling revised the definition of the term "accelerated filer" to permit an accelerated filer that has voting and non-voting common equity held by non-affiliates of less than \$50 million to exit accelerated filer status at the end of the fiscal year in which its equity falls below \$50 million and to file its annual report for that year and subsequent periodic reports on a non-accelerated basis. As of the fiscal year ended December 31, 2005, we are considered an accelerated filer and are required to comply with SOX 404 requirements for the 2005 fiscal year.

In addition to the foregoing, although our common stock was admitted to the OTC Bulletin Board for quotation on June 15, 2005, as a result of our noncompliance with Section 404 for our 2005 fiscal year, it may not have been appropriate for the OTC Bulletin Board to admit our common stock for quotation on June 15, 2005. Consequently, there is no assurance that our common stock will remain eligible for quotation on the OTC Bulletin Board.

**On January 16, 2006, our management completed and concluded its documentation, assessment and evaluation of its internal controls over financial reporting as of December 31, 2005. During the course of its assessment, management identified the control deficiencies described in Item 9A of our Form 10-K for the 2005 fiscal year. However, our independent auditors, Stonefield Josephson Inc., resigned on December 1, 2005, and on January 20, 2006, we engaged Choi, Kim & Park LLP ( CKP ) as our new independent registered public accounting firm. While we have advised CKP of the foregoing weaknesses in internal controls, due to the untimeliness of the foregoing events, CKP was unable to conduct an audit of our internal control over financial reporting pursuant to Section 404 of SOX, and thus, have issued a disclaimer of an opinion on the company's internal control over financial reporting as of December 31, 2005.**

#### **Recent Accounting Pronouncements**



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In February 2006, the FASB issued SFAS No. 155, ( SFAS No. 155 ), Accounting for Certain Hybrid Instruments, which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 also clarifies and amends certain other provisions of SFAS No. 133 and SFAS No. 140. This statement is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006. The Company does not expect the adoption of this new standard to have a material impact on its financial position, results of operations or cash flows.

In June 2005, the Emerging Issues Task Force ( EITF ) reached a consensus on Issue No. 05-2 The Meaning of Conventional Convertible Debt Instrument in EITF Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock. Issuers of convertible debt are required by Statement 133 to evaluate whether it is necessary to separate the embedded conversion feature from the debt contract and account for the conversion feature as if it were a separate derivative instrument. If the issuer determines that the embedded conversion feature would be classified in equity if it were a freestanding instrument, the conversion feature is not separated from the debt contract. EITF 00-19's criteria must be applied to determine whether a conversion feature qualifies for equity classification, but it exempts a conversion feature embedded in a conventional convertible debt instrument from some of

the criteria. EITF 05-2 requires convertible instruments that may be settled in a combination of cash or shares, e.g., those referred to as Instrument C in EITF 90-19, and instruments that may be convertible into a variable number of shares are not conventional. As a result, nonconventional instruments would need to satisfy all requirements of EITF 00-19 to support a conclusion that the conversion feature does not require accounting separate from that for the debt contract. The adoption of this Issue resulted in recognition of the embedded conversion feature from the senior convertible notes issued in March 2004, which were exchanged in August 2004, and August 2005 as liabilities of \$1.8 million and \$6.7 million as of December 31, 2005 and 2004, respectively, and a gain of \$9.1 million and \$2.1 million from the change in fair value of conversion feature liabilities for the years ended December 31, 2005 and 2004, respectively.

In June 2005, the EITF reached a consensus on Issue 05-6, Determining the Amortization Period for Leasehold Improvements, which requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of a lease be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of the business combination or purchase. EITF 05-6 is effective for periods beginning after June 29, 2005. Earlier application is permitted in periods for which financial statements have not been issued. The adoption of this Issue did not have an impact on the Company's financial statements.

In September 2005, the EITF reached a consensus on Issue 05-7 Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues, which requires that a change in the fair value of a conversion option brought about by modifying the debt agreement be included in analyzing in accordance with EITF 96-19 Debtor's Accounting for a Modification or Exchange of Debt Instruments whether a debt instrument is considered extinguished. Under EITF 96-19's requirements, an issuer who modifies a debt instrument must compare the present value of the original debt instrument's cash flows to the present value of the cash flows of the modified debt. If the present value of those cash flows varies by more than 10 percent, the modification is considered significant and extinguishments accounting is applied to the original debt. If the change in the present value of the cash flows is less than 10 percent, the debt is considered to be modified and is subject to EITF 96-19's modification accounting. EITF 05-7's Consensus requires that in applying the 10 percent test the change in the fair value of the conversion option be treated in the same manner as a current period cash flow. The Consensus also requires that, if a modification does not result in an extinguishment, the change in fair value of the conversion option be accounted for as an adjustment to interest expense over the remaining term of the debt. The issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon modification of the conversion option of a debt instrument that does not result in an extinguishment. EITF 05-7 is effective for modifications of debt instruments beginning in the first interim or annual reporting period beginning after December 15, 2005. The Company does not expect the adoption of the EITF to have material impact on the Company's financial statements.

In September 2005, the EITF reached a consensus on Issue No. 05-8, Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature. Under EITF 05-8, the issuance of convertible debt with a beneficial conversion feature results in a temporary difference for purposes of applying Statement 109. The deferred taxes recognized for the temporary difference should be recorded as an adjustment to paid-in capital. EITF 98-5 Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios and EITF 00-27 Application of Issue No. 98-5 to Certain Convertible Instruments require that the nondetachable conversion feature of a convertible debt security be accounted for separately if it is a beneficial conversion feature. A beneficial conversion feature is recognized and measured by allocating to additional paid-in capital a portion of the proceeds equal to the conversion feature's intrinsic value. A discount on the convertible debt is recognized for the amount that is allocated to additional paid-in capital. The debt discount is accreted from the date of issuance to the stated redemption date of the convertible instrument or through the earliest conversion date if the instrument does not have a stated redemption date. The U.S. Federal Income Tax Code includes the entire amount of proceeds received at issuance as the tax basis of the convertible debt security. The EITF 05-8 Consensus should be applied retrospectively to all instruments with a beneficial conversion feature accounted for under EITF 98-5 and EITF 00-27 for periods beginning after December 15, 2005. The Company does not expect the adoption of the EITF to have material impact on the Company's financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the





unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005. We do not believe the adoption of SFAS No. 154 will have a material effect on its consolidated financial position, results of operations or cash flows.

On March 29, 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the Staff's interpretation of SFAS 123(R). This interpretation expresses the views of the staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. In particular, this SAB provides guidance related to share-based payment transactions with no employees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of Statement 123(R) and disclosures in Management's Discussion and Analysis subsequent to adoption of SFAS 123(R). We have adopted SAB 107 in connection with its adoption of SFAS 123(R) effective January 1, 2006 using the modified prospective transition method, and recognized \$0.2 million of stock based compensation expense for the three months ended March 31, 2006 from the adoption.

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment*, which replaces SFAS No. 123. SFAS No. 123R requires public companies to recognize an expense for share-based payment arrangements including stock options and employee stock purchase plans. The statement eliminates a company's ability to account for share-based compensation transactions using APB 25, and generally requires instead that such transactions be accounted for using a fair value based method. SFAS No. 123R requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the date of grant, and to recognize the cost over the period during which the employee is required to provide service in exchange for the award. In April 2005, the SEC amended the compliance dates for SFAS 123(R), to allow companies to implement the standard at the beginning of their next fiscal year, instead of the next reporting period beginning after June 15, 2005. SFAS No. 123R is effective for our company in the quarter ending March 31, 2006. Upon adoption of SFAS 123R, companies are allowed to select one of three alternative transition methods, each of which has different financial reporting implications. We have adopted SFAS No. 123R effective January 1, 2006 using the modified prospective method, and recognized \$0.2 million of stock based compensation expense for the three months ended March 31, 2006 from the adoption.

In December 2004 the Financial Accounting Standards Board issued two FASB Staff Positions: FSP FAS 109-1, *Application of FASB Statement 109 Accounting for Income Taxes to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*, and FSP FAS 109-2 *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004*. Neither of these affected the Company as it does not participate in the related activities.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, an amendment of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*. The amendments made by Statement 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Previously, Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. Opinion 29 provided an exception to its basic measurement principle (fair value) for exchanges of similar productive assets. The Board believes that exception required that some nonmonetary exchanges, although commercially substantive, be recorded on a carryover basis. By focusing the exception on exchanges that lack commercial substance, the Board believes this Statement produces financial reporting that more faithfully represents the economics of the transactions. The Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of this Statement shall be applied prospectively. We have evaluated the impact of the adoption of SFAS 153, and do not believe the impact will be significant to our company's overall results of operations or financial position.



In November 2004, the FASB issued SFAS No. 151 Inventory Costs, an amendment of ARB No. 43, Chapter 4. The amendments made by Statement 151 clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 23, 2004. We have evaluated the impact of the adoption of SFAS 151, and do not believe the impact will be significant to our company's overall results of operations or financial position.

In March 2004, the FASB approved the consensus reached on the Emerging Issues Task Force (EITF) Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. The objective of this Issue is to provide guidance for identifying impaired investments. EITF 03-1 also provides new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB issued a FASB Staff Position (FSP) EITF 03-1-1 that delays the effective date of the measurement and recognition guidance in EITF 03-1 until after further deliberations by the FASB. The disclosure requirements are effective only for annual periods ending after June 15, 2004. We have evaluated the impact of the adoption of the disclosure requirements of EITF 03-1 and do not believe the impact will be significant to our company's overall results of operations or financial position. Once the FASB reaches a final decision on the measurement and recognition provisions, we will evaluate the impact of the adoption of EITF 03-1.

In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. SAB 104 supersedes SAB 101, Revenue Recognition in Financial Statements. SAB 104's primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superseded as a result of the issuance of EITF 00-21, Accounting for Revenue Arrangements with Multiple Deliverables. Additionally, SAB 104 rescinds the SEC's Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (the FAQ) issued with SAB 101 that had been codified in SEC Topic 13, Revenue Recognition. Selected portions of the FAQ have been incorporated into SAB 104. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104, which was effective upon issuance. The adoption of SAB 104 did not impact the consolidated financial statements. Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA and the SEC did not or are not believed by management to have a material impact on our company's present or future consolidated financial statements.

#### **Quantitative and Qualitative Disclosures About Market Risks**



We are exposed to various market risks in conducting the business of our company, and we anticipate that this exposure will increase if our business and revenues grow. In an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. These may take the form of forward sales contracts, option contracts, foreign currency exchange contracts, and interest rate swaps. We have not, and do not intend to, engage in the practice of trading derivative securities for profit.

*Interest Rates.* We are exposed to market risks relating to changes in interest rates. Fluctuations in interest rates may have a negative impact to existing short-term borrowings and future borrowings.

*Commodity Prices.* We are exposed to price risk related to anticipated purchases of certain commodities used as raw materials by our businesses, including titanium and zirconium. Although we do not currently enter into commodity future, forward, and option contracts to manage the fluctuations in prices of anticipated purchases, we may enter into such contacts in the future as our business grows and as our purchases of these raw materials increases.

*Foreign Exchange Rates.* As a result of our manufacturing presence in South Korea, a substantial portion of our costs will be denominated in South Korean Won. Consequently, fluctuations in the exchange rates of the South Korean won to the U.S. Dollar will affect our costs of goods sold and operating margins and could result in exchange losses. Although we do not currently enter into foreign exchange hedge transactions, we may do so in the future as our business grows. Fluctuations in exchange rates resulted in foreign currency translation gains of \$0.3 million, \$1.7 million, and \$0.2

million for the years ended December 31, 2005, 2004, and 2003, respectively, and \$0.1 million and \$0.3 million for the three months ended March 31, 2006 and 2005, respectively.

**BUSINESS**





**Overview**



## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

We are a materials technology company that develops and commercializes products made from amorphous alloys. Our Liquidmetal® family of alloys consists of a variety of proprietary coatings, powders, bulk alloys, and composites that utilize the advantages offered by amorphous alloy technology. We develop, manufacture, and sell products and components from bulk amorphous alloys to customers in various industries, and we also partner with third-party licensees and distributors to develop and commercialize bulk Liquidmetal alloy products. We believe that our proprietary bulk alloys are the only commercially viable bulk amorphous alloys currently available in the marketplace. In addition to our bulk alloys, we market and sell a line of proprietary amorphous alloy-based industrial coatings under the Liquidmetal® Armacor™ Coatings brand.

Amorphous alloys are unique materials that are distinguished by their ability to retain a random atomic structure when they solidify, in contrast to the crystalline atomic structure that forms in other metals and alloys when they solidify. Liquidmetal alloys possess a combination of performance, processing, and potential cost advantages that we believe will make them preferable to other materials in a variety of applications. The amorphous atomic structure of our alloys enables them to overcome certain performance limitations caused by inherent weaknesses in crystalline atomic structures, thus facilitating performance and processing characteristics superior in many ways to those of their crystalline counterparts. For example, our zirconium-titanium Liquidmetal alloys are approximately 250% stronger than commonly used titanium alloys such as Ti-6Al-4V, but they also have some of the beneficial processing characteristics more commonly associated with plastics. We believe these advantages could result in Liquidmetal alloys supplanting high-performance alloys, such as titanium and stainless steel, and other incumbent materials in a wide variety of applications. Moreover, we believe these advantages could enable the introduction of entirely new products and applications that are not possible or commercially viable with other materials.

### **General Corporate Information**



## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

We were originally incorporated in California in 1987, and we reincorporated in Delaware in May 2003. Our principal executive offices are located at 25800 Commercentre Dr., Suite 100, Lake Forest, California 92630. Our telephone number at that address is (949) 206-8000. Previously, our principal executive offices were located in Tampa, Florida. In December 2003, we consolidated all corporate functions into our Lake Forest facility, which had previously served as our principal research and development office. Our Internet website address is [www.liquidmetal.com](http://www.liquidmetal.com) and all of our filings with the Securities and Exchange Commission are available free of charge on our website.

### **Subsidiaries and Other Locations**



## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

We currently own and operate a manufacturing facility in Pyongtaek, South Korea, which became operational in the third quarter of 2002. This Korean subsidiary handles our Bulk Liquidmetal alloy business which includes market opportunities to manufacture and sell casing components for electronic devices, medical devices, sporting goods, tooling, prototype sampling, defense applications and metal processing equipment. We also opened a post processing facility in Weihai, China in the third quarter of 2004. This Chinese subsidiary facilitates our bulk alloy manufacturing business by handling most of our post manufacturing processes. Lastly, we operate a distribution warehouse division in Conroe, Texas to handle our Liquidmetal alloy industrial coatings which are used primarily as protective coatings for industrial machinery and equipment, such as drill pipe used by the oil drilling industry and boiler tubes used by coal burning power plants.

### **Our Technology**





The performance, processing, and potential cost advantages of Liquidmetal alloys are a function of their unique atomic structure and their proprietary material composition.

### *Unique Atomic Structure*

The atomic structure of Liquidmetal alloys is the fundamental feature that differentiates them from other alloys and metals. In the molten state, the atomic particles of all alloys and metals have an amorphous atomic structure, which means that the atomic particles appear in a completely random structure with no discernible patterns. However, when non-amorphous alloys and metals are cooled to a solid state, their atoms bond together in a repeating pattern of regular and predictable shapes, or crystalline grains. This process is analogous to the way ice forms when water freezes and crystallizes. In non-amorphous metals and alloys, the individual crystalline grains contain naturally occurring structural defects that limit the potential strength and performance characteristics of the material. These defects, known as dislocations, consist of discontinuities or inconsistencies in the patterned atomic structure of each grain. Unlike other alloys and metals, bulk Liquidmetal alloys can retain their amorphous atomic structure throughout the solidification process and therefore do not develop crystalline grains and the associated dislocations. Consequently, bulk Liquidmetal alloys exhibit superior strength and other superior performance characteristics compared to their crystalline counterparts. Our Liquidmetal alloy coatings, in contrast to our bulk alloys, have a crystalline atomic structure when initially applied, but their atomic structure becomes amorphous as the coatings rub against surfaces under force, thus improving their performance over time.

Prior to 1993, commercially viable amorphous alloys could be created only in thin forms, such as coatings, films, or ribbons. However, in 1993, researchers at the California Institute of Technology (Caltech) developed the first commercially viable amorphous alloy in a bulk form. Today, bulk Liquidmetal alloys can be formed into objects that are up to one inch thick, and we are not aware of any other commercially available amorphous alloys that can achieve this thickness. We have the exclusive right to commercialize bulk amorphous alloy technology through a license agreement with Caltech and other patents that we own.

### *Proprietary Material Composition*

The constituent elements and percentage composition of Liquidmetal alloys are critical to their ability to solidify into an amorphous atomic structure. We have several different alloy compositions that have different constituent elements in varying percentages. These compositions are protected by various patents that we own or exclusively license from third parties, including Caltech. The raw materials that we use in Liquidmetal alloys are readily available and can be purchased from multiple suppliers.

### **Advantages of Liquidmetal Alloys**

Liquidmetal alloys possess a unique combination of performance, processing and cost advantages that we believe makes them superior in many ways to other commercially available materials for a variety of existing and potential future product applications.

### *Performance Advantages*

Our bulk Liquidmetal alloys provide several distinct performance advantages over other materials, and we believe that these advantages make the alloys desirable in applications that require high yield strength, strength-to-weight ratio, elasticity and hardness.

The high yield strength of bulk Liquidmetal alloys means that a high amount of stress must be exerted to create permanent deformation. However, because the yield strength is so high, the yield strength of many of our bulk Liquidmetal alloy compositions is very near their ultimate strength, which is the measure of stress at which total breakage occurs. Therefore, very little additional stress may be required to break an object made of bulk Liquidmetal alloys once the yield strength is exceeded. Although we believe that the yield strength of many of our bulk alloys exceeds the ultimate strength of most other commonly used alloys and metals, our bulk alloys may not be suitable for certain applications, such as pressurized tanks, in which the ability of the material to yield significantly before it breaks is more important than its strength advantage. Additionally, although our bulk alloys show a high resistance to crack initiation because of their very high strength and hardness, certain of our bulk alloys are sensitive to crack propagation under certain long-term, cyclical loading conditions. Crack propagation is the tendency of a crack to grow after it forms. We are currently developing new alloy compositions that have improved material properties to overcome these limitations.

### *Processing Advantages*

The processing of a material generally refers to how a material is shaped, formed, or combined with other materials to create a finished product. Bulk Liquidmetal alloys possess processing characteristics that we believe make them preferable to other materials in a wide variety of applications. In particular, our alloys are amenable to processing options that are similar in many respects to those associated with plastics. For example, we believe that bulk Liquidmetal alloys have superior net-shape casting capabilities as compared to high-strength crystalline metals and alloys. Net-shape casting is a type of casting that permits the creation of near-to-net shaped products that reduce costly post-cast processing or machining. Additionally, unlike most metals and alloys, our bulk Liquidmetal alloys are capable of being thermoplastically molded in bulk form. Thermoplastic molding consists of heating a solid piece of material until it is transformed into a moldable state, although at temperatures much lower than the melting temperature, and then introducing it into a mold to form near-to-net shaped products. Accordingly, thermoplastic molding can be beneficial and economical for net shape fabrication of high-strength products.

Bulk Liquidmetal alloys also permit the creation of composite materials that cannot be created with most non-amorphous metals and alloys. A composite is a material that is made from two or more different types of materials. In general, the ability to create composites is beneficial because constituent materials can be combined with one another to optimize the composite's performance characteristics for different applications. In other metals and alloys, the high temperatures required for processing could damage some of the composite's constituent materials and therefore limit their utility. However, the relatively low melting temperatures of bulk Liquidmetal alloys allow mild processing conditions that eliminate or limit damage to the constituent materials when creating composites. In addition to composites, we believe that the processing advantages of Liquidmetal alloys will ultimately allow for a variety of other finished forms, including a coating or a spray. Most high-strength metals and alloys cannot be processed into these forms.

Notwithstanding the foregoing advantages, our bulk Liquidmetal alloys possess certain limitations relative to processing. The beneficial processing features of our bulk alloys are made possible in part by the alloys' relatively low melting temperatures. Although a lower melting temperature is a beneficial characteristic for processing purposes, it renders certain bulk alloy compositions unsuitable for certain high-temperature applications, such as jet engine exhaust components. Additionally, the current one-inch thickness limitation of our zirconium-titanium bulk alloy renders our alloys currently unsuitable for use as structural materials in large-scale applications, such as load-bearing beams in building construction. We are currently engaged in research and development with the goal of developing processing technology and new alloy compositions that will enable our bulk alloys to be formed into thicker objects.

### *Cost Advantages*

Liquidmetal alloys have the potential to provide cost advantages over other high-strength metals and alloys in certain applications. Because bulk Liquidmetal alloy has processing characteristics similar in some respects to plastics, which lends itself to near-to-net shape casting and molding, Liquidmetal alloys can in many cases be shaped efficiently into intricate, engineered products. This capability can eliminate or reduce certain post-casting steps, such as machining and re-forming, and therefore has the potential to significantly reduce processing costs associated with making parts in high volume.

Additionally, because the near-to-net shape processing of Liquidmetal alloys reduces the need for capital-intensive heavy industrial equipment such as that found in foundry and forging operations, Liquidmetal alloys can be processed with a smaller machinery footprint, which allows for more efficient development of facilities and reduced permitting and regulatory costs. We believe that these advantages may allow our customers an opportunity to maintain or improve the performance of their products without a commensurate increase in cost.

**Our Strategy**

As a result of the experience and knowledge that we have gained through our activities to date, and recognizing that developing and commercializing a revolutionary new technology is an evolutionary process, we are continually modifying our business strategy to enable us to better capitalize on our evolving core strengths and more effectively pursue revenue growth and profitability. The key elements of our strategy include:

*Identifying and Developing New Applications for Our Liquidmetal Alloy Technology.* We intend to continue to identify and develop new applications that will benefit from the performance, processing, and cost advantages of Liquidmetal alloys.

*Focusing Our Marketing and Internal Manufacturing Activities on Select Products with Expected Higher Gross-Margins.* We intend to focus our marketing and internal manufacturing activities on select products with anticipated higher gross margins. This strategy is designed to align our product development initiatives with our manufacturing processes and manufacturing cost structure, and to reduce our exposure to more commodity-type product applications that are prone to unpredictable demand and fluctuating pricing. Our focus is primarily on higher-margin products that possess design features that take optimal advantage of our existing and developing manufacturing technology and that command a price commensurate with the performance advantages of our alloys. In addition to our focus on products with higher gross margins, we will continue to engage in prototype manufacturing, both for internally manufactured products and for products that will ultimately be licensed to or manufactured by third parties.

*Further Developing Our Manufacturing Processes, Capabilities, and Efficiencies for Bulk Liquidmetal Alloys.* We intend to improve and enhance our internal manufacturing processes, capabilities, and efficiencies in order to maintain quality control over products made from bulk Liquidmetal alloys, to focus on improvements to the processing of our alloys, and to protect our intellectual property. As our alloys become more pervasive, however, we expect to enter into additional strategic relationships that would involve the licensing of Liquidmetal technology to third parties for certain market segments.

*Pursuing Strategic Partnerships In Order to More Rapidly Develop and Commercialize Products.* We intend to actively pursue and support strategic partnerships that will enable us to leverage the resources, strength, and technologies of other companies in order to more rapidly develop and commercialize products. These partnerships may include licensing transactions in which we license full commercial rights to our technology in a specific application area, or they may include transactions of a more limited scope in which, for example, we outsource manufacturing activities or grant distribution rights. We believe that utilizing such a partnering strategy will enable us to reduce our working capital burden, better fund product development efforts, better understand customer adoption practices, leverage the technical and financial resources of our partners, and more effectively handle product design and process challenges. As this partnering strategy evolves, a growing portion of our revenue mix may be comprised of revenue from the provision of product development services, technical support, and engineering services, as well as revenues from royalties on the sale of Liquidmetal alloy products by our partners.

*Advancing the Liquidmetal® Brand.* We believe that building our corporate brand will foster continued adoption of our technology. Our goal is to position Liquidmetal alloys as a superior substitute for materials currently used in a variety of products across a range of industries. Furthermore, we seek to establish Liquidmetal alloys as an enabling technology that will facilitate the creation of a broad range of commercially viable new products. To enhance industry awareness of our company and increase demand for Liquidmetal alloys, we are reviewing various brand development strategies that could include collaborative advertising and promotional campaigns with select customers, industry conference and trade show appearances, public relations, and other means.

**Applications for Liquidmetal Alloys**





We have focused our commercialization efforts for Liquidmetal alloys on five identified product areas. We believe that these areas are consistent with our strategy in terms of market size, building brand recognition, and providing an opportunity to develop and refine our processing capabilities. Although we believe that strategic partnering transactions could create valuable opportunities beyond the parameters of these target markets, we anticipate continuing to pursue these markets both internally and in conjunction with partners.

*Components for Electronic Products*

We produce components for electronic devices using our bulk Liquidmetal alloys and believe that our alloys offer enhanced performance and design benefits for these components in certain applications. Bulk Liquidmetal

alloys can be used for various structural components of a cellular phone, including the shield, faceplate, hinge, hinge housings, back plate, side plates, brackets, and the cover on the phones. We initially targeted the electronic casings market because of its potential for high product volumes and branding opportunities; however, unpredictable customer adoption practices, short product model lives, processing limitations, and intense pricing pressures make it very challenging to compete in this high-volume market. Accordingly, we are currently limiting our focus in this market to higher-margin applications that have the potential to benefit from the unique performance characteristics of bulk Liquidmetal alloys. We continue to believe that the high strength-to-weight ratio and elastic limit of bulk Liquidmetal alloys enable the production of stronger and thinner electronic devices as compared to plastic, zinc, and magnesium, and we intend to focus on products that require these design and performance benefits.

Through our shipments to date, we have demonstrated that bulk Liquidmetal alloys can be used for structural components of cellular phones and other electronic devices. During 2004 and 2005, we shipped production quantities of cell phone components to Samsung Electronics Company and Vertu Limited, the luxury communication products subsidiary of Nokia, for inclusion in various cellular phone models.

### *Sporting Goods and Leisure Products*

We are developing a variety of applications for Liquidmetal alloys in the sporting goods and leisure products area.

In the sporting goods industry, we believe that the high strength, hardness, and elasticity of our bulk alloys have the potential to enhance performance in a variety of products, and we further believe that many sporting goods products are conducive to our internal manufacturing strategy of focusing on high-margin products that meet our design criteria. Substantial opportunities also exist for our amorphous alloy coatings, powders and composites. In 2003, Rawlings Sporting Goods Company launched a new line of baseball and softball bats that utilize a Liquidmetal alloy coating, and HEAD NV Sport launched a new line of HEAD® Liquidmetal® tennis racquets that incorporates Liquidmetal alloy in composite form in their racquet design. In 2005, we also launched goods that utilize Liquidmetal alloy including skis. Other potential applications for our alloys in this industry include golf clubs, eyewear, fishing, hunting, and other sport products.

In the leisure products category, we believe that bulk Liquidmetal alloys can be used to efficiently produce intricately engineered designs with high-quality finishes, such as premium watchcases, and we further believe that Liquidmetal alloy technology can be used to make high-quality, high-strength jewelry from precious metals. We have successfully produced prototype rings made from an amorphous Liquidmetal platinum alloy that is harder (and hence more scratch resistant) than conventional platinum jewelry.

In order to accelerate the commercialization of Liquidmetal alloys in the jewelry and high-end luxury products market, in June 2003 we entered into a strategic licensing transaction with LLPG, Inc., a corporation headed by a former director of our company with ties to the Swiss jewelry and luxury goods market. While we have not generated revenues to date, under this agreement, LLPG was granted a 10-year exclusive worldwide license to manufacture and sell a variety of luxury goods, including watchcases and precious-metal jewelry, utilizing Liquidmetal alloys. Under the agreement, we are entitled to royalties over the life of the contract on all products produced and sold by LLPG.

In order to accelerate the commercialization of Liquidmetal alloys in the eyewear industry, in June of 2006, we entered into a joint venture with SAGA, SpA in Padova, Italy, a specialist precision part manufacturer. The joint venture is named Liquidmetal SAGA Italy, Srl ( LSI ), and it will have an exclusive manufacturing license for the eyewear industry. Its initial focus will be on the development and commercialization of eyewear with Safilo SpA, a worldwide leader in luxury eyewear, supplying frames and sunglasses for most of the luxury brands with operations in more than 120 countries worldwide

*Medical Devices*

We are engaged in product development efforts relating to various medical devices that could be made from Liquidmetal alloys. We believe that the unique properties of bulk Liquidmetal alloys provide a combination of performance and cost benefits that could make them a desirable replacement to incumbent materials, such as stainless steel and titanium, currently used in various medical device applications. Our ongoing emphasis in 2004, 2005 and 2006 has

been on surgical instrument applications for Liquidmetal alloys. These include, but are not limited to, specialized blades, orthopedic instruments utilized for implant surgery procedures, dental devices, and general surgery devices. The potential value offered by our alloys is high performance in some cases and cost reduction in others, the latter stemming from the ability of Liquidmetal alloys to be net shape cast into components, thus reducing costs of secondary processing. The status of most components in the prototyping phase is subject to non-disclosure agreements with our customers.

We believe that our future success in the medical device market will be driven largely by strategically aligning ourselves with well-established companies that are uniquely positioned to facilitate the introduction of Liquidmetal alloys into this market, especially as it relates to the unique processing challenges and stringent material qualification requirements that are prevalent in this industry. We also believe that our prospects for success in this market will be enhanced through our focus on optimizing existing alloy compositions and developing new alloy compositions to satisfy the industry's rigorous material qualification standards.

### ***Industrial Coatings and Powders***

We continue to market and sell amorphous alloy industrial coatings and powders under the Liquidmetal® Armacor™ Coatings brand name. Liquidmetal alloy coatings are used primarily as a protective coating for industrial machinery and equipment. Since the inception of this business in the late 1980s, our proprietary coatings have demonstrated a high degree of hardness and low coefficient of friction which, when combined with their strong adhesion properties, reduce the wear and consequent failure of the machinery and equipment on which they are used. In contrast to our bulk alloys, we sell Liquidmetal coatings primarily in the form of a wire or powder feedstock that is melted and applied to machinery or equipment through welding or thermal spray processes.

Our Liquidmetal coatings are widely used in the oil drilling industry as a protective coating on drill pipe and casings, and we estimate that our coatings represent a dominant share of annual worldwide sales of hard band coatings for new oil drill pipe. Drilling often places tremendous stress on pipes and casings, especially whenever the drill changes direction. Both the drill pipe and casing experience excessive wear, which leads to higher replacement costs and greater failure rates. Liquidmetal coatings are used to provide a protective coating, or hard band, around the outside of the drill pipe and the inside of casings to reduce wear and failure rates and accordingly reduce operating costs.

Liquidmetal coatings have also been sold into the power generation industry specifically for the purpose of coating boiler tubes in coal-burning power plants in order to extend the lives of these boilers. Boiler tubes are subject to high heat, erosion, and corrosion and often require costly replacement, both in terms of replacement parts and length of downtime for installation. Additionally, residue build-up in boiler tubes of coal burning power plants creates operating inefficiencies. Historic performance and testing of Liquidmetal coatings have demonstrated that our coatings extend the life of these boiler tubes meaningfully beyond their current average life depending on the specific environment. In addition, our coatings have demonstrated the ability to reduce build-up of residue on boiler tubes, helping to improve the efficiencies of the boilers. Historically, we have not concentrated sales efforts on the boiler tube market in a substantial way. However, given the size of the market and potential opportunities for our coatings, we have recently dedicated greater effort to this area.

### ***Defense Applications***

We are working with the U.S. Department of Defense, as well as a variety of defense-related research and development agencies and large defense contractors, to develop various defense-related applications for Liquidmetal alloys. For example, we are currently developing prototype kinetic energy penetrator rods for use in armor-piercing ammunition systems. Kinetic energy penetrators, or KEPs, are armor piercing munitions that are currently made primarily from depleted uranium or tungsten alloys. Initial ballistic tests under the Liquidmetal KEP program have

demonstrated that tungsten KEPs perform better whenever Liquidmetal alloy is combined with the tungsten to create a composite material. In August 2003, we signed a new \$3.0 million research and development contract with the U.S. Army for the development of KEPs. Our strategy is to orient the KEP program toward future systems such as the Joint Strike Fighter program and the Army's Future Combat System.

We also continue to work with a number of defense-related research and development agencies and large defense companies to identify additional military applications that may benefit from using Liquidmetal alloys. We believe that our alloys are well-positioned to capitalize on the trend toward lighter but stronger weapon systems in the U.S. military, and our strategy is to align ourselves with the largest and most significant players in this industry. Product development programs for defense applications are currently underway with several leading defense contractors, including Alliant Techsystems and General Dynamics.

**Going Concern**





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We have experienced significant operating losses since our inception. Our net loss for the fiscal years ended December 31, 2005 and 2004 was \$7.1 million and \$14.9 million, respectively, and net loss for the three months ended March 31, 2006 and 2005 was \$6.0 million and \$3.3 million, respectively. In the audit report on our financial statements for our fiscal years ended December 31, 2005 and 2004, our auditors included a going-concern qualification indicating that our significant operating losses and working capital deficit cause substantial doubt about our ability to continue as a going concern. By issuing an opinion stating that there is substantial doubt about our ability to continue as a going concern, our auditors have indicated that they are uncertain as to whether we have the capability to continue our operations without additional funding. Accordingly, we anticipate that we will need additional funding during the next 12 months, and we plan to seek to raise such funds through public or private equity financing, bank debt financing, or from other sources. Specifically, we anticipate that we could need \$1 million to \$5 million over the next twelve months to pursue our current operating plan, although this amount may be lower depending on the orders we receive for our products. The amount of funding that we plan to seek and the timing of such fundraising efforts will depend on the extent to which we are able to increase revenues through obtaining additional purchase orders for our products, particularly components for cellular phones and flash memory drive casings, and our ability to continue to improve our manufacturing processes. We evaluate our working capital needs and operating plan assumptions on a monthly basis to determine whether any adjustment to our cash and liquidity outlook is warranted, and we also review potential sources of financing on an ongoing basis. However, adequate funds may not be available when needed, and if we raise additional funds by issuing equity securities, existing stockholders may be diluted. If we don't receive sufficient funding to operate under our current plan, we intend to reduce operations and expenses and shift our focus to the pursuit of licensing transactions and other strategic transactions that are less capital intensive.

### **Liquidmetal Golf**



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From 1997 until September 2001, we engaged in the retail marketing and sale of golf clubs through a majority owned subsidiary, Liquidmetal Golf. The retail business of Liquidmetal Golf was discontinued in September 2001 and is now treated as a discontinued operation in our consolidated financial statements. Although the retail golf club business has been discontinued, Liquidmetal Golf will be engaged in the business of manufacturing and selling golf club components to golf original equipment manufacturers that will integrate these components into their own clubs and then sell them under their respective brand names. Liquidmetal Technologies owns 79% of the outstanding common stock in Liquidmetal Golf.

Our Liquidmetal Golf subsidiary has the exclusive right and license to utilize our Liquidmetal alloy technology for purposes of golf equipment applications. This right and license is set forth in an intercompany license agreement between Liquidmetal Technologies and Liquidmetal Golf. This license agreement provides that Liquidmetal Golf has a perpetual and exclusive license to use Liquidmetal alloy technology for the purpose of manufacturing, marketing, and selling golf club components and other products used in the sport of golf. In consideration of this license, Liquidmetal Golf has issued 4,500,000 shares of Liquidmetal Golf common stock to Liquidmetal Technologies.

### **Our Intellectual Property**



Our intellectual property consists of patents, trade secrets, know-how, and trademarks. Protection of our intellectual property is a strategic priority for our business, and we intend to vigorously protect our patents and other intellectual property. Our intellectual property portfolio includes 27 owned or licensed U.S. patents and numerous patent applications relating to the composition, processing, and application of our alloys, as well as various foreign counterpart patents and patent applications.

Our initial bulk amorphous alloy technology was developed by researchers at the California Institute of Technology ( Caltech ). We have purchased patent rights that provide us with the exclusive right to commercialize the amorphous alloy and other amorphous alloy technology acquired from Caltech through a license agreement ( Caltech License Agreement ) with Caltech. Under the Caltech license agreement, we have the exclusive worldwide right to make, use, and sell products from all of Caltech 's inventions, proprietary information, know-how, and other technology relating to amorphous alloys existing as of September 1, 2001. We also have an exclusive worldwide license to eleven issued patents and two patent applications held by Caltech relating to amorphous alloy technology, as well as all related foreign counterpart patents and patent applications. Of the patents currently issued to Caltech and licensed by us, the earliest expiration date is 2013 and the latest expiration date is 2021. Furthermore, the license agreement gives us the exclusive right to make, use, and sell products from substantially all amorphous alloy technology that was developed in Professor William Johnson 's Caltech laboratory during the period September 1, 2001 through August 31, 2005. All fees and other amounts payable by us for these rights and licenses have been paid in full, and no further royalties, license fees, or other amounts will be payable in the future under this license agreement.

Our rights under the license agreement are perpetual in duration. However, Caltech has the right to convert the license to a non-exclusive license if we fail to utilize the licensed technology for a period of 18 or more consecutive months, provided that Caltech must give us 180-days advance written notice of the conversion and we may cure the failure at any time during the 180-day notice period. If we cure the failure, then the license will not be converted into a non-exclusive license.

Under the license agreement, we have the right to sublicense any of the licensed technology or patents. The license agreement also provides that Caltech reserves the right to use the licensed technology and patents for noncommercial educational and research purposes. The patents and patent applications that we license from Caltech relate primarily to the composition and processing of our alloys. The currently issued U.S. patents covered by the license agreement will expire between 2012 and 2013.

Under the Caltech license agreement, the parties are obligated to provide reasonable cooperation to each other in connection with any threatened or actual infringement of the licensed technology by third parties. We have the right to commence an action for infringement of any of the licensed technology, and although Caltech is not obligated to bring suit or take action against infringers, Caltech is obligated to join in any such lawsuit upon our request.

In addition to the patents and patent applications that we license from Caltech, we are building a portfolio of our own patents to expand and enhance our technology position. These patents and patent applications primarily relate to various applications of our bulk amorphous alloys, the composition of our coatings and powders, and the processing of our alloys. The patents relating to our coatings expire on various dates between 2006 and 2017, and the patents relating to our bulk amorphous alloys expire on various dates between 2013 and 2021. Our policy is to seek patent protection for all technology, inventions, and improvements that are of commercial importance to the development of our business, except to the extent that we believe it is advisable to maintain such technology or invention as a trade secret.

In order to protect the confidentiality of our technology, including trade secrets, know-how, and other proprietary technical and business information, we require that all of our employees, consultants, advisors and collaborators enter into confidentiality agreements that prohibit the use or disclosure of information that is deemed confidential. The agreements also obligate our employees, consultants, advisors and collaborators to assign to us developments, discoveries and inventions made by such persons in connection with their work with us.

## **Research and Development**



We are engaged in ongoing research and development programs that are driven by the following key objectives:

*Enhance Material Processing and Manufacturing Efficiencies.* We plan to continue research and development of processes and compositions that will decrease our cost of making products from Liquidmetal alloys.



*Optimize Existing Alloys and Develop New Compositions.* We believe that the primary technology driver of our business will continue to be our proprietary alloy compositions. We plan to continue research and development on new alloy compositions to generate a broader class of amorphous alloys with a wider range of specialized performance characteristics. During 2003 and continuing into 2006, we have successfully expanded our portfolio of bulk amorphous alloys to include additional zirconium-titanium alloys, as well as alloys based on other metals, such as iron, gold, and platinum. Although these various compositions are at different stages of development and only a few are currently suitable for commercial use, we believe that a larger alloy portfolio will enable us to increase the attractiveness of our alloys as an alternative to incumbent materials and, in certain cases, drive down product costs. We also believe that our ability to optimize our existing alloy compositions will enable us to better tailor our alloys to our customers' specific application requirements.

*Develop New Applications.* We will continue research and development of new applications for Liquidmetal alloys. We believe the range of potential applications will broaden by expanding the forms, compositions, and methods of processing of our alloys.

We conduct our research and development programs internally and also through strategic relationships that we enter into with third parties. Our internal research and development efforts are currently focused on product and process development. Our internal research and development efforts are conducted by a team of 15 scientists, engineers and researchers whom we either employ directly or engage as consultants. Included among this team are Professor William Johnson, who discovered our initial bulk amorphous alloy at Caltech in 1993, and his graduate student at the time, Atakan Peker, who is employed as our Vice President of Technology. Professor Johnson was an employee of our company from October 2001 through December 2003 and then became a consultant to the Company. Professor Johnson continues to be a member of our board of directors.

In addition to our internal research and development efforts, we enter into cooperative research and development relationships with leading academic institutions. Professor Johnson continues to supervise a laboratory at Caltech, and through our license agreement with Caltech, we have a continuing relationship with the other researchers in Professor Johnson's Caltech laboratory. We have also entered into research relationships with several other academic institutions for the conduct of research relating to the properties and characteristics of our alloys.

We have entered into development relationships with other companies for the purpose of identifying new applications for our alloys and establishing customer relationships with such companies. Some of our product development programs are partially funded by our customers. We are also engaged in negotiations with other potential customers regarding possible product development relationships. Our research and development expenses for the years ended December 31, 2005, 2004, and 2003 were \$1.1 million, \$1.5 million, and \$8.8 million, respectively, and \$0.2 million and \$0.4 million for the three months ended March 31, 2006 and 2005, respectively.

## **Manufacturing**



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We currently own and operate a 166,000 square foot manufacturing facility in Pyongtaek, South Korea, which became operational in the third quarter of 2002. We opened a 14,400 square foot facility in Weihai, China in August 2004 to facilitate our bulk alloy manufacturing business. We believe that these facilities will meet our anticipated manufacturing needs for the foreseeable future, although these needs may change depending upon the actual and forecasted orders we receive for our products. We currently intend to develop supplemental research and development, prototyping and manufacturing capabilities elsewhere, including the United States, for purposes of meeting our long-term manufacturing needs and our customers' requirements. In December 2003, we entered into a license agreement with Florida Custom Mold, Inc., a Clearwater, Florida-based company that specializes in high-quality mold design and injection molding services, under which Florida Custom Mold is currently acting as a contract manufacturer to our company for purposes of producing prototypes of certain defense and medical products in the US.

### **Raw Materials**



Liquidmetal alloy compositions are comprised of many elements, all of which are available commodity products. We believe that each of these raw materials is readily available in sufficient quantities from multiple sources on

commercially acceptable terms. However, any substantial increase in the price or interruption in the supply of these materials could have an adverse effect on our profitability.

**Customers**



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During the three months ended March 31, 2006, one customer accounted for 13% of our total revenues. During 2005, one customer accounted for 10% or more of our revenue from continuing operations. Revenues from Samsung represented 10% of revenues from continuing operation for the year ended December 31, 2005. During 2004, four customers accounted for 10% or more of our revenue from continuing operations. Revenues from Charm Tech and Pntel, both of which are direct suppliers to Samsung, represented 62% of revenue from continuing operations for the year ended 2004. Also, revenues from defense related contracts with the United States of America represented 10% and Growell Metal represented 12% of revenue from continuing operations for the year ended December 31, 2004. We expect that a significant portion of our revenue may continue to be concentrated in a limited number of customers, even as our bulk Liquidmetal alloy business grows. During 2003, three customers accounted for 10% or more of our revenue from continuing operations. Revenue from Samsung represented 10% of revenue, revenue from LLPG, Inc. represented 12% and defense-related contracts with three departments of the United States of America represented 16% of revenue from continuing operations for the year ended December 31, 2003.

### **Competition**





We are not aware of any other company or business that manufactures, markets, distributes, or sells bulk amorphous alloys or products made from bulk amorphous alloys. We believe it would be difficult to develop a competitive bulk amorphous alloy without infringing our patents. However, our bulk Liquidmetal alloys face competition from other materials, including metals, alloys, plastics and composites, which are currently used in the commercial applications that we pursue. For example, we face significant competition from plastics and zinc in our electronics components business, and titanium and composites will continue to be used widely in medical devices and sporting goods. Based on our experience with developing products for a variety of customers, we believe that the selection of materials by potential customers will continue to be product-specific in nature, with the decision for each product being driven primarily by the performance needs of the application and secondarily by cost considerations and design flexibility. Because of the relatively high strength of our alloys and the design flexibility of our process, we are most competitive when the customer is seeking a higher strength as well as greater design flexibility than currently available with other materials. However, if currently available materials, such as plastics, are strong enough for the application, our alloys are often not competitive those applications with respect to price. We also believe that our alloys are generally not competitive with the cost of some of the basic metals, such as steel, aluminum or copper, when such basic metals can be used in specific applications, but our alloys are generally more competitive with price on more exotic metals, such as titanium. Our alloys could also face competition from new materials that may be developed in the future, including new materials that could render our alloys obsolete.

Our Liquidmetal alloy coatings face competition from industrial coatings currently manufactured or sold by other companies. At present, the primary competitors of our coatings business are Varco International, Inc. and Arnco Technology Trust, Limited. Although we believe, based on market data gathered by us, that our coatings compete favorably with these companies' products and that we continue to maintain the dominant market share with respect to protective coatings for oil drill pipe and casings, these competitors are larger well-established businesses that have substantially greater financial, marketing, and other resources than we do.

We will also experience indirect competition from the competitors of our customers. Because we will rely on our customers to market and sell finished goods that incorporate our components or products, our success will depend in part on the ability of our customers to effectively market and sell their own products and compete in their respective markets.

### **Backlog**

In our bulk alloy segment, because of the minimal lead-time associated with orders of bulk alloy parts, we generally do not carry a significant backlog. In our coatings segment, we typically ship our coating products shortly after receipt of an order, and our coatings backlog is therefore also insignificant. In both our bulk alloy segment and coatings segment, the backlog as of any particular date gives no indication of actual sales for any succeeding period.

**Sales and Marketing**



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We direct our marketing efforts towards customers that will incorporate our components and products into their finished goods. To that end, we will continue to hire business development personnel who, in conjunction with engineers and scientists, will actively identify potential customers that may be able to benefit from the introduction of Liquidmetal alloys to their products. In some cases, we will develop applications in conjunction with existing or potential customers. By adopting this strategy, we intend to take advantage of the sales and marketing forces and distribution channels of our customers to facilitate the commercialization of our alloys. We also direct business development efforts toward companies who we believe could be viable candidates for potential partnering transactions, such as licensing relationships, distribution arrangements, joint ventures, and the like.

### **Employees**



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As of July 3, 2006, we had 833 full-time and 150 part-time employees. As of that date, 90 of our Korean operation employees were represented by a labor union. We have not experienced any work stoppages and we consider our employee relations to be favorable.

### **Governmental Regulation**





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Medical instruments incorporating our Liquidmetal alloys will be subject to regulation in the United States by the FDA and corresponding state and foreign regulatory agencies. Any orthopedic devices that we develop will be regulated in a similar manner. Medical device manufacturers to whom we intend to sell our products may need to obtain FDA approval before marketing their medical devices that incorporate our products. Medical device manufacturers may need to obtain similar approvals before marketing these medical device products in foreign countries.

Because we intend to sell our medical device products to medical device manufacturers, we do not believe that we will need to obtain FDA approval or similar foreign approvals before selling products to medical device manufacturers. Nonetheless, as a manufacturer of medical device components, we would be subject to quality control and record keeping requirements of FDA and other federal and state statutes and regulations, as well as similar regulations in foreign countries.

The process of obtaining and maintaining required FDA and foreign regulatory approvals for medical devices that incorporate our products could be lengthy, expensive, and uncertain for our customers. Additionally, regulatory agencies can delay or prevent product introductions. Generally, before a medical device manufacturer can market a product incorporating one of our products, our customer must obtain for their finished product marketing clearance through a 510(k) premarket notification or approval of a pre-market approval application, or PMA. The FDA will typically grant a 510(k) clearance if the applicant can establish that the device is substantially equivalent to a predicate device. It generally takes a number of months from the date of a 510(k) submission to obtain clearance, but it may take longer, particularly if a clinical trial is required.

The FDA may find that a 510(k) is not appropriate for a medical device that incorporates our product or that substantial equivalence has not been shown and as a result will require a PMA. A PMA application must be submitted if a proposed medical device does not qualify for a 510(k) pre-market clearance procedure. PMA applications must be supported by valid scientific evidence to demonstrate the safety and effectiveness of the device, typically including the results of clinical trials, bench tests, and laboratory and animal studies. The PMA process can be expensive, uncertain and lengthy, requires detailed and comprehensive data, and generally takes significantly longer than the 510(k) process. Additionally, the FDA may never approve the PMA.

Similar regulations in foreign countries vary significantly from country to country and with respect to the nature of the particular medical device. The time required to obtain these foreign approvals to market our products may be longer or shorter than that required in the United States, and requirements for such approval may differ from FDA requirements.

**Environmental Law Compliance**



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Our manufacturing operations are subject to national, state, and local environmental laws in each of China, South Korea, and the United States. We believe that we are in material compliance with all applicable environmental regulations. While we continue to incur costs to comply with environmental regulations, we do not believe that such costs will have a material effect on our capital expenditures, earnings, or competitive position.

### **Material Legal Proceedings**



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In April 2006, we reached agreements in principle to settle our previously-disclosed consolidated securities class action and shareholder derivative actions. In early July, we jointly filed a Stipulation and Agreement of Settlement in the securities class action, which has been preliminarily approved and for which a settlement fairness hearing is set for October 18, 2006. Our settlement stipulation in the derivative actions will be filed in early August.

The settlement covers a series of nine securities class action lawsuits that were filed against the company beginning in April 2004 on behalf of persons who purchased our common stock between May 21, 2002 and May 13, 2004, in connection with our initial public offering in May 2002. These actions, which were brought under the federal securities laws against the company and certain of our former and current directors and officers, were consolidated in the United States District Court for the Middle District of Florida, Tampa Division. These cases alleged that the Prospectus issued in connection with the initial public offering in May 2002 contained material misrepresentations and omissions regarding the company's historical financial condition and regarding a personal stock transaction by the company's former chief executive officer. They also alleged that our company and certain of its present and former officers and directors engaged in improper revenue recognition with respect to certain of the company's business transactions, failed to maintain adequate internal controls, and knowingly disclosed unrealistic but favorable information about market demand for and commercial viability of the company's products to artificially inflate the value of the company's stock.

In addition to the securities class actions, in May 2004, two shareholder derivative actions were filed in the Superior Court of Orange County, California. Shortly thereafter, one additional shareholder derivative action was filed in the United States District Court for the Middle District of Florida, Tampa Division. These derivative actions were brought by certain shareholders against certain of our present and former officers and directors as well as our company (as a nominal defendant). The suits alleged that the defendants breached various fiduciary duties and otherwise violated state law based primarily upon the same underlying facts and circumstances as alleged in the federal securities class action. The settlement also covers these derivative actions.

If approved by the courts, the agreements would settle the consolidated class action litigation entitled *Primavera Investors v. Liquidmetal Technologies, Inc., et al.*, the consolidated shareholder derivative actions entitled *Brian Clair, Derivatively on Behalf of Liquidmetal Technologies, Inc. v. John Kang, et al.* and *Joseph Durgin, Derivatively on Behalf of Liquidmetal Technologies, Inc. v. John Kang, et al.*, and the shareholder derivative action entitled *Robert Story v. John Kang, et al.*, pending in the United States District Court for the Middle District of Florida, Tampa Division, the Superior Court of Orange County, California, and the United States District Court for the Middle District of Florida, Tampa Division, respectively.

As part of the agreements, our directors' and officers' liability insurance carriers will contribute a total of \$7.5 million to settle all of the actions: \$7.025 million for the consolidated class action and \$0.475 million for the two derivative actions. The funds paid to settle the consolidated class action will be principally paid into an escrow account within a specified period of time after the federal court grants preliminary approval of the settlement. The funds will be disbursed to certain purchasers of our securities according to a distribution plan to be devised and approved by the federal court. In addition, we will commit to maintaining or implementing various corporate governance measures in connection with the settlement of the derivative actions.

Taking into account the insurance contribution, the net cost of the settlement to us should be approximately \$0.5 million, which is the insurance deductible we paid over several quarters ending in the third quarter of 2005, and which we previously recorded as a charge.

## PROPERTIES

Our principal executive offices and principal research and development offices are located in Lake Forest, California and consist of approximately 30,000 square feet. This facility is occupied pursuant to a lease agreement that expires in June 2007.

In Conroe, Texas, we lease an office and warehouse for our coatings business segment. This facility, which is approximately 10,000 square feet, is leased through September 2006.

Our principal prototyping and manufacturing facility is in Pyongtaek, South Korea, and consists of approximately 166,000 square feet. We lease the land on which this facility is located, although we own the buildings, fixtures, and all personal property located on the land. The parcel of land consists of approximately four acres and is leased through 2022.

On August 2004, we entered into a 3 year lease for a post-processing facility located in Weihai, China, which consists of approximately 14,400 square feet, to facilitate our bulk alloy manufacturing.

We currently expect that the foregoing facilities will meet our anticipated internal manufacturing, research, warehousing, and administrative needs for the foreseeable future.

**MANAGEMENT**





**Directors**



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Listed below are the names of each of our directors, together with certain additional information concerning each such director as of July 3, 2006.

### Directors with Terms Expiring at 2007 Annual Meeting

| Name          | Age | Business Experience During Last Five Years  | Director Since |
|---------------|-----|---|----------------|
| James Kang    | 45  | James Kang has served as a director since December 1994 and as executive Founder of our company since August 2003. From December 1994 to June 2001, he served variously as our Chief Executive Officer, President, and Chairman. Mr. Kang received a B.A. degree in Marketing from the University of Illinois in 1983, and an M.B.A. degree from the Kellogg School of Management at Northwestern University in 1985. Mr. Kang is the brother of John Kang, Chairman of the Board of Directors, who was also our Chief Executive Officer and President during 2004.   | 1994           |
| Ricardo Salas | 42  | Ricardo Salas was elected as a director by the Board of Directors on December 30, 2005 to fill the vacancy created by Mr. Addonisio's resignation. Also on December 30, 2005, Mr. Salas was elected as President and Chief Executive Officer of the Company. Mr. Salas previously served as a Board member of the Company from April 1995 to May 2003. From January 2000 through June 2005, Mr. Salas served as Chief Executive Officer of iLIANT Corporation, an information technology and outsourcing service firm in the health care industry, and he continues to serve as Chairman of iLIANT. From 1987 through 2004, he was Vice President of J. Holdsworth Capital Ltd., a private investment firm. As an officer of J. Holdsworth Capital Ltd., Mr. Salas held positions in various investments including Medical Manager Corporation as a vice president between June 1999 and January 2000, National Medical Systems, Inc. as vice president between April 1994 and February 1997, and Uni Flange Corporation as vice president between June 1989 and June 1994. He currently serves as a director of VillageEDOCS, a provider of business information delivery services and products. Mr. Salas received a B.A. degree in Economics from Harvard College in 1986. | 2005           |

**Directors with Terms Expiring at 2006 Annual Meeting**

|              |    |   |      |
|--------------|----|---|------|
| Dean Tanella | 45 | Dean G. Tanella was elected as a director in February 2004. Mr. Tanella is a 20-year veteran of the institutional investment business and has worked for such leading firms as Raymond James & Associates, CS First Boston Corp., Adams Harkness & Hill, Drexel Burnham Lambert, Inc., Kidder Peabody & Co. and the Vanguard Group. Since 1999, Mr. Tanella has served as President of Safe Harbor Capital, LLC and, since 2003, as President of HarborLight Capital, LLC, both of which are private investment firms. Mr. Tanella received his bachelors degree from Princeton University and his MBA from the Harvard Graduate School of Business Administration. In December 2004, Mr. Tanella was also named Executive Vice President Capital Markets Group and a member of the Board of Directors at GunnAllen Financial Inc., a leading independent brokerage firm headquartered in Tampa, Florida. | 2004 |
| CK Cho       | 51 | CK Cho was elected as a director in January 2005. Mr. Cho has over 18 years of experience with Samsung Electronics and managed over \$700 million annual procurement budget responsible for semi-conductor and telecommunication equipment and other electronic components. He also served as CEO and President of Winvest Venture Partners Inc. and is currently serving as President and CEO of ATIC, an IT Venture Capital Company based in Korea. Mr. Cho received his bachelors degree majoring in Business Administration and Material Sciences from the Korea University of Seoul.   | 2005 |

**Directors with Terms Expiring at 2005 Annual Meeting or the First Annual Meeting Thereafter**

|           |    |   |      |
|-----------|----|---|------|
| John Kang | 43 | John Kang has been a director of our Company since 1994. From December 1994 to June 2001, he served as Chairman of our Board of Directors in various capacities. From June 2001 until December 30, 2005, Mr. Kang had served variously as our Chief Executive Officer and President. From July 1996 to September 2000, Mr. Kang served variously as Chief Executive Officer, President, and a director of Medical Manager Corporation, a public company traded on the Nasdaq National Market until its sale in September 2000 to WebMD Corporation. From 1988 to 1995, he was Chairman of the board of directors of Clayton Group, Inc., a private company engaged in the distribution of waterworks equipment. Mr. Kang received a B.A. degree in Economics from Harvard College in 1985. Mr. Kang is the brother of James Kang, one of our directors. On December 15, 2005, an indictment naming as defendants ten former officers and directors of Medical Manager Corporation, including our Chairman, John Kang, was filed in the United States District Court for the District of South Carolina (Beaufort Division). Medical Manager Corporation was a publicly traded company in which Mr. Kang was formerly the President and Chief Executive Officer. Mr. Kang was charged in counts for conspiracy to commit securities fraud, | 1994 |
|-----------|----|---|------|

conspiracy to commit mail fraud and conspiracy to launder money instruments relating to a series of acquisitions that were made by Medical Manager during the years 1996 through 2003, the accounting practices of Medical Manager during that time frame, and the filing of various financial statements during that time frame. Although the indictment is unrelated to Mr. Kang's services as a director and officer of our company, Mr. Kang resigned as our President and Chief Executive Officer on December 30, 2005; however, he continues to serve as Chairman of the Board of our company continues to work for the company on a full-time basis. Mr. Kang has pled not guilty to the indictment and plans to contest the charges vigorously.

|                        |    |  |      |
|------------------------|----|--|------|
| William Johnson, Ph.D. | 57 | <p>William Johnson, Ph.D., has served as a director since June 2000. From October 2001 to September 2003, he was employed as our executive Vice Chairman of Technology. Since 1988, Professor Johnson has been the Mettler Professor of Engineering and Applied Physics at Caltech. He held a Visiting Professor appointment at the Metal Physics Institute in Göttingen, Germany (1983) and received a Von Humboldt Distinguished Scientist Fellowship in Göttingen (1988). He is the 1995 recipient of the TMS/AIME Hume Rothery Award for his experimental work. He received a B.A. degree in Physics from Hamilton College and a Ph.D. degree in Applied Physics from Caltech. He spent two years at IBM's Research Center (1975-1977). At Caltech, Professor Johnson directed the research that led to the discovery of our bulk Liquidmetal alloy. Professor Johnson is currently a consultant to the Company.</p> | 2000 |
| Robert Biehl           | 63 | <p>Robert Biehl has served as a director since January 2005. Mr. Biehl is an executive mentor. In 1976, he founded Masterplanning Group International. As President, he has personally consulted with over 400 clients ranging from start up to multi-billion dollar organizations. He has published 20 books in the area of personal and organizational development. He is a frequent key note speaker at various conferences. Prior to starting Masterplanning Group, Mr. Biehl was an executive staff of World Vision International where he designed and developed the Love Loaf Program, which has raised millions of dollars for hunger worldwide. Mr. Biehl received his B.A. degree in psychology and a Masters Degree in Counseling from Michigan State University.</p>   | 2005 |

**Term of Directors**





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Our board of directors is divided into three classes (designated CLASS I, CLASS II, and CLASS III ), as nearly equal in number as possible, with each class serving three-year terms expiring at the third annual meeting of stockholders after their elections or until their respective successors have been elected and qualified. CLASS I currently consist of the following directors whose term is scheduled to expire at the 2005 annual meeting of stockholders or the first annual meeting thereafter: John Kang, William Johnson, and Robert Biehl. CLASS II currently consists of the following directors whose term is scheduled to expire at the 2006 annual meeting of stockholders: Dean Tanella and CK Cho.

CLASS III currently consists of the following directors whose term will expire at the 2007 annual meeting of stockholders: James Kang and Rick Salas.

**Audit Committee**



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Our board of directors has an Audit Committee that is currently comprised of Mr. Tanella, who has assumed the role of Audit Committee Chairman since Mr. Addoniso's resignation, and Mr. Biehl. The Audit Committee is responsible for reviewing the independence, qualifications, and activities of our independent certified accountants and our financial policies, control procedures, and accounting staff. The Audit Committee is also responsible for the review of transactions between us and any officer, director, or entity in which an officer or director of our company has a material interest. Our board of directors has determined that Mr. Tanella qualifies as an audit committee financial expert as defined by the regulations of the Securities and Exchange Commission. In addition, our board of directors has determined that Mr. Tanella is an independent director within the meaning of Rule 10A-3(b)(i) under the Securities Exchange Act of 1934. The Audit Committee is governed by a written charter approved by the board of directors.

### **Compensation Committee**



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The Compensation Committee is comprised of Mr. Cho and Mr. Biehl. All of the members of the Compensation Committee are independent directors, as defined by the rules applicable to members of the Compensation Committee. The Compensation Committee is responsible for establishing the compensation of our senior management, including salaries, bonuses, termination arrangements, and other executive officer benefits. The Compensation Committee also administers our equity incentive plans.

### **Corporate Governance and Nominating Committee**



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A Corporate Governance and Nominating Committee ( the Committee ) was formed on February 18, 2003, and is comprised of Mr. Tanella and Mr. Biehl. All members of the Committee are independent directors, as defined by the rules applicable to members of the Committee. The Committee is generally responsible for adopting policies, procedures, and practices designed to help ensure that our corporate governance policies, procedures, and practices continue to assist the board and our management in effectively and efficiently promoting the best interests of our stockholders. The Committee is also responsible for selecting and recommending for approval by the Board and the Company s stockholders a slate of director nominees for election at each of the Company s annual meetings of stockholders, and otherwise for determining the Board committee members and chairmen, subject to Board ratification, as well as recommending to the Board director nominees to fill vacancies or new positions on the Board or its committees that may occur or be created from time to time, all in accordance with the Company s Bylaws and applicable law.

The Corporate Governance Committee s principal functions include:

developing and maintaining our corporate governance policy guidelines;

developing and maintaining our codes of conduct and ethics;

overseeing the interpretation and enforcement of our Code of Conduct and our Code of Ethics for Chief Executive Officer and Senior Financial and Accounting Officers; and

evaluating the performance of our board, its committees, and committee chairmen and our directors.

selecting and recommending a slate of director nominees for election at each of the Company s annual meeting of the stockholders and recommending to the Board director nominees to fill vacancies or new positions on the Board or its committees that may occur from time to time.



**Code of Ethics**



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Our board of directors has adopted a Code of Ethics that is applicable to its principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions. The Code of Ethics is attached as Exhibit 14 to our Annual Report on Form 10-K filed on November 10, 2004. In addition, we intend to promptly disclose (1) the nature of any amendment to our Code that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions and (2) the nature of any waiver, including an implicit waiver, from a provision of our Code that is granted to one of these specified officers, the name of such person who is granted the waiver and the date of the waiver on our website in the future. You may also request a copy of the Code by sending the request to [information@liquidmetal.com](mailto:information@liquidmetal.com).

### **Director Compensation**



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Our non-employee directors receive an annual fee of \$10,000 for their service to our board and are reimbursed for expenses incurred in attending board and committee meetings. Non-employee directors are also entitled to receive a \$10,000 annual cash stipend for each standing board committee (excluding the Audit Committee) on which the director serves. For Audit Committee service, the Audit Committee chairman is entitled to a \$35,000 annual stipend, and the other members of the Audit Committee are entitled to a \$27,500 annual stipend. In addition to the annual stipends, each non-employee director is entitled to receive a per-meeting fee of \$1,000 for each meeting of the board of directors or any board committee attended in person. Effective December 30, 2005, Dean Tanella was elected as the lead independent director of the Company. The lead independent director is entitled to a \$30,000 annual stipend.

We also have a 2002 Non-employee Director Stock Option Plan pursuant to which our non-employee directors are entitled to receive stock options. Under this plan, when a director is first elected or appointed to our board of directors, the non-employee director is entitled to receive an initial stock option grant to purchase 50,000 shares of our common stock. Thereafter, on the first business day of January of each year in which the director continues to serve as a member of our board, the director is entitled to an annual stock option grant to purchase 10,000 shares of our common stock. All options granted under the plan have an exercise price equal to the fair market value of our common stock on the date of the grant. These stock options have a 10-year term, vest, and are exercisable pursuant to an equal 5-year vesting schedule, and remain exercisable for certain periods of time after a person is no longer a director.

No director who is an employee will receive separate compensation for services rendered as a director. However, our employee directors are eligible to participate in our 2002 Equity Incentive Plan

### **Executive Officers**



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The executive officers of our company as of July 3, 2006, are identified below. Biographical information for each of these executive officers is set forth above under MANAGEMENT Directors, except for Young Ham, whose biographical information is set forth below.

| NAME          | AGE | POSITION                              |
|---------------|-----|---------------------------------------|
| John Kang     | 43  | Chairman of the Board                 |
| Ricardo Salas | 42  | President and Chief Executive Officer |
| James Kang    | 45  | Director and Founder                  |
| Young Ham     | 37  | Chief Financial Officer               |

*Young Ham.* Young Ham has been our Chief Financial Officer since April 2005, prior to which he served as the CFO of our Asian operation in 2004. Prior to joining our company, he served as President and Chief Consultant of Dime Financial Advisory based in Seoul, Korea from November 1999 through July 2003. In addition, Mr. Ham was a founding partner for Hanmi Accounting Corporation in South Korea since July 2003, where he provided accounting and consulting services to multi-national corporations. Mr. Ham was also the Chief Internal Auditor and Financial Advisor to Answer International Asia Inc. and Director of Dongyang Economy Research Institute. Financial advisory and management consulting clients have included Nextel Co., Ltd, Korea Masterbuilders, Korea Spoland Co., Ltd., tax and legal service

clients range from Hyundai Merchant Marine to the Korea National Oil Company. An M.B.A. graduate student of Seoul National University in 1994, Young Ham is a CPA in both the United States and Seoul, South Korea.

**Summary Compensation Table**





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The following table sets forth certain information regarding compensation paid by us for each of our last three years to our Chief Executive Officer and each of our other executive officers as of December 31, 2005 (collectively, the named executive officers ) for services rendered in all capacities to us at any time during such periods.

| Name and Positions  | Year | Annual Compensation |       |  | Other Annual Compensation | Long-Term Compensation Shares Underlying Options Granted | All Other Compensation |
|---|------|---------------------|-------|--|---------------------------|--|------------------------|
|   |      | Salary              | Bonus |  |                           |  |                        |
| John Kang (1)<br>Chairman of the Board                        | 2005 | \$ 200,005          |       |  |                           | 50,000   |                        |
|   | 2004 | \$ 208,586          |       |  |                           |  |                        |
|   | 2003 | \$ 300,007          |       |  |                           |  |                        |
| Ricardo Salas (2)<br>Chief Executive Officer<br>and President | 2005 |                     |       |  |                           |  |                        |
|   | 2004 |                     |       |  |                           |  |                        |
|   | 2003 |                     |       |  |                           |  |                        |
| James Kang (3)<br>Founder and Director                        | 2005 | \$ 300,008          |       |  |                           |  |                        |
|   | 2004 | \$ 300,004          |       |  |                           |  |                        |
|   | 2003 | \$ 280,011          |       |  |                           | 2,877,420  |                        |
| Young Ham (4)<br>Chief Financial Officer                      | 2005 | \$ 150,000          |       |  |                           | 87,500   |                        |
|   | 2004 | \$ 64,052           |       |  |                           | 50,000   |                        |
|   | 2003 |                     |       |  |                           |  |                        |

- 
- (1) As of August 22, 2003, John Kang was named Chairman of our board of directors. Mr. Kang resigned from his position as President and Chief Executive Officer of our company on December 30, 2005. However, he will continue to serve as Chairman of the board and will continue to work for the Company on a full-time basis.
- (2) On December 30, 2005, Ricardo Salas was named Chief Executive Officer and President of the Company. Previously during 2005, Mr. Salas served as a consultant, and had accrued \$20,000 in unpaid service fees as of December 31, 2005.
- (3) As of August 22, 2003, James Kang became the executive Founder of the Company and ceased to be the Chairman of our board of directors.
- (4) On April 15, 2005, Young Ham became the Chief Financial Officer of the Company. Previously during 2005 and 2004, Mr. Ham Served as the Chief Financial Officer at Liquidmetal Korea.

**Option grants in last fiscal year**

| Name<br>(a)   | Number of Securities Underlying Options Granted (#)<br>(b) | Individual Grants  |    | Exercise of Base Price (\$/Share)<br>(d) | Expiration Date<br>(e) | Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term |                 |
|---------------|--|--|----|--|------------------------|--|-----------------|
|               |  | Percentage of Total Options Granted to Employees in Fiscal Year<br>(c) |    |  |                        | 5% (\$)<br>(f)   | 10% (\$)<br>(g) |
| John Kang     | 50,000   | 5%   | \$ | 2.33                                     | 12/31/2015             | \$ 73,466  | \$ 185,871      |
| Ricardo Salas |  |  |    |  |                        |  |                 |
| James Kang    |  |  |    |  |                        |  |                 |
| Young Ham     | 87,500   | 8%   | \$ | 1.96                                     | 2/28/2015              | \$ 107,997   | \$ 273,685      |

**Aggregate Option Exercises in Last Year and Year-End Option Values**

|               | Shares<br>Acquired on<br>Exercise | Value<br>Realized (1) | Number of Unexercised<br>Options at Year End |               | Value of Unexercised<br>In-The-Money Options<br>at Year End (2) |               |
|---------------|-----------------------------------|-----------------------|--|---------------|---|---------------|
|               |                                   |                       | Exercisable                                  | Unexercisable | Exercisable   | Unexercisable |
| John Kang     |                                   |                       | 1,622,904                                    | 40,000        |   |               |
| Ricardo Salas |                                   |                       |  |               |   |               |
| James Kang    |                                   |                       | 2,861,291                                    | 16,129        |   |               |
| Young Ham     |                                   |                       | 17,500                                       | 120,000       |   |               |

(1) Represents the difference between the fair market value of the underlying shares at the time of exercise and the exercise price of the options exercised.

(2) Based upon a value of \$0.88 per share as of December 31, 2005.

**Agreements with Named Executive Officers**



We have entered into the following employment agreements with the executive officers identified above.



**Ricardo Salas.** On April 19, 2006, we entered into an employment agreement with Ricardo Salas, which provides for his employment as our Chief Executive Officer and President. The agreement was made effective as of April 1, 2006. Mr. Salas' employment agreement expires March 31, 2011, and his term will continue subsequent to the expiration date on a month-to-month basis at the same salary until terminated by either party upon 90 days' prior written notice. His annual salary is \$300,000, and he received 500,000 stock options as part of the employment agreement with an exercise price of \$1.44 per share. The options expire on March 31, 2016 and vest at a rate of 20% per year for five years. If we terminate Mr. Salas' employment without cause, we are responsible for paying Mr. Salas a severance benefit of Mr. Salas' monthly base salary plus health and welfare benefits for twenty-four month period immediately following the effective date of the termination. Additionally, Mr. Salas will cease to receive severance benefits upon accepting employment with another employer at comparable salary and benefits.

**John Kang.** On December 31, 2000, we entered into an employment agreement with John Kang that, as amended, provides for his employment as our Chief Executive Officer and President, and on August 22, 2003, Mr. Kang was named Chairman of our Board of Directors. On December 30, 2005, Mr. Kang ceased to serve as our President and Chief Executive Officer, and Mr. Kang's employment agreement has an expiration date of December 31, 2005, although the agreement automatically renews on a year-to-year basis until Mr. Kang resigns or his employment is terminated by us with or without cause. Mr. Kang receives an annual base salary equal to \$200,000 per year, and his employment will terminate upon the earlier of his death, resignation, disability, or termination by the board of directors for any reason. If we terminate Mr. Kang's employment without cause, or if Mr. Kang terminates his own employment upon a change of control of our company or for other good reason, as defined in the agreement, we are responsible for paying Mr. Kang a lump-sum cash payment equal to 200% of Mr. Kang's annual base salary plus the average cash bonus during the two full fiscal years immediately preceding the termination. Pursuant to the agreement, Mr. Kang was issued options to purchase 1,612,904 shares of our common stock at an exercise price of \$4.65 per share. The options expire on December 31, 2010 and vested immediately upon grant. In addition, Mr. Kang is prohibited, during his employment with us and for one year after he is no longer employed by us, from soliciting any of our employees or competing with us in any manner. Starting in May 2003, Mr. Kang and other members of senior management took a 10% voluntary decrease in their base salary and returned to full salary in June 2004.

**James Kang.** On May 1, 2001, we entered into an employment agreement with James Kang that, as amended, provides for his employment as the named executive Founder of our company. Mr. Kang's employment agreement expired on May 1, 2006 and his employment is currently on an at will basis. Mr. Kang receives an annual base salary equal to \$300,000 per year, and his employment will terminate upon the earlier of his death, resignation, disability, or termination by the board of directors for any reason. If we terminate Mr. Kang's employment without cause, or if Mr. Kang terminates his own employment upon a change of control of our company or for other good reason, as defined in the agreement, we are responsible for paying Mr. Kang a severance benefit equal to a lump-sum cash payment equal to 200% of Mr. Kang's annual base salary plus the average cash bonus during the two full fiscal years immediately preceding the termination. Pursuant to the agreement, Mr. Kang was issued options to purchase 2,580,646 shares of our common stock at an exercise price of \$6.20 per share. The options expire on April 30, 2011 and vest at a rate of 33% per year for three years, with the first 33% vesting on May 21, 2002 and an additional 33% on May 21, 2003 and 2004. In addition, Mr. Kang is prohibited, during his employment with us and for two years after he is no longer employed by us, from soliciting any of our employees or customers. Starting in May 2003, Mr. Kang and other members of senior management took a 10% voluntary decrease in their base salary and returned to full salary in June 2004.

*Young Ham.* On April 15, 2005, we entered into an employment agreement with Young Ham, which provides for his employment as the named Chief Financial Officer. Mr. Ham's employment agreement expires April 15, 2008, and his term may continue subsequent to the expiration date on a month-to-month basis at the same salary. His annual salary is \$150,000, and he received 50,000 stock options as part of the employment agreement with an exercise price of \$1.42 per share. The options expire on July 14, 2014 and vest at a rate of 20% per year for five years. If we terminate Mr. Ham's employment without cause, we are responsible for paying Mr. Ham a severance benefit of Mr. Ham's monthly base salary for three-month period immediately following the effective date of the termination.

**Equity Incentive Plans/Equity Compensation Plans**



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Securities authorized for issuance under equity compensation plans as of July 3, 2006 were as follows:

| Plan Category  | Number of securities to be issued upon exercise of outstanding options, warrants, and rights<br>[a] | Weighted-average exercise price of outstanding options, warrants, and rights<br>[b] | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column [a])<br>[c] |
|--|---|---|--|
| Equity compensation plans approved by stockholders     | 8,483,223 \$  | 4.19  | 7,995,550  |
| Equity compensation plans not approved by stockholders | 5,218,125 \$  | 2.05  |  |
| <b>Total</b>   | <b>13,701,348</b>   |   | <b>7,995,550</b>   |

Equity compensation plans not approved by stockholders consist of:

Warrants to purchase up to 165,324 shares issued on March 1, 2004 with an adjusted exercise price of \$2.72 per share and an expiration date of the later of March 1, 2006 or 100 days after the effective registration of shares issuable under the warrants;

Warrants to purchase up to 893,750 shares issued on June 13, 2005 with an exercise price of \$2.00 per share and an expiration date of June 13, 2010;

Warrants to purchase up to 2,883,965 shares issued on August 2, 2005 with an exercise price of \$2.00 per share and an expiration date of August 2, 2010;

Warrants to purchase up to 125,000 shares issued on March 17, 2006 with an exercise price of \$2.00 per share and an expiration date of March 17, 2009;

Warrants to purchase up to 773,741 shares issued on May 17, 2006 with an exercise price of \$2.58 per share and an expiration date of May 17, 2011;

Warrants to purchase up to 376,345 shares issued to Paul Azinger on January 1, 2001 with an exercise price of \$1.16 per share and an expiration date of January 1, 2008.

The number of securities and type of plans available for future issuance of stock options as of July 3, 2006 were as follows:

| Plan Name                                    | Options and Warrants for Common Shares |           |             | Available |
|--|--|-----------|-------------|-----------|
|  | Authorized                             | Exercised | Outstanding |           |
| 1996 Stock Option Plan                       | 12,903,226                             | 1,974,365 | 3,257,265   |           |
| 2002 Equity Incentive Plan                   | 10,000,000                             |           | 2,724,450   | 7,275,550 |
| 2002 Non-employee Director Stock Option Plan | 1,000,000                              |           | 280,000     | 720,000   |
| Total Stock Options                          | 23,903,226                             | 1,974,365 | 6,261,715   | 7,995,550 |

### ***1996 Stock Option Plan***

Our 1996 Stock Option Plan provides for the grant of stock options to employees, directors, and consultants of our company and its affiliates. The purpose of the plan is to retain the services of existing employees, directors, and consultants; to secure and retain the services of new employees, directors, and consultants; and to provide incentives for such persons to exert maximum efforts for our success. The plan provides for the granting to employees of incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, and for the granting to employees and consultants of nonstatutory stock options. Our board of directors terminated the 1996 Stock Option Plan on April 4, 2002. The termination will not affect any outstanding options under the plan, and all such options will continue to remain outstanding and be governed by the plan.

Options granted under the 1996 Stock Option Plan are generally not transferable by the optionee except by will or the laws of descent and distribution, and each option is exercisable, during the lifetime of the optionee, only by the optionee. Options generally must be exercised within 90 days after the optionee's termination for cause, three months following the end of the optionee's status as an employee or consultant, other than for cause or for death or disability, or within six months after the optionee's termination by disability or twelve months following the optionee's termination by death. However, in no event may an option be exercised later than the earlier of the expiration of the term of the option or ten years from the date of the grant of the option or, where an optionee owns stock representing more than 10% of the voting power, five years from the date of the grant of the option in the case of incentive stock options.

As of July 3, 2006, options to purchase 3,257,265 shares of common stock were outstanding and exercisable at a weighted average price of \$6.20 per share under the 1996 Stock Option Plan. As of July 3, 2006, 1,974,365 shares had been issued upon exercise of options under the plan.

### ***2002 Equity Incentive Plan***

Our 2002 Equity Incentive Plan, which was adopted by our board of directors and approved by our stockholders in April 2002, provides for the grant of stock options to officers, employees, consultants, and directors of our company and its subsidiaries. The purpose of the plan is to advance the interests of our stockholders by enhancing our ability to attract, retain, and motivate persons who make or are expected to make important contributions to our company and its subsidiaries by providing such persons with equity ownership opportunities and performance-based incentives, thereby better aligning their interests with those of our stockholders. The plan provides for the granting to employees of incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, and for the granting to employees and consultants of nonstatutory stock options. In addition, the plan permits the granting of stock appreciation rights, or SARs, with or independently of options, as well as stock bonuses and rights to purchase restricted stock. A total of ten million shares of our common stock may be granted under the plan.

The plan is administered by our board of directors or a committee appointed by our board of directors. All members of such a committee must be a non-employee director and an outside director, as defined in the plan. Subject to the limitations set forth in the plan, the administrator has the authority to select the persons to whom grants are to be made, to designate the number of shares to be covered by each stock award, to determine whether an option is to be an incentive stock option or a nonstatutory stock option, to establish vesting schedules, to specify the option exercise price and the type of consideration to be paid upon exercise, and, subject to some restrictions, to specify other terms of stock awards.

The administrator establishes the option exercise price, which in the case of incentive stock options, must be at least the fair market value of the common stock on the date of the grant or, with respect to optionees who own at least 10% of our outstanding common stock, 110% of fair market value. If our common stock is listed and traded on a registered national or regional securities exchange, or quoted on the National

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Association of Securities Dealers Automated Quotation System, fair market value is the average closing price of a share of our common stock on such exchange or quotation system for the five trading days prior to the date of grant. If our common stock is not traded on a registered securities exchange or quoted in such a quotation system, fair market value is determined in good faith by the administrator.



Options granted under the plan are generally not transferable by the optionee except by will or the laws of descent and distribution, and to certain related individuals with the consent of the administrator. Options generally must be exercised within three months after the optionee's termination of employment for any reason other than disability or death, or within 12 months after the optionee's termination by disability. Options granted under the plan vest at the rate specified in the option agreement. However, in no event may an option be exercised later than the earlier of the expiration of the term of the option or 10 years from the date of the grant of the option, or when an optionee owns stock representing more than 10% of the voting power, five years from the date of the grant of the option in the case of incentive stock options.

Any incentive stock options granted to an optionee which, when combined with all other incentive stock options becoming exercisable for the first time in any calendar year that are held by that person, would have an aggregate fair market value in excess of \$0.1 million, shall automatically be treated as nonstatutory stock options.

The plan may be amended, altered, suspended or terminated by our board of directors at any time, but no such amendment, alteration, suspension or termination may adversely affect the terms of any option previously granted without the consent of the affected optionee. Unless terminated sooner, the plan will terminate automatically in April 2012. As of July 3, 2006, there were 2,724,450 outstanding options or stock awards at a weighted average price of \$2.29 under the plan.

In September 2005, the non-employee directors of our company were given the opportunity to receive shares of stock under the plan in lieu of past-due director and committee fees that were due to them for periods through September 30, 2005. Such shares were issuable to such directors at an average price of \$1.89 per share. As of December 31, 2005, a total of 92,219 shares were issued to non-employee directors in lieu of these past-due fees.

In February 2006, the non-employee directors of our company were given the opportunity to receive shares of stock under the plan in lieu of director and committee fees that were due for fiscal year 2006. Such shares were issuable to such directors at an average price of \$0.88 per share, the effective closing price of our stock on January 1, 2006 when the fees became due. In April 2006, we issued a total of 99,432 shares to non-employee directors in lieu of these fees.

In March 2006, one of the former non-employee directors of our company, Vincent Addonisio, was given the opportunity to receive shares of stock under the plan in lieu of past-due director and committee fees that were due to him for periods through December 31, 2005 at an average price of \$1.50. The Company issued a total of 10,000 shares at an average price of \$1.50 in March, 2006.

In April 2006, the non-employee directors of our company were given the opportunity to receive shares of stock under the plan in lieu of past-due director and committee fees that were due to them for director fees for fiscal year 2006 due to them as of January 1, 2006. Such shares were issuable to such directors at an average price of \$0.88 per share. In April 2006, a total of 109,437 shares were issued to non-employee directors in lieu of these past-due fees.

In May 2006, our President and Chief Operating Officer, Ricardo Salas, was given the opportunity to receive shares of stock under the plan in lieu of past-due salaries and fees that were due to him for services rendered through March 31, 2006. Such shares were issuable to Mr. Salas at an average price of \$1.41 per share. In May 2006, a total of 28,960 shares were issued to Mr. Salas in lieu of these past-due salaries and fees.

*2002 Non-employee Director Stock Option Plan*

Our 2002 Non-employee Director Stock Option Plan was adopted by our board of directors and by our stockholders in April 2002. We have reserved a total of one million shares of our common stock for issuance under the plan. The option grants under the plan are automatic and nondiscretionary, and the exercise price of the options is equal to 100% of the fair market value of our common stock on the grant date.

Only non-employee directors are eligible for grants under the plan. The plan will provide for an initial grant to a new non-employee director of an option to purchase 50,000 shares of our common stock. Subsequent to the initial grants, each non-employee director will be automatically granted on the first business day of January commencing January 1, 2003, an option to purchase 10,000 shares of our common stock.

The term of the options granted under the plan is 10 years, but the options expire 12 months after the termination of the optionee's status as a director or three months if the termination is due to the voluntary resignation of the optionee. The option grants will vest and become exercisable as to one-fifth of the shares on the date that is one year after the date of grant and an additional one-fifth of the shares subject to the option on a cumulative basis will vest and become exercisable annually thereafter.

As of July 3, 2006, options to purchase 280,000 shares of common stock were outstanding at a weighted average price of \$2.24 per share under the 2002 Non-employee Director Stock Option Plan. There were 54,000 options exercisable under the 2002 Non-employee Director Stock Option Plan as of July 3, 2006.

The plan will terminate in March 2012, unless our board of directors terminates it sooner.

#### ***401(k) Savings Plan***

We have adopted a tax-qualified employee savings and retirement plan, or 401(k) plan, that covers all of our employees. Pursuant to our 401(k) plan, participants may elect to reduce their current compensation, on a pre-tax basis, by up to 15% of their taxable compensation or of the statutorily prescribed annual limit, whichever is lower, and have the amount of the reduction contributed to the 401(k) plan. The 401(k) plan permits us, in our sole discretion, to make additional employer contributions to the 401(k) plan. However, we do not currently make employer contributions to the 401(k) plan and may not do so in the future. As such, contributions by employees or by us to the 401(k) plan, and the income earned on plan contributions, are not taxable to employees until withdrawn from the 401(k) plan, and we can deduct our contributions, if any, at the time they are made.

**PRINCIPAL STOCKHOLDERS**



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The following table sets forth certain information regarding the beneficial ownership of our common stock as of July 3, 2006 and as adjusted to reflect the sale of the common stock being registered for resale under this prospectus by:

each person known by us to be a beneficial owner of more than 5.0% of our outstanding common stock;

each of our directors;

each of our named executive officers; and

all directors and executive officers as a group.

The amounts and percentage of common stock beneficially owned are reported on the basis of the regulations of the SEC governing the determination of beneficial ownership of securities. Under the rules of the SEC, a person is deemed to be a beneficial owner of a security if that person has or shares voting power, which includes the power to vote or to direct the voting of such security, or investment power, which includes the power to dispose of or to direct the disposition of such security. A person is also deemed to be a beneficial owner of any securities of which that person has a right to acquire beneficial ownership within 60 days. Under these rules, more than one person may be deemed a beneficial owner of the same securities and a person may be deemed a beneficial owner of securities as to which he has no economic interest. The number of shares of common stock outstanding used in calculating the percentage for each listed person includes the shares of common stock underlying options or warrants held by such person that are, or within 60 days after July 3, 2006, exercisable, but excludes shares of common stock underlying options or warrants held by any other person (whether or not exercisable within 60 days). The percentage of common stock beneficially owned is based on 44,085,018 shares of common stock outstanding on July 3, 2006.

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| Name of Beneficial Owner   | Shares     | Percent of Class |
|--|------------|------------------|
| <b><u>5% Stockholders</u></b>  |            |                  |
| Tjoa Thian Song(7)<br>16 Raffles Quay #B1-14A<br>Hong Leong Building<br>Singapore 0101 | 4,008,523  | 9%               |
| Jack Chitayat(10)<br>1133 Park Avenue, Suite 1W<br>New York, NY 10128                  | 2,669,289  | 6%               |
| <b><u>Directors and Named Executive Officers</u></b>                                   |            |                  |
| Ricardo A. Salas(9)<br>25800 Commercentre Drive, Suite 100<br>Lake Forest, CA 92630    | 1,249,318  | 3%               |
| John Kang(1)<br>25800 Commercentre Drive, Suite 100<br>Lake Forest, CA 92630           | 5,104,973  | 12%              |
| James Kang(2)<br>25800 Commercentre Drive, Suite 100<br>Lake Forest, CA 92630          | 6,149,991  | 14%              |
| William Johnson(3)<br>25800 Commercentre Drive, Suite 100<br>Lake Forest, CA 92630     | 1,207,650  | 3%               |
| Dean Tanella(4)<br>25800 Commercentre Drive, Suite 100<br>Lake Forest, CA 92630        | 48,120     | *                |
| Robert Biehl(5)<br>25800 Commercentre Drive, Suite 100<br>Lake Forest, CA 92630        | 104,059    | *                |
| CK Cho(6)<br>25800 Commercentre Drive, Suite 100<br>Lake Forest, CA 92630              | 779,349    | 2%               |
| Young Ham(8)<br>25800 Commercentre Drive, Suite 100<br>Lake Forest, CA 92630           | 37,500     | *                |
| All directors and executive officers as a group (8 persons)                            | 14,680,960 | 33%              |

\* Less than one percent.

(1) As of August 22, 2003, John Kang was named Chairman of our board of directors. Mr. Kang resigned from his position as President and Chief Executive Officer of our company on December 30, 2005. However, he continues to serve as Chairman of the Board and continues to work for the Company on a full-time basis. The beneficial shares

include:



(a) 1,622,904 shares issuable pursuant to outstanding stock options that are exercisable currently or within 60 days of July 3, 2006. Does not include 40,000 shares that are issuable pursuant to outstanding stock options that are not exercisable currently or within 60 days of July 3, 2006; and

(b) 132,400 shares held by Mr. Kang's minor children.

(2) Includes 67,829 shares issuable pursuant to currently exercisable warrants. Also includes 2,877,420 shares issuable pursuant to outstanding stock options that are exercisable currently or within 60 days of July 3, 2006 and includes 969 shares held by James Kang's minor children. Does not include the 1,700,000 shares that Mr. Kang has agreed to personally purchase on October 31, 2006 from Innometal Co., Ltd. as an inducement for Innometal to enter into a Settlement Agreement with us. Innometal agreed to accept these shares in full satisfaction of all of our obligations to them under January 2004 settlement agreement.

(3) Includes 12,000 shares issuable pursuant to outstanding stock options that are exercisable currently or within 60 days of July 3, 2006. Does not include 58,000 shares that are issuable pursuant to outstanding stock options that are not exercisable currently or within 60 days of July 3, 2006.

(4) Includes 16,130 shares held by Mr. Tanella's investment firm, HarborLight Diversified Fund, LP. Also, includes 1,390 shares held by Mr. Tanella's family. Includes 22,000 shares issuable pursuant to outstanding stock options that are exercisable currently or within 60 days of July 3, 2006. Does not include 68,000 shares that are issuable pursuant to outstanding stock options that are not exercisable currently or within 60 days of July 3, 2006.

(5) Includes 10,000 shares issuable pursuant to outstanding stock options that are exercisable currently or within 60 days of July 3, 2006. Does not include 50,000 shares that are issuable pursuant to outstanding stock options that are not exercisable currently or within 60 days of July 3, 2006.

(6) Includes 92,584 shares issuable pursuant to currently exercisable warrants and 435,167 shares issuable pursuant to currently convertible notes. Also, includes 10,000 shares issuable pursuant to outstanding stock options that are exercisable currently or within 60 days of July 3, 2006. Does not include 50,000 shares that are issuable pursuant to outstanding stock options that are not exercisable currently or within 60 days of July 3, 2006.

(7) 3,874,585 of these shares are held of record by a revocable grantor trust established by Mr. Tjoa for himself and his family members. Mr. Tjoa continues to beneficially own all such shares.

(8) Includes 37,500 shares issuable pursuant to outstanding stock options exercisable currently or within 60 days of July 3, 2006. Does not include 125,000 shares that are issuable pursuant to outstanding stock options that are not exercisable currently or within 60 days of July 3, 2006.

(9) Includes 65,672 shares issuable pursuant to currently exercisable warrants and 217,584 shares issuable pursuant to currently convertible notes. Does not include 500,000 shares that are issuable pursuant to outstanding stock options that are not exercisable currently or within 60 days of July 3, 2006.

(10) Includes 125,000 shares issuable pursuant to currently exercisable warrants held by Atlantic Realty Group, Inc., a company controlled by Mr. Chitayat, and 91,792 shares held of record by a trust established by Mr. Chitayat for his family members. Mr. Chitayat continues to beneficially own all such shares.

**DESCRIPTION OF CAPITAL STOCK**



**General**



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We are authorized to issue up to 100,000,000 shares of common stock, par value \$0.001 per share, of which 44,085,018 shares were issued and outstanding as of July 3, 2006. We are also authorized to issue up to 10,000,000 shares of preferred stock, par value \$0.001 per share, of which no shares were issued and outstanding as of July 3, 2006.

### **Common Stock**





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The holders of our common stock are entitled to one vote per share on all matters to be voted upon by the stockholders. Subject to preferences that may be applicable to any outstanding preferred stock, the holders of common stock are entitled to receive ratably any dividends that may be declared from time to time by the board of directors out of funds legally available for that purpose. In the event of our liquidation, dissolution or winding up, the holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior distribution rights of preferred stock then outstanding. The common stock has no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to the common stock. All outstanding shares of common stock are fully paid and nonassessable, and the shares of common stock to be issued upon the closing of this offering will be fully paid and nonassessable.

### **Preferred Stock**



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Our board of directors has the authority, without action by our stockholders, to designate and issue up to 10,000,000 shares of preferred stock in one or more series. The board of directors may also designate the rights, preferences, and privileges of each series of preferred stock, any or all of which may be greater than the rights of the common stock. It is not possible to state the actual effect of the issuance of any shares of preferred stock upon the rights of holders of the common stock until the board of directors determines the specific rights of the holders of the preferred stock. However, these effects might include restricting dividends on the common stock; diluting the voting power of the common stock; impairing the liquidation rights of the common stock; and delaying or preventing a change in control of our company without further action by the stockholders. We have no present plans to issue any shares of preferred stock.

### **Convertible Notes**



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As of July 3, 2006, we had convertible promissory notes outstanding in the aggregate principal amount of \$12.2 million. The notes consist of \$2.3 million in aggregate principal amount of 6% Senior Convertible Notes Due July 2007 (the July 2007 Notes ) plus \$9.9 million in aggregate principal amount of 7% Convertible Secured Promissory Notes due August 2007 (the August 2007 Notes ).

The July 2007 Notes were issued in a private placement on July 29, 2004 and have a maturity date of July 29, 2007. The July 2007 Notes are convertible into shares of our common stock at a conversion price of \$1.00 per share, subject to specified anti-dilution adjustments. Under the July 2007 Notes, the noteholders have the right to call for repayment of such notes prior to maturity at any time after the second anniversary of the date of the issuance of the notes. The July 2007 Notes bear interest at a rate equal to 6% per annum, with interest being payable in cash on a quarterly basis.

The August 2007 Notes were issued in a private placement on August 2, 2005 and have a maturity date of August 2, 2007. The August 2007 Notes are convertible into shares of our common stock at a conversion price of \$2.00 per share, subject to specified anti-dilution adjustments. The August 2007 Notes bear interest at a rate equal to 7% per annum, with interest being payable in cash on a quarterly basis.

**Warrants and Special Stock Option**



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As of July 3, 2006, we had warrants outstanding to purchase up to 3,943,039 shares of our common stock issued to holders of our convertible notes. Of these warrants:

Warrants to purchase up to 165,324 shares were issued on March 1, 2004 at an adjusted exercise price of \$2.72 per share and with an expiration date of the later of March 1, 2006 or 100 days after the effective registration of shares issuable under the warrants;

Warrants to purchase up to 893,750 shares were issued on June 13, 2005 at an exercise price of \$2.00 per share and with an expiration date of June 13, 2010; and

Warrants to purchase up to 2,883,965 shares were issued on August 2, 2005 at an exercise price of \$2.00 per share and with an expiration date of August 2, 2010.

In each of the foregoing transactions, the warrants were issued in private placements and were issued to the purchasers of convertible notes in such private placements, as well as to placement agents in such transactions.

On January 1, 2001, we granted Paul Azinger, a professional golf player, a non-qualified stock option to purchase up to 1,021,507 shares of our common stock at an exercise price of \$1.16 per share. This option was granted to Mr. Azinger in consideration of Mr. Azinger entering into an endorsement agreement with our Liquidmetal Golf subsidiary, although the endorsement agreement was terminated effective January 1, 2003. As a result of the termination of the endorsement agreement, Mr. Azinger's option immediately vested as to 376,345 shares upon such termination, and the option was terminated as to the remaining shares. This stock option will expire on January 1, 2008, and as of July 3, 2006, no portion of this option has been exercised.

On March 17, 2006, we issued warrants to purchase an aggregate amount of up to 125,000 shares of common stock, exercisable at \$2.00 per share, to Atlantic Realty Group, Inc., a company controlled by Jack Chitayat (a former director of our company). The warrants will expire on March 17, 2009. As of July 3, 2006, no portion of these warrants have been exercised.

On May 17, 2006, we issued warrants to purchase an aggregate amount of up to 773,741 shares of common stock, exercisable at \$2.58 per share, to investors in a private placement of our 8% unsecured subordinated notes. The warrants will expire on May 17, 2011. As of July 3, 2006, no portion of these warrants has been exercised

### **Anti-Dilution Provisions in Notes and Warrants**





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Our convertible notes and warrants contain weighted-average anti-dilution provisions whereby, if we issue shares in the future for consideration below the conversion or exercise prices of such notes or warrants, then (with certain exceptions, including the issuance of stock options) the conversion price for our convertible notes would automatically be reduced (allowing the holders of the notes to receive additional shares of common stock upon conversion) and the exercise price of the warrants would automatically be reduced. The amount of the reduction would be equal to a portion of the difference between the conversion price of the notes and exercise price of the warrants, on the one hand, and the lower price at which the common stock was, or could effectively be acquired, in the subsequent transaction. The percentage by which the conversion price and exercise price could be reduced depends not only on the lower price at which our common stock was, or could be, acquired in the subsequent transaction, but also by the ratio that the number of shares of our common stock that were, or could be, acquired in such transaction bears to the total number of shares of our common stock that would be outstanding after such subsequent transaction.

If our available funds and cash generated from operations are insufficient to satisfy our liquidity requirements in the future, then we may need to raise substantial additional funds in the future to support our working capital requirements and for other purposes. If shares of our common stock or securities convertible into or exercisable for our common stock are issued in consideration of such funds at an effective per share price lower than the conversion and exercise prices of our convertible notes and warrants, then these anti-dilution provisions would be triggered, thus possibly

causing substantial dilution to our then-existing stockholders if the notes are converted or the warrants are exercised. Further, subsequent sales of the shares in the public market could depress the market price of our stock by creating an excess in supply of shares for sale.

**Registration Rights**



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On August 2, 2005, we entered into an amended and restated registration rights agreement with the holders of the July 2007 Notes, the holders of the August 2007 Notes, and the holders of the above-described outstanding warrants. This amended and restated registration rights agreement replaced all other registration rights agreements previously entered into by us in connection with the private sale by us of convertible notes and warrants. Under the amended and restated registration rights agreement, we are required to file a resale registration statement for the shares underlying all of our outstanding convertible notes and warrants, as described above, by October 31, 2005, to enable the resale of such shares by the selling stockholders on a delayed or continuous basis under Rule 415 of the Securities Act. We are then required to cause such registration statement to become effective within 60 days after we receive the first written comments on the registration statement from the SEC, or if the SEC notifies us that it will not review the registration statement, within five days after such notification. We will be subject to certain monetary penalties, as set forth in the registration rights agreement, if the registration statement is not filed or does not become effective on a timely basis. Specifically, if we do not file the registration statement on a timely basis, we will be obligated to pay a late filing fee to the selling stockholders in the amount of 3% of the warrant exercise price on each of the warrants held by them plus 3% of the principal amount of the outstanding notes held by them. This fee will be payable for each period of 30 business days that the filing of the registration statement is made past the required filing date, and the payments will be due 10 business days following the end of each 30-day period. If the registration statement has not been declared effective by the required effective date, we will be obligated to pay a monthly late registration fee to the selling stockholders in the amount of 2% of the aggregate warrant exercise prices and aggregate note principal amounts for the first 30 business days after the required effective date, and 1% for each 30-business day period thereafter until the registration statement is declared effective. Notwithstanding the foregoing, the late filing fees and late registration fees will not exceed 18% of the aggregate warrant exercise prices and aggregate note principal amounts.

On December 6, 2005, we received a letter from a representative of the holders of the August 2007 Notes demanding the payment of a late filing fee by us for the period following October 31, 2005, but under the terms of the amended and restated registration rights agreement, we did not believe that we were obligated to pay any late filing fees unless and until we failed to file the registration statement by December 13, 2005, which was the last day of the first 30-business day period following October 31, 2005. On December 9, 2005, we filed the registration statement and we believed that we have cured the default notice received on December 6, 2005.

On May 12, 2006, we received a letter from one holder holding \$0.5 million of the August 2007 Notes demanding immediate payment of late filing fees and late registration fees for the period following October 31, 2005 through May 3, 2006. As a result of the late fee provisions of the restated registration rights agreement, we are obligated to pay late filing and late registration fees accrued through July 3, 2006 of up to \$1.4 million to all of the noteholders. In addition, the letter purported to constitute a notice of default under the August 2007 Notes and July 2007 Notes ( Notes ) as a result of our failure to pay the late filing and late registration fees. Under the terms of Notes, if a default is not cured by us within thirty (30) days of notice thereof, the holder has the right to accelerate all principal and interest due under the Notes. As of July 3, 2006, \$9.9 million in aggregate principal amount of August 2007 Notes was still outstanding with accrued but unpaid interest in the amount of approximately \$175 thousand. In addition, \$2.3 million in aggregate principal amount of July 2007 Notes was also outstanding with accrued but unpaid interest in the amount of approximately \$35 thousand. As of July 14, 2006, we have not paid any amounts under the demand letter and we are currently in negotiations with the holder regarding the matters set forth in the letter with the goal of preventing any acceleration of amounts due under the Notes.

On May 17, 2006, we entered into a registration rights agreement with the holders of the warrants issued in connection with a private placement of 8% Unsecured Subordinated Notes due August 17, 2007 relating to the resale of the shares of our common stock issuable upon exercise of such warrants. Under the registration rights agreement, we must file a registration statement with the Securities and Exchange Commission covering the resale of the shares issuable under the warrants, if, following the 180<sup>th</sup> day after the date of the registration rights agreement, we receive a written request to do so from the holders of fifty percent or more of the warrants then outstanding. The warrant holders also have piggyback registration rights under the registration rights agreement, which requires us to register, upon request by a warrant holder,

the shares issuable upon exercise of such warrants in any registration statement filed in connection with the public offering of the our common stock.

Pursuant to the above-described non-qualified stock option granted to Paul Azinger, Mr. Azinger has piggyback registration rights with respect to any shares of common stock that Mr. Azinger receives upon the exercise of his stock option. Mr. Azinger's stock option agreement provides that, if we propose to register additional shares of common stock under the Securities Act of 1933, whether for our own account or the account of another stockholder, Mr. Azinger is entitled to receive notice of that registration and to include his shares in the registration, subject to limitations described in his stock option agreement. These registration rights will not apply to a registration of securities issued under an employee benefit plan or a registration incident to a corporate merger or reorganization. These registration rights expire on the date on which Mr. Azinger can sell all of his registrable securities under Rule 144 under the Securities Act of 1933 without any volume limitations. As a result of these registration rights, Mr. Azinger is a selling stockholder in this prospectus.

All of the above registration rights are subject to conditions and limitations, among them the right of the underwriters of any offering to limit the number of shares of common stock held by these security holders to be included in the registration. We are generally required to bear all of the expenses of all registrations, except underwriting discounts and selling commissions. Registration of the shares of common stock held by security holders with registration rights would result in these shares becoming freely tradeable without restriction under the Securities Act of 1933 immediately upon effectiveness of this registration. Other than the above-described registration rights, we have not granted any registration rights with respect to any shares of our capital stock.

#### **Stock Options**



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As of July 3, 2006, we had stock options outstanding under our equity incentive plans to purchase up to 8,483,223 shares of our common stock. Of these options, options to purchase 6,238,040 shares of common stock were exercisable at July 3, 2006 at a weighted-average exercise price of \$4.94 per share.

### **Anti-Takeover Effect**





Provisions of Delaware law and our certificate of incorporation and amended bylaws could make the acquisition of our company through a tender offer, a proxy contest or other means more difficult and could make the removal of incumbent officers and directors more difficult. We expect these provisions to discourage coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of our company to first negotiate with our board of directors. We believe that the benefits provided by our ability to negotiate with the proponent of an unfriendly or unsolicited proposal outweigh the disadvantages of discouraging these proposals. We believe the negotiation of an unfriendly or unsolicited proposal could result in an improvement of its terms.

*Delaware Law.* Upon the closing of this offering, we will be subject to Section 203 of the Delaware General Corporation Law, an anti-takeover law. In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder for a period of three years following the date the person became an interested stockholder, unless:

prior to the date of the transaction, the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder;

the stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding (a) shares owned by persons who are directors and also officers, and (b) shares owned by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or

on or subsequent to the date of the transaction, the business combination is approved by the board and authorized at an annual or special meeting of stockholders, and not by written consent, by the

affirmative vote of at least 66% of the outstanding voting stock which is not owned by the interested stockholder.

Generally, a business combination for these purposes includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. An interested stockholder for these purposes is a person who, together with affiliates and associates, owns or, within three years prior to the determination of interested stockholder status, did own 15% or more of a corporation's outstanding voting securities. We expect the existence of this provision to have an anti-takeover effect with respect to transactions our board of directors does not approve in advance. We also anticipate that Section 203 may also discourage attempts that might result in a premium over the market price for the shares of common stock held by stockholders.

*Certificate of Incorporation and Bylaw Provisions.* Our certificate of incorporation to be in effect provides for our board of directors to be divided into three classes serving staggered terms. Approximately one-third of the board of directors will be elected each year. The provision for a classified board could prevent a party who acquires control of a majority of the outstanding voting stock from obtaining control of the board of directors until the second annual stockholders meeting following the date the acquiring party obtains the controlling stock interest. The classified board provision could discourage a potential acquiror from making a tender offer or otherwise attempting to obtain control of our company and could increase the likelihood that incumbent directors will retain their positions. Our bylaws also provides that directors may be removed with cause by the affirmative vote of the holders of the outstanding shares of common stock.

Our bylaws establish an advance notice procedure for stockholder proposals to be brought before an annual meeting of our stockholders, including proposed nominations of persons for election to the board of directors. At an annual meeting, stockholders may only consider proposals or nominations specified in the notice of meeting or brought before the meeting by or at the direction of the board of directors. Stockholders may also consider a proposal or nomination by a person who was a stockholder of record on the record date for the meeting, who is entitled to vote at the meeting and who has given to our Secretary timely written notice, in proper form, of his or her intention to bring that business before the meeting. The bylaws do not give the board of directors the power to approve or disapprove stockholder nominations of candidates or proposals regarding other business to be conducted at a special or annual meeting of the stockholders. However, our bylaws may have the effect of precluding the conduct of business at a meeting if the proper procedures are not followed. These provisions may also discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror's own slate of directors or otherwise attempting to obtain control of our company.

Under Delaware law, a special meeting of stockholders may be called by the board of directors or by any other person authorized to do so in the certificate of incorporation or the bylaws. Our certificate of incorporation authorizes a majority of our board of directors to call a special meeting of stockholders, and it requires the President or Secretary to call a special meeting upon the written request of stockholders who own an aggregate of least 25% of the outstanding shares of voting stock. Because our stockholders owning less than an aggregate of 25% of our voting stock do not have the right to call a special meeting, such stockholders could not force stockholder consideration of a proposal over the opposition of the board of directors by calling a special meeting of stockholders prior to such time as a majority of the board of directors believed or the chief executive officer believed the matter should be considered or until the next annual meeting provided that the requestor met the notice requirements. The restriction on the ability of stockholders to call a special meeting means that a proposal to replace the board also could be delayed until the next annual meeting.

#### **Transfer Agent and Registrar**



The Transfer Agent and Registrar for the common stock is American Stock Transfer & Trust Company, New York, New York.

**PLAN OF DISTRIBUTION**



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We are registering the shares of common stock issuable upon conversion of our outstanding convertible notes, the exercise of our outstanding warrants, and the exercise a non-qualified stock option to permit the resale of these shares by the holders of such notes and warrants from time to time after the date of this prospectus. We will not receive any of the proceeds from the sale by any selling stockholder of these shares of common stock. We will bear all fees and expenses incident to our obligation to register the shares of common stock, except that a selling stockholder will pay all applicable underwriting discounts and selling commissions, if any.

Any selling stockholder may sell all or a portion of the common stock beneficially owned by it and offered hereby from time to time directly or through one or more underwriters, broker-dealers or agents. If the common stock is sold through underwriters or broker-dealers, then the selling stockholder will be responsible for underwriting discounts or commissions or agent's commissions. The common stock may be sold in one or more transactions at fixed prices, at prevailing market prices at the time of the sale, at varying prices determined at the time of sale, or at negotiated prices. These sales may be effected in transactions, which may involve crosses or block transactions,

- (1) on any national securities exchange or quotation service on which the securities may be listed or quoted at the time of sale,
- (2) in the over-the-counter market,
- (3) in transactions otherwise than on these exchanges or systems or in the over-the-counter market,
- (4) through the writing of options, whether the options are listed on an options exchange or otherwise,
- (5) through the settlement of short sales effected after the effective date of the registration statement of which this prospectus is a part;
- (6) through a combination of such methods of sale; or
- (7) through any other method permitted pursuant to applicable law.

If a selling stockholder effects such transactions by selling shares of common stock to or through underwriters, broker-dealers or agents, such underwriters, broker-dealers or agents may receive commissions in the form of discounts, concessions or commissions from the selling stockholder or commissions from purchasers of the shares of common stock for whom they may act as agent or to whom they may sell as principal (which discounts, concessions or commissions as to particular underwriters, broker-dealers or agents may be in excess of those customary in the types of transactions involved). In connection with sales of the common stock or otherwise, a selling stockholder may enter into hedging transactions with broker-dealers, which may in turn engage in short sales of the common stock in the course of hedging in positions they assume after the effective date of the registration statement of which this prospectus is a part. A selling stockholder may also sell shares of common stock short and deliver shares of common stock covered by this prospectus to close out short positions. Each selling stockholder may also loan or pledge shares of common stock to broker-dealers that in turn may sell such shares.

Each selling stockholder may pledge or grant a security interest in some or all of the convertible senior secured notes or shares of common stock owned by it and, if it defaults in the performance of its secured obligations, the pledgees or secured parties may offer and sell the shares of common stock from time to time pursuant to this prospectus or any amendment to this prospectus under Rule 424(b)(3) or other applicable provision of the Securities Act of 1933, as amended, amending, if necessary, the list of selling stockholders to include the pledgee, transferee or other successors-in-interest as selling stockholders under this prospectus. Each selling stockholder also may transfer and donate the shares of common stock in other circumstances in which case the transferees, donees, pledgees or other successors-in-interest will be the selling beneficial owners for purposes of this prospectus.



Each selling stockholder and any broker-dealer participating in the distribution of the shares of common stock may be deemed to be underwriters within the meaning of the Securities Act, and any commission paid, or any discounts or concessions allowed, to any such broker-dealer may be deemed to be underwriting commissions or discounts under the Securities Act. At the time a particular offering of the shares of common stock is made, a prospectus supplement, if required, will be distributed that will set forth the aggregate amount of shares of common stock being offered and the terms of the offering, including the name or names of any broker-dealers or agents, any discounts, commissions and other terms constituting compensation from each selling stockholder and any discounts, commissions or concessions allowed or reallocated or paid to broker-dealers. If a selling stockholder enters into an agreement after the effectiveness of the registration statement to sell its shares to a broker-dealer as principal and the broker-dealer is acting as an underwriter, then we will be required to file a post-effective amendment to the registration statement of which this prospectus is a part identifying the broker-dealer, providing the required information on the plan of distribution, revising the appropriate disclosures in the registration statement, and filing the agreement as an exhibit to the registration statement. Prior to the involvement of any broker-dealer in the offering, such broker-dealer must seek and obtain clearance of the underwriting compensation and arrangements from the NASD Corporate Finance Department.

Under the securities laws of some states, the shares of common stock may be sold in such states only through registered or licensed brokers or dealers. In addition, in some states the shares of common stock may not be sold unless the shares have been registered or qualified for sale in the state or an exemption from registration or qualification is available and is complied with.

There can be no assurance that any selling stockholder will sell any or all of the shares of common stock registered pursuant to the shelf registration statement of which this prospectus forms a part.

Each selling stockholder and any other person participating in such distribution will be subject to applicable provisions of the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder, including, without limitation, Regulation M of the Exchange Act, which may limit the timing of purchases and sales of any of the shares of common stock by the selling stockholders and any other participating person. Regulation M may also restrict the ability of any person engaged in the distribution of the shares of common stock to engage in market-making activities with respect to the shares of common stock. All of the foregoing may affect the marketability of the shares of common stock and the ability of any person or entity to engage in market-making activities with respect to the shares of common stock.

We and the selling stockholders will distribute the prospectus only by hand or the mails and only in the form of this prospectus. Neither we nor the selling stockholders will distribute or deliver the prospectus electronically or in any form of prospectus other than the printed form of this prospectus.

We have agreed to pay all expenses in connection with this offering, but not including underwriting discounts, concessions, commissions or fees of the selling stockholders, estimated to be approximately \$102 thousand in total, including, without limitation, Securities and Exchange Commission filing fees and expenses. We will indemnify the selling stockholders against liabilities, including some liabilities under the Securities Act, in accordance with the registration rights agreement, or the selling stockholders will be entitled to contribution. We may be indemnified by a selling stockholder against civil liabilities, including liabilities under the Securities Act, that may arise from any written information furnished to us by the selling stockholder specifically for use in this prospectus, in accordance with the registration rights agreement, or we may be entitled to contribution.

Once sold under the shelf registration statement, of which this prospectus forms a part, the shares of common stock will be freely tradable in the hands of persons other than our affiliates.



**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**



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In June 2003, we entered into an exclusive, ten-year license agreement with LLPG, Inc. ( LLPG ), a corporation primarily owned and led by Jack Chitayat, a former director of our company. Under the terms of the agreement, LLPG has the right to commercialize Liquidmetal alloys, particularly precious-metal based compositions, in jewelry and high-end luxury product markets. In turn, we will receive royalty payments over the life of the contract on all Liquidmetal products produced and sold by LLPG. In conjunction with its technology licensing contract, LLPG purchased two proprietary Liquidmetal alloy melting machines and three proprietary Liquidmetal alloy casting machines for a total purchase price of \$2.0 million. We have not received any royalties to date under this agreement.

On March 17, 2006, we issued a \$1.0 million 10% subordinated promissory note due October 16, 2006 (the March 2006 Note ) to Atlantic Realty Group, Inc., a company controlled by Jack Chitayat. The March 2006 Note is unsecured and subordinated to all prior indebtedness of the company. All accrued interest and unpaid principal under the note will be due October 16, 2006. The proceeds from the March 2006 Note is to be used solely for working capital purposes. In connection with the March 2006 Note, we issued warrants to purchase an aggregate amount of up to 125,000 shares of common stock, exercisable at \$2.00 per share. The warrants will expire on March 17, 2009, and include price adjustment provisions for anti-dilution purposes. There are no registration rights of the shares issuable from the exercise of the warrants. Further, cashless exercise of the warrants is permitted.

We are a party to a license agreement with California Institute of Technology ( Caltech ) under which we exclusively license from Caltech certain inventions and technology relating to amorphous alloys. Professor William Johnson, a member of our board of directors, is a professor at Caltech, and substantially all of the amorphous alloy technology licensed to us under the Caltech license agreement was developed in Professor Johnson's Caltech laboratory. Additionally, we reimburse Caltech for laboratory expenses incurred by Professor Johnson's Caltech laboratory, which during the three months ended March 31, 2006 and 2005, amounted to \$40 thousand and \$0, respectively. During the years ended December 31, 2005 and 2004, the fees amounted to \$20 thousand and \$0, respectively.

We are a party to a consulting agreement with William Johnson, a board member. Under this agreement, Mr. Johnson provides consulting services on an as-needed basis through 2004 as it relates to marketing and development Liquidmetal alloy. The agreement currently continues on a month-to-month basis. In April 2006, we entered into an agreement with Mr. Johnson effective from January 1, 2006 through December 31, 2006. During the three months ended March 31, 2006 and 2005, we incurred \$15 thousand and \$15 thousand in consulting fees from Mr. Johnson, respectively. During the years ended December 31, 2005 and 2004, we incurred approximately \$15 thousand and approximately \$90 thousand in consulting fees from Mr. Johnson, respectively.

We are a party to a consulting agreement with Chitnis Consulting, Inc., which is owned 100% by Shekhar Chitnis, a former director and executive officer of our company. Under this agreement, we have engaged Chitnis Consulting to provide consulting services on an as-needed basis through December 31, 2005. On January 1, 2006, the term of the agreement was extended to December 31, 2006. During the three months ended March 31, 2006 and 2005, we incurred \$0 and \$13 thousand in consulting fees from Chitnis Consulting. During the years ended December 31, 2005 and 2004, we incurred approximately \$53 thousand and \$54 thousand in consulting fees from Chitnis Consulting, respectively.

Soo Buchanan, the sister of John Kang and James Kang, was employed by our company and was paid aggregate compensation of approximately \$104 thousand and \$43 thousand as of December 31, 2005 and 2004. Effective, July 31, 2005, our Ms. Buchanan was terminated as an employee and began providing services to the company as a consultant. For the three months ended March 31, 2006 and 2005, we incurred \$0 and \$15 thousand as compensation costs for Ms. Buchanan, respectively. During the year ended December 31, 2005, we incurred \$18 thousand for her services as a consultant. Additionally, Otis Buchanan, the husband of Ms. Buchanan, was employed by our company and was paid aggregate compensation of approximately \$103 thousand and \$54 thousand as of December 31, 2005 and 2004, respectively. During the three months ended March 31, 2006 and 2005, the Company incurred \$32 thousand and \$14 thousand, respectively, as compensation costs for Mr. Buchanan.

In November 2004, we entered into an agreement with John Kang, our Chairman, President, and Chief Executive Officer, in which Mr. Kang agreed that certain stock transactions by him in 2002 involving our common stock should have resulted in a liability under Section 16(b) of the



16(b) ). These transactions include Mr. Kang's private sale of 285,715 shares of his personal Liquidmetal Technologies common stock to Growell Metal Co., Ltd. in February 2002, prior to our initial public offering. They also include Mr. Kang's subsequent indirect purchase and disposition of Liquidmetal Technologies common stock in order to satisfy a personal agreement Mr. Kang made to Growell Metal in February 2002 regarding the guaranteed minimum value of the stock purchased by Growell Metal in February 2002 (the purchases and dispositions incident to this agreement occurred in August and November 2002, respectively). Lastly, the transactions include open-market purchases of an aggregate of 89,300 shares of our common stock made by Mr. Kang in August 2002.

The Audit Committee of our Board of Directors conducted an independent inquiry into the above-described transactions with the aid of independent legal counsel and, as a result of such inquiry, the Audit Committee concluded that the transactions should have resulted in a liability to the Company under Section 16(b) in the amount of \$0.3 million. Mr. Kang has acknowledged this liability, and in an agreement negotiated between Mr. Kang and the Audit Committee and approved by the full Board, Mr. Kang will pay this liability through periodic installments in 2005 and 2006. As a result, the Company accrued for the \$0.3 million receivable in other assets and other income as of December 31, 2004. The above-described transactions involving Growell Metal was reported on a new Form 4 filed by Mr. Kang on November 15, 2004, and the open-market purchases were previously reported on a timely basis in August 2002. As of December 31, 2005, the outstanding amount of the receivable was \$0.2 million, which is included in other assets. Mr. Kang paid \$0.1 million during 2005. The Company agreed to defer Mr. Kang's payment schedule until 2006 as Mr. Kang has agreed accept reduced compensation for the remainder of 2005. The remaining outstanding balance of \$0.2 million will be due before the end of 2006.

During the year ended December 31, 2005, the Company executed a \$0.2 million promissory note with CK Cho, a member of our Board of Directors, for working capital purposes. The note was due and paid in full as of June 30, 2005. The note had an annual rate of interest of 6% resulting in the Company paying approximately \$2 thousand in interest. Mr. Cho also holds \$0.6 million of Senior Convertible Notes and holds 92,584 exercisable warrants as of December 31, 2005 and March 31, 2006. Further, during the year ended December 31, 2005, Mr. Cho advanced approximately \$1.3 million to cover short-term liquidity needs. The advances were made without interest and were repaid as of December 31, 2005.

During the year ended December 31, 2005, Ricardo Salas, our President and Chief Executive Officer, and Young Ham, our Chief Financial Officer, each advanced the company approximately \$0.1 million to cover short-term liquidity needs. The advances were made without interest and were repaid as of December 31, 2005. Mr. Salas also held \$0.3 million of Senior Convertible Notes and 46,292 warrants as of December 31, 2005. As of March 31, 2006, Mr. Salas held \$0.3 million of Senior Convertible Notes, and \$0.1 million of our 8% Unsecured Subordinated Notes, and 65,672 warrants.

We believe that each of the foregoing transactions was consummated on terms at least as favorable to us as we would expect to negotiate with unrelated third parties.

#### **CHANGES OF ACCOUNTANTS**





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On May 6, 2004, Deloitte & Touche LLP ( Deloitte ), the Company's independent auditors, notified the Company that they were resigning from the client-auditor relationship with the Company effective as of that date.

Deloitte was engaged by the Company to serve as the Company's independent auditors for the fiscal year ended December 31, 2003. The reports of Deloitte with respect to the Company's financial statements for the fiscal years ended December 31, 2002 and 2001 contained no adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles. During the fiscal years ended December 31, 2003 and 2002 and the period from December 31, 2003 through the date of Deloitte's resignation, there were no disagreements between the Company and Deloitte on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Deloitte, would have caused Deloitte to make reference to the subject matter of the disagreements in connection with its report on the Company's financial statements for such year.

The Company previously announced that it expected to restate revenues and results of operations for the third and fourth quarters of 2002 and the first quarter of 2003 in connection with the Company's sales of alloy melting and casting equipment during such quarters to Growell Metal Co., Ltd., a South Korea metals processing company ( "Growell" ). The Company's Audit Committee conducted an internal inquiry at the request of Deloitte into the Company's transactions with Growell and found that the original revenue recognition on the Growell equipment sales did not take into account all relevant documentation relating to the transactions. The Company announced in January 2004 that it entered into a dispute settlement agreement with Growell to resolve various outstanding claims between the parties relating to the Company's transactions with Growell.

In connection with the Audit Committee's inquiry into the Growell equipment sales and dispute settlement, the Audit Committee also reviewed the facts and circumstances relating to a personal stock transaction between the Company's CEO and Growell. In this transaction, as reported by the CEO, the CEO undertook a private sale of personal shares of the Company's common stock to Growell in February 2002, prior to the Company's initial public offering. As part of the inquiry, the CEO reported that this sale included a previously undisclosed personal agreement to ensure that the purchase price of the stock purchased by Growell would be at a thirty percent discount to the Company's initial public offering price, and he also provided information regarding his fulfillment of this personal agreement.

As of May 6, 2004, certain details of the foregoing transactions had not been resolved to Deloitte's satisfaction. As a result of the expected restatements and these unresolved issues, the Company's previously issued financial statements for the year ended December 31, 2002 and Deloitte's audit report thereon, as well as the Company's quarterly financial statements for the third quarter of 2002 and the first, second, and third quarters of 2003 (and Deloitte's related review reports thereon), should no longer be relied upon.

Deloitte communicated to the Company that it was unwilling to continue to rely on the representations of the Company's CEO. Deloitte had also previously communicated to the Company that, in light of the facts and circumstances surrounding the expected restatement, there were material weaknesses in the Company's internal accounting controls relating to the execution, administration, and accounting for contracts, particularly in the Company's South Korean operations. The Company has taken and is continuing to take steps to improve these internal controls.

Other than the foregoing, none of the reportable events described under Item 304(a)(1)(v) of Regulation S-K occurred within the two most recent fiscal years of the Company ended December 31, 2003 and 2002 or within the subsequent interim period through the date of Deloitte's resignation.

The Company's Audit Committee discussed with Deloitte the matters disclosed above regarding Deloitte's resignation. The Company authorized Deloitte to respond fully to the inquiries of the Company's successor accountant concerning the matters disclosed above.

On May 21, 2004, the Company's Audit Committee appointed Stonefield Josephson, Inc. ( "Stonefield" ) as the Company's independent auditors. During the two fiscal years prior to the engagement of Stonefield and through the date of the commencement of their engagement, the Company did not consult Stonefield regarding (i) the application of accounting principles to a specific transaction, either completed or proposed, or the type of audit opinion that may be rendered on the Company's financial statements, and neither a written report nor oral advice was provided to the Company that Stonefield Josephson concluded was an important factor considered by the Company in reaching a decision as to any accounting, auditing or financial reporting issue; or (ii) any matter that was either the subject of a disagreement (as defined in Item 304(a)(1)(iv) of Regulation S-K and the related instructions thereto) or a reportable event (as defined in Item 304(a)(1)(v) of Regulation S-K).

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On November 23, 2005, Stonefield, the Company's independent registered public accounting firm, notified the Company that Stonefield would resign as the Company's independent registered public accounting firm upon the completion of Stonefield's review of the Company's interim unaudited financial statements as of and for the three and nine month periods ended September 30, 2005. The Company's interim unaudited financial statements as of and for the three and nine month periods ended September 30, 2005 were included in the Company's report on Form 10-Q for the third quarter ended September 30, 2005 filed with the SEC on December 1, 2005, and the Company's relationship with Stonefield was therefore effectively terminated as of December 1, 2005.

The reports of Stonefield with respect to the Company's financial statements for the fiscal years ended December 31, 2003 and 2004 contained no adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope, or accounting principles, except for an explanatory paragraph regarding the Company's ability to continue as a going concern contained in Stonefield's report on the Company's financial statements and for a disclaimer of opinion made by Stonefield with respect to the Company's internal controls over financial reporting and the Company's assessment of those controls as of December 31, 2004.

From May 21, 2004, the date Stonefield was appointed as the Company's independent auditors, through the date of Stonefield's resignation, there were no disagreements between the Company and Stonefield on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Stonefield, would have caused Stonefield to make reference to the subject matter of the disagreements in connection with its report on the Company's financial statements for such years.

There were no reportable events as described under Item 304(a)(1)(v) of Regulation S-K occurring within the two most recent fiscal years of the Company ended December 31, 2004 and 2003 or within the subsequent interim period through the date of Stonefield's resignation, except as follows:

Stonefield has advised the Company that there are material weaknesses in its internal controls, mainly related to internal controls of its South Korean operations. Therefore, Stonefield has expanded the scope of its review of the interim unaudited financial statements as of and for the three and nine month periods ended September 30, 2005. The material deficiencies in the Company's internal controls over financial reporting include the following:

- a) Lack of adequate segregation of duties in the Company's South Korean operations in accounts receivable, involving cash receipts, shipping, delivery of products, and customer invoice reconciliations;
- b) Lack of adequate segregation of duties in the Company's Coatings Division in Texas in order processing and invoicing;
- c) Lack of adequate controls and documentation in the Company's South Korean operations to evidence proper customer invoicing and revenue recognition in the proper period;
- d) Lack of progress in documenting, assessing and evaluating the Company's internal controls in our South Korean Operations evidenced by aforementioned deficiencies of which remediations will need to be completed as of December 31, 2005;
- e) Lack of sufficient controls over internal access to the Company's SAP system of reporting by unauthorized users; and

- f) The manual performance of numerous procedures that could be automated using current reporting systems.

In connection with the foregoing, Stonefield has also advised the Company that it believes that the Company has made insufficient progress in documenting, assessing, and evaluating the Company's internal controls over financial reporting for purposes of timely complying with Section 404 of the SOX.

The Company's Audit Committee has discussed with Stonefield the matters disclosed above regarding Stonefield's resignation. The Company has authorized Stonefield to respond fully to the inquiries of the Company's successor accountant concerning the matters disclosed above.

Upon Stonefield's resignation, the Company's Audit Committee commenced an immediate search and on January 20, 2006, hired Choi Kim & Park LLP (CKP) as its new registered independent public accounting firm.

**UNITED STATES FEDERAL INCOME TAX CONSIDERATION**



**General**





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The following is a summary of certain material United States federal income tax considerations related to the ownership and disposition of our common stock that may be relevant to you if you acquire our common stock pursuant to this offering. This summary is based on the Internal Revenue Code of 1986, as amended (the Code), existing and proposed Treasury regulations promulgated under the Code and administrative and judicial interpretations of the Code, all as of the date of this prospectus and all of which are subject to change, possibly with retroactive effect. The Internal Revenue Service is referred to as IRS in this summary.

This summary discusses only the tax consequences to the investors who purchase our common stock pursuant to this offering and does not discuss the tax consequences applicable to subsequent purchasers of our common stock. This summary deals only with common stock held as capital assets within the meaning of Section 1221 of the Code. It does not discuss all of the tax considerations that may be relevant to holders of our common stock in light of their particular circumstances or to holders of common stock subject to special rules, such as financial institutions, regulated investment companies, holders subject to the alternative minimum tax, insurance companies, pension funds, tax-exempt organizations, partnerships or other pass-through entities, dealers in securities or currencies, traders who elect to mark to market their securities or persons holding the common stock as part of a hedging or constructive sale transaction, straddle, conversion transaction, or other integrated transaction, or holders of the common stock whose functional currency is not the United States dollar or persons who acquired our common stock in compensatory transactions. In addition, this summary does not discuss any United States tax consequences to a Non-U.S. Holder (as defined below) that is a controlled foreign corporation, passive foreign investment company, foreign personal holding company, corporation that accumulates earnings to avoid U.S. federal income tax, or a U.S. expatriate. This summary does not address any state, local or non-United States tax considerations, or tax considerations under other federal tax laws (such as estate and gift tax laws).

We have not requested a ruling from the IRS on the tax consequences of owning our common stock. As a result, the IRS could disagree with portions of this discussion. Persons considering the purchase of our common stock should consult with their own tax advisors about the application of the United States federal income tax laws to their particular situations, as well as any tax considerations under other United States federal tax laws, and the laws of any state, local or foreign jurisdiction.

As used in this prospectus, the term U.S. Holder means a beneficial owner of common stock that is, for United States federal income tax purposes:

a citizen or individual resident of the United States;

a corporation, partnership or other entity treated as a corporation, created in or under the laws of the United States or of any political subdivision thereof;

an estate the income of which is subject to United States federal income taxation regardless of its source; or

a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or a trust that has a valid election in effect under applicable United States Treasury Regulations to be treated as a U.S. person.

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As used in this prospectus, the term **Non-U.S. Holder** means a beneficial owner of common stock that is an individual, corporation, trust or estate that is not a U.S. Holder.

If an entity treated as a partnership for U.S. federal income tax purposes holds shares of common stock, the tax treatment of a partner will generally depend on the status of the partner and upon the activity of the partnership. If you are a partner of a partnership holding shares of common stock, we suggest you consult your own tax advisor.

**U.S. Holders**



*Distributions to U.S. Holders*

If distributions are paid on the shares of our common stock (other than distributions in liquidation and distributions in redemption of our common stock), these distributions generally will constitute dividends for U.S. federal income tax purposes to the extent paid from our current or accumulated earnings and profits, as determined under U.S. federal income tax principles, and will constitute a tax-free return of capital that is applied against your tax basis in the common stock to the extent these distributions exceed those earnings and profits. Distributions in excess of our current and accumulated earnings and profits and your tax basis in the common stock will be treated as a gain from the sale or exchange of the common stock, the treatment of which is discussed below. For the tax years 2004 through 2008, non-corporate U.S. Holders are subject to a maximum tax rate on dividends equal to 15%, which corresponds to the maximum tax rate for long-term capital gains; however, certain holding period requirements and other limitations may apply. Under current law for tax years beginning after December 31, 2008, dividends will be taxed at the same rate as other items of ordinary income. U.S. Holders that are corporations may be eligible for a dividend-received deduction in respect of a dividend distribution by us.

*Gain on Disposition of Common Stock by U.S. Holders*

A U.S. Holder will recognize gain or loss on the sale, exchange or other taxable disposition of our common stock to the extent of the difference between the amount realized on such sale, exchange or other disposition and the holder's adjusted tax basis in such shares. Such gain or loss generally will constitute capital gain or loss, and will be long-term capital gain or loss, if the holder has held such shares for more than one year at the time of sale or disposition. Non-corporate U.S. Holders are subject to a maximum tax rate of 15% on long-term capital gain (increased to 20% for years after 2008). The deductibility of capital losses by a U.S. Holder is subject to limitations.

**Non-U.S. Holders**



*Distributions to Non-U.S. Holders*

Dividends paid to a Non-U.S. Holder that are not effectively connected with the conduct of a U.S. trade or business of the Non-U.S. Holder generally will be subject to U.S. federal withholding tax at a 30% rate or, if an income tax treaty applies and certain certification requirements described below are satisfied, a lower rate specified by the treaty. A Non-U.S. Holder who wishes to claim the benefits of an applicable income tax treaty will be required to provide the appropriate IRS Form W-8 certifying its entitlement to benefits under an income tax treaty. Non-U.S. Holders should consult their tax advisors regarding their entitlement to benefits under a relevant tax treaty.

Withholding generally is imposed on the gross amount of a distribution, regardless of whether we have sufficient earnings and profits to cause the distribution to be a dividend for U.S. federal income tax purposes. However, we may elect to withhold on less than the gross amount of the distribution if we determine that the distribution is not paid out of our current or accumulated earnings and profits, based on our reasonable estimates.

A Non-U.S. Holder eligible for a reduced rate of U.S. federal withholding tax under a tax treaty may obtain a refund of any excess amounts withheld by filing an appropriate claim for a refund together with the required information with the IRS.

Dividends that are effectively connected with a Non-U.S. Holder's conduct of a trade or business within the United States and, if a tax treaty applies, attributable to a Non-U.S. Holder's U.S. permanent establishment, are exempt from U.S. federal withholding tax if the Non-U.S. Holder furnishes to us or our paying agent the appropriate IRS form and other applicable requirements are met. However, dividends exempt from U.S. federal withholding tax because they are effectively connected or attributable to a U.S. permanent establishment under an applicable tax treaty are subject to U.S. federal income tax on a net income basis at the regular graduated U.S. federal income tax rates. Any such effectively connected dividends received by a foreign corporation may, under certain circumstances, be subject to an additional branch profits tax at a 30% rate or a lower rate specified by an applicable tax treaty.



***Gain on Disposition of Common Stock by Non-U.S. Holders***

Subject to the discussion below concerning backup withholding, a Non-U.S. Holder generally will not be subject to U.S. federal income tax with respect to gain recognized on a sale or other disposition of our common stock unless one of the following applies:

The gain is effectively connected with a Non-U.S. Holder's conduct of a trade or business within the United States and, if a tax treaty applies, the gain is attributable to a Non-U.S. Holder's U.S. permanent establishment. In such case, the Non-U.S. Holder will, unless an applicable tax treaty provides otherwise, generally be taxed on its net gain derived from the sale at regular graduated U.S. federal income tax rates, and in the case of a foreign corporation, may also be subject to the branch profits tax described above;

A Non-U.S. Holder who is an individual holds our common stock as a capital asset, is present in the United States for 183 or more days in the taxable year of the sale or other disposition, and certain other conditions are met. In such a case, the Non-U.S. Holder will be subject to a flat 30% tax on the gain derived from the sale, which may be offset by certain U.S. capital losses; or

We are or have been a United States real property holding corporation (a USRPHC) for United States federal income tax purposes at any time during the shorter of the five-year period ending on the date of the sale or other disposition and the period such Non-U.S. Holder held our common stock (the shorter period hereinafter referred to as the lookback period); provided that if our common stock is regularly traded on an established securities market, this rule will generally not cause any gain to be taxable unless the Non-U.S. Holder owned more than 5% of our common stock at some time during the lookback period. We do not believe that we are a USRPHC and do not expect to become one in the future. However, we could become a USRPHC as a result of future changes in assets or operations.

**Information Reporting and Backup Withholding Tax**



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The amount of dividends paid to each U.S. Holder will be reported annually to the IRS and to each U.S. Holder. A U.S. Holder may be subject to backup withholding (currently at a rate of 28%) with respect to dividends on, and the proceeds from the sale or redemption of, common stock, unless such holder (a) is an entity that is exempt from withholding (including, among others, corporations and certain tax-exempt organizations) and when required, demonstrates this fact, or (b) provides the payor with its correct taxpayer identification number, which, for an individual, is ordinarily his or her social security number, and otherwise complies with applicable requirements of the backup withholding rules.

Generally, we must report annually to the IRS and to each Non-U.S. Holder the amount of dividends paid to, and the tax withheld with respect to, each Non-U.S. Holder. These reporting requirements apply regardless of whether withholding was reduced or eliminated by an applicable tax treaty. Copies of this information also may be available under the provisions of a specific tax treaty or agreement with the tax authorities in the country in which the Non-U.S. Holder resides or is established.

In general, backup withholding will not apply to dividends paid to a Non-U.S. Holder and to proceeds from the disposition of our common stock paid to a Non-U.S. Holder if the holder has provided the required certification that it is a Non-U.S. Holder and neither we nor our paying agents have actual knowledge or reason to know that the holder is a United States person.

Under United States Treasury Regulations, the payment of proceeds from the disposition of our common stock by a Non-U.S. Holder made to or through a foreign office of a broker to its customer generally are not subject to information reporting or backup withholding. However, if the broker is a U.S. person, a controlled foreign corporation for U.S. federal income tax purposes, a foreign person 50% or more of whose gross income from certain periods is effectively connected with a United States trade or business, or a foreign partnership with significant United States ownership, then information reporting (but not backup withholding) will be required, unless the broker has in its records documentary evidence that the beneficial owner of the payment is not a U.S. person or is otherwise entitled to an exemption, and other applicable certification requirements are met (and the broker has no actual knowledge to the contrary). Information

reporting and backup withholding generally will apply to proceeds of a disposition of our common stock effected at a United States office of any United States or foreign broker, unless the broker has in its records documentary evidence that the beneficial owner of the payment is not a U.S. person or is otherwise entitled to an exemption, and other applicable certification requirements are met.

Backup withholding does not represent an additional income tax. Any amounts withheld from a payment to a holder under the backup withholding rules will be allowed as a credit against the holder's United States federal income tax liability and may entitle the holder to a refund, provided that the required information or returns are timely furnished by the holder to the IRS.

**The foregoing discussion of certain U.S. federal income tax considerations is for general information only and is not tax advice. Accordingly, each prospective investor should consult with his own tax adviser regarding U.S. federal, state, local and non-U.S. income and other tax consequences of the acquisition, holding and disposing of our common stock.**

#### **LEGAL MATTERS**

The validity of the shares of common stock issued in this offering will be passed upon for us by the law firm of Foley & Lardner LLP, Tampa, Florida.

**EXPERTS**



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The consolidated financial statements as of and for the years ended December 31, 2005 included in this prospectus have been audited by Choi, Kim & Park, LLP., our current independent auditors, as stated in their report appearing herein and are included in reliance upon the report of such firm given upon their authority as experts in accounting and auditing. The consolidated financial statements as of and for the years ended December 31, 2004 and 2003 included in this prospectus have been audited by Stonefield Josephson, Inc., our former independent auditors, as stated in their report appearing herein and are included in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

### **WHERE YOU CAN FIND MORE INFORMATION**





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We are subject to the informational reporting requirements of the Securities Exchange Act of 1934, as amended. In accordance with the Exchange Act, we file reports, proxy statements and other information with the Securities and Exchange Commission. You can inspect and copy these reports, proxy statements and other information at the Public Reference Room of the Securities and Exchange Commission at 100 F Street N.E., Washington, D.C. 20549, at prescribed rates. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Our Securities and Exchange Commission filings are also available on the Securities and Exchange Commission's web site. The address of this site is <http://www.sec.gov>.

We have filed with the Securities and Exchange Commission a registration statement (which term includes all amendments, exhibits and schedules thereto) on Form S-1 under the Securities Act of 1933, as amended, with respect to the shares offered by this prospectus. This prospectus is part of that registration statement and, as allowed by Securities and Exchange Commission's rules, does not contain all the information set forth in the registration statement and the exhibits to the registration statement. The registration statement may be inspected at the public reference facilities maintained by the Securities and Exchange Commission at 100 F Street, N.E., Washington, D.C. 20549-0102 and is available to you on the Securities and Exchange Commission's web site.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**



## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

To the Board of Directors and Shareholders of  
Liquidmetal Technologies, Inc.

We have audited the accompanying consolidated balance sheet of Liquidmetal Technologies, Inc. and subsidiaries (the Company) as of December 31, 2005, and the related consolidated statements of operations and comprehensive loss, shareholders' equity (deficiency), and cash flows for the year ended December 31, 2005 as well as the effects of the adjustments for the correction of the error in Note 2 as of and for the year ended December 31, 2004. Our audit also included the financial statement schedule listed at index in Item 15(a) as of and for the year ended December 31, 2005. These financial statements and schedule are the responsibility of management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Liquidmetal Technologies, Inc. and subsidiaries as of December 31, 2005, and the results of their operations and cash flows for the year ended December 31, 2005, as well as the effects of the adjustments for the correction of the error described in Note 2 as of and for the year ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the consolidated financial statements, the Company's significant operating losses and working capital deficit raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 3. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Choi, Kim & Park LLP

Los Angeles, California

Certified Public Accountants

February 23, 2006, except for Note 2, as to which the date is July 17, 2006

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**



## Edgar Filing: LIQUIDMETAL TECHNOLOGIES INC - Form S-1/A

To the Board of Directors and Shareholders of Liquidmetal Technologies, Inc.

We have audited, before the effects of the adjustments for the correction of the error described in Note 2, the accompanying consolidated balance sheet of Liquidmetal Technologies, Inc. and subsidiaries (the Company) as of December 31, 2004, and the related consolidated statements of operations and comprehensive loss, shareholders' equity (deficiency), and cash flows for each of the two years in the period ended December 31, 2004 (the 2004 financial statements before the effects of the adjustments discussed in Note 2 are not presented herein). Our audit also included the financial statement schedule listed at index in Item 15(a), except for the correction of the error described in Note 2, as of and for the years ended December 31, 2004 and 2003. These financial statements and schedule are the responsibility of management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, except for the error described in Note 2, such consolidated financial statements present fairly, in all material respects, the financial position of Liquidmetal Technologies, Inc. and subsidiaries as of December 31, 2004, and the results of their operations and cash flows for each of the two years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, except for the error described in Note 2, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We were not engaged to audit, review, or apply any procedures to the adjustments for the correction of the error described in Note 2, and accordingly, we do not express an opinion or any other form of assurance about whether such adjustments are appropriate and have been properly applied. Those adjustments were audited by Choi, Kim & Park, LLP.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the consolidated financial statements, the Company's significant operating losses and working capital deficit raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 3. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Stonefield Josephson, Inc.

Irvine, California

Certified Public Accountants

March 3, 2005





## LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

|   | March 31,<br>2006<br>(Restated)<br>(Unaudited) | December 31,<br>2005<br>(Restated) | 2004<br>(Restated) |
|---|--|------------------------------------|--------------------|
| <b>ASSETS</b>   |  |                                    |                    |
| Current Assets:   |  |                                    |                    |
| Cash and cash equivalents   | \$ 1,263                                       | \$ 1,392                           | \$ 742             |
| Restricted cash   |  |                                    | 754                |
| Trade accounts receivables, net of allowance for doubtful accounts of \$69, \$61 and \$108 at March 31, 2006, December 31, 2005 and 2004, respectively                                      | 3,506  | 2,360                              | 1,668              |
| Inventories   | 1,764  | 1,748                              | 2,353              |
| Prepaid expenses and other current assets   | 561  | 609                                | 930                |
| Total current assets  | 7,094  | 6,109                              | 6,447              |
| Property, plant and equipment, net  | 13,300   | 13,437                             | 16,434             |
| Idle equipment  | 199  | 193                                | 1,906              |
| Long-term inventory   |  |                                    | 1,810              |
| Other intangibles, net  | 1,196  | 1,185                              | 1,143              |
| Other assets  | 547  | 639                                | 768                |
| Total assets  | \$ 22,336                                      | \$ 21,563                          | \$ 28,508          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |  |                                    |                    |
| Current liabilities:  |  |                                    |                    |
| Accounts payable and accrued expenses   | \$ 7,977                                       | \$ 6,530                           | \$ 4,969           |
| Settlement payable  |  | 3,331                              | 3,246              |
| Deferred revenue  | 407  | 1,275                              | 900                |
| Short-term debt   | 2,286  | 550                                |                    |
| Long-term debt, current portion, net of debt discount of \$0, \$0 and \$2,831 at March 31, 2006, December 31, 2005 and 2004, respectively   | 1,391  | 1,343                              | 4,010              |
| Other liabilities, current portion  | 300  | 483                                | 1,032              |
| Warrant liabilities   | 3,165  | 1,792                              | 550                |
| Conversion feature liabilities  | 3,554  | 1,798                              | 6,650              |
| Total current liabilities   | 19,080   | 17,102                             | 21,357             |
| Long-term debt, net of current portion and debt discount of \$7,004, \$8,259 and \$0 at March 31, 2006, December 31, 2005 and 2004, respectively  | 6,359  | 5,433                              | 2,618              |
| Other long-term liabilities, net of current portion   | 391  | 348                                | 342                |
| Total liabilities   | 25,830   | 22,883                             | 24,317             |
| Shareholder's equity (deficiency):  |  |                                    |                    |
| Preferred stock, \$0.001 par value; 10,000,000 authorized and 0 issued and outstanding at March 31, 2006, December 31, 2005 and 2004  |  |                                    |                    |
| Common stock, \$0.001 par value; 100,000,000 shares authorized and 43,956,621, 42,187,621 and 41,609,652 issued and outstanding at March 31, 2006, December 31, 2005 and 2004, respectively | 44   | 42                                 | 42                 |
| Additional paid-in capital  | 134,666  | 130,893                            | 129,650            |
| Accumulated deficit   | (140,574)                                      | (134,525)                          | (127,472)          |
| Accumulated other comprehensive income  | 2,370  | 2,270                              | 1,971              |
| Total shareholder's equity (deficiency)   | (3,494)  | (1,320)                            | 4,191              |

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|  |    |        |    |        |    |        |
|--|----|--------|----|--------|----|--------|
| Total liabilities and shareholders equity (deficiency) | \$ | 22,336 | \$ | 21,563 | \$ | 28,508 |
|--|----|--------|----|--------|----|--------|

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

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## LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(in thousands, except share data)

|  | Three Months Ended<br>March 31, |          | Years Ended December 31, |            |           |
|--|---------------------------------|----------|--------------------------|------------|-----------|
|  | 2006                            | 2005     | 2005                     | 2004       | 2003      |
|  | (Restated)<br>(Unaudited)       |          | (Restated)               | (Restated) |           |
| Revenue  | \$ 6,555                        | \$ 2,843 | \$ 16,365                | \$ 17,429  | \$ 13,658 |
| Cost of sales  | 5,324                           | 2,835    | 15,129                   | 12,168     | 18,162    |
| Gross (loss) profit  | 1,231                           | 8        | 1,236                    | 5,261      | (4,504)   |
| Operating expenses   |                                 |          |                          |            |           |
| Selling, general, and administrative   | 2,705                           | 2,590    | 8,534                    | 11,591     | 17,729    |
| Research and development   | 203                             | 397      | 1,120                    | 1,467      | 8,780     |
| Impairment of goodwill   |                                 |          |                          |            | 184       |
| Impairment of long lived assets  |                                 |          | 4,487                    |            | 2,684     |
| Total operating expenses   | 2,908                           | 2,987    | 14,141                   | 13,058     | 29,377    |
| Loss before interest, other income, income taxes, minority interest, and discontinued operations | (1,677)                         | (2,979)  | (12,905)                 | (7,797)    | (33,881)  |
| Loss from extinguishments of debt  |                                 |          | (1,247)                  | (2,941)    |           |
| Change in value of warrants, (loss) gain   | (1,289)                         | 133      | 3,985                    | 747        |           |
| Change in value of conversion feature, (loss) gain   | (1,783)                         | 1,115    | 9,118                    | 2,093      |           |
| Other income   | 480                             |          |                          | 302        |           |
| Interest expense   | (1,782)                         | (1,537)  | (6,021)                  | (6,577)    | (390)     |
| Interest income  | 2                               | 6        | 17                       | 37         | 304       |
| Gain on sale of marketable securities held-for-sale  |                                 |          |                          |            | 1,178     |
| Loss before income taxes, minority interest and discontinued operations                          | (6,049)                         | (3,262)  | (7,053)                  | (14,136)   | (32,789)  |
| Income taxes   |                                 |          |                          |            |           |
| Loss before minority interest and discontinued operations  | (6,049)                         | (3,262)  | (7,053)                  | (14,136)   | (32,789)  |
| Minority interest in loss of consolidated subsidiary   |                                 |          |                          |            | 21        |
| Loss from continuing operations  | (6,049)                         | (3,262)  | (7,053)                  | (14,136)   | (32,768)  |
| Discontinued operations:   |                                 |          |                          |            |           |
| Income (loss) from operations of discontinued operations, net                                    |                                 |          |                          | (749)      | (964)     |
| Gain (loss) from disposal of discontinued operations, net  |                                 |          |                          |            | 127       |
| Net Loss   | (6,049)                         | (3,262)  | (7,053)                  | (14,885)   | (33,605)  |
| Other comprehensive gain (loss):   |                                 |          |                          |            |           |

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|  |            |            |            |             |             |
|--|------------|------------|------------|-------------|-------------|
| Foreign exchange translation gain during the period                    | 100        | 321        | 299        | 1,716       | 211         |
| Net unrealized gain (loss) on marketable securities available-for-sale |            |            |            |             | (1,668)     |
| Comprehensive loss   | \$ (5,949) | \$ (2,941) | \$ (6,754) | \$ (13,169) | \$ (35,062) |
| Per common share basic and diluted:                                    |            |            |            |             |             |
| Loss per share - continuing operations                                 | \$ (0.14)  | \$ (0.08)  | \$ (0.17)  | \$ (0.34)   | \$ (0.79)   |
| Loss per share - discontinuing operations                              |            |            |            | (0.02)      | (0.02)      |
| Loss per share basic and diluted                                       | \$ (0.14)  | \$ (0.08)  | \$ (0.17)  | \$ (0.31)   | \$ (0.81)   |
| Number of weighted average shares - basic and diluted                  | 42,817     | 41,610     | 41,833     | 41,610      | 41,505      |

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

## LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (DEFICIENCY)

(in thousands, except share data)

|   | Common<br>Shares | Common<br>Stock | Additional<br>Paid-in<br>Capital<br>(Restated) | Unamortized<br>Stock-based<br>Compensation<br>(Restated) | Accumulated<br>Deficit<br>(Restated) | Accumulated<br>Other<br>Comprehensive<br>Income (loss) | Total      |
|---|------------------|-----------------|--|--|--------------------------------------|--|------------|
| <b>Balance, December 31, 2002 (As Restated)</b> | 41,009,245       | \$ 106,554      | \$ 21,575                                      | \$ (260)   | \$ (78,982)                          | \$ 1,712   | \$ 50,599  |
| Stock options exercised                         | 684,165          | 1,149           |  |  |                                      |  | 1,149      |
| Repurchase of shares                            | (93,758)         | (653)           |  |  |                                      |  | (653)      |
| Change in par value due to reincorporation      |                  | (107,008)       | 107,008  |  |                                      |  |            |
| Stock-based compensation                        | 10,000           |                 | 100  | 25   |                                      |  | 125        |
| Unamortized stock option-based compensation     |                  |                 | (107)  | 107  |                                      |  |            |
| Purchase of common stock of subsidiaries        |                  |                 | 5  |  |                                      |  | 5          |
| Foreign exchange translation gain               |                  |                 |  |  |                                      | 211  | 211        |
| Reclassification for net realized gain          |                  |                 |  |  |                                      | (1,668)  | (1,668)    |
| Net loss  |                  |                 |  |  | (33,605)                             |  | (33,605)   |
| <b>Balance December 31, 2003</b>                | 41,609,652       | \$ 42           | \$ 128,581                                     | \$ (128)   | \$ (112,587)                         | \$ 255   | \$ 16,163  |
| Stock-based compensation                        |                  |                 | 261  | 15   |                                      |  | 276        |
| Unamortized stock option-based compensation     |                  |                 | (113)  | 113  |                                      |  |            |
| Redemption of convertible notes payable         |                  |                 | 914  |  |                                      |  | 914        |
| Warrants cancelled                              |                  |                 | 7  |  |                                      |  | 7          |
| Foreign exchange translation gain               |                  |                 |  |  |                                      | 1,716  | 1,716      |
| Net loss  |                  |                 |  |  | (14,885)                             |  | (14,885)   |
| <b>Balance, December 31, 2004 (As Restated)</b> | 41,609,652       | \$ 42           | \$ 129,650                                     | \$   | \$ (127,472)                         | \$ 1,971   | \$ 4,191   |
| Stock based compensation                        |                  |                 | 41   |  |                                      |  | 41         |
| Conversion of notes payable                     | 485,750          |                 | 1,026  |  |                                      |  | 1,026      |
| Redemption of convertible notes payable         |                  |                 | 1  |  |                                      |  | 1          |
| Common stock issued as director's fees          | 92,219           |                 | 175  |  |                                      |  | 175        |
| Foreign exchange translation gain               |                  |                 |  |  |                                      | 299  | 299        |
| Net loss  |                  |                 |  |  | (7,053)                              |  | (7,053)    |
| <b>Balance, December 31, 2005 (As Restated)</b> | 42,187,621       | \$ 42           | \$ 130,893                                     | \$   | \$ (134,525)                         | \$ 2,270   | \$ (1,320) |
| Conversion of notes payable                     | 59,000           |                 | 86   |  |                                      |  | 86         |

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|  |            |       |            |              |            |
|--|------------|-------|------------|--------------|------------|
| Common stock issued as director s fees                   | 10,000     |       | 15         |              | 15         |
| Common stock issued to Innometal                         | 1,700,000  | 2     | 3,448      |              | 3,450      |
| Stock-based compensation                                 |            |       | 224        |              | 224        |
| Foreign exchange translation gain                        |            |       |            | 100          | 100        |
| Net loss   |            |       |            | (6,049)      | (6,049)    |
| <b>Balance, March 31, 2006 (As Restated) (Unaudited)</b> | 43,956,621 | \$ 44 | \$ 134,666 | \$ (140,574) | \$ 2,370   |
|  |            |       |            |              | \$ (3,494) |

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

## LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, except share data)

|  | Three Months Ended<br>March 31, |            | Years Ended December 31, |             |             |
|--|---------------------------------|------------|--------------------------|-------------|-------------|
|  | 2006                            | 2005       | 2005                     | 2004        | 2003        |
|  | (Restated)<br>(Unaudited)       |            | (Restated)               | (Restated)  |             |
| <b>Operating activities:</b>   |                                 |            |                          |             |             |
| Net loss   | \$ (6,049)                      | \$ (3,262) | \$ (7,053)               | \$ (14,885) | \$ (33,605) |
| Add (gain) loss from operations and loss on disposition of discontinued operations           |                                 |            |                          | 749         | 837         |
| (Loss) from continuing operations  | (6,049)                         | (3,262)    | (7,053)                  | (14,136)    | (32,768)    |
| Adjustments to reconcile net loss from operations to net cash used for operating activities: |                                 |            |                          |             |             |
| Impairment of long lived assets  |                                 |            | 4,307                    |             | 2,684       |
| Impairment of goodwill   |                                 |            |                          |             | 184         |
| Loss from growell settlement   |                                 |            |                          |             | 2,765       |
| Gain on sale of marketable securities held-for-sale  |                                 |            |                          |             | (1,178)     |
| (Gain) loss on disposal of asset   |                                 | (1)        | (14)                     | 4           |             |
| Depreciation and amortization  | 782                             | 843        | 3,401                    | 3,444       | 4,354       |
| Loss on extinguishments of debt  |                                 |            | 1,247                    | 2,941       |             |
| Amortization of debt discount  | 1,413                           | 477        | 3,869                    | 5,834       |             |
| Stock-based compensation   | 224                             |            | 41                       | 276         | 123         |
| Bad debt expense (recovery)  | 28                              | (20)       | (6)                      | 84          | (28)        |
| Warranty expense   | 74                              | 42         | 101                      | 288         | (297)       |
| Minority interest  |                                 |            |                          |             | (21)        |
| Loss (gain) from change in value of warrants   | 1,289                           | (133)      | (3,985)                  | (747)       |             |
| Loss (gain) from change in value of conversion feature                                       | 1,783                           | (1,115)    | (9,118)                  | (2,093)     |             |
| Changes in operating assets and liabilities:   |                                 |            |                          |             |             |
| Trade accounts receivable  | (1,174)                         | (97)       | (686)                    | 1,996       | 1,660       |
| Inventories  | (16)                            | 198        | (151)                    | (2,103)     | (100)       |
| Prepaid expenses and other current assets  | 48                              | 496        | 350                      | (535)       | 1,689       |
| Other assets   | 17                              | 16         | (378)                    | (869)       | 83          |
| Accounts payable and accrued expenses  | 1,388                           | 1,546      | 1,606                    | 998         | (5,969)     |
| Deferred revenue   | (868)                           | (20)       | 375                      | (535)       | 38          |
| Other liabilities  | (107)                           | (81)       | (412)                    | (1,244)     | 2,661       |
| Net cash used for continuing operations  | (1,168)                         | (1,111)    | (6,506)                  | (6,397)     | (24,120)    |
| Net cash provided by (used for) discontinued operations                                      |                                 |            |                          | 73          | (2,429)     |
| Net cash used for operating activities   | (1,168)                         | (1,111)    | (6,506)                  | (6,324)     | (26,549)    |
| <b>Investing Activities:</b>   |                                 |            |                          |             |             |
| Purchases of property and equipment  | (145)                           |            | (169)                    | (73)        | (2,329)     |
| Proceeds from sale of property and equipment   |                                 |            | 69                       | 38          |             |
|  |                                 |            |                          |             | 2,578       |



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|   |         |       |          |         |          |
|---|---------|-------|----------|---------|----------|
| Proceeds from sale of marketable securities held-for-sale   |         |       |          |         |          |
| Investment in patents and trademarks                        | (39)    | (45)  | (159)    | (273)   | (298)    |
| Net cash used for investing activities                      | (184)   | (45)  | (259)    | (308)   | (49)     |
| <b>Financing Activities:</b>                                |         |       |          |         |          |
| Proceeds from borrowings                                    | 3,995   | 158   | 17,774   | 9,924   | 5,488    |
| Repayment of borrowings                                     | (2,581) | (308) | (11,333) | (5,184) | (1,441)  |
| Repayment of other liabilities                              | (33)    | (33)  | (133)    | (135)   | (72)     |
| Proceeds from restricted cash                               |         | 754   | 754      | (754)   |          |
| Stock options exercised                                     |         |       |          |         | 899      |
| Proceeds from issuance of common stock by subsidiaries, net |         |       |          |         | 5        |
| Net cash provided by financing activities                   | 1,381   | 571   | 7,062    | 3,851   | 4,879    |
| Effect of foreign exchange translation                      | (158)   | 184   | 353      | 396     | (212)    |
| Net (decrease) increase in cash and cash equivalents        | (129)   | (401) | 650      | (2,385) | (21,931) |
| Cash and cash equivalents at beginning of period            | 1,392   | 742   | 742      | 3,127   | 25,058   |
| Cash and cash equivalents at end of period                  | 1,263   | 341   | 1,392    | 742     | 3,127    |
| <b>Supplemental cash flow information</b>                   |         |       |          |         |          |
| Interest paid   | \$ 293  | \$ 88 | \$ 1,472 | \$ 640  | \$ 443   |
| Taxes paid  | \$      | \$    | \$       | \$      | \$       |

The accompanying notes are an integral part of the consolidated financial statements

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During the three months ended March 31, 2006, the \$59 of the Company's 6% senior convertible notes due July 2007 was converted into 59,000 shares of the Company's common stock at a conversion price of \$1.00 per share.

During the three months ended March 31, 2006, the Company fulfilled its settlement payable to Innometal (formerly known as Growell Metal) of \$3,450, net of foreign exchange translation loss, through stock issuance of 1,700,000 shares of the Company's common stock at approximately \$2.01 per share.

In 2005, the Company's 6% senior convertible notes due July 2007 was converted into 485,750 of the Company's common stock at a conversion price of \$1.00 per share.

In 2004, the Company sold its 51% ownership interest in Dongyang to the 49% minority shareholder, which resulted in a loss of \$46 from disposal of discontinued operations.

In 2004, the Company sold assets and liability of its Taesung equipment manufacturing division in Korea to a third party which resulted in a loss of approximately \$184.

In 2003, an option holder surrendered 93,758 shares of the Company's common stock in lieu of cash payment for the option exercise price of \$250 and income taxes payable by the option holder of \$403. The Company immediately canceled the common shares received in lieu of cash payment upon receipt of the shares.

In 2003 the Company reclassified \$1,477 of machines from property, plant and equipment to machines held by customer.

In 2003, the Company entered into a lease agreement for \$291 of laboratory equipment that was recorded as a capital lease obligation.

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

**LIQUIDMETAL TECHNOLOGIES, INC AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except share data)**

**1. Description of Business**

Liquidmetal Technologies, Inc. ( Liquidmetal Technologies ) and its subsidiaries (collectively the Company ) are in the business of developing, manufacturing, and marketing products made from amorphous alloys. Liquidmetal Technologies markets and sells Liquidmetal® alloy industrial coatings and also manufactures, markets and sells products and components from bulk Liquidmetal alloys that can be incorporated into the finished goods of its customers across a variety of industries. The Company also partners with third-party licensees and distributors to develop and commercialize Liquidmetal alloy products.

The Company classifies operations into two reportable segments: Liquidmetal alloy industrial coatings and bulk Liquidmetal alloys. Liquidmetal alloy industrial coatings are used primarily as a protective coating for industrial machinery and equipment, such as drill pipe used by the oil drilling industry and boiler tubes used by coal-burning power plants. Bulk Liquidmetal alloys include potential market opportunities to manufacture and sell products and components for electronic devices, medical devices, defense applications, and sporting goods. In addition, the bulk Liquidmetal alloys segment includes tooling and prototype sampling, and the manufacture and sale of die casting and VIM equipment (see Note 4 for disclosure regarding the disposal of this segment). In addition, such alloys are used to generate research and development services revenue for developing uses related primarily to defense and medical applications as well as potential license fees, royalties, and other compensation from strategic partnering transactions.

On August 4, 2004, the Company established a post-processing plant in the city of Weihai in Shandong province of China under Weihai Liquidmetal Company Limited, which is 100 percent owned by Liquidmetal Korea, to facilitate our bulk alloy manufacturing business. Weihai Liquidmetal is consolidated into Liquidmetal Technologies with all intercompany transactions eliminated.

**2. Restatement**

As a part of the accompanying consolidated financial statements and the notes thereto, the Company has restated certain previously issued financial statements due to an error related to the Company's accounting for embedded convertible feature of senior convertible notes issued in March 2004, which was exchanged in August 2004, in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, (SFAS 133).

The Company previously had incorrectly accounted for the conversion feature of senior convertible notes during 2004 and 2005 in additional paid in capital for the beneficial conversion feature of the notes under Emerging Issues Task Force (EITF) 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, and EITF 00-27 Application of Issue No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios, to Certain Convertible Instruments. The Company had failed to identify and account for the conversion feature as an embedded derivative in accordance with SFAS 133.

The correction of the error to properly state the fair value of the embedded conversion feature of senior convertible notes in accordance with SFAS 133 resulted in recognition of \$7,595 as a conversion feature liability as of the issuance of the senior convertible note in March 2004 as the convertible notes are considered non-conventional convertible debt instrument. The correction resulted in recognition of the change in fair value of the embedded conversion feature in the Company's earnings as a gain (loss) of \$2,093, \$5,269, and (\$802) for the years ended December 31, 2004 and 2005, and the quarter ended March 31, 2006, respectively, as well as adjustments to amortization of debt discount as interest expense of \$2,974, \$1,076, and \$184 for the years ended December 31, 2004 and 2005, and the quarter ended March 31, 2006, respectively, and an additional loss on extinguishment of debt of \$1,278 for the year ended December 31, 2004. Additionally, the Company recognized \$914, \$542, and \$27 in additional paid in capital from redemption and conversion of convertible notes as of December 31, 2004, December 31, 2005, and March 31, 2006, respectively (see Note 15). As part of the restatement, reclassifications to prior period consolidated financial statements have been made for consistent presentation of our warrant liabilities, settlement payable, and change in value of warrant liabilities.

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The effects of the restatements are as follows:

|  | As of March 31,<br>2006 |           | 2005                   | As of December 31,<br>2005 |                        | 2004      | 2004     |
|--|-------------------------|-----------|------------------------|----------------------------|------------------------|-----------|----------|
|  | Previously<br>Reported  | Restated  | Previously<br>Reported | Restated                   | Previously<br>Reported | Restated  | Restated |
|  | (Unaudited)             |           |                        |                            |                        |           |          |
| <b>ASSETS</b>  |                         |           |                        |                            |                        |           |          |
| Current Assets:  |                         |           |                        |                            |                        |           |          |
| Cash and cash equivalents  | \$ 1,263                | \$ 1,263  | \$ 1,392               | \$ 1,392                   | \$ 742                 | \$ 742    |          |
| Restricted cash  |                         |           |                        |                            | 754                    | 754       |          |
| Trade accounts receivables, net of allowance for doubtful accounts   | 3,506                   | 3,506     | 2,360                  | 2,360                      | 1,668                  | 1,668     |          |
| Inventories  | 1,764                   | 1,764     | 1,748                  | 1,748                      | 2,353                  | 2,353     |          |
| Prepaid expenses and other current assets  | 561                     | 561       | 609                    | 609                        | 930                    | 930       |          |
| Total current assets   | 7,094                   | 7,094     | 6,109                  | 6,109                      | 6,447                  | 6,447     |          |
| Property, plant and equipment, net   | 13,300                  | 13,300    | 13,437                 | 13,437                     | 16,434                 | 16,434    |          |
| Idle equipment   | 199                     | 199       | 193                    | 193                        | 1,906                  | 1,906     |          |
| Long-term inventory  |                         |           |                        |                            | 1,810                  | 1,810     |          |
| Other intangibles, net   | 1,196                   | 1,196     | 1,185                  | 1,185                      | 1,143                  | 1,143     |          |
| Other assets   | 547                     | 547       | 639                    | 639                        | 768                    | 768       |          |
| Total assets   | \$ 22,336               | \$ 22,336 | \$ 21,563              | \$ 21,563                  | \$ 28,508              | \$ 28,508 |          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                         |           |                        |                            |                        |           |          |
| Current liabilities:   |                         |           |                        |                            |                        |           |          |
| Accounts payable and accrued expenses  | \$ 7,977                | \$ 7,977  | \$ 6,530               | \$ 6,530                   | \$ 4,969               | \$ 4,969  |          |
| Settlement payable   |                         |           | 3,331                  | 3,331                      | 3,246                  | 3,246     |          |
| Deferred revenue   | 407                     | 407       | 1,275                  | 1,275                      | 900                    | 900       |          |
| Short-term debt  | 2,286                   | 2,286     | 550                    | 550                        |                        |           |          |
| Long-term debt, current portion, net of debt discount  | 1,391                   | 1,391     | 1,343                  | 1,343                      | 5,991                  | 4,010     |          |
| Other liabilities, current portion   | 300                     | 300       | 483                    | 483                        | 1,032                  | 1,032     |          |
| Warrant liabilities  | 3,165                   | 3,165     | 1,792                  | 1,792                      | 550                    | 550       |          |
| Conversion feature liabilities   | 1,940                   | 3,554     | 959                    | 1,798                      |                        | 6,650     |          |
| Total current liabilities  | 17,466                  | 19,080    | 16,263                 | 17,102                     | 16,688                 | 21,357    |          |
| Long-term debt, net of current portion and debt discount March 31, 2006, December 31, 2005 and 2004, respectively                            | 7,080                   | 6,359     | 6,338                  | 5,433                      | 2,618                  | 2,618     |          |
| Other long-term liabilities, net of current portion  | 391                     | 391       | 348                    | 348                        | 342                    | 342       |          |
| Total liabilities  | 24,937                  | 25,830    | 22,949                 | 22,883                     | 19,648                 | 24,317    |          |
| Shareholder's equity (deficiency):   |                         |           |                        |                            |                        |           |          |
| Preferred stock, \$0.001 par value; 10,000,000 authorized and 0 issued and outstanding at December 31, 2005 and 2004                         |                         |           |                        |                            |                        |           |          |
| Common stock, \$0.001 par value; 100,000,000 shares authorized and 42,187,621 and 41,609,652 issued and outstanding at December 31, 2005 and | 44                      | 44        | 42                     | 42                         | 42                     | 42        |          |

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|  |           |           |           |           |           |           |
|--|-----------|-----------|-----------|-----------|-----------|-----------|
| 2004, respectively                                     |           |           |           |           |           |           |
| Additional paid-in capital                             | 136,607   | 134,666   | 132,861   | 130,893   | 132,160   | 129,650   |
| Accumulated deficit                                    | (141,622) | (140,574) | (136,559) | (134,525) | (125,313) | (127,472) |
| Accumulated other comprehensive income                 | 2,370     | 2,370     | 2,270     | 2,270     | 1,971     | 1,971     |
| Total shareholder equity (deficiency)                  | (2,601)   | (3,494)   | (1,386)   | (1,320)   | 8,860     | 4,191     |
| Total liabilities and shareholders equity (deficiency) | \$ 22,336 | \$ 22,336 | \$ 21,563 | \$ 21,563 | \$ 28,508 | \$ 28,508 |

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|  | Three Months Ended<br>March 31,               |                  |                                | Years Ended December 31, |                                |                  |
|--|---|------------------|--------------------------------|--------------------------|--------------------------------|------------------|
|  | 2006<br>Previously<br>Reported<br>(Unaudited) | 2006<br>Restated | 2005<br>Previously<br>Reported | 2005<br>Restated         | 2004<br>Previously<br>Reported | 2004<br>Restated |
| Revenue  | \$ 6,555                                      | \$ 6,555         | \$ 16,365                      | \$ 16,365                | \$ 17,429                      | \$ 17,429        |
| Cost of sales  | 5,324   | 5,324            | 15,129                         | 15,129                   | 12,168                         | 12,168           |
| Gross (loss) profit  | 1,231   | 1,231            | 1,236                          | 1,236                    | 5,261                          | 5,261            |
| Operating expenses   |   |                  |                                |                          |                                |                  |
| Selling, general, and administrative   | 2,705   | 2,705            | 8,534                          | 8,534                    | 11,591                         | 11,591           |
| Research and development   | 203   | 203              | 1,120                          | 1,120                    | 1,467                          | 1,467            |
| Impairment of goodwill   |   |                  |                                |                          |                                |                  |
| Impairment of long lived assets  |   |                  | 4,487                          | 4,487                    |                                |                  |
| Total operating expenses   | 2,908   | 2,908            | 14,141                         | 14,141                   | 13,058                         | 13,058           |
| Loss before interest, other income, income taxes, minority interest, and discontinued operations | (1,677)                                       | (1,677)          | (12,905)                       | (12,905)                 | (7,797)                        | (7,797)          |
| Loss from extinguishments of debt  |   |                  | (1,247)                        | (1,247)                  | (1,663)                        | (2,941)          |
| Change in value of warrants, (loss) gain   | (1,289)                                       | (1,289)          | 3,985                          | 3,985                    | 747                            | 747              |
| Change in value of conversion feature, (loss) gain   | (981)   | (1,783)          | 3,849                          | 9,118                    |                                | 2,093            |
| Other income   | 480   | 480              |                                |                          | 302                            | 302              |
| Interest expense   | (1,598)                                       | (1,782)          | (4,945)                        | (6,021)                  | (3,603)                        | (6,577)          |
| Interest income  | 2   | 2                | 17                             | 17                       | 37                             | 37               |
| Gain on sale of marketable securities held-for-sale  |   |                  |                                |                          |                                |                  |
| Loss before income taxes, minority interest and discontinued operations                          | (5,063)                                       | (6,049)          | (11,246)                       | (7,053)                  | (11,977)                       | (14,136)         |
| Income taxes   |   |                  |                                |                          |                                |                  |
| Loss before minority interest and discontinued operations  | (5,063)                                       | (6,049)          | (11,246)                       | (7,053)                  | (11,977)                       | (14,136)         |
| Minority interest in loss of consolidated subsidiary   |   |                  |                                |                          |                                |                  |
| Loss from continuing operations  | (5,063)                                       | (6,049)          | (11,246)                       | (7,053)                  | (11,977)                       | (14,136)         |
| Discontinued operations:   |   |                  |                                |                          |                                |                  |
| Income (loss) from operations of discontinued operations, net                                    |   |                  |                                |                          | (749)                          | (749)            |
| Gain (loss) from disposal of discontinued operations, net  |   |                  |                                |                          |                                |                  |
| Net Loss   | (5,063)                                       | (6,049)          | (11,246)                       | (7,053)                  | (12,726)                       | (14,885)         |
| Other comprehensive gain (loss):   |   |                  |                                |                          |                                |                  |
| Foreign exchange translation gain during the period  | 100   | 100              | 299                            | 299                      | 1,716                          | 1,716            |
| Net unrealized gain (loss) on marketable securities available-for-sale                           |   |                  |                                |                          |                                |                  |
| Comprehensive loss   | \$ (4,963)                                    | \$ (5,949)       | \$ (10,947)                    | \$ (6,754)               | \$ (11,010)                    | \$ (13,169)      |
| Per common share basic and diluted:  |   |                  |                                |                          |                                |                  |
| Loss per share - continuing operations   | \$ (0.12)                                     | \$ (0.14)        | \$ (0.27)                      | \$ (0.17)                | \$ (0.29)                      | \$ (0.34)        |

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|   |    |        |    |        |    |        |        |        |    |        |    |        |
|---|----|--------|----|--------|----|--------|--------|--------|----|--------|----|--------|
| Loss per share - discontinuing operations             |    |        |    |        |    | (0.02) | (0.02) |        |    |        |    |        |
| Loss per share basic and diluted                      | \$ | (0.12) | \$ | (0.14) | \$ | (0.27) | \$     | (0.17) | \$ | (0.31) | \$ | (0.36) |
| Number of weighted average shares - basic and diluted |    | 42,817 |    | 42,817 |    | 41,833 |        | 41,833 |    | 41,610 |    | 41,610 |

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### 3. Liquidity

The Company has experienced losses from continuing operations during the last two fiscal years and has an accumulated deficit of \$140,574 as of March 31, 2006 and cash flow from operations will likely be negative throughout fiscal year 2006. Cash used for continuing operations for the three months ended March 31, 2006 was \$1,168. As of March 31, 2006, the Company's principal source of liquidity is \$1,263 of cash and \$3,506 of trade accounts receivable. Such conditions raise substantial doubt that the Company will be able to continue as a going concern. These operating results occurred while the Company was developing and continues to develop and to commercialize and manufacture products from an entirely new and unique technology. These factors have placed a significant strain on the financial resources of the Company. The ability of the Company to overcome these challenges depends on its ability to correct its production inefficiencies, continues to reduce its operating costs, generate higher revenue, and achieve positive cash flow from continuing operations and profitability and continued sources of debt and equity financing. The consolidated financial statements do not include any adjustments that might result from the outcome of the uncertainty.

The Company completed a \$1,000 10% subordinated promissory note on March 17, 2006 for \$1,000 aggregate cash received. Further, the Company borrowed \$2,995, offset by repayments of \$2,259, under a factoring, loan, and security agreement executed on April 21, 2005 during the three months ended March 31, 2006 to fund our working capital requirements. (See Note 15)

Capital requirements during the next 12 months will depend on numerous factors, including the success of existing products, the development of new applications for Liquidmetal alloys, the resources devoted to develop and support Liquidmetal alloy products. Specifically, we anticipate that we could need \$1,000 to \$5,000 over the next twelve months to pursue our current operating plan, although this amount may be lower depending on the orders we receive for our products. The amount of funding that we plan to seek and the timing of such fundraising efforts will depend on the extent to which we are able to increase revenues through obtaining additional purchase orders for our products, particularly components for cellular phones and flash memory drive casings, and our ability to continue to improve our manufacturing processes. We evaluate our working capital needs and operating plan assumptions on a monthly basis to determine whether any adjustment to our cash and liquidity outlook is warranted, and we also review potential sources of financing on an ongoing basis. However, adequate funds may not be available when needed, and if we raise additional funds by issuing equity securities, existing stockholders may be diluted. If we don't receive sufficient funding to operate under our current plan, we intend to reduce operations and expenses and shift our focus to the pursuit of licensing transactions and other strategic transactions that are less capital intensive.

On May 12, 2006, the Company received a letter from one holder holding \$500 of the August 2007 Notes demanding immediate payment of late filing fees and late registration fees for the period following October 31, 2005 through May 3, 2006. As a result of the late fee provisions of the restated registration rights agreement, we are obligated to pay late filing and late registration fees accrued through May 1, 2006 of up to \$1,354 to all of the holders of the Company's senior convertible notes. In addition, the letter purported to constitute a notice of default under the August 2007 Notes and July 2007 Notes ( Notes ) as a result of our failure to pay the late filing and late registration fees. Under the terms of Notes, if a default is not cured by us within thirty (30) days of notice thereof, the holder has the right to accelerate all principal and interest due under the Notes. As of May 17, 2006, \$9,878 in aggregate principal amount of August 2007 Notes was still outstanding with accrued but unpaid interest in the amount of approximately \$175. In addition, \$2,310 in aggregate principal amount of July 2007 Notes was also outstanding with accrued but unpaid interest in the amount of approximately \$35. The Company intends to pursue negotiations with the holder regarding the matters set forth in the letter with the goal of preventing any acceleration of amounts due under the Notes (see note 15).

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 ( SOX 404 ), the SEC has adopted rules requiring public companies to include a report of management on the company's internal controls over financial reporting in their annual reports on Form 10-K. In addition, the public

accounting firm auditing a public company's financial statements must attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting. Although these requirements were first applicable to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004, the Company did not comply with these requirements for such fiscal year as described in the following paragraphs.

Effective December 27, 2005, the SEC announced final rulings on revisions to accelerated filer definition and deadlines for periodic reports. The ruling revised the definition of the term "accelerated filer" to permit an accelerated filer that has voting and non-voting common equity held by non-affiliates of less than \$50 million to exit accelerated filer status at the end of the fiscal year in which its equity falls below \$50 million and to file its annual report for that year and subsequent periodic reports on a non-accelerated basis. As of the fiscal year ended December 31, 2005, we are considered an accelerated filer and are required to comply with SOX 404 requirements for the 2005 fiscal year.

**The time and resources committed to the restatement of prior periods' financial statements as aforementioned delayed our internal timetable with respect to our documentation, assessment and evaluation of internal control over financial reporting. Due to the issues described in the foregoing paragraph, as well as limitation on financial and internal resources, management's assessment of the**

effectiveness of our internal control over financial reporting had been substantially delayed, which in turn had delayed the Company's independent registered public accounting firm, Stonefield Josephson, Inc. in performing its audit of management's assessment of the effectiveness of internal control over financial reporting pursuant to SOX 404. Therefore, the Company's independent registered public accounting firm issued a disclaimer of opinion with respect to the Company's internal control over financial reporting as of December 31, 2004, and such disclaimer was filed with the Company's amended Form 10-K filed on May 10, 2005.

The Company has devoted significant amount of financial and internal resources during 2005 and early part of 2006 to ensure compliance with SOX 404, and on January 16, 2006, Company's management believes that the Company has substantially completed its documentation, assessment and evaluation of its internal controls over financial reporting as of December 31, 2005. However, our independent auditors, Stonefield Josephson Inc., resigned on December 1, 2005, and on January 20, 2006, the Company hired Choi, Kim & Park LLP (CKP) as its new independent registered public accounting firm. While the Company has advised CKP of the foregoing weaknesses in internal controls, due to the untimeliness of the foregoing events, CKP was unable to satisfactorily complete their audit of the Company's internal control over financial reporting pursuant to SOX 404, and thus, have issued a disclaimer of an opinion on the company's internal control over financial reporting as of December 31, 2005. The Company's management will continue to monitor potential changes in the legal and regulatory requirements of SOX 404, particularly the requirements for small public companies.

The filing of a disclaimer does not comply with the SEC's rules and regulations under Section 404, and this noncompliance has resulted in the Company being in violation of Section 13(a) under the Securities Exchange Act of 1934. Section 13(a) establishes the general requirement that public companies must file with the SEC, in accordance with such rules and regulations as the SEC may prescribe, such information, documents, and reports as the SEC may from time to time require for the protection of investors, including Form 10-Ks and 10-Qs.

In addition to the foregoing, although the Company's common stock was admitted to the OTC Bulletin Board for quotation on June 15, 2005, as a result of our noncompliance with Section 404 for the 2005 fiscal year, it may not have been appropriate for the OTC Bulletin Board to admit our common stock for quotation on June 15, 2005. Consequently, there is no assurance that the Company's common stock will remain eligible for quotation on the OTC Bulletin Board.

#### Basis of Presentation of Interim Financial Information

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) and contain unaudited interim financial information. Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for any future periods or the year ending December 31, 2006. In the opinion of management, all adjustments (consisting of only of normal recurring accruals) considered necessary for a fair presentation have been included.

#### **4. Summary of Significant Accounting Policies**

*Principles of Consolidation.* The consolidated financial statements include the accounts of Liquidmetal Technologies, Inc. and its wholly-owned subsidiaries, Liquidmetal Korea Co., Ltd. (LMT Korea), located in South Korea, Chusik Hoesa Dongyang Yudoro (Dongyang), now accounted for as a discontinued operations, and Liquidmetal Golf and its

subsidiaries, which included the retail golf segment, now accounted for as discontinued operations. The Company acquired its 51% interest in Dongyang in 2002. The aggregate purchase price was \$333 in cash. As of March 2004, the Company divested of its 51% ownership in Dongyang to the minority shareholder. In June 2004, the Company sold assets and liability of its Taesung equipment manufacturing division in Korea to a third party. Accordingly, the results of Dongyang and Taesung's operations have been reclassified in the consolidated financial statements as discontinued operations (see Note 18). Previously, the results of Dongyang and Taesung's operations have been included in the consolidated financial statements from the acquisition date. All intercompany balances and transactions have been eliminated. A minority interest in Liquidmetal Golf is included in the consolidated financial statements as a component of the loss from operations of the discontinued retail golf segment (see Note 18). Effective in 2003, management closed the Japan operations and the Seoul office, which did not result in a significant impact on the financial position or results of operations for any of the periods presented. Also, effective in December 2003, management closed the Tampa office (see Note 13). In August 2004, the Company established a post-processing plant in the city of Weihai in Shandong province of China under Weihai Liquidmetal Company Limited, which is 100 percent owned by Liquidmetal Korea, to facilitate our bulk alloy manufacturing business.

*Sales of Stock by Subsidiaries.* Gains on sales of stock by Liquidmetal Golf are recognized as components of the Company's shareholders' equity (deficiency).

*Revenue Recognition.* Revenue is recognized pursuant to applicable accounting standards including Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 101 (SAB 101), *Revenue Recognition in Financial Statements*, and *SAB 104, Revenue Recognition*. SAB 101 as amended and SAB 104 summarize certain points of the SEC staff's views in applying

generally accepted accounting principles to revenue recognition in financial statements and provides guidance on revenue recognition issues in the absence of authoritative literature addressing a specific arrangement or a specific industry. The Company's revenue recognition policy complies with the requirements of SAB 101 and SAB 104. Revenue is recognized at the time the Company ships its products, as this is when title passes to the customer and all other incidences of a sale have occurred. Revenue is deferred and included in liabilities when the Company receives cash in advance for services not yet performed or goods not yet delivered.

The Company applies the percentage of completion method to recognize revenue earned from government contracts that have cost-plus-fixed-fee arrangements. These arrangements provide the Company with full reimbursement on the actual cost incurred, plus a fixed fee that the Company is entitled to. These arrangements are covered by the American Institute of Certified Public Accountants Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (SOP 81-1) and Accounting Research Bulletin No. 45, *Long-term Construction-Type Contracts* (ARB 45). In addition, cost-reimbursable contracts are also specifically covered by Accounting Research Bulletin No. 43, Chapter 11, Section A, *Government Contracts, Cost-Plus-Fixed Fee Contracts* (ARB 43). Substantially all of our cost-reimbursable and time and material contracts are with the U.S. Government, primarily with the Department of Defense. Revenues recognized under cost-plus-fixed fee are consistent with percentage of completion method and are consistent with ARB 43.

Sales on cost-reimbursable plus fixed fee type contracts are recognized as allowable costs are incurred on the contract and become billable to the customer, at an amount equal to the allowable costs plus the estimated profit on those costs. The estimated profit on a cost-reimbursable contract is generally fixed or variable based on the contract fee arrangement.

*Cash and Cash Equivalents.* The Company considers all highly liquid investments with maturity dates of three months or less when purchased to be cash equivalents. The Company limits the amount of credit exposure to each individual financial institution and places its temporary cash into investments of high credit quality. There are no significant concentrations of credit risk to the Company associated with cash and cash equivalents.

*Restricted Cash.* The Company considers all cash and cash equivalents held under restrictive accounts as restricted cash.

*Marketable Securities.* The Company follows Statement of Financial Accounting Standards ( SFAS ) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and classifies all of its investment securities as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported in Shareholders' Equity (Deficiency) under the caption Accumulated Other Comprehensive Income.

*Trade Accounts Receivables.* The Company grants credit to its customers generally in the form of short-term trade accounts receivable. The creditworthiness of customers is evaluated prior to the sale of inventory. There are no customers with greater than 10% of accounts receivable as of March 31, 2006. As of December 31, 2005, one customer represented 12%, or \$288, of the total outstanding trade accounts receivable. As of December 31, 2004, two customers represented 30%, or \$497, of the total outstanding trade accounts receivable.

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The allowance for doubtful accounts reflects management's best estimate of probable losses inherent in the trade accounts receivable. Management primarily determines the allowance based on the aging of accounts receivable balances, historical write-off experience, customer concentrations, customer creditworthiness and current industry and economic trends. The Company's provisions for uncollectible receivables are included in selling, general and administrative expense in the accompanying consolidated statements of operations and comprehensive loss.

*Inventories.* Inventories are accounted for using the moving average basis and at standard cost, which approximate cost on a first-in, first-out basis and are reported at the lower of cost or market. Inventories consist of raw materials, work in process, and finished goods. The Company records write-offs for inventory obsolescence when it is deemed that there is impairment of the value of the inventories on hand.

*Property, Plant and Equipment.* Property, plant and equipment are stated at cost less accumulated depreciation and amortization. Additions and major renewals are capitalized. Repairs and maintenance are charged to expense as incurred. Upon disposal, the related cost and accumulated depreciation are removed from the accounts, with the resulting gain or loss included in operating income. Depreciation is provided principally on the straight-line method over the estimated useful lives of the assets, which range from two to twenty years.

Leased property meeting certain criteria is capitalized and the present value of the related lease payments is recorded as a liability. Amortization of capitalized leased assets is provided on the straight-line method over the estimated useful lives of the assets, which is five years.

*Intangible Assets.* Intangible assets consist of the costs incurred to purchase patent rights and costs incurred to internally develop patents and trademarks. Intangible assets are reported net of accumulated amortization. Patents and trademarks are amortized using the straight-line method over a period based on their contractual lives ranging from eleven to seventeen years.

*Goodwill.* Beginning January 1, 2002, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 142, *Goodwill and Other Intangible Assets* (See New Accounting Pronouncements ). According to this statement, goodwill and other intangible assets are no longer subject to amortization, but instead must be reviewed annually for impairment by applying a fair value-based test.

*Impairment of Long-lived Assets.* The Company reviews long-lived assets to be held and used in operations for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may be impaired. An impairment loss is recognized when the estimated fair value of the assets is less than the carrying value of the assets. The Company recognized an impairment of long-lived assets in the amount of \$4,512 during the year ended December 31, 2005. There were no such impairment losses during the three months ended March 31, 2006 and the year ended December 31, 2004.

*Fair Value of Financial Instruments.* The estimated fair value of amounts reported in the consolidated financial statements have been determined using available market information and valuation methodologies, as applicable. The carrying amount of cash and cash equivalents, accounts receivable, accounts payable, and all other current assets and liabilities approximate their fair value because of their short term maturities at March 31, 2006, December 31, 2005 and 2004, unless otherwise stated. The fair value of non-current assets and liabilities approximate their carrying value unless otherwise stated. The fair value of the Company's long-term debt is based on interest rates that would be available to the Company for the issuance of debt with similar terms.

*Research and Development Expenses.* Research and development expenses represent salaries, related benefits expense, expenses incurred for the design and testing of new processing methods and other expenses related to the research and development of Liquidmetal alloys. Development costs incurred in research and development activities are expensed as incurred.

*Advertising and Promotion Expenses.* Advertising and promotion expenses are expensed when incurred. Advertising and promotion expenses were \$2 and \$1 for the three months ended March 31, 2006 and 2005. Advertising and promotion expenses were \$2, \$239, and \$136 for the years ended December 31, 2005, 2004 and 2003, respectively.

*Debt Discount Amortization.* Debt discounts for notes payable are amortized to interest expense, using a method that approximates the interest method over the term of the related debt instruments.

*Stock-Based Compensation.* The Company previously applied Accounting Principles Board ( APB ) Opinion No. 25 for options when the exercise price of options granted to employees is less than the fair value of the underlying stock on the date of grant. As permitted, the Company had previously elected to adopt provisions of Statement of Financial Accounting Standard ( SFAS ) No. 123, *Accounting for Stock-Based Compensation* for options granted to non-employees who perform services for the Company and the disclosure-only provisions of options granted to employees.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123R ), which replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, ( SFAS 123 ) and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, ( APB 25 ). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Under SFAS 123R, the Company is required to measure the cost of employee services received in exchange for stock options and similar awards based on the grant-date fair value of the award and recognize this cost in the income statement over the period during which an employee is required to provide service in exchange for the award. The pro forma disclosures previously permitted under SFAS 123 are no longer an alternative to financial statement recognition. The Company adopted SFAS 123R on January 1, 2006 using the modified prospective method and recorded \$224 of non-cash charges for stock compensation related to amortization of the fair value of restricted stock and unvested stock options representing a \$224 increase from the stock compensation that would have been recorded under APB 25 and SFAS 123. Under this method, the Company will recognize compensation cost, on a prospective basis, for the portion of outstanding awards for which the requisite service has not yet been rendered as of January 1, 2006 and any new grants, based upon the grant-date fair value of those awards calculated under SFAS 123 for pro forma disclosure purposes. Accordingly, we have not restated prior period amounts. The following table illustrates the pro forma effect on net income for periods prior to the adoption of SFAS 123R as if we had applied the fair value recognition provisions of SFAS 123 during such periods:



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|   | Three months<br>Ended March 31,<br>2005<br>(Restated)<br>(Unaudited) | 2005<br>(Restated) | For the years ended December 31,<br>2004<br>(Restated) |             | 2003    |
|---|--|--------------------|--|-------------|---------|
| Net loss from Continuing Operations:  |  |                    |  |             |         |
| As reported   | \$ (6,049)   | \$ (7,053)         | \$ (14,136)  | \$ (32,768) |         |
| Add: stock-based employee compensation expense included in reported net loss, net of related tax effects                                |  | 41                 | 276  |             | 123     |
| Deduct: total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax | (783)  | (2,861)            | (4,201)  |             | (5,427) |
| Proforma net loss from continuing operations  | \$ (6,832)   | \$ (9,873)         | \$ (18,061)  | \$ (38,072) |         |
| Basic and diluted net loss per share:   |  |                    |  |             |         |
| As reported   | \$ (0.14)  | \$ (0.17)          | \$ (0.34)  | \$ (0.79)   |         |
| Proforma  | \$ (0.16)  | \$ (0.24)          | \$ (0.43)  | \$ (0.92)   |         |

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants for the three months ended March 31, 2006 and 2005 and the years ended December 31, 2005, 2004, and 2003: expected volatility of approximately 100% for all periods; dividend yield of 0.0% for all periods; expected option life of approximately 5 years; and a risk-free interest rate ranging from 3.6% to 4.3%.

*Income Taxes.* Income taxes are provided under the asset and liability method as required by SFAS No. 109, *Accounting for Income Taxes*. Under this method, deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. The effect of a tax rate change on deferred taxes is recognized in operations in the period that the change in the rate is enacted. Valuation allowances are established when necessary to reduce net deferred tax assets to the amount expected to be realized.

*Translation of Foreign Currency.* Upon consolidation of the Company's foreign subsidiaries into the Company's consolidated financial statements, any balances with the subsidiaries denominated in the foreign currency are translated at the exchange rate at year end. The financial statements of LMT Korea have been translated based upon Korean Won as the functional currency. LMT Korea's assets and liabilities were translated using the exchange rate at period end and income and expense items were translated at the average exchange rate for the periods reported. The resulting translation adjustment was included in other comprehensive income (loss).

The Company applies *FASB No. 52, Foreign Currency Translation*, for translating foreign currency into US dollars in our consolidation of the financial statements. Due to our restatement of 2002 financial statements, certain footnote disclosures and previously reported financial statements were adjusted to conform to retroactive applications of FASB No. 52. These adjustments did not have a material impact in the financial statements. See Note 2 in the notes to consolidated financial statements in the fiscal 2003 annual report on Form 10-K filed on November 10, 2004, which reflects the restatements of prior year transactions.

*Earnings Per Share.* Basic earnings per share ( EPS ) is computed by dividing earnings (losses) attributable to common shareholders by the weighted average number of common shares outstanding for the periods. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

*Use of Estimates.* The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods. Actual results could differ from those estimates. These management estimates are primarily related to impairment of long-lived assets, inventory valuation, product warranty, and the allowance for bad debt account balances.

*Reclassifications.* Certain amounts from prior years have been reclassified to conform to the current year s presentation.

*Recent Accounting Pronouncements.*

In February 2006, the FASB issued SFAS No. 155, ( SFAS No. 155 ), Accounting for Certain Hybrid Instruments, which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 also clarifies and amends certain other provisions of SFAS No. 133 and SFAS No. 140. This statement is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006. The Company does not expect the adoption of this new standard to have a material impact on its financial position, results of operations or cash flows.

In September 2005, the Emerging Issues Task Force ( EITF) reached a consensus on Issue No. 05-8, Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature. Under EITF 05-8, the issuance of convertible debt with a beneficial conversion feature results in a temporary difference for purposes of applying Statement 109. The deferred taxes recognized for the temporary difference should be recorded as an adjustment to paid-in capital. EITF 98-5 Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios and EITF 00-27 Application of Issue No. 98-5 to Certain Convertible Instruments require that the nondetachable conversion feature of a convertible debt security be accounted for separately if it is a beneficial conversion feature. A beneficial conversion feature is recognized and measured by allocating to additional paid-in capital a portion of the proceeds equal to the conversion feature's intrinsic value. A discount on the convertible debt is recognized for the amount that is allocated to additional paid-in capital. The debt discount is accreted from the date of issuance to the stated redemption date of the convertible instrument or through the earliest conversion date if the instrument does not have a stated redemption date. The U.S. Federal Income Tax Code includes the entire amount of proceeds received at issuance as the tax basis of the convertible debt security. The EITF 05-8 Consensus should be applied retrospectively to all instruments with a beneficial conversion feature accounted for under EITF 98-5 and EITF 00-27 for periods beginning after December 15, 2005. The Company does not expect the adoption of the EITF to have material impact on the Company's financial statements.

In September 2005, the EITF reached a consensus on Issue 05-7 Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues, which requires that a change in the fair value of a conversion option brought about by modifying the debt agreement be included in analyzing in accordance with EITF 96-19 Debtor's Accounting for a Modification or Exchange of Debt Instruments whether a debt instrument is considered extinguished. Under EITF 96-19's requirements, an issuer who modifies a debt instrument must compare the present value of the original debt instrument's cash flows to the present value of the cash flows of the modified debt. If the present value of those cash flows varies by more than 10 percent, the modification is considered significant and extinguishments accounting is applied to the original debt. If the change in the present value of the cash flows is less than 10 percent, the debt is considered to be modified and is subject to EITF 96-19's modification accounting. EITF 05-7's Consensus requires that in applying the 10 percent test the change in the fair value of the conversion option be treated in the same manner as a current period cash flow. The Consensus also requires that, if a modification does not result in an extinguishment, the change in fair value of the conversion option be accounted for as an adjustment to interest expense over the remaining term of the debt. The issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon modification of the conversion option of a debt instrument that does not result in an extinguishment. EITF 05-7 is effective for modifications of debt instruments beginning in the first interim or annual reporting period beginning after December 15, 2005. The Company does not expect the adoption of the EITF to have material impact on the Company's financial statements.

In June 2005, the EITF reached a consensus on Issue 05-6, *Determining the Amortization Period for Leasehold Improvements*, which requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of a lease be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of the business combination or purchase. EITF 05-6 is effective for periods beginning after June 29, 2005. Earlier application is permitted in periods for which financial statements have not been issued. The adoption of this Issue did not have an impact on the Company's financial statements.

In June 2005, the EITF reached a consensus on Issue No. 05-2 *The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock'*. Issuers of convertible debt are required by Statement 133 to evaluate whether it is necessary to separate the embedded conversion feature from the debt contract and account for the conversion feature as if it were a separate derivative instrument. If the issuer determines that the embedded conversion feature would be classified in equity if it were a freestanding instrument, the conversion feature is not separated from the debt contract. EITF 00-19's criteria must be applied to determine whether a conversion feature qualifies for equity classification, but it exempts a conversion feature embedded in a conventional convertible debt instrument from some of the criteria. EITF 05-2 requires convertible instruments that may be settled in a combination of cash or shares, e.g., those referred to as *Instrument C* in EITF 90-19, and instruments that may be convertible into a variable number of shares are not conventional. As a result, nonconventional instruments would need to satisfy all requirements of EITF 00-19 to support a conclusion that the conversion feature does not require accounting separate from that for the debt contract. The adoption of this Issue resulted in recognition of embedded conversion feature from the senior convertible notes issued in March 2004, which was exchanged in August 2004, and August 2005 as liabilities of \$1,792 and \$6,650 as of December 31, 2005 and 2004, respectively,

and a gain of \$9,118 and \$2,093 from the change in fair value of conversion feature liabilities for the year ended December 31, 2005 and 2004, respectively (see Note 15).

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 replaces APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements* and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005. We do not believe the adoption of SFAS No. 154 will have a material effect on its consolidated financial position, results of operations or cash flows.

On March 29, 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the Staff's interpretation of SFAS 123(R). This interpretation expresses the views of the staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. In particular, this SAB provides guidance related to share-based payment transactions with no employees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of Statement 123(R) and disclosures in Management's Discussion and Analysis subsequent to adoption of SFAS 123(R). Our company will adopt SAB 107 in connection with its adoption of SFAS 123(R).

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment*, which replaces SFAS No. 123. SFAS No. 123R requires public companies to recognize an expense for share-based payment arrangements including stock options and employee stock purchase plans. The statement eliminates a company's ability to account for share-based compensation transactions using APB 25, and generally requires instead that such transactions be accounted for using a fair value based method. SFAS No. 123R requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the date of grant, and to recognize the cost over the period during which the employee is required to provide service in exchange for the award. In April 2005, the SEC amended the compliance dates for SFAS 123(R), to allow companies to implement the standard at the beginning of their next fiscal year, instead of the next reporting period beginning after June 15, 2005. SFAS No. 123R is effective for our company in the quarter ending March 31, 2006. Upon adoption of SFAS 123R, companies are allowed to select one of three alternative transition methods, each of which has different financial reporting implications. We have adopted SFAS No. 123R effective January 1, 2006 using the modified prospective method, and recognized \$224 of stock based compensation expense for the three months ended March 31, 2006 from the adoption.

In December 2004 the Financial Accounting Standards Board issued two FASB Staff Positions FSP FAS 109-1, *Application of FASB Statement 109 Accounting for Income Taxes* to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004, and FSP FAS 109-2 *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision* within the American Jobs Creation Act of 2004. Neither of these affected the Company as it does not participate in the related activities.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, an amendment of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*. The amendments made by Statement 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Previously, Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. Opinion 29 provided an exception to its basic measurement principle (fair value) for exchanges of similar productive assets. The Board believes that exception required that some

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nonmonetary exchanges, although commercially substantive, be recorded on a carryover basis. By focusing the exception on exchanges that lack commercial substance, the Board believes this Statement produces financial reporting that more faithfully represents the economics of the transactions. The Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of this Statement shall be applied prospectively. We have evaluated the impact of the adoption of SFAS 153, and do not believe the impact will be significant to our company's overall results of operations or financial position.

In November 2004, the FASB issued SFAS No. 151 Inventory Costs, an amendment of ARB No. 43, Chapter 4. The amendments made by Statement 151 clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and require the allocation of fixed production overheads to inventory based

on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 23, 2004. We have evaluated the impact of the adoption of SFAS 151, and do not believe the impact will be significant to our company's overall results of operations or financial position.

In March 2004, the FASB approved the consensus reached on the Emerging Issues Task Force (EITF) Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." The objective of this Issue is to provide guidance for identifying impaired investments. EITF 03-1 also provides new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB issued a FASB Staff Position (FSP) EITF 03-1 that delays the effective date of the measurement and recognition guidance in EITF 03-1 until after further deliberations by the FASB. The disclosure requirements are effective only for annual periods ending after June 15, 2004. We have evaluated the impact of the adoption of the disclosure requirements of EITF 03-1 and do not believe the impact will be significant to our company's overall results of operations or financial position. Once the FASB reaches a final decision on the measurement and recognition provisions, we will evaluate the impact of the adoption of EITF 03-1.

In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition." SAB 104 supersedes SAB 101, "Revenue Recognition in Financial Statements." SAB 104's primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superseded as a result of the issuance of EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." Additionally, SAB 104 rescinds the SEC's Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (the FAQ) issued with SAB 101 that had been codified in SEC Topic 13, Revenue Recognition. Selected portions of the FAQ have been incorporated into SAB 104. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104, which was effective upon issuance. The adoption of SAB 104 did not impact the consolidated financial statements.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA and the SEC did not or are not believed by management to have a material impact on our company's present or future consolidated financial statements.

## 5. Marketable Securities

On July 29, 2002, the Company invested \$2,000 in Growell Metal, Inc. (Growell), a metals processing company located in South Korea and publicly traded on South Korea's KOSDAQ stock market. The Company acquired 891,100 shares (or approximately 5%) of Growell's outstanding common stock in this transaction. During the fourth quarter of 2002, Growell's spin-off of its electronics division resulted in the creation of a new company named Growell Electronics, Inc. (Growell Electronics). As a result of the spin-off, 30% of the Company's 891,100 common shares of Growell were exchanged for an equal number of shares in the common stock of Growell Electronics. During the year ended December 31, 2002, the Company sold its shares in Growell Electronics for approximately \$1,432, which was based on the market price of the stock on the KOSDAQ stock market on the date of sale. This sale resulted in a realized gain of \$832. At December 31, 2002, the change in fair value of the remaining investment in Growell resulted in an unrealized gain of \$1,668, which is reported as other comprehensive income in the accompanying consolidated financial statements. In April 2003, the Company sold the stock owned in Growell, which resulted in a realized gain of \$1,178. A reclassification adjustment of (\$1,668) for net realized gains included in net loss is included in "Other comprehensive loss" on the accompanying Statement of Operations and Comprehensive Loss for the year ended December 31, 2003.

## 6. Trade accounts receivable

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Trade accounts receivables from continuing operations were comprised of the following:

|                                       | March 31,<br>2006<br>(unaudited) | 2005     | December 31,<br>2004 |
|---------------------------------------|----------------------------------|----------|----------------------|
| Trade accounts receivable             | \$ 3,575                         | \$ 2,421 | \$ 1,776             |
| Less: Allowance for doubtful accounts | (69)                             | (61)     | (108)                |
| Trade accounts receivable, net        | \$ 3,506                         | \$ 2,360 | \$ 1,668             |

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**7. Inventories**

Inventories were comprised of the following:

|                           | March 31,<br>2006<br>(unaudited) |    | December 31,<br>2005 |    | 2004  |
|---------------------------|----------------------------------|----|----------------------|----|-------|
| Raw materials             | \$ 659                           | \$ | 565                  | \$ | 1,688 |
| Work in process           | 587                              |    | 763                  |    | 352   |
| Finished goods            | 518                              |    | 420                  |    | 313   |
| Total current inventories | 1,764                            |    | 1,748                |    | 2,353 |
| Long-term inventories     |                                  |    |                      |    | 1,810 |
| Total inventories         | \$ 1,764                         | \$ | 1,748                | \$ | 4,163 |

The Company maintains certain of its raw material inventories in amounts in excess of our operating cycle of one year due to the nature of our manufacturing process, production lead time, and the recyclability of our raw material. These inventories were classified as long-term inventory as of March 31, 2006, and December 31, 2005 and 2004. The Company determined that its current and projected raw material requirements are not sufficient enough to warrant the use of such raw materials in the foreseeable future. Accordingly, the Company reduced the carrying value of raw materials held by its subsidiary, Liquidmetal Korea, by the amounts considered to be excessive during 2005. The write-down during the year ended December 31, 2005 amounted to \$2,746 and is included in *Impairment of long lived assets* in the accompanying Consolidated Statement of Operations and Comprehensive Loss for the year ended December 31, 2005. There were no such write-downs during the three months ended March 31, 2006 and 2005. The total amount of long term inventory was \$0 as of March 31, 2006 and December 31, 2005 and \$1,810 as of December 31, 2004.

The Company analyzes inventory held for any excess or obsolescence issues. Any amounts considered excess or obsolete are written off. Further, as significant amount of sales of Liquidmetal bulk alloy parts are used primarily in consumer electronics components, our inventory is subject to fluctuations in demand for those consumer electronics goods. Accordingly, the Company reduces the carrying value of raw materials held by its subsidiary, Liquidmetal Korea, by the amounts considered to be excess or obsolete. The Company recorded a net write-down of \$933 for inventory in excess and obsolescence for the three months ended March 31, 2006 and a benefit of \$27 from inventory that was previously written down for inventory in excess and obsolescence for the three months ended March 31, 2005 and are included in *Cost of Sales* in the accompanying Statement of Operations and Comprehensive Loss. As of December 31, 2005, the write-downs included in *Cost of Sales* in the accompanying Statement of Operations and Comprehensive Loss amounted to \$1,644. As of December 31, 2004, the write-downs included in *Cost of Sales* in the accompanying Statement of Operations and Comprehensive Loss amounted to \$605, which includes a \$406 charge incurred during the fourth quarter of 2004 related to certain hinge finished goods used in our customer's cell phone models which were nearing its end of life.

**8. Property, Plant and Equipment**

Property, plant and equipment consist of the following:

March 31,

December 31,

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|   | 2006<br>(unaudited) |    | 2005     |    | 2004    |
|---|---------------------|----|----------|----|---------|
| Machinery and equipment                         | \$ 11,622           | \$ | 11,365   | \$ | 12,600  |
| Computer equipment                              | 1,354               |    | 1,354    |    | 1,357   |
| Office equipment, furnishings, and improvements | 1,824               |    | 1,824    |    | 1,910   |
| Buildings                                       | 12,732              |    | 11,892   |    | 9,719   |
| Construction in progress                        |                     |    | 6        |    |         |
| Total   | 27,532              |    | 26,441   |    | 25,586  |
| Accumulated depreciation                        | (14,232)            |    | (13,004) |    | (9,152) |
| Total property, plant and equipment, net        | \$ 13,300           | \$ | 13,437   | \$ | 16,434  |

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Depreciation expense is classified as follows:

|                                     | Three Months<br>Ended March 31,<br>2006<br>(unaudited) |     | 2005 | Years ended December 31,<br>2004 |    | 2003  |    |       |    |       |
|-------------------------------------|--|-----|------|----------------------------------|----|-------|----|-------|----|-------|
| Cost of Sales                       | \$   | 677 | \$   | 678                              | \$ | 2,744 | \$ | 2,623 | \$ | 2,908 |
| Selling, general and administrative |  | 75  |      | 144                              |    | 542   |    | 700   |    | 627   |
| Research and development            |  |     |      |                                  |    |       |    | 8     |    | 730   |
| Total depreciation expense          | \$   | 752 | \$   | 822                              | \$ | 3,286 | \$ | 3,331 | \$ | 4,265 |

During 2003, the Company experienced significant operational difficulties as a result of problems and delays encountered in manufacturing bulk amorphous parts. These events, along with the Company's history of operating or cash flow losses and uncertainty surrounding its future cash flows, led the Company to evaluate its long-lived assets for recoverability as of December 31, 2003. As a result, the Company determined that the carrying value of its manufacturing plant in Pyongtaek, South Korea exceeded its fair value as of December 31, 2003 in the amount of \$2,684. The fair value of the building was based on the average of two independent appraisals of the building. This impairment loss is recorded in operating expenses as Impairment of long lived assets in the accompanying Consolidated Statement of Operations and Comprehensive Loss for the year ended December 31, 2003.

## 9. Idle Equipment

Idle equipment consists of certain equipment held by the Company for use in expansion of bulk alloy parts manufacturing. Due to excess manufacturing capacity, the Company classified the equipment as idle equipment at December 31, 2004. While the equipment may be used internally to meet future capacity requirements, considering our current revenue and foreseeable production requirements, the Company does not anticipate utilizing this equipment internally in the near future. For these reasons, during the second quarter of 2005, the Company determined to write down the carrying value of the idle equipment held by its subsidiary, Liquidmetal Korea, to its net realizable value. The write-down during the quarter ended June 30, 2005 amounted to \$1,741 and is included in operating expenses as Impairment of long lived assets in the accompanying Consolidated Statement of Operations and Comprehensive Loss for the year ended December 31, 2005. There were no such write-downs during the three months ended March 31, 2006 and 2005. Total amount of idle equipment remaining was \$199, \$193, and \$1,906 as of March 31, 2006, December 31, 2005 and 2004, respectively.

## 10. Other Intangible Assets

Intangible assets consist of the following:

|   | March 31,<br>2006<br>(unaudited) | 2005  | December 31,<br>2004 | 2004  |    |       |
|---|----------------------------------|-------|----------------------|-------|----|-------|
| Intangible assets consist of the following: |                                  |       |                      |       |    |       |
| Purchased and licensed patent rights        | \$                               | 559   | \$                   | 559   | \$ | 555   |
| Internally developed patents                |                                  | 1,251 |                      | 1,212 |    | 1,056 |

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|                              |    |       |    |       |    |       |
|------------------------------|----|-------|----|-------|----|-------|
| Trademarks                   |    | 85    |    | 85    |    | 85    |
| Total                        |    | 1,895 |    | 1,856 |    | 1,696 |
| Accumulated amortization     |    | (699) |    | (670) |    | (553) |
| Total intangible assets, net | \$ | 1,196 | \$ | 1,186 | \$ | 1,143 |

Amortization expense was \$30 and \$26 for the three months ended March 31, 2006 and 2005, respectively. Amortization expense was \$117, \$113, and \$100, for the years ended December 31, 2005, 2004, and 2003, respectively. The estimated aggregate amortization expense for each of the five succeeding years is as follows:

| December 31, | Aggregate Amortization<br>Expense |
|--------------|-----------------------------------|
| 2006         | 114                               |
| 2007         | 112                               |
| 2008         | 110                               |
| 2009         | 108                               |
| 2010         | 106                               |

Accumulated Amortization consist of the following:

|                                      | March 31,<br>2006<br>(unaudited) | 2005     | December 31,<br>2004 |
|--------------------------------------|----------------------------------|----------|----------------------|
| Purchased and licensed patent rights | \$ (221)                         | \$ (211) | \$ (181)             |
| Internally developed patents         | (447)                            | (430)    | (352)                |
| Trademarks                           | (31)                             | (28)     | (20)                 |
| Total                                | \$ (699)                         | \$ (670) | \$ (553)             |

The weighted average amortization periods are as follows:

|                                     | March 31,<br>2006<br>(unaudited) | 2005 | December 31,<br>2004 | 2003 |
|-------------------------------------|----------------------------------|------|----------------------|------|
| Purchased and licensed patent right | 17.0                             | 17.0 | 17.0                 | 17.0 |
| Internally developed patents        | 17.0                             | 17.0 | 17.0                 | 17.0 |
| Trademarks                          | 10.0                             | 10.0 | 10.0                 | 10.0 |

Purchased patent rights represent the exclusive right to commercialize the bulk amorphous alloy and other amorphous alloy technology acquired from California Institute of Technology ( Caltech ), a shareholder, through a license agreement with Caltech ( License Agreement ). Under the License Agreement, the Company has the exclusive right to make, use, and sell products from all of Caltech 's inventions, proprietary information, know-how, and other technology relating to amorphous alloys in existence as of September 1, 2001. The Company also has an exclusive license to eleven issued US patents and two patent applications held by Caltech relating to amorphous alloy technology, as well as all related foreign counterpart patents and patent applications. Of the patents currently issued to Caltech and licensed by the Company, the earliest expiration date is 2013 and the latest expiration date is 2021. Furthermore, the license agreement gives the Company the exclusive right to make, use, and sell products from substantially all amorphous alloy technology that is developed in Professor William Johnson 's Caltech laboratory during the period September 1, 2001 through August 31, 2005. All fees and other amounts payable by the Company for these rights and licenses have been paid or accrued in full, and no further royalties, license fees or other amounts will be payable in the future under the License Agreements.

In addition to the patents and patent applications under the License Agreement with Caltech, the Company has internally developed patents. Internally developed patents include legal and registration costs incurred to obtain the respective patents. The Company currently holds various patents and numerous pending patent applications in the United States, as well as numerous foreign counterparts to these patents outside of the United States.

**11. Goodwill**

During 2002, the Company completed an impairment review and did not recognize any impairment of goodwill. Accordingly, for 2002, the Company has forgone all related goodwill amortization expense. During 2003, Dongyang experienced net losses as a result of a continuing economic downturn in markets for its machinery products. These events, along with Dongyang's operating loss, cash flow losses and uncertainty surrounding its future cash flows, led the Company to evaluate its investment for recoverability as of December 31, 2003. As a result, the Company determined that the carrying value of its investment in Dongyang exceeded its fair value as of December 31, 2003 in the amount of \$184. This impairment loss is recorded in operating expenses as Impairment of Goodwill in the accompanying Statement of Operations and Comprehensive Loss for the year ended December 31, 2003.

In March 2004, the Company sold its 51% investment in Dongyang to the 49% minority shareholder (see Note 18).

## 12. Settlement Payable

The settlement payable balance consists of payables to Growell Metal Co., Ltd., a South Korean metals processing company ( Growell ), as a result of a settlement agreement executed in January 2004. Under the terms of the January 2004 settlement of the dispute over certain sales transactions from 2003 and 2002 between Liquidmetal Korea and Growell, Liquidmetal Korea agreed to pay Growell \$4,895 to purchase Growell's investment in alloy inventories, proprietary alloying equipment purchased from Liquidmetal Korea, and supporting equipment purchased from other suppliers. Also as part of the settlement, Growell satisfied in full a balance of \$2,058 owed to Liquidmetal Korea for the die casting machines Growell purchased from Liquidmetal Korea in the first quarter of 2003 as part of a license agreement to manufacture Liquidmetal alloy parts for the South Korean automotive industry. The remaining settlement payable of \$2,837 were to be paid to Growell (in cash or stock at the Company's discretion) by December 31, 2004. As of December 31, 2005, the settlement payable was not paid to Growell due to Growell's breach of warranty on equipment repurchased by Liquidmetal Korea. The outstanding balance of payables to Growell from the settlement was \$3,331 and \$3,246 as of December 31, 2005 and 2004, respectively, net of foreign exchange translation loss. In January 2005, Growell was acquired by a third party and the Company is currently in negotiations to settle this balance with the third party.

**The Company recorded a loss on the settlement at December 31, 2003 of \$2,765 which is included in Cost of Sales in the December 31, 2003 Consolidated Statements of Operations and Comprehensive Loss. The loss on settlement reflects the write-down of the assets received in the settlement to their fair market value. The sale of the die casting machines to Growell was reflected in the first quarter of 2004. Under the settlement agreement between the parties, the Company and Growell granted to the other party (and the other party's affiliates) a release of all known and unknown claims of any nature arising between the parties through the date of settlement, as well as a release against future claims under agreements between the parties that were terminated as a part of the settlement. The settlement agreement provided that all agreements of any nature between the parties and their respective affiliates were terminated as of the date of settlement, with the exception of certain confidentiality agreements, a Liquidmetal coatings distribution agreement, and future rights under the die casting agreement pursuant to which Growell purchased the die casting machines and obtained a license to make auto parts from Liquidmetal alloys. The settlement agreement also includes, as an accommodation to Growell, if the Company becomes aware of any prospective customer that desires to purchase a proprietary Company casting machine at a time when Growell desires to sell any of its Liquidmetal die casting machines, then the Company will not sell such die casting machine to the prospective customer unless the Company first directs the prospective customer to Growell and encourages the prospective customer to purchase the machine from Growell.**

In January 2005, Growell was acquired by a third party, Innometal Co., Ltd., and on March 21, 2006, the Company entered into an Amendment to Settlement Agreement (the Settlement Amendment) with Innometal Co., Ltd. ( Innometal ). Under the Settlement Amendment, Innometal and the Company have agreed that the Company's obligation of \$3,331 under the Settlement Agreement will be fully satisfied through the issuance to Innometal of 1,700,000 shares of our common stock. The Company issued 1,700,000 shares to Innometal on March 22, 2006. The shares were issued to Innometal in a private placement exempt from registration under the Securities Act of 1933, as amended (the Securities Act). Specifically, the shares were issued by virtue of Section 4(2) of the Securities Act in that the issuance did not involve a public offering, Innometal has adequate access to information about the company, and appropriate restrictive legends were affixed to all certificates representing the shares issued to Innometal. The shares received by Innometal under the Settlement Amendment are restricted securities within the meaning of Rule 144 under the Securities Act, and Innometal has not been granted any registration rights by the company with respect to such shares.

As an inducement for Innometal to enter into the Settlement Amendment, James Kang, a director and founder of the Company, has entered into a buy-sell agreement with Innometal whereby Mr. Kang has agreed to personally purchase from Innometal, and Innometal has agreed to sell to Mr. Kang, the 1,700,000 shares issued to Innometal under the Settlement Amendment, with such purchase and sale to take place on October 31, 2006. The aggregate purchase price for the shares payable by Mr. Kang under this buy-sell agreement will be approximately \$2,800. In order to secure his obligations under the buy-sell agreement, Mr. Kang has pledged to Innometal 500,000 shares of the company's common stock currently held by him. Mr. Kang will receive no consideration from us in connection with his entering into this buy-sell agreement, and Mr. Kang will not have any registration rights with respect to the shares purchased under the buy-sell agreement.

**13. Other Liabilities**

The other liabilities balance consists of accrued severance and operating lease costs associated with the Company's cost reduction measures for the Tampa, Florida executive offices, capital lease obligation for office furniture and furnishings and capital lease obligations for a SEM Microscope and a JSM Electron Microscope used in the laboratory in Lake Forest, California.



|   | March 31,<br>2006<br>(unaudited) | 2005   | December 31, | 2004    |
|---|----------------------------------|--------|--------------|---------|
| Accrued severance                                 | \$ 489                           | \$ 550 | \$           | 579     |
| Accrued operating lease costs                     | 160                              | 215    |              | 596     |
| Accrued capital lease costs                       | 44                               | 69     |              | 213     |
| Total   | 693                              | 833    |              | 1,388   |
| Imputed interest                                  | (2)                              | (3)    |              | (14)    |
| Total   | 691                              | 831    |              | 1,374   |
| Less current portion                              | (300)                            | (483)  |              | (1,032) |
| Other long term liabilities, less current portion | \$ 391                           | \$ 348 | \$           | 342     |

During 2003, the Company initiated activities to substantially reduce the number of employees and consolidate manufacturing and administrative facilities to improve operational effectiveness and efficiency and reduce expenses. During the year ended December 31, 2003, there was a total of 225 employees terminated. The total amount of severance granted to the terminated employees is \$2,718 which is included in Cost of Sales in the amount of \$199, Selling, general and administrative in the amount of \$2,253, and Research and Development in the amount of \$266 in the accompanying Consolidated Statement of Operations for the year ended December 31, 2003. The amount of severance paid was \$174 and \$1,104 as of December 31, 2005 and 2004, respectively. The remaining severance owed to the terminated employees is \$0, \$48, and \$579 as of March 31, 2006, December 31, 2005 and 2004, respectively. The total severance granted to terminated employees of \$2,718 is separated into the following reportable segments as of December 31, 2003: Coatings at \$75 and Bulk alloy at \$2,643. The categories of employees that were eliminated include the following: Product management positions at various levels, including Vice President; entry level technicians; accounting and finance positions from entry level through executive; marketing mid to senior level positions; engineering mid to senior levels positions; information technology support; administrative, legal and executive support; senior internal legal counsel; human resources and senior executives. Also, there were other relocation expenses associated with relocating the Tampa, Florida office to Lake Forest, California totaling \$759, which included the accrual of all remaining facility and telecommunication lease payments for the Tampa, Florida office. Total liability accrued from the relocation and terminations in 2003, including the severance and lease accruals, were \$160, \$276 and \$1,175 as of March 31, 2006, December 31, 2005 and 2004, respectively. The Company has substantially concluded all cost reduction and restructuring activities as of March 31, 2004. The remaining portion of the 2003 termination and relocation liability, all classified as current liability, is \$257 and \$416 at March 31, 2006 and December 31, 2005, respectively. At December 31, 2004, the current portion of the 2003 termination and relocation liability was \$909 and the long-term portion of the liability was \$266.

All leases with an initial term greater than one year are accounted for under SFAS No. 13 *Accounting for Leases*. These leases are classified as either capital leases or operating leases, as appropriate. Assets under capital leases are capitalized using interest rates appropriate at the inception of each lease. As of March 31, 2006, the cost recorded for the office furniture and furnishings, the SEM Microscope and the JSM 6360 Electron Microscope under the capital lease was \$107, \$47 and \$289, respectively, and the accumulated amortization was \$84, \$28 and \$162, respectively. At December 31, 2005, the cost recorded for the office furniture and furnishings, the SEM Microscope and the JSM 6360 Electron Microscope under the capital lease was \$107, \$47 and \$289, respectively, and the accumulated amortization was \$79, \$27 and \$147, respectively. At December 31, 2004, the cost recorded for the office furniture and furnishings, the SEM Microscope and the JSM 6360 Electron Microscope under the capital lease was \$107, \$47 and \$289, respectively and the accumulated amortization \$57, \$22 and \$89, respectively. Future minimum lease payments for the above assets under capital leases during subsequent years are as follows:

| December 31,           | Minimum<br>Payments |
|------------------------|---------------------|
| 2006                   | \$ 38               |
| 2007                   | 7                   |
| Total                  | 45                  |
| Imputed interest       | (2)                 |
| Total, current portion | 43                  |

#### 14. Product Warranty

Management estimates product warranties as a percentage of bulk alloy product revenues. During the three months ended March 31, 2006 and the years ended December 31, 2005 and 2004, the Company used five percent of bulk alloy product sales as an estimate of warranties to be claimed. During the three months ended March 31, 2006 and the years ended December 31, 2005 and 2004, the Company's product warranty accrual balance had the following activity:

|                                     |        |
|-------------------------------------|--------|
| Balance, December 31, 2003          | \$ 303 |
| Expense accrual                     | 288    |
| Warranty charges                    | (72)   |
| Balance, December 31, 2004          | \$ 519 |
| Expense accrual                     | 101    |
| Warranty charges                    | 14     |
| Balance, December 31, 2005          | \$ 634 |
| Expense accrual                     | 97     |
| Warranty charges                    |        |
| Balance, March 31, 2006 (unaudited) | \$ 731 |

The product warranty accrual balance was included in accounts payable and accrued expenses at March 31, 2006, December 31, 2005 and December 31, 2004 and included in that number is foreign exchange translation net loss of \$23.

#### 15. Notes Payable

##### Senior Convertible Note

On March 3, 2004, the Company issued \$9,924 of 6% senior convertible notes due 2007 (the March Notes ) to investor groups in a transaction led by Michigan Venture Capital Co., Ltd, a South Korea-based institutional investment firm, and IndiGo Ventures LLC, a New York-based investment firm (the Placement Agents ) that served as a financial advisor to the Company for the transaction. The notes were collateralized by the patents held by the Company and second priority mortgage interest in plant facilities and certain equipment in South Korea. The notes were convertible at any time into common stock at a price of \$3.00 per share. Investors in the private placement and the Placement Agents received warrants to purchase an aggregate amount of up to approximately 1.2 million shares of common stock, exercisable at \$3.00 per share for varying periods but no later than 100 days following the effectiveness of a registration statement covering the resale of shares issuable upon exercise of the warrants. The conversion and warrant exercise price are subject to price adjustments for anti-dilution purposes. In addition, the investors had the right to call for repayment of the notes prior to maturity at any time after the second anniversary of the closing of the transaction.

Pursuant to Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, EITF 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments, and EITF 05-2 The Meaning of Conventional Convertible Debt Instrument in EITF Issue No. 00-19, the original fair value of the embedded conversion feature of \$7,595 have been recorded as conversion feature liabilities as the debt is considered non-conventional convertible debt. The original fair value was computed using the Black-Scholes model under the following assumptions: (1) expected life of 3 years; (2) volatility of 82%; (3) risk free interest of 2.15% and dividend rate of 0%. The fair value of the conversion feature on the date of issuance has been recorded as debt discount to be amortized over the life the debt.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, the original fair value of the 1.2 million warrants of \$1,302 has been recorded as warrant liabilities as the shares issuable under the warrants have not been registered. The original fair value was computed using the Black-Scholes pricing model under the following assumptions: (1) expected life of 3 years; (2) volatility of 82%, (3) risk free interest of 0.95% and dividend rate of 0%.

In March 2004, the original fair value of the embedded conversion feature of \$7,595, and the original fair value of the 0.6 million warrants issued to investors of \$584, and the original fair value of 0.6 million warrants issued to Placement Agents of \$718 were recorded as discounts of the convertible note. In addition, \$581 direct costs incurred relating to issuance of the convertible note were recorded as debt issuance cost in other assets.

During 2004, the Company redeemed \$4,465 of the outstanding note balance in cash. The redemption resulted in a write down of debt issuance costs and debt discount of \$3,571 to interest expense and a reduction in conversion feature liabilities of \$914 from cancellation of the embedded conversion feature of the redeemed notes to additional paid in capital during the year ended December 31, 2004. Further, 500,000 of warrants originally issued to a financial advisor for the transaction expired during June 2004 and 163,748 of unexercised warrants originally issued to investors were cancelled as a result of the Company's redemption of the note balances during the year ended December 31, 2004. The 663,748 total expired and canceled warrants immediately prior to the expiration and cancellation resulted in a reduction of warrant liability of \$7 and \$279 to additional paid in capital and change in value of warrants, respectively, during the year ended December 31, 2004.

On August 19, 2004, the Company completed a private exchange offer for its March Notes with the remaining holders after the redemption. Under terms of the exchange offer, approximately \$5,459 in aggregate principal amount of the March Notes have been exchanged for an aggregate of (i) \$2,729 of 6% Senior Secured Notes Due 2007 (the July 2007 Notes) and (ii) \$2,730 of 10% Senior Secured Notes Due 2005 (the July 2005 Notes), collectively referred to as Exchange Notes. The Exchange Notes are collateralized by certain patents owned by the Company and second priority mortgage interest in plant facilities and certain equipment at our South Korea plant. The July 2005 Notes had a maturity date of July 29, 2005, and a conversion price of \$2.00 per share (compared to a conversion price of \$3.00 per share under the March Notes). The July 2005 Notes have been exchanged and redeemed subsequent to the close of the second quarter of 2005 (see 2005 Senior Convertible Notes below). The July 2007 Notes have a maturity date of July 29, 2007, and a conversion price of \$1.00 per share. The conversion prices of the July 2007 Notes and July 2005 Notes are subject to price adjustments for anti-dilution purposes. Further, the exchange notes are convertible into Common Stock, at the option of the Company, if at any time after the issuance of the notes, the closing per share price of the Common Stock exceeds \$4.00 (as adjusted for stock splits, reverse splits, stock dividends, and recapitalizations) for 30 consecutive trading days, and further provided that there has been effective registration during such period. Holders of the July 2007 Notes also have the right to call for repayment of the July 2007 Notes prior to maturity at any time after the second anniversary of the closing of the exchange offer. The July 2007 Notes have been amended subsequent to the close of the second quarter of 2005 to provide for an Amended Registration Rights Agreement, and Amended and Restated Security Agreement (see 2005 Senior Convertible Notes below).

A total of 563,151 warrants to purchase our common stock at an exercise price of \$3.00 per share all of which were previously issued in connection with the purchase of the March Notes have been amended to provide for an extended expiration date of March 1, 2006. The warrants issued to placement agents are to expire the later of March 1, 2006 or 100 days after the effectiveness of registration of shares issuable under the warrants and senior convertible debt. The warrant exercise price is subject to price adjustment for anti-dilution purposes. As of March 31, 2006, there were 165,324 warrants outstanding and the exercise price of the warrants was \$2.72 per share.

The exchange offer was treated as an extinguishment of the March Notes in accordance with Emerging Issues Task Force No. 96-19, Debtors Accounting for a Modification or Exchange of Debt Instruments. The exchange resulted in a \$2,941 loss from extinguishment of the March Notes, which consisted of write down of \$352 of deferred issue costs in other assets, \$670 of debt discount, and an increase of \$1,919 in conversion feature liability as a result of the change in carrying value of exchanged notes.

In connection with the private exchange offer, the Company issued \$250 of private placement notes to certain Placement Agents as issuance costs. Of the \$250 notes issued, \$125 was paid in the form of long-term notes which is due in 2007 with interest rate of 6% per annum (July 2007 Notes) and \$125 was paid in the form of short-term notes which is due in 2005 with interest rate of 10% per annum (July 2005 Notes). The July 2005 and July 2007 Notes are convertible into Common Stock at \$2.00 and \$1.00, respectively, and have the same terms as the Exchange Notes issued to the investors. Further, \$143 of original fair value of the embedded conversion feature of the \$250 notes issued to Placement Agents was recorded as conversion feature liabilities during August 2004.

The Company was obligated, pursuant to a Registration Rights Agreement, as amended by the Exchange Notes, between the Company, the Placement Agents and the note holders to file a registration statement with the Securities and Exchange Commission ( SEC ) to register the shares of Common Stock issuable upon conversion of the notes payable and the related warrants within 90 days following the effective closing date of the exchange notes (July 29, 2004), and to use best efforts to cause such registration

statement to become effective within 60 days following the SEC's first written comments on the registration statement. Further, if the Company is not in compliance with the registration or listing requirements, the holders have rights to late registration payments equal to between 2% and 3% of the purchase price paid for the unconverted notes for the first 30 business days of late registration, and 1% and 3% for each 30 business days thereafter, but no more than 18% of the purchase price of the unconverted note balance. Late registration fee of \$1,028 has been recorded as interest expense during the year ended December 31, 2005.

Interest payments are due quarterly, and failure to make timely interest payments will result in increase in interest rate to 10% and 14% on the 6% and 10% senior convertible notes ( Default Rates ). The Default Rates became effective on April 1, 2005 from non-payment of a scheduled interest payment. The Company became compliant with timely interest payments during the third quarter of fiscal year 2005, and as of March 31, 2006, the Company has complied with all scheduled interest payments.

On August 9, 2005, the July 2005 Notes, accrued interest and late registration fees were redeemed in cash and exchanged for 7% Convertible Secured Promissory Notes due August 2007 (see 2005 Senior Convertible Notes below).

During the year ended December 31, 2005, \$485 of the July 2007 Notes were converted into 485,750 of the Company's common stock at a conversion price of \$1.00 per share. Additionally, during the three months ended March 31, 2006, \$59 of the July 2007 Notes were converted into 59,000 of the Company's common stock at a conversion price of \$1.00 per share. The conversion resulted in reduction of conversion feature liabilities of \$541 and \$27 to additional paid in capital for the year ended December 31, 2005 and for the three months ended March 31, 2006, respectively.

The Company's gross outstanding loan balance of the July 2005 and July 2007 Notes totaled \$0 and \$2,310, respectively, as of March 31, 2006, \$0 and \$2,369, respectively, as of December 31, 2005, and \$2,854 and \$2,855, respectively, as of December 31, 2004. As of March 31, 2006, December 31, 2005, and December 31, 2004, un-amortized discounts for conversion feature and warrants totaled \$992, \$1,207 and \$2,831, and other asset debt issuance costs totaled \$35, \$43, and \$183, respectively. Interest expense for the amortization of debt issuance cost and discount on note was \$223 and \$477 for the three months ended March 31, 2006 and 2005, respectively. Interest expense for the amortization of debt issuance cost and discount on note was \$1,765 and \$3,763 for the year ended December 31, 2005 and 2004, respectively. As of March 31, 2006 and December 31, 2005, the effective interest rates for the July 2007 Notes were 37%. As of December 31, 2004, the effective interest rates for the July 2005 and July 2007 Notes were 40% and 37% respectively.

Pursuant to Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, the Company is required to report a value of the conversion liability as a fair value and record the fluctuation to the fair value of the conversion feature liability to current operations. The change in the fair value of the conversion feature liability resulted in a loss of \$802 and a gain of \$1,115 for the three months ended March 31, 2006 and 2005, respectively. The change in the fair value of the conversion feature liability resulted in a gain of \$5,269 and \$2,093 for the year ended December 31, 2005 and 2004, respectively. The fair value of conversion feature liability outstanding at March 31, 2006 and December 31, 2005 was \$1,615 and \$840. The fair value of conversion features outstanding at March 31, 2006 was computed using the Black-Scholes model under the following assumptions: (1) 1.33 years; (2) volatility of 82%, (3) risk free interest of 4.82% and dividend rate of 0%.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, the Company is required to report a value of the warrant as a fair value and record the fluctuation to the fair value of the warrant liability to current

operations. The change in the fair value of the warrants resulted in a loss of \$3 and a gain of \$133 for the three months ended March 31, 2006 and 2005, respectively. The change in the fair value of the warrants resulted in a net gain of \$550 and \$747 for the year ended December 31, 2005 and 2004, respectively. The fair value of warrants outstanding was \$3, \$0, and \$550 at March 31, 2006, December 31, 2005 and 2004, respectively. The fair value of warrants outstanding as of March 31, 2006 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 0.27 years; (2) volatility of 82%, (3) risk free interest of 4.63% and dividend rate of 0%.

**The following is a repayment schedule of the July 2005 and July 2007 Notes based on maturity date of the notes:**

**July 2005 and 2007 Notes  
Repayment Schedule  
December 31,**

|       |    | <b>Minimum<br/>Payments</b> |
|-------|----|-----------------------------|
| 2005  | \$ |                             |
| 2006  |    |                             |
| 2007  |    | 2,310                       |
| Total | \$ | 2,310                       |

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Convertible Notes

On June 13, 2005, the Company completed a private placement (the June 2005 Private Placement ) of 10% Convertible Unsecured Notes Due June 13, 2006 in the aggregate principal amount of \$3,250 (the June 2006 Notes ), together with warrants to purchase up to an aggregate of 893,750 shares of the Company's common stock (the Warrants ).

The June 2006 Notes issued by the Company in the June 2005 Private Placement are unsecured and were due on the earlier of June 13, 2006 or the consummation of a follow-on equity or debt offering or restructuring transaction pursuant to which the Company receives gross proceeds of at least \$4,000. Prior to maturity, the June 2006 Notes are interest-only, with interest payments due quarterly, at the rate of 10% per year. The June 2006 Notes can be prepaid by the Company at any time without penalty. If, within 120 days following the issue date of the June 2006 Notes, the Company either fails to redeem the notes for the principal amount and accrued interest thereon or fails to close a Qualified Financing, then the June 2006 Notes will thereafter be convertible at a conversion price equal to seventy five percent (75%) of the closing price of the Company's common stock on the first trading day immediately preceding the conversion date. A Qualified Financing is defined in the June 2006 Notes as any debt or equity financing of the Company resulting in aggregate gross proceeds to the Company of at least \$5,000 and in which the holders of at least sixty percent (60%) of the aggregate principal amount of the Company's July 2007 Notes either (i) agree that the equity or debt securities to be issued in such financing shall be *pari passu* in order of payment to the July 2007 Notes held by them or (ii) exchange their July 2007 Notes for new securities in the financing transaction. On August 9, 2005, the Company successfully completed Qualified Financing, which resulted in exchange and redemption of the Convertible Notes (see 2005 Senior Convertible Notes below). As a result, the June 2006 Notes never became convertible.

As a part of the June 2005 Private Placement, the Company issued warrants to the purchasers of the June 2006 Notes giving them the right to purchase up to an aggregate of 812,500 shares of the Company's common stock. In addition, warrants to purchase 81,250 shares of the Company's common stock were issued to the placement agent in the transaction. The warrants have an exercise price of \$2.00 per share, provided that upon the consummation of the first ensuing public or private equity or debt offering or restructuring transaction in which the Company receives gross proceeds of at least \$3,250 (including without limitation any restructuring of the Company's July 2005 Notes), the exercise price will be automatically adjusted downward (but not upward) as of the closing date of such offering or restructuring transaction so that it is equal to the lowest effective common stock purchase price paid for any securities issued by the Company to the investors in such offering or restructuring transaction. The warrants will expire on June 13, 2010 and are subject to exercise price adjustment for anti-dilution purposes.

**The fair value of the 893,750 warrants totaled \$1,160 and was computed using the Black-Scholes pricing model under the following assumptions: (1) expected life of 5 years; (2) volatility of 118%, (3) risk free interest of 3.87% and dividend rate of 0%. In accordance with Emerging Issues Task Force No. 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments the embedded beneficial conversion feature of the debt was not recorded as the debt is considered contingently convertible at the time of issuance, and as a result of the completion of the Qualified Financing the debt subsequent to the close of the second quarter, the debt was determined to be not convertible. In June 2005, the fair value of the 812,500 warrants issued to investors of \$1,055 was recorded as discounts of the convertible note. In addition \$105 relating to the fair value of the 81,250 warrants issued to the Placement Agents and \$278 direct costs incurred relating to issuance of the convertible note were recorded as debt issuance cost as a contra liability account in debt discount and other assets, respectively, and will be amortized using the effective interest rate method over the life of the loan.**

On August 9, 2005, the June 2006 Notes were redeemed in cash and exchanged for 7% Convertible Secured Promissory Notes due August 2007 (see 2005 Senior Convertible Notes below). The exchange offer was treated as an extinguishment of the June 2006 Notes in accordance with Emerging Issues Task Force No. 96-19, Debtors Accounting for a Modification or Exchange of Debt Instruments. The exchange resulted in a \$1,247 loss from extinguishment of the June 2006 Notes as of December 31, 2005, which consists of write down of \$240 of deferred issue costs in other assets, \$92 of contra liability deferred issuance costs, and \$915 of debt discount as a result of the change in carrying value of exchanged notes.

Pursuant to EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the original fair values of the warrants of \$1,160 have been recorded as other liability as the Company has not yet filed the registration statement. In addition, the Company is required to report a value of the warrant as a fair value and record the fluctuation to the fair value of the warrant liability to current operations. The change in the fair value of the warrants resulted in a loss of \$302 and \$0 for the three months ended March 31, 2006 and 2005. The change in the fair value of the warrants resulted in a net gain of \$743 for the year ended December 31, 2005. The fair value of warrants outstanding at March 31, 2006 and December 31, 2005 was \$719 and \$418. The fair value of warrants outstanding at March 31, 2006 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 4.20 years; (2) volatility of 82%, (3) risk free interest of 4.82% and dividend rate of 0%.

2005 Senior Convertible Notes

On August 9, 2005, the Company completed a private placement (the August 2005 Private Placement) of \$9,878 in principal amount of new 7% Convertible Secured Promissory Notes due August 2007 (the August 2007 Notes). The issuance consisted of \$5,000 cash, exchange of \$1,284 in principal amount of the July 2005 Notes, the exchange of \$2,996 in principal amount of the June 2006 Notes, satisfaction of accrued interest and late registration fees in the amount of \$589 on the July 2005 Notes, and satisfaction of accrued interest of \$9 on the June 2006 Notes. The August 2007 Notes were issued pursuant to a Securities Purchase Agreement dated effective as of August 2, 2005 among the Company, the purchasers of the August 2007 Notes, and the holders of July 2005 Notes and June 2006 Notes of the Company.

Interest payments are due quarterly, and failure to make timely interest payments will result in an increase to the interest rates to 14% per annum on the August 2007 Notes (Default Rates). As of March 31, 2006, the Company has made timely interest payments.

The August 2007 Notes are convertible into shares of the Company's common stock at \$2.00 per share Pursuant to an Amended and Restated Security Agreement. The convertible price of the August 2007 Notes is subject price adjustment for anti-dilution purposes. As of December 31, 2005, the convertible price of the August 2007 Notes remained unchanged at \$2.00 per share.

Further, pursuant to Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, EITF 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments, and EITF 05-2 The Meaning of Conventional Convertible Debt Instrument in EITF Issue No. 00-19, the original fair value of the embedded conversion feature of \$4,808 have been recorded as conversion feature liability as the debt is considered non-conventional convertible debt. The original fair value was computed using the Black-Scholes model under the following assumptions: (1) expected life of 2 years; (2) volatility of 93%; (3) risk free interest of 4.06% and dividend rate of 0%. In addition, the Company is required to report a value of the conversion liability as a fair value and record the fluctuation to the fair value of the conversion feature liability to current operations. The change in the fair value of the conversion feature liability resulted in a loss of \$981 for the three months ended March 31, 2006. The change in the fair value of the conversion feature liability resulted in a gain of \$3,849 for the year ended December 31, 2005. The fair value of conversion feature liability outstanding at March 31, 2006 and December 31, 2005 was \$1,940 and \$959. The fair value of beneficial conversion features outstanding at March 31, 2006 was computed using the Black-Scholes model under the following assumptions: (1) 1.34 years; (2) volatility of 82%, (3) risk free interest of 4.82% and dividend rate of 0%.

The August 2007 Notes are secured by substantially all assets of the Company and rank senior to all other obligations of the Company, other than the Company's loan with Kookmin Bank of South Korea (or any refinancing of such loan), the July 2007 Notes, purchase money asset financing, trade creditors in the ordinary course of business, and any inventory or receivables-based credit facility that the Company may obtain in the future, provided that the amount of the credit facility does not exceed 50% of eligible inventory and 80% of eligible receivables. The August 2007 Notes will automatically convert into common stock if the Company's common stock has an average closing price of more than \$5.00 per share during 30 consecutive trading days.

**The Company also issued warrants to the purchasers of the August 2007 Notes and placement agents giving them the right to purchase up to 2,469,470 and 414,495 shares of Company common stock, respectively, with an exercise price of \$2.00 per share, which is subject to price adjustment for anti-dilution purposes. The warrants will expire on August 2, 2010.**

**Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, the original fair values of the warrants of \$4,068 have been recorded as warrant liability as the Company has not yet filed the registration statement, which was computed using the Black-Scholes pricing model under the following assumptions: (1) expected life of 5 years; (2) volatility of 93%; (3) risk free interest of 4.17% and dividend rate of 0%. In addition, the Company is required to report a value of the warrant as a fair value and record the fluctuation to the fair value of the warrant liability to current operations. The change in the fair value of the warrants resulted in a net loss of \$985 for the three months ended March 31, 2006. The change in the fair value of the warrants resulted in a net gain of \$2,693 for the year ended December 31, 2005. The fair value of warrants outstanding at March 31, 2006 and December 31, 2005 was \$2,359 and \$1,375, respectively. The fair value of warrants outstanding at March 31, 2006 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 4.34 years; (2) volatility of 82%, (3) risk free interest of 4.82% and dividend rate of 0%.**

In connection with the August 2005 Private Placement, the Company entered into an amended and restated registration rights agreement with the holders of the July 2007 Notes, the holders of the August 2007 Notes, and the holders of the above-described outstanding warrants. This amended and restated registration rights agreement replaced all other registration rights agreements previously entered into by us in connection with the private sale by us of convertible notes and warrants. Under the amended and restated registration rights agreement, the Company is required to file a resale registration statement for the shares underlying all of our outstanding convertible

notes and warrants, as described above, by October 31, 2005, to enable the resale of such shares by the selling stockholders on a delayed or continuous basis under Rule 415 of the Securities Act. The Company is then required to cause such registration statement to become effective within 60 days after we receive the first written comments on the registration statement from the SEC, or if the SEC notifies us that it will not review the registration statement, within five days after such notification. The Company will be subject to certain monetary penalties, as set forth in the registration rights agreement, if the registration statement is not filed or does not become effective on a timely basis. Specifically, if the Company does not file the registration statement on a timely basis, we will be obligated to pay a late filing fee to the selling stockholders in the amount of 3% of the warrant exercise price on each of the warrants held by them plus 3% of the principal amount of the outstanding notes held by them. This fee will be payable for each period of 30 business days that the filing of the registration statement is made past the required filing date, and the payments will be due 10 business days following the end of each 30-day period. If the registration statement has not been declared effective by the required effective date, the Company will be obligated to pay a monthly late registration fee to the selling stockholders in the amount of 2% of the aggregate warrant exercise prices and aggregate note principal amounts for the first 30 business days after the required effective date, and 1% for each 30-business day period thereafter until the registration statement is declared effective. Notwithstanding the foregoing, the late filing fees and late registration fees will not exceed 18% of the aggregate warrant exercise prices and aggregate note principal amounts.

On December 6, 2005, the Company received a letter from a representative of the holders of the August 2007 Notes demanding the payment of a late filing fee by us for the period following October 31, 2005, but under the terms of the amended and restated registration rights agreement, the Company does not believe that it is obligated to pay any late filing fees unless and until the Company fails to file the registration statement by December 13, 2005, which is the last day of the first 30-business day period following October 31, 2005. The letter also stated that the letter was serving as a notice of default under the Senior Notes as a result of our failure to file a registration statement by October 31, 2005, although under the terms of the Senior Notes, the Company has thirty days after delivery of the letter in which to cure such default. On December 9, 2005 the Company filed the registration statement, which was within the 30-day period and has cured the default notice.

The Company has received first written comments in January 2006. However, the registration statement has not been made effective within the 60 day period called for by the registration rights agreement and the Company may be subject to default notices by the holders of the convertible notes and warrants.

On May 12, 2006, the Company received a letter from one holder demanding immediate payment of late filing fees and late registration fees for the period following October 31, 2005 through May 3, 2006 (see Note 26).

As of March 31, 2006 and December 31, 2005, our gross outstanding loan balance of the August 2007 Notes totaled \$9,878. As of March 31, 2006 and December 31, 2005, unamortized discounts for beneficial conversion feature and warrants totaled \$5,551 and \$5,663, and other asset debt issuance costs totaled \$316 and \$384, and contra liability debt issuance cost totaled \$391 and \$464, respectively. Interest expense for the amortization of debt issuance cost and discount on note was \$1,177 for the three months ended March 31, 2006 and 2005. Interest expense for the amortization of debt issuance cost and discount on note was \$1,913 for the year ended December 31, 2005. As of March 31, 2006 and December 31, 2005, the effective interest rate for the August 2007 Notes was 54%.

**The following is a repayment schedule of the August 2007 Notes based on maturity date of the notes:**

**August 2007 Notes  
Repayment Schedule  
December 31,**

|       | <b>Minimum<br/>Payments</b> |
|-------|-----------------------------|
| 2005  | \$                          |
| 2006  |                             |
| 2007  | 9,878                       |
| Total | \$ 9,878                    |

Subordinated Promissory Note

On March 17, 2006, the Company issued a \$1,000 10% subordinated promissory note due October 16, 2006 (the October 2006 Note ) to Atlantic Realty Group, Inc., a company controlled by Jack Chitayat, a former director of the Company. The October 2006 Note is unsecured and subordinated to all prior indebtedness of the Company. All accrued interest and unpaid principal under the note will be due October 16, 2006. The proceeds from the October 2006 Note is to be used solely for working capital purposes. In connection with the October 2006 Note, the Company issued warrants to purchase an aggregate amount of up to 125,000 shares of common stock, exercisable at \$2.00 per share. The warrants will expire on March 17, 2009, and include price adjustment provisions for anti-dilution purposes. As of March 31, 2006, the exercise price of the warrants remained unchanged at \$2.00 per share. There are no registration rights of the shares issuable from the exercise of the warrants. Further, cashless exercise of the warrants is permitted.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, the original fair value of the warrants of \$84 have been recorded as warrant liability as the warrant holders can elect to settle the warrants in cash, which was computed using Black-Scholes pricing model under the following assumptions: (1) expected life of 2.96 years; (2) volatility of 84%; (3) risk free interest of 4.64% and dividend rate of 0%. In addition, the Company is required to report a value of the warrant as a fair value and record the fluctuation to the fair value of the warrant liability to current operations. The change in the fair value of the warrants resulted in a net gain of \$1 which is recorded as change in value of warrants for the three months ended March 31, 2006. The fair value of warrants outstanding at March 31, 2006 of \$83 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 2.96 years; (2) volatility of 82%, (3) risk free interest of 4.83% and dividend rate of 0%.

Our gross outstanding loan balance of the October 2006 Note totaled \$1,000 as of March 31, 2006. As of March 31, 2006, un-amortized discounts for warrants totaled \$71. Interest expense for the amortization of discount on the note was \$13 for the three months ended March 31, 2006. As of March 31, 2006, the effective interest rate for the October 2006 Note was 22%.

#### Factoring Agreement

The Company entered into a Factoring, Loan, and Security Agreement (the Agreement) with a financing company on April 21, 2005, which allows for borrowings of up to \$1,500. The Agreement expires on April 21, 2006, and automatically renews annually thereafter. All borrowings are secured by outstanding receivables specifically assigned to the financing company. Assigned receivables are considered Approved or Non-Approved by the financing company. On January 27, 2006, the terms of the agreement were amended whereas advances are made on 85% of Approved receivables assigned and 50% of Non-Approved receivables assigned. Payments on assigned receivables are received directly by the financing company, and applied to outstanding advances. All outstanding advances and uncollected assigned receivables are subject to fees and interest charges ranging from 0.55% to 1.5% plus prime rate as published by the Wall Street Journal, with a minimum annual fee of \$30. All receivables assigned and advances made are subject to return and recall by the financing company, respectively. As such, the advances have been classified as short-term secured borrowings in accordance with SFAS No. 140 Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities. For the three months ended March 31, 2006, the Company borrowed \$2,995 and repaid \$2,259 under the Agreement. For the year ended December 31, 2005, the Company borrowed \$4,449 and repaid \$3,899 under the Agreement. The total outstanding advance made under the agreement is \$1,286 and \$550 as of March 31, 2006 and December 31, 2005, which is presented as short-term debt. The weighted average rate of interest for borrowings made under the Agreement was 9% for the three months ended March 31, 2006 and 8.5% for the year ended December 31, 2005. The Company has \$214 and \$950 available for future borrowings under the Agreement as of March 31, 2006 and December 31, 2005, which is contingent on approval of eligible receivables by the financing company.

#### Kookmin Note

On February 4, 2003, our Korean subsidiary received 6,500,000 in South Korean Won, or approximately \$5,488, under a loan from Kookmin Bank of South Korea. The loan bears interest at an annual rate of 7.1%. In the event of delayed repayment, the interest increases to a maximum of 21%, depending on the length of time the repayment is delayed. As of March 31, 2006 and December 31, 2005, the interest rate was increased to 9.2% from delayed interest payments made. This loan is collateralized by the plant facilities and certain equipment in South Korea. During the first eighteen months from the origination date, interest was payable on a monthly basis. In October 2003, the Company paid \$873 of principal at the request of Kookmin Bank due to the sale of machines that had been part of the collateral on the loan. Subsequent to October 31, 2003, Kookmin Bank requested that the Company pay an additional \$866 of principal by February 2004 due to the Company's current credit rating. The Company made two payments on the requested additional loan pay down in November and December 2003 of \$320 and \$205, respectively. The remaining payment of \$341 was subsequently made in February 2004. Beginning in September 2004, the Company is required to make equal monthly installments of principal and interest to repay the remaining balance of the loan over a 36-month period. For the year ended December 31, 2005 and 2004, principal payments made to Kookmin Bank totaled \$1,036 and \$296, which includes \$95 and \$(422) of foreign exchange translation gain (loss), respectively. For the three months ended March 31, 2006 and 2005, principal payments made to Kookmin Bank totaled \$222 and \$225, which includes \$100 and \$83 of foreign exchange translation loss, respectively. The outstanding loan balance

totaled \$2,568, of which \$1,391 is included in current portion of long-term debt, as of March 31, 2006. The outstanding loan balance totaled \$2,790 and \$3,751, of which \$1,343 and \$1,208 is included in current portion of long-term debt as of December 31, 2005 and 2004, respectively.

The notes payable from Kookmin Loan as of March 31, 2006 and December 31, 2005 and the activity for the three months ended March 31, 2006 is shown in the following table:

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|                                      | December 31,<br>2005 | Borrowings | Repayments | March 31,<br>2006 |
|--------------------------------------|----------------------|------------|------------|-------------------|
| Kookmin Loan 9.2%, principal \$5,488 | \$ 2,790             | \$         | \$ (222)   | \$ 2,568          |

**Kookmin Repayment Schedule  
December 31,**

|       | Minimum<br>Payments |
|-------|---------------------|
| 2006  | \$ 1,121            |
| 2007  | 1,240               |
| 2008  | 207                 |
| Total | \$ 2,568            |

**16. Shareholders Equity (Deficiency)**

*Initial Public Offering.* Pursuant to the Company's Registration Statement (Registration No. 333-73716) on Form S-1, as amended, initially filed with the Securities and Exchange Commission on November 20, 2001 and declared effective May 21, 2002, the Company closed an initial public offering of 5,000,000 registered shares of common stock on May 28, 2002, plus an additional 229,000 shares on June 10, 2002 pursuant to an over allotment option, at a price of \$15.00 per share (which sale is referred to herein as the Offering). The Offering generated net cash proceeds for the Company during the second quarter 2002 of approximately \$70,721, net of underwriting commissions of \$5,490 and other transaction fees of approximately \$2,224.

*Stock Split.* On June 29, 2001 the Company declared a ten-for-one stock split to its common shareholders of record on June 29, 2001. This stock split was effected in the form of a stock dividend. On April 4, 2002, the Company declared a one-for-3.1 reverse stock split to its common shareholders of record on April 4, 2002. The consolidated financial statements and accompanying notes have been retroactively adjusted to reflect the effects of the split and reverse split.

*Reincorporation.* On May 21, 2003, the Company completed a reincorporation by transitioning from a California corporation to a Delaware corporation. The reincorporation was effected through the merger of the former California entity into its newly created wholly owned Delaware subsidiary. In connection with the reincorporation, the number of authorized common shares was reduced from 200,000,000 to 100,000,000. Additionally, the par value of the common stock was changed from no par value common stock to common stock with a par value of \$0.001 per share. For purposes of these notes, the term Company refers to the former California entity with respect to periods prior to May 21, 2003.

*Preferred Stock.* As of December 31, 2001, the Company received net proceeds of \$5,577 from the sale of the preferred stock at a per share price of \$12.40, as adjusted for the revised stock split. Upon the completion of the Offering, each share of preferred stock was converted automatically into one share of Class A common stock pursuant to the terms of the preferred stock issued.

Warrants

As of March 31, 2006, outstanding warrants to acquire shares of the Company's common stock are as follows:

| <b>Number of Shares</b> | <b>Exercise Price</b> | <b>Expiration Date</b> |     |
|-------------------------|-----------------------|------------------------|-----|
| 165,324                 | 2.72                  | March 1, 2006          | (*) |
| 893,750                 | 2.00                  | June 13, 2010          |     |
| 125,000                 | 2.00                  | March 17, 2009         |     |
| 2,883,965               | 2.00                  | August 2, 2010         |     |
| 4,068,039               |                       |                        |     |

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(\*) Warrants are to expire the later of March 1, 2006 or 100 days after the effectiveness of registration of shares issuable under the warrants.

## 17. Stock Compensation Plan

Under the Company's 1996 Stock Option Plan ( 1996 Company Plan ) the Company could grant to employees, directors or consultants options to purchase up to 12,903,226 shares of common stock as adjusted for the reverse stock split. The stock options are exercisable over a period determined by the Board of Directors or the Compensation Committee, but no longer than 10 years.

On April 4, 2002, our shareholders and board of directors adopted the 2002 Equity Incentive Plan ( 2002 Equity Plan ). The 2002 Equity Plan provides for the grant of stock options to officers, employees, consultants and directors of the Company and its subsidiaries. In addition, the plan permits the granting of stock appreciation rights with, or independently of, options, as well as stock bonuses and rights to purchase restricted stock. A total of 10,000,000 shares of our common stock may be granted under the 2002 Equity Plan. As of March 31, 2006, there were 1,871,950 options outstanding under the 2002 Equity Plan.

Prior to the approval of the 2002 Equity Plan, options were primarily granted under the Company's 1996 Stock Option Plan ( 1996 Company Plan ). On April 4, 2002, our board of directors terminated the 1996 Company Plan. The termination will not affect any outstanding options under the 1996 Company Plan and all such options will continue to remain outstanding and be governed by the Plan. No additional options may be granted under the 1996 Company Plan. As of March 31, 2006, there were 3,257,265 options outstanding under the 1996 Company Plan.

On April 4, 2002, our shareholders and board of directors adopted the 2002 Non-employee Director Stock Option Plan ( 2002 Director Plan ). Only non-employee directors are eligible for grants under the 2002 Director Plan. A total of 1,000,000 shares of the Company's Common Stock may be granted under the 2002 Director Plan. There were 280,000 options outstanding under the 2002 Director Plan as of March 31, 2006.

Options granted under the above plans are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant; those option awards generally vest based on 5 years of continuous service and have 10-year contractual terms.

In September 2005, the non-employee directors of our Company were given the opportunity to receive shares of stock under the plan in lieu of past-due director and committee fees that were due to them from periods through September 2005. The Company issued a total of 92,219 as of December 31, 2005 at an average price of \$1.90 per share. In March 2006, one of the former non-employee directors of our company was given the opportunity to receive shares of stock under the plan in lieu of past-due director and committee fees that were due to him for periods through December 31, 2005 at an average price of \$1.50. The Company issued a total of 10,000 shares at an average price of \$1.50 in March 2006. Such shares were issuable to such directors in lieu of these past-due fees.

Additionally, the Company has 2,221,508 options outstanding at March 31, 2006 which were granted outside the 1996 Company Plan, 2002 Equity Plan and 2002 Director Plan.

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The Company previously applied Accounting Principles Board ( APB ) Opinion No. 25 for options when the exercise price of options granted to employees is less than the fair value of the underlying stock on the date of grant. As permitted, the Company had previously elected to adopt provisions of Statement of Financial Accounting Standard ( SFAS ) No. 123, *Accounting for Stock-Based Compensation* for options granted to non-employees who perform services for the Company and the disclosure-only provisions of options granted to employees.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123R ), which replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, ( SFAS 123 ) and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, ( APB 25 ). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Under SFAS 123R, the Company is required to measure the cost of employee services received in exchange for stock options and similar awards based on the grant-date fair value of the award and recognize this cost in the income statement over the period during which an employee is required to provide service in exchange for the award. The pro forma disclosures previously permitted under SFAS 123 are no longer an alternative to financial statement recognition. The Company adopted SFAS 123R on January 1, 2006 using the modified prospective method and recorded \$224 of non-cash charges for stock compensation related to amortization of the fair value of restricted stock and unvested stock options representing a \$224, or less than \$0.01 per share, increase from the stock compensation that would have been recorded under APB 25 and SFAS 123. Under this method, the Company will recognize compensation cost, on a prospective basis, for the portion of outstanding awards for which the requisite service has not yet been rendered as of January 1, 2006 and any new grants, based upon the grant-date fair value of those awards calculated under SFAS 123 for pro forma disclosure purposes. Accordingly, we have not restated prior period amounts.

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the assumptions noted in the following table. Expected volatilities are based on historical volatility expected over the expd life of the options. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The

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expected term of options granted is derived from vesting period of each option grant, which represents the period of time that options granted are expected to be outstanding. Forfeitures are estimated on the date of grant based on historical forfeitures, and was 5% for the three months ended March 31, 2006. Actual forfeitures were used for years ended December 31, 2005, 2004, and 2003. The risk free rate for period within the expected life of the options is based on U.S. Treasury rates in effect at the time of grant.

|                          | March 31,<br>2006<br>(unaudited) | 2005        | December 31,<br>2004 | 2003        |
|--------------------------|----------------------------------|-------------|----------------------|-------------|
| Expected volatility      | 100%                             | 100%        | 100%                 | 100%        |
| Expected dividends       |                                  |             |                      |             |
| Expected term (in years) | 5                                | 5           | 5                    | 5           |
| Risk-free rate           | 4.3%                             | 3.6% - 4.3% | 2.9% - 3.6%          | 2.6% - 3.3% |

Stock-based compensation expense was recognized as follows in accordance with SFAS No. 123R for the three months ended March 31, 2006 (unaudited):

|                            | Three Months Ended<br>March 31, 2006 |
|----------------------------|--------------------------------------|
| General and administrative | \$ 224                               |
| Research and development   |                                      |
| Total                      | \$                                   |

Stock-based compensation expense was recognized as follows for the three months ended March 31, 2005 (unaudited):

|                            | APB Opinion<br>No. 25 | In accordance with<br>SFAS<br>No. 123 | Total |
|----------------------------|-----------------------|---------------------------------------|-------|
| General and administrative | \$                    | \$                                    | \$    |
| Research and development   |                       |                                       |       |
| Total                      | \$                    | \$                                    | \$    |

Stock-based compensation expense was recognized as follows for the year ended December 31, 2005:

|                            | APB Opinion<br>No. 25 | In accordance with<br>SFAS<br>No. 123 | Total |
|----------------------------|-----------------------|---------------------------------------|-------|
| General and administrative | \$                    | \$ 41                                 | \$ 41 |
| Research and development   |                       |                                       |       |
| Total                      | \$                    | \$ 41                                 | \$ 41 |

Stock-based compensation expense was recognized as follows for the year ended December 31, 2004:

|                            | <b>APB Opinion<br/>No. 25</b> | <b>In accordance with<br/>SFAS<br/>No. 123</b> | <b>Total</b>  |
|----------------------------|-------------------------------|--|---------------|
| General and administrative | \$                            | \$ 240   | \$ 240        |
| Research and development   |                               | 36   | 36            |
| <b>Total</b>               | <b>\$</b>                     | <b>\$ 276</b>                                  | <b>\$ 276</b> |

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Stock-based compensation expense was recognized as follows for the year ended December 31, 2003:

|                            | APB Opinion<br>No. 25 | In accordance with<br>SFAS<br>No. 123 | Total |
|----------------------------|-----------------------|---------------------------------------|-------|
| General and administrative | \$ 50                 | \$ 5                                  | \$ 55 |
| Research and development   | 6                     | 62                                    | 68    |
| <b>Total</b>               | <b>\$ 56</b>          | <b>\$</b>                             |       |