

LIQUIDMETAL TECHNOLOGIES INC
Form 10-Q
May 15, 2008

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2008

OR

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

For the transition period from to

Commission File No. 001-31332

LIQUIDMETAL TECHNOLOGIES, INC.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of

33-0264467
(I.R.S. Employer

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incorporation or organization)

Identification No.)

30452 Esperanza

Rancho Santa Margarita, CA 92688

(address of principal executive office, zip code)

Registrant's telephone number, including area code: **(949) 635-2100**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days.

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

As of May 1, 2008, there were 44,726,295 shares of the registrant's common stock, \$0.001 par value, outstanding.

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LIQUIDMETAL TECHNOLOGIES, INC.
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2008

FORWARD-LOOKING INFORMATION

Statements in this report concerning the future sales, expenses, profitability, financial resources, product mix, market demand, product development and other statements in this report concerning the future results of operations, financial condition and business of Liquidmetal Technologies, Inc. are forward-looking statements as defined in the Securities Act of 1933 and Securities Exchange Act of 1934. Investors are cautioned that the Company's actual results in the future may differ materially from those projected in the forward-looking statements due to risks and uncertainties that exist in the Company's operations and business environment, including competition, need for increased acceptance of products, ability to continue to develop and extend our brand identity, ability to anticipate and adapt to a competitive market, ability to effectively manage rapidly expanding operations, amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure, ability to provide superior customer service, dependence upon key personnel and the like. The Company's most recent filings with the Securities and Exchange Commission, including Form 10-K, contain additional information concerning many of these risk factors, and copies of these filings are available from the Company upon request and without charge.

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PART I**FINANCIAL INFORMATION****Item 1 Financial Statements****LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

	March 31, 2008 (unaudited)	December 31, 2007
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 234	\$ 1,180
Trade accounts receivables, net of allowance for doubtful accounts of \$217 and \$89	4,453	5,165
Inventories	1,836	2,298
Prepaid expenses and other current assets	408	708
Total current assets	6,931	9,351
Property, plant and equipment, net	9,321	9,730
Idle equipment	168	178
Other intangibles, net	1,105	1,142
Investment in joint venture	306	306
Other assets	1,714	1,806
Total assets	19,545	22,513
<u>LIABILITIES AND SHAREHOLDERS' DEFICIENCY</u>		
Current liabilities:		
Accounts payable and accrued expenses	7,983	8,056
Deferred revenue	244	316
Short-term debt	1,805	2,182
Long-term debt, current portion, net of debt discounts of \$2,455 and \$838	5,382	6,092
Warrant liabilities	2,477	2,583
Conversion feature liabilities	1,860	2,083
Other liabilities, current portion	54	398
Total current liabilities	19,805	21,710
Long-term debt, net of current portion and debt discounts of \$7,365 and \$9,634	16,406	14,588
Other long-term liabilities, net of current portion	390	411
Total liabilities	36,601	36,709
Minority interests	532	384
Shareholders' deficiency:		
Common stock, \$0.001 par value; 100,000,000 shares authorized and 44,726,295 issued and outstanding at March 31, 2008 and December 31, 2007	45	45
Additional paid-in capital	137,461	137,293
Accumulated deficit	(157,426)	(154,710)

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Accumulated other comprehensive income	2,332	2,792
Total shareholders' deficiency	(17,588)	(14,580)
Total liabilities and shareholders' deficiency	\$ 19,545	\$ 22,513

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

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(in thousands, except per share data)

(unaudited)

	For the Three Months Ended March 31,	
	2008	2007
Revenue	\$ 6,768	\$ 5,067
Cost of sales	4,901	6,441
Gross profit (loss)	1,867	(1,374)
Operating expenses		
Selling, general, and administrative	1,874	2,532
Research and development	258	263
Total operating expenses	2,132	2,795
Loss from operations	(265)	(4,169)
Loss from extinguishments of debt		(648)
Change in value of warrants, gain	106	3,692
Change in value of conversion feature, gain	222	4,344
Interest expense	(1,741)	(2,763)
Interest income	2	61
(Loss) income before minority interest	(1,676)	517
Minority interests	(149)	
(Loss) income from continuing operations	(1,825)	517
Net (loss) income	(1,825)	517
Other comprehensive (loss) income:		
Foreign exchange translation loss	(460)	(222)
Comprehensive (loss) income	\$ (2,285)	\$ 295
Net (loss) income per share basic and diluted:		
(Loss) income per share basic and diluted	\$ (0.04)	\$ 0.01
Number of weighted average shares - basic and diluted	44,726	44,925

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

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS DEFICIENCY

For the Three Months Ended March 31, 2008

(in thousands, except per share data)

(unaudited)

	Common Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (loss)	Total
Balance, December 31, 2007	44,726,295 \$	45 \$	137,293 \$	(154,710) \$	2,792 \$	(14,580)
Stock-based compensation			168			168
Foreign exchange translation gain					(460)	(460)
Cash distribution to minority interests				(891)		(891)
Net loss				(1,825)		(1,825)
Balance, March 31, 2008	44,726,295 \$	45 \$	137,461 \$	(157,426) \$	2,332 \$	(17,588)

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

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, except per share data)

(unaudited)

	For the Three Months Ended March 31,	
	2008	2007
Operating activities:		
Net (loss) income	\$ (1,825)	\$ 517
Adjustments to reconcile loss from operations to net cash provided by (used in) operating activities:		
Gain on disposal of asset	21	1
Minority interests in income of consolidated subsidiary	148	
Depreciation and amortization	381	881
Loss on extinguishment of debt		648
Amortization of debt discount	762	1,735
Stock-based compensation	168	229
Bad debt expense	(15)	(17)
Warranty expense	(11)	207
Gain from change in value of warrants	(106)	(3,692)
Gain from change in value of conversion feature	(222)	(4,344)
Changes in operating assets and liabilities:		
Trade accounts receivable	727	865
Inventories	462	1,224
Prepaid expenses and other current assets	299	(231)
Other assets	(43)	(1,109)
Accounts payable and accrued expenses	(62)	(2,314)
Deferred revenue	(72)	(77)
Other liabilities	(366)	32
Net cash provided by (used in) operating activities	246	(5,445)
Investing Activities:		
Purchases of property and equipment	(100)	(5)
Proceeds from the sale of property and equipment	(17)	10
Investment in patents and trademarks	(14)	(16)
Investment in joint venture		(217)
Net cash used in investing activities	(131)	(228)
Financing Activities:		
Proceeds from borrowings	7,212	19,894
Repayment of borrowings	(7,111)	(9,265)
Restricted cash		(2,083)
Cash distributions	(891)	
Net cash (used in) provided by financing activities	(790)	8,546
Effect of foreign exchange translation	(271)	(80)
Net (decrease) increase in cash and cash equivalents	(946)	2,793

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Cash and cash equivalents at beginning of period		1,180		144
Cash and cash equivalents at end of period	\$	234	\$	2,937
Supplemental cash flow information				
Interest paid	\$	906	\$	354
Taxes paid	\$		\$	

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

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During the three months ended March 31, 2007, \$400 of the Company's 7% senior convertible notes due July 2007 was converted into 320,000 shares of the Company's common stock at a conversion price of \$1.25 per share.

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

LIQUIDMETAL TECHNOLOGIES AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March 31, 2008 and 2007

(in thousands, except share data)

(unaudited)

1. Basis of Presentation / Description of Business

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. All intercompany balances and transactions have been eliminated. Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for any future periods or the year ending December 31, 2008. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company's Form 10-K filed with the Securities and Exchange Commission on April 3, 2008.

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 (see Note 9). 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. 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.

In July 2007, the Company transferred substantially all of the assets of its Liquidmetal alloy industrial coatings business to a newly formed, newly capitalized subsidiary named Liquidmetal Coatings, LLC, a Delaware limited liability company (LMC), and LMC assumed substantially all of the liabilities of the coatings business. The transfer included the thermal spray coatings assets and liabilities acquired under a purchase agreement with Foster Wheeler Energy Services in June 2007. The Company holds a 69.25% ownership interest in LMC. The results of operation of LMC are consolidated and comprise our Liquidmetal alloy industrial coatings segment for financial reporting purposes.

2. Basis of Presentation and Recent Accounting Pronouncements

Translation of Foreign Currency

The Company applies *FASB No. 52, Foreign Currency Translation*, for translating foreign currency into US dollars in our consolidation of the financial statements. 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 period-end. The financial statements of Liquidmetal Korea have been translated based upon Korean Won as the functional currency. Liquidmetal 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 reporting period. The resulting translation adjustment was included in other comprehensive loss.

LIQUIDMETAL TECHNOLOGIES AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March 31, 2008 and 2007

(in thousands, except share data)

(unaudited)

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 (SFAS 159)", which permits entities to voluntarily choose to measure many financial instruments and certain other items at fair value. SFAS 159 was effective for the Company on January 1, 2008. The Company's management did not elect to report its financial assets or liabilities at fair value upon adoption of SFAS 159 and, therefore, SFAS 159 did not have an impact on the Company's consolidated financial statement.

In December 2007, the FASB issued SFAS 141R, "Business Combinations (SFAS 141R)". SFAS 141R amends the requirements for accounting for business combinations. SFAS 141R will be effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact of the adoption of SFAS 141R on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements (SFAS 160)". SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary (minority interest) is an ownership interest in the consolidated entity that should be reported as equity in the Consolidated Financial Statements and separate from the parent company's equity. Among other requirements, this statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the Consolidated Statement of Operations, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS 160 will be effective on January 1, 2009. The Company is currently evaluating the potential impact of the adoption of SFAS 160 on the Company's consolidated financial statements.

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, "Disclosures about Derivative Instruments and Hedging Activities - An Amendment of SFAS No. 133 (SFAS 161)". SFAS 161 seeks to improve financial reporting for derivative instruments and hedging activities by requiring enhanced disclosures regarding the impact on financial position, financial performance, and cash flows. SFAS 161 will be effective on January 1, 2009. The Company is currently evaluating the potential impact of the adoption of SFAS 161 on the Company's 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.

3. Liquidity

The Company has experienced losses from continuing operations during the last three fiscal years and has an accumulated deficit of \$157,426 as of March 31, 2008. Cash provided by operations for the three months ended March 31, 2008 was \$246, however, cash flow from operations will likely be negative throughout fiscal year 2008. As of March 31, 2008, the Company's principal sources of liquidity are \$234 of cash and \$4,453 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, 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, reduce its operating costs, generate higher revenue, achieve positive cash flow from continuing operations and continued sources of debt and equity financing. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

LIQUIDMETAL TECHNOLOGIES AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March 31, 2008 and 2007

(in thousands, except share data)

(unaudited)

The Company borrowed \$4,679, which was offset by repayments of \$5,055, under a factoring, loan, and security agreement executed on April 21, 2005 and a revolving loan agreement executed on July 24, 2007, to fund its working capital requirements during the three months ended March 31, 2008.

On February 22, 2008, the Company received \$1,714 distribution from its majority owned subsidiary, Liquidmetal Coatings, LLC (LMC) from which it issued and sold \$2,500 in preferred membership units to two existing holders of LMC common membership units. The preferred units issued by LMC have an accruing priority return of 14% per year and are redeemable by the preferred holders on the fourth anniversary of the issue date

The Company anticipates that it will not have sufficient funds to pursue its current operating plan beyond the second quarter of 2008 and will therefore require additional funding. The Company is actively seeking additional sources of capital and seeking to restructure and/or modify existing indebtedness. The amount of funding that the Company seeks and the timing of such fundraising efforts will depend on the extent to which The Company is able to increase revenues through obtaining additional purchase orders for its products and/or the extent to which The Company can restructure or modify its debt. Because the Company cannot be certain that it will be able to obtain adequate funding from debt, equity, or other traditional financing sources, it is also actively exploring several strategic financing options, including the possible sale of its manufacturing plant in South Korea (which would then be replaced with a smaller facility) and additional licensing and outsourcing of our manufacturing operations.

The Company cannot guarantee that adequate funds will be available when needed, and if it does not receive sufficient capital, the Company may be required to alter or reduce the scope of our operations.

Additionally, the Company has approximately \$1,152 of principal and accrued interest outstanding as of March 31, 2008, under the 8% unsecured subordinated notes (the Bridge Notes), which were due August 17, 2007. The Company intends to fully repay the amounts due under the Bridge Notes. However, as of the filing of this report it does not have sufficient funds to repay the Bridge Notes. As a result, the Company is currently in default under the Bridge Notes. Such a default may have material adverse effect on our operations, financial condition, and results of operations. The Company has not received a formal notice of default and it is currently working to resolve this matter with investors holding our Bridge Notes.

The Company was required under its amended Security Purchase Agreement, dated April 23, 2007, between the Company and holders of the 8% convertible subordinated notes due January 2010 (the January 2010 Notes), to repay outstanding debt under previously issued promissory notes, including the Bridge Notes (Debt Satisfaction Covenant) by October 1, 2007. As the Company has not yet fully repaid the Bridge Notes, it is

not in compliance with this covenant and is subject to default under the January 2010 Notes. Such a default may have material adverse effect on the Company's operations, financial condition, and results of operations. The Company have not received a formal notice of default under this covenant and are currently working to resolve this matter.

On July 31, 2008, and at the end of each month thereafter, the Company will be required to redeem 1/36th of the principal amount of the January 2010 Notes in cash or, at the Company's election, with shares of the Company's common stock. The ability to pay the redemption amounts with shares of common stock will be subject to specified conditions. Under the current conditions, the Company does not have the capital resources to redeem the January 2010 Notes with cash nor will the Company meet the specified condition that will enable the Company to redeem the January 2010 Notes with shares of its common stock. If the Company cannot commence the scheduled principal payment in July, it will be subject to default under the January 2010 Notes. Such a default may have material adverse effect on the Company's operations, financial condition, and results of operations. The Company is currently in negotiations with holders of the Notes to allow for the Company to delay the repayment of the January 2010 notes.

4. 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 valued at the lower of cost or market. Inventories were comprised of the following:

LIQUIDMETAL TECHNOLOGIES AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March 31, 2008 and 2007

(in thousands, except share data)

(unaudited)

	March 31, 2008 (Unaudited)	December 31, 2007
Raw materials	\$ 924	\$ 1,216
Work in process	298	536
Finished goods	614	546
Total inventories	\$ 1,836	\$ 2,298

5. Idle Equipment

Idle equipment consists of certain equipment held by the Company for use in expansion of bulk alloy parts manufacturing. 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. Total amount of idle equipment remaining was \$168 as of March 31, 2008 and \$178 as of December 31, 2007.

During the three months ended March 31, 2007, the Company disposed of \$7 of its idle equipment as part of the equipment purchase agreement and transfer agreement regarding Weihai operations with Grace Metal (see Note 12).

6. Product Warranty

Management estimates product warranties as a percentage of certain bulk alloy product sales earned during the period. As of March 31, 2008, the Company used 5% of bulk alloy product sales as an estimate of warranties to be claimed. The percentage is based on industry averages and historical information. During the three months ended March 31, 2008 and 2007, the Company recorded \$18 of net gain and \$207 of warranty expense, respectively.

Additionally, as of March 31, 2008 the Company used 1% of coatings applications sales as estimates of warranties to be claimed and recorded \$7 of warranty expense. The warranty accrual balance is included in accounts payable and accrued expenses.

7. Notes Payable

Secured Senior Convertible Note

On August 19, 2004, the Company issued \$2,855 of 6% Senior Secured Notes Due 2007 (the July 2007 Notes) and \$2,855 of 10% Senior Secured Notes Due 2005 (the July 2005 Notes) in exchange for previously issued 6% Senior Convertible Notes Due 2007 including placement agent costs. The July 2005 and July 2007 Notes are convertible into Common Stock at \$2.00 and \$1.00, respectively.

In August 2005, the July 2005 Notes were retired and exchanged for 7% Convertible Secured Promissory Notes Due August 2007. Additionally, the July 2007 Notes were retired in July 2007.

The Company's gross outstanding loan balance of the July 2007 Notes totaled \$0 as of March 31, 2008 and December 31, 2007. As of March 31, 2008 and December 31, 2007, un-amortized discounts for conversion feature and warrants and other asset debt issuance costs totaled \$0. Interest expense for the amortization of debt issuance cost and discount on note was \$0 and \$174 for the three months ended March 31, 2007 and 2006, respectively.

LIQUIDMETAL TECHNOLOGIES AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March 31, 2008 and 2007

(in thousands, except share data)

(unaudited)

On August 9, 2005, the Company issued \$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 previously issued July 2005 Notes, the exchange of \$2,996 in principal amount of the 10% Convertible Unsecured Notes Due June 2006 (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 convertible into shares of the Company s common stock at \$2.00 per share.

In July 2007, the August 2007 Notes were retired.

As of March 31, 2008 and December 31, 2007, our gross outstanding loan balance of the August 2007 Notes totaled \$0. As of March 31, 2008 and December 31, 2007, un-amortized discounts for beneficial conversion feature and warrants, other asset debt issuance costs, and contra liability debt issuance cost totaled \$0. Interest expense for the amortization of debt issuance cost and discount on note was \$0 and \$962 for the three months ended March 31, 2008 and 2007, 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 gain of \$0 and \$373 for the three months ended March 31, 2008 and 2007 respectively. The fair value of conversion feature outstanding at March 31, 2007 of \$12 was computed using the Black-Scholes model under the following assumptions: (1) 0.34 year; (2) volatility of 55%, (3) risk free interest of 5.04% and dividend rate of 0%.

Unsecured Subordinated Note

On May 17, 2006, September 21, 2006, and December 1, 2006, the Company issued 8% unsecured subordinated notes due August 2007 in the aggregate principal amount of \$4,584 (the August 2007 Subordinated Notes). The August 2007 Subordinated Notes are unsecured and became due August 2007.

In January 2007, \$900 of August Subordinated 2007 Notes and \$46 of accrued interest was retired as of December 31, 2007.

Further, as part of a private placement offer in January 2007, \$925 of August Subordinated 2007 Notes and \$45 of accrued interest was exchanged for 8% Convertible Subordinated Notes due January 2010 (see Secured Convertible Subordinated Notes below).

As of March 31, 2008 and December 31, 2007, the Company's gross outstanding loan balance of the August 2007 Subordinated Notes totaled \$1,009 and \$2,659, respectively. The Company intends to fully repay the amounts due under Notes. However, as of the filing of this report the Company does not have sufficient funds to repay the Notes. As a result, the Company is currently in default under the notes. The Company has not received a formal notice of default and is currently working to resolve this matter with investors holding the August 2007 Subordinated Notes.

As of March 31, 2008 and December 31, 2007, un-amortized discounts for warrants totaled \$0. Interest expense for the amortization of discount on the note was \$0 and \$218 for the three months ended March 31, 2007 and 2006, respectively. As of March 31, 2008 and 2007, the effective interest rate for the August 2007 Subordinated Notes was 8% and 37.6%, respectively.

As part of the issuance of the August 2007 Subordinated Notes in 2006, the Company issued warrants to the purchasers of the notes and placement agents giving them right to purchase up to an aggregate of 972,964 shares of the Company's common stock. The warrants had an original exercise price of \$2.58 per share, which is subject to price adjustment for anti-dilution purposes. In October 2007, the Company reduced the exercise price of warrants to \$1.75 and increased the outstanding warrants with certain holders of the August 2007 Subordinated Notes by 30% for an extension of the maturity of the August 2007 Subordinated Notes. As of March 31, 2008, the exercise price of the warrants was reduced to \$1.72 and \$2.07 per share and total amount of warrants was increased to 1,313,380. The warrants will expire on May 17, 2011.

LIQUIDMETAL TECHNOLOGIES AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March 31, 2008 and 2007

(in thousands, except share data)

(unaudited)

Secured Convertible Subordinated Notes

On January 3, 2007, the Company completed a private placement of 8% Convertible Subordinated Notes due January 2010 (the January 2010 Notes). Under the private placement, as amended, the Company issued \$16,300 in principal amount of January 2010 Notes. The January 2010 Notes were issued for aggregate cash in the amount of \$12,850, in payment of a total of \$3,377 in principal and accrued but unpaid interest under our previously issued 7% Senior Secured Convertible notes due August 2007 (August 2007 Notes) and our 8% Unsecured Subordinated notes (the August 2007 Subordinated Notes), and \$73 cash discount.

The payment of the previously issued notes was treated as an extinguishment of the debt in accordance with Emerging Issues Task Force No. 96-19, Debtors Accounting for a Modification or Exchange of Debt Instruments. The placement resulted in a \$648 loss from extinguishment of debt, which consisted of write down of \$64 of deferred issue costs, \$733 of debt discount, and decrease of \$149 in conversion feature liability as a result of the change in carrying value of exchanged notes.

The January 2010 Notes were originally convertible into the Company's common stock at \$1.55 per share. 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 5,257,921 shares of our common stock at an exercise price of \$1.93 per share. In connection with the private placement, the Company also issued to the placement agent for the transaction warrants to purchase an aggregate of 248,710 shares of our common stock at an exercise price of \$1.55 per share. The warrants will expire on January 3, 2012 and are subject to exercise price adjustment for anti-dilution purposes.

In April 2007, the Company entered into an amendment to the Securities Purchase Agreement, dated January 3, 2007, between the Company and the purchasers of the January 2010 Notes (April 2007 Amendment) providing that the Company will have until October 1, 2007 to repay approximately \$15,461 of the Company's outstanding debt under previously issued promissory notes, including the August 2007 Subordinated Notes (Debt Satisfaction Covenant). The Company has not fully repaid \$1,009 principal due under the August 2007 Subordinated Notes as of March 31, 2008. As a result, the Company is not in compliance with the Debt Satisfaction Covenant and are subject to default under the January 2010 Notes. We have not received a formal notice of default under this covenant and we are currently working to resolve this matter.

The April 2007 Amendment also finalized the schedule of investors in the Private Placement to show a total of \$16,300 in principal amount of Notes; decreased the conversion price of the Notes to \$1.10, decreased the warrant exercise price for the warrants issued to \$1.55, increased the number of shares subject to such warrants issued to equal 7,657,591, and the purchasers of the Notes consented to the Company granting a security interest in its South Korean manufacturing plant to purchasers of convertible notes in a subsequent offering, provided a pari passu security interest is granted to the purchasers of the Notes.

On December 28, 2007, the Company issued \$1,000 of January 2010 Notes, together with warrants to purchase up to an aggregate of 909,091 and 200,000 of the Company's common stock to purchasers of the notes and placement agents. The warrants will expire on December 28, 2012 and are subject to exercise price adjustment for anti-dilution purposes.

In December 2007, the Company entered into agreements with two holders of the January 2010 Notes and Grace Metal, a South Korean company formed by investor groups including our former Founder and director, James Kang, and the two holders, whereby Grace Metal would assume the liabilities due under the January 2010 Notes, including principal, interest, and fees due to the two holders totaling \$434. In connection with the assumption of the liabilities by Grace Metal, warrants to purchase 179,620 shares of our common stock held by the holders were cancelled (see Note 12).

The January 2010 Notes bear interest at 8% per annum with interest payable quarterly in arrears in cash, or, at our option, in the form of additional January 2010 Notes (in which case the interest rate will be 10% per annum). The ability to pay interest with additional January 2010 Notes is subject to specified conditions, including the existence of an effective registration statement covering the resale of the shares issued in payment of interest and certain minimum trading volumes in the stock to be issued. From and after an event of default under the January 2010 Notes and for so long as the event of default is continuing, the January 2010 Notes will bear default interest at a rate of 12% per annum (or 15% per annum if we elect to pay interest with additional January 2010 Notes). During 2007, the Company issued \$971 of additional January 2010 Notes for accrued interest and late registration fees.

LIQUIDMETAL TECHNOLOGIES AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March 31, 2008 and 2007

(in thousands, except share data)

(unaudited)

Beginning July 31, 2008 and at the end of each month thereafter, the Company will be required to redeem 1/36th of the principal amount of the January 2010 Notes in cash or, at the Company's election, with shares of our common stock. The January 2010 Notes are subordinate to certain secured financing from commercial lenders incurred by the Company in the future.

In connection with the January 2007 private placement, the Company entered into a Registration Rights Agreement with the purchasers of the January 2010 Notes under which the Company is subject to monetary penalties up to a maximum amount of 18% of the aggregate amount of Notes sold in the Private Placement if the registration statement is not filed or does not become effective on a timely basis. The monetary penalties will accrue at the rate of 1% per month of the then-outstanding principal amount of the January 2010 Notes. As of March 31, 2008, an aggregate of \$682 in monetary penalties under the Registration Rights Agreement had already been paid to investors in the form of additional notes, while an additional \$273 in such penalties was accrued but unpaid.

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 \$6,205 have been recorded as conversion feature liability as the debt is considered nonconventional convertible debt. The original fair value was computed using the Black-Scholes model under the following assumptions: (1) expected life of 1.6 to 3 years; (2) volatility of 55%; (3) risk free interest of 4.69% to 4.76% and dividend rate of 0%. The original fair value of the additional embedded conversion feature of \$1,005 resulting from reduced conversion price under the amended Securities Purchase Agreement, have been recorded as conversion feature liability. The value was computed using the Black-Scholes model under the following assumptions: (1) expected life of 1.3 to 2.7 years;