LIQUIDMETAL TECHNOLOGIES INC
Form 10-Q/A
July 20, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 3

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

For the quarterly period ended June 30, 2005

OR

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

For the transition period from to

Commission File No. 001-31332

LIQUIDMETAL TECHNOLOGIES, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**33-0264467**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

25800 Commercentre Drive, Suite 100
Lake Forest, California 92630
(address of principal executive office, zip code)

Registrant s telephone number, including area code: **(949) 206-8000**

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 ýNo o

Indicate by check mark whether the registrant is a large accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer ý
Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes oNo ý

As of July 11, 2005, there were 41,609,652 shares of the registrant s common stock, $.001 par value, outstanding.

As of July 11, 2005, there were 41,609,652 shares of the registrant s common stock, $.001 par value, outstanding.

LIQUIDMETAL TECHNOLOGIES, INC.
AMENDMENT NO. 3 TO FORM 10-Q
FOR THE QUARTER ENDED June 30, 2005

EXPLANATORY NOTE

We are filing this Amendment No. 3 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, as filed with the U.S. Securities and Exchange Commission (SEC) on August 15, 2005, as amended on August 30, 2005 and March 16, 2006, to restate our financial statements to properly account for the conversion feature of the senior convertible notes issued in March 2004 (see Note 8 to the condensed consolidated financial statements). Additionally, reclassifications to our financial statements have been made for consistent presentation of our change in value of warrant liabilities.

Other than the changes referred to above, all other information included in the above described Form 10-Q, remains unchanged. This amendment does not reflect events occurring after the filing of such Form 10-Q and does not modify or update the disclosures therein in any way other than as required to reflect the amendment as described above and set forth below.

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.

TABLE OF CONTENTS

PART I

Item 1 Financial Statements
Condensed Consolidated Balance Sheets (unaudited)
Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) (unaudited)
Condensed Consolidated Statements of Cash Flows (unaudited)
Notes to Condensed Consolidated Financial Statements (unaudited)

Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

Item 3 Quantitative and Qualitative Disclosures about Market Risk

Item 4 Controls and Procedures

PART II Other Information

Item 1 Legal Proceedings

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

Item 3 Defaults Upon Senior Securities

Item 6 Exhibits

Signatures

Certifications

PART I

FINANCIAL INFORMATION

Item 1 Financial Statements

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	(unaudited) June 30, 2005 (Restated)	December 31, 2004 (Restated)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,256	$ 742
Restricted cash		754
Trade accounts receivables, net of allowance for doubtful accounts of $69 and $108	2,359	1,668
Inventories	2,190	2,353
Prepaid expenses and other current assets	954	930
Total current assets	6,759	6,447
Property, plant and equipment, net	14,996	16,434
Idle equipment	193	1,906
Long term inventory		1,810
Other intangibles, net	1,158	1,143
Other assets	816	768
Total assets	$ 23,922	$ 28,508
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable and accrued expenses	$ 7,095	$ 4,969
Settlement payable	3,294	3,246
Deferred revenue	934	900
Short-term debt	493	
Long-term debt, current portion, net of debt discount of $3,082 and $2,831	7,102	4,010
Warrant liabilities	1,677	550
Conversion feature liabilities	4,368	6,650
Other liabilities, current portion	752	1,032
Total current liabilities	25,715	21,357
Long-term debt, net of current portion	2,044	2,618
Other long-term liabilities, net of current portion	373	342
Total liabilities	28,132	24,317
Shareholders Equity (Deficiency):		
Common stock, $0.001 par value; 100,000,000 shares authorized and 41,609,652 issued and outstanding at June 30, 2005 and December 31, 2004	42	42
Additional paid-in capital	129,650	129,650
Accumulated deficit	(136,256)	(127,472)
Accumulated other comprehensive income	2,354	1,971

Total shareholders equity (deficiency)		(4,210)		4,191
Total liabilities and shareholders equity (deficiency)	$	23,922	$	28,508

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 June 30,		For the Six Months Ended June 30,	
	2005 (Restated)	2004 (Restated)	2005 (Restated)	2004 (Restated)
Revenue	$ 3,727	$ 4,055	$ 6,570	$ 10,343
Cost of sales	3,962	2,475	6,797	6,032
Gross (loss) profit	(235)	1,580	(227)	4,311
Operating Expenses:				
Selling, general, and administrative	1,567	2,544	4,157	5,609
Research and development	213	345	610	686
Impairment of long lived assets	3,394		3,394	
Total expenses	5,174	2,889	8,161	6,295
(Loss) from operations	(5,409)	(1,309)	(8,388)	(1,984)
Change in value of warrants, gain (loss)	(100)	694	33	1,280
Change in value of conversion feature, gain	1,167	3,904	2,282	5,614
Interest expense	(1,181)	(2,255)	(2,718)	(2,651)
Interest income	1	22	7	34
(Loss) income from continuing operations	(5,522)	1,056	(8,784)	2,293
(Loss) from discontinued equipment manufacturing operations, net of tax		(356)		(749)
Net (loss) income	(5,522)	700	(8,784)	1,544
Other comprehensive (loss) income				
Foreign exchange translation gain	62	43	383	422
Comprehensive (loss) income	$ (5,460)	$ 743	$ (8,401)	$ 1,966
Net (loss) income per share basic and diluted:				
(Loss) income per share continuing operations	$ (0.13)	$ 0.03	$ (0.21)	$ 0.06
(Loss) per share discontinued operations	$	$ (0.01)	$	$ (0.02)
(Loss) income per share basic and diluted	$ (0.13)	$ 0.02	$ (0.21)	$ 0.04
Number of weighted average shares basic and diluted	41,610	41,610	41,610	41,610

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

6

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, except per share data)

(unaudited)

	For the Six Months Ended June 30, 2005 (Restated)	For the Six Months Ended June 30, 2004 (Restated)
Operating activities:		
Net income (loss)	$ (8,784)	$ (1,544)
Adjustments to reconcile net loss from operations to net cash used for operating activities:		
Impairment of long lived assets	3,394	
Loss on disposal of asset	1	
Depreciation and amortization	1,694	1,823
Amortization of debt discount	1,031	2,283
Gain from change in value of warrants	(33)	(1,280)
(Loss) gain from change in value of conversion feature	(2,282)	5,614
Stock-based compensation		276
Bad debt (recovery) expense	(43)	105
Warranty expense	76	137
Changes in operating assets and liabilities:		
Accounts receivable	(648)	(521)
Inventories	320	(2,235)
Prepaid expenses and other current assets	(24)	189
Other assets	(169)	(575)
Accounts payable and accrued expenses	2,050	(201)
Deferred revenue	34	(597)
Other liabilities	(182)	(927)
Net cash used for continuing operations	(3,565)	(5,593)
Net cash provided by discontinued operations		822
Net cash used for operating activities	(3,565)	(4,771)
Investing Activities:		
Purchases of property and equipment	(63)	
Proceeds from sale of property and equipment	1	
Investment in patents and trademarks	(70)	(102)
Net cash used for investing activities	(132)	(102)
Financing Activities:		
Proceeds from borrowings	4,669	9,924
Repayment of borrowings	(1,613)	(1,841)
Proceeds from restricted cash	754	(58)
Net cash provided by financing activities	3,810	8,025
Effect of foreign exchange translation	401	77
Net increase in cash and cash equivalents	514	3,229
Cash and cash equivalents at beginning of period	742	3,127
Cash and cash equivalents at end of period	$ 1,256	$ 6,356
Supplemental cash flow information:		
Interest paid	$ 229	$ 208
Taxes paid	$	$

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

7

During the six months ended June 30, 2004, the Company sold it s 51% ownership interest in Dongyang to the 49% minority shareholder, which resulted in a loss of $46 from disposal of discontinued operations as of June 30, 2004.

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 Six Months Ended June 30, 2005 and 2004

(in thousands, except per 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. In addition, certain reclassifications have been made for consistent presentation. Operating results for the three and six months ended June 30, 2005 are not necessarily indicative of the results that may be expected for any future periods or the year ending December 31, 2005. 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 March 30, 2005.

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 equipment (see Note 7). 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.

Stock-based compensation

The Company applies 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. The Company applies Statement of Financial Accounting Standards (SFAS) No. 123 for options granted to non-employees who perform services for the Company.

Had the Company determined compensation cost based on the fair value at the grant date for stock options consistent with the method of SFAS No. 123, the Company s loss from continuing operations and basic and diluted loss per share from continuing operations would have been as follows:

	For the Three Months Ended June 30, 2005 (Restated)	For the Three Months Ended June 30, 2004 (Restated)	For the Six Months Ended June 30, 2005 (Restated)	For the Six Months Ended June 30, 2004 (Restated)
Net income (loss) from continuing operations as reported	$ (5,522)	$ 1,056	$ (8,784)	$ 2,293
Add: stock-based employee compensation expense included in reported net loss, net of related tax effects		7		276
Deduct: total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(736)	(1,100)	(1,519)	(2,809)
Proforma net loss from continuing operations:	$ (6,258)	$ (44)	$ (10,303)	$ (240)
Basic and diluted loss per share:				
As reported	$ (0.13)	$ 0.03	$ (0.21)	$ 0.06
Proforma	$ (0.15)	$ (0.00)	$ (0.25)	$ (0.01)

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 six months ended June 30, 2005 and 2004, respectively: 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 2.9% to 4.2%.

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 year-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 income (loss).

Reclassifications

Certain amounts from the prior year have been reclassified to conform to current year s presentation.

Restatements

SFAS 133 Accounting for Derivative Instruments and Hedging Activities

As a part of the accompanying consolidated financial 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 in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities , (SFAS 133) (see Note 8).

Recent Accounting Pronouncements

In March 2004, the EITF reached a consensus on recognition and measurement guidance previously discussed under EITF 03-01 The consensus clarifies the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, and other investments accounted for under the cost method. The recognition and measurement guidance for which the consensus was reached in March 2004 is to be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. In September 2004, the FASB issued a final FASB Staff Position that delays the effective date for the measurement and recognition guidance for all investments within the scope of EITF Issue No. 03-01; however, the disclosure requirements remain effective for annual periods ending after June 15, 2004. The Company does not believe that the adoption of this statement will have a material effect on the Company s results of operation and financial position.

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 the 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. The Company is currently evaluating the transition methods, valuation methodologies and other assumptions for employee stock options in light of SFAS No. 123R. Current estimates of option values using the Black-Scholes method may not be indicative of results from valuation methodologies ultimately implemented by the Company upon adoption of SFAS No. 123R. Although the Company has not yet fully quantified the impact this standard will have on its financial statements, it is likely that the adoption of SFAS No. 123R will have a material impact on the Company s financial position and results of operations. Stock-based Compensation under Note 1 included in these Condensed Consolidated Financial Statements provides the pro forma net income and earnings per share as if the Company had used a fair-value-based method similar to the methods required under SFAS 123(R) to measure the compensation expense for employee stock awards during the three and six months ended June 30, 2005 and 2004.

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 nonemployees, 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). The Company will adopt SAB 107 in connection with its adoption of SFAS 123(R).

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. The Company does not believe the adoption of SFAS No. 154 will have a material effect on its consolidated financial position, results of operations or cash flows.

11

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 the Company s present or future consolidated financial statements.

3. Liquidity

The Company has experienced losses from continuing operations during the last two fiscal years and has an accumulated deficit of $136,256 as of June 30, 2005. Cash used for continuing operations for the six months ended June 30, 2005 was $3,565 and cash flow from continuing operations may be negative throughout fiscal year 2005. As of June 30, 2005, the Company s principal source of liquidity is $1,256 of cash and trade accounts receivable of $2,359. Such conditions raise substantial doubt that the Company will be able to continue as a going concern for a reasonable period of time. These operating results occurred while the Company was developing and attempting to commercialize and manufacture products from an entirely new and unique technology. This business plan required significant spending related to start-up costs and capital expenditures. These factors have placed a significant strain on the financial resources of the Company. The ultimate success of the Company depends on its ability to continue reducing operating costs, generate higher revenue, and achieve positive cash flow from continuing operations and profitability. The consolidated financial statements do not include any adjustments that might result from the outcome of the uncertainty.

Additionally, the Company is not in compliance with certain covenant requirements of the senior convertible debt as of June 30, 2005. Although there has been no formal notice of default received from the note holders, as the note holders have the right to call for repayment of the outstanding balance of the senior convertible debt, the total outstanding debt balance of $5,709 have been included as current liabilities as of June 30, 2005 (see Note 8).

The Company completed $3,250 private placement of 10% convertible debt on June 13, 2005 and Factoring, Loan, and Security Agreement (Factoring Agreement) on April 21, 2005, which allows for borrowing up to $1,500, to meet working capital needs of the Company (see Note 8). Borrowings made under the Factoring Agreement are secured by the Company s trade receivables. Such borrowings totaled $1,222, which was offset by $729 of repayments made as June 30, 2005.

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, and the cost of successful implementation of Section 404 of the Sarbanes-Oxley Act of 2002. If the available funds and cash generated from operations are insufficient to satisfy liquidity requirements, the Company may need additional funds in the future to support working capital requirements and for other purposes, and may need to raise additional funds through public or private equity financing, bank debt financing, or from other sources. Subsequent to the close of the second quarter of 2005, the Company completed a private placement of $9,877 of 7% convertible debt in consideration for $5,000 aggregate cash received, $4,280 exchange of previously issued notes, and satisfaction of accrued interest and fees of $597 from the previously issued notes (see Note 14). Adequate funds may not be available when needed or may not be available on favorable terms. However, the Company anticipates capital expenditures in the next 12 months will be less than $0.5 million. The Company expects to continue to devote limited capital to our research and development activities, to further develop and strengthen our manufacturing capabilities, and for working capital and other general corporate purposes.

Our cash flow projections from operations and, consequently, future cash needs are subject to uncertainty. If our available funds and cash generated from operations are insufficient to satisfy our liquidity requirements, we may need to raise additional capital to fund our operations and capital expenditure requirements. We cannot be certain that additional capital, whether through selling additional debt or equity securities or obtaining a line of credit or other loan, will be available to us or, if available, will be on terms acceptable to us. If we issue additional securities to raise funds, these securities may have rights, preferences, or privileges senior to those of the rights of our common stock and our stockholders may experience additional dilution.

4. Inventories

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 December 31, 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. The write-down amounted to $1,653 is included in Impairment of long lived assets in the accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss for the three and six months ended June 30, 2005. The total amount of long term inventory was $0 and $1,810 as of June 30, 2005 and December 31, 2004, respectively.

	June 30, 2005	December 31, 2004
Raw materials	$ 1,515	$ 1,688
Work in process	412	352
Finished goods	263	313
Total current inventories	2,190	2,353
Long-term inventories		1,810
Total inventories	$ 2,190	$ 4,163

5. 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 quarter ended June 30, 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 amounted to $1,741 and is included in operating expenses as Impairment of long lived assets in the accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss for the three and six months ended June 30, 2005. Total amount of idle equipment remaining was $194 and $1,906 as of June 30, 2005 and December 31, 2004, respectively.

6. Discontinued Operations

Dongyang

On June 28, 2002, the Company acquired a 51% interest in Chusik Hoesa Dongyang Yudoro (Dongyang). In March 2004, the Company sold its 51% investment in Dongyang to the 49% minority shareholder. The selling price of the Company s 51% interest in Dongyang was $80, which was equal to the Company s net carrying value for the 51% ownership held. Further, the Company agreed to pay Dongyang $155 for the purchase of a receivable balance from Growell. The transaction resulted in net payable to Dongyang of $75 and a loss of $46 from transfer of the Company s interest in Donyang to the minority shareholder. The loss from operations for the six months ended June, 2004 totaled $50 and is included in the loss from discontinued equipment manufacturing operations for the period. The net payable balance of $75 is to be paid in quarterly installments throughout 2004, with $25 to be paid subsequent to 2004. The outstanding amount payable to Dongyang is $11 and $25 as of June 30, 2005 and December 31, 2004, respectively, and is included in accounts payable and accrued liabilities.

Summarized operating results of Dongyang s discontinued operations are as follows.

	For the Three months Ended June 30,		For the Six months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Revenue	$	$	$	$ 22
Loss from discontinued equipment manufacturing operations, net of tax				(96)

Taesung

On June 14, 2004, the Company entered into an Asset Purchase Agreement whereby all the assets and liabilities of its Taesung equipment manufacturing division in Korea were sold to a third party for $345 which is payable by the third party in four equal installments with the last installment being due on June 30, 2005. As of March 31, 2004, management determined that no impairment was anticipated on the divestiture of its Taesung division. Ultimately, the sale resulted in a loss of approximately $184. The loss from operations for the three and six months ended June 30, 2004 totaled $179 and $469 and is included in the loss from discontinued equipment manufacturing operations for the period.

Summarized operating results of Taesung s operations are as follows:

	For the Three months Ended June 30,		For the Six months Ended June 30,	
	2005	2004	2005	2004
Revenue	$	$ 72	$	$ 172
Loss from discontinued equipment manufacturing operations, net of tax		(356)		(653)

7. Product Warranty

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. During the three and six months ended June 30, 2005, the Company recorded $34 and $76, respectively, of warranty expense. During the three and six months ended June 30, 2004, the Company recorded $79 and $137, respectively, of warranty expense. The product warranty accrual balance is included in accounts payable and accrued expenses.

8. Notes Payable

Senior Convertible Note

On March 3, 2004, the Company issued $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 (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. 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 $5.5 million in aggregate principal amount of the March Notes have been exchanged for an aggregate of (i) $2.75 million of 6% Senior Secured Notes Due 2007 (the Long-Term Notes) and (ii) $2.75 million of 10% Senior Secured Notes Due 2005 (the Short-Term 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 Short-Term Notes have 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 Short-Term Notes have been exchanged and redeemed subsequent to the close of the second quarter of 2005 (see Note 14). The Long-Term 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 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 Long-Term Notes also have the right to call for repayment of the Long-Term Notes prior to maturity at any time after the second anniversary of the closing of the exchange offer. The Long-Term 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 Note 14).

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 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 $1919 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 (Long-Term Notes) and $125 was paid in the form of short-term notes which is due in 2005 with interest rate of 10% per annum (Short-Term Notes). The Short-Term and Long-Term 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 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 percent of the purchase price paid for the unconverted notes for the first 30 business days of late registration, and 1 and 3 percent for each 30 business days thereafter, but no more than 18 percent of the purchase price of the unconverted note balance. Late registration fee of $1,028 has been accrued as interest expense, and is included in accounts payable and accrued liabilities as of June 30, 2005. The $5,709 balance of the note and un-amortized discounts for conversion feature and warrants of $3,082 is presented as current liability as of June 30, 2005 as the note holders have the right to call for payment on demand as the registration statement has not been filed in accordance with the amended Registration Rights Agreement. As of the filing of this report, the Company has not received any demands for payment from the note holders.

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. As such, the Company accrued $171 of additional interest from the default rates applied to the loan balance as of June 30, 2005, which is included in accounts payable and accrued liabilities.

As of June 30, 2005 and December 31, 2004, our gross outstanding loan balance of the Short-Term and Long-Term Notes totaled $5,709, un-amortized discounts for beneficial conversion feature and warrants totaled $3,082 and $2,831, and other asset debt issuance costs totaled $75 and $183, respectively. Interest expense for the amortization of debt issuance cost and discount on note was $483 and $960 for the three and six months ended June 30, 2005, and $1,360 and $1,549 for the three and six months ended June 30, 2004, respectively. As of June 30, 2005, the effective interest rates for the Short-Term and Long-Term Notes were 40% and 37%, respectively.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock , the original relative fair values of the warrants of $1,302 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 gain of $154 and $287 for the three and six months ended June 30, 2005, and a gain of $694 and $1,280 for the three and six months ended June 30, 2004. The fair value of warrants outstanding at June 30, 2005 of $263 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 0.67 years; (2) volatility of 117%, (3) risk free interest of 3.45%and dividend rate of 0%.

Convertible Notes

On June 13, 2005, the Company completed a private placement (the Private Placement) of 10% Convertible Unsecured Notes Due June 13, 2006 in the aggregate principal amount of $3,250 (the Notes), together with warrants to purchase up to an aggregate of 893,750 shares of the Company s common stock (the Warrants).

The Notes issued by the Company in the Private Placement are unsecured and will become 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 Notes will be interest-only, with interest payments due quarterly, at the rate of 10% per year. The Notes can be prepaid by the Company at any time without penalty. If, within 120 days following the issue date of the 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 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 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 Long Term Notes due July 2007 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 2007 Notes held by them or (ii) exchange their 2007 Notes for new securities in the financing transaction. Subsequent to the close of the second

quarter of 2005, the Company successfully completed Qualified Financing, which resulted in exchange and redemption of the Convertible Notes (see Note 14). As a result, the Notes never become convertible.

The holders of the Notes will have the right to call for early repayment of the Notes if, on the date that is 180 days of the issue date of the Notes (i) the Company is not then compliant with its SEC reporting obligations, or (ii) the Company s common stock is not then listed or quoted on the OTC Bulletin Board, Nasdaq Stock Market, New York Stock Exchange, or American Stock Exchange.

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 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 previously issued 10% Senior Secured Notes Due July 29, 2005), 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.

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. As of June 30, 2005, the gross outstanding loan balance of the Notes totaled $3,250, un-amortized discounts for warrants totaled $1,003, and other asset debt issuance costs totaled $264, and contra liability debt issuance cost totaled $100. Interest expense for the amortization of debt issuance cost and discount on note was $71 for the three months ended June 30, 2005. As of June 30, 2005, the effective interest rates for Notes was 54%.

Under a registration rights agreement entered into between the Company and the purchasers of the Notes, the Company is required, within 90 days of the date of the issuance of the Notes, to file a registration statement with the SEC covering the resale of the shares of Company common stock into which the Notes are convertible and for which the Warrants are exercisable. The Company is required to cause this registration statement to become effective within 60 days after the Company receives the first written comments on the registration statement from the SEC, or if the SEC notifies the Company 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. As the Company was unable to complete the documentation, assessment and evaluation of internal control over financial reporting, which are required to be undertaken to comply with Section 404 of the Sarbanes-Oxley Act of 2002 (SOX 404) as of December 31, 2004, the Company cannot determine the impact of the non-compliance as of December 31, 2004 on the registration statement and cannot ensure that the registration statements will be completed in a timely manner. The Company has taken steps to ensure compliance with SOX 404 requirements as of December 31, 2005. There can be no assurance, however, that the Company will be in compliance with Section 404 as of December 31, 2005 and 2004 and/or that the Company will have the Registration statement declared effective by the SEC prior to such compliance.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock , the original relative 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

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the warrants resulted in a net loss of $254 for the three months ended June 30, 2005. The fair value of warrants outstanding at June 30, 2005 of $1,414 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 4.96 years; (2) volatility of 117%, (3) risk free interest of 3.72%and dividend rate of 0%.

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. Advances are made on 80% of Approved receivables assigned and 30% of 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 0.65 percent to 2 percent 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 FAS 140 Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities. As of June 30, 2005, the Company has borrowed $1,222 and repaid $729. The total outstanding advance made under the agreement is $493 as of June 30, 2005, which is presented as short-term debt.

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. 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. Principal payments made to Kookmin Bank totaled $621 for the six months ended June 2005, which includes $65 of foreign exchange translation loss. The outstanding loan balance totaled $3,270, of which $1,226 is included in current portion of long-term debt, as of June 30, 2005.

9. Stock Compensation Plan

During the three and six months ended June 30, 2005, under the Company s 2002 Equity Incentive Plan which provides for the grant of stock options to officers, employees, consultants and directors, the Company granted options to purchase 7,500 and 891,165 common shares of the Company for an average exercise price of $1.63 and $2.21, respectively, which equaled the fair market value on the date of grant

During the three months ended June 30, 2005, under the Company s 2002 Non-employee Director Stock Option Plan which provides for the grant of stock options to non-employee directors, the Company did not grant any options. During the six months ended June 30, 2005, the

Company granted 180,000 common shares of the Company for an average exercise price of $2.33 under this plan. Further, all options granted under this plan had exercise prices that were equal to the fair market value on the date of grant.

The Company canceled 84,582 and 244,184 options during the three and six months ended June 30, 2005, respectively, for terminated employees and directors.

10. Segment Reporting and Geographic Information

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information,* requires companies to provide certain information about their operating segments. In April 2002, the Company began classifying operations into two reportable segments: Liquidmetal alloy industrial coatings and bulk Liquidmetal alloys. The 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 market opportunities to manufacture and sell casing components for electronic devices, medical devices, sporting goods, tooling, prototype sampling, defense applications and metal processing equipment. Primarily, the expenses incurred by the bulk Liquidmetal alloy segment are research and development costs and selling expenses associated with identifying and developing market opportunities. Bulk Liquidmetal alloys products can be distinguished from Liquidmetal alloy coatings in that the bulk Liquidmetal alloy can have significant thickness, up to approximately one inch, which allows for their use in a wider variety of applications other than a thin protective coating applied to machinery and equipment. Revenue and expenses associated with research and development services and product licensing arrangements are included in the bulk Liquidmetal alloy segment. The accounting policies of the reportable segments are the same as those described in Note 3 to the consolidated financial statements included in the Company s Form 10-K filed with the Securities and Exchange Commission on March 30, 2005.

Summarized financial information concerning the Company s reportable segments is shown in the following tables:

	Coatings	Bulk Alloy	Segment Totals
Three months ended June 30, 2005:			
Revenue to external customers	$ 1,332	$ 2,395	$ 3,727