

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. 2**



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

**For the quarterly period ended March 31, 2005**

**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**

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## **LIQUIDMETAL TECHNOLOGIES, INC.**

(Exact name of Registrant as specified in its charter)

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

**33-0264467**  
(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**

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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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes  No

As of May 10, 2005, there were 41,609,652 shares of the registrant's common stock, \$.001 par value, outstanding.





**LIQUIDMETAL TECHNOLOGIES, INC.  
AMENDMENT NO. 2 TO FORM 10-Q  
FOR THE QUARTER ENDED MARCH 31, 2005**

**EXPLANATORY NOTE**

We are filing this Amendment No. 2 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2005, as filed with the U.S. Securities and Exchange Commission (SEC) on May 16, 2005, and as amended on 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 6 to the condensed consolidated financial statements). Additionally, reclassifications to our financial statements have been made for consistent presentation of our warrant liabilities and 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.

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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)

	(Unaudited) March 31, 2005 (Restated)	December 31, 2004 (Restated)
<b>ASSETS</b>		
Current Assets:		
Cash	\$ 341	\$ 742
Restricted cash		754
Trade accounts receivables, net of allowance for doubtful accounts of \$97 and \$108	1,785	1,668
Inventories	2,273	2,353
Prepaid expenses and other current assets	434	930
Total current assets	4,833	6,447
Property, plant and equipment, net	15,941	16,434
Idle equipment	1,948	1,906
Long term inventory	1,692	1,810
Other intangibles, net	1,161	1,143
Other assets	700	768
Total assets	\$ 26,275	\$ 28,508
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 6,557	\$ 4,969
Settlement payable	3,317	3,246
Deferred revenue	880	900
Long-term debt, current portion, net of debt discounts of \$2,407 and \$2,831	4,692	4,010
Warrant liabilities	417	550
Conversion feature liabilities	5,535	6,650
Other liabilities, current portion	932	1,032
Total current liabilities	22,330	21,357
Long-term debt, net of current portion	2,367	2,618
Other long-term liabilities, net of current portion	328	342
Total liabilities	25,025	24,317
Shareholders' Equity:		
Common stock, \$0.001 par value; 100,000,000 shares authorized and 41,609,652 issued and outstanding at March 31, 2005 and December 31, 2004	42	42
Additional paid-in capital	129,650	129,650
Accumulated deficit	(130,734)	(127,472)
Accumulated other comprehensive income	2,292	1,971
Total shareholders' equity	1,250	4,191
Total liabilities and shareholders' equity	\$ 26,275	\$ 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)**

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(in thousands, except per share data)

(unaudited)

	For the Three Months Ended March 31,	
	2005 (Restated)	2004 (Restated)
Revenue	\$ 2,843	\$ 6,288
Cost of sales	2,835	3,557
Gross profit	8	2,731
Operating expenses:		
Selling, general, and administrative	2,590	3,065
Research and development	397	341
Total operating expenses	2,987	3,406
Loss from operations	(2,979)	(675)
Change in value of warrants, gain	133	586
Change in value of conversion feature, gain	1,115	1,710
Interest expense	(1,537)	(396)
Interest income	6	12
(Loss) income from continuing operations	(3,262)	1,237
Loss from discontinued equipment manufacturing operations, net of tax of \$0		(393)
Net (Loss) income	(3,262)	844
Other comprehensive income (loss):		
Foreign exchange translation gain	321	379
Comprehensive (loss) income	\$ (2,941)	\$ 1,223
Net income (loss) per share basic and diluted:		
Income (loss) per share continuing operations	\$ (0.08)	\$ 0.03
(Loss) per share discontinued operations	\$	\$ (0.01)
(Loss) income per share basic and diluted	\$ (0.08)	\$ 0.02
Number of weighted average shares basic and diluted	41,610	41,610

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

**LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

**For the Three Months Ended March 31, 2005**

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(in thousands, except per share data)

	Common Shares	Common Stock	Additional Paid in Capital (Restated)	Accumulated Deficit (Restated)	Accumulated Other Comprehensive Income	Total
<b>Balance, December 31, 2004 (As Restated)</b>	41,609,652	\$ 42	\$ 129,650	\$ (127,472)	1,971	\$ 4,191
Foreign exchange translation gain					321	321
Net loss				(3,262)		(3,262)
<b>Balance, March 31, 2005 (Unaudited) (As Restated)</b>	41,609,652	\$ 42	\$ 129,650	\$ (130,734)	2,292	\$ 1,250

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



**LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

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(in thousands, except per share data)

(unaudited)

	For the Three Months Ended March 31,	
	2005 (Restated)	2004 (Restated)
<b>Operating activities:</b>		
Net (loss) income	\$ (3,262)	\$ 844
Adjustments to reconcile loss from operations to net cash provided by (used for) operating activities:		
Gain on disposal of asset	(1)	
Depreciation and amortization	843	894
Amortization of debt discount	477	259
Gain from change in value of warrants	(133)	(586)
Gain from change in value of conversion feature,	(1,115)	(1,710)
Stock-based compensation		269
Bad debt (recovery) expense	(20)	72
Warranty expense	42	57
Changes in operating assets and liabilities:		
Accounts receivable	(97)	726
Inventories	198	(1,922)
Prepaid expenses and other current assets	496	(59)
Other assets	16	(579)
Accounts payable and accrued expenses	1,546	623
Deferred revenue	(20)	(598)
Other liabilities	(81)	(578)
Net cash used for continuing operations	(1,111)	(2,288)
Net cash provided by discontinued operations		266
Net cash used for operating activities	(1,111)	(2,022)
<b>Investing Activities:</b>		
Investment in patents and trademarks	(45)	(20)
Net cash used for investing activities	(45)	(20)
<b>Financing Activities:</b>		
Proceeds from borrowings	158	9,924
Repayment of borrowings	(341)	(369)
Proceeds from restricted cash	754	
Net cash provided by financing activities	571	9,555
Effect of foreign exchange translation	184	109
Net (decrease) increase in cash and cash equivalents	(401)	7,622
Cash and cash equivalents at beginning of period	742	3,127
Cash and cash equivalents at end of period	\$ 341	\$ 10,749
Supplemental cash flow information:		
Interest paid	\$ 88	\$ 86
Taxes paid	\$	\$

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



During the three months ended March 31, 2004, the Company sold its 51% ownership interest in Dongyang to the 49% minority shareholder, which resulted in a loss of \$46 from disposal of discontinued operations as of March 31, 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 Three Months Ended March 31, 2005 and 2004**

**(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. In addition, certain reclassifications have been made for consistent presentation. Operating results for the three months ended March 31, 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 5). 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:

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		For the Three Months Ended March 31,	
		2005 (Restated)	2004 (Restated)
Net income (loss) from continuing operations as reported		\$ (3,262)	\$ 1,237
<i>Add:</i>	stock-based employee compensation expense included in reported net income, net of related tax effects		270
<i>Deduct:</i>	total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(783)	(1,709)
Proforma net loss		\$ (4,045)	\$ (202)
Basic and diluted loss per share:			
As reported		\$ (0.08)	\$ (0.03)
Pro forma		(0.10)	(0.00)

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants for the three months ended March 31, 2005 and 2004, respectively: expected volatility of 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).

### 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 6).

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 123(R), Share Based Payment, which the Company will adopt in the third quarter of 2005. SFAS 123(R) will result in the recognition of compensation expense relating to our employee stock option and employee stock purchase plans. Under the new rules, the Company is required to adopt a fair-value-based method for measuring the compensation expense related to employee stock awards. This may lead to substantial additional compensation expense. 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 months ended March 31, 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), and does not believe the impact will be significant to the Company's overall results of operations or financial position.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA and the SEC did not or is 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 \$130,734 as of March 31, 2005. Cash used for continuing operations for the quarter ended March 31, 2005 was \$1,111 and cash flow from continuing operations may be negative throughout fiscal year 2005. As of March 31, 2005, the Company's principal source of liquidity is \$341 of cash and trade accounts receivable of \$1,785. 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 March 31, 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

March 31, 2005 (see Note 6).

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, and the resources devoted to develop and support Liquidmetal alloy products. 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. 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. 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 Dongyang to the minority shareholder. The loss from operations for the three months ended March 31, 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 March 31, 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.

	<b>For the Three months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
Revenue	\$	\$ 22
Loss from discontinued equipment manufacturing operations, net of tax		(96)

##### *Taesung*

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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 months ended March 31, 2004 totaled \$297 and is included in the loss from discontinued equipment manufacturing operations for the period.

Summarized operating results of Taesung's operations are as follows:

	<b>For the Three months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
Revenue	\$	\$ 100
Loss from discontinued equipment manufacturing operations, net of tax		(297)

**5. 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 months ended March 31, 2005 and 2004, the Company recorded \$42 and \$57, respectively, of warranty expense. The product warranty accrual balance is included in accounts payable and accrued expenses.

**6. 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 as a contra liability account in other assets.

From June through August 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 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.

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 \$1,919 in conversion feature liability as a result of the change in carrying value of exchanged notes.

In connection with the private exchange offer, the Company issued \$250 of private placement notes to certain Placement Agents as issuance costs. Of the \$250 notes issued, \$125 was paid in the form of long-term notes which is due in 2007 with interest rate of 6% per annum (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 of \$250 notes issued to Placement Agents was recorded as conversion feature liabilities during August 2004.

As of March 31, 2005 and December 31, 2004, our gross outstanding loan balance totaled \$5,709, un-amortized discounts for conversion feature and warrants totaled \$2,407 and \$2,831, and other asset debt issuance costs totaled \$131 and \$183, respectively. Interest expense for the amortization of debt issuance cost and discount on note was \$477 and \$258 for the quarters ended March 31, 2005 and 2004, respectively. As of March 31, 2005, the effective interest rates for the Short-Term and the Long-Term Notes were 40% and 37%, respectively.

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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 \$856 has been accrued as interest expense, and is included in accounts payable and accrued liabilities as of March 31, 2005. The \$5,709 balance of the note and un-amortized discounts for beneficial conversion feature and warrants of \$2,407 is presented as current liability as of March 31, 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.

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 \$133 and \$586 for the quarters ended March 31, 2005 and 2004, respectively. The fair value of warrants outstanding at March 31, 2005 of \$417 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 0.92 years; (2) volatility of 128%, (3) risk free interest of 3.35% and dividend rate of 0%.

#### 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. For the quarter ended March 31, 2005, principal payments made to Kookmin Bank totaled \$225, which includes \$83 of foreign exchange translation loss. The outstanding loan balance totaled \$3,600 as of March 31, 2005.

## **7. Stock Compensation Plan**

During the quarter ended March 31, 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 883,665 common shares of the Company for an exercise price of \$2.18 which equaled the fair market value on the date of grant

During the quarter ended March 31, 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 granted options to purchase 180,000 common shares of the Company for an average exercise price of \$2.33. 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 159,602 options during the quarter ended March 31, 2005 for terminated employees and directors.

**8. 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
<b>Three months ended March 31, 2005:</b>			
Revenue to external customers	\$ 1,049	\$ 1,794	\$ 2,843
Gross profit	568	(576)	8
Income (loss) before interest expense and discontinued operations	327	(1,149)	(822)
Total identifiable assets at end of period	701	22,054	22,755
<b>Three months ended March 31, 2004:</b>			
Revenue to external customers	\$ 1,016	\$ 5,272	\$ 6,288
Gross profit	467	2,264	2,731
Income before interest expense and discontinued operations	349	1,480	1,829
Total identifiable assets at end of period	985	23,698	24,683

Reconciling information between reportable segments and the Company's consolidated totals is shown in the following table:

	For the Three Months Ended March 31,	
	2005 (Restated)	2004 (Restated)
Total operating income (loss) before interest expense and discontinued operations	\$ (822)	\$ 1,829
General and administrative expenses	(2,157)	(2,504)
Consolidated loss before interest expense and discontinued operations	(2,979)	(675)
Change in value of warrant, gain	133	586
Change in value of conversion feature, gain	1,115	1,710
Interest expense	(1,537)	(396)
Interest income	6	12
Income (loss) from discontinued operations, net		(347)
Loss from disposal of discontinued operations, net		(46)
Consolidated net income (loss)	\$ (3,262)	\$ 844

Excluded general and administrative expenses are attributable to the Company's corporate headquarters. These expenses primarily include corporate salaries, consulting, professional fees and facility costs. Research and development expenses are included in the operating costs of the

segment that performed the research and development.

Revenues from sales to companies in the United States were \$1,401 and \$1,725 during the three months ended March 31, 2005 and 2004, respectively. The revenue related to the United States of America was earned under three defense-related research and development contracts and sales of coatings products.

As of March 31, 2005, two customers represented 36%, or \$636, of the total outstanding trade accounts receivable. As of December 31, 2004, two customers represented 30%, or \$497, of the total outstanding trade accounts receivable. Three customers represent 80%, or \$2,266, of total sales as of March 31, 2005. Three customers represented 84%, or \$5,261, of total sales as of March 31, 2004.

During the three months ended March 31, 2005, the Company had revenues from companies outside of the United States of \$1,442 of which \$934 represented sales to companies located in South Korea. During the three months ended March 31, 2004, the Company had revenue from sales to companies outside of the United States of \$4,685 of which \$4,158 represented sales to companies located in South Korea. Of the \$4,158 sales in South Korea, \$122 was from our discontinued equipment manufacturing business. The revenue related to sales to companies outside of the United States was from bulk alloy products including equipment sales.

Long-lived assets include net property, plant, and equipment, and net intangible assets. The Company had long-lived assets of \$2,006 and \$1,594 located in the United States at March 31, 2005 and December 31, 2004, respectively. The Company had long-lived assets of \$15,050 and \$15,422 located in South Korea at March 31, 2005 and December 31, 2004, respectively.

Reconciling information between reportable segments and the Company's consolidated totals is shown in the following table:

	<b>March 31,</b>
	<b>2005</b>
Total segment assets	\$ 22,755
Cash and cash equivalents	341
Prepaid expenses and other current assets	434
Other property, plant and equipment	884
Intangibles, net	1,161
Other assets	700
Total consolidated assets	\$ 26,275

Assets excluded from segment assets include assets attributable to the Company's corporate headquarters. The largest asset represents the Company's intangible assets, consisting primarily of the Company's patents and trademarks.

## 9. Income (Loss) Per Common Share

Basic earnings per share (EPS) is computed by dividing earnings (loss) attributable to common shareholders by the weighted average number of common shares outstanding for the periods. Diluted EPS reflects the potential dilution of securities that could share in the earnings. Common stock equivalents consist of 9,011,540 and 8,706,413 equity instruments and 4,281,751 and 3,308,001 senior equity convertible debt instruments at March 31, 2005 and 2004, respectively, and have not been included in the EPS calculation at March 31, 2005 and 2004 as the amounts are anti-dilutive.

**10. Commitments and Contingencies**

In September 2004, as part of a security agreement to finance a certain insurance policy, the Company used certificates of deposits with maturities of less than one year as collateral. The \$754 held in certificates of deposits is presented as restricted cash at December 31, 2004. During the quarter ended March 31, 2005, the certificate of deposits was liquidated and the proceeds were used to paydown balance of the financing on the insurance policy.

In August 2004, the Company entered into a consulting agreement whereby the Company was to receive services from a third party to improve the Company's bulk alloy manufacturing process. The service is to be provided from August 2004 through

October 2005. The total amount of service fees is \$172, of which \$59 was included in trade accounts payable as of March 31, 2005. As of December 31, 2004, the total amount of outstanding balance included in trade accounts payable was \$15.

The Company is from time to time a party to certain legal proceedings arising in the ordinary course of business. Although outcomes cannot be predicted with certainty, the Company does not believe that any legal proceeding to which it is a party will have a material adverse effect on the Company's financial position, results of operations, and cash flows.

Liquidmetal Technologies and certain of its present and former officers and directors were named as defendants in nine purported class action complaints filed in the United States District Courts for the Middle District of Florida, Tampa Division, and the Central District of California, Southern Division, alleging violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. In August 2004, four complaints were consolidated in the United States District Court for the Middle District of Florida under the caption *Primavera Investors v. Liquidmetal Technologies, Inc., et al.*, Case No. 8:04-CV-919-T-23EAJ. John Lee, Chris Cowley, Dwight Mamanteo, Scott Purcell and Mark Rabold, were appointed co-lead plaintiffs (the Lead Plaintiffs). In September 2004, the other five complaints filed in the Central District of California were transferred to the Middle District of Florida for consolidation with the *Primavera Investors* action. The Lead Plaintiffs served their Consolidated Amended Class Action Complaint on January 12, 2005. The Amended Complaint alleges that the Prospectus issued in connection with the Company's initial public offering in May 2002 contained material misrepresentations and omissions regarding the Company's historical financial condition and regarding a personal stock transaction by the Company's chief executive officer. The Lead Plaintiffs further generally allege that during the proposed Class Period of May 21, 2002, through May 13, 2004, the defendants engaged in improper revenue recognition with respect to certain of the Company's business transactions, failed to maintain adequate internal controls, and knowingly disclosed unrealistic but favorable information about market demand for and commercial viability of the Company's products to artificially inflate the value of the Company's stock. The Amended Complaint seeks unspecified compensatory damages and other relief. We filed a Motion to Dismiss on March 28, 2005. Plaintiffs' response to our Motion to Dismiss is presently due on June 3, 2005. The Company intends to vigorously defend against the class action. The Company cannot currently predict the impact or resolution of this litigation or reasonably estimate a range of possible loss, which could be material.

In addition to the above, certain present and former officers and directors of Liquidmetal Technologies, as well as Liquidmetal Technologies as a nominal defendant, have been named in three shareholder derivative actions. Two shareholder derivative complaints were filed in California state court styled Brian Clair, Derivatively on Behalf of Liquidmetal Technologies, Inc. v. John Kang, et al., Case No. 04CC00551, and Joseph Durgin, Derivatively on Behalf of Liquidmetal Technologies, Inc. v. John Kang, et al., Case No. 04CC00553, both commenced in the Superior Court of Orange County, California. A third shareholder derivative complaint was filed in Florida federal court styled Robert Story v. John Kang, et al., Case No. 8:04-CV-1587-T23TBM, commenced in the Middle District of Florida, Tampa Division. These shareholder derivative lawsuits allege that the defendants breached various fiduciary duties and otherwise violated state law based primarily upon the same underlying facts and circumstances as alleged in the federal shareholder class action. The plaintiffs seek unspecified compensatory damages, restitution and disgorgement of profits, equitable and/or injunctive relief as permitted by law and other relief. The two shareholder derivative complaints in California state court have been consolidated. Plaintiffs served a Consolidated Shareholder Derivative Complaint on October 12, 2004. The defendants served a Demurrer to the Consolidated Shareholder Derivative Complaint on November 22, 2004, seeking dismissal of that complaint. At a hearing on February 10, 2005, the court sustained the demurrer, dismissing the Consolidated Shareholder Derivative Complaint but giving the plaintiffs 45 days within which to amend the complaint. Plaintiffs filed their Consolidated Amended Shareholder Derivative Complaint on March 28, 2005. The Company, along with other defendants, will file a Demurrer on May 16, 2005, again seeking dismissal of the amended complaint. In the Florida derivative action, the Plaintiff filed a First Amended Shareholder Derivative Complaint on November 22, 2004. The Company's Motion to Dismiss, which was filed on December 20, 2004, is fully briefed. The Company cannot anticipate when the Court will rule on the Motion to Dismiss. The Company intends to vigorously defend against the derivative actions. We cannot currently predict the impact or resolution of this litigation or reasonably estimate a range of possible loss, which could be material.

In March 1996, the Company entered into a distribution agreement whereby it granted to a third party exclusive rights to market and sell golf products incorporating Liquidmetal Technology to certain Japanese sporting equipment companies. The





third party paid the Company a \$1.0 million distribution fee as part of this agreement, of which a portion was refundable according to a formula based on the gross profit earned by the third party. On March 28, 2003, the distribution agreement was terminated and the Company entered into a new agreement to pay to the same third party a commission on the net sales price of all Liquidmetal golf equipment that is shipped by the Company or its affiliates to Japanese golf companies for sale into the Japanese end-market. This commission will apply to golf equipment shipped by the Company or its affiliates during the period beginning on March 28, 2003 and ending on March 28, 2006. If, by March 28, 2006, the Company has not paid \$350 in commission payments, the balance between commission paid and \$350 will be paid by April 30, 2006, thereby guaranteeing the third party a \$350 minimum payment during the term of the agreement. The Company will recognize the unearned distribution fee of \$830 as revenue proportionately with the payment of commissions under the new agreement. As of March 31, 2005 and December 31, 2004, the unearned distribution fee remained unchanged at \$830.

Under terms of the January 2004 settlement of the dispute over certain sales transactions from 2003 and 2002 between Liquidmetal Korea and Growell Metal Co., Ltd., a South Korean metals processing company ( Growell ), Liquidmetal Korea agreed to pay Growell \$4,895 to purchase Growell's investment in alloy inventories, proprietary alloying equipment purchased from Liquidmetal Korea, and supporting equipment purchased from other suppliers. Also as part of the settlement, Growell satisfied in full a balance of \$2,058 owed to Liquidmetal Korea for the die casting machines Growell purchased from Liquidmetal Korea in the first quarter of 2003 as part of a license agreement to manufacture Liquidmetal alloy parts for the South Korean automotive industry. The remaining settlement payable of \$2,837 and trade accounts payable of \$14 were to be paid to Growell (in cash or stock at the Company's discretion) by December 31, 2004. As of December 31, 2004, the settlement payable of \$3,246, net of foreign exchange translation loss, was not paid to Growell due to Growell's breach of warranty on equipment repurchased by Liquidmetal Korea. In January 2005, Growell was acquired by a third party. As of March 31, 2005, the outstanding settlement payable to the third party of \$3,317, net of foreign exchange translation loss, was not paid, and the Company is currently in negotiations to settle this balance with the third party.

## 11. Related Party Transactions

In June 2003, the Company entered into an exclusive, ten-year license agreement with LLPG, Inc. ( LLPG ), a corporation headed by a former director of the Company. Under the terms of the agreement, LLPG has the right to commercialize Liquidmetal alloys, particularly precious-metal based compositions, in jewelry and high-end luxury product markets. The Company, in turn, will receive royalty payments over the life of the contract on all Liquidmetal products produced and sold by LLPG. In conjunction with its technology licensing contract, LLPG purchased two proprietary Liquidmetal alloy melting machines and three proprietary Liquidmetal alloy casting machines for a total purchase price of \$2,000. At December 31, 2003, the Company had a remaining receivable balance of \$500 due from LLPG, which was subsequently paid in full in March, 2004.

We are a party to a consulting agreement with Chitnis Consulting, Inc., which is owned 100% by Shekhar Chitnis, a former director and executive officer of our company. Under this agreement, we have engaged Chitnis Consulting to provide consulting services on an as-needed basis through December 31, 2005. During each quarter ended March 31, 2005 and 2004, we incurred \$13 in consulting fees from Chitnis Consulting.

We are a party to a consulting agreement with William Johnson, a board member. Under this agreement, Mr. Johnson provides consulting services on an as-needed basis through 2004 as it relates to marketing and development Liquidmetal alloy. During each quarter ended March 31, 2005 and 2004, we incurred \$15 and \$15 in consulting fees from Mr. Johnson, respectively.

In November 2004, we entered into an agreement with John Kang, our Chairman, President, and Chief Executive Officer, in which Mr. Kang agreed that certain stock transactions by him in 2002 involving our common stock should have resulted in a liability under Section 16(b) of the Securities Exchange Act of 1934, as amended ( Section 16(b) ). These transactions include Mr. Kang's private sale of 285,715 shares of his

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personal Liquidmetal Technologies common stock to Growell Metal Co., Ltd. in February 2002, prior to our initial public offering. They also include Mr. Kang's subsequent indirect purchase and disposition of Liquidmetal Technologies common stock in order to satisfy a personal agreement Mr. Kang made to

Growell Metal in February 2002 regarding the guaranteed minimum value of the stock purchased by Growell Metal in February 2002 (the purchases and dispositions incident to this agreement occurred in August and November 2002, respectively). Lastly, the transactions include open-market purchases of an aggregate of 89,300 shares of our common stock made by Mr. Kang in August 2002.

The Audit Committee of our Board of Directors conducted an independent inquiry into the above-described transactions with the aid of independent legal counsel and, as a result of such inquiry, the Audit Committee concluded that the transactions should have resulted in a liability to the Company under Section 16(b) in the amount of \$302. Mr. Kang has acknowledged this liability, and in an agreement negotiated between Mr. Kang and the Audit Committee and approved by the full Board, Mr. Kang will pay this liability through periodic installments in 2005 and 2006. As a result, the Company accrued for the \$302 receivable in other assets and other income as of December 31, 2004. The above-described transactions involving Growell Metal was reported on a new Form 4 filed by Mr. Kang on November 15, 2004, and the open-market purchases were previously reported on a timely basis in August 2002. As of March 31, 2005, the outstanding amount of the receivable remained unchanged at \$302. Mr. Kang has paid approximately \$50 in April 2005 and will make monthly installments of approximately \$12 to pay down the outstanding balance.

In March 2005, the Company entered into a note agreement with CK Cho, a member of our Board of Directors, for \$195 at an annual rate of interest of 6%. As of March 31, 2005, the Company received \$158, which is included in current portion of long term notes. The remaining \$37 was received in April 2005. The amounts borrowed under the note agreement are due June 25, 2005. Mr. Cho also is a Chief Executive Officer of Winvest Venture Partners Inc., who holds \$500 of Senior Convertible Notes as of March 31, 2005 (see Note 6).

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

*This management's discussion and analysis should be read in conjunction with the condensed consolidated financial statements and notes included elsewhere in this report on Form 10-Q.*

*This management's discussion and analysis, as well as other sections of this report on Form 10-Q, may contain forward-looking statements that involve risks and uncertainties, including statements regarding our plans, future events, objectives, expectations, forecasts, or assumptions. Any statement that is not a statement of historical fact is a forward-looking statement, and in some cases, words such as believe, estimate, project, expect, intend, may, anticipate, plans, seeks, and similar expressions identify forward-looking statements. These statements involve risks and uncertainties that could cause actual outcomes and results to differ materially from the anticipated outcomes or results, and undue reliance should not be placed on these statements. These risks and uncertainties include, but are not limited to, the matters discussed under the caption Factors Affecting Future Results in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004 and other risks and uncertainties discussed in filings made with the Securities and Exchange Commission (including risks described in subsequent reports on Form 10-Q, Form 10-K, Form 8-K, and other filings). Liquidmetal Technologies disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.*

## Overview

We are a materials technology company that develops and commercializes products made from amorphous alloys. Our Liquidmetal® family of alloys consists of a variety of coatings, powders, bulk alloys, and composites that utilize the advantages offered by amorphous alloy technology. We develop, manufacture, and sell products and components from bulk amorphous alloys that are incorporated into the finished goods of our customers, and we also market and sell amorphous alloy industrial coatings. We also partner with third-party licensees and distributors to develop and commercialize Liquidmetal alloy products. We have the exclusive right to develop, manufacture, and sell what we believe are the only commercially viable bulk amorphous alloys.

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

Our revenues are derived from two principal operating segments: Liquidmetal alloy industrial coatings and bulk Liquidmetal alloy products. Liquidmetal alloy industrial coatings are used primarily as a protective coating for industrial machinery and equipment, such as drill pipe used by the oil drilling industry and boiler tubes used in coal-burning power plants. The historical operating information for fiscal year 2001 is based substantially on sales of Liquidmetal alloy coatings. In the second half of 2002, we began producing bulk Liquidmetal alloy components and products for incorporation into our customers' finished goods. Bulk Liquidmetal alloy segment revenue includes sales of parts or components of electronic devices, medical products, and sports and leisure goods; tooling and prototype parts (including demonstration parts and test samples) for customers with products in development, product licensing and arrangements, and research and development revenue relating primarily to defense and medical applications. We expect that these sources of revenue will continue to significantly change the character of our revenue mix.

The cost of sales for our Liquidmetal coatings segment consists primarily of the costs of outsourcing our manufacturing to third parties. Consistent with our expectations, our cost of sales has been increasing over historical results as we further build our bulk Liquidmetal alloy

business. Although we plan to continue outsourcing the manufacturing of our coatings, we will internally manufacture many products derived from our bulk Liquidmetal alloys.

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

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

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

The following discussion and analysis of our financial condition and results of operations focuses on the historical results of our continuing operations.

#### **Critical Accounting Policies and Estimates**





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The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions.

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

Exchange rate fluctuations

Warranty accrual

Allowance for doubtful accounts

Inventories at lower of cost or net realizable value

Deferred tax assets

Valuation of derivatives of warrants and embedded conversion features

Our 10-K Report as of December 31, 2004 contains further discussions on our critical accounting policies and estimates.

### **Results of Operations**

Comparison of the three months ended March 31, 2005 and 2004

*Revenue.* Revenue decreased \$3.5 million to \$2.8 million for the three months ended March 31, 2005 from \$6.3 million for the three months ended March 31, 2004. The decrease included a \$2.6 million decrease from restatement of revenues from 2003 to 2004 as a part of our 2003 financial statement restatement which resulted in one-time recognition of revenues as of March 31, 2004, a decrease of \$0.4 million from the sales and prototyping of parts manufactured from bulk Liquidmetal alloys, and a decrease of \$0.4 million from research and development services related primarily to defense applications.

*Cost of Sales.* Cost of sales decreased to \$2.8 million, or 100% of revenue, for the three months ended March 31, 2005 from \$3.6 million, or 57% of revenue, for the three months ended March 31, 2004. The decrease was a result of the decrease in bulk Liquidmetal alloy business. Cost of sales as a percentage of revenue has increased as a lower business volumes generated from our bulk Liquidmetal alloys. Significant portion of our manufacturing costs continue to remain fixed. We believe that

anticipated higher manufacturing volumes and an expected greater mix of higher-margin products in the future will cause the gross profit to continue to improve over time. The cost to manufacture parts from our bulk Liquidmetal alloys is variable and differs based on the unique design of each product. However, the cost of sales for the products sold by the coatings business segment is generally consistent because the Liquidmetal coatings products are produced by third parties and sold wholesale to various industries.

*Selling, General, and Administrative Expenses.* Selling, general, and administrative expenses decreased to \$2.6 million, or 91% of revenue, for the three months ended March 31, 2005 from \$3.1 million, or 49% of revenue, for the three months ended March 31, 2004. This decrease was primarily a result of decrease in wages and related expense by \$0.4 million, decrease in bad debt expenses by \$0.1 million, decrease in advertising and promotions expense by \$0.2 million, offset by an increase in insurance costs by \$0.2 million. These and other decreases in selling, general and administrative expenses represent the Company's efforts to manage costs and focus on our core business while continuing to build our corporate infrastructure required to prepare for and support the anticipated growth of our bulk Liquidmetal alloy business.

*Research and Development Expenses.* Research and development expenses increased to \$0.4 million, or 14% of revenue, for the three months ended March 31, 2005 from \$0.3 million, or 5% of revenue, for the three months ended March 31, 2004. The Company continues to perform research and development of new Liquidmetal alloys and related processing capabilities, develop new manufacturing techniques, and contract with consultants to advance the development of Liquidmetal alloys. The increase was primarily due to increases in salaries, wages and the related costs by \$0.1 million.

*Change in Value of Warrants.* Change in value of warrants decreased to a gain of \$0.1 million, or 5% of revenue, for the three months ended March 31, 2005 from a gain of \$0.6 million, or 9% of revenue, for the three months ended March 31, 2004. The change in value of warrants consists of change in value of warrant liabilities from warrants issued from the senior convertible debt funded in March 2004 and exchanged in August 2004 primarily as a result of fluctuations in our stock price.

*Change in Value of Conversion Feature.* Change in value of conversion feature liability from our senior convertible debt funded in March 2004 and exchanged in August 2004 resulted in a change in value of conversion feature gain of \$1.1 million, or 39% of revenue, and a gain of \$1.7 million, or 27% of revenue, during the three months ended March 31, 2005 and 2004, respectively, primarily due to fluctuations in our stock price.

*Interest Expense.* Interest expense was \$1.5 million, or 54% of revenue, for the three months ended March 31, 2005 and was \$0.4 million, or 6% of revenue, for the three months ended March 31, 2004. During the three months ended March 31, 2005, the interest expense was primarily due to the interest accrued on the Kookmin Bank loan funded on February 4, 2003 and senior convertible debt funded on March 3, 2004, as well as amortization of debt issuance costs and discount on the senior convertible debt funded in March 2004 and exchanged in August 2004. As of March 31, 2005, \$0.9 million of late registration penalty fee of our senior convertible debt was accrued as interest expense (see Item 3 Defaults Upon Senior Securities, Part II). During the three months ended March 31, 2004, interest expense was primarily due to the interest accrued on the Kookmin Bank loan.

*Interest Income.* Interest income was \$6 thousand for the three months ended March 31, 2005, and \$12 thousand for the three months ended March 31, 2004 from interest earned on certificate of deposits. The decrease was primarily due to decrease in deposits held.

**Liquidity and Capital Resources**



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Our cash used in operating activities was \$1.1 million for the three months ended March 31, 2005 and \$2.0 million, which includes cash used in our discontinued equipment manufacturing business of \$0.3 million, for the three months ended March 31, 2004. Our working deficit increased from \$(14.9) million at December 31, 2004 to \$(17.5) million at March 31, 2005. The Company's working deficit increase of \$2.6 million was primarily attributable to decrease in cash of \$0.4 million, decrease in restricted cash of \$0.8 million, decrease of current inventories of \$0.1 million, decrease of prepaid expenses and other current assets of \$0.5 million, increase in accounts payable and accrued liability of \$1.6 million, an increase in current portion of long term debt of \$0.7 million, offset by increase in net accounts receivable of \$0.1 million, decrease in warrant liabilities of \$0.1 million, decrease in conversion feature liabilities of \$1.1 million, and a decrease in other current liabilities of \$0.1 million.

Our cash used in investing activities was \$45 thousand for the three months ended March 31, 2005 for the acquisition of property and equipment.

Our cash provided by financing activities was \$0.6 million for the three months ended March 31, 2005, which consists of \$0.9 million in proceeds from restricted cash and proceeds from borrowings from our short term debt, offset by \$0.3 million on repayment of borrowings.

We anticipate that our capital expenditures will be approximately less than \$0.5 million for the full year 2005 for the acquisition of furniture, fixtures, and other business equipment. This amount is subject to change, however, depending upon the nature and the amount of the product orders that we actually receive from customers.

Our capital requirements during the next twelve months will depend on numerous factors, including the success of existing products either in manufacturing or development, the development of new applications for Liquidmetal alloys, the resources we devote to develop and support our Liquidmetal alloy products, and the success of pursuing strategic licensing and funded product development relationships with external partners. During the next twelve months, based on our current business plan, we expect to have sufficient resources to continue to devote limited capital to our research and development activities, to further develop and strengthen our manufacturing technology, and to provide for working capital and other general corporate purposes. However, based on our historical operating results and the continued development of our manufacturing capabilities and alloy compositions, there exists the possibility that these resources will not be adequate to operate at the proposed business plan levels. These expenses and capital expenditures could consume a material amount of our cash resources, but the amount of these requirements will depend on the nature and amount of orders we receive for the purchase of our bulk Liquidmetal alloy products.

Our business is based on commercializing an entirely new and unique technology, and our current business plan contains a variety of assumptions and expectations that are subject to uncertainty, including assumptions and expectations about order flow, unit volumes, manufacturing efficiencies, product cost and pricing, continuing technology improvements, customer adoption practices, strategic licensing relationships and other relevant matters. These assumptions take into account recent significant cost reductions, as well as recent improvements to our manufacturing processes. We have experienced losses from continuing operations during the last two fiscal years and have an accumulated deficit of \$129.4 million as of March 31, 2005. At March 31, 2005, our principal source of liquidity was \$0.3 million of cash and cash equivalents and trade accounts receivables of \$1.8 million. Such conditions raise substantial doubt that our Company will be able to continue as a going concern for a reasonable period of time without receiving additional funding. These operating results occurred while we were 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 our financial resources. The ultimate success of the Company depends on our ability to continue to reduce operating costs, generate higher revenue, achieve positive cash flow from continuing operations and achieve profitability.

Additionally, the Company is not in compliance with certain covenant requirements of our senior convertible debt as of March 31, 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 March 31, 2005 (see Item 3 Defaults Upon Senior Securities, Part II).

Our future success depends on our ability to continue reducing operating costs and ultimately to generate higher revenue and attain profitability. 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 our common stock, and our current stockholders may experience dilution.





**Contractual Obligations**

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The following table summarizes the Company's obligations and commitments as of March 31, 2005:

Contractual Cash Obligations (1)	Total	Payments Due by Period (in thousands)			
		Less Than 1 Year	1-3 Years	3-5 Years	After 5 Years
Long-term debt (2)	\$ 9,309	\$ 6,942	\$ 2,367	\$	\$
Capital lease obligation (3)	175	100	75		
Operating leases and rents	1,498	461	853	183	1
Growell settlement payable (4)	3,317	3,317			
Consulting services payable	114	114			
Dongyang payable	11	11			
	\$ 14,424	\$ 10,945	\$ 3,295	\$ 183	\$ 1

(1) Contractual cash obligations include Long-Term Debt comprised of \$5,709 of Senior Convertible Notes and \$3,600 of Kookmin Notes, and future minimum lease payments under capital and operating leases, liabilities incurred from settlement with a former customer (Growell) and divesture of our equipment manufacturing business, and purchase commitments from a consultant.

(2) Does not include interest payments of \$968, un-amortized discounts for conversion feature and warrants of \$2,407 of our Senior Convertible Notes, and short-term note payable of \$158.

(3) Includes imputed interest of \$10.

(4) In January 2005 Growell was acquired by a third party, and we **are currently in negotiations to settle this balance with the third party.**

**Off Balance Sheet Arrangements**

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

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

### **Item 3 Quantitative and Qualitative Disclosures about Market Risk**

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

*Interest Rates.* We are exposed to market risks relating to changes in interest rates. Some of the proceeds of our initial public offering are invested in short-term, interest-bearing, investment grade securities. The value of these securities will be subject to interest rate risk and could fall in value if interest rates rise.

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

*Foreign Exchange Rates.* As a result of our operation of a manufacturing facility in South Korea, a substantial portion of our costs will be denominated in the South Korean won. Consequently, fluctuations in the exchange rates of the South Korean won to the U.S. dollar will affect our costs of goods sold and operating margins and could result in exchange losses. Although we do not currently enter into foreign exchange hedge transactions, we may do so in the future as our business grows.

**Item 4 Controls and Procedures**

Evaluation of disclosure controls and procedures. During the course of the audit of the financial statements of Liquidmetal Technologies, Inc. (the Company) for the fiscal years ended December 31, 2001, 2002, and 2003, it was determined that revenues from certain equipment sales made by the Company to Growell Metal Co., Ltd. in the third and fourth quarters of 2002 and the first quarter of 2003 should not have been recognized in those periods. It was also determined that certain amounts relating to sales made to Samsung in December 2002, to JS Technologies in September 2002, and AM Corporation in December 2002 should not have been recognized. It also was determined that compensation expense related to certain stock options granted in 2001 and 2002 were not calculated in accordance with generally accepted accounting principles under APB Opinion No. 25, SFAS No. 123, and EITF 00-23. These determinations and the associated restatement of previously issued financial statements, as described more fully elsewhere in the Form 10-K for the year ended December 31, 2003, filed on November 10, 2004, suggest that, at the time of the subject transactions and the preparation of the Company's financial statements for the relevant periods, the Company's disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934) were not effective as of the end of the period covered by such Form 10-K.

Liquidmetal Technologies, Inc. (the Company) carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Vice President of Finance, of the effectiveness as of March 31, 2005 of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended. Based on that evaluation, the Chief Executive Officer and Vice President of Finance have concluded that these disclosure controls and procedures, as of March 31, 2005, were not effective. This determination was based primarily on the material weaknesses in internal controls over financial reporting identified below.

Update on Management's Assessment of Internal Control Over Financial Reporting. The time and resources committed to the restatement of prior periods' financial statements (as aforementioned) delayed the Company's internal timetable with respect to its 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). Due in part to the issues described in the foregoing paragraph, management's assessment of the effectiveness of the Company's internal control over financial reporting has been substantially delayed and is not complete, which in turn has prevented the Company's independent registered public accounting firm, Stonefield Josephson, Inc. (Stonefield) from being able to satisfactorily complete an audit of the Company's internal control over financial reporting pursuant to SOX 404. Based on the foregoing, Stonefield has disclaimed an opinion on the Company's internal control over financial reporting.

In attempting to complete its assessment of internal control over financial reporting, management used the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Although management has not yet completed its review and assessment of all of the Company's internal controls over financial reporting, based on the review and assessment efforts that have actually been completed, management has identified several control deficiencies that existed during and as of the year ended December 31, 2004, some of which have been determined to be material weaknesses in internal control over financial reporting. As a result of the material weaknesses identified below, management has concluded that it did not maintain effective internal control over financial reporting as of December 31, 2004, based on the criteria established in COSO.

We have identified the following material weaknesses in connection with our ongoing assessment of internal controls as follows:

**1. *Lack of adequate segregation of duties in accounts payable and accounts receivable involving cash receipts and deposits, bank reconciliations, cash disbursements, purchasing, and accounts receivable reconciliations:***

After the Company completely moved its accounting function from Tampa, Florida to Lake Forest, California in July 2004 and reduced the size of its accounting staff, duties such as booking of cash receipts, bank reconciliations and journal entries for corporate accounting were primarily being done by two accountants. During the course of the Company's audit for its 2004 fiscal year (which audit occurred during the first three months of 2005) and in the course of the Company's efforts to complete the assessment required by SOX 404 at the same time, it was determined that this lack of segregation could contribute to preventing detection of potential fraud or misstatements of financial information. Accordingly, beginning in the second quarter of 2005, the Company started taking steps to evaluate its overall accounting duties and segregate these functions for better internal control structure. For example, the Company began segregating the cash receipts booking and bank reconciliation among the two accountants, as well as segregating invoice entry and check run function. Additionally, as discussed below, beginning in the second quarter of 2005, the Company augmented its supervisory review process to mitigate the potential for fraud and misstatements. The Company has not identified any adjustments as a result of this lack of segregation of duties.

**2. *Lack of adequate controls and monitoring of payroll processing, currently outsourced to a third party provider:***

This material weakness existed throughout 2004 as the Company utilized the services of a third party payroll processor that was not certified under SAS 70 (Type II). During the course of the Company's audit for its 2004 fiscal year, it was determined that the risk of using a third party payroll provider that is not SAS 70 certified may contribute to misstatements of payroll and related financial information. The Company intends to remediate this weakness by retaining the services of ADP for payroll processing. ADP is certified under SAS 70 (Type II).

**3. *Lack of documentation to evidence reviews of certain reconciliations:***

During the course of the Company's audit for the 2004 fiscal year, which audit occurred in January 2005, the Company discovered that certain reconciliations, including bank statements and general ledger accounts, were not fully documented because the supervisors performing the review on such reconciliations occasionally omitted their signature evidencing their review. It was determined at the time that this lack of documentation may result in certain accounting documents not being properly reviewed or there being no evidence of review. Beginning in the second quarter of 2005, the Company began taking steps to require that all reviews of reconciliations by supervisors are evidenced by a supervisor signature and that all accounting documents are subject to proper review. For example, the Company started utilizing a Prepared by, Reviewed by, Checked by stamp and required all reconciliations to have evidence of the review prior to closing month end.

**4. *Lack of documentation of authorization of transactions:***

During the course of the Company's audit for the 2004 fiscal year, the Company discovered that, although accounting transactions may have been authorized by the appropriate persons, the authorizing person occasionally omitted his signature on the relevant documents or approval forms to evidence his authorization. This lack of documentation on invoices, purchase requisitions and expense reports may result in certain

transactions not being properly approved, so in the second quarter of 2005, the Company began implementing additional procedures for ensuring that all accounting documents are subject to proper approval as well as indication of the approval. For example, the Company began utilizing a

Prepared by, Reviewed by, Checked by stamp and required that all documents have evidence of the approval prior to entry into the Company's accounting system.

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

The Company uses the SAP system for financial reporting. During the course of the audit for the 2004 fiscal year, it was determined that the Company was manually performing numerous procedures that could be automated by using the current SAP system. For example, a sales order module in SAP could be utilized to automate the entire order fulfillment process. While SAP contains many modules and features which would allow the Company to automate certain operational and accounting procedures and thereby minimize the potential for human error, utilization of such modules would require significant investment in upgrading and maintaining the SAP system. Considering the Company's current size and limited resources, management has determined that it is not prudent to make this investment at the current time. Nevertheless, beginning in the second quarter of 2005 and continuing thereafter, the Company has been taking various steps to minimize the potential for human error caused by manual procedures. For example, the Company has established specific procedures for proper review and approval of transactions as outlined in paragraphs 3 and 4 above and expanded utilization of other software tools such as programmed spreadsheets.

***6. Material adjustments to the accounting records and financial statements as of and for the year ended December 31, 2004 that were not initially identified by the Company's internal control over financial reporting:***

During the course of the Company's SOX 404 assessment efforts during the first several months of 2005, the Company and its auditors identified a number of necessary material adjustments to the Company's accounting records for 2004. For example, certain adjustments were booked to properly value complex debt instruments associated with the refinancing of the Company's debt. In addition, certain adjustments were booked to impair the Company's assets which are based on Management forecasts and overall assessment of the Company's business. The Company believes that these adjustments were a result of the Company's focus during 2004 on completing the Company's three-year re-audit of its 2001, 2002, and 2003 fiscal years. As a result of the Company's SOX 404 assessment efforts, the Company has identified these adjustments and has implemented additional controls to timely review and assess accounting issues and prevent the need for such adjustments. While there can be no assurance that adjustments to financial statements will not occur in the future, with the completion of the three-year re-audit, the Company believes that it will be able to devote its resources to completing its accounting assessments and entries timely and effectively.

***7. Management's documentation of the evaluation of the significance of numerous control deficiencies and significant deficiencies identified, which could rise to the level of a material weakness, has not been completed:***

The Company is continuing to diligently work to document and evaluate its internal controls under the requirements of SOX 404 during 2005.

***8. The company had inadequate controls related to timely performance of its assessment of internal control over financial reporting:***

The Company is diligently working to complete its assessment of its internal controls over financial reporting under the requirements of SOX 404 during 2005.

***9. Assurance Consulting 3, the independent third party engaged to help document and assess the Company's internal controls, has identified numerous and significant deficiencies, including those identified above, which management has not completed evaluating whether they would rise to the level of a material weakness in accordance to the PCAOB Audit Standard No. 2.***

The Company will review these deficiencies during its assessment of internal controls under the requirements of SOX 404 during 2005.

Management believes that it has taken appropriate steps to address these material deficiencies subsequent to March 31, 2005, including hiring an independent consulting firm (Assurance Consulting 3) to identify and propose remedial actions to address and mitigate the deficiencies.



Changes in internal controls. There were no changes in the Company's internal controls that occurred during the quarter ended March 31, 2005 (although various changes to internal controls occurring after March 31, 2005 are described above). The Company is in the process of re-evaluating its internal controls pursuant to SOX 404, as indicated above.

**PART II**

**OTHER INFORMATION**

**Item 1 Legal Proceedings**

There were no material developments in our legal proceedings during the current quarter.

**Item 3 Defaults Upon Senior Securities**

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

On August 19, 2004, the Company completed a private exchange offer for its March Notes. 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 . In addition, the Company redeemed approximately \$4.5 million of the March Notes in cash. 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 plant in South Korea.

In connection with the private exchange offer, the Company issued \$250 thousand of private placement notes to certain Placement Agents as issuance costs. Of the \$250 thousand notes issued, \$125 thousand 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 thousand 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 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 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 completion of the exchange offer. A total of 563,151 warrants to purchase our common stock at an exercise price of \$3.00 per share all of which were previously issued in connection with the purchase of the March Notes have been amended to provide for an extended expiration date of March 1, 2006. As of March 31, 2005, we were in breach of a covenant in the Note Exchange Agreement requiring us to become current in our SEC filings, as well as file a registration statement with the SEC for the shares into which the notes are convertible, within 90 days of the issue date of the new notes. Late registration fee of \$0.9 million has been accrued as interest expense, and is included in accounts payable and accrued liabilities as of March 31, 2005. If written notice of default is delivered to us for breach of this covenant, then we will have a period of 30 days to cure the breach before it becomes an event of default under the notes, and if the breach is not cured during such time period, the holders of the notes will become entitled to accelerate the remaining balance of their respective notes and declare them immediately due and payable. As of the date of the filing of this Form 10-Q, we have not received a notice for demand for payment as a result of not meeting the registration and listing requirements.

**Item 6 Exhibits**

The following documents are filed as an exhibit to this Report:

<b>Exhibit Number</b>	<b>Description of Document</b>
31.1	Certification of the President and Chief Executive Officer, Ricardo A. Salas, as required by Section 3.02 of Sarbane-Oxley Act of 2002
31.2	Certification of Chief Financial Officer, Young Ham, as required by Section 3.02 of Sarbane-Oxley Act of 2002
32.1	Certification of Principal Executive Officer, Ricardo A. Salas, pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer, Young Ham, pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002

**SIGNATURES**

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

LIQUIDMETAL TECHNOLOGIES  
(Registrant)

Date: July 20, 2006

/s/ Ricardo A. Salas  
Ricardo A. Salas  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: July 20, 2006

/s/ Young Ham  
Young Ham  
Chief Financial Officer  
(Principal Financial and Accounting Officer)