Cambridge Display Technology, Inc.
Form 10-Q
May 15, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2007

or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number: 000-51079

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Delaware	**13-4085264**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

c/o Cambridge Display Technology Limited

2020 Cambourne Business Park

Cambridge CB3 6DW, United Kingdom

(Address of principal executive offices)

011-44-1954-713-600

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

The number of outstanding shares of the registrant s Common Stock, par value $0.01 per share, was 21,630,703 as of April 30, 2007.

Table of Contents

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

INDEX

Table of Contents

CAUTIONARY STATEMENT

CONCERNING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains some "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. This Quarterly Report on Form 10-Q also contains information relating to us that is based on the beliefs of our management, as well as assumptions made by, and the information currently available to, our management. Among other things, these statements include, but are not limited to, the statements in this Quarterly Report on Form 10-Q regarding:

- the outcomes of our ongoing and future research and development activities, and those of our licensees, related to our polymer organic light emitting diode, or P-OLED, Total Matrix Addressing, or TMA, and related technologies referred to below ;
- the potential commercial applications of our P-OLED, TMA and related technologies, and of OLED products in general;
- our ability to form and continue joint ventures and other strategic relationships with manufacturers of P-OLED materials, displays and other devices which incorporate our technologies;
- successful commercialization of products including our P-OLED, TMA or related technologies by ourselves or by our licensees;
- the willingness of these manufacturers and licensees to continue to develop, manufacture and sell commercial products integrating our technology;
- future demand for products using our P-OLED, TMA or related technologies;
- the comparative advantages and disadvantages of our technologies versus competing technologies currently on the market;
- the nature and potential advantages of any competing technologies that may be developed in the future;
- our ability to compete against third parties with resources greater than ours;
- our ability to maintain and improve our competitive position following the expiration of our fundamental patents;
- the adequacy of protection afforded to us by the patents that we own or license and the cost to us of enforcing that protection;
- our ability to obtain, expand and maintain patent protection in the future and to protect our unpatentable intellectual property;
- developments in and expenses associated with resolving matters currently in litigation;

- the payments that we expect to receive in the future under our existing contracts and the terms that we are able to enter into with new licensees of our technology;
- exposure of our international operations and those of our licensees to significant risks;
- our future capital requirements and our ability to obtain additional financing when needed; and
- our future P-OLED technology licensing and other revenues and results of operations.

In addition, when used in this Quarterly Report on Form 10-Q the words "estimate", "project", "believe", "expect", "intend", anticipate , seek , will , may and "plan" and similar expressions involving potential future developments are intended to identify forward-looking statements. All of these forward-looking statements reflect our current views with respect to future events and are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated by the statements, including those risks discussed in this Quarterly Report on Form 10-Q.

You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to update beyond that required by law any forward-looking statements whether as a result of new information, future events or otherwise.

In this Quarterly Report on Form 10-Q, the terms the Company , our company , CDT , we , us and our refer to Cambridge Display Technolo Inc. and its subsidiaries, unless the context otherwise requires.

This Quarterly Report on Form 10-Q contains references to a number of trademarks that are registered trademarks of ours or our affiliates or trademarks for which we or our affiliates have pending applications or common law rights. These include P-OLED, TMA, CDT, Cambridge Display Technology and Sumation.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

Consolidated Balance Sheets

(in thousands, except share information)

	March 31, 2007 (unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,696	$ 12,015
Marketable securities		7,252
Inventory		30
Accounts receivable, net	90	187
Taxes receivable	1,439	1,861
Prepaid expenses and other current assets	2,486	1,680
Total current assets	20,711	23,025
Property, equipment and leasehold improvements, net	8,449	9,579
Investments in affiliates	2,528	3,951
Marketable securities	393	298
Goodwill	65,612	65,612
Other intangible assets, net	1,339	1,484
Other non-current assets	4	20
Total assets	$ 99,036	$ 103,969
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 5,761	$ 6,597
Deferred revenue	5,934	5,143
Due to affiliate	20	95
Other current liabilities		2,109
Total current liabilities	11,715	13,944
Deferred revenue, non-current	3,293	193
Other liabilities	543	596
Commitments and contingencies (Note 6)		
Common shareholders equity:		
Preferred stock, voting $0.01 par value, 46,667 authorized, none issued or outstanding		
Common stock, $0.01 par value, 100,000,000 shares authorized		
21,903,549 issued and 21,630,703 outstanding	216	216
Additional paid-in capital	286,391	284,531
Accumulated other comprehensive loss	(171)	(271)
Accumulated deficit	(202,951)	(195,240)

Total common shareholders equity	83,485	89,236
Total liabilities and shareholders equity	$ 99,036	$ 103,969

See accompanying notes.

Table of Contents

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Three months ended March 31, 2007	2006
Operating revenues:		
License fees and royalties	$ 1,103	$ 79
Technology services and development	970	698
Equipment and supplies	927	258
Total operating revenues	3,000	1,035
Cost of sales:		
License fees and royalties	11	1
Technology services and development	673	216
Equipment and supplies	631	158
Total cost of sales	1,315	375
Gross profit	1,685	660
Operating expenses:		
Research and development expenses	3,735	3,095
Selling, general and administrative expenses	4,356	3,969
Amortization of intangibles acquired	145	395
Total operating expenses	8,236	7,459
Loss from operations	(6,551)	(6,799)
Other income/(expense):		
Equity in loss of affiliates	(1,316)	(1,415)
Foreign currency transaction loss	(7)	(213)
Other income	1	253
Interest income	167	257
Total other expense	(1,155)	(1,118)
Loss before benefit for income taxes	(7,706)	(7,917)
Expense / (Benefit) for income taxes	5	(284)
Net loss	$ (7,711)	$ (7,633)
Net loss per common share attributable to common shareholders, basic and diluted	$ (0.36)	$ (0.36)
Weighted average number of common shares outstanding, basic and diluted	21,630	21,483

See accompanying notes.

Table of Contents

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three months ended March 31, 2007	2006
Operating activities		
Net loss	$ (7,711)	$ (7,633)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization of property, equipment and leasehold improvements	1,364	1,342
Loss on sale of property, equipment and leasehold improvements	(1)	
Effect of exchange rate changes on cash and cash equivalents	(21)	42
Amortization of other intangible assets	145	395
Stock compensation expense	1,506	933
Stock consideration costs on asset acquisition	316	
Equity in loss of affiliates	1,316	1,415
Changes in operating assets and liabilities:		
Accounts and tax receivable	519	1,169
Inventory	30	(29)
Prepaid expenses and other current assets	(790)	(115)
Accounts and tax payable and accrued expenses	(836)	(2,045)
Due to affiliates	(75)	52
Deferred revenue	3,891	543
Other current and non-current liabilities	(2,162)	2
Net cash used in operating activities	(2,509)	(3,929)
Investing activities		
Acquisition of property, equipment and leasehold improvements	(195)	(141)
Recharge to / (Investment in) affiliates	112	(1,596)
Disposal of / (Investment in) marketable securities	7,252	(1,735)
Net cash generated by / (used in) investing activities	7,169	(3,472)
Effect of exchange rate changes on cash and cash equivalents	21	(42)
Net increase / (decrease) in cash	4,681	(7,443)
Cash and cash equivalents - beginning of period	12,015	31,263
Cash and cash equivalents - end of period	$ 16,696	$ 23,820

See accompanying notes.

Table of Contents

Cambridge Display Technology, Inc.

Notes to Consolidated Financial Statements

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006, or our 2006 Form 10-K.

The Company's consolidated financial statements have been presented on the basis that it is a going concern. The Company has incurred significant operating losses and negative cash flows from operations since inception, its revenues have declined in recent periods and it has commitments to fund the activities of Sumation, its joint venture with Sumitomo Chemical.

Based on the Company s current existing cash balances, contracted revenues and projected cash flows during 2007, management believes that it will be able to address its funding requirements into 2008. Further, management recognizes that, in order to continue as a going concern, it will need to seek and is seeking additional funding, which may include new revenue opportunities as well as the issuance of new equity or debt securities. Although there can be no assurances, if successful in achieving these measures, management believes it will be able to address its business plan into 2009.

2. Other Comprehensive Loss

	Three months ended March 31,	
	2007	**2006**
	(in thousands)	
Net Loss	$ (7,711)	$ (7,633)
Other comprehensive loss:		
Unrealized gains / (losses) on marketable securities	95	(82)
Foreign currency translation adjustments	5	31
Other comprehensive gain / (loss):	100	(51)
Comprehensive loss	$ (7,611)	$ (7,684)

3. Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (the FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. The Company adopted FIN 48 effective January 1, 2007 and the impact and method of adoption is described in Note 4 below.

4. Income Taxes

Income taxes are a benefit for the three months ended March 31, 2007 and 2006 reflecting tax credits to be received for research and development costs from the United Kingdom government, net of Delaware franchise tax payments.

Table of Contents

The Taxes receivable balance of $1.4 million at March 31, 2007 includes $1.2 million of income tax refunds due for the year ended December 31, 2006 and $0.1 million for the three months ended March 31, 2007. The balance represents anticipated United Kingdom value added tax recoveries.

As a result of the implementation of FIN 48, no liability for unrecognized tax benefits was recognized. Although no interest and penalties have been recognized, the Company, upon adoption of FIN 48, has elected a policy to classify any future interest and penalties as a component of tax expense.

The Company does not anticipate that the total amount of unrecognized tax benefits will significantly increase or decrease within the next 12 months.

The Company s UK subsidiary tax returns for the year ended December 31, 2005, based upon which the Company received tax refunds of $2.1 million, are still subject to examination by the UK tax authorities. Periods prior to this are closed, unless the authorities become aware of fraud or negligence. The tax returns for the year ended December 31, 2006, based upon which the Company expects to receive tax refunds of $1.2 million, are still to be submitted to the UK tax authorities.

The statute of limitations for the Company s US tax returns for the years ended December 31, 2003, 2004 and 2005 are still open. The tax return for the year ended December 31, 2006 has not yet been submitted to the US tax authorities.

5. Stock-Based Compensation

A summary of stock-based compensation costs for the three months ended March 31, 2007 and 2006 is included below:

	Compensation Expense for three months ended March 31, 2007	Compensation Expense for three months ended March 31, 2006
	(in thousands)	
Stock Options		
CDT Acquisition Corp. Stock Incentive Plan	$ 4	$ 21
2004 Stock Incentive Plan	120	164
Total Compensation Expense for Stock Options	**$ 124**	**$ 185**
Restricted Stock Units		
Special Bonus Plan	824	748
2004 Stock Incentive Plan	558	
Total Compensation Expense for Restricted Stock Units	**$ 1,382**	**$ 748**
Total Stock-Based Compensation Expense	**$ 1,506**	**$ 933**

Employee Stock Options

The Company granted 120,150 options in the three months ended March 31, 2007, and the fair value of these options was $3.47 each.

The Company recognized $0.1 million of compensation expense in relation to stock options in the three months ended March 31, 2007. The Company will recognize $0.4 million of compensation expense in the remaining nine months of 2007, $0.4 million in 2008 and $0.2 million in 2009 with respect to stock options which were granted prior to March 31, 2007 but were not fully vested on that date, assuming that all such options do vest. Lower expense will be recorded to the extent that such options are cancelled prior to becoming fully vested and higher expenses will be recorded to the extent that the Company issues further stock options.

Table of Contents

Restricted Stock Units

In the three months ended March 31, 2007, the Company issued 717,000 restricted stock units awards under its 2004 Stock Incentive Plan to officers and employees. These awards represent a right to receive, in the aggregate, 717,000 shares of the Company s common stock. These awards will vest entirely on December 31, 2008.

The expense recognized in the three months ended March 31, 2007 for these awards was $0.3 million.

In the three months ended March 31, 2007, the Company issued a further 54,258 restricted stock units under its 2004 Stock Incentive Plan to officers and employees. These awards were issued in settlement of liabilities for annual bonuses which had been accrued in 2006. These awards vested immediately. The stock compensation expense recognized for these awards was $0.3 million.

6. Commitments and Contingencies

Commitments

In December 2006, the Company entered into an Asset Purchase Agreement with Next Sierra, Inc. and certain of its shareholders named therein, pursuant to which the Company agreed to purchase, in January 2007, substantially all of the assets of Next Sierra, a Mountain View, California-based hardware developer that specializes in designing light-emitting diode display driver chips. The primary rationale for the transaction was to acquire a team of chip developers. All the members of this team are now employees of the Company. The Company accepted assignments of a building lease and certain software license contracts in conjunction with this transaction but did not assume responsibility for any other significant liabilities of Next Sierra. The aggregate consideration payable by the Company is 285,510 shares of the Company s common stock, payable in three installments. The first installment of 28,551 shares was issued on January 3, 2007 and the Company is required to deliver the second (30% of the aggregate consideration) and third (60% of the aggregate consideration) installments upon the completion of certain technical milestones as provided in the Asset Purchase Agreement.

The first installment of stock was valued at the average daily closing price of the Company s common stock for the five trading days period ended on the second business day prior to January 3, 2007, the day on which this transaction closed. Less than $0.1 million was allocated to fixed assets based on the fair value of those assets on the closing date of the transaction, the remaining $0.1 million was charged to research and development expense. The Company will charge the value of the second and third installments to research and development expense over the period during which the corresponding technical milestones are expected to be achieved. The amount charged to research and development expense in respect of the second installment in the first quarter of 2007 was $0.2 million.

Table of Contents

Contingencies

In January 2005, Sunnyside Development Company LLC ("Sunnyside") served a complaint against one of the subsidiaries of Cambridge Display Technology, Inc. (CDT Inc.), Opsys Limited, and a company named by Sunnyside as CDT Limited, in the Superior Court for the County of Alameda, State of California, alleging claims for breach of contract and fraud arising out of an alleged property lease agreement between Opsys Limited and Sunnyside. In February 2005, the case was removed to the United States District Court for the Northern District of California, as Sunnyside Development Company LLC v. Opsys Limited, a United Kingdom Company. All claims against Cambridge Display Technology Limited and the claim for fraud against Opsys Limited have been dismissed.

CDT Inc. was never a party to the lease. In October 2002, Opsys Limited and Sunnyside executed an Assignment of Lease and Consent of Lessor (the "Assignment"), which included a release of Opsys Limited from its obligations under the lease by Sunnyside. Sunnyside contends that the Assignment and release never became effective or were voided. Opsys Limited believed that the Assignment effectively released it from liability under the lease, and therefore believed that the claim had no merit. In March 2007 a jury verdict was delivered in favor of Sunnyside with damages of $4.9 million. Sunnyside is attempting to collect the judgment that it seeks to have entered against Opsys Limited on the jury verdict, plus its legal costs of approximately $1.0 million, from CDT Inc. under a successor liability theory. The Company believes that Sunnyside s successor liability claim against CDT Inc. will not succeed.

On the basis of facts presently known, the Company is not involved in any other legal proceedings which could have a material adverse effect on the Company s financial condition, liquidity or results of operations.

7. Subsequent Events

In April 2007, the Company invested $4.9 million to maintain its 50% equity stake in its joint venture, Sumation. In April 2007, Sumation paid $4.8 million to the Company in reimbursement of research and development incurred on projects for Sumation and $1.0 million to the Company in license fees.

Table of Contents

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

The following discussion of our financial condition and results of operations should be read together with the consolidated financial statements and related notes that are included elsewhere in this Quarterly Report on Form 10-Q. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those expected in these forward-looking statements as a result of various factors, including those set forth under Risk Factors in Item 1A of Part II below or elsewhere in this Quarterly Report on Form 10-Q.

Overview

We are a pioneer in the development of P-OLEDs and their use in next-generation flat panel displays and other applications. The fundamental discoveries relating to our P-OLED materials were made by a team of researchers at the Cavendish laboratories at the University of Cambridge in 1989 that included Dr. Jeremy Burroughes, our Chief Technical Officer. Since our inception in 1992, we have focused on continuing research and development related to the production, manufacturing and commercialization of P-OLED technology in the flat panel display and other industries. Our revenues are primarily generated from the licensing of rights to use our IP portfolio, from ongoing product royalties, from fees generated from transfer of technology and joint technology development agreements and from the sale of ink jet printing equipment, display test equipment and polymer inks.

We sold our first P-OLED license in 1996 to Royal Philips Electronics and currently have ten device licensees, three materials licensees and two component licensees and are working with a number of additional display manufacturers through joint technology development programs and informal relationships. We recognized our first royalty revenues in 2002 when commercial consumer electronics products began incorporating our P-OLED technology. Currently, our P-OLED technology is being used in mobile phones, MP3 players, medical equipment and other applications.

While we have made significant progress over the past few years in advancing our P-OLED technology into a number of display licenses, we have incurred significant losses and will continue to do so unless our P-OLED technology becomes more widely adopted and commercialized by flat panel display manufacturers. As of March 31, 2007, we had an accumulated deficit of $203 million in large part due to the research and development expenditures we have incurred. Our total research and development expenditures since 1999 exceed $105 million.

Our business objective is to license our technology to leading display manufacturers and to generate royalties based on the sales of their products. As a pre-cursor to our licensing and royalty business we sell technology services, development services and ink jet printing equipment and polymer inks to companies working on P-OLED technology. We market our P-OLED IP and technology by building relationships with established and new entrant flat panel display manufacturers. This may involve developing relationships at a senior level over a period of years. Some manufacturers purchase a license from us at an early stage in their P-OLED development program. Other manufacturers begin their efforts to develop products using our P-OLED technology by working with us through a series of informal meetings, then by entering, either publicly or confidentially, into a formal technology development or technology transfer program which may culminate in the purchase of a license from us.

In order to accommodate our many current and potential Asian licensees and partners, we maintain representative offices in Japan and Taiwan. One of our senior executives is based in Japan, and one is based in Taiwan. Other senior executives, including our Chief Executive Officer, travel frequently from our corporate offices to Asia and other destinations in order to develop our relationships with both existing and potential new licensees.

We believe that the key factors that will contribute to the successful execution of our strategy are:

- the further development of P-OLED materials and device structures in order to increase the commercial lifetimes of P-OLED products;
- the further development of ink jet printing equipment and process, and other deposition processes, so that mass production of full color P-OLED displays can be demonstrated;
- the further development of other technologies required for P-OLED displays, in particular active matrix thin-film transistor (TFT) display drivers and passive matrix display drivers based on our TMA technology; and

the adoption of P-OLED technology by increasing numbers of existing and potential future display manufacturers.

Management monitors performance in achieving these goals by reference to internal and external technology developments. Progress in the other areas is demonstrated by the increasing service lifetimes of our P-OLED materials, the size of demonstration displays being exhibited by ourselves and display manufacturers, the increasing number of companies which are working with us on technology services and development projects and increasing revenues from these projects.

Table of Contents

Although we believe that P-OLED display technology has the potential to enable displays to be manufactured at lower cost than competing LCD technology, this cost advantage will not be realized until P-OLED technology is proved in volume manufacturing. LCD manufacturing companies continue to strive to reduce unit manufacturing costs and such cost reductions will make it more difficult for P-OLED technology to penetrate the market, although we believe that the simpler structure of P-OLED display devices compared to LCD will mean that, ultimately, P-OLED displays will be cheaper to produce.

We believe that the flat panel display, or FPD, market will remain price sensitive. Limited penetration of P-OLED displays will be possible if there is a price premium, but we believe that any such premium will have to erode and that production costs at volume will have to be lower for P-OLED than for competing technologies in order that P-OLED products can take significant market share.

The commercial exploitation of P-OLED technology is not limited to display applications. In March 2006, Seiko Epson Corporation announced that they had succeeded in creating a print head that uses OLED as a high brightness light source. We believe that this opens the way for utilization of P-OLED as a new technology for printers and will potentially lead to the manufacture of color printers that are smaller and have higher resolution and faster printing speeds.

In November 2006, we announced the development of a new passive matrix driver, Total Matrix Addressing , or TMA™. Prior to TMA, large OLED displays have only been feasible by using active matrix (AM) technology incorporating an expensive thin-film transistor (TFT) layer. Passive matrix (PM) displays, which are driven by cheaper external chips, have been restricted to smaller screen sizes. TMA is a technology which potentially can be incorporated into driver chips to bring active matrix capabilities to passive matrix displays. TMA reduces power consumption and enhances panel lifetime for a given pixel count in passive matrix displays. Measurements on small passive matrix displays that incorporated the TMA solution demonstrated at least a 50% reduction in power consumption or exhibited double the display luminescence at the same power consumption. The TMA driving system can be applied to both P-OLED and small molecule OLED, or SMOLED, technology passive matrix displays. Industry response has been very positive to this new technology and in January 2007, we acquired the assets of Next Sierra, an OLED display design chip house to help accelerate our development of this technology, which we believe has strong commercial potential.

In reading our financial statements, you should be aware of the following factors and trends that our management believes are important in understanding our financial performance:

- because our license fees often consist of large one-time payments and our royalties for the foreseeable future are expected to be smaller, recurring payments, we expect fluctuations in these revenues depending on the periods in which we enter into new licenses;

- we have and will continue to invest significant resources in research and development in order to develop and effectively demonstrate our technology so that it can be commercialized in a growing number of applications, which is indicated by our total research and development expenditures in the first quarter of 2007 of $ 3.7 million;

- we expect that our future royalties will be impacted by the extent to which we continue to enter into new technology development agreements and existing technology development partners enter into commercial licenses for use of our P-OLED technology; and

- we expect that our future royalties will be impacted by the extent to which our existing licensees expand the use of our P-OLED technology in commercial applications in their consumer electronic products.

Table of Contents

Results of Operations

Comparison of Three Months Ended March 31, 2007 and March 31, 2006

Operating revenues *(in thousands, except percentages)*	**Three months ended March 31, 2007**	**Three months ended March 31, 2006**	**% Increase / (Decrease)**
License fees and royalties	$ 1,103	$ 79	1296%
Technology services and development	970	698	39%
Equipment and supplies	927	258	259%
Total operating revenues	**$ 3,000**	**$ 1,035**	**190%**

License fees and royalties revenues increased by $1.0 million, or 1,296% from $0.1 million in the first quarter of 2006 as compared to $1.1 million in the first quarter of 2007. This increase is due to recognition in the first quarter of 2007 of revenue from one license agreement which was signed in September 2006. License revenue will be recognized ratably over the period in which we have obligations to the licensee, which will be approximately three years. The amount recognized in the first quarter of 2007 was $1.0 million.

Royalties revenues were unchanged, being $0.1 million in the first quarter of 2007 from four licensees and $0.1 million in the first quarter of 2006 from five licensees.

Technology services and development revenues increased by $0.3 million, or 39%, from $0.7 million in the first quarter of 2006 to $1.0 million in the first quarter of 2007. This is due to the recognition of $0.9 million of revenue in the first quarter of 2007 from a development contract which was signed in September 2006. In the first quarter of 2006, revenues came from a number of smaller contracts. Technology services and development revenues were received from two customers during the first quarter of 2007 compared with seven customers during the first quarter of 2006.

Equipment and supplies revenues increased by $0.6 million, or 259%, from $0.3 million for the first quarter of 2006 to $0.9 million in the first quarter of 2007. The increase was due to revenue generated from the sale of an ink jet printer in the first quarter of 2007. No such high value printer sales were made in the first quarter of 2006, where the revenue received was from sales of polymer inks.

Matsushita Electric Industrial Co., Ltd. accounts for in excess of 10% of revenue in the first quarter of 2007. Toshiba Matsushita Displays, Toppan Printing and OTB NV each accounted for in excess of 10% of our revenues for the first quarter of 2006.

Cost of sales *(in thousands, except percentages)*	**Three months ended March 31, 2007**	**% of Revenues ***	**Three months ended March 31, 2006**	**% of Revenues ***
License fees and royalties	$ 11	1%	$ 1	1%
Technology services and development	673	69%	216	31%
Equipment and supplies	631	68%	158	61%
Total cost of sales	**$ 1,315**	**44%**	**$ 375**	**36%**
Gross profit	**$ 1,685**	**56%**	**$ 660**	**64%**

* the percentages shown in these columns represent each Cost of sales figure divided by the corresponding Revenue figure from the Operating Revenues table above

Cost of sales related to License fees and royalties was 1% of related sales for the first quarters of both 2007 and 2006. This comprises payments made to third parties from whom we have acquired intellectual property. We expect that cost of sales for License fees and royalties will average between 1% and 2% of related sales in the future.

10

Table of Contents

Cost of sales related to Technology services and development increased from 31% of related sales for the first quarter of 2006 to 69% for the first quarter of 2007. We believe that the increased complexity of Technology services and development contracts and market pressure on pricing will result in this higher cost of sales percentage continuing in future periods. A portion of this higher cost of sales cost is due to our existing research and development team devoting a higher proportion of their effort in supporting revenue-generating projects than had been the case in prior periods. We seek to ensure that the nature of these projects is such that the objectives of these commercial projects are aligned with and complementary to our internal research and development priorities.

Cost of sales related to Equipment and supplies revenues increased from 61% of related sales for the first quarter of 2006 to 68% for the first quarter of 2007. Margins on equipment and supplies will continue to vary from quarter to quarter due to differing margins on different products but we believe that the margins reported for the first quarter of 2007 will be representative of future periods.

Gross profit increased by $1.0 million from $0.7 million in the first quarter of 2006 to $1.7 million in the first quarter of 2007 due to higher revenues. The aggregate margin percentage was lower for the first quarter of 2007 because of the lower margin in Technology services and development and Equipment and supplies.

We only charge direct labor cost and variable cost of materials associated with each revenue-generating project to cost of sales and do not charge any allocation of fixed cost overheads. Therefore, relatively high margins are required, for both Technology services and development and Equipment and supplies, in order for the related contracts to make a contribution to our fixed costs, including our research and development costs.

Operating expenses

(in thousands, except percentages)	**Three months ended March 31, 2007**	**Three months ended March 31, 2006**	**% Increase / (Decrease)**
Research and development expenses	$ 3,735	$ 3,095	21%
Selling, general and administrative expenses	4,356	3,969	10%
Amortization of intangibles acquired	145	395	(63%)
Total operating expenses	**$ 8,236**	**$ 7,459**	**10%**

Our research and development expenses increased by $0.6 million from $3.1 million in the first quarter of 2006 to $3.7 million in the first quarter of 2007 because of:

a decrease of $0.2 million due to an increase in costs being reimbursed by Sumation, our 50%-owned joint venture with Sumitomo Chemical, which level of reimbursement we anticipate is likely to continue in future periods;

an increase of $0.1 million in stock compensation expense due to the issuing of stock options and restricted stock units during the first quarter of 2007;

a decrease of $0.1 million due to increased grant income being earned in the first quarter of 2007, which we anticipate will increase in future periods.

an increase of $0.5 million due to the costs incurred in the development of our TMA technology;

an increase of $0.3 million due to research and development costs recognized in first quarter of 2007 on the purchase of the assets of Next Sierra;

an increase of $0.3 million due to higher expenditure on research programs, including higher facilities costs; and

a decrease of $0.3 million due to more of the cost of the research and development function being charged to revenue-generating projects and correspondingly less being charged to Research and development expense, which decrease was due to $0.5 million being spent in the first quarter of 2007 compared with $0.2 million in the first quarter of 2006 on activities which were similar in nature to research and development but which directly supported revenue-generating projects and were not therefore classified as Research and development expenses.

Research and development expenses will continue to vary from quarter to quarter due to the specific requirements of the projects being carried out in any quarter.

Our selling, general and administrative expenses increased by $0.4 million from $4.0 million for the first quarter of 2006 to $4.4 million for the first quarter of 2007 because of:

an increase of $0.1 million in stock compensation expense due to the issuing of stock options and restricted stock units during the first quarter of 2007 and costs related to the modifications of restricted stock unit awards granted to two of our executives;

Table of Contents

a decrease of $0.1 million due to an increase in costs being reimbursed by Sumation, our 50%-owned joint venture with Sumitomo Chemical, which level of reimbursement is likely to continue in future periods;

an increase of $0.9 million due to increased litigation expenses; and

a decrease of $0.5 million due to reductions in other administrative costs including staff relocation, insurance and other staff costs.

Amortization of intangibles acquired decreased by $0.3 million from $0.4 million for the first quarter of 2006 to $0.1 million for the first quarter of 2007. This is because certain intangible assets became fully amortized in October 2006. The quarterly amortization charge of $0.1 million for the first quarter of 2007 is expected to continue until 2009, unless we acquire further intangible assets.

Other expense

(in thousands)	Three months ended March 31, 2007	Three months ended March 31, 2006
Equity in loss of affiliates	$ (1,316)	$ (1,415)
Foreign currency transaction loss	(7)	(213)
Other income	1	253
Interest income	167	257
Total Other expense	**$ (1,155)**	**$ (1,118)**

Equity in loss of affiliates: Equity in loss of affiliates for both the first quarter of 2007 and 2006 included 50% of the losses of Sumation. We expect to continue reporting losses for Sumation in future periods.

Foreign currency transaction loss: The loss of $0.2 million in the first quarter of 2006 was primarily due to losses realized on the execution of forward foreign exchange contracts. We no longer execute forward foreign exchange contracts.

Other income: The gain of $0.3 million in the first quarter of 2006 relates to the reversal of unrealized losses on forward foreign exchange contracts which had been reported in prior periods.

Interest income: Interest income decreased by $0.1 million from $0.3 million in the first quarter of 2006 to $0.2 million in the first quarter of 2007 due to lower average cash balances.

Our benefit for income taxes fell from $0.3 million in the first quarter of 2006 to zero in the first quarter of 2007. A benefit is shown because we surrender tax losses which related to certain research and development expenditures to the U.K. tax authorities in return for a cash payment. The amount of benefit we can accrue is reduced to the extent that such expenses support revenue-generating contracts and this amount is lower in the first quarter of 2007 because of the increased amount of research being funded by third parties and thus not qualifying for tax relief. The tax credit calculated for the first quarter of 2007 was offset by Delaware franchise taxes and Japanese withholding tax incurred on license income.

Our net loss increased by $0.1 million from $7.6 million in the first quarter of 2006 to $7.7 million in the first quarter of 2007 because higher Gross profit was more than offset by higher Operating expense, as described above.

Table of Contents

Liquidity and Capital Resources

Net cash used in operations decreased by $1.4 million from $3.9 million in the first quarter of 2006 to $2.5 million in the first quarter of 2007 due to:

- a decrease of $3.9 due to an increase of receipts from customers from $3.1 million in the first quarter of 2006 to $7.0 million in the first quarter of 2007;
- an increase of $0.6 million due to increased expenses related to commercial projects;
- an increase of $0.7 million due to increased cash operating expenses;
- an increase of $0.1 million due to a decrease in interest income;
- an increase of $2.0 million due to no research reimbursement being received from Sumation in first quarter of 2007; and
- a decrease of $0.9 million due to changes in working capital.

We invested $4.9 million of capital in Sumation in April 2007. We expect to provide additional funding in future periods. The amount of funding required by Sumation will be dependent on the extent to which Sumation is able to fund its activities from sales of P-OLED materials. Sumation funds some of our research and development activities and we expect to receive more in reimbursements from Sumation than we will invest in the funding of Sumation.

In 2007, we redeemed $7.3 million in certificates of deposit and floating rate notes with maturities of more than 90 days but less than one year.

We expect, based on our internal forecast and assumptions relating to our operations (including, among others, assumptions regarding our working capital requirements, additional equity investments, the progress of our research and development efforts and revenues, including stage payments due to us pursuant to our contractual arrangements with Matsushita Electric Industrial) that we have sufficient cash to meet our obligations for at least the next 12 months.

Critical Accounting Policies

General

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements. The preparation of these statements requires us to make certain estimates and judgments that affect the statement of operations, balance sheet, cash flow or disclosures relating to contingent assets or liabilities. Our actual results might, under different assumptions and conditions, differ from our estimates. Significant estimates include the valuation of our IP, lives of our long-lived assets and estimates related to the delivery of know-how and services under technology services contracts. The following is an update of the discussion of our critical accounting policies set forth in our 2006 Form 10-K. For a complete discussion of our most critical accounting policies, as well as the estimates and judgments involved, refer to Critical Accounting Policies and Significant Developments and Estimates under Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, of our 2006 Form 10-K.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

A majority of our revenues are denominated in U.S. dollars. These revenues include royalties based on revenues or production costs of our licensees that may be denominated in U.S. dollars or other currencies. Where such revenues or productions costs of our licensees are denominated in other currencies, they are converted to U.S. dollars for the purpose of calculating any licensing royalties due to us. Our licensing royalty revenues may decrease as a result of any appreciation of the U.S. dollar against these other currencies.

The majority of our current expenditures are incurred in British pounds in order to fund our operations in the United Kingdom. If the U. S. dollar depreciates versus the British pound, additional U.S. dollars will be required to fund our operations in the United Kingdom. For example, a change in the rate at which we exchange U.S. dollars to British pounds from 1.9 to 2.0 would, at the current rate of expenditure, cost us approximately an additional $1 million per year.

Item 4. Controls and Procedures

(a) ***Evaluation of disclosure controls and procedures.*** Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2007. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of March 31, 2007.

(b) ***Changes in internal control over financial reporting***. There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with the evaluation described in Item 4(a) above that occurred during the quarter ended March 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In January 2005, Sunnyside served a complaint against one of CDT Inc. s subsidiaries, Opsys Limited, and a company named by Sunnyside as CDT Limited, in the Superior Court for the County of Alameda, State of California, alleging claims for breach of contract and fraud arising out of an alleged property lease agreement between Opsys Limited and Sunnyside. In February 2005, the case was removed to the United States District Court for the Northern District of California, as Sunnyside Development Company LLC v. Opsys Limited, a United Kingdom Company. All claims against CDT Limited and the claim for fraud against Opsys Limited have been dismissed.

CDT Inc. was never a party to the lease. In October 2002, Opsys Limited and Sunnyside executed an Assignment of Lease and Consent of Lessor (the "Assignment"), which included a release of Opsys Limited from its obligations under the lease by Sunnyside. Sunnyside contends that the Assignment and release never became effective or were voided. Opsys Limited believed that the Assignment effectively released it from liability under the lease, and therefore believed that the claim had no merit. In March 2007 a jury verdict was delivered in favor of Sunnyside with damages of $4.9 million. Sunnyside is attempting to collect the judgment that it seeks to have entered against Opsys Limited on the jury verdict, plus its legal costs of approximately $1.0 million, from CDT Inc. under a successor liability theory. We believe that Sunnyside s successor liability claim against CDT Inc. will not succeed

Table of Contents

Item 1A. Risk Factors

An investment in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below together with all of the other information included in this Quarterly Report on Form 10-Q and our 2006 Form 10-K before making an investment decision. If any of the following risks or uncertainties actually occurs, our business, financial condition or results of operations could suffer. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. This Quarterly Report on Form 10-Q also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those expected in those forward-looking statements as a result of certain factors, including the risks and uncertainties faced by us described below and elsewhere in this Quarterly Report on Form 10-Q and our 2006 Form 10-K.

Risks Relating to Our Business and Industry

We have a history of losses, do not expect to be profitable in the foreseeable future and may never be profitable.

Since inception, we have generated limited revenues while incurring significant losses. We expect to incur losses for the foreseeable future until such time, if ever, as we are able to achieve sufficient levels of revenue from the commercial exploitation of our P-OLED, TMA and related technologies to support our operations. You should note that:

- neither P-OLED, TMA nor related technologies may never be broadly commercially adopted;
- markets for FPD using P-OLED, TMA and related technologies may be limited; and
- we may never generate sufficient revenues from the commercial exploitation of our P-OLED, TMA and related technologies to become profitable.

We license our P-OLED and related technologies to P-OLED materials manufacturers and display manufacturers, which then incorporate our technologies into the materials and products they sell. Even if we and our display manufacturer licensees develop commercially viable applications for our technologies, we may never recover our research and development expenses. We have had significant net losses in previous periods and expect to report net losses in future periods, and as of March 31, 2007, we had an accumulated deficit of $203 million. We cannot predict what impact continued net losses might have on our ability to finance our operations in the future or on the market value of our common stock.

Because we are at an early stage of development and have a limited operating history, our future results are unpredictable.

Our future success is uncertain because we have a limited operating history and face many risks and uncertainties. If we are unsuccessful in addressing these risks and uncertainties, we may be unable to generate sufficient revenue growth to support ongoing operations. We were formed in 1992 to research and develop P-OLED technology. We began licensing P-OLED technology to original equipment manufacturers, or OEMs, in 1996, and in 2002 this technology was initially commercialized. Accordingly, there is only a limited amount of past experience upon which to evaluate our business and prospects, and a potential investor should consider the challenges, expenses, delays and other difficulties involved in the development of our business, including the continued development of our P-OLED, TMA and related technologies, refinement of processes and components for commercial products using our P-OLED, TMA and related technologies, formation of additional commercial relationships and achievement of market acceptance for products using P-OLED, TMA and related technologies.

If our P-OLED, TMA and related technologies are not feasible for broad-based product applications, we may never generate revenues sufficient to support ongoing operations.

Before manufacturers of displays and other products which use our P-OLED, TMA and related technologies will agree to use these technologies for wide-scale commercial production, they will likely require us to demonstrate to their satisfaction that these technologies are feasible for their particular product applications. This, in turn, would require additional advances in our research and development efforts, as well as those of others, for applications in a number of areas, including:

device reliability;

the development of TMA driver chips;

the development of P-OLED materials with sufficient lifetimes, brightness and color coordinates for the applications in question; and

Table of Contents

issues related to scalability and cost-effective fabrication technologies.

Currently, P-OLED displays are being or have been used or tested for small- to medium-sized product applications such as mobile phones, PDAs, digital cameras and camcorders (including electronic viewfinders), portable DVD players, electric shavers, MP3 players, in-car entertainment and navigation displays and other applications. P-OLED displays have not yet been commercially introduced in larger applications such as laptop computers, desktop computer monitors or televisions other than in prototypes. To date, we have not attained the service lifetimes required by the manufacturers of these more demanding larger applications. Our TMA technology is at an early stage of development and has only been demonstrated in a proof of concept demonstrator.

Our research and development efforts remain subject to all of the risks associated with the development of new products based on emerging and innovative technologies, including, for example, unexpected technical problems or the possible insufficiency of funds for completing development of these products. Technical problems may result in delays in the implementation of our technologies in specific applications and cause us to incur additional expenses that would increase our losses. If we cannot complete research and development of our P-OLED technology successfully, or if we experience delays in completing research and development of our P-OLED technology for use in potential commercial applications, particularly after incurring significant expenditures, our business may fail.

Even if our P-OLED, TMA and related technologies are technically feasible, they may not be adopted by display manufacturers.

The potential size, timing and viability of market opportunities targeted by us through our display manufacturer licensees are uncertain at this time. Market acceptance of our P-OLED, TMA and related technologies will depend, in part, upon this technology providing benefits comparable to or greater than those provided by cathode ray tube display, LCD or plasma technology (the current standard display technologies) at an advantageous cost to manufacturers, and the adoption of products incorporating this technology by consumers.

Display manufacturers make the determination during their product development programs whether to incorporate our P-OLED, TMA or related technologies or pursue other alternatives, and they may be forced to make significant investments of time and cost well before they introduce their products incorporating our technology to the consumer market and before they can be sure that they will generate any significant sales to recover their investment. Moreover, certain existing licensees and potential licensees of our P-OLED technology currently manufacture FPDs using competing technologies, and they may, therefore, be reluctant to redesign their products or manufacturing processes or invest in new or converted facilities to incorporate our P-OLED, TMA or related technologies.

During a display manufacturer licensee s entire product development process, we face the risk that our technology will fail to meet our licensee s technical, performance or cost requirements or will be replaced by a competing product or alternative technology. For example, we are aware that some of our licensees have entered into arrangements with our competitors regarding the development of competing technologies, including the potential production of OLED displays by ink jet printing using phosphorescent materials. Even if we offer technology that is satisfactory to a display manufacturer licensee, they may choose to delay or terminate their product development efforts for reasons unrelated to our technology. The occurrence of any of these events would adversely affect our royalty revenues and may make it difficult to attract additional licensees.

Our TMA technology may not be adopted by display manufacturers if chips cannot be developed at a price and with power consumption and other technical characteristics which are attractive to display manufacturers.

There are alternatives to P-OLEDs for FPDs, which may limit our ability to commercialize our P-OLED technology.

The FPD market is currently, and will likely continue to be for some time, dominated by displays based on LCD technology. Numerous companies have made and are continuing to make substantial investments in, and are conducting research to improve the characteristics of, LCDs. Several other FPD technologies have been, or are being, developed, including technologies for the production of field emission, inorganic electroluminescence and plasma. Advances in LCD technology or any of these other technologies may overcome their current limitations and permit them to remain or become more attractive technologies for FPDs, either of which could limit the potential market for FPDs using our P-OLED technology. This, in turn, would cause display manufacturers to avoid entering into commercial relationships with us or to renegotiate, terminate or not renew their existing relationships with us, which may cause our business strategy to fail.

Table of Contents

Other OLED technologies may be more successful than ours, which may limit the commercial adoption of our P-OLED technology.

Other companies have developed OLED technologies that differ from and compete with our P-OLED technology. Certain of these competing OLED technologies entered the marketplace prior to ours and may become entrenched in the flat panel industry before our P-OLED technologies have a chance to become widely adopted. Moreover, competitors may succeed in developing new OLED technologies or new manufacturing techniques that are more cost-effective or have fewer limitations than our P-OLED technology or other existing OLED technologies. If our P-OLED technology is unable to capture a substantial portion of the OLED display market, our business strategy may fail.

We believe that a competitive advantage of our P-OLED technology is that, unlike the materials used by competing OLED technologies, our P-OLED materials can be dissolved in common organic solvents to make inks which can be patterned using high precision printing processes to make displays. Several other companies, including, we believe, DuPont Displays, Universal Display Corporation and Seiko Epson, are attempting to develop alternative OLED materials with similar properties and some have claimed progress in this work. If other companies succeed in the development of such materials and also develop associated device structures and manufacturing techniques, it may become possible to print OLED displays which are not covered by our intellectual property. If such technologies are successfully developed and commercialized and are perceived by display makers to be superior to our P-OLED technology, our business strategy may fail.

In the short term, a major market for our TMA technology will be Kodak s SMOLED technology, which may not be successful.

Currently, a significant market for our TMA technology is Small Molecule OLED technology. A number of plants which manufacture SMOLED displays have discontinued production during the last two years. By the time our TMA technology is ready to be commercialized, the SMOLED market may be too small to make this technology profitable. TMA technology may increase the price competitiveness of SMOLED technology and, therefore, increase the barriers to entry for our own P-OLED technology.

Because we do not manufacture or sell any products to end users, we depend on the manufacturing capabilities of our display manufacturer licensees. Any difficulties or delays affecting their manufacturing processes or any decision to terminate or reduce their display manufacturing businesses could harm our business.

We license our P-OLED and related technologies to display manufacturers, who then incorporate our technologies into the products that they sell. Because we do not manufacture any commercial products, our success depends on the ability and willingness of our licensees to develop, manufacture and sell commercial products integrating our technologies. Any significant disruption or increase in cost of the manufacturing processes of our display manufacturer licensees or a decision by any of our display manufacturer licensees to terminate or reduce their efforts to manufacture or sell displays would adversely affect our royalty revenues and thus our business.

Mass production of P-OLED displays will require the availability of suitable manufacturing equipment, components and materials. Equipment is currently available for many of the required process steps, but the processes and equipment that will be required to deposit P-OLED materials for large-sized, full-color displays are still under development. High precision ink jet printing equipment that could be used to deposit P-OLED materials is being developed by some companies, but, to our knowledge, is only being made available for sale at this time by Litrex, our former subsidiary. The availability of suitable ink jet printing equipment will be contingent on the continued technical success of and sufficient funding for Litrex s or another manufacturer s development program. In addition, certain of the components, such as low temperature poly silicon backplanes, used in the production of our licensees display products are available only from a limited number of suppliers.

If display manufacturers are unable to obtain ink jet printing or other suitable P-OLED deposition equipment or are unable to source other key equipment for the manufacture of large panel sizes or, if they experience unexpected difficulties, expenses or delays with respect to additional required technologies, components or other materials, they may experience increased costs or manufacturing delays and may not be able to manufacture larger-sized, full-color P-OLED displays or may exit the display manufacturing business entirely. This would adversely affect our license fees or royalty payments from them, and we may not be able to increase our revenues and achieve profitability.

Table of Contents

We expect to derive an increasing portion of our revenues from royalties on sales of products commercialized by our licensees that incorporate our technology. Our display manufacturer licensees operate in a highly competitive environment, and they may not be able to achieve and sustain market position. If they fail to compete successfully, our royalties will decrease or be eliminated.

Because we do not sell any products directly to end-users, our success depends upon the ability and continuing willingness of our display manufacturer licensees to market commercial products integrating our technology and the widespread acceptance of those products. Any slowdown in the demand for our licensees products would adversely affect our royalty revenues and thus our business. The markets for our display manufacturer licensees products are highly competitive, with pressure on prices and profit margins due largely to additional and growing capacity from FPD industry competitors. The principal elements affecting our licensees competitive performance in the market for end-user products include their abilities to:

- access required capital;
- conduct research and development;
- reduce time-to-market;
- reduce production costs;
- offer a competitive price;
- offer attractive product features and quality;
- offer customer service, including product design support; and
- provide sufficient quantity of products to fulfill end-user demand.

Success in the market for end-user products that may integrate our P-OLED technology also depends on factors beyond the control of our licensees and us, including the cyclical and seasonal nature of the end-user markets that our licensees serve, as well as industry and general economic conditions. If our licensees fail or otherwise reduce their efforts to commercialize products that incorporate our technology or exit the display manufacturing business entirely, our business strategy may fail.

Many of our competitors have greater resources, which may make it difficult for us to compete successfully against them.

The FPD industry is characterized by intense competition. Many of our LCD and OLED competitors have better name recognition and greater financial and personnel resources and technical, marketing and research capabilities than us, and because of these differences, we may never be able to compete successfully in the FPD market.

LCD is currently the dominant technology in the FPD market. Many of the leading LCD panel manufacturers, such as AU Optronics, Chunghwa Picture Tubes, LG.Philips, Samsung Electronics and Sharp, are large, established companies with global marketing capabilities, widespread brand recognition and extensive financial resources.

Eastman Kodak Company is our principal competitor in the OLED industry, with a number of licensees already in commercial production of displays incorporating its passive matrix small molecule OLED, or SMOLED, technology and two companies in production of active matrix driven displays.

With the formation of our 50%-owned joint venture, Sumation, we have an interest in the supply of materials to the OLED industry. Merck OLED currently competes with Sumation in the supply of P-OLED materials and other companies, such as DuPont, are believed to be developing similar products. Kodak, Idemitsu Kosan and Universal Display Corporation supply materials to display makers using Kodak s SMOLED technology.

The leading LCD panel manufacturers, who use competing technologies but are also potential licensees of our P-OLED technology, are considerably larger and more established companies, and they have global marketing capabilities and substantially greater financial resources to devote to research and development than we have. If our technology does not compete effectively with these and other display technologies, our business strategy may fail.

If our materials supplier licensees fail to make advances in their research, or if they exit that business or otherwise terminate or elect not to renew their relationships with us, we might not succeed in commercializing our P-OLED technology.

Research and development of commercially viable applications for our P-OLED technology depends substantially on the success of work relating to P-OLED materials, including resolution of issues relating to materials lifetimes and efficiencies at the brightness levels required for large panel applications. We cannot be certain that we or our materials supplier licensees will make sufficient additional advances in the research and development of P-OLED materials to satisfy these requirements. Moreover, if our materials supplier licensees are unable to meet the requirements of our display manufacturer licensees, or if they exit the P- OLED materials supply business or otherwise terminate or elect not to renew their relationships with us and no viable successor can be found, our business strategy may fail.

Table of Contents

If we cannot form and maintain lasting business relationships with P-OLED display manufacturers, our business strategy will fail.

Our business strategy depends upon our development and maintenance of commercial licensing relationships with high-volume manufacturers of P-OLED displays. We have issued licenses to a number of display manufacturers and have technology development relationships with a number of other companies in the industry for the purpose of evaluating our P-OLED technology for possible use in commercial production. Any of these relationships may fail to result in the display manufacturers entering into a licensing arrangement or, subsequently, commercial production, as applicable, of devices using our P-OLED technology on a scale sufficient for our business strategy to succeed. Moreover, if a licensee is no longer using our technology, it can generally terminate the license agreement upon notice and without further payment to us.

Under our existing technology development and evaluation agreements, we are working with display manufacturers to incorporate our technology into their products for the commercial production of P-OLED displays. However, these technology development and evaluation agreements typically last for limited periods of time, and these relationships may never lead to development of products and entry into license agreements.

Currently, and for the foreseeable future, a significant portion of our revenues are and will be derived from a concentrated number of licensees. Our future success will depend upon our ability to establish and maintain relationships with key licensees and to attract new licensees. If our royalty revenues continue to be derived from a few licensee relationships, our operating results will be harmed if those licensees experience operating difficulties or curtail or terminate their use of our licensed technology, and we are not able to obtain replacement royalty sources. Replacement royalty sources may be difficult to obtain because of the lengthy periods required to attract and sign-up new licensees and have them enter commercial production.

Our ability to enter into additional commercial licenses, or to maintain our existing technology development and evaluation relationships, may require us to make financial or other commitments. We might not be able, for financial or other reasons, to enter into or continue these relationships on commercially acceptable terms or at all. Failure to do so would cause our business strategy to fail.

Conflicts may arise with our licensees or joint development partners, resulting in renegotiation or termination of, or litigation related to, our agreements with them. This would adversely affect our revenues.

Conflicts could arise between us and our licensees or joint development partners as to royalty rates, milestone payments or other commercial terms. Similarly, the parties may disagree as to which party owns or has the right to commercialize intellectual property that is developed during the course of the relationship or as to other non-commercial terms. If such a conflict were to arise, a licensee or joint development partner might attempt to compel renegotiation of certain terms of their agreement or terminate their agreement entirely, and we might lose the royalty revenues and other benefits of the agreement. Either we or the licensee or joint development partner might initiate litigation to determine commercial obligations, establish intellectual property rights or resolve other disputes under the related agreements. Such litigation could be costly to us and require substantial attention of management. If we were unsuccessful in such litigation, we could lose the commercial benefits of the agreement, be liable for other financial damages and suffer losses of intellectual property or other rights that are the subject of dispute. Any of these adverse outcomes could cause our business strategy to fail. Some of our licenses contain most favored nation provisions. These provisions give licensees the right to reduced royalty rates or refunds of upfront fees in the event that we issue new licenses that have more favorable upfront fee or royalty rates than the existing licenses that contain these most favored nation provisions, but are otherwise similar in their terms.

If we do not receive additional financing in the future, we might not be able to continue the research, development and commercialization of our P-OLED, TMA and related technologies.

Our capital requirements have been, and will continue to be, significant. Substantial additional funds will be required in the future to maintain current levels of expenditure for research, development and commercialization of our P-OLED, TMA and related technologies, to obtain and maintain patents and other intellectual property, or IP, rights in these technologies, as well as for working capital and other purposes, the timing and amount of which are difficult to forecast. If we do not achieve our revenue goals, our cash on hand may not be sufficient to meet all of our future needs. When we need additional funds, such funds may not be available on commercially reasonable terms or at all. If we cannot obtain more money when needed, we might be forced to cut back our current

Table of Contents

activities and our business might fail. We expect, based on our internal forecast and assumptions relating to our operations (including, among others, assumptions regarding our working capital requirements, the progress of our research and development efforts and our revenues, including stage payments due to us pursuant to our contractual arrangements with Matsushita Electrical Industrial), that we will have sufficient cash to meet our obligations for at least the next 12 months. If at some future time, we are unable to demonstrate that we have sufficient cash to meet our obligations for at least the following 12 months, we might have to reconsider the going c