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 June 30, 2006

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 21,483,205 as of August 11, 2006.

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CAUTIONARY STATEMENT

CONCERNING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains 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, technology referred to below;
- the potential commercial applications of our P-OLED technology, and of OLED products in general;
- our ability to form and continue joint ventures and other strategic relationships with manufacturers of P-OLED materials and displays;
- successful commercialization of products including our P-OLED technology 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 technology;
- the comparative advantages and disadvantages of our technology 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 , w 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.

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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, CDT, Cambridge Display Technology and Sumation.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

Consolidated Balance Sheets

(in thousands, except share information)

	June 30, 2006 (unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,106	$ 31,263
Marketable securities	1,874	
Inventory	124	32
Accounts receivable, net	100	2,266
Taxes receivable	2,879	2,045
Prepaid expenses and other current assets	2,224	2,473
Total current assets	28,307	38,079
Property, equipment and leasehold improvements, net	11,463	13,593
Investments in affiliates.	3,845	1,899
Marketable securities	334	633
Goodwill	65,612	65,612
Other intangible assets, net	2,107	2,897
Total assets.	$ 111,668	$ 122,713
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 6,149	$ 7,910
Deferred revenue	1,044	1,290
Due to affiliate	70	52
Taxes payable		6
Other current liabilities	2,109	
Total current liabilities	9,372	9,258
Other liabilities	580	567
Commitments and contingencies (Note 8)		
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, 21,674,703 issued and 21,483,205 outstanding	215	215
Additional paid-in capital	283,090	287,514
Deferred compensation		(6,082)
Accumulated other comprehensive loss	(1,277)	(1,052)

Accumulated deficit	(180,312)	(167,707)
Total common shareholders equity	101,716	112,888
Total liabilities and shareholders equity	$ 111,668	$ 122,713

See accompanying notes.

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CAMBRIDGE DISPLAY TECHNOLOGY, INC.

Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Three months ended June 30, 2006	2005
Operating revenues:		
License fees and royalties	$ 2,002	$ 994
Technology services and development	683	1,678
Equipment and supplies	12	
Total operating revenues	2,697	2,672
Cost of sales:		
License fees and royalties	11	12
Technology services and development	270	649
Equipment and supplies	11	
Total cost of sales	292	661
Gross profit	2,405	2,011
Operating expenses:		
Research and development expenses	3,210	4,184
Selling, general and administrative expenses	3,605	4,358
Amortization of intangibles acquired	395	395
Total operating expenses	7,210	8,937
Loss from operations	(4,805)	(6,926)
Other (expense) / income:		
Equity in loss of affiliates	(1,599)	191
Foreign currency transaction gain / (loss)	489	(172)
Other income/(expense)	357	(373)
Interest income	304	191
Total other expense	(449)	(163)
Loss before benefit for income taxes	(5,254)	(7,089)
Benefit for income taxes	(282)	(380)
Net loss	$ (4,972)	$ (6,709)
Net loss per common share attributable to common shareholders, basic and diluted	$ (0.23)	$ (0.34)
Weighted average number of common shares outstanding, basic and diluted	21,483	19,485

See accompanying notes.

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CAMBRIDGE DISPLAY TECHNOLOGY, INC.

Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Six months ended June 30, 2006	2005
Operating revenues:		
License fees and royalties	$ 2,081	$ 1,123
Technology services and development	1,381	3,110
Equipment and supplies	270	
Total operating revenues	3,732	4,233
Cost of sales:		
License fees and royalties	12	13
Technology services and development	486	1,124
Equipment and supplies	169	
Total cost of sales	667	1,137
Gross profit	3,065	3,096
Operating expenses:		
Research and development expenses	6,305	8,164
Selling, general and administrative expenses	7,574	8,383
Amortization of intangibles acquired	790	790
Total operating expenses	14,669	17,337
Loss from operations	(11,604)	(14,241)
Other (expense) / income:		
Equity in loss of affiliates	(3,014)	(1,410)
Foreign currency transaction gain / (loss)	276	(94)
Other income/(expense)	610	(789)
Interest income	561	361
Total other expense	(1,567)	(1,932)
Loss before benefit for income taxes	(13,171)	(16,173)
Benefit for income taxes	(566)	(795)
Net loss	$ (12,605)	$ (15,378)
Net loss per common share attributable to common shareholders, basic and diluted	$ (0.59)	$ (0.79)
Weighted average number of common shares outstanding, basic and diluted	21,483	19,485

See accompanying notes.

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CAMBRIDGE DISPLAY TECHNOLOGY, INC.

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six months ended June 30, 2006	2005
Operating activities		
Net loss	$ (12,605)	$ (15,378)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization of property, equipment and leasehold improvements	2,689	2,830
Loss on sale of property, equipment and leasehold improvements	(2)	(14)
Amortization of other intangible assets	790	790
Stock compensation expense	1,658	1,537
Equity in loss of affiliates	3,014	1,410
Changes in operating assets and liabilities:		
Accounts and tax receivable	1,332	2,857
Due from affiliates		308
Inventories and demo machines	(92)	
Prepaid expenses and other current assets	249	(1,585)
Accounts and tax payable and accrued expenses	(1,767)	(1,598)
Due to affiliates	18	
Deferred revenue	(246)	861
Other current and non-current liabilities	2,122	82
Net cash used in operating activities	(2,840)	(7,900)
Investing activities		
Acquisition of property, equipment and leasehold improvements	(557)	(1,031)
Disposal of property, equipment and leasehold improvements		21
Loans advanced to affiliate (Litrex)		(1,715)
Investment in affiliates	(4,886)	(1,127)
Investment in marketable securities	(1,874)	
Net cash used in investing activities	(7,317)	(3,852)
Financing activities		
Issuance of common stock		(67)
Net cash used in financing activities		(67)
Net decrease in cash	(10,157)	(11,819)
Cash and cash equivalents beginning of period	31,263	26,892
Cash and cash equivalents end of period	$ 21,106	$ 15,073
Supplemental disclosures of cash flow information		
Interest paid	$ 2	
Taxes paid	$ 108	$ 111

See accompanying notes.

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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 six and three months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. 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, 2005, or our 2005 Form 10-K .

2. Significant Accounting Policies

In March 2006, the Company purchased a number of certificates of deposits, some with maturities of 90 days or less and others with maturities of more than 90 days but less than one year. The Company includes certificates of deposits with maturities of 90 days or less within Cash and cash equivalents and includes certificates of deposits with maturities of more than 90 days but less than one year as Marketable securities within current assets. The Company intends to hold these certificates until maturity and, therefore, considers these as held to maturity investments and not available for sale investments. The Company accrues interest receivable from these certificates as of the end of each period, but does not revalue them based on current market prices.

See Notes 5 and 7 for a description of changes to the Company s accounting policy with regard to stock-based compensation.

3. Other Comprehensive Loss

An unrealized loss of $0.2 million was reported in the six months ended June 30, 2006 due to the revaluation of securities held by the Company. The reported unrealized loss is due to the decline in the market price of these securities. The foreign currency translation adjustments include the effect of revaluing the marketable securities which are held in British pounds and also the effect of revaluing the Company s Japanese yen investment in Sumation Company Limited, or Sumation, a 50%-owned joint venture between the Company and Sumitomo Chemical Company Limited, or Sumitomo Chemical.

	Six months ended June 30,	
	2006	2005
	(in thousands)	
Net Loss	$ (12,605)	$ (15,378)
Other comprehensive loss:		
Unrealized losses on marketable securities	(325)	(140)
Foreign currency translation adjustments	100	(76)
Other comprehensive loss:	(225)	(216)
Comprehensive loss	$ (12,830)	$ (15,594)

4. Investments in Affiliates

In January 2006 and April 2006, the Company invested $1.6 million and $3.3 million, respectively, in Sumation. In the six months ended June 30, 2006, Sumation paid to the Company $6.0 million, in aggregate, as reimbursement of research and development expenses. This reimbursement covers the nine months from January 2006 to September 30, 2006 and, therefore,

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$4.0 million has been credited to research and development expense and the remaining $2.0 million is included within other current liabilities. In March 2006, Summation purchased from the Company intellectual property rights which the Company had acquired from a third party for $1.4 million.

5. Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)), which replaces SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), and supersedes Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first interim period after December 15, 2005. The Company adopted SFAS 123(R) effective January 1, 2006 and the impact and method of adoption is described in Note 7 below.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140 (SFAS 155). SFAS 155 amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140). SFAS 155 permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. Since the Company does not have any such instruments, it does not expect the adoption of SFAS 155 to have a material impact on its financial condition or results of operations.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140 (SFAS 156). SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations. Since the Company does not have any such liabilities, it does not expect the adoption of SFAS 156 to have a material impact on its financial condition or results of operations.

In June 2006, the FASB ratified a tentative conclusion of the Emerging Issues Task Force (EITF) on Issue 06-03 How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation) . The EITF conclusion requires companies to disclose whether reported revenues include any government-imposed sales or value added taxes. The Company will adopt this conclusion in its financial statements for the fiscal year ending December 31, 2006 by including in its significant accounting policy disclosures a statement that revenues are reported on a net basis, excluding sales and value added taxes but does not expect this to have a material impact on its financial condition or results of operations.

In July 2006, 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. FIN 48 is effective beginning with the Company s first fiscal quarter of 2007. The Company has not yet evaluated the impact of FIN 48 s implementation on its financial condition or results of operations.

6. Income Taxes

Income taxes are a benefit for the six months ended June 30, 2006 and 2005 reflecting tax credits to be received for research and development costs from the United Kingdom government, net of Delaware franchise tax payments.

The Taxes receivable balance of $2.9 million at June 30, 2006 includes $2.0 million of income tax refunds due for the year ended December 31, 2005 and $0.7 million for the six months ended June 30, 2006. The remaining balance represents anticipated United Kingdom value added tax recoveries.

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7. Stock-Based Compensation

At June 30, 2006, the Company had three stock-based employee compensation plans, which are described more fully below. Prior to January 1, 2006, the Company accounted for those plans under the recognition and measurement provisions of APB 25 and related interpretations, as permitted by SFAS 123. No stock-based employee compensation cost was recognized in relation to the Company s two stock option plans in the Statement of Operations for the three and six months ended June 30, 2005, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Stock compensation expense was recognized in relation to restricted stock units which had been issued pursuant to the Company s special bonus plan. Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123(R) using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the three and six months ended June 30, 2006 includes (a) compensation cost for all share-based payments granted prior to, but not yet vested, as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Results for prior periods have not been restated.

SFAS 123(R) requires that compensation expense be adjusted for projected forfeitures of stock options. In calculating pro-forma stock-based employee compensation expense prior to January 1, 2006, the Company did not make any adjustment for such forfeitures.

The effect of the adoption of SFAS 123(R) on the Company s Loss from operations, Loss before benefit for income taxes and Net loss has been to decrease each of these by less than $0.1 million for the three months ended June 30, 2006 and to increase each of these by $0.2 million for the six months ended June 30, 2006, in relation to compensation expense for stock options as shown in the table below. The adoption of SFAS 123(R) has had no net impact on the Company s statement of cash flows and no material impact on earnings per share.

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	Compensation Expense for three months ended June 30, 2006	Pro Forma Compensation Expense for three months ended June 30, 2005
	(in thousands)	
CDT Acquisition Corp. Stock Incentive Plan (1)	$ 4	$ 77
2004 Stock Incentive Plan (1)	(32)	58
Total Compensation Expense for Stock Options (1)	**$ (28)**	**$ 135**
Special Bonus Plan (2)	$ 753	$ 770
Total Compensation Expense for Restricted Stock Units (2)	**$ 753**	**$ 770**
Total Stock-Based Compensation Expense	**$ 725**	**$ 905**

	Compensation Expense for six months ended June 30, 2006	Pro Forma Compensation Expense for six months ended June 30, 2005
	(in thousands)	
CDT Acquisition Corp. Stock Incentive Plan (1)	$ 25	$ 159
2004 Stock Incentive Plan (1)	132	109
Total Compensation Expense for Stock Options (1)	**$ 157**	**$ 268**
Special Bonus Plan (2)	$ 1,501	$ 1,537
Total Compensation Expense for Restricted Stock Units (2)	**$ 1,501**	**$ 1,537**
Total Stock-Based Compensation Expense	**$ 1,658**	**$ 1,805**

(1) compensation expense for stock options for the three and six months ended June 30, 2005 was only reported in pro-forma footnote disclosures and not in the Statement of Operations.

(2) compensation expense for restricted stock units issued in relation to the special bonus plan for the three and six months ended June 30, 2005 was both reported in pro-forma footnote disclosures and recognized in the Statement of Operations. The only impact on the adoption of SFAS 123(R) on the compensation expense recognized with respect to these units was to account for estimated future forfeitures. This impact is not material.

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For the three and six months ended June 30, 2005, the Company followed APB 25 and related interpretations in accounting for stock options awarded to employees. Accordingly the Company recognized no compensation expense with respect to options granted to employees. Had compensation cost been determined based upon the fair value at grant date for awards consistent with the methodology prescribed by SFAS 123, the Company s net loss for the three months and six months ended June 30, 2005 would have been the pro forma amounts indicated below:

	Three Months Ended June 30, 2005 2005	Six Months Ended June 30, 2005 2005
	(in thousands)	
Net loss as reported	$ (6,709)	$ (15,378)
Add back: APB 25 expense	770	1,537
Less: total stock-based employee compensation expense under the fair value method	(905)	(1,805)
Net loss attributable to common shareholders - pro forma	$ (6,844)	$ (15,646)
Net loss per share:		
Basic and diluted as reported	$ (0.34)	$ (0.79)
Basic and diluted pro forma	$ (0.35)	$ (0.80)

Employee Stock Options

In April 2000, the Company adopted the CDT Acquisition Corp. Stock Incentive Plan (the 2000 Plan). Under the 2000 Plan, options may be granted to employees, consultants and directors. Options available for grant under the 2000 Plan totaled 1,170,361. Under the 2000 Plan, employees generally were granted two types of options in one grant: Service Options (one-third of total grant) and Exit Options (two-thirds of total grant). Service Options granted in 2002 and later were granted at fair market value at date of grant, and generally vest 25% on the six-month anniversary of grant, and 25% on the anniversary date of each grant for each of the next three years and have lives of no more than 10 years. Fair value was determined by reference to equity sold during the relevant period. Prior to 2002, Service Options were generally granted at fair market value at date of grant, vest 25% on the date of grant and 25% per annum thereafter and have lives of no more than 10 years. Exit Options become exercisable, if at all, on the date of the first occurrence of a change in control (a Vesting Event , as defined in the 2000 Plan) in which the majority shareholders receive an internal rate of return of at least 30%. If upon the first Vesting Event, the required internal rate of return is not achieved, they shall not become exercisable as a result of a Subsequent Vesting Event, as defined in the 2000 Plan.

In August 2004, the Company adopted the 2004 Stock Incentive Plan (the 2004 Plan). The 2004 Plan provides for the award of (i) stock options (including incentive stock options), (ii) restricted stock and restricted units, (iii) stock appreciation rights, (iv) incentive stock and incentive units and (v) deferred shares and supplemental units. Awards may be made to directors, officers, employees and consultants. Any options issued will be priced at fair market value and the number of shares subject to such options and awards will be a maximum of 725,000 shares of the Company s common stock plus such number of options granted under the 2000 Plan as are forfeited under the 2000 Plan or which otherwise lapse after December 2004. To date, only stock options with exercise prices of the fair market value on the date of grant have been issued under the 2004 Plan. All such options vest in three equal annual installments from the date of grant, with accelerated vesting upon change of control, and have no conditions attached to exercise other than continued employment with the Company. These options expire 10 years after grant. Effective January 1, 2006, the Company has been recognizing compensation expense for stock options ratably over the vesting period of the option, adjusted for projected and actual forfeitures.

The fair value of options is estimated at the date of grant using the Black-Scholes option pricing model using assumptions for the risk-free interest rate, volatility factor and expected life as detailed in the table below. The volatility factor for options issued prior to the Company s initial public offering in December 2004 was based on the volatility of the Company s stock price as measured using the prices at which stock was bought while the Company remained private. The volatility factor used for options issued on or after the Company s initial public offering but before the December 31, 2005 was based on fluctuations in the stock price of comparable public companies. Effective January 1, 2006, the Company calculated the volatility of its own stock using the daily closing price for the period since its initial public offering and determined that this provided a reasonable estimate of future volatility. The Company believes that an expected life of four years is a reasonable assumption for a company whose stock is relatively volatile but does not currently have any history of options being exercised.

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Options Issued in:	2006 Q1	2005	2004 (post-IPO)	2004 (pre-IPO)	2003
Black-Scholes Assumptions:					
Risk Free Interest Rate	4.363%	3.31%	3.31%	4.25%	4.25%
Volatility Factor	68.0%	74.8%	74.8%	15.3%	15.7%
Expected Life	4 Years	4 Years	4 Years	4 Years	4 Years
Dividend Yield	Zero	Zero	Zero	Zero	Zero

No stock options were issued by the Company in the three months ended June 30, 2006.

The Company makes an estimate of projected stock option forfeitures based on historical staff departures, adjusted for any one-time events which it does not believe will be representative of future periods.

A summary of stock option activity for the six months ended June 30, 2006 is shown in the table below.

Stock Options	Shares	Exercise Price Range	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding December 31, 2005	**786,690**	**$ 5.70 - $27.60**	**$ 20.50**		
Granted	149,400	$ 8.21 - $ 8.21	$ 8.21		
Cancelled	(47,863)	$ 8.00 - $27.60	$ 19.13		
Outstanding March 31, 2006	**888,227**	**$ 5.70 - $27.60**	**$ 14.30**	**7.51**	**$ 205**
Cancelled	(243,716)	$ 7.40 - $27.60	$ 8.98		
Outstanding June 30, 2006	**644,511**	**$ 5.70 - $27.60**	**$ 16.32**	**6.69**	**$ 7**
Exercisable at June 30, 2006	**248,532**	**$ 8.04 - $27.60**	**$ 19.31**	**5.34**	**$ 0**

The fair value of each of the 149,400 options granted in the six months ended June 30, 2006 was $4.48. No options have been exercised since the Company s initial public offering in December 2004. The Company will issue new shares in the event that any options are exercised. At June 30, 2006, 942,406 shares were available for future grants.

The Company recognized less than $0.1 million of stock compensation expense in relation to stock options in the three months ended June 30, 2006 and $0.2 million of such compensation expense in the six months ended June 30, 2006. The Company will recognize $0.3 million of compensation expense in the remaining six months of 2006, $0.5 million in 2007 and $0.3 million in 2008 with respect to stock options which were granted prior to June 30, 2006 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.

Special Bonus Plan

In December 2004, the Company allocated awards under its special bonus plan to officers and employees. These awards were made from a bonus pool with a value of $14.4 million, based on the initial public offering price for our common stock of $12.00 per share. All awards under this plan made with respect to this offering were made in restricted stock units representing a right to receive, in the aggregate, 1,200,000 shares of our common stock. Such awards generally vest in three equal installments on each of the first three anniversaries of the public offering. However, if Kelso & Company, or Kelso, the Company s largest shareholder, sells, in the aggregate, more than 25% of its shares of our common stock, such awards will vest in full upon such sale. Except as discussed below in relation to the award made to the Company s chief executive officer, the Company is expensing the value of these awards over a three-year period commencing December 2004, subject to acceleration in the event of a Kelso sale.

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A large majority of the awards made under this plan will be subject to U.K. employer s national insurance tax, which is currently 12.8% of the value of the awards and which would be payable by the Company based on the market value of the stock on the date it becomes available for sale. The charge for the U.K. employer s national insurance tax will depend on the market price of our common stock when it is delivered and will have to be paid at the time the stock is issued to the award holders.

The award to the Company s chief executive officer, representing 35% of the bonus pool, or restricted stock units with a value of $5.0 million at the initial public offering price of $12.00 per share, will vest whether or not he remains employed by the Company unless (a) he is terminated for cause (as defined in his employment agreement), (b) his employment agreement is not extended for cause or (c) he terminates his employment in circumstances that justify termination for cause. The value of the award to the Company s chief executive officer, plus the U.K. estimated employer s national insurance tax of 12.8% payable by the Company, was expensed in December 2004.

Until December 31, 2005, the Company accounted for these issued units under APB 25 whereby the fair value of these units at the issuance date is expensed over the vesting period. In adopting SFAS 123(R) effective January 1, 2006, the Company has continued to use the same fair value assumption for these units. The Company has considered likely future forfeitures of awards made under this plan and, in doing so, has divided the recipients into two categories: executive management which holds 92% of the award and other employees which hold 8% of the awards. The Company believes that it is highly unlikely that any of the executive management will forfeit any of their awards under this plan prior to vesting and has, therefore, applied a staff turnover assumption of zero to this category. It has applied the same staff turnover percentage as is being used for stock options to the other employees category. The result of applying these forfeiture assumptions is immaterial and no cumulative effect of accounting change has been reported as a result of the adoption of SFAS 123(R) with respect to this plan.

In the three months and six months ended June 30, 2006, the Company charged $0.8 million and $1.6 million, respectively, to operating expenses in relation to awards to bonus holders other than the Company s chief executive officer. There was a reduction of the liability which had been accrued at December 31, 2005 for U. K. national insurance tax on special bonus plan awards due to a decline in the Company s share price between December 31, 2005 and June 30, 2006 and a charge in relation to U.K. national insurance tax on awards which were expensed in the six months ended June 30, 2006. The net of these two amounts was $0.1 million and so no net charge of this amount was made in relation to U. K. national insurance tax on special bonus plan awards in the three and six months ended June 30, 2006.

The U.K. national insurance tax accrual on special bonus plan awards will continue to vary depending on the share price at the end of each quarter, the vesting schedule, the current U. K. employer s national insurance tax rate and whether or not award holders become subject to, or continue to be subject to, U.K. national insurance tax.

8. Commitments and Contingencies

In January 2005, Sunnyside Development Company filed a complaint against Opsys Limited and a company named by Sunnyside Development as CDT Limited, which is presumably intended to refer to one of the Company s subsidiaries, Cambridge Display Technology Limited, in California Supreme Court alleging breach of contract and fraud arising out of an alleged property lease agreement between Opsys Limited and Sunnyside Development. Sunnyside Development seeks compensatory damages that it claims exceed $10 million (principally by way of unpaid rent and other costs associated with the lease) and punitive damages in the amount of $25 million.

In February 2005, the action was removed to the United States District Court for the Northern District of California. In April 2005, the United States District Court dismissed all the claims against CDT Limited and the claim for fraud against Opsys Limited, but gave Sunnyside permission to amend all its claims. On May 11, 2005, Sunnyside filed an amended complaint reasserting breach of contract and fraud claims against both Opsys Limited and CDT Ltd. The Company made a further application to dismiss the claims and on August 8, 2005 the amended claims against CDT Limited and Opsys Limited were dismissed with prejudice and with no leave to amend, except for the claim for breach of contract against Opsys Limited. On January 17th, 2006 Sunnyside Development filed a Second Amended Complaint for breach of contract against Opsys Limited only.

Cambridge Display Technology Limited was not party to the lease and prior to the Company s acquisition of an interest in certain of the activities of Opsys in October 2002, Opsys Limited and Sunnyside Development executed an Assignment of Lease and Consent of Lessor, which included a release of Opsys Limited by Sunnyside Development. The Company therefore believes that the claim has no merit. The Company further believes that the claim for punitive damages is no longer valid since the claim for fraud has been dismissed.

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The Company therefore expects to defend the remaining claim. Fact discovery is ongoing and scheduled to close on September 8, 2006. The matter is scheduled for trial in February 2007.

Under the terms of a contract research agreement between Merck OLED, formerly known as Covion Organic Semiconductors, and the Company, the Company was obligated to provide the equivalent of ten full service equivalent scientists and engineers to work on research and development projects related to P-OLED materials until December 2006. The Company receives royalties from Merck OLED based on the revenues for all Merck OLED s sales of P-OLED materials, whether or not those materials were developed by the project team. These royalties were payable pursuant to the contract research agreement and a separate intellectual property license. Until June 30, 2006, the royalties received from Merck OLED were less than the costs of funding the project team and such excess costs were expensed. In July 2006, Merck OLED and the Company agreed to terminate the contract research agreement but the intellectual property license remains in force.

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.

Commitments

In March 2006, the Company cancelled its line of credit from Lloyds TSB which had been secured by a letter of credit arranged by IPI Financial Services. As a result of this cancellation, the Company has been released from its obligations to pay certain fees to both Lloyds TSB and IPI Financial Services, to report the filing of any new patents, trademarks and copyrights and add those to the existing intellectual property portfolio which has been assigned as security to IPI Financial Services and to maintain the validity of all of its patents and only to license such patents to third parties under terms which are within the parameters of its customary licensing practices or to which IPI Financial Services has provided its consent.

8. Subsequent Events

In July 2006, pursuant to contractual arrangements which had been entered into in March 2005, the Company delivered a license to certain intellectual property to Add-Vision, Inc. in consideration for which it was issued with shares of preferred stock. Prior to this transaction, the Company had a 31% voting interest and a 42% ownership interest in Add-Vision, Inc. After the transaction, the Company had a 42% voting interest and a 55% ownership interest in Add-Vision, Inc.

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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, from 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 nine 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, 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 June 30, 2006, we had an accumulated deficit of $180.3 million, in large part due to the research and development expenditures we have incurred. Our total research and development expenditures since 1999 exceed $94 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, 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. Two of our senior executives are based in Japan, one of whom is seconded to Sumation, our 50%-owned joint venture with Sumitomo Chemical. 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 display drivers; 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.

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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, have higher resolution and faster printing speeds. Other companies are conducting research and development into lighting applications for P-OLED technology.

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 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 six months of 2006 of $ 6.3 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 consumer and industrial electronic products.

Results of Operations

Comparison of Three and Six Months Ended June 30, 2006 and June 30, 2005

Operating Revenues

(in thousands, except percentages)	Three months ended June 30, 2006	Three months ended June 30, 2005	% Increase / (Decrease)	Six months ended June 30, 2006	Six months ended June 30, 2005	% Increase / (Decrease)
License fees and royalties	$ 2,002	$ 994	101%	$ 2,081	$ 1,123	85%
Technology services and development	683	1,678	(59)%	1,381	3,110	(56)%
Equipment and supplies	12		N/A	270		N/A
Total operating revenues	**$ 2,697**	**$ 2,672**	**1%**	**$ 3,732**	**$ 4,233**	(12)%

License fees and royalties revenues increased by $1.0 million, or 101%, from $1.0 million in the second quarter of 2005 to $2.0 million in the second quarter of 2006. This increase was attributable to a license fee of $1.0 million recognized in the second quarter of 2006 in relation to the licensing of intellectual property rights and the balance in each quarter comprised royalties received from four licensees in the second quarter of 2006 and five licensees in the second quarter of 2005.

License fees and royalty revenues increased by $1.0 million, or 85%, from $1.1 million in the first six months of 2005 to $2.1 million in the first six months of 2006 for the same reasons as described in the previous paragraph Royalty revenues were received from six licensees in both periods.

Technology services and development revenues declined by $1.0 million, or 59%, from $1.7 million in the second quarter of 2005 to $0.7 million in the second quarter of 2006 because revenue was received from Sumitomo Chemical in the second quarter of 2005 but no corresponding revenue was received from Sumitomo Chemical in the second quarter of 2006, due to the establishment of Sumation, our 50%-owned joint venture with Sumitomo Chemical, in November 2005 and the termination of the contract research arrangements with Sumitomo Chemical which had previously applied. Technology services and development revenues were received from seven customers during each of the second quarters of 2006 and 2005.

Technology services and development revenues declined by $1.7 million, or 56%, from $3.1 million in the first six months of 2005 to $1.4 million in the first six months of 2006 because of lower revenues from Sumitomo Chemical, as described in the previous paragraph. Technology services and development revenues were received from seven customers during each of the second quarters of 2006 and 2005.

Equipment and supplies revenue was less than $0.1 million in the second quarter of 2006 and $0.3 million in the first six months of 2006 compared with zero in the second quarter and first six months of 2005.

Samsung Electronics and Osram Opto each accounted for in excess of 10% of our revenues in both the second quarter and the first six months of 2006.

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Cost of Sales

(in thousands, except percentages)	Three months ended June 30, 2006	% of Revenues *	Three months ended June 30, 2005	% of Revenues *	Six months ended June 30, 2006	% of Revenues *	Six months ended June 30, 2005	% of Revenues *
License fees and royalties	$ 11	1%	$ 12	1%	$ 12	1%	$ 13	1%
Technology services and development	270	40%	649	39%	486	35%	1,124	36%
Equipment and supplies	11	92%			169	63%		
Total cost of sales	**$ 295**	**11%**	**$ 661**	**25%**	**$ 670**	**18%**	**$ 1,137**	**27%**
Gross profit	**$ 2,405**	**89%**	**$ 2,011**	**75%**	**$ 3,065**	**82%**	**$ 3,096**	**73%**

* 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 in the both the second quarters and the first six months of both 2006 and 2005. 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.

Cost of sales related to Technology services and development increased from 39% in the second quarter of 2005 to 40% in the second quarter of 2006 and decreased from 36% in the first six months of 2005 to 35% in the first six months of 2006. Although the cost of sales percentage will fluctuate from quarter to quarter due to the differing requirements of revenue generating projects, we believe that the percentage reported in the second quarter of 2006 will be broadly representative of future periods.

Cost of sales related to Equipment and supplies revenues was 92% of related sales for the second quarter of 2006 and 63% of related sales for the first six months of 2006. There were no revenues or costs for Equipment and supplies in the first six months of 2005. We believe that cost of sales as a percentage of revenue for Equipment and supplies reported in the first six months of 2006 will be representative of future quarters.

Gross profit increased by $0.4 million, or 20%, from $2.0 million in the second quarter of 2005 to $2.4 million in the second quarter of 2006 and was $3.1 million in the first six months of both 2005 and 2006. The aggregate margin percentage was higher in each of the second quarter and the first six months of 2006 because of the revenue mix: a higher proportion of our revenues in each of the second quarter and the first six months of 2006 came from higher margin revenue categories compared with the second quarter and the first six months of 2005.

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.

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Operating Expenses

(in thousands, except percentages)	Three months ended June 30, 2006	Three months ended June 30, 2005	% Increase / (Decrease)	Six months ended June 30, 2006	Six months ended June 30, 2005	% Increase / (Decrease)
Research and development expenses	3,210	4,184	(23)%	6,305	8,164	(23)%
Selling, general and administrative expenses	3,605	4,358	(17)%	7,574	8,383	(10)%
Amortization of intangibles acquired	395	395		790	790	
Total Operating Expenses	**$ 7,210**	**$ 8,937**	**(19)%**	**$ 14,669**	**$ 17,337**	**(15)%**

Our research and development expenses decreased by $1.0 million, or 23%, from $4.2 million in the second quarter of 2005 to $3.2 million in the second quarter of 2006 because of:

- a decrease of $1.9 million due to costs being reimbursed by Sumation, our 50%-owned joint venture with Sumitomo Chemical (this level of reimbursement is likely to continue in future periods);
- an increase of $0.5 million due to government grants received in the second quarter of 2005 versus zero in the second quarter of 2006;
- an increase of $0.1 million in stock compensation expense;
- a decrease of $0.1 million due to lower expenditures on research projects; and
- an increase of $0.4 million due to less of the cost of the research and development function being charged to revenue generating projects and correspondingly more being charged to Research and development expense, which $0.4 million increase was due to $0.9 million of such cost in the second quarter of 2005 compared with $0.5 million of such cost in the second quarter of 2006 incurred 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.

Our research and development expenses decreased by $1.9 million, or 23%, from $8.2 million in the first six months of 2005 to $6.3 million in the first six months of 2006 because of:

- a decrease of $3.7 million due to costs being reimbursed by Sumation, our 50%-owned joint venture with Sumitomo Chemical (this level of reimbursement is likely to continue in future periods);
- an increase of $0.6 million due to government grants received in the first six months of 2005 versus zero in the first six months of 2006;
- an increase of $0.2 million in stock compensation expense; and
- an increase of $1.0 million due to less of the cost of the research and development function being charged to revenue generating projects and correspondingly more being charged to Research and development expense, which $1.0 million increase was due to

$1.7 million of such cost in the first six months of 2005 compared with $0.7 million of such cost in the first six months of 2006 incurred 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 decreased by $0.8 million, or 17%, from $4.4 million in the second quarter of 2005 to $3.6 million in the second quarter of 2006 because of:

- a decrease of $0.3 million due to lower stock compensation expense due primarily to a reversal of the expense accrued in prior periods with respect to unvested stock options which were forfeited when the option holders ceased being employed by us;

- a decrease of $0.2 million due to administrative expenses being re-imbursed by Sumation, our 50%-owned joint venture with Sumitomo Chemical, a level of reimbursement which is expected to continue in future periods; and

- a decrease of $0.3 million in relation to reductions in a number of expense items, the most significant of which was a $0.1 million decrease in relation to our line of credit which was terminated by us in the first quarter of 2006.

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Our selling, general and administrative expenses decreased by $0.8 million, or 10%, from $8.4 million in the first six months of 2005 to $7.6 million in the first six months of 2006 because of:

a decrease of $0.2 million due to lower stock compensation expense due primarily to a reversal of the expense accrued in prior periods with respect to unvested stock options which were forfeited when the option holders ceased being employed by us;

a decrease of $0.3 million due to administrative expenses being re-imbursed by Sumation, our 50%-owned joint venture with Sumitomo Chemical, a level of reimbursement which is expected to continue in future periods; and

a decrease of $0.3 million in relation to reductions in a number of expense items, the most significant of which was a $0.1 million decrease in relation to our line of credit which was terminated by us in the first quarter of 2006.

Our amortization of intangibles acquired remained constant at $0.4 million in each of the second quarters of 2005 and 2006 and $0.8 million in each of the first six months of 2005 and 2006.

Other Income / (Expense)

(in thousands, except percentages)	**Three months ended June 30, 2006**	**Three months ended June 30, 2005**	**Six months ended June 30, 2006**	**Six months ended June 30, 2005**
(in thousands, except percentages)				
Equity in loss of affiliates	(1,599)	$ 191	$ (3,014)	$ (1,410)
Foreign currency transaction gain / (loss)	489	(172)	276	(94)
Other income / (expense)	357	(373)	610	(789)
Interest income	304	191	561	361
Total (Expense) / Income	**$ (449)**	**$ (163)**	**$ (1,567)**	**$ (1,932)**

Equity in loss of affiliates: Equity in loss of affiliates in the first six months of 2005 included 50% of the losses of Litrex Corporation, or Litrex. We ceased reporting any equity in loss in relation to Litrex in November 2005 following the sale of our remaining equity stake. Also in November 2005, we acquired a 50% interest in Sumation and the Equity in loss reported for the first six months of 2006 relates to our 50% interest in Sumation. We expect to continue reporting losses for Sumation in future periods. Sumation s revenues to customer other than ourselves were $0.5 million for the second quarter of 2006 and $1.0 million for the six months ended June 30, 2006.

Foreign currency transaction gain / (loss): Currency losses in the first six months of 2005 primarily resulted from the revaluing of assets and liabilities denominated in currencies other than U.S. dollars. We would expect a gain from such revaluations in 2006 if the U.S. dollar weakens versus the British pound during the year and a loss if it strengthens since our British pound assets exceed our British pound liabilities. The gain reported in the first six months of 2006 was primarily due to gains realized on the revaluation of bank balances held in British pounds.

Other income / (expense): The loss of $0.8 million reported in the first six months of 2005 related to unrealized losses in the value of forward exchange contracts, which we had taken out in order to economically hedge future British pound expenses. The gain of $0.6 million in the first six months of 2006 relates to the reversal of unrealized losses on these contracts which had been reported in prior periods. We expect to realize a loss of $0.1 million in the third quarter of 2006 due to the reversal of unrealized gains on these contracts as at June 30, 2006. We are not currently intending to take out additional forward exchange contracts and all existing contracts will have matured by September 30, 2006.

Interest income: Interest income increased by $0.2 million from $0.4 million in the first six months of 2005 to $0.6 million in the first six months of 2006 due to higher average cash balances.

Our benefit for income taxes fell from $0.8 million in the first six months of 2005 to $0.6 million in the first six months of 2006. 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 2006 because we are not able to claim any benefit in relation to research and development costs which are re-imbursed by Sumation, our 50%-owned joint venture company with Sumitomo Chemical.

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Our net loss decreased by $1.7 million from $6.7 million in the second quarter of 2005 to $5.0 million in the second quarter of 2006 because higher Gross profit, lower Total operating expenses, higher Interest income and higher gains related to foreign exchange movements more than offset the increase Equity in loss of affiliates and decrease in tax benefit, as described above. Our net loss decreased by $2.8 million from $15.4 million for the first six months of 2005 to $12.6 million in the first six months of 2006 for the same reasons.

Liquidity and Capital Resources

(in thousands)	Six months ended June 30, 2006	2005
Summary Cash Flow		
Net loss	$ (12,605)	$ (15,378)
Non-cash items	8,149	6,553
Changes in operating assets and liabilities	1,616	925
Net cash used in operating activities	**$ (2,840)**	**$ (7,900)**
Acquisition of fixed and intangible assets	$ (557)	$ (1,010)
Acquisition of equity interests	(4,886)	(1,127)
Loans to affiliates		(1,715)
Investments in marketable securities	(1,874)	
Net cash used in investing activities	**$ (7,317)**	**$ (3,852)**
Cash used in financing activities		**$ (67)**
Net decrease in cash	**$ (10,157)**	**$ (11,819)**
Cash at December 31, 2005 and 2004	**$ 31,263**	**$ 26,892**
Cash at June 30, 2006 and 2005	**$ 21,106**	**$ 15,073**
Current Marketable Securities at June 3, 2006 and 2005	$ 1,874	
Cash and Current Marketable Securities at June 30, 2006 and 2005	**$ 22,980**	**$ 15,073**

Net cash used in operating activities decreased by $5.1 million from $7.9 million in the first six months of 2005 to $2.8 million in the first six months of 2006 due to:

a decrease of $2.7 million due to lower operating expenses;

a decrease of $1.8 million due to foreign currency gains and losses and other income and expense related to the revaluation of foreign exchange contracts;

a decrease of $0.2 million due to an increase in interest income;

an increase of $0.2 million due to taxation; and

a decrease of $0.6 million due to changes in operating assets and liabilities.

In the first six months of 2005 we invested $1.1 million in Add-Vision Inc, a California company. We have not made additional investments since then but may do so in future periods. In the first six months of 2006 we invested $4.9 million in Sumation and are committed to investing a further $3.2 million during 2006 and 2007. We expect to provide funding in excess of the amounts we have already committed 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.

We have $1.9 million invested in certificates of deposit with maturities of more than 90 days but less than one year. We anticipate holding these investments to maturity.

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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 revenues) that we have sufficient cash to meet our obligations for at least the next 12 months. Until March 2006 we had a line of credit for a maximum amount of $15.0 million, of which $0.5 million could not be borrowed. We have had no drawings under this line of credit since December 2004 and, in March 2006, we determined that it was no longer cost effective to retain this facility and we terminated the line of credit at that time.

During 2005 we entered into a number of forward exchange contracts to sell U.S. dollars and buy British pounds in order to fund our U. K. operating expenses during 2006. Under the terms of these contracts, if the spot exchange rate as each contract matures is higher than an agreed protection rate we will sell the U.S. dollars at that rate. If the spot exchange rate as each contract matures is lower than the protection rate we will sell half of the contracted U.S. dollars at that rate and half at the spot exchange rate. The purpose of these transactions is to limit the risk of adverse exchange rate fluctuations while retaining some benefit in the event of favorable fluctuations. At June 30, 2006, we had outstanding contracts covering each of the months from July to September 2006 each for an amount of $1.75 million and at exchange rates of between 1.80 and 1.83 U. S. dollars to one British Pound. We are no longer entering into such contracts but may do so in the future. These contracts were not designated as hedging instruments and, therefore, gains and losses are recognized immediately in earnings during the period.

In February 2006 we outsourced responsibility for managing our cash investments and foreign exchange conversion requirements to Schroder Investment Management Limited, or Schroders, a professional treasury management firm. We now sell U. S. dollars and buy British pounds at spot exchange rates based on our cash requirement projections and advice as to the timing of such transaction provided by Schroders.

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 goodwill, 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 2005 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 2005 Form 10-K.

Stock Based Compensation

As explained in Note 7 to our consolidated financial statements, we followed APB 25 and related interpretations in accounting for stock options through December 31, 2005. Accordingly, we recognized no compensation expense with respect to options granted to employees in the second quarter and first six months of 2005.

Effective January 1, 2006, we adopted SFAS 123(R), which replaces SFAS123 and supersedes APB 25, and started recorded compensation expense with respect to unvested stock options using the modified prospective method. We have continued using the Black-Scholes model to calculate the fair value of stock option awards. Prior to December 2004, we issued some options which could only vest if a specified rate of return was made by our largest shareholders but, since December 2004, no such conditions have applied to any of our stock option awards. We are using similar assumptions to those we used previously when applying this model with the exception that, instead of basing our volatility assumption solely on the historic volatility of stocks comparable to ours, we use the historic volatility of our own stock as a guide to assist us in making a reasonable determination of expected future volatility.

We have made no modifications to the terms of any stock option awards prior to the adoption of SFAS 123(R). We will continue to calculate vesting using the straight line method over the requisite service period.

In adopting SFAS 123(R) we have taken account of projected future stock option forfeitures when calculating stock option compensation expense which was not included in determining the pro forma expense discussed above.

SFAS 123(R) also applies to our special bonus plan pursuant to which restricted stock units were issued to employees in December 2004. We have charged the fair value of these units to compensation expense over their vesting period, other than with

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respect to those units issued to our Chief Executive Officer which were charged to compensation expenses in the period in which they were issued. The application of SFAS 123(R) has not had a material impact on the expense recorded in relation to these restricted stock units.

We recognized $0.2 million of compensation expense in relation to stock options in the first six months of 2006, all of which was recognized in the first quarter due to a significant number of options being forfeited in the second quarter. We will recognize $0.3 million of compensation expense in the remaining six months of 2006, $0.5 million in 2007 and $0.3 million in 2008 with respect to stock options which were granted prior to June 30, 2006 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 expense will be recorded to the extent that we issue further stock options.

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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 1.8 to 1.9 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.*** The Company s management, with the participation of the Company s Chief Executive Officer and Vice-President Finance, has evaluated the effectiveness of the Company s disclosure controls and procedures as of June 30, 2006. Based on that evaluation, the Company s Chief Executive Officer and Vice-President Finance concluded that the Company s disclosure controls and procedures were effective as of June 30, 2006.

(b) ***Changes in internal control over financial reporting***. Daniel Abrams, Chief Financial Officer, resigned on June 30, 2006 and his responsibilities were assumed on July 3, 2006 by Michael Black, Vice-President, Finance as Principal Financial Officer. As a result of this change and in order to maintain effective internal control over financial reporting, responsibilities for operating certain financial controls were reallocated within the finance department in order to preserve adequate segregation of duties. There were no other changes 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 June 30, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In January 2005, Sunnyside Development Company filed a complaint against Opsys Limited and a company named by Sunnyside Development as CDT Limited, which is presumably intended to refer to one of our subsidiaries, Cambridge Display Technology Limited, in the California Supreme Court alleging breach of contract and fraud arising out of an alleged property lease agreement between Opsys Limited and Sunnyside Development. Sunnyside Development asserted compensatory damages that it claims exceed $10 million (principally by way of unpaid rent and other costs associated with the lease) and punitive damages in the amount of $25 million.

In February 2005, the action was removed to the United States District Court for the Northern District of California. In April 2005, the United States District Court dismissed all the claims against CDT Limited and the claim for fraud against Opsys Limited, but gave Sunnyside Development permission to amend all its claims. On May 11, 2005, Sunnyside Development filed an amended complaint reasserting breach of contract and fraud claims against both Opsys Limited and CDT Ltd. We made a further application to dismiss the claims and on August 8, 2005 the amended claims against CDT Limited and Opsys Limited were dismissed with prejudice and with no leave to amend, except for the claim for breach of contract against Opsys Limited. On January 17, 2006 Sunnyside Development filed a second amended complaint for breach of contract against Opsys Limited only, which is still being pursued by Sunnyside Development.

Cambridge Display Technology Limited was not party to the lease and prior to our acquisition of an interest in certain of the activities of Opsys in October 2002, Opsys Limited and Sunnyside Development executed an Assignment of Lease and Consent of Lessor, which included a release of Opsys Limited from its obligations under the lease by Sunnyside Development. We therefore believe that the claim has no merit. We further believe that the claim for punitive damages is no longer valid since the claim for fraud has been dismissed.

We expect to defend the action. Fact discovery is ongoing and scheduled to close on September 8, 2006. The action is scheduled for trial in February 2007.

We review any outstanding claims against us with internal and, if deemed appropriate, external legal counsel to assess the probability and estimates of loss. We reassess the risk of loss as new information becomes available and we adjust liabilities, if any, as appropriate. The actual cost of resolving any claims may be substantially different from the amounts of liability recorded. We have not recorded any liability with respect to the action by Sunnyside Development described above.

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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 2005 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 2005 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 technology to support our operations. You should note that:

- P-OLED technologies may never be broadly commercially adopted;
- markets for FPD using P-OLED technologies may be limited; and
- we may never generate sufficient revenues from the commercial exploitation of our P-OLED technology to become profitable.

We license our P-OLED technology to P-OLED materials manufacturers and display manufacturers, which then incorporate our technology into the materials and products they sell. Even if we and our display manufacturer licensees develop commercially viable applications for our P-OLED 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 June 30, 2006, we had an accumulated deficit of $180.3 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 technology, refinement of processes and components for commercial products using our P-OLED technology, formation of additional commercial relationships and achievement of market acceptance for products using P-OLED technology.

If our P-OLED technology is 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 technology will agree to use this technology for wide-scale commercial production, they will likely require us to demonstrate to their satisfaction that our P-OLED technology is 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 P-OLED materials with sufficient lifetimes, brightness and color coordinates for the applications in question; and

issues related to scalability and cost-effective fabrication technologies.

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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 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 technology is technically feasible, it 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 technology 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 technology 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 technology.

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.

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.

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.

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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 technology to display manufacturers, who then incorporate our technology 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 technology. 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.

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.

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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.