

Cambridge Display Technology, Inc.

Form 10-Q

August 14, 2007

Table of Contents

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

---

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

For the quarterly period ended June 30, 2007

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-51079

---

**CAMBRIDGE DISPLAY TECHNOLOGY, INC.**

(Exact name of registrant as specified in its charter)

---

Delaware  
(State or other jurisdiction of

incorporation or organization)

c/o Cambridge Display Technology Limited

13-4085264  
(IRS Employer

Identification No.)

2020 Cambourne Business Park

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

Cambridge CB23 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  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

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

The number of outstanding shares of the registrant's Common Stock, par value \$0.01 per share, was 21,631,703 as of August 14, 2007.

---

**Table of Contents**

**CAMBRIDGE DISPLAY TECHNOLOGY, INC.**

**INDEX**

	<b>Page</b>
<b><u>PART I: FINANCIAL INFORMATION</u></b>	
<b>Item 1.</b> <u>Financial Statements</u>	1
<u>Consolidated Balance Sheets</u>	1
<u>Consolidated Statements of Operations</u>	2
<u>Consolidated Statements of Cash Flows</u>	4
<u>Notes to Consolidated Financial Statements</u>	5
<b>Item 2.</b> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	10
<b>Item 3.</b> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	18
<b>Item 4.</b> <u>Controls and Procedures</u>	18
<b><u>PART II: OTHER INFORMATION</u></b>	
<b>Item 1.</b> <u>Legal Proceedings</u>	19
<b>Item 1A.</b> <u>Risk Factors</u>	20
<b>Item 4.</b> <u>Submission of Matters to a Vote of Security Holders</u>	34
<b>Item 6.</b> <u>Exhibits</u>	34
<u>Signatures</u>	35

**Table of Contents**

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;

## Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

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;

our future P-OLED technology licensing and other revenues and results of operations; and

the completion of the proposed merger with Sumitomo.

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

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

**Table of Contents**

In this Quarterly Report on Form 10-Q, the terms the Company , our company , CDT , we , us and our refer to Cambridge Display Technology, 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.

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CAMBRIDGE DISPLAY TECHNOLOGY, INC.****Consolidated Balance Sheets**

(in thousands, except share information)

	June 30, 2007 (unaudited)	December 31, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 21,294	\$ 12,015
Marketable securities		7,252
Inventory		30
Accounts receivable, net	61	187
Taxes receivable	1,885	1,861
Prepaid expenses and other current assets	2,093	1,680
<b>Total current assets</b>	<b>25,333</b>	<b>23,025</b>
Property, equipment and leasehold improvements, net	7,872	9,579
Investments in affiliates	4,459	3,951
Marketable securities	486	298
Goodwill	65,612	65,612
Other intangible assets, net	1,194	1,484
Other non-current assets	4	20
<b>Total assets.</b>	<b>\$ 104,960</b>	<b>\$ 103,969</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 7,061	\$ 6,597
Deferred revenue	15,204	5,143
Due to affiliate		95
Other current liabilities	2,309	2,109
<b>Total current liabilities</b>	<b>24,574</b>	<b>13,944</b>
Deferred revenue, non-current	2,392	193
Other liabilities	543	596
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, 21,903,549 issued and 21,630,703 outstanding	216	216
Additional paid-in capital	287,912	284,531
Deferred compensation		
Accumulated other comprehensive loss	(283)	(271)
Accumulated deficit	(210,394)	(195,240)

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

Total common shareholders equity	77,451	89,236
Total liabilities and shareholders equity	\$ 104,960	\$ 103,969

See accompanying notes.



**Table of Contents****CAMBRIDGE DISPLAY TECHNOLOGY, INC.****Consolidated Statements of Operations**

(in thousands, except per share amounts)

(unaudited)

	<b>Three months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Operating revenues:		
License fees and royalties	\$ 1,791	\$ 2,002
Technology services and development	741	683
Equipment and supplies	143	12
Total operating revenues	2,675	2,697
Cost of sales:		
License fees and royalties	16	11
Technology services and development	636	270
Equipment and supplies	89	11
Total cost of sales	741	292
Gross profit	1,934	2,405
Operating expenses:		
Research and development expenses	3,550	3,210
Selling, general and administrative expenses	4,568	3,605
Amortization of intangibles acquired	145	395
Total operating expenses	8,263	7,210
Loss from operations	(6,329)	(4,805)
Other (expense) / income:		
Equity in loss of affiliates	(1,667)	(1,599)
Foreign currency transaction gain	66	489
Other (expense) / income	(3)	357
Interest income	169	304
Total other expense	(1,435)	(449)
Loss before benefit for income taxes	(7,764)	(5,254)
Benefit for income taxes	(321)	(282)
Net loss	\$ (7,443)	\$ (4,972)
Net loss per common share attributable to common shareholders, basic and diluted	\$ (0.34)	\$ (0.23)
Weighted average number of common shares outstanding, basic and diluted	21,630	21,483

See accompanying notes.



**Table of Contents****CAMBRIDGE DISPLAY TECHNOLOGY, INC.****Consolidated Statements of Operations**

(in thousands, except per share amounts)

(unaudited)

	<b>Six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Operating revenues:		
License fees and royalties	\$ 2,894	\$ 2,081
Technology services and development	1,711	1,381
Equipment and supplies	1,070	270
<b>Total operating revenues</b>	<b>5,675</b>	<b>3,732</b>
Cost of sales:		
License fees and royalties	27	12
Technology services and development	1,309	486
Equipment and supplies	720	169
<b>Total cost of sales</b>	<b>2,056</b>	<b>667</b>
<b>Gross profit</b>	<b>3,619</b>	<b>3,065</b>
Operating expenses:		
Research and development expenses	7,285	6,305
Selling, general and administrative expenses	8,924	7,574
Amortization of intangibles acquired	290	790
<b>Total operating expenses</b>	<b>16,499</b>	<b>14,669</b>
<b>Loss from operations</b>	<b>(12,880)</b>	<b>(11,604)</b>
Other (expense)/income:		
Equity in loss of affiliates	(2,983)	(3,014)
Foreign currency transaction gain	59	276
Other (expense)/income	(2)	610
Interest income	336	561
<b>Total other expense</b>	<b>(2,590)</b>	<b>(1,567)</b>
<b>Loss before benefit for income taxes</b>	<b>(15,470)</b>	<b>(13,171)</b>
<b>Benefit for income taxes</b>	<b>(316)</b>	<b>(566)</b>
<b>Net loss</b>	<b>\$ (15,154)</b>	<b>\$ (12,605)</b>
<b>Net loss per common share attributable to common shareholders, basic and diluted</b>	<b>\$ (0.70)</b>	<b>\$ (0.59)</b>
<b>Weighted average number of common shares outstanding, basic and diluted</b>	<b>21,630</b>	<b>21,483</b>

See accompanying notes.



**Table of Contents****CAMBRIDGE DISPLAY TECHNOLOGY, INC.****Consolidated Statements of Cash Flows**

(in thousands)

(unaudited)

	<b>Six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Operating activities</b>		
Net loss	\$ (15,154)	\$ (12,605)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization of property, equipment and leasehold improvements	2,058	2,689
Loss on sale of property, equipment and leasehold improvements	(1)	(2)
Effect of exchange rate changes on cash and cash equivalents	(171)	(428)
Amortization of other intangible assets	290	790
Stock compensation expense	3,343	1,658
Equity in loss of affiliates	2,983	3,014
Changes in operating assets and liabilities:		
Accounts and tax receivable	102	1,332
Inventories and demo machines	30	(92)
Prepaid expenses and other assets	(397)	249
Accounts and tax payable and accrued expenses	464	(1,767)
Due to affiliates	(95)	18
Deferred revenue	12,260	(246)
Other current and non-current liabilities	147	2,122
Net cash generated by / (used in) operating activities	5,859	(3,268)
<b>Investing activities</b>		
Acquisition of property, equipment and leasehold improvements	(312)	(557)
Investment in affiliates	(3,691)	(4,886)
(Investment in) / sale of marketable securities	7,252	(1,874)
Net cash generating by / (used in) investing activities	3,249	(7,317)
<b>Financing activities</b>		
Net cash generated by / (used in) financing activities		
Effect of exchange rate changes on cash and cash equivalents	171	428
Net increase / (decrease) in cash	9,279	(10,157)
Cash and cash equivalents beginning of period	12,015	31,263
Cash and cash equivalents end of period	21,294	\$ 21,106

See accompanying notes.

**Table of Contents****Cambridge Display Technology, Inc.****Notes to Consolidated Financial Statements****1. Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the rules and regulations of the Securities and Exchange Commission.

Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006, or our 2006 Form 10-K.

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

Based on the Company's current existing cash balances, and because of the potential of a future merger with Sumitomo Chemical (see note 7), management believes it will be able to address its business plan into 2009 and beyond.

**2. Other Comprehensive Loss**

	<b>Six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(in thousands)</b>	
Net Loss	\$ (15,154)	\$ (12,605)
Other comprehensive loss:		
Unrealized gains/(losses) on marketable securities	178	(325)
Foreign currency translation adjustments	(190)	100
Other comprehensive loss:	(12)	(225)
Comprehensive loss	\$ (15,166)	\$ (12,830)

**3. Recent Accounting Pronouncements**

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

**Table of Contents****4. Income Taxes**

Income taxes are a benefit for the six months ended June 30, 2007 and 2006 reflecting tax credits to be received for research and development costs from the United Kingdom government.

The Taxes receivable balance of \$1.9 million at June 30, 2007 includes \$1.2 million of income tax refunds due for the year ended December 31, 2006 and \$0.6 million for the six months ended June 30, 2007. The balance represents anticipated United Kingdom value added tax recoveries.

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

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

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

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

**5. Stock-Based Compensation**

A summary of stock-based compensation costs for the six months ended June 30, 2007 and 2006 is included below:

	Compensation Expense for six months ended June 30, 2007	Compensation Expense for six months ended June 30, 2006
	<i>(in thousands)</i>	
<b>Stock Options</b>		
CDT Acquisition Corp. Stock Incentive Plan	\$ 9	\$ 25
2004 Stock Incentive Plan	272	132
<b>Total Compensation Expense for Stock Options</b>	<b>\$ 281</b>	<b>\$ 157</b>
<b>Restricted Stock Units</b>		
Special Bonus Plan	1,526	1,501
2004 Stock Incentive Plan	1,001	
<b>Total Compensation Expense for Restricted Stock Units</b>	<b>\$ 2,527</b>	<b>\$ 1,501</b>
<b>Total Stock-Based Compensation Expense</b>	<b>\$ 2,808</b>	<b>\$ 1,658</b>

*Employee Stock Options*

The Company granted 5,000 options in the three months ended June 30, 2007, and the fair value of these options was \$3.63 each.





---

## **Table of Contents**

The Company recognized \$0.3 million of compensation expense in relation to stock options in the six months ended June 30, 2007. The Company will recognize \$0.3 million of compensation expense in the remaining six months of 2007, \$0.4 million in 2008 and \$0.2 million in 2009 with respect to stock options which were granted prior to June 30, 2007 but were not fully vested on that date, assuming that all such options do vest. Lower expense will be recorded to the extent that such options are cancelled prior to becoming fully vested and higher expenses will be recorded to the extent that the Company issues further stock options.

### *Restricted Stock Units*

In the three months ended June 30, 2007, the Company issued 18,000 restricted stock units awards under its 2004 Stock Incentive Plan to officers and employees. These awards represent a right to receive, in the aggregate, 18,000 shares of the Company's common stock. These awards will vest entirely on December 31, 2008. However, if the proposed Merger with Sumitomo Chemical goes ahead, the awards will be cancelled in exchange for cash (see note 7).

## **6. Commitments and Contingencies**

### *Commitments*

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

The first installment of stock was valued at the average daily closing price of the Company's common stock for the five trading days period ended on the second business day prior to January 3, 2007, the day on which this transaction closed. \$0.04 million was allocated to fixed assets based on the fair value on the closing date of the transaction, the remainder (\$0.1 million) was charged as research and development expense. The Company will charge the value of the second and third installments, valued at the quarter end closing price of the Company's common stock, to research and development expense over the period during which the corresponding technical milestones are expected to be achieved. The amount charged to research and development expense in respect of the second installment in the second quarter of 2007 was \$0.2 million and in the six months ended June 30, 2007 was \$0.4 million.

In May 2007, the Company entered into an agreement with Cowen and Company LLC to act as exclusive financial advisor in connection with the proposed Merger with Sumitomo Chemical Co. Ltd (see note 7). In consideration of services performed, a total fee of approximately \$3.8 million was agreed. This comprised a transaction fee of \$3.4 million, a fairness opinion fee of \$0.3 million and expenses up to \$0.1 million. As at June 30, 2007 less than \$0.1 million of these costs had been charged to the income statement.

### *Contingencies*

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

CDT Inc. was never a party to the lease. In October 2002, Opsys Limited and Sunnyside executed an Assignment of Lease and Consent of Lessor (the "Assignment"), which included a release of Opsys Limited from its obligations under the lease

---

## **Table of Contents**

by Sunnyside. Sunnyside contends that the Assignment and release never became effective or were voided. Opsys Limited believed that the Assignment effectively released it from liability under the lease, and therefore believed that the claim had no merit. In March 2007 a jury verdict was delivered in favor of Sunnyside with damages of \$4.9 million. In May 2007, judgment was entered against Opsys Limited on the jury verdict, which has been appealed. Additionally, reimbursement of legal costs of approximately \$1.0 million has been claimed. Sunnyside has applied to the court to have CDT Inc. held liable for any judgment against Opsys Limited in relation to this matter under a successor liability theory. The Company believes that Sunnyside's successor liability claim against CDT Inc. will not succeed.

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

## **7. Subsequent Events**

### **Merger Agreement**

On July 31, 2007, the Company, entered into an Agreement and Plan of Merger (the Merger Agreement) with Sumitomo Chemical Co., Ltd. (Sumitomo) and Rosy Future, Inc., a wholly owned subsidiary of Sumitomo (Merger Sub).

The Merger Agreement provides that, on the terms and subject to the conditions set forth in the Merger Agreement, Merger Sub will merge with and into the Company, with the Company continuing as the surviving corporation and a wholly-owned subsidiary of Sumitomo (the Proposed Merger). At the effective time and as a result of the consummation of the proposed Merger, the Company's stockholders will receive \$12.00 in cash (without interest) for each share of the Company's issued and outstanding common stock. All of the options to purchase the Company's common stock with an exercise price of less than \$12.00 per share (whether or not vested) outstanding as of the effective time of the proposed Merger will be cancelled in exchange for a cash payment equal to the product of (1) the excess of \$12.00 over the applicable option exercise price by (2) the number of shares subject to such option. All restricted stock units (whether or not vested) outstanding as of the effective time of the proposed Merger will be cancelled in exchange for a cash payment equal to the product of (1) \$12.00 by (2) the number of shares subject to such restricted stock units. Any remaining options with exercise prices at or above \$12.00 will be cancelled. For certain options and restricted stock units issued to United Kingdom employees of the Company, award holder consent will be required to cancel the options or restricted stock units.

The Company has made representations, warranties and covenants in the Merger Agreement, including, among others, covenants (i) to carry on its business in the ordinary course and in substantially the same manner as previously conducted during the interim period between the execution of the Merger Agreement and consummation of the proposed Merger, (ii) not to engage in certain types of transactions during such period absent Sumitomo's prior written consent (not to be unreasonably withheld), (iii) to cause a special meeting of Company common stockholders to be held to consider approval of the proposed Merger and the other transactions contemplated by the Merger Agreement, (iv) subject to certain exceptions, for its board of directors to recommend adoption and approval by Company common stockholders of the Merger Agreement and the transactions contemplated thereby, (v) not to solicit proposals relating to alternative business combination transactions, and (vi) subject to certain exceptions, involving unsolicited superior acquisition proposals, not to enter into discussions concerning, or provide confidential information in connection with, alternative business combination transactions.

Consummation of the proposed Merger is subject to customary closing conditions, including (i) approval of the Merger Agreement and the proposed Merger by holders of a majority of the Company's common stock, (ii) the absence of any material adverse effect on the Company and (iii) the election of statutory appraisal rights by holders of no more than 10% of the Company's common stock. Consummation of the proposed Merger is not conditioned on the receipt of financing by Sumitomo.

The Merger Agreement contains certain termination rights for both Sumitomo and the Company and further provides that, upon termination in specified circumstances, the Company may be required to pay to Sumitomo certain fees, as follows. If (i) the Company terminates the Merger Agreement in order to enter into a definitive, binding agreement with a third party for a superior offer or (ii) Sumitomo terminates the Merger Agreement (A) because the Company's board of directors changes, withdraws or otherwise modifies in a manner adverse to Sumitomo its recommendation in favour of the proposed Merger, or approves or recommends a competing acquisition proposal, or fails to reaffirm its recommendation in favour of the proposed Merger upon Sumitomo's request, or (B) due to breach by the Company of its representations, warranties, covenants or agreements in the Merger Agreement, such that the closing conditions would not be satisfied, and such breach is incurable, or if curable is not cured within 30 days of written notice being given, and within one year of termination the Company enters into (or consummates) a change of control transaction, or (C) because the Company or its directors, officers, employees, representatives or agents breach the Company's non-solicitation obligations and within one year of termination the Company enters into (or consummates) a change of control transaction, the Company is required to pay Sumitomo a termination fee of \$11.3 million.



**Table of Contents**

In addition, the Company has agreed to reimburse Sumitomo for \$5 million of its out-of-pocket expenses (of which \$1 million would be payable on termination and \$4 million plus 5% interest would be payable no later than 15 months after termination) if the Merger Agreement is terminated by Sumitomo because (i) the Company breaches any of its representations, warranties, covenants or agreements, such that the closing conditions would not be satisfied, and such breach is incurable or, if curable, it is not cured within thirty days of written notice; or (ii) the Company's non-solicitation obligations are breached by the Company or any of the Company's officers, directors, employees, representatives or agents.

Finally, the Company has agreed to reimburse Sumitomo for specified expenses actually incurred (not to exceed \$8 million) if (i) the Merger Agreement is terminated by the mutual agreement of Sumitomo and the Company and within one year of the termination the Company enters into (or consummates) a change of control transaction; (ii) the Merger Agreement is terminated by either Sumitomo or the Company because the proposed Merger fails to close by March 31, 2008 and within one year of the termination the Company enters into (or consummates) a change of control transaction; or (iii) the Merger Agreement is terminated by either Sumitomo or the Company because the Company's stockholders vote against the transaction and within one year of the termination the Company enters into (or consummates) a change of control transaction.

The description of the Merger Agreement above does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is filed hereto as Exhibit 2.1 and incorporated herein by reference.

The representations and warranties of each party set forth in the Merger Agreement have been made solely for the benefit of the other party to the Merger Agreement, and such representations and warranties should not be relied upon by any other person. In addition, the Company's representations and warranties are qualified by materiality standards that may differ from what may be viewed as material by investors and information in disclosures made by the Company to Sumitomo in connection with signing the Merger Agreement.

**Support Agreements**

Concurrently with entering into the Merger Agreement, certain of the Company's stockholders, including Kelso & Company, its principal stockholder, and several management stockholders, entered into Support Agreements with Sumitomo and the Company, pursuant to which each of those stockholders severally agreed to vote all shares of the Company's common stock beneficially owned in favour of the proposed Merger and against competing transactions. In the aggregate, these stockholders beneficially own approximately 43% of the Company's outstanding common stock. Each of the Support Agreements terminates upon the earlier of (i) the effective date of the proposed Merger or (ii) termination of the Merger Agreement pursuant to its terms (including if the Company terminates the Merger Agreement to accept a superior acquisition proposal). The description of the Support Agreements does not purport to be complete and is qualified in its entirety by the form of Support Agreement, which is filed as an exhibit to the Company's Current Report on Form 8-K filed with the SEC on July 30, 2007.

---

## **Table of Contents**

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

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

#### **Overview**

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

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

While we have made significant progress over the past few years in advancing our P-OLED technology into a number of display licenses, we have incurred significant losses and will continue to do so unless our P-OLED technology becomes more widely adopted and commercialized by flat panel display manufacturers. As of June 30, 2007, we had an accumulated deficit of \$210 million in large part due to the research and development expenditures we have incurred. Our total research and development expenditures since 1999 exceed \$108 million.

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

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

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

the further development of P-OLED materials and device structures in order to increase the commercial lifetimes of P-OLED products;

the further development of ink jet printing equipment and process, and other deposition processes, so that mass production of full color P-OLED displays can be demonstrated;

the further development of other technologies required for P-OLED displays, in particular active matrix thin-film transistor (TFT) display drivers and passive matrix display drivers based on our TMA technology; and

## Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

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

## Table of Contents

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

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

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

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

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

we have and will continue to invest significant resources in research and development in order to develop and effectively demonstrate our technology so that it can be commercialized in a growing number of applications, which is indicated by our total research and development expenditures in the first six months of 2007 of \$ 7.3 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 their consumer electronic products.

**Table of Contents****Results of Operations****Comparison of Three and Six Months Ended June 30, 2007 and June 30, 2006**

Operating Revenues	Three months ended June 30, 2007	Three months ended June 30, 2006	%	Six months ended June 30, 2007	Six months ended June 30, 2006	%
<i>(in thousands, except percentages)</i>			Increase / (Decrease)			Increase / (Decrease)
License fees and royalties	\$ 1,791	\$ 2,002	(11%)	\$ 2,894	\$ 2,081	39%
Technology services and development	741	683	8%	1,711	1,381	24%
Equipment and supplies	143	12	1,092%	1,070	270	296%
<b>Total operating revenues</b>	<b>\$ 2,675</b>	<b>\$ 2,697</b>	<b>(1%)</b>	<b>\$ 5,675</b>	<b>\$ 3,732</b>	<b>52%</b>

License fees and royalties revenues decreased by \$0.2 million, or 11%, from \$2.0 million in the second quarter of 2006 to \$1.8 million in the second quarter of 2007. This decrease was due to the fact that a license fee of \$1.0 million was recognized in the second quarter of 2006 in relation to the licensing of intellectual property rights, and in the second quarter of 2007 recognition of revenue of \$0.8 million came from one license agreement which was signed in September 2006. In this latter case, license revenue is being recognized ratably over the period in which we have obligations to the licensee, which will be approximately three years. The balance of License fees and royalties revenues in each quarter comprised royalties received from four licensees in the second quarter of 2007 and five licensees in the second quarter of 2006.

License fees and royalty revenues increased by \$0.8 million, or 39%, from \$2.1 million in the first six months of 2006 to \$2.9 million in the first six months of 2007. This is because in 2007, recognition of revenue of \$1.9 million came from one license agreement which was signed in September 2006, whereas in the same period in 2006, only \$1.0 million of revenue was recognized in relation to the licensing of intellectual property rights. Royalty revenues were received from four licensees in 2007 and six licensees in 2006.

Technology services and development revenues stayed constant at \$0.7 million in the second quarter of 2007 and 2006. This is due to the recognition of \$0.7 million of revenue in the second quarter of 2007 from a development contract which was signed in September 2006. In the second quarter of 2006, the same amount of revenue was generated from seven smaller contracts. Technology services and development revenues were received from two customers during the second quarter of 2007 and seven customers during the second quarters of 2006.

Technology services and development revenues increased by \$0.3 million, or 24%, from \$1.4 million in the first six months of 2006 to \$1.7 million in the first six months of 2007. This is due to the recognition of \$1.6 million of revenue in the first six months of 2007 from a development contract which was signed in September 2006. In the second quarter of 2006, a smaller amount of revenue was generated from eight smaller contracts. Technology services and development revenues were received from two customers during the first six months of 2007 and eight customers during the first six months of 2006.

Equipment and supplies revenue was \$0.1 million in the second quarter of 2007 compared with less than \$0.1 million in the second quarter of 2006. In both quarters, these revenues came from sales of polymer ink.

Equipment and supplies revenue was \$1.1 million in the first six months of 2007 compared with \$0.3 million in the first six months of 2006. The increase was due to revenue generated from the sale of an ink jet printer for \$0.8 million in the first quarter of 2007. No such high value printer sales were made in 2006, where the revenue received was from sales of polymer inks.

Matsushita Electric Industrial Co., Ltd and Osram Opto each accounted for in excess of 10% of our revenues in the second quarter of 2007. Samsung Electronics and Osram Opto each accounted for in excess of 10% of our revenues in the second quarter of 2006.

Matsushita Electric Industrial Co., Ltd and Osram Opto each accounted for in excess of 10% of our revenues in the first six months of 2007. Samsung Electronics, Toppan Printing and Osram Opto each accounted for in excess of 10% of our revenues in the first six months of 2006.



**Table of Contents**

Cost of Sales <i>(in thousands, except percentages)</i>	Three months ended June 30, 2007		Three months ended June 30, 2006		Six months ended June 30, 2007		Six months ended June 30, 2006	
		% of Revenues *		% of Revenues *		% of Revenues *		% of Revenues *
License fees and royalties	\$ 16	1%	\$ 11	1%	\$ 27	1%	\$ 12	1%
Technology services and development	636	86%	270	40%	1,309	77%	486	35%
Equipment and supplies	89	62%	11	92%	720	67%	169	63%
<b>Total cost of sales</b>	<b>\$ 741</b>	<b>28%</b>	<b>\$ 292</b>	<b>11%</b>	<b>\$ 2,056</b>	<b>36%</b>	<b>\$ 667</b>	<b>18%</b>
<b>Gross profit</b>	<b>\$ 1,934</b>	<b>72%</b>	<b>\$ 2,405</b>	<b>89%</b>	<b>\$ 3,619</b>	<b>64%</b>	<b>\$ 3,065</b>	<b>82%</b>

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

Cost of sales related to Technology services and development increased from 40% in the second quarter of 2006 to 86% in the second quarter of 2007 and increased from 35% in the first six months of 2006 to 77% in the first six months of 2007. We believe that the increased complexity of Technology services and development contracts and market pressure on pricing will result in this higher cost of sales percentage continuing in future periods. A portion of this higher cost of sales cost is due to our existing research and development team devoting a higher proportion of their effort in supporting revenue-generating projects than had been the case in prior periods. We seek to ensure that the nature of these projects is such that the objectives of these commercial projects are aligned with and complementary to our internal research and development priorities.

Cost of sales related to Equipment and supplies revenues decreased from 92% of related sales for the second quarter of 2006 to 62% of related sales for the second quarter of 2007 and increased from 63% of related sales for the first six months of 2006 to 67% for the first six months of 2007. We believe that cost of sales as a percentage of revenue for Equipment and supplies reported in the first six months of 2007 will be representative of future quarters.

Gross profit decreased by \$0.5 million, from \$2.4 million in the second quarter of 2006 to \$1.9 million in the second quarter of 2007 but increased by \$0.5 million from \$3.1 million in the first six months of 2006 to \$3.6 million in the first six months of 2007. The aggregate margin percentage was higher in each of the second quarter and the first six months of 2006 compared to 2007 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, namely License fees and royalties, compared with the second quarter and the first six months of 2007.

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.

**Table of Contents**

Operating Expenses	Three months ended June 30, 2007	Three months ended June 30, 2006	% Increase/ (Decrease)	Six months ended June 30, 2007	Six months ended June 30, 2006	% Increase/ (Decrease)
<i>(in thousands, except percentages)</i>						
Research and development expenses	3,550	3,210	11%	7,285	6,305	16%
Selling, general and administrative expenses	4,568	3,605	27%	8,924	7,574	18%
Amortization of intangibles acquired	145	395	(63)%	290	790	(63)%
<b>Total Operating Expenses</b>	<b>\$ 8,263</b>	<b>\$ 7,210</b>	<b>15%</b>	<b>\$ 16,499</b>	<b>\$ 14,669</b>	<b>12%</b>

Our research and development expenses increased by \$0.4 million, or 11%, from \$3.2 million in the second quarter of 2006 to \$3.6 million in the second quarter of 2007 because of:

a decrease of \$0.3 million due to an increase in costs being reimbursed by Sumation, our 50%-owned joint venture with Sumitomo Chemical in the first second quarter of 2007, which level of reimbursement we anticipate is likely to continue in future periods;

a decrease of \$0.2 million due to increased government grant income received in the second quarter of 2007;

an increase of \$0.3 million in stock compensation expense due to the issuance of stock options and restricted stock units during the first quarter of 2007 and also due to costs related to the modifications of restricted stock unit and stock option awards granted to one of our employees;

an increase of \$0.8 million due to the costs incurred in the development of our TMA technology in the second quarter of 2007;

an increase of \$0.2 million due to research and development costs recognized in the second quarter of 2007 in relation to stock which is to be issued in consideration for the purchase of the assets of Next Sierra;

a decrease of \$0.6 million due to lower depreciation charges in the second quarter of 2007 due to a number of assets at our Technology Development Centre having become fully depreciated; and

an increase of \$0.2 million due to higher expenditure on research programs, including higher facilities costs in the second quarter of 2007.

Our research and development expenses increased by \$1.0 million, or 16%, from \$6.3 million in the first six months of 2006 to \$7.3 million in the first six months of 2007 because of:

a decrease of \$0.5 million due to an increase in costs being reimbursed by Sumation, our 50%-owned joint venture with Sumitomo Chemical, in the first six months of 2007, which level of reimbursement we anticipate is likely to continue in future periods;

a decrease of \$0.2 million due to increased government grant income received in the first six months of 2007;

## Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

an increase of \$0.3 million in stock compensation expense due to the issuance of stock options and restricted stock units during the first quarter of 2007 and also due to costs related to the modifications of restricted stock unit and stock option awards granted to one of our employees; and

an increase of \$1.4 million due to the costs incurred in the development of our TMA technology in the first six months of 2007;

an increase of \$0.5 million due to research and development costs recognized in the first six months of 2007 in relation to stock which is to be issued in consideration for the purchase of the assets of Next Sierra;

a decrease of \$0.6 million due to reduced depreciation charges in the second quarter of 2007 due to a number of assets at our Technology Development Centre having become fully depreciated;

an increase of \$0.4 million due to higher expenditure on research programs, including higher facilities costs in the first six months of 2007; and

a decrease of \$0.3 million due to more of the cost of the research and development function being charged to revenue-generating projects in the first six months of 2007 and correspondingly less being charged to Research and development expense, which decrease was due to \$1.0 million being spent in the first six months of 2007 compared with \$0.7 million in the first six months of 2006 on activities which were similar in nature to research and development but which directly supported revenue-generating projects and were not therefore classified as Research and development expenses.

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

**Table of Contents**

Our selling, general and administrative expenses increased by \$1.0 million, or 27%, from \$3.6 million in the second quarter of 2006 to \$4.6 million in the second quarter of 2007 because of:

an increase of \$0.3 million in stock compensation expense due to the issuance of stock options and restricted stock units during the first quarter of 2007 and also due to costs related to the modifications of restricted stock unit awards granted to two of our executives;

an increase of \$0.3 million due to accrued professional fees connected with the proposed Merger with Sumitomo in the second quarter of 2007;

an increase of \$0.1 million due to Delaware Franchise tax costs being reclassified from tax to selling, general and administrative expenses in the second quarter of 2007;

an increase of \$0.1 million due to increased litigation expenses in the second quarter of 2007; and

an increase of \$0.2 million in relation to significant one-off service costs being incurred in the second quarter of 2007 relating to the headquarters building.

Our selling, general and administrative expenses increased by \$1.3 million, or 18%, from \$7.6 million in the first six months of 2006 to \$8.9 million in the first six months of 2007 because of:

an increase of \$0.4 million in stock compensation expense due to the issuance of stock options and restricted stock units during the first quarter of 2007 and also due to costs related to the modifications of restricted stock unit awards granted to two of our executives;

an increase of \$0.3 million due to accrued professional fees connected with the proposed Merger with Sumitomo in the second quarter of 2007;

an increase of \$0.1 million due to Delaware Franchise tax costs being reclassified from tax to selling, general and administrative expenses in the second quarter of 2007;

a decrease of \$0.2 million due to an increase in costs being reimbursed by Sumation, our 50%-owned joint venture with Sumitomo Chemical in the first six months of 2007,

an increase of \$1.0 million due to increased litigation expenses in the first six months of 2007; and

a decrease of \$0.3 million due to reductions in other administrative costs including staff relocation, insurance and other staff costs, offset by increased facilities costs in the second quarter of 2007.

Amortization of intangibles acquired decreased by \$0.3 million from \$0.4 million for the second quarter of 2006 to \$0.1 million for the second quarter of 2007, and decreased by \$0.5 million from \$0.8 million for the first six months of 2006 to \$0.3 million for the first six months of 2007. This is because certain intangible assets became fully amortized in October 2006. The quarterly amortization charge of \$0.1 million for the

## Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

second quarter of 2007 is expected to continue until 2009, unless we acquire further intangible assets.

Other Income/ (Expense)	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
<i>(in thousands, except percentages)</i>				
Equity in loss of affiliates	\$ (1,667)	\$ (1,599)	\$ (2,983)	\$ (3,014)
Foreign currency transaction gain	66	489	59	276
Other income / (expense)	(3)	357	(2)	610
Interest income	169	304	336	561
<b>Total (Expense) / Income</b>	<b>\$ (1,435)</b>	<b>\$ (449)</b>	<b>\$ (2,590)</b>	<b>\$ (1,567)</b>

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

*Foreign currency transaction gain:* We would expect a gain from revaluations of assets and liabilities denominated in currencies other than US dollars if the U.S. dollar weakens versus the British pound during the year since our British pound assets exceed our British pound liabilities. The gain reported in the first six months of 2006 was primarily due to significant gains realized on the revaluation of bank balances held in British pounds offsetting smaller losses realized on the execution of forward foreign exchange contracts in quarter one. We no longer execute forward foreign exchange contracts. In the first six months of 2007, the revaluation gain was smaller since the US dollar did not weaken as much versus the British pound.

## **Table of Contents**

*Other income / (expense):* The gain of \$0.4 million in the second quarter of 2006 and the gain of \$0.6 million in the first six months of 2006 relate to the reversal of unrealized losses on forward exchange contracts which had been reported in prior periods.

*Interest income:* Interest income decreased by \$0.1 million from \$0.3 million in the second quarter of 2006 to \$0.2 million in the second quarter of 2007 and by \$0.3 million from \$0.6 million in the first six months of 2006 to \$0.3 million in the first six months of 2007 due to lower average cash balances.

Our benefit for income taxes fell from \$0.6 million in the first six months of 2006 to \$0.3 million in the first six months of 2007. A benefit is shown because we surrender tax losses 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 six months of 2007 because of the increased amount of research being funded by third parties and thus not qualifying for tax relief. The tax credit calculated for the first six months of 2007 was offset by Japanese withholding tax incurred on license income.

Our net loss increased by \$2.4 million from \$5.0 million in the second quarter of 2006 to \$7.4 million in the second quarter of 2007 because of lower Gross profit, higher total operating expenses, lower Interest income and lower gains related to foreign exchange movements. Our net loss increased by \$2.6 million from \$12.6 million for the first six months of 2006 to \$15.2 million in the first six months of 2007 for similar reasons.

## **Liquidity and Capital Resources**

Net cash used in operating activities was \$3.3 million in the first six months of 2006 and net cash generated by operations was \$5.8 million in the first six months of 2007 due to, an increase in cash generated by operating activities of \$9.1 million:

an increase of \$12.4 million due to an increase in receipts from customers from \$5.7 million in the first six months of 2006 to \$18.1 million in the first six months of 2007. The main item making up the difference is \$10 million received for a major licence agreement signed in June 2007;

a decrease of \$1.0 million due to increased expenses related to commercial projects;

a decrease of \$1.7 million due to increased cash operating expenses;

a decrease of \$0.3 million due to a decrease in interest income;

a decrease of \$1.4 million due to a lower research reimbursement being received from Sumation in six months of 2007 compared with first six months of 2006 (due to invoices being for a shorter period); and

an increase of \$1.1 million due to changes in working capital.

We invested \$4.9 million of capital in Sumation in April 2007, which was the same amount invested by Sumitomo Chemical, our joint venture partner. Thus, we continue to have a 50% ownership of this joint venture. We expect to provide additional funding in future periods. The amount of funding required by Sumation will be dependent on the extent to which Sumation is able to fund its activities from sales of P-OLED materials. Sumation funds some of our research and development activities and we expect to receive more in reimbursements from Sumation than we will invest in the funding of Sumation.

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

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

obligations for at least the next 12 months.

**Table of Contents**

**Critical Accounting Policies**

*General*

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



**Table of Contents**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

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

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

**Item 4. Controls and Procedures**

(a) *Evaluation of disclosure controls and procedures.* The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of June 30, 2007. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2007.

(b) *Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with the evaluation described in Item 4(a) above that occurred during the quarter ended June 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

CDT Inc. was never a party to the lease. In October 2002, Opsys Limited and Sunnyside executed an Assignment of Lease and Consent of Lessor (the "Assignment"), which included a release of Opsys Limited from its obligations under the lease by Sunnyside. Sunnyside contends that the Assignment and release never became effective or were voided. Opsys Limited believed that the Assignment effectively released it from liability under the lease, and therefore believed that the claim had no merit. In March 2007 a jury verdict was delivered in favor of Sunnyside with damages of \$4.9 million. In May 2007, judgment was entered against Opsys Limited on the jury verdict. Additionally, reimbursement of legal costs of approximately \$1.0 million has been claimed. Sunnyside has applied to the court to have CDT Inc. held liable for any judgment against Opsys Limited in relation to this matter under a successor liability theory. We believe that Sunnyside's successor liability claim against CDT Inc. will not succeed.

## **Table of Contents**

### **Item 1A. Risk Factors**

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

#### **Risks Relating to Our Business and Industry**

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

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

neither P-OLED, TMA nor related technologies may never be broadly commercially adopted;

markets for FPD using P-OLED, TMA and related technologies may be limited; and

we may never generate sufficient revenues from the commercial exploitation of our P-OLED, TMA and related technologies to become profitable.

We license our P-OLED and related technologies to P-OLED materials manufacturers and display manufacturers, which then incorporate our technologies into the materials and products they sell. Even if we and our display manufacturer licensees develop commercially viable applications for our technologies, we may never recover our research and development expenses. We have had significant net losses in previous periods and expect to report net losses in future periods, and as of June 30, 2007, we had an accumulated deficit of over \$210 million. We cannot predict what impact continued net losses might have on our ability to finance our operations in the future or on the market value of our common stock.

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

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

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

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

device reliability;

the development of TMA driver chips;

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

issues related to scalability and cost-effective fabrication technologies.

## **Table of Contents**

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

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

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

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

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

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

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

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

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

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

## **Table of Contents**

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

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

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

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

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

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

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

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

***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.***

## Table of Contents

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

access required capital;

conduct research and development;

reduce time-to-market;

reduce production costs;

offer a competitive price;

offer attractive product features and quality;

offer customer service, including product design support; and

provide sufficient quantity of products to fulfill end-user demand.

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

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

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

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

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

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

## Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

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

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

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



## **Table of Contents**

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

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

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

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

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

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

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

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

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

## **Table of Contents**

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

In November 2005, we sold Litrex to ULVAC, Inc. of Japan. Under the terms of our agreements with Litrex and ULVAC, they are obligated to continue to support Litrex's development of ink jet printers for the display manufacturing industry. If they do not fulfill this obligation, we may exercise our rights under a fallback license to obtain the necessary IP to develop, manufacture and supply ink jet printing equipment for use by manufacturers using our P-OLED technology independent of Litrex. In any such circumstance, we may incur substantial additional costs in order to ensure that ink jet printing equipment is made available for P-OLED display manufacturers. We have the right, but no obligation, to fund ink jet printing development programs at Litrex and may incur costs in doing so if we believe this is necessary for the furtherance of our P-OLED technology.

If we are unable to meet our currently projected liquidity requirements from our existing resources, we may need to borrow money or issue additional equity or debt securities. We may not be able to borrow money on commercially reasonable terms or at all. If we attempt to raise money in an offering of shares of our common stock, preferred stock, warrants or debt securities, or if we engage in acquisitions involving the issuance of such securities, our then-existing stockholders may be diluted. If we are unable to obtain required financing or reasonable terms, our business may fail.

Sumation, our 50%-owned joint venture with Sumitomo Chemical, will require additional funding in future periods. If we are unable to provide such funding our ownership interest may become diluted and the potential realizable value from this investment may be reduced.

### ***We or our licensees may incur substantial costs or lose important rights as a result of litigation or other proceedings relating to our patent and other intellectual property rights.***

In recent years, there has been significant litigation involving patents and other IP rights in many technology-related industries, including our own.

There may be patents owned by third parties that may be infringed by the use of our technology or a part thereof, thus substantially interfering with the future conduct of our or our licensees' businesses. Our licensees could be sued by such parties for patent infringement. Such lawsuits could subject them to liability for damages, prevent our licensees from incorporating such patented technology in their products or require our licensees to obtain additional licenses that could increase the cost of their products. As a result there could be an adverse affect on their sales and thus our royalties and this could also cause our licensees to seek to renegotiate our royalty rates. This problem is made more difficult to evaluate, because certain patent applications in the United States are retained in secrecy unless and until the patent issues.

In addition, in the future we may assert our IP rights by instituting legal proceedings against others. We cannot assure you that we will be successful in enforcing our patents in any lawsuits we may commence. Defendants in any litigation we may commence to enforce our patents may attempt to establish that our patents are invalid or are unenforceable. Thus, any patent litigation we commence could lead to a determination that one or more of our patents are invalid or unenforceable. If a third party succeeds in invalidating one or more of our patents, that party and others could compete more effectively against us. Our ability to derive licensing revenues from products or technologies covered by these patents could also be adversely affected.

Whether our licensees are defending the assertion of third-party IP rights against their businesses arising as a result of the use of our technology, or we are asserting our own IP rights against others, such litigation can be complex, costly, protracted and highly disruptive to our or our licensees' business operations by diverting the attention and energies of management and key technical personnel. As a result, the pendency or adverse outcome of any IP litigation to which we or our licensees are subject could disrupt business operations, require the incurrence of substantial costs and subject us or our licensees to significant liabilities, each of which could severely harm our business.

Plaintiffs in IP cases often seek injunctive relief. Any IP litigation commenced against our licensees could force them to take actions that could be harmful to their business and thus to our royalties, including the following:

stop selling their products that incorporate or otherwise use technology that contains our allegedly infringing IP;



---

**Table of Contents**

attempt to obtain a license to the relevant third-party IP, which may not be available on reasonable terms or at all; or

attempt to redesign their products to remove our allegedly infringing IP to avoid infringement of the third-party IP. If our licensees are forced to take any of the foregoing actions, they may be unable to manufacture and sell their products that incorporate our technology at a profit or at all. Furthermore, the measure of damages in IP litigation can be complex and is often subjective or uncertain. If our licensees were to be found liable for infringement of proprietary rights of a third party, the amount of damages they might have to pay could be substantial and is difficult to predict. Decreased sales of our licensees' products incorporating our technology would adversely affect our royalty revenues under existing licenses. Any necessity to procure rights to the third-party technology might cause our existing licensees to renegotiate the royalty terms of their license with us to compensate for this increase in their cost of production or, in certain cases, to terminate their license with us entirely. Were this renegotiation to occur, certain of our license agreements that contain most favored nation provisions, requiring that we offer at least as favorable terms to the holder of such a license as we offer to any other licensee, would be affected and we would also receive reduced royalties from those licenses. These developments would also harm our ability to compete for new licensees and would adversely affect the terms of the royalty arrangements we could enter into with any new licensees.

As is commonplace in technology companies, we employ individuals who were previously employed at other technology companies. To the extent our employees are involved in research areas that are similar to those areas in which they were involved at their former employers, we may be subject to claims that such employees or we have, inadvertently or otherwise, used or disclosed the alleged trade secrets or other proprietary information of the former employers. Litigation may be necessary to defend against such claims. The costs associated with these actions or the loss of rights critical to our or our licensees' business could negatively impact our revenues or cause our business to fail.

***If we cannot obtain and maintain appropriate patent and other intellectual property rights protection for our P-OLED, TMA and related technologies, our business will suffer.***

The value to us of our P-OLED, TMA and related technologies is dependent on our ability to secure and maintain appropriate patent and other IP rights protection. Although we own or license many patents covering our technology that have already been issued, there can be no assurance that additional patents applied for will be obtained or that any of these patents, once issued, will afford commercially significant protection for our technology or will be found valid if challenged. Moreover, we have not obtained patent protection for some of our technology in all foreign countries in which P-OLED displays or materials, or chips incorporating our TMA technology, might be manufactured or sold. In any event, the patent laws and enforcement regimes of other countries may differ from those of the United States as to the patentability of our P-OLED, TMA and related technologies and the degree of protection afforded.

The strength of our current P-OLED IP position results primarily from the essential nature of our fundamental patents covering the P-OLED device and its manufacturing process and electroluminescent devices containing conjugated polymers. These patents expire in 2010, 2011 and 2015. While we hold a wide range of additional patents and patent applications whose expiration dates extend (and in the case of patent applications, will extend) well beyond 2015, many of which are also of key importance in the OLED industry, none is of an equally essential nature as our fundamental patents, and therefore our competitive position after their expiration may be less certain.

We may become engaged in litigation to protect or enforce our patent and other IP rights or in International Trade Commission proceedings to abate the importation of goods that would compete unfairly with those of our licensees. In addition, we may have to participate in interference or reexamination proceedings before the U.S. Patent and Trademark office, or in opposition, nullity or other proceedings before foreign patent offices, with respect to our patents or patent applications. All of these actions would place our patents and other IP rights at risk and may result in substantial costs to us as well as a diversion of management attention. Moreover, if successful, these actions could result in the loss of patent or other IP rights protection for the key P-OLED, TMA and related technologies on which our business strategy depends.

In addition, we rely in part on unpatented proprietary technology, and others may independently develop the same or similar technology or otherwise obtain access to our unpatented technology. To protect our trade secrets, know-how and other proprietary information, we require employees, consultants, financial advisors and strategic partners to enter into confidentiality agreements. These agreements may not ultimately provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of those trade secrets, know-how or other proprietary information. In particular, we may not be able to fully or adequately protect our proprietary information as we conduct discussions with potential strategic partners. If we are unable to protect the proprietary nature of our technology, it will harm our business.

---

## **Table of Contents**

### ***We are subject to developments in and expenses associated with resolving matters currently in litigation.***

We have been and may continue to be the subject of complaints or litigation in connection with disputes unrelated to patent or other IP rights described above. We are currently the subject of litigation with Sunnyside as described under "Legal Proceedings" in Item 1 of Part II above. There is considerable risk associated with any litigation, particularly litigation such as this action, which has been the subject of a jury verdict and the ultimate outcome of which will be affected by a number of factors beyond our control. As is also the case with other complaints or litigation to which we may become subject, we may incur significant legal costs in continuing to defend or settling the action with Sunnyside, and if a court finds against us, we could be liable for substantial financial damages or suffer other losses that are the subject of dispute. Such complaints and litigation are also often complex and protracted and disrupt our business operations by diverting the attention and energies of management and key technical personnel. As a result, the pendency or adverse outcome of such complaints and litigation could require the incurrence of substantial costs, subject us to significant liabilities and otherwise disrupt our business operations, each of which could severely harm our business.

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 referred to above.

### ***We are exposed to currency fluctuations, which may have an adverse effect on us.***

A substantial majority of our licensing revenues are denominated in U.S. dollars. These licensing 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 production 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.

We do not currently take out forward contracts, but we may do so in the future, the management of which we may outsource to third parties. There is no guarantee that we or any such third parties will be successful in reducing the risks to us of our exposure to foreign currency fluctuations and these fluctuations may adversely affect our results of operations, financial condition or cash flows.

### ***We are a holding company with no significant independent operations, and we therefore rely on our subsidiaries to make funds available to us.***

We are a holding company with no significant independent operations and no significant assets other than the capital stock of our subsidiaries. We, therefore, will be dependent upon the receipt of dividends or other distributions from our subsidiaries. The declaration of dividends by our subsidiaries will be subject to the discretion of their boards of directors and will depend on a number of factors, including their results of operations, financial condition, liquidity requirements and indebtedness and restrictions imposed by applicable law. Our inability to receive funds from our operating subsidiaries would adversely affect our ability to meet our obligations and to make dividend payments and other distributions, if any, to holders of our common stock.

### ***Due to our significant level of international operations, we are subject to international operational, financial, legal and political risks that may negatively impact our operations.***

A substantial part of our operations are in the United Kingdom, one of our senior executives is resident in Japan, and many of our licensees have a majority of their operations in countries outside the United States and Europe. Risks associated with our doing business internationally include:

compliance with a wide variety of foreign laws and regulations, particularly labor, environmental and other laws and regulations that govern our operations in the United Kingdom;

legal uncertainties regarding taxes, tariffs, quotas, export controls, export licenses and other trade barriers;

potentially difficulties in managing an organization effectively where management is geographically dispersed;

## Table of Contents

difficulties in creating and maintaining effective business relationships in foreign cultural environments;

economic instability in the countries of our licensees, particularly in the Asia-Pacific region, causing delays or reductions in orders for their products and therefore our royalties;

political instability in the countries in which our licensees operate, particularly in South Korea relating to its disputes with North Korea and in Taiwan relating to its disputes with China;

difficulties in collecting accounts receivable and longer accounts receivable payment cycles; and

potentially adverse tax consequences.

Any of these factors could harm our or our licensees' existing international operations and business and impair our or our licensees' ability to continue expanding into international markets.

A significant portion of our assets and most of our executive officers are located outside of and are not residents of the United States. As a result, it may be difficult or impossible for U.S. investors to effect service of process upon such non-resident directors or officers within the United States or to realize against them in the United States upon judgment of courts of the United States predicated upon civil liabilities under the federal securities laws of the United States or the securities or blue sky laws of any state or other jurisdiction within the United States. In addition, courts of another country may not enforce judgments of United States courts obtained in actions against us, our directors or officers predicated upon the civil liability provisions of the United States federal securities laws or the securities or blue sky laws of any state or other jurisdiction within the United States or enforce, in original actions, liabilities against us, our directors or our officers predicated upon the United States federal securities laws or any state securities or blue sky laws.

***Our agreements with our licensees and joint development partners are subject to regulation by the European Commission, and particularly to antitrust provisions of such regulations, which could result in fines to us or in those agreements being declared void in whole or in part, either of which would negatively impact our revenues.***

Our IP licensing agreements and joint development agreements fall under the antitrust provisions of the Treaty of Rome and related regulations. While our display license agreements are generally non-exclusive and without geographic restriction, and while our licensing and joint development relationships generally represent lower market shares than would result in the application of the regulations' remedies, any violation of the regulations could result in the anti-competitive provisions or the entire relevant agreement being declared void and unenforceable. In addition, we could be subject to a fine of up to 10% of the income of our worldwide group.

***If we cannot keep our key employees or hire other talented persons as we grow, our business might not succeed.***

Our performance is substantially dependent on the continued services of senior management, particularly our Chief Executive Officer who has been principally responsible for establishing and maintaining many of our most important commercial relationships, and our Chief Technology Officer, who was one of the inventors of our fundamental P-OLED technology and helps direct our technology development program, and on our ability to offer competitive salaries and benefits to our employees. Also, our Chief Executive Officer's current employment agreement with us expires in December 2008. We do not carry key person life insurance on any of our senior management or other key personnel. If we lose the services of key senior management personnel, we may not be able to find suitable replacements in a timely manner or at all, which would seriously harm our business. Additionally, competition for highly skilled technical, managerial and other personnel is intense. We might not be able to attract, hire, train, retain and motivate the highly skilled managers and employees that we might need to be successful. If we fail to attract and retain the necessary technical and managerial personnel, our business will suffer and might fail. We currently have fewer than 140 employees, and we may encounter increasing difficulty in attracting enough qualified personnel as our operations expand and the demand for their services increases. This difficulty could impede the attainment of our research and development objectives and cause our business strategy to fail.

In February 2007, we awarded restricted stock units to a number of our senior executives as a long term incentive. These units vest over a two-year period that will end in December 2008, and are intended to retain the services of these executives during this period. There is no assurance that the award of these units will be effective in retaining their services or that we will be able to continue to retain their services after

these restricted stock units have fully vested.

***Our Technology Development Center and our research and development laboratories are critical to our success.***



## Table of Contents

Our Technology Development Center in Godmanchester, England and our research and development laboratories are critical to our success. These facilities currently house our principal research, development, engineering and design operations. Our research and development activities involve the controlled use of a small amount of hazardous substances as well as other potentially harmful materials, waste and chemicals, which could cause interruption of our research and development efforts or injury to our employees, resulting in liabilities under federal, state, local or foreign laws or regulations governing the use, storage and disposal of these materials. While to date we have not had any issues relating to the use of hazardous materials, any event that causes a disruption of the operation of these facilities for even a relatively short period of time would adversely affect our ability to conduct research and development operations and to provide technical support for our licensees, which would negatively affect our revenues.

*If we acquire or invest in any companies or technologies or enter into joint ventures in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value or have an adverse effect on our results of operations.*

We intend to expand our business primarily through internal growth, but from time to time we may consider strategic acquisitions or other investments, as well as joint ventures, to develop P-OLED materials and displays and related technologies. Any future acquisition, investment or joint venture would involve numerous risks, including:

potential disruption of our ongoing business and distraction of management;

difficulty integrating the operations and products of the acquired business;

unexpected expenses related to technology integration;

exposure to unknown liabilities, including litigation against the companies we may acquire or in which we invest or the joint ventures we form;

future losses or failure of the acquired business resulting in the impairment of the carrying value of any investment;

additional costs due to differences in culture, geographic locations and duplication of key talent; and

potential loss of key employees or customers of the acquired company.

In addition, the failure to complete any such acquisition, investment or joint venture after it has been announced and negotiations commenced may have an adverse effect on our business, including the diversion of our management's time and attention, the negative impact on our business prospects or a decline in the market price for shares of our common stock.

We have made investments in Add-Vision Inc., a California company, and MicroEmissive Displays, or MED, which is a publicly quoted company in the United Kingdom. We may not be successful in addressing the risks or any other problems encountered in connection with these or other investments. If the companies in which we invest are not successful in achieving their business objectives the value of their stock may fall and we might have to write down the respective values of our investments.

In November 2005, we and Sumitomo Chemical entered into a joint venture agreement, which provides for the organization and capitalization of Sumation to develop and supply advanced P-OLED materials and formulated inks for use in commercial P-OLED displays and lighting applications. Each party to the joint venture agreement has contributed initial working capital to Sumation in exchange for a 50% voting and ownership interest, with an initial two-year budget and any additional funds to be funded equally by each party. To the extent that Sumation does not achieve its expected sales revenues or margins, we may need to provide 50% of any additional working capital funding requirements, although we will be under no formal obligation to do so. The joint venture agreement includes provisions for the possible sale of part or all of our equity stake to Sumitomo Chemical at fair market value after a minimum of five years. After the initial two-year period of the joint venture,

## Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

the parties have agreed to engage in good faith discussions regarding how the manpower and facilities requirements of the joint venture will be resourced in the third and subsequent years. The joint venture agreement may be terminated by either party by mutual written agreement, or by one of the parties in the case of a material breach of the other party. It may also be terminated in the event of the bankruptcy or insolvency of either party, or if a 40% interest is acquired in one party by a direct and substantial competitor of the other joint venture party. The agreement will also terminate if Sumitomo Chemical acquires 100% of the shares in Sumation.

Although we already had a strong research relationship with Sumitomo Chemical, we believe that the strengthening of our relationship through the formation of this joint venture is the most effective way of accelerating P-OLED material development in the future. There can be no assurance, however, that the joint venture will not be terminated or that part or all of our interest in Sumation will not be acquired or that we will be successful in addressing the risks described above or any other problems encountered in connection with our joint venture, whether as a result of potential disruption of our ongoing business and distraction or duplication of management and other key talent or additional and unexpected costs and expenses related to technology integration or that could result from cultural differences or as a result of the geographic location of the joint venture in Japan.

## **Table of Contents**

### **Risks Relating to our Common Stock and Financial Results**

*Our operating results may have significant period-to-period fluctuations, which would make it difficult to predict our future performance.*

Due to the current stage of commercialization of our technology and the significant development and manufacturing objectives that we and our licensees must achieve to be successful, our quarterly operating results will be difficult to predict and may vary significantly from quarter to quarter.

We believe that period-to-period comparisons of our operating results are not a reliable indicator of our future performance at this time. Among other factors affecting our period-to-period results, our license fees often consist of large one-time payments in the period during which we enter into a new license, followed by smaller recurring payments in later periods, resulting in significant fluctuations in our revenues. We recognize revenues in accordance with accounting principles generally accepted in the United States and, depending on the exact nature of the deliverables in any agreement, or set of agreements entered into contemporaneously, the recognition of revenues may be substantially delayed following receipt of cash from our customers and may be difficult to predict. If, in some future period, our operating results or business outlook fall below the expectations of securities analysts or investors, our stock price would be likely to decline and investors in our common stock may not be able to resell their shares at or above the price at which they were purchased. Broad market, industry and global economic factors may also materially reduce the market price of our common stock, regardless of our operating performance.

*The market price of our common stock may be highly volatile.*

The market price of our common stock has been highly volatile, as has been the case with the securities of many other emerging growth companies. Factors such as the following may have a significant impact on the market price of our common stock in the future:

our operating results and capital resources;

announcements by us or our competitors of technological developments, new product applications or license arrangements; and

other factors affecting the FPD and related industries in general.

In addition, the stock market in general has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies like us.

*One of our stockholders owns a significant amount of our common stock. If this ownership concentration continues, it could prevent you and other stockholders from influencing significant corporate decisions.*

Affiliates of Kelso & Company, or Kelso, beneficially own approximately 40% of the outstanding shares of our common stock. Kelso is also represented on our board. As a result, Kelso exercises significant influence over matters requiring stockholder approval. The concentrated holding of Kelso may result in the delay or deterrence of possible changes in control of our company, which may negatively impact the market price of our common stock. The interests of Kelso and other of our existing stockholders may conflict with the interests of our other stockholders.

*Because we do not intend to pay dividends, stockholders will benefit from an investment in our common stock only if it appreciates in value.*

We have never declared or paid any cash dividends on our common stock. We currently intend to retain our future earnings, if any, to finance the operation and growth of our business and do not expect to pay any cash dividends in the foreseeable future. As a result, the success of an investment in our common stock will depend upon any future appreciation in its value. There is no guarantee that our common stock will appreciate in value or even maintain the price at which stockholders have purchased their shares.

**Table of Contents*****Our share price may decline due to the large number of shares eligible for future sale.***

Sales of substantial amounts of our common stock, or the possibility of such sales, may adversely affect the price of our common stock and impede our ability to raise capital through the issuance of equity securities. As of June 30, 2007, there were 21,630,703 shares of our common stock outstanding. In addition, we may in the future issue additional shares of our common stock that might be or become freely transferable, including shares that may be issued under additional registration statements that we may file, such as our shelf registration statement described below, upon the exercise of warrants or options or pursuant to our special bonus or other plans.

Shares freely transferable without restriction or further registration under the Securities Act of 1933 pursuant to Rule 144 or otherwise *	12,853,353	59.4%
Shares held by executive officers *	119,517	0.6%
Shares held by Kelso and eligible for sale under Rule 144 *	8,657,833	40.0%
<b>Total shares outstanding at June 30, 2007</b>	<b>21,630,703</b>	<b>100.0%</b>
Shares issuable pursuant to outstanding warrants	659,464	
Shares issuable pursuant to outstanding stock options	665,681	
Shares issuable pursuant to awards under our special bonus plan	999,705	
Shares issuable pursuant to other restricted stock unit awards	789,258	
Shares issuable pursuant to other contractual arrangements	256,959	
Shares reserved for future grants under stock incentive plans	136,364	

\* stock held by affiliates is subject to volume, manner of sale, holding period and other limitations of Rule 144

We have registered 6.5 million shares of our common stock with the SEC under a "shelf" registration statement on Form S-3, which covers 3.9 million shares that may be issued and sold by us and 2.6 million outstanding shares that may be sold by certain selling stockholders, including Kelso. We have entered into a contract with Next Sierra, pursuant to which we are required to file a registration statement with the SEC for 28,551 shares of our common stock which were issued to Next Sierra in January 2007 and 256,959 shares which may be issued to them in future.

Kelso, which, together with its affiliates, owns an aggregate of approximately 40% of the outstanding shares of our common stock, has rights, subject to some conditions, to require us to file registration statements covering the unregistered shares that it currently holds or may acquire or to include these shares in registration statements that we may file for ourselves or other stockholders, including in connection with our shelf registration statement described above. Sales by Kelso of a substantial number of shares could significantly reduce the market price of our common stock.

The price of our common stock can be expected to decrease if we issue additional shares of our common stock that might be or become freely salable, including shares that may be issued under additional registration statements that we may file, such as our proposed shelf registration described above, upon the exercise of warrants or options or pursuant to our special bonus or other plans.

***We can issue shares of preferred stock that may adversely affect your rights as a shareholder of our common stock.***

Our certificate of incorporation authorizes us to issue up to 46,667 shares of preferred stock with designations, rights and preferences determined from time-to-time by our board of directors. Accordingly, our board of directors is empowered, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting or other rights superior to those of stockholders of our common stock. For example, an issuance of shares of preferred stock could:

adversely affect the voting power of the stockholders of our common stock;

make it more difficult for a third party to gain control of us;

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

discourage bids for our common stock at a premium;

limit or eliminate any payments that the stockholders of our common stock could expect to receive upon our liquidation; or

otherwise adversely affect the market price of our common stock.

## **Table of Contents**

We may issue additional shares of authorized preferred stock at any time in the future.

### ***We are incurring costs as a result of being a public company.***

We incur significant legal, accounting, administrative and other costs and expenses as a public company. We are required to comply with the Sarbanes-Oxley Act of 2002, as well as rules subsequently implemented by the SEC and the Nasdaq Global Market. Compliance with these rules and regulations causes us to incur legal, audit and financial compliance costs, and diverts management attention from operations and strategic opportunities. We will incur additional costs in evaluating and reporting on our internal control over financial reporting and having our independent auditors annually attest to our evaluation as required by Section 404 of the Sarbanes-Oxley Act of 2002 and the rules and regulations thereunder, which we expect to commence with our Annual Report on Form 10-K for the fiscal year ending December 31, 2007. We are preparing to comply with Section 404 by strengthening, assessing and testing our system of internal controls to provide the basis for our initial report on our internal control over financial reporting. The process of strengthening our internal controls and complying with Section 404 is expensive and time consuming, and it requires significant management attention. We cannot be certain that these measures will ensure that we will maintain adequate controls over our financial processes and reporting in the future. Effective internal controls are necessary for us to provide reliable financial reports. We have in the past discovered, and may in the future discover, areas of our internal controls that require improvement. Failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. If we or our independent auditors discover a material weakness, the disclosure of the fact, even if quickly remedied, could reduce the market's confidence in our financial statements and harm our stock price. In addition, non-compliance with Section 404 could subject us to a variety of administrative sanctions, including the suspension or delisting of our common stock from the Nasdaq Global Market and the inability of registered broker-dealers to make a market in our common stock, which would further reduce our stock price.

We are required to retain independent directors to serve on our board of directors. If vacancies on our board of directors or our audit committee occur that need to be filled by independent directors, we may encounter difficulty in attracting qualified persons to serve on our board, and, in particular, our audit committee. If we fail to attract and retain the required number of independent directors we may be subject to SEC enforcement proceedings and delisting of our common stock from the Nasdaq Global Market. We are also incurring high costs to maintain directors and officers insurance.

### ***Our certificate of incorporation and bylaws and Delaware law may discourage takeovers and business combinations that our stockholders might consider in their best interests.***

Provisions in our certificate of incorporation and by-laws may delay, defer, prevent or render more difficult a takeover attempt that our stockholders might consider in their best interests. These provisions may prevent our stockholders from receiving the benefit from any premium to the market price of our common stock offered by a bidder in a takeover context. Even in the absence of a takeover attempt, the existence of these provisions may adversely affect the prevailing market price of our common stock if they are viewed as discouraging takeover attempts in the future.

## **Risks Relating to the Proposed Merger with Sumitomo**

### ***We cannot make any assurance that the proposed merger will be completed.***

Completion of the proposed merger is subject to customary closing conditions, including approval of the merger agreement and the merger by a majority of our stockholders, the absence of any material adverse effect on our company and the election of statutory appraisal rights by holders of no more than 10% of our common stock. We cannot guarantee that these closing conditions will be satisfied.

### ***Failure to complete the proposed merger could have a negative impact on the market price of our common stock and our business.***

If the proposed merger is not completed, the price of our common stock may decline to the extent that the current market price reflects a market assumption that the proposed merger will be completed. In addition, if the proposed merger is not completed:

our management's attention from our day-to-day business may be diverted;



**Table of Contents**

we may lose key employees;

our business and operations may be harmed to the extent that our licensees, joint development partners or others believe that we cannot compete effectively in the marketplace without the merger;

our relationships with our licensees or joint development partners may be disrupted as a result of uncertainties with regard to our business and prospects; or

under specified circumstances we may be required to pay a termination fee of \$11.3 million to Sumitomo in connection with a termination of the merger agreement or to reimburse Sumitomo for its expenses up to \$8 million

Any such events could have a material negative impact on our results of operations and financial condition and could adversely affect our stock price.



**Table of Contents****Item 4. Submission of Matters to a Vote of Security Holders**

- (a) The Annual Meeting of Stockholders was held on June 5, 2007.
- (b) The matters voted upon at the meeting and results of the voting with respect to those matters were as follows:
- (1) Election of Directors:

	<b>Votes For</b>	<b>Withheld</b>
Dr. David Fyfe	15,621,235	1,491,930
Dr. Malcolm J. Thompson	16,834,582	278,583
Joseph Carr	16,834,882	278,283
Frank K. Bynum, Jr.	16,817,882	295,283
Thomas G. Rosencrants	16,832,582	280,583

- (2) Ratification of the appointment of Ernst & Young LLP as the Company's independent registered public accounting firm

<b>Votes For</b>	<b>Against</b>	<b>Abstain</b>
17,108,359	3,465	1,340

**Item 6. Exhibits****Exhibit**

<b>Number</b>	<b>Description of Document</b>
2.1	Agreement and Plan of Merger, dated as of July 31, 2007, by and among Sumitomo Chemical Co., Ltd, Rosy Future, Inc. and the Registrant (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K dated July 31, 2007 (File No. 000-51079))
10.1	Patent Licence for Displays and Display Illumination dated June 25, 2007 between Cambridge Display Technology Limited and Sumitomo Chemical Co., Ltd.
31.1	Rule 13a-14(a) Certification of Principal Executive Officer
31.2	Rule 13a-14(a) Certification of Principal Financial Officer
32.1	(1) Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)
32.2	(1) Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)

- (1) In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the material contained in Exhibits 32.1 and 32.2 is furnished and not deemed filed with the SEC, and is not to be incorporated by reference into any filing of the registrant under the Securities Act of 1933 or the Exchange Act whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing, except to the extent that the registrant specifically incorporates it by reference.

An application for confidential treatment has been filed with the SEC with respect to certain portions of this agreement.



**Table of Contents**

**SIGNATURES**

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

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

Dated: August 14, 2007

By: /s/ DAVID FYFE  
DAVID FYFE  
Chief Executive Officer  
(Principal Executive Officer)

Dated: August 14, 2007

By: /s/ MICHAEL BLACK  
MICHAEL BLACK  
Chief Financial Officer  
(Principal Financial Officer)