SUPERCONDUCTOR TECHNOLOGIES INC
Form 10-Q
November 10, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 2, 2010

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

For the transition period from _____ to _____

Commission File Number 0-21074

SUPERCONDUCTOR TECHNOLOGIES INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0158076**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

460 Ward Drive,
Santa Barbara, California 93111-2356
(Address of principal executive offices & zip code)
(805) 690-4500
(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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large Accelerated Filer o	Accelerated Filer o	Non-accelerated Filer o (*do not check if a smaller reporting company)*	Smaller reporting company þ

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

The registrant had 27,217,408 shares of common stock outstanding as of the close of business on November 1, 2010.

SUPERCONDUCTOR TECHNOLOGIES INC.
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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995 for these forward looking statements. Our forward-looking statements relate to future events or our future performance and include, but are not limited to, statements concerning our business strategy, future commercial revenues, market growth, capital requirements, new product introductions, expansion plans and the adequacy of our funding. Other statements contained in this Report that are not historical facts are also forward-looking statements. We have tried, wherever possible, to identify forward-looking statements by terminology such as may, will, could, should, expects, anticipates, intends, plans, believes, seeks, estimates and other comparable terminology.

We caution investors that any forward-looking statements presented in this Report, or that we may make orally or in writing from time to time, are based on the beliefs of, assumptions made by, and information currently available to, us. Such statements are based on assumptions, and the actual outcome will be affected by known and unknown risks, trends, uncertainties and factors that are beyond our control or ability to predict. Although we believe that our assumptions are reasonable, they are not guarantees of future performance and some will inevitably prove to be incorrect. As a result, our actual future results can be expected to differ from our expectations, and those differences may be material. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on known results and trends at the time they are made, to anticipate future results or trends.

Some of the risks and uncertainties that may cause our actual results, performance or achievements to differ materially from those expressed or implied by forward-looking statements include the following:

- *limited cash and a history of losses;*
- *limited number of potential customers;*
- *limited number of suppliers for some of our components;*
- *no significant backlog from quarter to quarter;*
- *our market is characterized by rapidly advancing technology;*
- *fluctuations in product demand from quarter to quarter can be significant;*
- *the impact of competitive filter products, technologies and pricing;*
- *manufacturing capacity constraints and difficulties; and*
- *general economic conditions, such as the current worldwide recession.*

For further discussion of these and other factors see, Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors in our Annual Report on Form 10-K for 2009.

This Report and all subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We do not undertake any obligation to release publicly any revisions to our forward-looking statements to reflect events or circumstances after the date of this Report.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

SUPERCONDUCTOR TECHNOLOGIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended		Nine Months Ended	
	October 2, 2010	**September 26, 2009**	**October 2, 2010**	**September 26, 2009**
Net revenues:				
Net commercial product revenues	$ 1,830,000	$ 2,985,000	$ 5,901,000	$ 5,893,000
Government and other contract revenues	144,000	1,307,000	1,857,000	2,708,000
Total net revenues	**1,974,000**	**4,292,000**	**7,758,000**	**8,601,000**
Costs and expenses:				
Cost of commercial product revenues	2,110,000	2,947,000	6,464,000	7,186,000
Cost of government and other contract revenue	86,000	993,000	1,095,000	2,227,000
Research and development	1,507,000	902,000	3,998,000	2,984,000
Selling, general and administrative	1,622,000	1,629,000	5,338,000	5,164,000
Total costs and expenses	5,325,000	6,471,000	16,895,000	17,561,000
Loss from operations	**(3,351,000)**	**(2,179,000)**	**(9,137,000)**	**(8,960,000)**
Other Income and Expense				
Noncontrolling interest in joint venture		(30,000)		(117,000)
Adjustments to fair value of derivatives	2,000	393,000	171,000	(387,000)
Interest income	2,000	4,000	4,000	21,000
Interest expense	(7,000)	(7,000)	(21,000)	(25,000)
Net loss	**$(3,354,000)**	**$ (1,819,000)**	**$ (8,983,000)**	**$ (9,468,000)**
Basic and diluted loss per common share	**$ (0.14)**	**$ (0.08)**	**$ (0.40)**	**$ (0.50)**
Weighted average number of common shares outstanding	23,335,955	21,621,035	22,334,644	19,116,136

See accompanying notes to the unaudited interim condensed consolidated financial statements.

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SUPERCONDUCTOR TECHNOLOGIES INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	October 2, 2010 (Unaudited)	December 31, 2009 (See Note)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 8,275,000	$ 10,365,000
Accounts receivable, net	250,000	462,000
Inventory, net	2,396,000	2,644,000
Prepaid expenses and other current assets	493,000	445,000
Total Current Assets	11,414,000	13,916,000
Property and equipment, net of accumulated depreciation of $21,760,000 and $21,076,000, respectively	1,457,000	1,832,000
Patents, licenses and purchased technology, net of accumulated amortization of $2,466,000 and $2,384,000, respectively	2,236,000	2,163,000
Other assets	205,000	215,000
Total Assets	**$ 15,312,000**	**$ 18,126,000**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 817,000	$ 467,000
Accrued expenses	1,128,000	671,000
Fair value of warrant derivative		171,000
Current portion of capitalized lease obligations and long term debt	34,000	50,000
Total Current Liabilities	1,979,000	1,359,000
Other long term liabilities	607,000	526,000
Total Liabilities	2,586,000	1,885,000
Commitments and contingencies-Notes 6 and 7		
Stockholders Equity:		
Preferred stock, $.001 par value, 2,000,000 shares authorized, 611,523 shares issued and outstanding	1,000	1,000
Common stock, $.001 par value, 250,000,000 shares authorized, 26,617,408 and 22,512,033 shares issued and outstanding, respectively	27,000	23,000
Capital in excess of par value	247,346,000	241,882,000

Accumulated deficit	(234,648,000)	(225,665,000)
Total Stockholders Equity	12,726,000	16,241,000
Total Liabilities and Equity	**$ 15,312,000**	**$ 18,126,000**

See accompanying notes to the condensed consolidated financial statements
Note-December 31, 2009 balances were derived from audited financial statements.

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SUPERCONDUCTOR TECHNOLOGIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended	
	October 2, 2010	**September 26, 2009**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	**$ (8,983,000)**	**$ (9,468,000)**
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	766,000	1,143,000
Stock-based compensation expense	822,000	843,000
Provision for excess and obsolete inventories	270,000	192,000
Noncontrolling interest in joint venture		117,000
Fair value of derivatives	(171,000)	387,000
Changes in assets and liabilities:		
Accounts receivable	212,000	(670,000)
Inventory, net	(22,000)	2,024,000
Prepaid expenses and other current assets	(48,000)	(710,000)
Patents, licenses and purchased technology	(154,000)	(123,000)
Other assets	8,000	309,000
Accounts payable, accrued expenses and other long-term liabilities	873,000	838,000
Net cash used in operating activities	**(6,427,000)**	**(5,118,000)**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in joint venture		(8,000)
Purchases of property and equipment	(309,000)	(183,000)
Net cash used in investing activities	**(309,000)**	**(191,000)**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repurchase of common shares for withholding obligations	(573,000)	
Net proceeds from the sale of common stock	5,219,000	10,456,000
Net cash provided by financing activities	**4,646,000**	**10,456,000**
Net increase (decrease) in cash and cash equivalents	(2,090,000)	5,147,000
Cash and cash equivalents at beginning of period	10,365,000	7,569,000
Cash and cash equivalents at end of period	**$ 8,275,000**	**$ 12,716,000**

See accompanying notes to the unaudited interim condensed consolidated financial statements.

SUPERCONDUCTOR TECHNOLOGIES INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. General

Superconductor Technologies Inc. (together with its subsidiaries, we or us) was incorporated in Delaware on May 11, 1987, and we maintain our headquarters in Santa Barbara, California. We are a global leader in high temperature superconductor (HTS) materials and related technologies. We have been awarded more than 100 patents and also relay on significant proprietary trade secrets and manufacturing expertise. Our current commercial efforts have been focused on the design, manufacture and sale of high performance infrastructure products for wireless voice and data applications, including our SuperLink® (high-temperature superconducting filters), AmpLink® (high performance, ground-mounted amplifiers) and SuperPlex (high performance multiplexers) products. We are now leveraging our key enabling technologies, including radio frequency filtering, HTS materials and cryogenics, to pursue emerging opportunities in the electrical grid and in equipment platforms that utilize electrical circuits, as well as government products and reconfigurable handset filters.

For the nine months ended October 2, 2010 and September 26, 2009, commercial revenues accounted for 76% and 69%, respectively, of our net revenues.

We have also generated significant revenues from government contracts. We typically own the intellectual property developed under these contracts and grant the U.S. government a royalty-free, non-exclusive and nontransferable license to use it. For the nine months ended October 2, 2010 and September 26, 2009, government related contracts accounted for 24% and 31%, respectively, of our net revenues.

The unaudited condensed consolidated financial information furnished herein has been prepared in accordance with generally accepted accounting principles and reflects all adjustments, consisting only of normal recurring adjustments that, in our opinion, are necessary for a fair statement of the results of operations for the periods presented. The preparation of these condensed consolidated financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates, and such differences may be material to the financial statements. This quarterly report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for 2009. The results of operations for the nine months ended October 2, 2010 are not necessarily indicative of the results for all of 2010.

2. Summary of Significant Accounting Policies

Basis of Presentation

For the nine months ended October 2, 2010, we incurred a net loss of $9.0 million and negative cash flows from operations of $6.4 million. In 2009, we incurred a net loss of $13.0 million and had negative cash flows from operations of $7.4 million.

At October 2, 2010, we had $8.3 million in cash and cash equivalents. Our cash resources, together with our line of credit, should be sufficient to fund our business through the second quarter of 2011. We believe the key factors to our liquidity will be our ability to successfully use our expertise and our technology to generate revenues in various ways, including commercial operations, government contracts, joint ventures and licenses. Because of the uncertainty of these factors, we may need to raise funds to meet our working capital needs. If we require additional financing, we cannot assure you that additional financing will be available on acceptable terms or at all. If we issue additional equity securities to raise funds, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise any needed funds, we might be forced to make further substantial reductions in our operating expenses, which could adversely affect our ability to implement our current business plan and ultimately our viability as a company.

Our condensed consolidated financial statements have been prepared assuming that we will continue as a going concern. The factors described above raise substantial doubt about our ability to continue as a going concern. Our financial statements do not include any adjustments that might result from this uncertainty.

Principles of Consolidation

The interim condensed consolidated financial statements include the accounts of Superconductor Technologies Inc. and our wholly owned subsidiaries. All significant intercompany transactions have been eliminated from the condensed consolidated financial statements.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less. Cash equivalents are maintained with quality financial institutions and from time to time exceed FDIC limits. Our money market funds are not insured or guaranteed by the FDIC. Historically we have not experienced any losses due to such concentration of credit risk.

Accounts Receivable

We sell predominantly to entities in the wireless communications industry and to entities of the United States government. We grant uncollateralized credit to our customers. We perform usual and customary credit evaluations of our customers before granting credit. Trade accounts receivable are recorded at the invoiced amount and do not bear interest. We record an allowance for doubtful accounts that represents our best estimate of the amount of probable credit losses in our existing accounts receivable based on our historical write-off experience. Past due balances are reviewed for collectibility. Accounts balances are charged off against the allowance when we deem it is probable the receivable will not be recovered. We do not have any off balance sheet credit exposure related to our customers.

Revenue Recognition

Commercial revenues are principally derived from the sale of our SuperLink, AmpLink and SuperPlex family of products and are recognized once all of the following conditions have been met: a) an authorized purchase order has been received in writing, b) customer s credit worthiness has been established, c) shipment of the product has occurred, d) title has transferred, and e) if stipulated by the contract, customer acceptance has occurred and all significant vendor obligations, if any, have been satisfied.

Contract revenues are principally generated under research and development contracts. Contract revenues are recognized utilizing the percentage-of-completion method measured by the relationship of costs incurred to total estimated contract costs. If the current contract estimate were to indicate a loss, utilizing the funded amount of the contract, a provision would be made for the total anticipated loss. Revenues from research-related activities are derived primarily from contracts with agencies of the U.S. Government. Credit risk related to accounts receivable arising from such contracts is considered minimal. These contracts include cost-plus, fixed price and cost sharing arrangements and are generally short-term in nature.

All payments to us for work performed on contracts with agencies of the U.S. Government are subject to adjustment upon audit by the Defense Contract Audit Agency. Contract audits through 2003 are closed. Based on historical experience and review of current projects in process, we believe that adjustments from open audits will not have a significant effect on our financial position, results of operations or cash flows.

Shipping and Handling Fees and Costs

Shipping and handling fees billed to customers are included in net commercial product revenues. Shipping and handling fees associated with freight are generally included in cost of commercial product revenues.

Warranties

We offer warranties generally ranging from one to five years, depending on the product and negotiated terms of purchase agreements with our customers. Such warranties require us to repair or replace defective product returned to us during such warranty period at no cost to the customer. Our estimate for warranty-related costs is recorded at the time of sale based on our actual historical product return rates and expected repair costs. Such costs have been within our expectations.

Guarantees

In connection with the sales and manufacturing of our commercial products, we indemnify, without stated limit or term, our customers and contract manufacturers against claims, suits, demands, damages, liabilities, expenses, judgments, settlements and penalties arising from actual or alleged infringement or misappropriation of any intellectual property relating to our products or other claims arising from our products. We cannot reasonably develop an estimate of the maximum potential amount of payments that might be made under our indemnities because of the uncertainty as to whether a claim might arise and how much it might total. Historically, we have not incurred any expenses related to these indemnities.

Research and Development Costs

Research and development costs are expensed as incurred and include salary, facility, depreciation and material expenses. Research and development costs are charged to research and development expense. Research and development costs incurred solely in connection with contracts are charged to government and other contract expense.

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Inventories

Inventories are stated at the lower of cost or market, with costs primarily determined using standard costs, which approximate actual costs utilizing the first-in, first-out method. We review inventory quantities on hand and on order and record, on a quarterly basis, a provision for excess and obsolete inventory and/or vendor cancellation charges related to purchase commitments. If we determine that a write-down is necessary, we recognize a loss in the period in which the loss is identified, whether or not the inventory is retained. Our inventory reserves establish a new cost basis for inventory and are not reversed until we sell or dispose of the related inventory. Such provisions are established based on historical usage, adjusted for known changes in demands for such products, or the estimated forecast of product demand and production requirements. Costs associated with idle capacity are expensed immediately.

Property and Equipment

Property and equipment are recorded at cost. Equipment is depreciated using the straight-line method over its estimated useful life ranging from three to five years. Leasehold improvements and assets financed under capital leases are amortized over the shorter of their useful lives or the lease term. Furniture and fixtures are depreciated over seven years. Expenditures for additions and major improvements are capitalized. Expenditures for minor tooling, repairs and maintenance and minor improvements are charged to expense as incurred. When property or equipment is retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts. Gains or losses from retirements and disposals are recorded in selling, general and administrative expenses.

Patents, Licenses and Purchased Technology

Patents and licenses are recorded at cost and are amortized using the straight-line method over the shorter of their estimated useful lives or approximately seventeen years. Purchased technology acquired through the acquisition of Conductus, Inc. in 2002 was recorded at its estimated fair value and has been amortized using the straight-line method over seven years.

Long-Lived Assets

The realizability of long-lived assets is evaluated periodically as events or circumstances indicate a possible inability to recover the carrying amount. Long-lived assets that will no longer be used in our business are written off in the period identified since they are no longer expected to generate any positive cash flows for us. Long-lived assets that continue to be used by us are periodically evaluated for recoverability. Such evaluation is based on various analyses, including cash flow and profitability projections. The analyses necessarily involve significant management judgment. In the event the projected undiscounted cash flows are less than net book value of the assets, the carrying value of the assets is written down to its estimated fair value. We tested our long lived assets for recoverability during 2009 and did not believe that there was any impairment.

While we believe the expected cash flows from our long-lived assets, including intangible assets, exceed their carrying amounts, materially different assumptions regarding future performance and discount rates could result in future impairment losses. In particular, if we no longer believe we will achieve our long-term projected sales or operating expenses, we may conclude, in future impairment tests, that the estimated fair value of our long-lived assets, including intangible assets, is less than their book value and recognize an impairment charge. Any impairment charge would adversely affect our earnings.

Other Investments

From time to time we may pursue joint ventures with other entities to commercialize our technology. In 2007, we formed a joint venture with Hunchun BaoLi Communication Co. Ltd. to manufacture and sell our SuperLink interference elimination solution in China. We use the equity method of accounting for our 45 percent joint venture interest. The joint venture agreement called for our joint venture partner to supply the capital and local expertise, and for us to provide a license of certain technology and supply key parts for manufacturing. Since 2007, we have been conducting lab and field trials in the existing China 2G market using our TD-SCDMA and SuperLink solutions. Although those activities continue, the parties have not completed their contributions to the joint venture, including most of the funding and our license, within the two year period specified by the agreement and Chinese law. The future of the joint venture, including any commencement of manufacturing and the transfer of our processes, will depend on product demand in China, completion of funding by our joint venture partner, as well as a number of other conditions, including certain critical approvals from the Chinese and United States governments. There continues to be no assurance that these conditions will be met. As a result of this uncertainty, at December 31, 2009, we fully reserved against our investment in the joint venture of $521,000. Other expense included $30,000 and $117,000 in the three and nine months ended September 26, 2009, respectively, from our 45 percent equity ownership. There was no such expense in 2010.

Restructuring Expenses
Liability for costs associated with an exit or disposal activity are recognized when the liability is incurred.
Loss Contingencies
In the normal course of our business we are subject to claims and litigation, including allegations of patent infringement. Liabilities relating to these claims are recorded when it is determined that a loss is probable and the amount of the loss can be reasonably estimated. The costs of our defense in such matters are expensed as incurred. Insurance proceeds recoverable are recorded when deemed probable.
Income Taxes
We recognize deferred tax liabilities and assets based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit (expense) results from the change in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all deferred tax assets will not be realized. The accounting guidance further clarifies the accounting for uncertainty in income taxes and sets a consistent framework to determine the appropriate level of tax reserve to maintain for uncertain tax positions. This framework uses a two-step approach under which a tax benefit is recognized if a position is more-likely-than-not to be sustained. The amount of the benefit is then measured to be the highest tax benefit that is greater than 50% likely to be realized and sets out disclosure requirements to enhance transparency of our tax reserves. Guidance is also provided on the accounting for the related interest and penalties, financial statement and disclosure. We are currently not under examination by any taxing authority nor have we been notified of an impending examination. The oldest tax year that remains open to possible evaluation and interpretation of our tax position is 1995. As of December 31, 2009, we had net operating loss carryforwards for federal and state income tax purposes of approximately $298.8 million and $169.9 million, respectively. Due to the uncertainty surrounding their realization, we recorded a full valuation allowance against our net deferred tax assets. Accordingly, no deferred tax asset has been recorded in the accompanying condensed consolidated balance sheets.
Marketing Costs
All costs related to marketing and advertising our products are expensed as incurred or at the time the advertising takes place. Advertising costs were not material in the three and nine months ended October 2, 2010 or the three or nine months ended September 26, 2009.
Net Loss Per Share
Basic and diluted net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding in each year. Potential common shares are not included in the calculation of diluted loss per share because their effect is anti-dilutive.
Stock-based Compensation
We grant both restricted stock awards and stock options to our key employees, directors and consultants. For the three and nine months ended October 2, 2010 and September 26, 2009, the weighted average fair value of options was estimated at the date of the grant using the Black-Scholes option-pricing model. The following are the significant weighted average assumptions used for estimating the fair value under our stock option plans:

	Three months ended		**Nine months ended**	
	October 2, 2010	**September 26, 2009**	**October 2, 2010**	**September 26, 2009**
Expected life in years	n/a	n/a	4.0	n/a
Risk free interest rate	n/a	n/a	2.04%	n/a
Expected volatility	n/a	n/a	117%	n/a
Dividend yield	n/a	n/a	0%	n/a

The expected life was based on the contractual term of the options and expected employee exercise behavior. Typically, options to our employees have a 3 or 4 year vesting term and a 10 year contractual term. The risk-free interest rate is based on U. S. Treasury zero-coupon issues with a remaining term equal to the expected option life assumed at the grant date. The future volatility is based on our 4 year historical volatility. We used an expected dividend yield of 0% because we have never paid a dividend and do not anticipate paying dividends. We assumed a 10% forfeiture rate based on our historical stock option cancellation rates over the last 4 years.

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The stock-based compensation expense for our restricted stock awards is measured at fair value on the date of grant based on the number of shares expected to vest and the quoted market price of our common stock.
The following table presents details of total stock-based compensation expense that is included in each functional line item on our condensed consolidated statements of operations:

	Three months ended		Nine months ended	
	October 2, 2010	September 26, 2009	October 2, 2010	September 26, 2009
Cost of revenue	$ 5,000	$ 8,000	$ 16,000	$ 23,000
Research and development	89,000	67,000	226,000	200,000
Selling, general and administrative	212,000	224,000	580,000	620,000
Total stock-based compensation expense	$ 306,000	$ 299,000	$ 822,000	$ 843,000

Use of Estimates
The preparation of condensed consolidated financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The significant estimates in the preparation of the financial statements relate to the assessment of the carrying amount of accounts receivable, inventory, fixed assets, intangibles, estimated provisions for warranty costs, accruals for restructuring and lease abandonment costs, contract revenues, income taxes and disclosures related to litigation. Actual results could differ from those estimates, and such differences may be material to the condensed consolidated financial statements.
Fair Value of Financial Instruments
We have estimated the fair value of our financial instruments using the available market information and valuation methodologies considered to be appropriate and have determined that the book value of our cash and cash equivalents, accounts receivables, inventories, prepaid expenses and accrued expenses approximate fair value.
Comprehensive Income (Loss)
We have no items of other comprehensive income (loss) in any period presented and consequently have not presented a statement of comprehensive income (loss).
Segment Information
We operate in a single business segment, the research, development, manufacture and marketing of high performance products used in cellular base stations to maximize the performance of wireless telecommunications networks by improving the quality of uplink signals from mobile wireless devices. We currently derive net commercial product revenues primarily from the sales of our SuperLink, AmpLink and SuperPlex products. We currently sell most of our products directly to wireless network operators in the United States. Net revenues derived principally from government research and development contracts are presented separately on the unaudited condensed consolidated statements of operations for all periods presented.
Certain Risks and Uncertainties
Our long-term prospects are dependent upon the continued and increased market acceptance for our products.
We currently sell most of our products directly to wireless network operators in the United States, and our product sales have historically been concentrated in a small number of customers. In the nine months ended October 2, 2010, we had two customers that represented 59% and 12% of total net revenues and collectively 75% of accounts receivable. In 2009, these two customers represented 51% and 11% of total net revenues and collectively 38% of accounts receivable. The loss of or reduction in sales to, or the inability to collect outstanding accounts receivable from, any of these customers could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We currently rely on a limited number of suppliers for key components of our products. The loss of any of these suppliers could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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In connection with the sales of our commercial products, we indemnify, without stated limit or term, our customers against claims, suits, demands, damages, liabilities, expenses, judgments, settlements and penalties arising from actual or alleged infringement or misappropriation of any intellectual property relating to our products or other claims arising from our products. We cannot reasonably develop an estimate of the maximum potential amount of payments that might be made under our indemnities because of the uncertainty as to whether a claim might arise and how much it might total.

Recent Accounting Pronouncements

In February 2010, the Financial Accounting Standards Board issued updated guidance related to subsequent events. As a result of this updated guidance, we must still evaluate subsequent events through the issuance date of our financial statements; however, we are not required to disclose that date in our financial statement disclosures. This amended guidance became effective upon its issuance on February 24, 2010. We adopted this updated guidance effective as of that date and all subsequent event references in our Securities and Exchange Commission filings will reflect these amended disclosure requirements.

We have considered all other newly issued accounting guidance that is applicable to our operations and the preparation of our condensed consolidated statements, including guidance that we have not yet adopted. We do not believe that any such guidance will have a material effect on our financial position or results of operation.

3. Short Term Borrowings

We have a line of credit with a bank. There was no amount outstanding under this facility at October 2, 2010 or December 31, 2009. The line of credit was renewed in July 2010 and expires in July 2011. The loan agreement is structured as a sale of accounts receivable and provides for the sale of up to $3.0 million of eligible accounts receivable, with advances to us totaling 80% of the receivables sold. Any advances bear interest at the bank s prime rate (4.0% at October 2, 2010) plus 2.50%, subject to a minimum monthly charge. Advances (if any) under the agreement are collateralized by all our assets. Under the terms of the agreement, we must continue to service the sold receivables and are subject to recourse provisions.

The agreement contains representations and warranties, affirmative and negative covenants and events of default customary for financings of this type. The failure to comply with these provisions, or the occurrence of any one of the events of default, would prevent any further borrowings and would generally require the repayment of any outstanding borrowings. Such representations, warranties and events of default include (a) non-payment of debt and interest thereunder, (b) non-compliance with terms of the agreement covenants, (c) insolvency or bankruptcy, (d) material adverse change, (e) merger or consolidation where our stockholders do not hold a majority of the voting rights of the surviving entity, (f) transactions outside the normal course of business, or (g) payment of dividends.

4. Stockholders Equity

The following is a summary of stockholders equity transactions for the nine months ended October 2, 2010:

	Convertible Preferred Stock		Common Stock		Capital in Excess of	Accumulated	
	Shares	**Amount**	**Shares**	**Amount**	**Par Value**	**Deficit**	**Total**
Balance at December 31, 2009	611,523	$ 1,000	22,512,033	$ 23,000	$ 241,882,000	$ (225,665,000)	$ 16,241,000
Issuance of common stock			4,000,000	4,000	5,217,000		5,221,000
Repurchase of common stock to satisfy withholding obligations			(182,520)		(573,000)		(573,000)
			287,895		820,000		820,000

Stock-based compensation							
Net loss						(8,983,000)	(8,983,000)
Balance at October 2, 2010	611,523	$ 1,000	26,617,408	$ 27,000	$ 247,346,000	$ (234,648,000)	$ 12,726,000

Common Stock

In an underwritten offering completed in August 2010 we raised net proceeds of $5.2 million, net of offering costs of $800,000, from the sale of 4 million shares of common stock at $1.50 per share.

Stock Options

We have three equity award option plans, the 1998 and 1999 Stock Option Plans and the 2003 Equity Incentive Plan, although we can only grant new awards under the 2003 Equity Incentive Plan. Under the 2003 Equity Incentive Plan, equity awards may consist of stock options, stock appreciation rights, restricted stock awards, performance awards, and performance share awards. Stock options granted under these plans must be granted at prices no less than the market value on the date of grant. There were no stock option exercises during the three and nine months ended October 2, 2010 or during the three and nine months ended September 26, 2009.

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The option compensation impact was $142,000 and $406,000 on net income and $0.01 and $0.02 on basic and diluted earnings per share for the three and nine months ended October 2, 2010, respectively, compared to $130,000 and $391,000 on net income and $0.01 and $0.02 on basic and diluted earnings per share for the three and nine months ended September 26, 2009, respectively. No stock compensation cost was capitalized during any period. For the first nine months of 2010 we issued 187,498 stock options with a weighted-average fair value at the grant date of $2.01 per share. There were no stock options issued in the first nine months of 2009. The total compensation cost related to non-vested awards not yet recognized is $985,000, and the weighted-average period over which the cost is expected to be recognized is 1.1 years.

The following is a summary of stock option transactions under our equity award plans during the first nine months of 2010:

	Number of Shares	Price Per Share	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
Balance at December 31, 2009	1,144,876	$ 1.43 - $493.75	$ 20.16	970,703	$ 22.96
Granted	187,498	2.62	2.62		
Exercised					
Canceled	199,043	1.85 - 493.75	73.36		
Balance at October 2, 2010	1,133,331	$ 1.43 - $216.70	$ 7.91	900,131	$ 9.18

The outstanding options expire on various dates through the end of May 2020. The weighted-average contractual term of outstanding options is 6.2 years and the weighted-average contractual term of currently exercisable stock options is 5.4 years. The exercise prices for options range from $1.43 to $216.70 per share, for an aggregate exercise price of approximately $9.0 million. At October 2, 2010, outstanding options covering 2,200 shares, with an intrinsic value of $196, had an exercise price less than the current market value, and all of these options were exercisable.

Restricted Stock Awards

There were no awards of restricted stock during the three months ended October 2, 2010. In May 2010, we issued 242,498 shares of restricted stock under awards that have performance and service conditions, and generally vest over three years. The per share grant-date fair value was $2.62. In February 2010, we issued 75,000 shares of restricted stock under awards that have performance and service conditions, and generally vest over four years. The per share grant-date fair value was $3.12. In May 2009, we issued awards covering 55,000 shares of restricted stock, vesting 50% after one year and 50% after two years. The per share grant-date fair value was $3.24. In January 2009, we issued awards covering 835,998 shares of restricted stock, vesting 50% after one year and 50% after two years. The per share grant-date fair value was $1.00. In January 2010, 50%, or 417,999, of these 835,998 awards vested and because plan participants may surrender vested shares back to us to satisfy their minimum statutory tax withholding requirements, we repurchased 181,982 shares. The 181,982 repurchased shares had a fair value of $573,000 based on the closing price of our common stock on the Nasdaq Stock Market of $3.15 on their vesting date. The impact of restricted stock awards was $164,000 and $416,000 to the condensed consolidated statements of operations and $0.01 and $0.02 on basic and diluted earnings per share for the three and nine months ended October 2, 2010, respectively and $169,000 and $452,000 to the condensed consolidated statements of operations and $0.01 and $0.02 on basic and diluted earnings per share for the three and nine months ended September 26, 2009, respectively. No stock compensation cost was capitalized during any period. As of October 2, 2010 the total compensation cost related to non-vested restricted stock awards not yet recognized was $672,000, and the weighted-average period over which the cost is expected to be recognized was one year.

Warrants

The following is a summary of outstanding warrants at October 2, 2010:

	Total and Currently Exercisable	Common Shares Price per Share	Expiration Date
Warrants related to April 2004 Bridge Loans	10,000	18.50	April 28, 2011*

* The terms of these warrants contain net exercise provisions, under which holders can elect to receive common stock equal to the difference between the exercise price and the sale price for common shares on the exercise date or the date immediately preceding the exercise date instead of paying the exercise price in cash.

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On August 16, 2010, 608,237 warrants related to the issuance of common stock expired. The exercise price of these warrants had been adjusted under special anti-dilution adjustment provisions in the warrants relating to the price of other issuances of our common stock. Accordingly, we determined that these warrants were subject to fair value accounting as a derivative. We used the Black-Scholes valuation model to estimate the fair value of these warrants. For the three and nine months ended October 2, 2010 this fair value adjustment was a gain of $2,000 and $171,000, respectively, compared to a gain of $393,000 and a loss of $387,000, respectively, in the three and nine months ended September 26, 2009.

5. Earnings Per Share

Basic and diluted loss per share is based on the weighted-average number of common shares outstanding.

Since their impact would be anti-dilutive, our loss per common share does not include the effect of the assumed exercise of any of the following options or warrants or the vesting of any of the following restricted stock awards:

	October 2, 2010	September 26, 2009
Outstanding stock options	1,133,331	1,157,136
Unvested restricted stock awards	720,730	910,998
Outstanding warrants	10,000	618,237
Total	1,864,061	2,686,371

6. Commitments and Contingencies

Operating Leases

We lease our offices and production facilities under a non-cancelable operating lease that expires in November 2016. This lease contains escalation clauses for increases in annual renewal options and requires us to pay utilities, insurance, taxes and other operating expenses.

Rent expense was $277,000 and $822,000, respectively, for the three and nine months ended October 2, 2010 and $282,000, and $845,000, respectively, for the three and nine months ended September 26, 2009.

Patents and Licenses

We have entered into various licensing agreements requiring royalty payments ranging from 0.13% to 2.5% of specified product sales. Certain of these agreements contain provisions for the payment of guaranteed or minimum royalty amounts. In the event that we fail to pay minimum annual royalties, these licenses may automatically become non-exclusive or be terminated. These royalty obligations terminate at various times from 2010 to 2020. Royalty expense totaled $46,000 and $137,000 for the three and nine months ended October 2, 2010, respectively, compared to $40,000 and $115,000 for the three and nine months ended September 26, 2009, respectively. Under the terms of certain royalty agreements, royalty payments made may be subject to audit. There have been no audits to date.

The minimum lease payments under operating leases and license obligations are as follows:

Year ending December 31,	Licenses	Operating Leases
Remainder of 2010	$	$ 329,000
2011	175,000	1,338,000
2012	175,000	1,369,000
2013	175,000	1,401,000
2014	180,000	1,442,000

Thereafter	930,000	2,884,000
Total payments	$ 1,635,000	$ 8,763,000

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7. Contractual Guarantees and Indemnities

During our normal course of business, we make certain contractual guarantees and indemnities pursuant to which we may be required to make future payments under specific circumstances. We have not recorded any liability for these contractual guarantees and indemnities in the accompanying unaudited interim condensed consolidated financial statements.

Warranties

We establish reserves for future product warranty costs that are expected to be incurred pursuant to specific warranty provisions with our customers. Our warranty reserves are established at the time of sale and updated throughout the warranty period based upon numerous factors, including historical warranty return rates and expenses over various warranty periods.

Intellectual Property Indemnities

We indemnify certain customers and our contract manufacturers against liability arising from third-party claims of intellectual property rights infringement related to our products. These indemnities appear in development and supply agreements with our customers as well as manufacturing service agreements with our contract manufacturers, are not limited in amount or duration and generally survive the expiration of the contract. Given that the amount of any potential liabilities related to such indemnities cannot be determined until an infringement claim has been made, we are unable to determine the maximum amount of losses that we could incur related to such indemnities.

Director and Officer Indemnities and Contractual Guarantees

We have entered into indemnification agreements with our directors and executive officers that require us to indemnify such individuals to the fullest extent permitted by Delaware law. Our indemnification obligations under such agreements are not contractually limited in amount or duration. Certain costs incurred in connection with such indemnities may be recovered under certain circumstances under various insurance policies. Given that the amount of any potential liabilities related to such indemnities cannot be determined until a lawsuit has been filed against a director or executive officer, we are unable to determine the maximum amount of losses that we could incur relating to such indemnities. Historically, any amounts payable pursuant to such director and officer indemnities have not had a material negative effect on our business, financial condition or results of operations.

We have also entered into severance and change in control agreements with certain of our executives. These agreements provide for the payment of specific compensation benefits to such executives upon the termination of their employment with us.

General Contractual Indemnities/Products Liability

During the normal course of business, we enter into contracts with customers where we agree to indemnify the other party for personal injury or property damage caused by our products. Our indemnification obligations under such agreements are not generally contractually limited in amount or duration. Given that the amount of any potential liabilities related to such indemnities cannot be determined until a lawsuit has been filed, we are unable to determine the maximum amount of losses that we could incur relating to such indemnities. Historically, any amounts payable pursuant to such indemnities have not had a material negative effect our business, financial condition or results of operations. We maintain general and product liability insurance as well as errors and omissions insurance, which may provide a source of recovery to us in the event of an indemnification claim.

Short Term Borrowings

We also have an existing line of credit with a bank, which expires in July 2011. *See Note 3 Short Term Borrowings.*

8. Severance Expense

During the third quarter of 2010, we reduced our workforce and generated severance charges totaling $204,000. There were no severance charges for the quarter and nine months ended September 26, 2009.

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9. Details of Certain Financial Statement Components and Supplemental Disclosures of Cash Flow Information and Non-Cash Activities

Balance Sheet Data:

	October 2, 2010	December 31, 2009
Accounts receivable:		
Accounts receivable-trade	$ 208,000	$ 204,000
United States government accounts receivable-billed	51,000	269,000
Less: allowance for doubtful accounts	(9,000)	(11,000)
	$ 250,000	$ **462,000**

	October 2, 2010	December 31, 2009
Inventories:		
Raw materials	$ 1,518,000	$ 2,010,000
Work-in-process	610,000	543,000
Finished goods	1,307,000	919,000
Less inventory reserve	(1,039,000)	(828,000)
	$ 2,396,000	**$ 2,644,000**

	October 2, 2010	December 31, 2009
Property and Equipment:		
Equipment	$ 16,037,000	$ 15,743,000
Leasehold improvements	6,776,000	6,761,000
Furniture and fixtures	404,000	404,000
	23,217,000	22,908,000
Less: accumulated depreciation and amortization	(21,760,000)	(21,076,000)
	$ 1,457,000	**$ 1,832,000**

Depreciation expense amounted to $230,000 and $684,000, respectively, for the three and nine month periods ended October 2, 2010 and $274,000 and $890,000, respectively, for the three and nine month periods ended September 26, 2009.

	October 2, 2010	December 31, 2009
Patents and Licenses:		
Patents pending	$ 1,134,000	$ 1,118,000
Patents issued	1,285,000	1,141,000
Less accumulated amortization	(533,000)	(477,000)

Net patents issued	752,000	664,000
Licenses Pending	12,000	18,000
Licenses Issued	563,000	563,000
Less accumulated amortization	(225,000)	(200,000)
Net licenses	338,000	363,000
	$ 2,236,000	**$ 2,163,000**

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Amortization expense related to these items totaled $48,000 and $82,000, respectively, for the three and nine month periods ended October 2, 2010 and $85,000 and $253,000, respectively, for the three and nine month periods ended September 26, 2009. Amortization expenses are expected to total $29,000 for the remainder of 2010 and $116,000 in each of 2011 and 2012.

	October 2, 2010	December 31, 2009
Accrued Expenses and Other Long Term Liabilities:		
Salaries payable	$ 258,000	$ 107,000
Compensated absences	367,000	397,000
Compensation related	106,000	39,000
Warranty reserve	313,000	255,000
Deferred rent	406,000	384,000
Other	319,000	236,000
	1,769,000	1,418,000
Less current portion	(1,162,000)	(892,000)
Long term portion	**$ 607,000**	**$ 526,000**

	For the nine months ended,	
	October 2, 2010	September 26, 2009
Warranty Reserve Activity:		
Beginning balance	$ 255,000	$ 262,000
Additions	66,000	21,000
Deductions	(8,000)	(6,000)
Ending balance	**$ 313,000**	**$ 277,000**

10. Subsequent Events

Sale of Common Stock

In October 2010 we raised net proceeds of $830,000, net of offering costs of $70,000, from the sale of 600,000 shares of common stock at $1.50 per share. The sale was the result of the exercise of the over-allotment option relating to our August 2010 underwritten sale of common stock. *See Note 4.*

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

General

We are a global leader in high temperature superconductor (HTS) materials and related technologies. HTS materials have the unique ability to conduct electrical current with little or no resistance when cooled to very low critical temperatures. As a result, HTS materials can substantially improve the performance of electrical systems by reducing the power loss and minimizing heat generation caused when electrical currents flow through conventional conductors. To obtain these benefits on a cost effective basis, we have developed patented and proprietary technologies relating to matters such as thin film deposition manufacturing, cryogenic cooling and radio frequency (RF) circuit filter tuning. We have had over $150 million in HTS sales to date, with over 6,000 of our commercial systems deployed worldwide. We are now pursuing new applications in HTS wire and tunable handset filters, as well as expanding our existing applications in the next generation of wireless networks.

Our Proprietary Technology

We focus on research and development to maintain our technological edge in solving the technical challenges in commercializing HTS technology. Many of our employees hold advanced degrees in physics, materials science, electrical engineering and other related fields. Our development efforts have yielded an extensive patent portfolio as well as critical trade secrets, unpatented technology and proprietary knowledge. We enter into confidentiality and non-disclosure agreements with our employees, suppliers and consultants to protect our proprietary information. As of October 2, 2010, we held 60 U.S. patents in the following categories:

- 7 patents for technologies directed toward producing thin-film materials and structures, which expire between 2010 and 2025. We have developed a proprietary state-of-the-art manufacturing process for producing HTS thin-films of the highest quality.
- 35 patents for cryogenic and non-microwave circuit designs, which expire between 2012 and 2028. The expertise of our highly qualified team has allowed us to design and fabricate extremely small, high-performance circuits including RF signal filters.

17 patents covering cryogenics, packaging and systems, which expire between 2013 and 2025. Our proprietary and patented cryogenic packaging innovation provides us with a significant competitive advantage in maintaining our HTS materials at their critical temperatures.

1 patent covering other superconducting technologies, which expires in 2013.

As of October 2, 2010, we also had 21 issued foreign patents, 19 U.S. patent applications pending and 62 foreign patent applications pending.

We are currently focusing our efforts on applications of our proprietary HTS technology in the following areas:

Superconducting Power Applications

We are adapting our patented HTS material deposition techniques to develop energy efficient, cost-effective and high performance second generation (2G) HTS wire for existing and emerging power applications. HTS wire enables greater electrical current carrying capacity than comparable size copper wires, dramatically reducing the volume and weight of the required wire. To date, the market for 2G HTS wire has been limited by the inability of the existing suppliers to establish production processes that are capable of producing wire that meets target specifications and cost requirements. We plan to utilize our patented and proprietary manufacturing methods to overcome these challenges and make the HTS wire cost effective in a number of applications.

To accelerate our efforts in the development and manufacturing processes for our 2G HTS wire, we have established a Cooperative Research and Development Agreement with Los Alamos National Laboratory and have partnered with other HTS industry leaders. After successfully producing 2G HTS wire in one meter lengths, we are now completing the design of a wire deposition machine to produce 50 meter lengths, with the goal of producing one kilometer lengths in our production machine. Assuming we overcome the technical hurdles, we intend to be a supplier of HTS wire to manufacturing concerns, primarily large businesses, which would incorporate the wire into their products. We expect to begin delivering samples of our 2G HTS wire before year end for testing by prospective customers, at which time we can begin to formalize our commercial relationships.

We are initially targeting markets where we believe the advantages of HTS wire are at a premium, such as:

Wind Turbines: Current wind turbine power generating capacity is limited by the size and weight of the generator. Turbine manufacturers believe that building a generator utilizing HTS wire will reduce its size and weight sufficiently to enable the development of 10 megawatt (MW) and larger wind turbines. According to Emerging Energy Research, 2731 MW of worldwide offshore capacity of wind turbines producing more than 5 MW is expected to be installed in 2016, which will rise to nearly 5377 MW in 2020. Using a current estimated installed offshore cost of $2 million per MW, this translates into an investment for 5 MW capacity or larger wind turbines of approximately $5.5 billion in 2016 and nearly $11 billion in 2020.

Power Cables: Because they can carry significantly more electrical current with less electrical loss than conventional cables, HTS power cables allow utilities to deliver significantly more electrical current utilizing existing power cable entry facilities in office buildings and other facilities with large and growing power requirements.

Fault Current Limiters: A fault current limiter is a device in a power transmission network which cuts off electrical flow in the same manner as a ground fault interrupter in the home. By eliminating the superconductor properties of the HTS wire when too much electricity is flowing, the resistance in the fault current limiter can be substantially increased, stopping current flow and preventing damage to the rest of the power distribution network.

Superconducting Magnetic Energy Storage (SMES): As renewable energy generating systems continue to proliferate, the power grid needs reliable power backup to offset the intermittent nature of those systems. The low power loss from HTS wire could be used to provide an alternative to chemical and other forms of current battery technology for energy storage.

Magnetic Resonance Imaging (MRI): MRI machines used for medical imaging already use existing low temperature superconducting wire; the improvements targeted for 2G HTS wire may enable the manufacturers of MRI machines to reduce the initial cost and operating expenses of these devices.

Industrial Motors and Generators: The reduced weight and size required for a generator built with HTS wire could enable motors and generators that can generate two to three times the power as existing generators of the same size.

Tunable Filter Products

We have developed and patented several techniques to allow a single HTS or conventional (SAW or BAW) RF filter to be tuned between multiple frequency bands. Current cell phone handsets generally utilize two or three discrete filters for each frequency band, and thus require ten or more filters in each handset to enable seamless worldwide coverage with today s five bands. However, with the forecasted growth in the future generations of cell phones to ten or more bands, a discrete filter approach would be both expensive and occupy scarce space in the handset. To address this challenge, we are pursuing opportunities with existing wireless handset module providers to incorporate tunable filters into the future generations of smart phones. These tunable filters will allow significant reduction in size, power, and cost over conventional discrete filter technologies.

Wireless Networks

Our current commercial products help maximize the performance of wireless telecommunications networks by improving the quality of uplink signals from mobile wireless devices. Our products increase capacity utilization, lower dropped and blocked calls, extend coverage, and enable higher wireless data throughput, while reducing capital and operating costs for the carrier. While we continue to serve the market for retrofitting existing towers, we are currently pursuing an opportunity to include our HTS filters in the Long Term Evolution (LTE) data networks now being deployed by the top U.S. wireless carriers (expected to be over 75,000 base stations in the next few years). Our HTS filters have been incorporated into one of the two base station solutions selected by a major carrier for live market trials currently planned for 2010.

Our Business Model

To be successful, we must use our expertise and our technology to generate revenues in various ways, including government contracts, commercial operations, joint ventures and licenses:

Government Contracts

We have generated significant revenues from government contracts. We typically own the intellectual property developed under these contracts, and grant the U.S. government a royalty-free, non-exclusive and nontransferable license to use it. As a result, our government contracts can not only generate a profit for us, but we can also make additional money through exploiting of the resulting technology in our commercial operations as well as government products, or through licenses or joint ventures.

Commercial Applications

We have chosen to manufacture and sell certain commercial products on our own. To date, our commercial efforts have been focused on the design, manufacture, and sale of high performance infrastructure products for wireless voice and data applications. We have three current product lines, all of which relate to wireless base stations:

- *SuperLink*, a highly compact and reliable receiver front-end HTS wireless filter system to eliminate out-of-band interference for wireless base stations, combining filters with a proprietary cryogenic cooler and a cooled low-noise amplifier.
- *AmpLink*, a ground-mounted unit for wireless base stations that includes a high-performance amplifier and up to nine dual duplexers.
- *SuperPlex*, a high-performance multiplexer that provides extremely low insertion loss and excellent cross-band isolation designed to eliminate the need for additional base station antennas and reduce infrastructure costs.

We sell most of our current commercial products to a small number of wireless carriers in the United States, including AT&T, Sprint Nextel, T-Mobile and Verizon Wireless. Verizon Wireless and AT&T each accounted for more than 10% of our commercial revenues in the nine months ended October 2, 2010 and for all of 2009. We are seeking to expand our customer base by selling directly to other wireless network operators and manufacturers of base station equipment, including internationally. Demand for wireless communications equipment fluctuates dramatically and unpredictably. The wireless communications infrastructure equipment market is extremely competitive and is characterized by rapid technological change, new product development, product obsolescence and evolving industry standards. We expect these trends to continue and may cause significant fluctuations in our quarterly and annual revenues. Our commercial operations are subject to a number of significant risks, some of which are set out in our public filings, including in particular the *Risk Factors* included in Item 1A of our Annual Report on Form 10-K for 2009 (2009 Form 10-K).

Joint Ventures

From time to time we may pursue joint ventures with other entities to commercialize our technology. In 2007, we formed a joint venture with Hunchun BaoLi Communication Co. Ltd. (BAOLI) to manufacture and sell our SuperLink interference elimination solution in China. We use the equity method of accounting for our 45 percent joint venture interest. The joint venture agreement calls for our joint venture partner to supply the capital and local expertise, and for us to provide a license of certain technology and supply key parts for manufacturing. Since 2007, we have been conducting lab and field trials in the existing China 2G market using our TD-SCDMA and SuperLink solutions. Although those activities continue, the parties have not completed their contributions to the joint venture, including most of the funding and our license, within the two year period specified by the agreement and Chinese law. The future of the joint venture, including any commencement of manufacturing and the transfer of our processes, will depend on product demand in China, completion of funding by our joint venture partner, as well as a number of other conditions, including certain critical approvals from the Chinese and United States governments. There continues to be no assurance that these conditions will be met. As a result of this uncertainty, at December 31, 2009, we fully reserved against our investment in the joint venture of $521,000. Other expense included $30,000 and $117,000 in the three and nine months ended September 26, 2009, respectively, from our 45 percent equity ownership. There was no such expense in 2010.

Licenses

From time to time we grant licenses for our technology to other companies. Specifically, we have granted licenses to, among others, (1) Bruker for Nuclear Magnetic Resonance application, (2) General Dynamics for government applications and (3) Star Cryoelectronics for Superconducting Quantum Interference Device applications.

Backlog

Our commercial backlog consists of accepted product purchase orders with scheduled delivery dates during the next twelve months. We had commercial backlog of $106,000 at October 2, 2010 compared to $795,000 at December 31, 2009.

Results of Operations

Quarter and nine months ended October 2, 2010 compared to the quarter and nine months ended September 26, 2009

Total net revenues decreased by $2.3 million or 54%, to $2.0 million in the third quarter of 2010 from $4.3 million in the third quarter of 2009. Total net revenues decreased by $843,000, or 10%, to $7.8 million in the first nine months of 2010 from $8.6 million in the same period of 2009. Total net revenues consist primarily of commercial product revenues and government contract revenues.

Net commercial product revenues decreased by $1.2 million or 39%, to $1.8 million in the third quarter of 2010 from $3.0 million in the third quarter of 2009. The decrease in the quarter was primarily the result of lower sales volume to our major customer. For the first nine months of 2010 and 2009, net commercial revenues were unchanged at $5.9 million. The average sales prices for our products were unchanged. Our three largest customers accounted for 97% of our total net commercial product revenues in the first nine months of 2010 compared to 98% in the first nine months of 2009. These customers generally purchase products through non-binding commitments with minimal lead times. Consequently, our commercial product revenues can fluctuate dramatically from quarter to quarter based on changes in our customers capital spending patterns.

Government contract revenues decreased $1.2 million, or 89%, to $144,000 in the third quarter of 2010 from $1.3 million in the third quarter of 2009. For the first nine months of 2010 government contract revenues decreased to $1.9 million from $2.7 million, a decrease of $851,000, or 31%. This decrease was principally the result of the completion of our SURF contract. This reduced level of government contract revenue will continue as we use more of our limited engineering resources on our commercial projects.

Cost of commercial product revenues includes all direct costs, manufacturing overhead, provision for excess and obsolete inventories and restructuring and impairment charges relating to the manufacturing operations. The cost of commercial product revenue decreased $837,000, or 28%, to $2.1 million for the third quarter of 2010 compared to $2.9 million in the third quarter of 2009. For the first nine months of 2010, the cost of commercial product revenues totaled $6.5 million compared with $7.2 million for the first nine months of 2009, a decrease of $722,000 or 10%. The lower costs resulted primarily from lower production as a result of lower sales in the second and third quarters.

Our cost of sales includes both variable and fixed cost components. The variable component consists primarily of materials, assembly and test labor, transportation costs and warranty costs. The fixed component includes test equipment and facility depreciation, purchasing and procurement expenses and quality assurance costs. Given the fixed nature of such costs, the absorption of our production overhead costs into inventory decreases, and the amount of production overhead variances expensed to cost of sales increases, as production volumes decline since we have fewer units against which to absorb our overhead costs. Conversely, the absorption of our production overhead costs into inventory increases, and the amount of production overhead variances expensed to cost of sales decreases, as production volumes increase since we have more units against which to absorb our overhead costs. As a result, our gross profit margins generally decrease as revenue and production volumes decline due to lower sales volume and higher amounts of production overhead variances expensed to cost of sales; and our gross profit margins generally increase as our revenue and production volumes increase due to higher sales volume and lower amounts of production overhead variances expensed to cost of sales.

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The following is an analysis of our commercial product gross profit and margins:

	Three Months Ended				Nine Months Ended			
Dollars in thousands	October 2, 2010		September 26, 2009		October 2, 2010		September 26, 2009	
Net commercial product sales	$ 1,830	100%	$ 2,985	100%	$ 5,901	100%	$ 5,893	100%
Cost of commercial product sales	2,110	115%	2,947	99%	6,464	110%	7,186	122%
Gross profit (loss)	$ (280)	(15)%	$ 38	1%	$ (563)	(10)%	$ (1,293)	(22)%

We had a gross loss from the sale of our commercial products of $280,000 in the third quarter of 2010 compared to a $38,000 profit in the third quarter of 2009. We experienced a gross loss in the third quarter of 2010 because the reduced level of commercial sales was insufficient to cover our fixed manufacturing overhead costs. The gross profit in the third quarter of 2009 resulted from higher sales that covered our fixed manufacturing overhead costs. We regularly review inventory quantities on hand and provide an allowance for excess and obsolete inventory based on numerous factors including sales backlog, historical inventory usage and forecasted product demand and production requirements for the next twelve months. Our gross margin was also adversely impacted by charges for excess and obsolete inventory of $90,000 and $270,000 in the third quarter and year to date in 2010, respectively, compared to $90,000 and $192,000 in the third quarter and year to date in 2009 respectively. There were no sales of previously written-off inventory in first nine months of 2010 and 2009.

Cost of government and other contract revenue totaled $86,000 in the third quarter of 2010 compared to $993,000 in the third quarter of 2009 and $1.1 million in the first nine months of 2010 compared to $2.2 million in the first nine months of 2009. This decrease was the result of lower expenses associated with less revenue from government contracts.

Research and development expenses relate principally to development of new wireless commercial products and other products related to our expertise. We also incur design expenses associated with reducing the cost and improving the manufacturability of our existing products. These expenses totaled $1.5 million and $4.0 million, respectively, in the three and nine months ended October 2, 2010 compared to $902,000 and $3.0 million in the three and nine months ended September 26, 2009. These expenses increased due to government and other contracts using relatively less of our limited engineering resources and commercial projects using more of our resources.

Selling, general and administrative expenses totaled $1.6 million and $5.3 million, respectively, in the three months and nine months ended October 2, 2010 compared to $1.6 million and $5.2 million in the three and nine months ended September 26, 2009. Our 2010 regulatory compliance expenses were slightly higher compared to 2009.

Other expense included $30,000 and $117,000 in the three and nine months ended September 26, 2009, respectively, from our 45 percent equity ownership of a joint venture with BAOLI in China. There was no such expense in 2010. The investment had been fully written off at the end of 2009 and no further losses were recordable under the equity method of accounting.

The adjustment of the fair value expense in 2010 and 2009 represents the treatment, as a derivative, of 608,237 warrants that are exercisable for common stock. We used the Black-Scholes valuation model to determine their fair value. These warrants expired in August 2010.

Interest income in the three and nine months ended October 2, 2010 was $2,000 and $4,000, respectively, compared to $4,000 and $21,000, respectively, in the three and nine months ended September 26, 2009. The decreases resulted from lower interest rates and less cash available for investment.

Interest expense in the three and nine months ended October 2, 2010 was $7,000 and $21,000, respectively, compared to $7,000 and $25,000, respectively, in the three and nine months ended September 26, 2009.

We had a net loss of $3.4 million for the quarter ended October 2, 2010 compared to a net loss of $1.8 million in the same period of 2009. For the nine months ended October 2, 2010, our loss totaled $9.0 million compared to a net loss of $9.5 million in the same period of 2009.

The net loss available to common stockholders totaled $0.14 per common share in the third quarter of 2010 compared to a net loss of $0.08 per common share in the same period of 2009. The net loss available to common stockholders totaled $0.40 per common share in the first nine months of 2010 compared to $0.50 per common share in the first nine months of 2009.

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Liquidity and Capital Resources

Cash Flow Analysis

As of October 2, 2010, we had working capital of $9.4 million, including $8.3 million in cash and cash equivalents, compared to working capital of $12.6 million at December 31, 2009, which included $10.4 million in cash and cash equivalents. We currently invest our excess cash in short-term, investment-grade, money-market instruments with maturities of three months or less. We believe that all of our cash investments would be readily available to us should the need arise.

Cash and cash equivalents decreased by $2.1 million from $10.4 million at December 31, 2009 to $8.3 million at October 2, 2010. Cash was used principally in operations and to a lesser extent for the purchase of property and equipment. In addition, in the first nine months of 2010, $573,000 was used to repurchase shares from our employees to satisfy withholding taxes due upon the vesting of their restricted stock awards. We realized a net $5.2 million from the sale of common stock in the third quarter of 2010.

Net cash used in operations totaled $6.4 million in the first nine months of 2010. We used $7.3 million to fund the cash portion of our net loss. We also used cash to fund a $224,000 increase in prepaid assets and patents, inventory, and other assets. Operating cash was provided by a $1.1 million increase in accounts payable and long term liabilities and a decrease in accounts receivable.

Net cash used in investing activities totaled $309,000 in the first nine months of 2010 compared to $191,000 in the first nine months of 2009. In the first nine months of 2010, all cash used in investing activities was for purchases of property and equipment.

Financing Activities

We have historically financed our operations through a combination of cash on hand, cash provided from operations, equipment lease financings, available borrowings under bank lines of credit and both private and public equity offerings. Net cash provided by financing activities in the first nine months of 2010 totaled $5.2 million, net of $800,000 expenses, from the sale of 4 million shares of common stock at $1.50 per share in August 2010. In January we repurchased $573,000 of our common shares from our employees to satisfy withholding taxes due upon the vesting of their restricted stock awards.

We also have an existing line of credit from a bank. The line of credit was renewed in July 2010 and expires in July 2011. The loan agreement is structured as a sale of our accounts receivable and provides for the sale of up to $3.0 million of eligible accounts receivable, with advances to us totaling 80% of the receivables sold. Advances bear interest at the bank s prime rate (4% at October 2, 2010) plus 2.50% subject to a minimum monthly charge. There was no amount outstanding under this facility at October 2, 2010 or December 31, 2009. Advances are collateralized by a lien on all of our assets. Under the terms of the loan agreement, we would continue to service the sold receivables and are subject to recourse provisions.

Contractual Obligations and Commercial Commitments

We have not had any material changes outside the ordinary course of business in the contractual obligations as specified in our 2009 Form 10-K.

Capital Expenditures

We plan to invest approximately $100,000 in fixed assets during the remainder of 2010.

Future Liquidity

For the nine months ended October 2, 2010, we incurred a net loss of $9.0 million and had negative cash flows from operations of $6.4 million. In 2009, we incurred a net loss of $13.0 million and had negative cash flows from operations of $7.4 million. Our independent registered public accounting firm has included in its audit reports for 2009 and 2008 an explanatory paragraph expressing doubt about our ability to continue as a going concern.

At October 2, 2010, we had $8.3 million in cash and cash equivalents. Subsequent financing activities in October 2010 totaled $830,000, net of $70,000 expenses, from the sale of 600,000 shares of common stock at $1.50. The sale was the result of the exercise of the over-allotment option relating to our August 2010 sale of common stock. Our cash resources, together with our line of credit, should be sufficient to fund our business through the second quarter of 2011. We believe the key factors to our liquidity will be our ability to successfully use our expertise and our technology to generate revenues in various ways, including commercial operations, government contracts, joint ventures and licenses. Because of the uncertainty of these factors, we may need to raise funds to meet our working capital needs. If we require additional financing, we cannot assure you that additional financing will be available on acceptable terms or at all. If we issue additional equity securities to raise funds, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise any needed funds, we might be forced to make further substantial reductions in our operating expenses, which could adversely affect our ability to implement our current business plan and ultimately our viability as a company.

Net Operating Loss Carryforward

As of December 31, 2009, we had net operating loss carryforwards for federal and state income tax purposes of approximately $298.8 million and $169.9 million**,** respectively, which expire in the years 2010 through 2029. Of these amounts, $80.9 million and $23.5 million, respectively, resulted from the acquisition of Conductus, Inc. Included in the net operating loss carryforwards are deductions related to stock options of approximately $24.1 million and $13.1 million for federal and California income tax purposes, respectively. To the extent net operating loss carryforwards are recognized for accounting purposes, the resulting benefits related to the stock options will be credited to stockholders equity. In addition, we had research and development and other tax credits for federal and state income tax purposes of approximately $3.1 million and $1.4 million, respectively, which expire in the years 2010 through 2029. Of these amounts, $549,000 and $581,000, respectively, resulted from the acquisition of Conductus.

Due to the uncertainty surrounding their realization, we have recorded a full valuation allowance against our net deferred tax assets. Accordingly, no deferred tax asset has been recorded in the accompanying balance sheet.

Section 382 of the Internal Revenue Code imposes an annual limitation on the utilization of net operating loss carryforwards and other tax attributes based on a statutory rate of return (usually the applicable federal funds rate , as defined in the Internal Revenue Code) and the value of the corporation at the time of a change of ownership as defined by Section 382. We had changes in ownership in August 1999, December 2002 and June 2009. In addition, we acquired the right to Conductus net operating losses, which are also subject to the limitations imposed by Section 382. Conductus underwent four ownership changes, which occurred in February 1999, February 2001, December 2002 and June 2009. Therefore, the ability to utilize Conductus and our net operating loss carryforwards will be subject to annual limitations upon utilization in future periods. We are currently studying the impact of these Section 382 limitations on the future realizability of our various tax attributes.

Critical Accounting Policies and Estimates

Our discussion and analysis of our historical financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements in conformity with those principles requires us to make estimates of certain items and judgments as to certain future events including for example those related to bad debts, inventories, recovery of goodwill and long-lived assets (including intangible assets), income taxes, warranty obligations, and contingencies. These determinations, even though inherently subjective and subject to change, affect the reported amounts of our assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. While we believe that our estimates are based on reasonable assumptions and judgments at the time they are made, some of our assumptions, estimates and judgments will inevitably prove to be incorrect. As a result, actual outcomes will likely differ from our accruals, and those differences positive or negative could be material. Some of our accruals are subject to adjustment, as we believe appropriate, based on revised estimates and reconciliation to the actual results when available.

In addition, we identified certain critical accounting policies that affect certain of our more significant estimates and assumptions used in preparing our consolidated financial statements in our 2009 Form 10-K. We have not made any material changes to these policies.

Recent Accounting Pronouncements

In February 2010, the Financial Accounting Standards Board issued updated guidance related to subsequent events. As a result of this updated guidance, we must still evaluate subsequent events through the issuance date of our financial statements; however, we are not required to disclose that date in our financial statement disclosures. This amended guidance became effective upon its issuance on February 24, 2010. We adopted this updated guidance effective as of that date and all subsequent event references in our Securities and Exchange Commission filings will reflect these amended disclosure requirements.

We have considered all other newly issued accounting guidance that is applicable to our operations and the preparation of our condensed consolidated statements, including guidance that we have not yet adopted. We do not believe that any such guidance will have a material effect on our financial position or results of operation.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We do not believe that there was a material change in our exposure to market risk at October 2, 2010 compared with our market risk exposure on December 31, 2009. See *Management s Discussion and Analysis of Financial Condition and Results of Operations Market Risk* in our 2009 Form 10-K.

Item 4. Controls and Procedures.

We have established disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). As of the end of the period covered by this report we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer), of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities and Exchange Act of 1934, as amended. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934) that occurred during the period covered by this report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We do not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time, we are party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of our business. Excluding ordinary, routine litigation incidental to our business, we are not currently a party to any legal proceedings that we believe would reasonably be expected to have a material adverse effect on our business, financial condition or results of operation or cash flow.

Item 1A. Risk Factors.

A description of the risk factors associated with our business is contained in Item 1A, Risk Factors, of our 2009 Form 10-K. We are not aware of any material changes to those risk factors.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. (Removed and Reserved)

Item 5. Other Information

None.

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Item 6. Exhibits.

Number	Description of Document
10.1	Eighth Amendment to Loan and Security Agreement by and between Registrant and Silicon Valley Bank dated July 28, 2010*
31.1	Statement of CEO Pursuant to 302 of the Sarbanes-Oxley Act of 2002*
31.2	Statement of CFO Pursuant to 302 of the Sarbanes-Oxley Act of 2002*
32.1	Statement of CEO Pursuant to 906 of the Sarbanes-Oxley Act of 2002*
32.2	Statement of CFO Pursuant to 906 of the Sarbanes-Oxley Act of 2002*

* Filed herewith.

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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.

	SUPERCONDUCTOR TECHNOLOGIES INC.
Dated: November 10, 2010	/s/ William J. Buchanan William J. Buchanan Vice President and Chief Financial Officer
	/s/ Jeffrey A. Quiram Jeffrey A. Quiram President and Chief Executive Officer