

SUPERCONDUCTOR TECHNOLOGIES INC

Form 10-Q

May 08, 2009

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

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended March 28, 2009**

**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**

(State or other jurisdiction of  
incorporation or organization)

**77-0158076**

(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  No

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  No

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company   
(Do not check if a smaller reporting company)

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

The registrant had 18,705,028 shares of the common stock outstanding as of the close of business on May 1, 2009.



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Three Months Ended March 28, 2009

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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.*

*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 the year ended December 31, 2008.*

*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)

	<b>Three Months Ended</b>	
	<b>March 28, 2009</b>	<b>March 29, 2008</b>
Net revenues:		
Commercial product revenues	\$ 1,131,000	\$ 1,993,000
Government and other contract revenues	546,000	1,479,000
Total net revenues	<b>1,677,000</b>	<b>3,472,000</b>
Costs and expenses:		
Cost of commercial product revenues	1,797,000	2,019,000
Contract research and development	569,000	1,243,000
Other research and development	1,084,000	408,000
Selling, general and administrative	1,723,000	2,200,000
Total costs and expenses	<b>5,173,000</b>	<b>5,870,000</b>
Loss from operations	<b>(3,496,000)</b>	<b>(2,398,000)</b>
Noncontrolling interest in joint venture	(50,000)	
Interest income	13,000	99,000
Interest expense	(9,000)	(9,000)
Net loss	<b>\$ (3,542,000)</b>	<b>\$ (2,308,000)</b>
Basic and diluted loss per common share	<b>\$ (0.20)</b>	<b>\$ (0.17)</b>
Weighted average number of common shares outstanding	17,869,030	13,636,083

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

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**SUPERCONDUCTOR TECHNOLOGIES INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>March 28, 2009</b>	<b>December 31, 2008</b>
	(Unaudited)	(See Note)
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 5,077,000	\$ 7,569,000
Accounts receivable, net	543,000	355,000
Inventory, net	5,020,000	5,278,000
Prepaid expenses and other current assets	350,000	416,000
<b>Total Current Assets</b>	<b>10,990,000</b>	<b>13,618,000</b>
Property and equipment, net of accumulated depreciation of \$20,264,000 and \$19,943,000, respectively	2,443,000	2,739,000
Patents, licenses and purchased technology, net of accumulated amortization of \$2,139,000 and \$2,055,000, respectively	2,195,000	2,252,000
Investment in joint venture	457,000	521,000
Other assets	223,000	228,000
<b>Total Assets</b>	<b>\$ 16,308,000</b>	<b>\$ 19,358,000</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 784,000	\$ 707,000
Accrued expenses	732,000	578,000
Current portion of capitalized lease obligations and long term debt	67,000	80,000
<b>Total Current Liabilities</b>	<b>1,583,000</b>	<b>1,365,000</b>
Other long term liabilities	455,000	441,000
<b>Total Liabilities</b>	<b>2,038,000</b>	<b>1,806,000</b>
<b>Commitments and contingencies Notes 6 and 7</b>		
<b>Stockholders Equity:</b>		
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, 18,705,028 and 17,869,030 shares issued and outstanding, respectively	19,000	18,000
Capital in excess of par value	230,478,000	230,219,000
Accumulated deficit	(216,228,000)	(212,686,000)

<b>Total Stockholders Equity</b>	14,270,000	17,552,000
<b>Total Liabilities and Equity</b>	<b>\$ 16,308,000</b>	<b>\$ 19,358,000</b>

See accompanying notes to the condensed consolidated financial statements

Note-December 31, 2008 balances were derived from audited financial statements.

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

	<b>Three Months Ended</b>	
	<b>March 28, 2009</b>	<b>March 29, 2008</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
<b>Net loss</b>	<b>\$ (3,542,000)</b>	<b>\$ (2,308,000)</b>
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	404,000	396,000
Stock-based compensation expense	260,000	118,000
Provision for excess and obsolete inventories	12,000	
Noncontrolling interest in joint venture	50,000	
Changes in assets and liabilities:		
Accounts receivable	(187,000)	525,000
Inventory	246,000	(1,965,000)
Prepaid expenses and other current assets	65,000	28,000
Patents, licenses and purchased technology	(26,000)	(76,000)
Other assets	6,000	(6,000)
Accounts payable, accrued expenses and other long-term liabilities	232,000	208,000
 Net cash used in operating activities	 <b>(2,480,000)</b>	 <b>(3,080,000)</b>
 <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(25,000)	(62,000)
Investment in joint venture	14,000	
 Net cash used in investing activities	 <b>(11,000)</b>	 <b>(62,000)</b>
 <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from preferred and common stock		10,911,000
 Net cash provided by financing activities		 <b>10,911,000</b>
 Net increase (decrease) in cash and cash equivalents	 (2,491,000)	 7,769,000
Cash and cash equivalents at beginning of period	7,568,000	3,939,000
 Cash and cash equivalents at end of period	 <b>\$ 5,077,000</b>	 <b>\$ 11,708,000</b>

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

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**SUPERCONDUCTOR TECHNOLOGIES INC.**

**NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. General**

Superconductor Technologies Inc. (together with our subsidiaries, we or us ) was incorporated in Delaware on May 11, 1987, and we maintain our headquarters in Santa Barbara, California. We are a leading company in high temperature superconductor (HTS) and related technologies. We operate in a single industry segment, the research, development, manufacture and marketing of products utilizing our HTS materials science and manufacturing expertise. We are currently focusing our efforts on applications in areas such as government products, wireless networks, reconfigurable handset filters and superconducting power transmission lines.

Our 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®, AmpLink®, and SuperPlex products. For the three months ended March 28, 2009 and March 29, 2008, commercial revenues accounted for 67% and 57%, respectively, of our net revenues.

We also generate 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 three months ended March 28, 2009 and March 29, 2008, government related contracts accounted for 33% and 43%, respectively, of our net revenues.

The unaudited 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 the opinion of management, are necessary for a fair statement of the results of operations for the periods presented.

The preparation of 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 the year ended December 31, 2008 (our 2008 Form 10-K ). The results of operations for the three months ended March 28, 2009 are not necessarily indicative of the results for all of 2009.

**2. Summary of Significant Accounting Policies**

*Basis of Presentation*

For the three months ended March 28, 2009, we incurred a net loss \$3.5 million and negative cash flows from operations of \$2.5 million. In 2008, we incurred a net loss of \$12.7 million and had negative cash flows from operations of \$12.1 million.

At March 28, 2009, we had \$5.1 million in cash. Our cash resources, together with our line of credit, and a planned inventory reduction, may not be sufficient to fund our business through 2009. We believe one of the key factors to our liquidity will be our ability to successfully execute on our plans to increase sales levels in a highly concentrated industry where we experience significant fluctuations in sales from quarter to quarter. Our cash requirements will also depend on numerous other variable factors, including the rate of growth of sales, the timing and levels of products purchased, payment terms and credit limits from manufacturers, and the timing and level of accounts receivable collections. Because of the uncertainty of these many factors, we may need to raise funds in the next few months to meet our working capital needs.

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.

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Our 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 unaudited 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 unaudited 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 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. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable. We determine the allowance based on 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<sup>®</sup>, AmpLink<sup>®</sup> 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 the 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.

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### *Guarantees*

In connection with the sales and manufacturing of our commercial products, we indemnify, without limit or term, our customers and contract manufacturers against all 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 guarantees 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 guarantees.

### *Research and Development Costs*

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

### *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 the results of the review 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 their estimated useful lives 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 is 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 the business are written off in the period identified since they will no longer generate any positive cash flows for us. Periodically, long-lived assets that will continue to be used by us will need to be 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 will be written down to their estimated fair values. We tested our long lived assets for recoverability during 2008 and determined there was no impairment.

While we believe the expected cash flows from these long-lived assets, including intangible assets, exceed the 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 connection with any future impairment tests, that the estimated fair value of

our long-lived assets, including intangible assets, is less than the book value and recognize an impairment charge. Any impairment charge would adversely affect our earnings.

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We use the equity method of accounting for our joint venture with Hunchun BaoLi Communications ( BAOLI ) in China. We have agreed to license certain technology for our SuperLink® interference elimination solution for the China market to this joint venture where we own 45 percent of the equity. In the fourth quarter of 2008, we successfully completed lab and field trials for our new TD-SCDMA solution in China and in the first quarter of 2009, we successfully completed a field trial in the existing China 2G market using our SuperLink® solution. The commencement of manufacturing and the transfer of our processes to the joint venture will be driven by product demand from the China market. The joint venture's activities remain subject to successful product marketing efforts in addition to a number of other conditions, including certain critical approvals from the Chinese and U.S. governments. In particular, we have been in discussions with the U.S. government concerning the national security implications of our joint venture and investment from BAOLI. There continues to be no assurance that these conditions will be met, or that all required approvals (if obtained) will be obtained on a timely basis.

*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 account for income taxes in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 109, *Accounting for Income Taxes*, which requires that 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.

In July 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation ( FIN ) No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 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 interpretation uses a two-step approach wherein 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. FIN 48 also sets out disclosure requirements to enhance transparency of our tax reserves. We adopted FIN 48 effective January 1, 2007, and the provisions of FIN 48 have been applied to all income tax positions commencing from that date. There was no material impact from this adoption. As of December 31, 2008, we had net operating loss carryforwards for federal and state income tax purposes of approximately \$291.4 million and \$168.8 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 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 each of the quarters ended March 28, 2009 and March 29, 2008.

*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 did not grant any options in the first quarter of 2009. For the quarter ended March 29, 2008, the weighted average fair value of options we granted was estimated as of the date of the grant using the Black-Scholes option-pricing model and the significant weighted average assumptions used for estimating the fair value under our stock option plans was as follows: expected life of 4.0 years; risk free interest rate of 2.4%; expected volatility of

110% and; dividend yield of 0%.

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The expected life was based on the contractual term of the options and the expected employee exercise behavior. Typically, options to our employees have a three or four year vesting term and a 10 year contractual term. The risk-free interest rate is based on the 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 four year historical volatility. We used an expected dividend yield of 0% because we has 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 four years.

The following table presents details of total stock-based compensation expense that is included in each functional line item on our unaudited condensed consolidated statements of operations:

	<b>Three months ended</b>	
	<b>March 28, 2009</b>	<b>March 29, 2008</b>
Cost of Revenue	\$ 7,000	\$ 5,000
Research and development	65,000	22,000
Selling, general and administrative	188,000	91,000
<b>Total stock-based compensation expense</b>	<b>\$ 260,000</b>	<b>\$ 118,000</b>

*Use of Estimates*

The preparation of 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, goodwill, 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 financial statements

*Fair Value of Financial Instruments*

The carrying amount of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value due to the short-term nature of these instruments. We estimate that the carrying amount of the debt approximates fair value based on our current incremental borrowing rates for similar types of borrowing arrangements.

*Comprehensive Income (Loss)*

We have no items of other comprehensive income (loss) in any period therefore no statements of comprehensive income (loss) has been presented.

*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. Net commercial product revenues are primarily derived 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*

We have continued to incur operating losses. Our long-term prospects and execution of our business plan 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. At March 28, 2009, we had two customers that





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represented 52% and 12% of total net revenues and 41% of accounts receivable. In 2008, these two customers represented 44% and 13% of total net revenues and 7% 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 one supplier for purchases of high quality substrates for growth of high-temperature superconductor films and on a limited number of suppliers for other 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.

In connection with the sales of our commercial products, we indemnify, without limit or term, our customers against all 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 guarantee because of the uncertainty as to whether a claim might arise and how much it might total.

*Recent Accounting Pronouncements*

In April 2009 the FASB issued FSP No. 141R-1 *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*, or FSP 141R-1. FSP 141R-1 amends the provisions in Statement 141R for the initial recognition and measurement, subsequent measurement and accounting, and disclosures for assets and liabilities arising from contingencies in business combinations. The FSP eliminates the distinction between contractual and non-contractual contingencies, including the initial recognition and measurement criteria in Statement 141R and instead carries forward most of the provisions in SFAS 141 for acquired contingencies. FSP 141R-1 is effective for contingent assets and contingent liabilities acquired in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We expect FSP 141R-1 will not have an impact on our consolidated financial statements.

In April 2009 the FASB issued three related Staff Positions: (i) FSP 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly*, or FSP 157-4, (ii) SFAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, or FSP 115-2 and FSP 124-2, and (iii) SFAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, or FSP 107 and APB 28-1, which will be effective for interim and annual periods ending after June 15, 2009. FSP 157-4 provides guidance on how to determine the fair value of assets and liabilities under SFAS 157 in the current economic environment and reemphasizes that the objective of a fair value measurement remains an exit price. If we were to conclude that there has been a significant decrease in the volume and level of activity of the asset or liability in relation to *normal* market activities, quoted market values may not be representative of fair value and we may conclude that a change in valuation technique or the use of multiple valuation techniques may be appropriate. FSP 115-2 and FSP 124-2 modify the requirements for recognizing other-than-temporarily impaired debt securities and revise the existing impairment model for such securities, by modifying the current *intent and ability* indicator in determining whether a debt security is other-than-temporarily impaired. FSP 107 and APB 28-1 enhance the disclosure of instruments under the scope of SFAS 157 for both interim and annual periods. We are currently evaluating these Staff Positions and do not expect their adoption to have a material impact on our consolidated financial position, results of operations or cash flows.

**3. Short Term Borrowings**

We have a line of credit with a bank. The line of credit expires in July 2009 and is structured as a sale of accounts receivable. The agreement provides for the sale of up to \$5.0 million of eligible accounts receivable, with advances to us totaling 80% of the receivables sold. Advances under the agreement are collateralized by all of our assets. Under the terms of the agreement, we continue to service the sold receivables and are subject to recourse provisions. Advances bear interest at the prime rate (3.25% at March 28, 2009) plus 2.50% subject to a minimum monthly charge. There was no amount outstanding under this borrowing facility at March 28, 2009.

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.

**Table of Contents****4. Stockholders Equity**

The following is a summary of stockholders equity transactions for the three months ended March 28, 2009:

	Convertible Preferred Stock		Common Stock		Capital in Excess of Par Value	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
<b>Balance at December 31, 2008</b>	611,523	\$ 1,000	17,869,030	\$ 18,000	\$ 230,219,000	\$(212,686,000)	\$ 17,552,000
Issuance of common stock							
Issuance of preferred stock							
Issuance of awards and stock based compensation			835,998	1,000	259,000		260,000
Net loss						(3,542,000)	(3,542,000)
<b>Balance at March 28, 2009</b>	611,523	\$ 1,000	18,705,028	\$ 19,000	\$ 230,478,000	\$(216,228,000)	\$ 14,270,000

**Equity Awards**

We have four equity award option plans, the nonstatutory 1992 Directors Stock Option Plan, 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 months ended March 28, 2009 or during the three months ended March 29, 2008.

As a result of adopting SFAS 123R, the option compensation impact to the unaudited condensed consolidated statements of operations for the quarter ended March 28, 2009 on net income was \$131,000 and \$0.01 on basic and diluted earnings per share and for the quarter ended March 29, 2008 the impact was \$23,000 and zero on basic and diluted earnings per share. No stock compensation cost was capitalized during either period. There were no stock options issued in the first quarter 2009 and the weighted-average fair value at the grant date for options issued in the first quarter of 2008 was \$5.00 per share. The total compensation cost related to non-vested awards not yet recognized is \$1.4 million and the weighted-average period over which the cost is expected to be recognized is 2.9 years in the first quarter of 2009 versus \$1.8 million and 3.8 years in the first quarter of 2008.

The following is a summary of stock option transactions under our equity award plans at March 28, 2009:

	Number of Shares	Price Per Share	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
Balance at December 31, 2008	1,234,025	\$ 1.43 - \$493.75	\$22.18	674,061	\$36.67
Granted					
Exercised					
Canceled	(19,020)	\$ 6.10 - \$186.50	\$19.37		
Balance at March 28, 2009	1,215,005	\$ 1.43 - \$493.75	\$22.23	864,833	\$29.36

The outstanding options expire on various dates through the end of July 2018. The weighted-average contractual term of outstanding options is 6.2 years and the weighted-average contractual term of currently exercisable stock options is slightly less than 6 years. The exercise prices for options range from \$1.43 to \$493.75 per share, for an aggregate exercise price of approximately \$27 million. At March 28, 2009, no outstanding stock options and no exercisable options had an exercise price less than the current market value or had any intrinsic value.

In January 2009, we issued awards covering 835,998 shares of restricted stock, with 50% of the shares vesting after one year of service and the remaining 50% of the shares vesting after two years of service. The per share weighted average grant-date fair value was \$1.00. A 10% forfeiture rate was assumed.

In September 2008, we issued awards covering 20,000 shares of restricted stock, all vesting after two years of service, with a per share weighted average grant-date fair value of \$1.62. A 10% forfeiture rate was assumed.

The restricted stock compensation impact to the unaudited condensed consolidated statements of operations for the three months ended March 28, 2009 was \$129,000 and \$0.01 on basic and diluted earnings per share and for the quarter

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ended March 29, 2008 the impact was \$56,000 and zero on basic and diluted earnings per share. No stock compensation cost was capitalized during the period. The total compensation cost related to non-vested awards not yet recognized was \$648,000 and the weighted-average period over which the cost is expected to be recognized was 1.2 years.

*Warrants*

The following is a summary of outstanding warrants at March 28, 2009:

	<b>Total and Currently Exercisable</b>	<b>Common Shares Price per Share</b>	<b>Expiration Date</b>
Warrants related to the issuance of common stock	342,466	6.74	August 16, 2010* **
Warrants related to April 2004 Bridge Loans	10,000	18.50	April 28, 2011*
Total	352,466		

\* 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.

\*\*

These warrants contain special anti-dilution adjustment provisions relating to the price of other issuances.

## 5. Earnings Per Share

We present basic and diluted earnings per common share pursuant to the provisions of SFAS No. 128, Earnings per Share. Basic earnings (loss) per share is based on the weighted-average number of common shares outstanding and diluted earnings (loss) per share is based on the weighted-average number of common shares outstanding plus all potentially dilutive 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:

	<b>March 28, 2009</b>	<b>March 29, 2008</b>
Outstanding stock options	1,215,005	1,234,689
Unvested restricted stock awards	855,998	318,000
Outstanding warrants	352,466	468,745
Total	2,423,469	2,021,434

## 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.

For both the three months ended March 28, 2009 and March 29, 2008, rent expense was \$282,000.

### *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.

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These royalty obligations terminate at various times from 2009 to 2020. For both the three months ended March 28, 2009 and March 29, 2008, royalty expense totaled \$38,000. Under the terms of certain royalty agreements, royalty payments made may be subject to audit. There have been no audits to date, and we do not expect any future audit adjustments to be significant.

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

<b>Year ending December 31,</b>	<b>Licenses</b>	<b>Operating Leases</b>
Remainder of 2009	\$ 150,000	\$ 987,000
2010	150,000	1,333,000
2011	150,000	1,364,000
2012	150,000	1,396,000
2013	150,000	1,429,000
Thereafter	900,000	4,413,000
Total payments	\$ 1,650,000	\$ 10,922,000

**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 indemnifications.

*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 limited in amount or duration. Certain costs incurred in connection with such indemnifications 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 indemnifications. Historically, any amounts payable pursuant to such director and officer indemnifications 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 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 against a director or executive officer, we are unable to determine the

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maximum amount of losses that we could incur relating to such indemnifications. Historically, any amounts payable pursuant to such guarantees 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 have a line of credit with a bank. The line of credit expires in July 2009 and is structured as a sale of accounts receivable. Advances under the line of credit are collateralized by all our assets. Under the terms of the agreement, we continue to service the sold receivables and are subject to recourse provisions. Under the terms of the agreement, if the bank determines that there is a material adverse change in our business, it may declare a default and exercise all our rights and remedies under the agreement. There was no amount outstanding under this facility at March 28, 2009. *See Note 3 Short Term Borrowings.*

*Contractual Contingency*

We have a contract to deliver several custom products to a government contractor, with respect to which delivery of the product was delayed because we were unable to manufacture the products for technical reasons. In December 2008, new terms and amended specifications were agreed upon, and we now expect to deliver these custom products around July 2009.

**8. Details of Certain Financial Statement Components and Supplemental Disclosures of Cash Flow Information and Non-Cash Activities***Balance Sheet Data:*

	<b>March 28, 2009</b>	<b>December 31, 2008</b>
<b>Accounts receivable:</b>		
Accounts receivable-trade	\$ 265,000	\$ 110,000
United States government accounts receivable-billed	353,000	320,000
Less: allowance for doubtful accounts	(75,000)	(75,000)
	<b>\$ 543,000</b>	<b>\$ 355,000</b>
	<b>March 28, 2009</b>	<b>December 31, 2008</b>
<b>Inventories:</b>		
Raw materials	\$ 2,710,000	\$ 2,753,000
Work-in-process	1,050,000	1,038,000
Finished goods	2,129,000	2,348,000
Less inventory reserve	(869,000)	(861,000)
	<b>\$ 5,020,000</b>	<b>\$ 5,278,000</b>
	<b>March 28, 2009</b>	<b>December 31, 2008</b>
<b>Property and Equipment:</b>		
Equipment	\$ 15,562,000	\$ 15,537,000
Leasehold improvements	6,741,000	6,741,000
Furniture and fixtures	404,000	404,000

	22,707,000	22,682,000
Less: accumulated depreciation and amortization	(20,264,000)	(19,943,000)
	<b>\$ 2,443,000</b>	<b>\$ 2,739,000</b>

Depreciation expense amounted to \$321,000 and \$272,000 for the three month periods ended March 28, 2009 and March 29, 2008, respectively.

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	<b>March 28, 2009</b>	<b>December 31, 2008</b>
<b>Patents and Licenses:</b>		
Patents pending	\$ 994,000	\$ 940,000
Patents issued	1,070,000	1,059,000
Less accumulated amortization	(425,000)	(409,000)
Net patents issued	645,000	650,000
Licenses Pending		39,000
Licenses Issued	563,000	563,000
Less accumulated amortization	(175,000)	(167,000)
Net licenses	388,000	396,000
Purchased technology	1,706,000	1,706,000
Less accumulated amortization	(1,538,000)	(1,479,000)
Net purchased technology	168,000	227,000
	<b>\$ 2,195,000</b>	<b>\$ 2,252,000</b>

Amortization expense related to these items totaled \$83,000 for each of the three month periods ended March 28, 2009 and March 29, 2008. Amortization expenses are expected to total \$239,000 for the remainder of 2009 and \$95,000 in each of 2010 and 2011.

	<b>March 28, 2009</b>	<b>December 31, 2008</b>
<b>Accrued Expenses and Other Long Term Liabilities:</b>		
Salaries payable	\$ 147,000	\$ 12,000
Compensated absences	358,000	375,000
Compensation related	53,000	12,000
Warranty reserve	255,000	261,000
Deferred rent	331,000	325,000
Other	109,000	114,000
	1,253,000	1,099,000
Less current portion	(798,000)	(658,000)
Long term portion	<b>\$ 455,000</b>	<b>\$ 441,000</b>
	<b>For the three months ended, March 28, 2009</b>	<b>March 29, 2008</b>

**Warranty Reserve Activity:**

Beginning balance	\$ 261,000	\$ 380,000
Additions	7,000	12,000
Deductions	(13,000)	(85,000)
Ending balance	<b>\$ 255,000</b>	<b>\$ 307,000</b>

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

We are a leading company in high temperature superconductor ( HTS ) materials and related technologies. HTS materials have the unique ability to conduct various signals or energy (e.g., electrical current or radio frequency ( RF ) signals) with little or no resistance when cooled to critical temperatures. Electric currents that flow through conventional conductors encounter resistance that requires power to overcome and generates heat. HTS materials can substantially improve the performance characteristics of electrical systems, reducing power loss, lowering heat generation and decreasing electrical noise. Circuits designed to remove interference inherent in some RF signals can also be made from HTS materials. Commercial use of HTS materials requires a number of cutting edge technologies, including development of HTS materials,

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specialized manufacturing expertise to create uniform thin layers of these materials, expert designs of circuits optimized for HTS materials, and technologies to maintain an extremely low temperature environment for HTS applications (although the critical temperatures for HTS are high compared with traditional superconductors, but they are still extremely cold by other standards).

### **Our Proprietary Technology**

We are focused on research and development to maintain our technological edge. As of March 28, 2009 we had 35 employees in our research and development division; 9 of our employees have Ph.D.s, and 14 others hold advanced degrees, in physics, materials science, electrical engineering and other fields. Our development efforts over the last 21 years have yielded an extensive patent portfolio as well as critical trade secrets, unpatented technology and proprietary knowledge. We enter into confidentiality and nondisclosure agreements with our employees, suppliers and consultants to protect our proprietary information. As of March 28, 2009, we held 58 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.

30 patents for cryogenic and non-microwave circuit designs, which expire between 2010 and 2026. 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.

4 patents covering other superconducting technologies, which expire between 2013 and 2015.

As of March 28, 2009, we also had 17 issued foreign patents, 23 U.S. patent applications pending and 49 foreign applications patents pending.

We are currently focusing our efforts on applications in areas such as:

**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 all while reducing capital and operating costs.

**Reconfigurable Handset Filters.** The trend in the wireless handset industry is to continually reduce size and cost, while adding more features and making the unit more adaptable to different air interfaces and frequencies throughout the world. This drives the need for more complex and reconfigurable transceivers. We believe our strong intellectual property and expertise in frequency agile and thin film filters position us well to meet this demand.

**Superconducting Power Transmission Lines.** We have entered into a collaborative effort and signed a Material Transfer Agreement with the Department of Energy's Los Alamos National Laboratory ( LANL ) to apply our HTS expertise to LANL's research initiative to develop HTS coated conductors for power transmission lines. If successfully developed, HTS superconducting cables could replace copper power transmission lines, resulting in higher capacity with less resistive cable losses.

**Government Products.** As the worldwide leader in developing tunable HTS filter systems for military applications, we continue to be a crucial partner in the U.S. government's future success. Our high-performance HTS filter systems have been proven to increase the detection range, reduce interference, and in some cases, detect signals that were previously undetectable with conventional technology.

Currently, we actively participate in the development of technologies for application in military communications, signals intelligence, and electronic warfare.

Our development efforts can take a significant number of years to commercialize, and we must overcome significant technical barriers and deal with other 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 the year ended December 31, 2008 (our 2008 Form 10-K ).

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### **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 generate 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*<sup>®</sup>, 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*<sup>®</sup>, a ground-mounted unit for wireless base stations that includes a high-performance amplifier and up to six 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 ALLTEL, 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 three months ended March 28, 2009 and for all of 2008. 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, evolving industry standards and price erosion over the life of a product. We face constant pressures to reduce prices. Consequently, we expect the average selling prices of our products will continue decreasing over time. 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 2008 Form 10-K.

#### *Joint Ventures*

From time to time we may pursue joint ventures with other entities to commercialize our technology. In particular, we have agreed to license certain technology for our SuperLink<sup>®</sup> interference elimination solution for the China market to a joint venture where we own 45 percent of the equity. In the fourth quarter of 2008, we successfully completed lab and field trials for our new TD-SCDMA solution in China and in the first quarter of 2009, we successfully completed a field trial in the existing China 2G market using our SuperLink<sup>®</sup> solution. The commencement of manufacturing and the transfer of our processes to the joint venture will be driven by product demand from the China market. The joint venture's activities remain subject to successful product marketing efforts in addition to a number of other conditions, including certain critical approvals from the Chinese and United States governments. In particular, we have been in discussions with the United States government concerning the national security implications of our joint venture and investment from Hunchun BaoLi Communications ( BAOLI ). There continues to be no assurance that these conditions will be met, or that all required approvals (if obtained) will be obtained on a timely basis. Even if these conditions are met and the approvals received, the results from our joint venture will be subject to a number of significant risks associated with international operations and new ventures,



some of which are set forth in our public filings, including in particular the *Risk Factors* included in Item 1A of our 2008 Form 10-K.

*Licenses*

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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.

**Recent Developments**

In April 2009, we signed a letter of intent to participate with a major wireless original equipment manufacturer (OEM) in a long-term evolution (LTE) field trial with a tier-one U.S. wireless operator for its new 700 megahertz (MHz) network. The trial is scheduled to be completed in the fourth quarter of 2009.

**Backlog**

Our commercial backlog consists of accepted product purchase orders with scheduled delivery dates during the next twelve months. We had commercial backlog of \$434,000 at March 28, 2009 compared to \$272,000 at December 31, 2008.

**Results of Operations**

*Quarter Ended March 28, 2009 compared to the Quarter Ended March 29, 2008*

Net revenues decreased by \$1.8 million, or 52%, from \$3.5 million in the first quarter of 2008 to \$1.7 million in the first quarter of 2009. Net revenues consist primarily of commercial product revenues and government contract revenues.

Net commercial product revenues decreased to \$1.1 million in the first quarter of 2009 from \$2.0 million in the first quarter of 2008, a decrease of \$862,000, or 43%. The decrease is primarily the result of lower sales volume for our SuperLink® product due to customer program delays. The average sales prices for our products were unchanged. Our three largest customers accounted for 98% of our total net commercial product revenues in the first quarter of 2009, compared to 97% in the first quarter of 2008. 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 \$933,000, or 63%, to \$546,000 in the first quarter of 2009 from \$1.5 million in the first quarter of 2008. This decrease was due to a funding delay on a current contract. In March, that contract was funded for an additional twelve months and provides for progress billing of up to \$4.1 million.

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 \$222,000, or 11%, to \$1.8 million for the first quarter of 2009 compared to \$2.0 million for the first quarter of 2008. The lower costs resulted principally from lower production as a result of lower sales. There was a \$74,000 reduction in a specific warranty provision in the first quarter of 2008 on the expiration of a warranty. There was no such warranty expense reduction in the first quarter of 2009.

Our cost of sales includes both variable and fixed cost components. The variable component consists primarily of materials, assembly and test labor, overhead (which includes equipment and facility depreciation), 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 to absorb our overhead costs against. 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 to absorb our overhead costs against. 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.

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

<b>For the quarters ended</b>	
<b>March 28, 2009</b>	<b>March 29, 2008</b>
(Dollars in thousands)	

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Net commercial product sales	\$ 1,131	100.0%	\$ 1,993	100.0%
Total cost of commercial product sales	1,797	158.9%	2,019	101.3%
Gross profit	\$ (666)	(58.9%)	\$ (26)	(1.3%)

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We had a negative gross profit of \$666,000 in the first quarter of 2009 from the sale of our commercial products compared to a negative gross profit of \$26,000 in the first quarter of 2008. We experienced negative gross profit in the first quarters of 2009 and 2008 because the reduced level of commercial sales was insufficient to cover 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, forecasted product demand and production requirements for the next twelve months. Gross margin in the first quarter of 2008 and 2009 was not impacted by the sale of previously written-off inventory.

Contract research and development expenses totaled \$569,000 in the first quarter of 2009 compared to \$1.2 million in the first quarter of 2008. This decrease was the result of lower expenses associated with performing a fewer number of government contracts.

Other 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 \$1.1 million in the first quarter of 2009 compared to \$408,000 in the same quarter of the prior year. This increase is due to fewer government contracts using relatively less of our limited engineering resources.

Selling, general and administrative expenses totaled \$1.7 million in the first quarter of 2009 compared to \$2.2 million in the first quarter of the prior year. The lower expenses in 2009 resulted primarily from a reduction in employees in the fourth quarter of 2008 as well as lower expenses for insurance premiums, fewer repairs and maintenance charges, and lower consulting expenses.

Interest income decreased in the first quarter of 2009 compared to the prior year period, because of lower interest rates in 2009, and we had less cash available for investment.

Interest expense in both the first quarter of 2009 and 2008 was \$9,000.

We had a net loss of \$3.5 million for the quarter ended March 28, 2009, compared to a net loss of \$2.3 million in the same period last year.

The net loss available to common stockholders totaled \$0.20 per common share in the first quarter of 2009 compared to a net loss of \$0.17 per common share in the same period last year.

## **Liquidity and Capital Resources**

### *Cash Flow Analysis*

As of March 28, 2009, we had working capital of \$9.4 million, including \$5.1 million in cash and cash equivalents, compared to working capital of \$12.3 million at December 31, 2008, which included \$7.6 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 do not own any auction rate securities. We believe that all of our cash investments would be readily available to us should the need arise.

Cash and cash equivalents decreased by \$2.5 million from \$7.6 million at December 31, 2008 to \$5.1 million at March 28, 2009. Cash was used principally in operations and for the purchase of property and equipment.

Net cash used in operations totaled \$2.5 million in the first quarter of 2009. We used \$2.8 million to fund the cash portion of our net loss. We also used cash to fund a \$213,000 increase in accounts receivable and patents, offset by cash provided by a \$549,000 decrease in inventory and prepaid expenses and other assets, as well as an increase in accounts payable and accrued expenses.

Net cash used in investing activities totaled \$11,000 in the first quarter of 2009 compared to \$62,000 in the first quarter of last year. In the first quarter of 2009 we used \$25,000 to purchase property and equipment, offset by a \$14,000 net reduction in our joint venture investment.

We had no financing activities in the first quarter of 2009 compared to cash provided by \$11.0 million from the \$15.0 million BAOLI investment, net of \$89,000 in expenses, in the first quarter of 2008.

### *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. We have effective registration statements on file with the Securities and Exchange Commission covering the public resale by investors of common stock issued in our private placements, as well as any common

stock acquired upon exercise of their warrants.

We did not complete any financing activities in the first quarter of 2009.

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We also have an existing line of credit from a bank. The line of credit expires in July, 2009. The loan agreement is structured as a sale of our accounts receivable and provides for the sale of up to \$5.0 million of eligible accounts receivable, with advances to us totaling 80% of the receivables sold. Advances bear interest at the prime rate (3.25% at March 28, 2009) plus 2.50% subject to a minimum monthly charge. There was no amount outstanding under this borrowing facility at March 28, 2009 or December 31, 2008. Advances are collateralized by a lien on all of our assets. Under the terms of the agreement, we would continue to service the sold receivables and are subject to recourse provisions.

*Contractual Obligations and Commercial Commitments*

In February 2009, we amended our office and production facilities lease. The base rent and the minimum annual escalation clause were reduced and the term of the lease was extended five years to November 2016. Except for that change, we have not had any material changes outside the ordinary course of business in the contractual obligations as specified in our 2008 Form 10-K.

*Capital Expenditures*

We plan to invest approximately \$200,000 in fixed assets during the remainder of 2009.

*Future Liquidity*

For the quarter ended March 28, 2009, we incurred a net loss of \$3.5 million and had negative cash flows from operations of \$2.5 million. In 2008, we incurred a net loss of \$12.7 million and had negative cash flows from operations of \$12.1 million. Our independent registered public accounting firm has included in its audit reports for 2008 and 2007 an explanatory paragraph expressing doubt about our ability to continue as a going concern.

At March 28, 2009, we had \$5.1 million in cash. Our cash resources, together with our line of credit and a planned inventory reduction, may not be sufficient to fund our business through the end of 2009. We believe one of the key factors to our liquidity will be our ability to successfully execute on our plans to increase sales levels in a highly concentrated industry where we experience significant fluctuations in sales from quarter to quarter. Our cash requirements will also depend on numerous other variable factors, including the rate of growth of sales, the timing and levels of products purchased, payment terms and credit limits from manufacturers, and the timing and level of accounts receivable collections. Because of the uncertainty of these many factors, we may need to raise funds in the next few months to meet our working capital needs.

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, 2008, we had net operating loss carryforwards for federal and state income tax purposes of approximately \$291.4 million and \$168.8 million, respectively, which expire in the years 2009 through 2028. Of these amounts \$88.3 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 \$3.0 million and \$1.4 million, respectively, which expire in the years 2009 through 2028. Of these amounts \$661,000 and \$736,000, 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 sheets.

Section 382 of the Internal Revenue Code imposes an annual limitation on the utilization of net operating loss carryforwards 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 and December 2002. In addition, we acquired the right to Conductus' net

operating losses, which are also subject to the limitations imposed by Section 382. Conductus underwent three ownership changes, which occurred in February 1999, February 2001 and December 2002. Therefore, the ability to utilize our net operating loss carryforwards of \$94.3 million incurred prior to the ownership changes and Conductus net operating loss carryforwards of \$83.7 million incurred prior to the ownership changes will be subject in future periods to an annual limitation of \$1.3 million and \$700,000, respectively. Net operating losses incurred by us subsequent to the ownership changes totaled \$113.4 million and are not subject to this limitation.

**Critical Accounting Policies and Estimates**

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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 2008 Form 10-K. We have not made any material changes to these policies.

**Recent Accounting Pronouncements**

In April 2009 the FASB issued FSP No. 141R-1 *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*, or FSP 141R-1. FSP 141R-1 amends the provisions in Statement 141R for the initial recognition and measurement, subsequent measurement and accounting, and disclosures for assets and liabilities arising from contingencies in business combinations. The FSP eliminates the distinction between contractual and non-contractual contingencies, including the initial recognition and measurement criteria in Statement 141R and instead carries forward most of the provisions in SFAS 141 for acquired contingencies. FSP 141R-1 is effective for contingent assets and contingent liabilities acquired in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We expect FSP 141R-1 will not have an impact on our consolidated financial statements.

In April 2009 the FASB issued three related Staff Positions: (i) FSP 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly*, or FSP 157-4, (ii) SFAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, or FSP 115-2 and FSP 124-2, and (iii) SFAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, or FSP 107 and APB 28-1, which will be effective for interim and annual periods ending after June 15, 2009. FSP 157-4 provides guidance on how to determine the fair value of assets and liabilities under SFAS 157 in the current economic environment and reemphasizes that the objective of a fair value measurement remains an exit price. If we were to conclude that there has been a significant decrease in the volume and level of activity of the asset or liability in relation to *normal* market activities, quoted market values may not be representative of fair value and we may conclude that a change in valuation technique or the use of multiple valuation techniques may be appropriate. FSP 115-2 and FSP 124-2 modify the requirements for recognizing other-than-temporarily impaired debt securities and revise the existing impairment model for such securities, by modifying the current *intent and ability* indicator in determining whether a debt security is other-than-temporarily impaired. FSP 107 and APB 28-1 enhance the disclosure of instruments under the scope of SFAS 157 for both interim and annual periods. We are currently evaluating these Staff Positions and do not expect their adoption to have a material impact on our consolidated financial position, results of operations or cash flows.

**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 March 28, 2009 compared with our market risk exposure on December 31, 2008. See *Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk* in our 2008 Annual Report on Form 10-K.

**Item 4T. Controls and Procedures.**

We have established disclosure controls and procedures to ensure that material information relating to us and our consolidated subsidiaries is made known to the officers who certify our financial reports, as well as other members of senior management and the Board of Directors, to allow timely decisions regarding required disclosures. As of the



March 28, 2009, we carried out an evaluation under the supervision and with the participation of our management, including the our Chief Executive Officer and Controller ( Principal Financial Officer ), of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities and Exchange Act of 1934. Based upon that evaluation, the Chief Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information related to us that is required to be included in our periodic Securities and Exchange Commission filings.

There were no changes in our internal controls over financial reporting during the first quarter of 2009 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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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.**

We may be involved in routine litigation arising in the ordinary course of our business, and, while the results of the proceedings cannot be predicted with certainty, we believe that the final outcome of such matters will not have a material adverse effect on our financial position, operating results or cash flows.

**Item 1A. Risk Factors.**

A description of the risk factors associated with our business is contained in Item 1A, Risk Factors, of our 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 20, 2009. 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. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

Number	Description of Document
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 our behalf by the undersigned thereunto duly authorized.

**SUPERCONDUCTOR TECHNOLOGIES INC.**

Dated: May 8, 2009

/s/ William J. Buchanan

William J. Buchanan  
Controller

/s/ Jeffrey A. Quiram

Jeffrey A. Quiram  
President and Chief Executive Officer

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