

LIQUIDMETAL TECHNOLOGIES INC
Form 10-Q/A
July 20, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 3

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

For the quarterly period ended June 30, 2005

OR

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 No. 001-31332

LIQUIDMETAL TECHNOLOGIES, INC.

(Exact name of Registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

33-0264467
(I.R.S. Employer
Identification No.)

25800 Commercentre Drive, Suite 100
Lake Forest, California 92630
(address of principal executive office, zip code)

Registrant's telephone number, including area code: **(949) 206-8000**

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 at least the past 90 days.

Yes No

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

Large accelerated filer
Non-accelerated filer

Accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of July 11, 2005, there were 41,609,652 shares of the registrant's common stock, \$.001 par value, outstanding.

As of July 11, 2005, there were 41,609,652 shares of the registrant's common stock, \$.001 par value, outstanding.

**LIQUIDMETAL TECHNOLOGIES, INC.
AMENDMENT NO. 3 TO FORM 10-Q
FOR THE QUARTER ENDED June 30, 2005**

EXPLANATORY NOTE

We are filing this Amendment No. 3 to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, as filed with the U.S. Securities and Exchange Commission (SEC) on August 15, 2005, as amended on August 30, 2005 and March 16, 2006, to restate our financial statements to properly account for the conversion feature of the senior convertible notes issued in March 2004 (see Note 8 to the condensed consolidated financial statements). Additionally, reclassifications to our financial statements have been made for consistent presentation of our change in value of warrant liabilities.

Other than the changes referred to above, all other information included in the above described Form 10-Q, remains unchanged. This amendment does not reflect events occurring after the filing of such Form 10-Q and does not modify or update the disclosures therein in any way other than as required to reflect the amendment as described above and set forth below.

FORWARD-LOOKING INFORMATION

Statements in this report concerning the future sales, expenses, profitability, financial resources, product mix, market demand, product development and other statements in this report concerning the future results of operations, financial condition and business of Liquidmetal Technologies, Inc. are forward-looking statements as defined in the Securities Act of 1933 and Securities Exchange Act of 1934. Investors are cautioned that the Company's actual results in the future may differ materially from those projected in the forward-looking statements due to risks and uncertainties that exist in the Company's operations and business environment, including competition, need for increased acceptance of products, ability to continue to develop and extend our brand identity, ability to anticipate and adapt to a competitive market, ability to effectively manage rapidly expanding operations, amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure, ability to provide superior customer service, dependence upon key personnel and the like. The Company's most recent filings with the Securities and Exchange Commission, including Form 10-K, contain additional information concerning many of these risk factors, and copies of these filings are available from the Company upon request and without charge.

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PART I

FINANCIAL INFORMATION

Item 1 Financial Statements

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	(unaudited) June 30, 2005 (Restated)	December 31, 2004 (Restated)
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 1,256	\$ 742
Restricted cash		754
Trade accounts receivables, net of allowance for doubtful accounts of \$69 and \$108	2,359	1,668
Inventories	2,190	2,353
Prepaid expenses and other current assets	954	930
Total current assets	6,759	6,447
Property, plant and equipment, net	14,996	16,434
Idle equipment	193	1,906
Long term inventory		1,810
Other intangibles, net	1,158	1,143
Other assets	816	768
Total assets	\$ 23,922	\$ 28,508
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 7,095	\$ 4,969
Settlement payable	3,294	3,246
Deferred revenue	934	900
Short-term debt	493	
Long-term debt, current portion, net of debt discount of \$3,082 and \$2,831	7,102	4,010
Warrant liabilities	1,677	550
Conversion feature liabilities	4,368	6,650
Other liabilities, current portion	752	1,032
Total current liabilities	25,715	21,357
Long-term debt, net of current portion	2,044	2,618
Other long-term liabilities, net of current portion	373	342
Total liabilities	28,132	24,317
Shareholders Equity (Deficiency):		
Common stock, \$0.001 par value; 100,000,000 shares authorized and 41,609,652 issued and outstanding at June 30, 2005 and December 31, 2004	42	42
Additional paid-in capital	129,650	129,650
Accumulated deficit	(136,256)	(127,472)
Accumulated other comprehensive income	2,354	1,971

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Total shareholders' equity (deficiency)	(4,210)	4,191
Total liabilities and shareholders' equity (deficiency)	\$ 23,922	\$ 28,508

The accompanying notes are an integral part of the condensed consolidated financial statements.

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

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(in thousands, except per share data)

(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2005 (Restated)	2004 (Restated)	2005 (Restated)	2004 (Restated)
Revenue	\$ 3,727	\$ 4,055	\$ 6,570	\$ 10,343
Cost of sales	3,962	2,475	6,797	6,032
Gross (loss) profit	(235)	1,580	(227)	4,311
Operating Expenses:				
Selling, general, and administrative	1,567	2,544	4,157	5,609
Research and development	213	345	610	686
Impairment of long lived assets	3,394		3,394	
Total expenses	5,174	2,889	8,161	6,295
(Loss) from operations	(5,409)	(1,309)	(8,388)	(1,984)
Change in value of warrants, gain (loss)	(100)	694	33	1,280
Change in value of conversion feature, gain	1,167	3,904	2,282	5,614
Interest expense	(1,181)	(2,255)	(2,718)	(2,651)
Interest income	1	22	7	34
(Loss) income from continuing operations	(5,522)	1,056	(8,784)	2,293
(Loss) from discontinued equipment manufacturing operations, net of tax		(356)		(749)
Net (loss) income	(5,522)	700	(8,784)	1,544
Other comprehensive (loss) income				
Foreign exchange translation gain	62	43	383	422
Comprehensive (loss) income	\$ (5,460)	\$ 743	\$ (8,401)	\$ 1,966
Net (loss) income per share basic and diluted:				
(Loss) income per share continuing operations	\$ (0.13)	\$ 0.03	\$ (0.21)	\$ 0.06
(Loss) per share discontinued operations	\$	\$ (0.01)	\$	\$ (0.02)
(Loss) income per share basic and diluted	\$ (0.13)	\$ 0.02	\$ (0.21)	\$ 0.04
Number of weighted average shares basic and diluted	41,610	41,610	41,610	41,610

The accompanying notes are an integral part of the condensed consolidated financial statements.

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

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(in thousands, except per share data)

(unaudited)

	For the Six Months Ended June 30,	
	2005 (Restated)	2004 (Restated)
Operating activities:		
Net income (loss)	\$ (8,784)	\$ (1,544)
Adjustments to reconcile net loss from operations to net cash used for operating activities:		
Impairment of long lived assets	3,394	
Loss on disposal of asset	1	
Depreciation and amortization	1,694	1,823
Amortization of debt discount	1,031	2,283
Gain from change in value of warrants	(33)	(1,280)
(Loss) gain from change in value of conversion feature	(2,282)	5,614
Stock-based compensation		276
Bad debt (recovery) expense	(43)	105
Warranty expense	76	137
Changes in operating assets and liabilities:		
Accounts receivable	(648)	(521)
Inventories	320	(2,235)
Prepaid expenses and other current assets	(24)	189
Other assets	(169)	(575)
Accounts payable and accrued expenses	2,050	(201)
Deferred revenue	34	(597)
Other liabilities	(182)	(927)
Net cash used for continuing operations	(3,565)	(5,593)
Net cash provided by discontinued operations		822
Net cash used for operating activities	(3,565)	(4,771)
Investing Activities:		
Purchases of property and equipment	(63)	
Proceeds from sale of property and equipment	1	
Investment in patents and trademarks	(70)	(102)
Net cash used for investing activities	(132)	(102)
Financing Activities:		
Proceeds from borrowings	4,669	9,924
Repayment of borrowings	(1,613)	(1,841)
Proceeds from restricted cash	754	(58)
Net cash provided by financing activities	3,810	8,025
Effect of foreign exchange translation	401	77
Net increase in cash and cash equivalents	514	3,229
Cash and cash equivalents at beginning of period	742	3,127
Cash and cash equivalents at end of period	\$ 1,256	\$ 6,356
Supplemental cash flow information:		
Interest paid	\$ 229	\$ 208
Taxes paid	\$	\$

The accompanying notes are an integral part of the condensed consolidated financial statements.

During the six months ended June 30, 2004, the Company sold its 51% ownership interest in Dongyang to the 49% minority shareholder, which resulted in a loss of \$46 from disposal of discontinued operations as of June 30, 2004.

The accompanying notes are an integral part of the condensed consolidated financial statements

LIQUIDMETAL TECHNOLOGIES AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Six Months Ended June 30, 2005 and 2004

(in thousands, except per share data)

(unaudited)

1. Basis of Presentation / Description of Business

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. In addition, certain reclassifications have been made for consistent presentation. Operating results for the three and six months ended June 30, 2005 are not necessarily indicative of the results that may be expected for any future periods or the year ending December 31, 2005. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company's Form 10-K filed with the Securities and Exchange Commission on March 30, 2005.

Liquidmetal Technologies, Inc. (Liquidmetal Technologies) and its subsidiaries (collectively the Company) are in the business of developing, manufacturing, and marketing products made from amorphous alloys. Liquidmetal Technologies markets and sells Liquidmetal® alloy industrial coatings and also manufactures, markets and sells products and components from bulk Liquidmetal alloys that can be incorporated into the finished goods of its customers across a variety of industries. The Company also partners with third-party licensees and distributors to develop and commercialize Liquidmetal alloy products.

The Company classifies operations into two reportable segments: Liquidmetal alloy industrial coatings and bulk Liquidmetal alloys. Liquidmetal alloy industrial coatings are used primarily as a protective coating for industrial machinery and equipment, such as drill pipe used by the oil drilling industry and boiler tubes used by coal-burning power plants. Bulk Liquidmetal alloys include potential market opportunities to manufacture and sell products and components for electronic devices, medical devices, defense applications, and sporting goods. In addition, the bulk Liquidmetal alloys segment includes tooling and prototype sampling, and the manufacture and sale of die casting equipment (see Note 7). In addition, such alloys are used to generate research and development services revenue for developing uses related primarily to defense and medical applications as well as potential license fees, royalties, and other compensation from strategic partnering transactions.

Stock-based compensation

The Company applies Accounting Principles Board (APB) Opinion No. 25 for options when the exercise price of options granted to employees is less than the fair value of the underlying stock on the date of grant. The Company applies Statement of Financial Accounting Standards (SFAS) No. 123 for options granted to non-employees who perform services for the Company.

Had the Company determined compensation cost based on the fair value at the grant date for stock options consistent with the method of SFAS No. 123, the Company's loss from continuing operations and basic and diluted loss per share from continuing operations would have been as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2005 (Restated)	2004 (Restated)	2005 (Restated)	2004 (Restated)
Net income (loss) from continuing operations as reported	\$ (5,522)	\$ 1,056	\$ (8,784)	\$ 2,293
<i>Add:</i>				
stock-based employee compensation expense included in reported net loss, net of related tax effects		7		276
<i>Deduct:</i>				
total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(736)	(1,100)	(1,519)	(2,809)
Proforma net loss from continuing operations:	\$ (6,258)	\$ (44)	\$ (10,303)	\$ (240)
Basic and diluted loss per share:				
As reported	\$ (0.13)	\$ 0.03	\$ (0.21)	\$ 0.06
Proforma	\$ (0.15)	\$ (0.00)	\$ (0.25)	\$ (0.01)

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants for the six months ended June 30, 2005 and 2004, respectively: expected volatility of approximately 100% for all periods; dividend yield of 0.0% for all periods; expected option life of approximately 5 years; and a risk-free interest rate ranging from 2.9% to 4.2%.

2. Basis of Presentation and Recent Accounting Pronouncements

Translation of Foreign Currency

The Company applies *FASB No. 52, Foreign Currency Translation*, for translating foreign currency into US dollars in our consolidation of the financial statements. Upon consolidation of the Company's foreign subsidiaries into the Company's consolidated financial statements, any balances with the subsidiaries denominated in the foreign currency are translated at the exchange rate at year-end. The financial statements of Liquidmetal Korea have been translated based upon Korean Won as the functional currency. Liquidmetal Korea's assets and liabilities were translated using the exchange rate at period end and income and expense items were translated at the average exchange rate for the reporting period. The resulting translation adjustment was included in other comprehensive income (loss).

Reclassifications

Certain amounts from the prior year have been reclassified to conform to current year's presentation.

Restatements

SFAS 133 Accounting for Derivative Instruments and Hedging Activities

As a part of the accompanying consolidated financial and the notes thereto, the Company has restated certain previously issued financial statements due to an error related to the Company's accounting for embedded convertible feature of senior convertible notes issued in March 2004 in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, (SFAS 133) (see Note 8).

Recent Accounting Pronouncements

In March 2004, the EITF reached a consensus on recognition and measurement guidance previously discussed under EITF 03-01. The consensus clarifies the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and other investments accounted for under the cost method. The recognition and measurement guidance for which the consensus was reached in March 2004 is to be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. In September 2004, the FASB issued a final FASB Staff Position that delays the effective date for the measurement and recognition guidance for all investments within the scope of EITF Issue No. 03-01; however, the disclosure requirements remain effective for annual periods ending after June 15, 2004. The Company does not believe that the adoption of this statement will have a material effect on the Company's results of operation and financial position.

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment*, which replaces SFAS No. 123. SFAS No. 123R requires public companies to recognize an expense for share-based payment arrangements including stock options and employee stock purchase plans. The statement eliminates a company's ability to account for share-based compensation transactions using APB 25, and generally requires instead that such transactions be accounted for using a fair value based method. SFAS No. 123R requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the date of grant, and to recognize the cost over the period during which the employee is required to provide service in exchange for the award. In April 2005, the SEC amended the compliance dates for SFAS 123(R), to allow companies to implement the standard at the beginning of their next fiscal year, instead of the next reporting period beginning after June 15, 2005. SFAS No. 123R is effective for the Company in the quarter ending March 31, 2006. Upon adoption of SFAS 123R, companies are allowed to select one of three alternative transition methods, each of which has different financial reporting implications. The Company is currently evaluating the transition methods, valuation methodologies and other assumptions for employee stock options in light of SFAS No. 123R. Current estimates of option values using the Black-Scholes method may not be indicative of results from valuation methodologies ultimately implemented by the Company upon adoption of SFAS No. 123R. Although the Company has not yet fully quantified the impact this standard will have on its financial statements, it is likely that the adoption of SFAS No. 123R will have a material impact on the Company's financial position and results of operations. Stock-based Compensation under Note 1 included in these Condensed Consolidated Financial Statements provides the pro forma net income and earnings per share as if the Company had used a fair-value-based method similar to the methods required under SFAS 123(R) to measure the compensation expense for employee stock awards during the three and six months ended June 30, 2005 and 2004.

On March 29, 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the Staff's interpretation of SFAS 123(R). This interpretation expresses the views of the staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. In particular, this SAB provides guidance related to share-based payment transactions with nonemployees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of Statement 123(R) and disclosures in Management's Discussion and Analysis subsequent to adoption of SFAS 123(R). The Company will adopt SAB 107 in connection with its adoption of SFAS 123(R).

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 replaces APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements* and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005. The Company does not believe the adoption of SFAS No. 154 will have a material effect on its consolidated financial position, results of operations or cash flows.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA and the SEC did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

3. Liquidity

The Company has experienced losses from continuing operations during the last two fiscal years and has an accumulated deficit of \$136,256 as of June 30, 2005. Cash used for continuing operations for the six months ended June 30, 2005 was \$3,565 and cash flow from continuing operations may be negative throughout fiscal year 2005. As of June 30, 2005, the Company's principal source of liquidity is \$1,256 of cash and trade accounts receivable of \$2,359. Such conditions raise substantial doubt that the Company will be able to continue as a going concern for a reasonable period of time. These operating results occurred while the Company was developing and attempting to commercialize and manufacture products from an entirely new and unique technology. This business plan required significant spending related to start-up costs and capital expenditures. These factors have placed a significant strain on the financial resources of the Company. The ultimate success of the Company depends on its ability to continue reducing operating costs, generate higher revenue, and achieve positive cash flow from continuing operations and profitability. The consolidated financial statements do not include any adjustments that might result from the outcome of the uncertainty.

Additionally, the Company is not in compliance with certain covenant requirements of the senior convertible debt as of June 30, 2005. Although there has been no formal notice of default received from the note holders, as the note holders have the right to call for repayment of the outstanding balance of the senior convertible debt, the total outstanding debt balance of \$5,709 have been included as current liabilities as of June 30, 2005 (see Note 8).

The Company completed \$3,250 private placement of 10% convertible debt on June 13, 2005 and Factoring, Loan, and Security Agreement (Factoring Agreement) on April 21, 2005, which allows for borrowing up to \$1,500, to meet working capital needs of the Company (see Note 8). Borrowings made under the Factoring Agreement are secured by the Company's trade receivables. Such borrowings totaled \$1,222, which was offset by \$729 of repayments made as June 30, 2005.

Capital requirements during the next 12 months will depend on numerous factors, including the success of existing products, the development of new applications for Liquidmetal alloys, the resources devoted to develop and support Liquidmetal alloy products, and the cost of successful implementation of Section 404 of the Sarbanes-Oxley Act of 2002. If the available funds and cash generated from operations are insufficient to satisfy liquidity requirements, the Company may need additional funds in the future to support working capital requirements and for other purposes, and may need to raise additional funds through public or private equity financing, bank debt financing, or from other sources. Subsequent to the close of the second quarter of 2005, the Company completed a private placement of \$9,877 of 7% convertible debt in consideration for \$5,000 aggregate cash received, \$4,280 exchange of previously issued notes, and satisfaction of accrued interest and fees of \$597 from the previously issued notes (see Note 14). Adequate funds may not be available when needed or may not be available on favorable terms. However, the Company anticipates capital expenditures in the next 12 months will be less than \$0.5 million. The Company expects to continue to devote limited capital to our research and development activities, to further develop and strengthen our manufacturing capabilities, and for working capital and other general corporate purposes.

Our cash flow projections from operations and, consequently, future cash needs are subject to uncertainty. If our available funds and cash generated from operations are insufficient to satisfy our liquidity requirements, we may need to raise additional capital to fund our operations and capital expenditure requirements. We cannot be certain that additional capital, whether through selling additional debt or equity securities or obtaining a line of credit or other loan, will be available to us or, if available, will be on terms acceptable to us. If we issue additional securities to raise funds, these securities may have rights, preferences, or privileges senior to those of the rights of our common stock and our stockholders may experience additional dilution.

4. Inventories

The Company maintains certain of its raw material inventories in amounts in excess of our operating cycle of one year due to the nature of our manufacturing process, production lead time, and the recyclability of our raw material. These inventories

were classified as long-term inventory as of December 31, 2004. The Company determined that its current and projected raw material requirements are not sufficient enough to warrant the use of such raw materials in the foreseeable future. Accordingly, the Company reduced the carrying value of raw materials held by its subsidiary, Liquidmetal Korea, by the amounts considered to be excessive. The write-down amounted to \$1,653 is included in Impairment of long lived assets in the accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss for the three and six months ended June 30, 2005. The total amount of long term inventory was \$0 and \$1,810 as of June 30, 2005 and December 31, 2004, respectively.

	June 30, 2005	December 31, 2004
Raw materials	\$ 1,515	\$ 1,688
Work in process	412	352
Finished goods	263	313
Total current inventories	2,190	2,353
Long-term inventories		1,810
Total inventories	\$ 2,190	\$ 4,163

5. Idle Equipment

Idle equipment consists of certain equipment held by the Company for use in expansion of bulk alloy parts manufacturing. Due to excess manufacturing capacity, the Company classified the equipment as idle equipment at December 31, 2004. While the equipment may be used internally to meet future capacity requirements, considering our current revenue and foreseeable production requirements, the Company does not anticipate utilizing this equipment internally in the near future. For these reasons, during the quarter ended June 30, 2005, the Company determined to write down the carrying value of the idle equipment held by its subsidiary, Liquidmetal Korea, to its net realizable value. The write-down amounted to \$1,741 and is included in operating expenses as Impairment of long lived assets in the accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss for the three and six months ended June 30, 2005. Total amount of idle equipment remaining was \$194 and \$1,906 as of June 30, 2005 and December 31, 2004, respectively.

6. Discontinued Operations

Dongyang

On June 28, 2002, the Company acquired a 51% interest in Chusik Hoesa Dongyang Yudoro (Dongyang). In March 2004, the Company sold its 51% investment in Dongyang to the 49% minority shareholder. The selling price of the Company's 51% interest in Dongyang was \$80, which was equal to the Company's net carrying value for the 51% ownership held. Further, the Company agreed to pay Dongyang \$155 for the purchase of a receivable balance from Growell. The transaction resulted in net payable to Dongyang of \$75 and a loss of \$46 from transfer of the Company's interest in Donyang to the minority shareholder. The loss from operations for the six months ended June, 2004 totaled \$50 and is included in the loss from discontinued equipment manufacturing operations for the period. The net payable balance of \$75 is to be paid in quarterly installments throughout 2004, with \$25 to be paid subsequent to 2004. The outstanding amount payable to Dongyang is \$11 and \$25 as of June 30, 2005 and December 31, 2004, respectively, and is included in accounts payable and accrued liabilities.

Summarized operating results of Dongyang's discontinued operations are as follows.

	For the Three months Ended June 30,		For the Six months Ended June 30,	
	2005	2004	2005	2004
Revenue	\$	\$	\$	\$ 22
Loss from discontinued equipment manufacturing operations, net of tax				(96)

Taesung

On June 14, 2004, the Company entered into an Asset Purchase Agreement whereby all the assets and liabilities of its Taesung equipment manufacturing division in Korea were sold to a third party for \$345 which is payable by the third party in four equal installments with the last installment being due on June 30, 2005. As of March 31, 2004, management determined that no impairment was anticipated on the divestiture of its Taesung division. Ultimately, the sale resulted in a loss of approximately \$184. The loss from operations for the three and six months ended June 30, 2004 totaled \$179 and \$469 and is included in the loss from discontinued equipment manufacturing operations for the period.

Summarized operating results of Taesung's operations are as follows:

	For the Three months Ended June 30,		For the Six months Ended June 30,	
	2005	2004	2005	2004
Revenue	\$	\$ 72	\$	\$ 172
Loss from discontinued equipment manufacturing operations, net of tax		(356)		(653)

7. Product Warranty

Due to the lack of historical information for warranty expense related to bulk alloy products, management estimates product warranties as a percentage of bulk alloy product sales earned during the period. During the three and six months ended June 30, 2005, the Company recorded \$34 and \$76, respectively, of warranty expense. During the three and six months ended June 30, 2004, the Company recorded \$79 and \$137, respectively, of warranty expense. The product warranty accrual balance is included in accounts payable and accrued expenses.

8. Notes Payable

Senior Convertible Note

On March 3, 2004, the Company issued \$9.9 million of 6.0% senior convertible notes due 2007 (the March Notes) to investor groups in a transaction led by Michigan Venture Capital Co., Ltd, a South Korea-based institutional investment firm, and IndiGo Ventures LLC, a New York-based investment firm (the Placement Agents) that served as a financial advisor to the Company for the transaction. The notes were collateralized by the patents held by the Company and second priority mortgage interest in plant facilities and certain equipment in South Korea. The notes were convertible at any time into common stock at a price of \$3.00 per share. Investors in the private placement and the Placement Agents received warrants to purchase an aggregate amount of up to approximately 1.2 million shares of common stock, exercisable at \$3.00 per share for varying periods but no later than 100 days following the effectiveness of a registration statement covering the resale of shares issuable upon exercise of the warrants. In addition, the investors had the right to call for repayment of the notes prior to maturity at any time after the second anniversary of the closing of the transaction.

Pursuant to Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, EITF 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments, and EITF 05-2 The Meaning of Conventional Convertible Debt Instrument in EITF Issue No. 00-19, the original fair value of the embedded conversion feature of \$7,595 have been recorded as conversion feature liabilities as the debt is considered non-conventional convertible debt. The original fair value was computed using the Black-Scholes model under the following assumptions: (1) expected life of 3 years; (2) volatility of 82%; (3) risk free interest of 2.15% and dividend rate of 0%. The fair value of the conversion feature on the date of issuance has been recorded as debt discount to be amortized over the life the debt.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, the original fair value of the 1.2 million warrants of \$1,302 has been recorded as warrant liabilities as the shares

issuable under the warrants have not been registered. The original fair value was computed using the Black-Scholes pricing model under the following assumptions: (1) expected life of 3 years; (2) volatility of 82%, (3) risk free interest of 0.95% and dividend rate of 0%.

In March 2004, the original fair value of the embedded conversion feature of \$7,595 and the original fair value of the 0.6 million warrants issued to investors of \$584, and the original fair value of 0.6 million warrants issued to Placement Agents of \$718 were recorded as discounts of the convertible note. In addition, \$581 direct costs incurred relating to issuance of the convertible note were recorded as debt issuance cost in other assets.

During 2004, the Company redeemed \$4,465 of the outstanding note balance in cash. The redemption resulted in a write down of debt issuance costs and debt discount of \$3,571 to interest expense and a reduction in conversion feature liabilities of \$914 from cancellation of the embedded conversion feature of the redeemed notes to additional paid in capital during the year ended December 31, 2004. Further, 500,000 of warrants originally issued to a financial advisor for the transaction expired during June 2004 and 163,748 of unexercised warrants originally issued to investors were cancelled as a result of the Company's redemption of the note balances during the year ended December 31, 2004. The 663,748 total expired and canceled warrants immediately prior to the expiration and cancellation resulted in a reduction of warrant liability of \$7 and \$279 to additional paid in capital and change in value of warrants, respectively, during the year ended December 31, 2004.

On August 19, 2004, the Company completed a private exchange offer for its March Notes with the remaining holders after the redemption. Under terms of the exchange offer, approximately \$5.5 million in aggregate principal amount of the March Notes have been exchanged for an aggregate of (i) \$2.75 million of 6% Senior Secured Notes Due 2007 (the Long-Term Notes) and (ii) \$2.75 million of 10% Senior Secured Notes Due 2005 (the Short-Term Notes), collectively referred to as Exchange Notes. The Exchange Notes are collateralized by certain patents owned by the Company and second priority mortgage interest in plant facilities and certain equipment at our South Korea plant. The Short-Term Notes have a maturity date of July 29, 2005, and a conversion price of \$2.00 per share (compared to a conversion price of \$3.00 per share under the March Notes). The Short-Term Notes have been exchanged and redeemed subsequent to the close of the second quarter of 2005 (see Note 14). The Long-Term Notes have a maturity date of July 29, 2007, and a conversion price of \$1.00 per share. Further, the exchange notes are convertible into Common Stock, at the option of the Company, if at any time after the issuance of the notes, the closing per share price of the Common Stock exceeds \$4.00 (as adjusted for stock splits, reverse splits, stock dividends, and recapitalizations) for 30 consecutive trading days, and further provided that there has been effective registration during such period. Holders of the Long-Term Notes also have the right to call for repayment of the Long-Term Notes prior to maturity at any time after the second anniversary of the closing of the exchange offer. The Long-Term Notes have been amended subsequent to the close of the second quarter of 2005 to provide for an Amended Registration Rights Agreement, and Amended and Restated Security Agreement (see Note 14).

A total of 563,151 warrants to purchase our common stock at an exercise price of \$3.00 per share all of which were previously issued in connection with the purchase of the March Notes have been amended to provide for an extended expiration date of March 1, 2006.

The exchange offer was treated as an extinguishment of the March Notes in accordance with Emerging Issues Task Force No. 96-19, Debtors Accounting for a Modification or Exchange of Debt Instruments. The exchange resulted in a \$2,941 loss from extinguishment of the March Notes, which consisted of write down of \$352 of deferred issue costs in other assets, \$670 of debt discount, and an increase of \$1919 in conversion feature liability as a result of the change in carrying value of exchanged notes.

In connection with the private exchange offer, the Company issued \$250 of private placement notes to certain Placement Agents as issuance costs. Of the \$250 notes issued, \$125 was paid in the form of long-term notes which is due in 2007 with interest rate of 6% per annum (Long-Term Notes) and \$125 was paid in the form of short-term notes which is due in 2005 with interest rate of 10% per annum (Short-Term Notes). The Short-Term and Long-Term Notes are convertible into Common Stock at \$2.00 and \$1.00, respectively, and have the same terms as the Exchange Notes issued to the investors. Further, \$143 of original fair value of the embedded conversion feature was recorded as conversion

feature liabilities during August 2004.

The Company was obligated, pursuant to a Registration Rights Agreement, as amended by the Exchange Notes, between the Company, the Placement Agents and the note holders to file a registration statement with the Securities and Exchange Commission (SEC) to register the shares of Common Stock issuable upon conversion of the notes payable and the related warrants within 90 days following the effective closing date of the exchange notes (July 29, 2004), and to use best efforts to cause such registration statement to become effective within 60 days following the SEC's first written comments on the registration statement. Further, if the Company is not in compliance with the registration or listing requirements, the holders have rights to late registration payments equal to between 2 and 3 percent of the purchase price paid for the unconverted notes for the first 30 business days of late registration, and 1 and 3 percent for each 30 business days thereafter, but no more than 18 percent of the purchase price of the unconverted note balance. Late registration fee of \$1,028 has been accrued as interest expense, and is included in accounts payable and accrued liabilities as of June 30, 2005. The \$5,709 balance of the note and un-amortized discounts for conversion feature and warrants of \$3,082 is presented as current liability as of June 30, 2005 as the note holders have the right to call for payment on demand as the registration statement has not been filed in accordance with the amended Registration Rights Agreement. As of the filing of this report, the Company has not received any demands for payment from the note holders.

Interest payments are due quarterly, and failure to make timely interest payments will result in increase in interest rate to 10% and 14% on the 6% and 10% senior convertible notes (Default Rates). The Default Rates became effective on April 1, 2005 from non-payment of a scheduled interest payment. As such, the Company accrued \$171 of additional interest from the default rates applied to the loan balance as of June 30, 2005, which is included in accounts payable and accrued liabilities.

As of June 30, 2005 and December 31, 2004, our gross outstanding loan balance of the Short-Term and Long-Term Notes totaled \$5,709, un-amortized discounts for beneficial conversion feature and warrants totaled \$3,082 and \$2,831, and other asset debt issuance costs totaled \$75 and \$183, respectively. Interest expense for the amortization of debt issuance cost and discount on note was \$483 and \$960 for the three and six months ended June 30, 2005, and \$1,360 and \$1,549 for the three and six months ended June 30, 2004, respectively. As of June 30, 2005, the effective interest rates for the Short-Term and Long-Term Notes were 40% and 37%, respectively.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, the original relative fair values of the warrants of \$1,302 have been recorded as other liability as the Company has not yet filed the registration statement. In addition, the Company is required to report a value of the warrant as a fair value and record the fluctuation to the fair value of the warrant liability to current operations. The change in the fair value of the warrants resulted in a gain of \$154 and \$287 for the three and six months ended June 30, 2005, and a gain of \$694 and \$1,280 for the three and six months ended June 30, 2004. The fair value of warrants outstanding at June 30, 2005 of \$263 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 0.67 years; (2) volatility of 117%, (3) risk free interest of 3.45% and dividend rate of 0%.

Convertible Notes

On June 13, 2005, the Company completed a private placement (the Private Placement) of 10% Convertible Unsecured Notes Due June 13, 2006 in the aggregate principal amount of \$3,250 (the Notes), together with warrants to purchase up to an aggregate of 893,750 shares of the Company's common stock (the Warrants).

The Notes issued by the Company in the Private Placement are unsecured and will become due on the earlier of June 13, 2006 or the consummation of a follow-on equity or debt offering or restructuring transaction pursuant to which the Company receives gross proceeds of at least \$4,000. Prior to maturity, the Notes will be interest-only, with interest payments due quarterly, at the rate of 10% per year. The Notes can be prepaid by the Company at any time without penalty. If, within 120 days following the issue date of the Notes, the Company either fails to redeem the notes for the principal amount and accrued interest thereon or fails to close a Qualified Financing, then the Notes will thereafter be convertible at a conversion price equal to seventy five percent (75%) of the closing price of the Company's common stock on the first trading day

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immediately preceding the conversion date. A Qualified Financing is defined in the Notes as any debt or equity financing of the Company resulting in aggregate gross proceeds to the Company of at least \$5,000 and in which the holders of at least sixty percent (60%) of the aggregate principal amount of the Company's Long Term Notes due July 2007 either (i) agree that the equity or debt securities to be issued in such financing shall be *pari passu* in order of payment to the 2007 Notes held by them or (ii) exchange their 2007 Notes for new securities in the financing transaction. Subsequent to the close of the second

quarter of 2005, the Company successfully completed Qualified Financing, which resulted in exchange and redemption of the Convertible Notes (see Note 14). As a result, the Notes never become convertible.

The holders of the Notes will have the right to call for early repayment of the Notes if, on the date that is 180 days of the issue date of the Notes (i) the Company is not then compliant with its SEC reporting obligations, or (ii) the Company's common stock is not then listed or quoted on the OTC Bulletin Board, Nasdaq Stock Market, New York Stock Exchange, or American Stock Exchange.

As a part of the Private Placement, the Company issued Warrants to the purchasers of the Notes giving them the right to purchase up to an aggregate of 812,500 shares of the Company's common stock. In addition, Warrants to purchase 81,250 shares of the Company's common stock were issued to the placement agent in the transaction. The Warrants have an exercise price of \$2.00 per share, provided that upon the consummation of the first ensuing public or private equity or debt offering or restructuring transaction in which the Company receives gross proceeds of at least \$3,250 (including without limitation any restructuring of the Company's previously issued 10% Senior Secured Notes Due July 29, 2005), the exercise price will be automatically adjusted downward (but not upward) as of the closing date of such offering or restructuring transaction so that it is equal to the lowest effective common stock purchase price paid for any securities issued by the Company to the investors in such offering or restructuring transaction. The Warrants will expire on June 13, 2010.

The fair value of the 893,750 warrants totaled \$1,160 and was computed using the Black-Scholes pricing model under the following assumptions: (1) expected life of 5 years; (2) volatility of 118%, (3) risk free interest of 3.87% and dividend rate of 0%. In accordance with Emerging Issues Task Force No. 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments the embedded beneficial conversion feature of the debt was not recorded as the debt is considered contingently convertible at the time of issuance, and as a result of the completion of the Qualified Financing the debt subsequent to the close of the second quarter, the debt was determined to be not convertible. In June 2005, the fair value of the 812,500 warrants issued to investors of \$1,055 was recorded as discounts of the convertible note. In addition \$105 relating to the fair value of the 81,250 warrants issued to the Placement Agents and \$278 direct costs incurred relating to issuance of the convertible note were recorded as debt issuance cost as a contra liability account in debt discount and other assets, respectively, and will be amortized using the effective interest rate method over the life of the loan. As of June 30, 2005, the gross outstanding loan balance of the Notes totaled \$3,250, un-amortized discounts for warrants totaled \$1,003, and other asset debt issuance costs totaled \$264, and contra liability debt issuance cost totaled \$100. Interest expense for the amortization of debt issuance cost and discount on note was \$71 for the three months ended June 30, 2005. As of June 30, 2005, the effective interest rates for Notes was 54%.

Under a registration rights agreement entered into between the Company and the purchasers of the Notes, the Company is required, within 90 days of the date of the issuance of the Notes, to file a registration statement with the SEC covering the resale of the shares of Company common stock into which the Notes are convertible and for which the Warrants are exercisable. The Company is required to cause this registration statement to become effective within 60 days after the Company receives the first written comments on the registration statement from the SEC, or if the SEC notifies the Company that it will not review the registration statement, within five days after such notification. The Company will be subject to certain monetary penalties, as set forth in the registration rights agreement, if the registration statement is not filed or does not become effective on a timely basis. As the Company was unable to complete the documentation, assessment and evaluation of internal control over financial reporting, which are required to be undertaken to comply with Section 404 of the Sarbanes-Oxley Act of 2002 (SOX 404) as of December 31, 2004, the Company cannot determine the impact of the non-compliance as of December 31, 2004 on the registration statement and cannot ensure that the registration statements will be completed in a timely manner. The Company has taken steps to ensure compliance with SOX 404 requirements as of December 31, 2005. There can be no assurance, however, that the Company will be in compliance with Section 404 as of December 31, 2005 and 2004 and/or that the Company will have the Registration statement declared effective by the SEC prior to such compliance.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, the original relative fair values of the warrants of \$1,160 have been recorded as other liability as the Company has not yet filed the registration statement. In addition, the Company is required to report a value of the warrant as a fair value and record the fluctuation to the fair value of the

warrant liability to current operations. The change in the fair value of

the warrants resulted in a net loss of \$254 for the three months ended June 30, 2005. The fair value of warrants outstanding at June 30, 2005 of \$1,414 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 4.96 years; (2) volatility of 117%, (3) risk free interest of 3.72% and dividend rate of 0%.

Factoring Agreement

The Company entered into a Factoring, Loan, and Security Agreement (the Agreement) with a financing company on April 21, 2005, which allows for borrowings of up to \$1,500. The Agreement expires on April 21, 2006, and automatically renews annually thereafter. All borrowings are secured by outstanding receivables specifically assigned to the financing company. Assigned receivables are considered Approved or

Non-Approved by the financing company. Advances are made on 80% of Approved receivables assigned and 30% of receivables assigned. Payments on assigned receivables are received directly by the financing company, and applied to outstanding advances. All outstanding advances and uncollected assigned receivables are subject to fees and interest charges ranging from 0.65 percent to 2 percent plus prime rate as published by the Wall Street Journal, with a minimum annual fee of \$30. All receivables assigned and advances made are subject to return and recall by the financing company, respectively. As such, the advances have been classified as short-term secured borrowings in accordance with FAS 140 Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities. As of June 30, 2005, the Company has borrowed \$1,222 and repaid \$729. The total outstanding advance made under the agreement is \$493 as of June 30, 2005, which is presented as short-term debt.

Kookmin Note

On February 4, 2003, our Korean subsidiary received 6,500,000 in South Korean Won, or approximately \$5,488, under a loan from Kookmin Bank of South Korea. The loan bears interest at an annual rate of 7.1%. In the event of delayed repayment, the interest increases to a maximum of 21%, depending on the length of time the repayment is delayed. This loan is collateralized by the plant facilities and certain equipment in South Korea. During the first eighteen months from the origination date, interest was payable on a monthly basis. In October 2003, the Company paid \$873 of principal at the request of Kookmin Bank due to the sale of machines that had been part of the collateral on the loan. Subsequent to October 31, 2003, Kookmin Bank requested that the Company pay an additional \$866 of principal by February 2004 due to the Company's current credit rating. The Company made two payments on the requested additional loan pay down in November and December 2003 of \$320 and \$205, respectively. The remaining payment of \$341 was subsequently made in February 2004. Beginning in September 2004, the Company is required to make equal monthly installments of principal and interest to repay the remaining balance of the loan over a 36-month period. Principal payments made to Kookmin Bank totaled \$621 for the six months ended June 2005, which includes \$65 of foreign exchange translation loss. The outstanding loan balance totaled \$3,270, of which \$1,226 is included in current portion of long-term debt, as of June 30, 2005.

9. Stock Compensation Plan

During the three and six months ended June 30, 2005, under the Company's 2002 Equity Incentive Plan which provides for the grant of stock options to officers, employees, consultants and directors, the Company granted options to purchase 7,500 and 891,165 common shares of the Company for an average exercise price of \$1.63 and \$2.21, respectively, which equaled the fair market value on the date of grant

During the three months ended June 30, 2005, under the Company's 2002 Non-employee Director Stock Option Plan which provides for the grant of stock options to non-employee directors, the Company did not grant any options. During the six months ended June 30, 2005, the

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Company granted 180,000 common shares of the Company for an average exercise price of \$2.33 under this plan. Further, all options granted under this plan had exercise prices that were equal to the fair market value on the date of grant.

The Company canceled 84,582 and 244,184 options during the three and six months ended June 30, 2005, respectively, for terminated employees and directors.

10. Segment Reporting and Geographic Information

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, requires companies to provide certain information about their operating segments. In April 2002, the Company began classifying operations into two reportable segments: Liquidmetal alloy industrial coatings and bulk Liquidmetal alloys. The Liquidmetal alloy industrial coatings are used primarily as a protective coating for industrial machinery and equipment, such as drill pipe used by the oil drilling industry and boiler tubes used by coal burning power plants. Bulk Liquidmetal alloys include market opportunities to manufacture and sell casing components for electronic devices, medical devices, sporting goods, tooling, prototype sampling, defense applications and metal processing equipment. Primarily, the expenses incurred by the bulk Liquidmetal alloy segment are research and development costs and selling expenses associated with identifying and developing market opportunities. Bulk Liquidmetal alloys products can be distinguished from Liquidmetal alloy coatings in that the bulk Liquidmetal alloy can have significant thickness, up to approximately one inch, which allows for their use in a wider variety of applications other than a thin protective coating applied to machinery and equipment. Revenue and expenses associated with research and development services and product licensing arrangements are included in the bulk Liquidmetal alloy segment. The accounting policies of the reportable segments are the same as those described in Note 3 to the consolidated financial statements included in the Company's Form 10-K filed with the Securities and Exchange Commission on March 30, 2005.

Summarized financial information concerning the Company's reportable segments is shown in the following tables:

	Coatings	Bulk Alloy	Segment Totals
Three months ended June 30, 2005:			
Revenue to external customers	\$ 1,332	\$ 2,395	\$ 3,727
Gross profit (loss)	574	(809)	(235)
Income (loss) before interest expense and discontinued operations	435	(4,691)	(4,256)
Total identifiable assets at end of period	1,170	17,228	18,398
Three months ended June 30, 2004:			
Revenue to external customers	\$ 706	\$ 3,349	\$ 4,055
Gross profit	327	1,253	1,580
Income before interest expense, discontinued operations, and general	192	619	811
Total identifiable assets at end of period	821	24,702	25,523
Six months ended June 30, 2005:			
Revenue to external customers	\$ 2,381	\$ 4,189	\$ 6,570
Gross profit	1,056	(1,283)	(227)
Income (loss) before interest expense and discontinued operations	762	(5,840)	(5,078)
Total identifiable assets at end of period	1,170	17,228	18,398
Three months ended June 30, 2004:			
Revenue to external customers	\$ 1,722	\$ 8,621	\$ 10,343
Gross profit	795	3,516	4,311
Income before interest expense and discontinued operations	540	2,100	2,640
Total identifiable assets at end of period	821	24,702	25,523

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Reconciling information between reportable segments and the Company's consolidated totals is shown in the following table:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2005 (Restated)	2004 (Restated)	2005 (Restated)	2004 (Restated)
Total operating income (loss) before minority interest, interest expense and discontinued operations	\$ (4,256)	\$ 811	\$ (5,078)	\$ 2,640
General and administrative expenses not allocated to segments	1,153	(2,120)	3,310	(4,624)
Consolidated loss before interest, other income, income taxes, minority interest and discontinued operations	(5,409)	(1,309)	(8,388)	(1,984)
Change in value of warrants, gain (loss)	(100)	694	33	1,280
Change in value of conversion feature, gain	1,167	3,904	2,282	5,614
Interest expense	(1,181)	(2,255)	(2,718)	(2,651)
Interest income	1	22	7	34
Loss from discontinued operations, net		(356)		(749)
Consolidated net income (loss)	\$ (5,522)	\$ 700	\$ (8,784)	\$ 1,544

Excluded general and administrative expenses are attributable to the Company's corporate headquarters. These expenses primarily include corporate salaries, consulting, professional fees and facility costs. Research and development expenses are included in the operating costs of the segment that performed the research and development.

Revenues from sales to companies in the United States were \$1,925 and \$1,328 during the three months ended June 30, 2005 and 2004, respectively. The revenue related to the United States of America was earned under three defense-related research and development contracts and sales of coatings products.

As of June 30, 2005, one customer represented 11%, or \$263, of the total outstanding trade accounts receivable. As of December 31, 2004, two customers represented 30%, or \$497, of the total outstanding trade accounts receivable. Two customers represented 23%, or \$1,535, of total sales for the six months ended June 30, 2005. Three customers represented 55%, or \$5,692, of total sales for the six months ended of June 30, 2004.

During the three months ended June 30, 2005, the Company had revenues from companies outside of the United States of \$1,802 of which \$971 represented sales to companies located in South Korea. During the three months ended June 30, 2004, the Company had revenue from sales to companies outside of the United States of \$2,799 of which \$2,006 represented sales to companies located in South Korea. Of the sales in South Korea, \$72 was from our discontinued equipment manufacturing business. The revenue related to sales to companies outside of the United States was from bulk alloy products including equipment sales.

Long-lived assets include net property, plant, and equipment, and net intangible assets. The Company had long-lived assets of \$1,874 and \$1,594 located in the United States at June 30, 2005 and December 31, 2004, respectively. The Company had long-lived assets of \$14,279 and \$15,422 located in South Korea at June 30, 2005 and December 31, 2004, respectively.

Reconciling information between reportable segments and the Company's consolidated totals is shown in the following table:

	June 30, 2005
Total segment assets	\$ 18,398
Cash and cash equivalents	1,256
Prepaid expenses and other current assets	954
Other property, plant and equipment, net	710
Intangibles, net	1,158
Other assets	816
Total consolidated assets	\$ 23,292

Assets excluded from segment assets include assets attributable to the Company's corporate headquarters. The largest asset represents the Company's intangible assets, consisting primarily of the Company's patents and trademarks.

11. Income (Loss) Per Common Share

Basic earnings per share (EPS) is computed by dividing earnings (loss) attributable to common shareholders by the weighted average number of common shares outstanding for the periods. Diluted EPS reflects the potential dilution of securities that could share in the earnings. Common stock equivalents consist of 9,828,208 and 8,308,922 equity instruments and 6,973,877 and 3,457,894 senior equity convertible debt instruments at June 30, 2005 and 2004, respectively, and have not been included in the EPS calculation at June 30, 2005 and 2004 as the amounts are anti-dilutive.

12. Commitments and Contingencies

In September 2004, as part of a security agreement to finance a certain insurance policy, the Company used certificates of deposits with maturities of less than one year as collateral. The \$754 held in certificates of deposits is presented as restricted cash at December 31, 2004. During the quarter ended March 31, 2005, the certificate of deposits was liquidated and the proceeds were used to paydown the balance of the financing on the insurance policy.

In August 2004, the Company entered into a consulting agreement whereby the Company was to receive services from a third party to improve the Company's bulk alloy manufacturing process. The service is to be provided from August 2004 through October 2005. The total amount of service fees is \$172, of which \$15 was included in trade accounts payable as of June 30, 2005. As of December 31, 2004, the total amount of outstanding balance included in trade accounts payable was \$15.

The Company is from time to time a party to certain legal proceedings arising in the ordinary course of business. Although outcomes cannot be predicted with certainty, the Company does not believe that any legal proceeding to which it is a party will have a material adverse effect on the Company's financial position, results of operations, and cash flows.

Liquidmetal Technologies and certain of its present and former officers and directors were named as defendants in nine purported class action complaints filed in the United States District Courts for the Middle District of Florida, Tampa Division, and the Central District of California, Southern Division, alleging violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. In August 2004, four complaints were consolidated in the United States District Court for the Middle District of Florida under the caption *Primavera Investors v. Liquidmetal Technologies, Inc., et al.*, Case No.

8:04-CV-919-T-23EAJ. John Lee, Chris Cowley, Dwight Mamanteo, Scott Purcell and Mark Rabold, were appointed co-lead plaintiffs (the Lead Plaintiffs). In September 2004, the other five complaints filed in the Central District of California were transferred to the Middle District of Florida for consolidation with the *Primavera Investors* action. The Lead Plaintiffs served their Consolidated Amended Class Action Complaint on January 12, 2005. The Amended Complaint alleges that the Prospectus issued in connection with the Company's initial public offering in May 2002 contained material misrepresentations and omissions regarding the Company's historical financial condition and regarding a personal stock transaction by the Company's chief executive officer. The Lead Plaintiffs further generally allege that

during the proposed Class Period of May 21, 2002, through May 13, 2004, the defendants engaged in improper revenue recognition with respect to certain of the Company's business transactions, failed to maintain adequate internal controls, and knowingly disclosed unrealistic but favorable information about market demand for and commercial viability of the Company's products to artificially inflate the value of the Company's stock. The Amended Complaint seeks unspecified compensatory damages and other relief. We filed a Motion to Dismiss on March 29, 2005. Plaintiffs' response to our Motion to Dismiss was filed on June 3, 2005. The Company cannot anticipate when the Court will rule on the Motion to Dismiss. The Company intends to vigorously defend against the class action. The Company cannot currently predict the impact or resolution of this litigation or reasonably estimate a range of possible loss, which could be material.

In addition to the above, certain present and former officers and directors of Liquidmetal Technologies, as well as Liquidmetal Technologies as a nominal defendant, have been named in three shareholder derivative actions. Two shareholder derivative complaints were filed in California state court styled Brian Clair, Derivatively on Behalf of Liquidmetal Technologies, Inc. v. John Kang, et al., Case No. 04CC00551, and Joseph Durgin, Derivatively on Behalf of Liquidmetal Technologies, Inc. v. John Kang, et al., Case No. 04CC00553, both commenced in the Superior Court of Orange County, California. A third shareholder derivative complaint was filed in Florida federal court styled Robert Story v. John Kang, et al., Case No. 8:04-CV-1587-T23TBM, commenced in the Middle District of Florida, Tampa Division. These shareholder derivative lawsuits allege that the defendants breached various fiduciary duties and otherwise violated state law based primarily upon the same underlying facts and circumstances as alleged in the federal shareholder class action. The plaintiffs seek unspecified compensatory damages, restitution and disgorgement of profits, equitable and/or injunctive relief as permitted by law and other relief. The two shareholder derivative complaints in California state court have been consolidated. Plaintiffs served a Consolidated Shareholder Derivative Complaint on October 12, 2004. The defendants served a Demurrer to the Consolidated Shareholder Derivative Complaint on November 22, 2004, seeking dismissal of that complaint. At a hearing on February 10, 2005, the court sustained the demurrer, dismissing the Consolidated Shareholder Derivative Complaint but giving the plaintiffs 45 days within which to amend the complaint. Plaintiffs filed their Consolidated Amended Shareholder Derivative Complaint on March 28, 2005. The Company, along with other defendants, filed a Demurrer on May 17, 2005. The Court sustained the demurrer at a hearing on July 7, 2005, again dismissing the complaint but giving the plaintiffs 40 days within which to further amend the complaint. Separately, the plaintiffs moved to compel the Company to respond to certain written discovery on March 7, 2005. The Motion to Compel was granted on April 28, 2005. The class action defendants subsequently filed a Motion to Stay Discovery in Related State Action on June 9, 2005. The plaintiffs filed a Memorandum of Law in Opposition to the Defendants' Motion to Stay on June 20, 2005. The Motion to Stay is pending. By stipulation, if the Motion to Stay is denied, the Company will be required to respond to the written discovery and produce documents within 10 days of the court's ruling on the Motion. In the Florida derivative action, the Plaintiff filed a First Amended Shareholder Derivative Complaint on November 22, 2004. The Company's Motion to Dismiss, which was filed on December 20, 2004, is fully briefed. The Company cannot anticipate when the Court will rule on the Motion to Dismiss. The Company intends to vigorously defend against the derivative actions. We cannot currently predict the impact or resolution of this litigation or reasonably estimate a range of possible loss, which could be material.

As of June 30, 2005, the Company has accrued \$626 as receivables from insurance companies from excess legal costs incurred to defend against the class action and derivative lawsuits. The amount is included in prepaid expenses and other current assets.

In March 1996, the Company entered into a distribution agreement whereby it granted to a third party exclusive rights to market and sell golf products incorporating Liquidmetal Technology to certain Japanese sporting equipment companies. The third party paid the Company a \$1.0 million distribution fee as part of this agreement, of which a portion was refundable according to a formula based on the gross profit earned by the third party. On March 28, 2003, the distribution agreement was terminated and the Company entered into a new agreement to pay to the same third party a commission on the net sales price of all Liquidmetal golf equipment that is shipped by the Company or its affiliates to Japanese golf companies for sale into the Japanese end-market. This commission will apply to golf equipment shipped by the Company or its affiliates during the period beginning on March 28, 2003 and ending on March 28, 2006. If, by March 28, 2006, the Company has not paid \$350 in commission payments, the balance between commission paid and \$350 will be paid by April 30, 2006, thereby guaranteeing the third party a \$350 minimum payment during the term of the agreement. The Company will recognize the

unearned distribution fee of \$830 as revenue proportionately with the payment of commissions under the new agreement. As of June 30, 2005 and December 31, 2004, the unearned distribution fee remained unchanged at \$830.

Under terms of the January 2004 settlement of the dispute over certain sales transactions from 2003 and 2002 between Liquidmetal Korea and Growell Metal Co., Ltd., a South Korean metals processing company (Growell), Liquidmetal Korea agreed to pay Growell \$4,895 to purchase Growell's investment in alloy inventories, proprietary alloying equipment purchased from Liquidmetal Korea, and supporting equipment purchased from other suppliers. Also as part of the settlement, Growell satisfied in full a balance of \$2,058 owed to Liquidmetal Korea for the die casting machines Growell purchased from Liquidmetal Korea in the first quarter of 2003 as part of a license agreement to manufacture Liquidmetal alloy parts for the South Korean automotive industry. The remaining settlement payable of \$2,837 and trade accounts payable of \$14 were to be paid to Growell (in cash or stock at the Company's discretion) by December 31, 2004. As of December 31, 2004, the settlement payable of \$3,246, net of foreign exchange translation loss, was not paid to Growell due to Growell's breach of warranty on equipment repurchased by Liquidmetal Korea. In January 2005, Growell was acquired by a third party. As of June 30, 2005, the outstanding settlement payable to the third party of \$3,294, net of foreign exchange translation loss, was not paid, and the Company is currently in negotiations to settle this balance with the third party.

13. Related Party Transactions

In June 2003, the Company entered into an exclusive, ten-year license agreement with LLPG, Inc. (LLPG), a corporation headed by a former director of the Company. Under the terms of the agreement, LLPG has the right to commercialize Liquidmetal alloys, particularly precious-metal based compositions, in jewelry and high-end luxury product markets. The Company, in turn, will receive royalty payments over the life of the contract on all Liquidmetal products produced and sold by LLPG. In conjunction with its technology licensing contract, LLPG purchased two proprietary Liquidmetal alloy melting machines and three proprietary Liquidmetal alloy casting machines for a total purchase price of \$2,000. At December 31, 2003, the Company had a remaining receivable balance of \$500 due from LLPG, which was subsequently paid in full in March 2004.

We are a party to a consulting agreement with Chitnis Consulting, Inc., which is owned 100% by Shekhar Chitnis, a former director and executive officer of our company. Under this agreement, we have engaged Chitnis Consulting to provide consulting services on an as-needed basis through December 31, 2005. During each of the three and six months ended June 30, 2005 and 2004, we incurred \$13 and \$25, respectively, in consulting fees from Chitnis Consulting.

We are a party to a consulting agreement with William Johnson, a board member. Under this agreement, Mr. Johnson provides consulting services on an as-needed basis through 2004 as it relates to marketing and development Liquidmetal alloy. During the three and six months ended June 30, 2005, we incurred \$5 and \$10 in consulting fees from Mr. Johnson, respectively. During the three and six months ended June 30, 2004, we incurred \$14 in consulting fees from Mr. Johnson, respectively.

In November 2004, we entered into an agreement with John Kang, our Chairman, President, and Chief Executive Officer, in which Mr. Kang agreed that certain stock transactions by him in 2002 involving our common stock should have resulted in a liability under Section 16(b) of the Securities Exchange Act of 1934, as amended (Section 16(b)). These transactions include Mr. Kang's private sale of 285,715 shares of his personal Liquidmetal Technologies common stock to Growell Metal Co., Ltd. in February 2002, prior to our initial public offering. They also include Mr. Kang's subsequent indirect purchase and disposition of Liquidmetal Technologies common stock in order to satisfy a personal agreement Mr. Kang made to Growell Metal in February 2002 regarding the guaranteed minimum value of the stock purchased by Growell Metal in February 2002 (the purchases and dispositions incident to this agreement occurred in August and November 2002, respectively). Lastly, the transactions include open-market purchases of an aggregate of 89,300 shares of our common stock made by Mr. Kang in August 2002.

The Audit Committee of our Board of Directors conducted an independent inquiry into the above-described transactions with the aid of independent legal counsel and, as a result of such inquiry, the Audit Committee concluded that the transactions should have resulted in a liability to the Company under Section 16(b) in the amount of \$302. Mr. Kang has acknowledged this liability, and in an agreement negotiated between Mr. Kang and the Audit Committee and approved by the full Board, Mr. Kang will pay this liability through periodic installments in 2005 and 2006. As a result, the Company accrued for the \$302

receivable in other assets and other income as of December 31, 2004. The above-described transactions involving Growell Metal was reported on a new Form 4 filed by Mr. Kang on November 15, 2004, and the open-market purchases were previously reported on a timely basis in August 2002. As of June 30, 2005, the outstanding amount of the receivable was \$235, which is included in other assets. Mr. Kang has paid approximately \$67 as of June 30, 2005 and will make monthly installments of approximately \$12 to pay down the outstanding balance.

During the period ended June 30, 2005, the Company borrowed approximately \$198 from CK Cho, a member of our Board of Directors for working capital purposes. The note was due and paid in full as of June 30, 2005. The note has an annual rate of interest of 6% resulting in the Company paying approximately \$2 in interest. Mr. Cho also is a Chief Executive Officer of Winvest Venture Partners Inc., who holds \$500 of Senior Convertible Notes as of June 30, 2005 (see Note 8).

14. Subsequent Events

On August 9, 2005, the Company completed a private placement (the Private Placement) of \$9,877 in principal amount of new 7% Convertible Secured Promissory Notes due August 2007 (the Notes). The issuance consisted of \$5,000 cash, exchange of \$1,284 in principal amount of previously issued 10% Senior Secured Notes Due July 29, 2005 (the July 2005 Notes), the exchange of \$2,996 in principal amount of previously issued 10% Convertible Unsecured Notes Due June 2006 (the June 2006 Notes), and satisfaction of accrued interest and late registration fees in the amount of \$597 on the previously issued notes by the Company. The Notes were issued pursuant to a Securities Purchase Agreement dated effective as of August 2, 2005 among the Company, the purchasers of the Notes, and the holders of previously issued Senior Convertible Notes and Convertible Notes of the Company (see Note 8). The Notes are convertible into shares of the Company's common stock at \$2.00 per share Pursuant to an Amended and Restated Security Agreement. The Notes are secured by substantially all assets of the Company and rank senior to all other obligations of the Company, other than the Company's loan with Kookmin Bank of South Korea (or any refinancing of such loan), the 6% Senior Convertible Notes due July 2007, and the receivable based financing arrangement. The Company also issued Warrants to the purchasers of the Notes and placement agents giving them the right to purchase up to 2,469,175 and 384,808 shares of Company common stock, respectively, with an exercise price of \$2.00 per share. The Warrants will expire on August 2, 2010. The fair value of the warrants issued totaled \$4,024 as of effective date of the Notes, and was computed using the Black-Scholes pricing model under the following assumptions: (1) expected life of 5 years; (2) volatility of 93%; (3) risk free interest of 4.12% and dividend rate of 0%. Further, the beneficial conversion feature of the Notes approximated \$3,185 as of the effective date of the Note. As of the date of the report, the Company has not yet completed the analysis for the accounting treatment of the Notes on its financial statements. The Company estimates write-downs and net loss in regards to this transaction to be approximately \$1,500 to \$2,000.

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

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This management's discussion and analysis should be read in conjunction with the condensed consolidated financial statements and notes included elsewhere in this report on Form 10-Q.

This management's discussion and analysis, as well as other sections of this report on Form 10-Q, may contain forward-looking statements that involve risks and uncertainties, including statements regarding our plans, future events, objectives, expectations, forecasts, or assumptions. Any statement that is not a statement of historical fact is a forward-looking statement, and in some cases, words such as believe, estimate, project, expect, intend, may, anticipate, plans, seeks, and similar expressions identify forward-looking statements. These statements involve risks and uncertainties that could cause actual outcomes and results to differ materially from the anticipated outcomes or results, and undue reliance should not be placed on these statements. These risks and uncertainties include, but are not limited to, the matters discussed under the caption Factors Affecting Future Results in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004 and other risks and uncertainties discussed in filings made with the Securities and Exchange Commission (including risks described in subsequent reports on Form 10-Q, Form 10-K, Form 8-K, and other filings). Liquidmetal Technologies disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Overview

We are a materials technology company that develops and commercializes products made from amorphous alloys. Our Liquidmetal® family of alloys consists of a variety of coatings, powders, bulk alloys, and composites that utilize the advantages offered by amorphous alloy technology. We develop, manufacture, and sell products and components from bulk amorphous alloys that are incorporated into the finished goods of our customers, and we also market and sell amorphous alloy industrial coatings. We also partner with third-party licensees and distributors to develop and commercialize Liquidmetal alloy products. We have the exclusive right to develop, manufacture, and sell what we believe are the only commercially viable bulk amorphous alloys.

Amorphous alloys are unique materials that are distinguished by their ability to retain a random atomic structure when they solidify, in contrast to the crystalline atomic structure that forms in ordinary metals and alloys when they solidify. Liquidmetal alloys possess a combination of performance, processing, and cost advantages that we believe makes them preferable to other materials in a variety of applications. The amorphous atomic structure of our alloys enables them to overcome certain performance limitations caused by inherent weaknesses in crystalline atomic structures, thus facilitating performance and processing characteristics superior in many ways to those of their crystalline counterparts. For example, our zirconium-titanium Liquidmetal alloys are approximately 250% stronger than commonly used titanium alloys, such as Ti-6Al-4V, but they have processing characteristics similar in many respects to plastics. We believe these advantages could result in Liquidmetal alloys supplanting other incumbent materials in a wide variety of applications. Moreover, we believe these advantages will enable the introduction of entirely new products and applications that are not possible or commercially viable with other materials.

Our revenues are derived from two principal operating segments: Liquidmetal alloy industrial coatings and bulk Liquidmetal alloy products. Liquidmetal alloy industrial coatings are used primarily as a protective coating for industrial machinery and equipment, such as drill pipe used by the oil drilling industry and boiler tubes used in coal-burning power plants. The historical operating information for fiscal year 2001 is based substantially on sales of Liquidmetal alloy coatings. In the second half of 2002, we began producing bulk Liquidmetal alloy components and products for incorporation into our customers' finished goods. Bulk Liquidmetal alloy segment revenue includes sales of parts or components of electronic devices, medical products, and sports and leisure goods; tooling and prototype parts (including demonstration parts and test samples) for customers with products in development, product licensing and arrangements, and research and development revenue relating primarily to defense and medical applications. We expect that these sources of revenue will continue to significantly change the character of our revenue mix.

The cost of sales for our Liquidmetal coatings segment consists primarily of the costs of outsourcing our manufacturing to third parties. Consistent with our expectations, our cost of sales has been increasing over historical results as we further build our bulk Liquidmetal alloy business. Although we plan to continue outsourcing the manufacturing of our coatings, we will internally manufacture many products derived from our bulk Liquidmetal alloys.

Selling, general, and administrative expenses currently consist primarily of salaries and related benefits, severance costs, travel, consulting and professional fees, depreciation and amortization, insurance, office and administrative expenses, and other expenses related to our operations.

Research and development expenses represent salaries, related benefits expense, stock-based compensation, depreciation of research equipment, consulting and contract services, expenses incurred for the design and testing of new processing methods, expenses for the development of sample and prototype products, and other expenses related to the research and development of Liquidmetal alloys. Costs associated with research and development activities are expensed as incurred. We plan to enhance our competitive position by improving our existing technologies and developing advances in amorphous alloy technologies. We believe that our research and development efforts will focus on the discovery of new alloy compositions, the development of improved processing technology, and the identification of new applications for our alloys.

On August 4, 2004, the Company established a plant in the city of Weihai in Shandong province of China under Weihai Liquidmetal Company Limited, which is 100 percent owned by Liquidmetal Korea, to facilitate our bulk alloy manufacturing business. Weihai Liquidmetal is consolidated into Liquidmetal Technologies with all intercompany transactions eliminated.

The following discussion and analysis of our financial condition and results of operations focuses on the historical results of our continuing operations.

Critical Accounting Policies and Estimates

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The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect 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 period. These estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions.

We believe that the following accounting policies are the most critical to our condensed consolidated financial statements since these policies require significant judgment or involve complex estimates that are important to the portrayal of our financial condition and operating results:

- Exchange rate fluctuations
- Warranty accrual
- Allowance for doubtful accounts
- Inventories at lower of cost or net realizable value
- Deferred tax assets
- Valuation of derivatives of warrants and embedded conversion features

Our 10-K Report as of December 31, 2004 contains further discussions on our critical accounting policies and estimates.

Results of Operations

Comparison of the three months ended June 30, 2005 and 2004

Revenue. Revenue decreased \$0.3 million to \$3.7 million for the three months ended June 30, 2005 from \$4.0 million for the three months ended June 30, 2004. The decrease consisted of a decrease of \$0.6 million from the sales and prototyping of parts manufactured from bulk Liquidmetal alloys to consumer electronics customers as a result of decreased demand for conventional hinge components used in certain cellular phone models, and a decrease of \$0.2 million from decreased activity from research and development services related primarily to defense applications, offset by an increase of \$0.6 million from sales of our coatings products.

Cost of Sales. Cost of sales increased to \$4.0 million, or 106% of revenue, for the three months ended June 30, 2005 from \$2.5 million, or 61% of revenue, for the three months ended June 30, 2004. The increase was a result of decreases in bulk Liquidmetal alloy business. Cost of sales as a percentage of revenue has increased as a result of lower business volumes generated from our bulk Liquidmetal alloys. Significant portion of our manufacturing costs continue to remain fixed. We

believe that higher manufacturing volumes and greater mix of higher-margin products in the future will cause the gross profit to improve over time. The cost to manufacture parts from our bulk Liquidmetal alloys is variable and differs based on the unique design of each product. However, the cost of sales for the products sold by the coatings business segment is generally consistent because the Liquidmetal coatings products are produced by third parties and sold wholesale to various industries.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses decreased to \$1.6 million, or 42% of revenue, for the three months ended June 30, 2005 from \$2.5 million, or 63% of revenue, for the three months ended June 30, 2004. This decrease was primarily a result of decrease professional services by \$0.8 million, decrease in bad debt expense of \$0.1 million, and decrease in depreciation, travel expenses, and product warranty costs of \$0.1 million, offset by an increase in insurance costs by \$0.1 million. These and other decreases in selling, general and administrative expenses represent the Company's efforts to manage costs and focus on our core business while continuing to build our corporate infrastructure required to prepare for and support the anticipated growth of our bulk Liquidmetal alloy business.

Research and Development Expenses. Research and development expenses decreased to \$0.2 million, or 6% of revenue, for the three months ended June 30, 2005 from \$0.3 million, or 9% of revenue, for the three months ended June 30, 2004. The Company continues to perform research and development of new Liquidmetal alloys and related processing capabilities, develop new manufacturing techniques, and contract with consultants to advance the development of Liquidmetal alloys. The decrease was primarily due to decreases in salaries, wages and the related costs by \$0.1 million.

Impairment of Long Lived Assets. Impairment of long lived assets increased to \$3,394, or 91% of revenue, for the three months ended June 30, 2005 from \$0 for the three months ended June 30, 2004. Impairment expense represents write-down of \$1,653 of raw materials considered to be long term inventory and \$1,741 of idle equipment. While we may use the excess raw materials beyond one year to fulfill future demand, we cannot currently foresee use of this inventory in the foreseeable future. Further, while we have marketed the idle equipment for ultimate sale since early 2004, we were unable to sell this equipment. In addition, while the equipment may be used internally to meet future capacity requirements, considering our current revenue, we do not anticipate utilizing this equipment internally in the near future. As such, we have reduced the carrying values of the excess raw material and idle equipment.

Change in Value of Warrants. Change in value of warrants was a loss of \$0.1 million, or 3% of revenue, and a gain of 0.7 million, or 17% of revenue, for the three months ended June 30, 2005 and 2004, respectively, from change in valuation of warrant liabilities from the warrants issued from the senior convertible debt funded in March 2004 and exchanged in August 2004 and convertible debt issued in June 2005 primarily as a result of fluctuations in our stock price.

Change in Value of Conversion Feature. Change in value of our conversion feature liability from our senior convertible debt funded in March 2004 and exchanged in August 2004 resulted in a change in value of conversion feature gain of \$1.2 million, or 31% of revenue, and a gain of \$3.9 million, or 96% of revenue, during the three months ended June 30, 2005 and 2004, respectively, primarily due to fluctuation in our stock price.

Interest Expense. Interest expense was \$1.2 million, or 32% of revenue, for the three months ended June 30, 2005 and was \$2.3 million, or 56% of revenue, for the three months ended June 30, 2004. During each of the three months ended June 30, 2005 and 2004, the interest expense was primarily due to the interest accrued on the Kookmin Bank loan funded on February 4, 2003, senior convertible debt funded on March 3, 2004 and exchanged in August 2004, and convertible debt funded on June 13, 2005, as well as amortization of debt issuance costs and discount on the senior convertible debt funded in March 2004 and exchanged in August 2004 and convertible debt funded on June 13, 2005. The decrease was primarily due to acceleration of amortization of debt issuance costs and discount on debt during the three months ended June 30, 2004 from principal payments made. During the three months ended June 30, 2005, \$0.2 million of interest expense was accrued from default interest rates applied to the senior convertible notes effective April 1, 2005 from non payment of quarterly scheduled interest payments (see Item 3 Defaults Upon Senior Securities, Part II).

Interest Income. Interest income was \$1 thousand for the three months ended June 30, 2005, and \$22 thousand for the three months ended June 30, 2004 from interest earned on cash deposits. The decrease was primarily due to decrease in deposits held.

Comparison of the six months ended June 30, 2005 and 2004

Revenue. Revenue decreased \$3.8 million to \$6.6 million for the six months ended June 30, 2005 from \$10.3 million for the six months ended June 30, 2004. The decrease included a \$2.6 million decrease from restatement of revenues from 2003 to 2004 as a part of our 2003 financial statement restatement which resulted in one-time recognition of revenues during the first quarter of 2004, a decrease of \$1.2 million from the sales and prototyping of parts manufactured from bulk Liquidmetal alloys to consumer electronics customers as a result of decreased demand for conventional hinge components used in certain cellular phone models, and a decrease of \$0.6 million from decreased activity from research and development services related primarily to defense applications, offset by an increase of \$0.6 million from sale of our coatings products.

Cost of Sales. Cost of sales increased to \$6.8 million, or 103% of revenue, for the six months ended June 30, 2005 from \$6.0 million, or 58% of revenue, for the six months ended June 30, 2004. The increase was a result of decreases in bulk Liquidmetal alloy business. Cost of sales as a percentage of revenue has increased as a result of lower business volumes generated from our bulk Liquidmetal alloys. Significant portion of our manufacturing costs continue to remain fixed. We believe that higher manufacturing volumes and greater mix of higher-margin products in the future will cause the gross profit to improve over time. The cost to manufacture parts from our bulk Liquidmetal alloys is variable and differs based on the unique design of each product. However, the cost of sales for the products sold by the coatings business segment is generally consistent because the Liquidmetal coatings products are produced by third parties and sold wholesale to various industries.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses decreased to \$4.2 million, or 63% of revenue, for the six months ended June 30, 2005 from \$5.6 million, or 54% of revenue, for the six months ended June 30, 2004. This decrease was primarily a result of decrease in wages and related expense by \$0.2 million, decrease in bad debt expenses by \$0.1 million, decrease in professional and contracted services of \$0.7 million, decrease in advertising and promotions expense by \$0.2 million, and decrease in telephone and communication expense by \$0.1 million, offset by an increase in insurance costs by \$0.2 million. These and other decreases in selling, general and administrative expenses represent the Company's efforts to manage costs and focus on our core business while continuing to build our corporate infrastructure required to prepare for and support the anticipated growth of our bulk Liquidmetal alloy business.

Research and Development Expenses. Research and development expenses decreased to \$0.6 million, or 9% of revenue, for the six months ended June 30, 2005 from \$0.7 million, or 7% of revenue, for the six months ended June 30, 2004. The Company continues to perform research and development of new Liquidmetal alloys and related processing capabilities, develop new manufacturing techniques, and contract with consultants to advance the development of Liquidmetal alloys. The decrease was primarily due to decrease in laboratory and prototype supplies used by \$0.1 million.

Impairment of Long Lived Assets. Impairment of long lived assets increased to \$3,394, or 91% of revenue, for the six months ended June 30, 2005 from \$0 for the six months ended June 30, 2004. Impairment expense represents write-down of \$1,653 of raw materials considered to be long term inventory and \$1,741 of idle equipment. While we may use the excess raw materials beyond one year to fulfill future customer order, we have determined that our current capacity was not significant enough to warrant holding this inventory as a long term asset. Further, while we have actively marketed the idle equipment for ultimate sale since early 2004, we were unable to sell this equipment. In

addition, while the equipment may be used internally to meet future capacity requirements, considering our current revenue, we do not anticipate utilizing this equipment internally in the near future. As such, we have reduced the carrying values of the excess raw material and idle equipment.

Change in Value of Warrants. Change in value of warrants was a gain of \$33 thousand, or 1% of revenue, and a gain of \$1.3 million, or 12% of revenue, during the six months ended June 30, 2005 and 2004, respectively, from change in valuation of warrant liabilities from the warrants issued from the senior convertible debt funded in March 2004 and exchanged in August 2004, and convertible debt funded in June 2005 primarily as a result of fluctuations in our stock price.

Change in Value of Conversion Feature. Change in value of our conversion feature liability from our senior convertible debt funded in March 2004 and exchanged in August 2004 resulted in a change in value of conversion feature gain of \$2.3 million, or 35% of revenue, and a gain of \$5.6 million, or 54% of revenue, during the six months ended June 30, 2005 and 2004, respectively, primarily due to fluctuation in our stock price.

Interest Expense. Interest expense was \$2.7 million, or 41% of revenue, for the six months ended June 30, 2005 and was \$2.7 million, or 26% of revenue, for the six months ended June 30, 2004. During each of the six months ended June 30, 2005 and 2004, the interest expense was primarily due to the interest accrued on the Kookmin Bank loan funded on February 4, 2003, senior convertible debt funded on March 3, 2004 and exchanged in August 2004, and convertible debt funded on June 13, 2005, as well as amortization of debt issuance costs and discount on the senior convertible debt funded in March 2004 and exchanged in August 2004, and convertible debt funded on June 13, 2005. As of June 30, 2005, \$0.2 million of interest

expense was accrued from default interest rates applied to the senior convertible notes effective April 1, 2005 from non payment of quarterly scheduled interest payments and \$1.0 million of late registration penalty fee of our senior convertible debt was accrued as interest expense (see Item 3 Defaults Upon Senior Securities, Part II). The increase in interest expense was primarily due to increases costs accrued for penalties during the six months ended June 30, 2005.

Interest Income. Interest income was \$7 thousand for the six months ended June 30, 2005, and \$34 thousand for the six months ended June 30, 2004 from interest earned on cash deposits. The decrease was primarily due to decrease in deposits held.

Liquidity and Capital Resources

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Our cash used in operating activities was \$3.6 million for the six months ended June 30, 2005 and \$5.6 million, which includes cash used in our discontinued equipment manufacturing business of \$0.8 million, for the six months ended June 30, 2004. Our working deficit increased from \$14.9 million at December 31, 2004 to \$19.0 million at June 30, 2005. The Company's working deficit increase of \$4.1 million was primarily attributable to decrease in restricted cash of \$0.8 million, decrease in current inventories of \$0.2 million, increase in accounts payable and accrued liability of \$2.1 million, increase in current portion of long term debt of \$3.1 million, increase in short-term debt of \$0.5 million, increase in warrant liabilities of \$1.1 million, increase in deferred revenues and settlement payable of \$0.1 million, offset by increase in cash of \$0.5 million, increase in accounts receivable of \$0.7 million, decrease in conversion feature liabilities of \$2.3 million, and a decrease in current portion of other liability of \$0.3 million.

Our cash used in investing activities was \$0.1 million for the six months ended June 30, 2005 for the acquisition of property and equipment and investments in patents and trademarks.

Our cash provided by financing activities was \$3.8 million for the six months ended June 30, 2005, which consists of \$0.8 million in proceeds from restricted cash and \$3.2 million in proceeds from convertible debt funded on June 13, 2005, \$1.2 million in proceeds from factoring agreement executed in April 2005, and \$0.2 million in proceeds from borrowings from our short term debt executed in March 2005, offset by \$1.6 million on repayment of borrowings.

We anticipate that our capital expenditures will be approximately less than \$0.5 million for the full year 2005 for the acquisition of furniture, fixtures, and other business equipment. This amount is subject to change, however, depending upon the nature and the amount of the product orders that we actually receive from customers.

Our capital requirements during the next twelve months will depend on numerous factors, including the success of existing products either in manufacturing or development, the development of new applications for Liquidmetal alloys, the resources we devote to develop and support our Liquidmetal alloy products, the success of pursuing strategic licensing and funded product development relationships with external partners, and the cost of successful implementation of Section 404 of the Sarbanes-Oxley Act of 2002. During the next twelve months, based on our current business plan, we expect to have sufficient resources to continue to devote limited capital to our research and development activities, to further develop and strengthen our manufacturing technology, and to provide for working capital and other general corporate purposes. However, based on our historical operating results and the continued development of our manufacturing capabilities and alloy compositions, there exists the possibility that these resources will not be adequate to operate at the proposed business plan levels. These expenses and capital expenditures could consume a material amount of our cash resources, but the amount of these requirements will depend on the nature and amount of orders we receive for the purchase of our bulk Liquidmetal alloy products.

Our business is based on commercializing an entirely new and unique technology, and our current business plan contains a variety of assumptions and expectations that are subject to uncertainty, including assumptions and expectations about order flow, unit volumes, manufacturing efficiencies, product cost and pricing, continuing technology improvements, customer adoption practices, strategic licensing relationships and other relevant matters. These assumptions take into account recent significant cost reductions, as well as recent improvements to our manufacturing processes. We have experienced losses from continuing operations during the last two fiscal years and have an accumulated deficit of \$135.8 million as of June 30, 2005. At June 30, 2005, our principal source of liquidity was \$1.3 million of cash and cash equivalents and trade accounts receivables of \$2.4 million. Such conditions raise substantial doubt that our Company will be able to continue as a going concern for a reasonable period of time without receiving additional funding. These operating results occurred while we were developing and attempting to commercialize and manufacture products from an entirely new and unique technology. This business plan required significant spending related to start-up costs and capital expenditures. These factors have placed a

significant strain on our financial resources. The ultimate success of the Company depends on our ability to continue to reduce operating costs, generate higher revenue, achieve positive cash flow from continuing operations and achieve profitability.

Additionally, the Company is not in compliance with certain covenant requirements of our senior convertible debt as of June 30, 2005. Although there has been no formal notice of default received from the note holders, as the note holders have the right to call for repayment of the outstanding balance of the senior convertible debt, the total outstanding debt balance of \$5,709 have been included as current liabilities as of June 30, 2005. Further, \$0.2 million of interest expense was accrued from default interest rates applied to the senior convertible notes effective April 1, 2005 from non-payment of quarterly scheduled interest payments as of June 30, 2005. (See Item 3 Defaults Upon Senior Securities, Part II)

Our future success depends on our ability to continue reducing operating costs and ultimately to generate higher revenue and attain profitability. We cannot be certain that additional capital, whether through selling additional debt or equity securities or obtaining a line of credit or other loan, will be available to us or, if available, will be on terms acceptable to us. If we issue additional securities to raise funds, these securities may have rights, preferences, or privileges senior to those of our common stock, and our current stockholders may experience dilution.

Contractual Obligations

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The following table summarizes the Company's obligations and commitments as of June 30, 2005:

Contractual Cash Obligations (1)	Total	Payments Due by Period (in thousands)			
		Less Than 1 Year	1-3 Years	3-5 Years	After 5 Years
Long-term debt (2)	\$ 12,229	\$ 10,185	\$ 2,044	\$	\$
Short-term debt (3)	493	493			
Capital lease obligation (4)	142	67	75		
Operating leases and rents	1,180	239	762	178	1
Growell settlement payable (5)	3,294	3,294			
Consulting services payable	60	60			
Dongyang payable	11	11			
	\$ 17,409	\$ 14,349	\$ 2,881	\$ 178	\$ 1

(1) Contractual cash obligations include Long-Term Debt comprised of \$5,709 of Senior Convertible Notes issued in 2004, \$3,250 of Convertible Notes issued in 2005, and \$3,270 of Kookmin Notes, Short-Term Debt comprised of \$493 advances received under factoring, loan, and security agreement, and future minimum lease payments under capital and operating leases, liabilities incurred from settlement with a former customer (Growell) and divestiture of our equipment manufacturing business, and purchase commitments from a consultant.

(2) Does not include interest payments of \$1,369, un-amortized discounts for conversion feature and warrants of \$3,082 of our convertible notes.

(3) Does not include minimum interest and fee payments of \$30.

(4) Includes imputed interest of \$7.

(5) In January 2005 Growell was acquired by a third party, and we **are currently in negotiations to settle this balance with the third party.**

Off Balance Sheet Arrangements

An off-balance sheet arrangement is any transaction, agreement or other contractual arrangement involving an unconsolidated entity under which a company has (1) made guarantees, (2) a retained or a contingent interest in transferred assets, (3) an obligation under derivative instruments classified as equity, or (4) any obligation arising out of a material variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the company, or that engages in leasing, hedging, or research and development arrangements with the company.

We have made no arrangements of the types described in any of the categories that may have a material current or future effect on our financial condition, liquidity or results of operations.

Item 3 Quantitative and Qualitative Disclosures about Market Risk

We are exposed to various markets risks in conducting the business of the Company, and we anticipate that this exposure will increase as a result of our planned growth. In an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. These may take the form of forward sales contracts, option contracts, foreign currency exchange contracts, and interest rate swaps. We have not, and do not intend to, engage in the practice of trading derivative securities for profit.

Interest Rates. We are exposed to market risks relating to changes in interest rates. Some of the proceeds of our initial public offering are invested in short-term, interest-bearing, investment grade securities. The value of these securities will be subject to interest rate risk and could fall in value if interest rates rise.

Commodity Prices. We are exposed to price risk related to anticipated purchases of certain commodities used as raw materials by our businesses, including titanium and zirconium. Although we do not currently enter into commodity future, forward, and option contracts to manage the fluctuations in prices of anticipated purchases, we may enter into such contacts in the future as our business grows and as our purchases of these raw materials increase.

Foreign Exchange Rates. As a result of our operation of a manufacturing facility in South Korea, a substantial portion of our costs will be denominated in the South Korean won. Consequently, fluctuations in the exchange rates of the South Korean won to the U.S. dollar will affect our costs of goods sold and operating margins and could result in exchange losses. Although we do not currently enter into foreign exchange hedge transactions, we may do so in the future as our business grows.

Item 4 Controls and Procedures

Evaluation of disclosure controls and procedures. During the course of the audit of the financial statements of Liquidmetal Technologies, Inc. (the Company) for the fiscal years ended December 31, 2001, 2002, and 2003, it was determined that revenues from certain equipment sales made by the Company to Growell Metal Co., Ltd. in the third and fourth quarters of 2002 and the first quarter of 2003 should not have been recognized in those periods. It was also determined that certain amounts relating to sales made to Samsung in December 2002, to JS Technologies in September 2002, and AM Corporation in December 2002 should not have been recognized. It also was determined that compensation expense related to certain stock options granted in 2001 and 2002 were not calculated in accordance with generally accepted accounting principles under APB Opinion No. 25, SFAS No. 123, and EITF 00-23. These determinations and the associated restatement of previously issued financial statements, as described more fully elsewhere in the Form 10-K for the year ended December 31, 2003, filed on November 10, 2004, suggest that, at the time of the subject transactions and the preparation of the Company's financial statements for the relevant periods, the Company's disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934) were not effective as of the end of the period covered by such Form 10-K.

Liquidmetal Technologies, Inc. (the Company) carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Vice President of Finance, of the effectiveness as of June 30, 2005 of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended. Based on that evaluation, the Chief Executive Officer and Vice President of Finance have concluded that these disclosure controls and procedures, as of June 30, 2005, were not effective. This determination was based primarily on the material weaknesses in internal controls over financial reporting identified below.

Update on Management's Assessment of Internal Control Over Financial Reporting. The time and resources committed to the restatement of prior periods' financial statements (as aforementioned) delayed the Company's internal timetable with respect to its documentation, assessment and evaluation of internal control over financial reporting, which are required to be undertaken to comply with Section 404 of the Sarbanes-Oxley Act of 2002 (SOX 404). Due in part to the issues described in the foregoing paragraph, management's assessment of the effectiveness of the Company's internal control over financial reporting has been substantially delayed and is not complete, which in turn has prevented the Company's independent registered public accounting firm, Stonefield Josephson, Inc. (Stonefield) from being able to satisfactorily complete an audit

of the Company's internal control over financial reporting pursuant to SOX 404. Based on the foregoing, Stonefield has disclaimed an opinion on the Company's internal control over financial reporting.

In attempting to complete its assessment of internal control over financial reporting, management used the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Although management has not yet completed its review and assessment of all of the Company's internal controls over financial reporting, based on the review and assessment efforts that have actually been completed, management has identified several control deficiencies that existed during and as of the year ended December 31, 2004, some of which have been determined to be material weaknesses in internal control over financial reporting. As a result of the material weaknesses identified below, management has concluded that it did not maintain effective internal control over financial reporting as of December 31, 2004, based on the criteria established in COSO.

We have identified the following material weaknesses in connection with our ongoing assessment of internal controls as follows:

1. Lack of adequate segregation of duties in accounts payable and accounts receivable involving cash receipts and deposits, bank reconciliations, cash disbursements, purchasing, and accounts receivable reconciliations:

After the Company completely moved its accounting function from Tampa, Florida to Lake Forest, California in July 2004 and reduced the size of its accounting staff, duties such as booking of cash receipts, bank reconciliations and journal entries for corporate accounting were primarily being done by two accountants. During the course of the Company's audit for its 2004 fiscal year (which audit occurred during the first three months of 2005) and in the course of the Company's efforts to complete the assessment required by SOX 404 at the same time, it was determined that this lack of segregation could contribute to preventing detection of potential fraud or misstatements of financial information. Accordingly, beginning in the second quarter of 2005, the Company started taking steps to evaluate its overall accounting duties and segregate these functions for better internal control structure. For example, the Company began segregating the cash receipts booking and bank reconciliation among the two accountants, as well as segregating invoice entry and check run function. Additionally, as discussed below, beginning in the second quarter of 2005, the Company augmented its supervisory review process to mitigate the potential for fraud and misstatements. The Company has not identified any adjustments as a result of this lack of segregation of duties.

2. Lack of adequate controls and monitoring of payroll processing, currently outsourced to a third party provider:

This material weakness existed throughout 2004 as the Company utilized the services of a third party payroll processor that was not certified under SAS 70 (Type II). During the course of the Company's audit for its 2004 fiscal year, it was determined that the risk of using a third party payroll provider that is not SAS 70 certified may contribute to misstatements of payroll and related financial information. The Company intends to remediate this weakness by retaining the services of ADP for payroll processing. ADP is certified under SAS 70 (Type II).

3. Lack of documentation to evidence reviews of certain reconciliations:

During the course of the Company's audit for the 2004 fiscal year, which audit occurred in January 2005, the Company discovered that certain reconciliations, including bank statements and general ledger accounts, were not fully documented because the supervisors performing the

review on such reconciliations occasionally omitted their signature evidencing their review. It was determined at the time that this lack of documentation may result in certain accounting documents not being properly reviewed or there being no evidence of review. Beginning in the second quarter of 2005, the Company began taking steps to require that all reviews of reconciliations by supervisors are evidenced by a supervisor signature and that that all accounting documents are subject to proper review. For example, the Company started utilizing a Prepared by, Reviewed by, Checked by stamp and required all reconciliations to have evidence of the review prior to closing month end.

4. Lack of documentation of authorization of transactions:

During the course of the Company's audit for the 2004 fiscal year, the Company discovered that, although accounting transactions may have been authorized by the appropriate persons, the authorizing person occasionally omitted his signature on the relevant documents or approval forms to evidence his authorization. This lack of documentation on invoices, purchase requisitions and expense reports may result in certain transactions not being properly approved, so in the second quarter of

2005, the Company began implementing additional procedures for ensuring that all accounting documents are subject to proper approval as well as indication of the approval. For example, the Company began utilizing a Prepared by, Reviewed by, Checked by stamp and required that all documents have evidence of the approval prior to entry into the Company's accounting system.

5. Manual performance of numerous procedures that could be automated using current reporting systems:

The Company uses the SAP system for financial reporting. During the course of the audit for the 2004 fiscal year, it was determined that the Company was manually performing numerous procedures that could be automated by using the current SAP system. For example, a sales order module in SAP could be utilized to automate the entire order fulfillment process. While SAP contains many modules and features which would allow the Company to automate certain operational and accounting procedures and thereby minimize the potential for human error, utilization of such modules would require significant investment in upgrading and maintaining the SAP system. Considering the Company's current size and limited resources, management has determined that it is not prudent to make this investment at the current time. Nevertheless, beginning in the second quarter of 2005 and continuing thereafter, the Company has been taking various steps to minimize the potential for human error caused by manual procedures. For example, the Company has established specific procedures for proper review and approval of transactions as outlined in paragraphs 3 and 4 above and expanded utilization of other software tools such as programmed spreadsheets.

6. Material adjustments to the accounting records and financial statements as of and for the year ended December 31, 2004 that were not initially identified by the Company's internal control over financial reporting:

During the course of the Company's SOX 404 assessment efforts during the first several months of 2005, the Company and its auditors identified a number of necessary material adjustments to the Company's accounting records for 2004. For example, certain adjustments were booked to properly value complex debt instruments associated with the refinancing of the Company's debt. In addition, certain adjustments were booked to impair the Company's assets which are based on Management forecasts and overall assessment of the Company's business. The Company believes that these adjustments were a result of the Company's focus during 2004 on completing the Company's three-year re-audit of its 2001, 2002, and 2003 fiscal years. As a result of the Company's SOX 404 assessment efforts, the Company has identified these adjustments and has implemented additional controls to timely review and assess accounting issues and prevent the need for such adjustments. While there can be no assurance that adjustments to financial statements will not occur in the future, with the completion of the three-year re-audit, the Company believes that it will be able to devote its resources to completing its accounting assessments and entries timely and effectively.

7. Management's documentation of the evaluation of the significance of numerous control deficiencies and significant deficiencies identified, which could rise to the level of a material weakness, has not been completed:

The Company is continuing to diligently work to document and evaluate its internal controls under the requirements of SOX 404 during 2005.

8. The company had inadequate controls related to timely performance of its assessment of internal control over financial reporting:

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The Company is diligently working to complete its assessment of its internal controls over financial reporting under the requirements of SOX 404 during 2005.

9. Assurance Consulting 3, the independent third party engaged to help document and assess the Company's internal controls, has identified numerous and significant deficiencies, including those identified above, which management has not completed evaluating whether they would rise to the level of a material weakness in accordance to the PCAOB Audit Standard No. 2.

The Company will review these deficiencies during its assessment of internal controls under the requirements of SOX 404 during 2005.

Management believes that it has taken appropriate steps to address these material deficiencies subsequent to March 31, 2005, including hiring an independent consulting firm (Assurance Consulting 3) to identify and propose remedial actions to address and mitigate the deficiencies.

Changes in internal controls. The Company made various material changes in its internal control over financial reporting during the second quarter ended June 30, 2005. These material changes are described in paragraphs 1, 3, 4, and 5 above under the caption "Update on Management's Assessment of Internal Control Over Financial Reporting."

PART II

OTHER INFORMATION

Item 1 Legal Proceedings

There were no material developments in our legal proceedings during the current quarter.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

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On June 13, 2005, we completed a private placement (the Private Placement) of 10% Convertible Unsecured Notes Due June 13, 2006 in the aggregate principal amount of \$3,250 (the Notes), together with warrants to purchase up to an aggregate of 893,750 shares of the Company's common stock (the Warrants). The net proceeds were \$3.0 million after deducting transaction fees and expenses of \$0.25 million.

The Notes issued in the Private Placement are unsecured and will become due on the earlier of June 13, 2006 or the consummation of a follow-on equity or debt offering or restructuring transaction pursuant to which the Company receives gross proceeds of at least \$4,000. Prior to maturity, the Notes will be interest-only, with interest payments due quarterly, at the rate of 10% per year. The Notes can be prepaid at any time without penalty. If, within 120 days following the issue date of the Notes, the Company either fails to redeem the notes for the principal amount and accrued interest thereon or fails to close a Qualified Financing, then the Notes will thereafter be convertible at a conversion price equal to seventy five percent (75%) of the closing price of our common stock on the first trading day immediately preceding the conversion date. A

Qualified Financing is defined in the Notes as any debt or equity financing of the Company resulting in aggregate gross proceeds to the Company of at least \$5,000 and in which the holders of at least sixty percent (60%) of the aggregate principal amount of the Company's 6% Senior Secured Notes due July 2007 Notes either (i) agree that the equity or debt securities to be issued in such financing shall be *pari passu* in order of payment to the 2007 Notes held by them or (ii) exchange their 2007 Notes for new securities in the financing transaction.

The Notes rank senior to all other debt, except for indebtedness in existence on the issue date of the Notes (including the convertible notes issued in July 2004), purchase money loans for future acquired assets, trade debt incurred in the ordinary course of business, and loans used to refinance indebtedness with Kookmin Bank. The holders of the Notes will have the right to call for early repayment of the Notes if, on the date that is 180 days of the issue date of the Notes (i) the we are not then compliant with its SEC reporting obligations, or (ii) our common stock is not then listed or quoted on the OTC Bulletin Board, Nasdaq Stock Market, New York Stock Exchange, or American Stock Exchange.

As a part of the Private Placement, we issued Warrants to the purchasers of the Notes giving them the right to purchase up to an aggregate of 812,500 shares of the Company's common stock. In addition, Warrants to purchase 81,250 shares of our common stock were issued to the placement agent in the transaction. The Warrants have an exercise price of \$2.00 per share, provided that upon the consummation of the first ensuing public or private equity or debt offering or restructuring transaction in which the Company receives gross proceeds of at least \$3,250 (including without limitation any restructuring of the Company's previously issued 10% Senior Secured Notes Due July 29, 2005), the exercise price will be automatically adjusted downward (but not upward) as of the closing date of such offering or restructuring transaction so that it is equal to the lowest effective common stock purchase price paid for any securities issued by the Company to the investors in such offering or restructuring transaction. The Warrants will expire on June 13, 2010.

As of June 30, 2005, we have used \$1.7 million of the net proceeds from the Private Placement for working capital uses.

Item 3 Defaults Upon Senior Securities

On March 3, 2004, we sold \$9.9 million of 6.0% senior convertible notes due 2007 (the March Notes) to investor groups in a transaction led by Michigan Venture Capital Co., Ltd, a South Korea-based institutional investment firm, and IndiGo Ventures LLC, a New York-based investment firm that served as a financial advisor to the Company for the transaction. The notes were convertible at any time into our common stock at a price of \$3.00 per share. Investors in the private placement received warrants to purchase an aggregate amount of up to approximately 1.2 million shares of common stock, exercisable at \$3.00 per share for varying periods but no later than 100 days following the effectiveness of a registration statement covering the resale of shares issuable upon exercise of the warrants. In addition, the investors had the right to call for repayment of the notes prior to maturity at any time after the second anniversary of the closing of the transaction.

On August 19, 2004, the Company completed a private exchange offer for its March Notes. Under terms of the exchange offer, approximately \$5.5 million in aggregate principal amount of the March Notes have been exchanged for an aggregate of (i) \$2.75 million of 6% Senior Secured Notes Due 2007 (the Long-Term Notes) and (ii) \$2.75 million of 10% Senior Secured Notes Due 2005 (the Short-Term Notes), collectively referred to as Exchange Notes . In addition, the Company redeemed approximately \$4.5 million of the March Notes in cash. The Exchange Notes are collateralized by certain patents owned by the Company and second priority mortgage interest in plant facilities and certain equipment at our plant in South Korea.

In connection with the private exchange offer, the Company issued \$250 thousand of private placement notes to certain Placement Agents as issuance costs. Of the \$250 thousand notes issued, \$125 thousand was paid in the form of long-term notes which is due in 2007 with interest rate of 6% per annum (Long-Term Notes) and \$125 thousand was paid in the form of short-term notes which is due in 2005 with interest rate of 10% per annum (Short-Term Notes).

Interest payments are due quarterly, and failure to make timely interest payments will result in increase in interest rate to 10% and 14% on the 6% and 10% senior convertible notes. The default interest rates became effective on April 1, 2005 from non-payment of a scheduled interest payment. As such, the Company accrued \$171 of additional interest from the default rates applied to the loan balance as of June 30, 2005, which is included in accounts payable and accrued liabilities.

The Short-Term Notes have a maturity date of July 29, 2005, and a conversion price of \$2.00 per share (compared to a conversion price of \$3.00 per share under the March Notes). The Long-Term Notes have a maturity date of July 29, 2007, and a conversion price of \$1.00 per share. Further, the exchange notes are convertible into Common Stock, at the option of the Company, if at any time after the issuance of the notes, the closing per share price of the Common Stock exceeds \$4.00 (as adjusted for stock splits, reverse splits, stock dividends, and recapitalizations) for 30 consecutive trading days, and further provided that there has been effective registration during such period. Holders of the Long-Term Notes also have the right to call for repayment of the Long-Term Notes prior to maturity at any time after the second anniversary of the completion of the exchange offer. A total of 563,151 warrants to purchase our common stock at an exercise price of \$3.00 per share all of which were previously issued in connection with the purchase of the March Notes have been amended to provide for an extended expiration date of March 1, 2006. As of June 30, 2005, we were in breach of a covenant in the Note Exchange Agreement requiring us to become current in our SEC filings, as well as file a registration statement with the SEC for the shares into which the notes are convertible, within 90 days of the issue date of the new notes. Late registration fee of \$1.0 million has been accrued as interest expense, and is included in accounts payable and accrued liabilities as of June 30, 2005. If written notice of default is delivered to us for breach of this covenant, then we will have a period of 30 days to cure the breach before it becomes an event of default under the notes, and if the breach is not cured during such time period, the holders of the notes will become entitled to accelerate the remaining balance of their respective notes and declare them immediately due and payable. Further, As of the date of the filing of this Form 10-Q, we have not received a notice for demand for payment as a result of not meeting the registration and listing requirements.

Item 6 Exhibits

The following documents are filed as an exhibit to this Report:

Exhibit Number	Description of Document
10.1 (1)	Securities Purchase Agreement dated August 2, 2005, among the registrant and the parties identified as Purchasers therein.
10.2 (1)	Form of 7% Senior Secured Convertible Note, dated August 2, 2005.
10.3 (1)	Form of Common Stock Purchase Warrant, dated August 2, 2005.
10.4 (1)	Amended and Restated Registration Rights Agreement, dated August 2, 2005, among the registrant and the parties identified as Purchasers therein.
10.5 (1)	Amended and Restated Security Agreement, dated August 2, 2005, among the registrant and the parties identified as the Secured Parties therein.
31.1	Certification of the President and Chief Executive Officer, Ricardo A. Salas, as required by Section 3.02 of Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer, Young Ham, as required by Section 3.02 of Sarbanes-Oxley Act of 2002
32.1	Certification of Principal Executive Officer, Ricardo A. Salas, pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer, Young Ham, pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002

(1) Previously filed

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 hereunto duly authorized.

LIQUIDMETAL TECHNOLOGIES
(Registrant)

Date: July 20, 2006

/s/ Ricardo A. Salas
Ricardo A. Salas
President and Chief Executive Officer
(Principal Executive Officer)

Date: July 20, 2006

/s/ Young Ham
Young Ham
Chief Financial Officer
(Principal Financial and Accounting Officer)