LIQUIDMETAL TECHNOLOGIES INC
Form 424B3
August 14, 2007

Prospectus Supplement Filed pursuant to Rule 424(b)(3)
Registration No. 333-130251

PROSPECTUS SUPPLEMENT NO. 12
DATED August 14, 2007
(To Prospectus Dated August 7, 2006)

LIQUIDMETAL TECHNOLOGIES, INC.

11,614,322 Shares of Common Stock

This prospectus supplement supplements information contained in, and should be read in conjunction with, that certain Prospectus, dated August 7, 2006, of Liquidmetal Technologies, Inc., as supplemented by Supplement #1, dated August 9, 2006, Supplement #2, dated August 16, 2006, Supplement #3, dated October 12, 2006, Supplement #4, dated October 24, 2006, Supplement #5, dated November 14, 2006, Supplement #6 dated January 4, 2007, Supplement #7 dated March 16, 2007, Supplement #8 dated April 25, 2007, Supplement #9 dated May 15, 2007, Supplement #10 dated June 6, 2007, and Supplement #11 dated July 27, 2007.

This prospectus supplement is not complete without, and may not be delivered or used except in connection with, the original Prospectus and Supplements #1, #2, #3, #4, #5, #6, #7, #8, #9, #10, and #11 thereto. The Prospectus relates to the public sale, from time to time, of up to 11,614,322 shares of our common stock by the selling shareholders identified in the Prospectus.

The information attached to this prospectus supplement modifies and supersedes, in part, the information in the Prospectus, as supplemented. Any information that is modified or superseded in the Prospectus shall not be deemed to constitute a part of the Prospectus, except as modified or superseded by this prospectus supplement or Prospectus Supplements #1, #2, #3, #4, #5, #6, #7, #8, #9, #10 and #11.

This prospectus supplement includes the attached Quarterly Report on Form 10-Q, as filed by us with the Securities and Exchange Commission on August 14, 2007.

We may amend or supplement the Prospectus, as supplemented, from time to time by filing amendments or supplements as required. You should read the entire Prospectus and any amendments or supplements carefully before you make an investment decision.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities or determined if this Prospectus Supplement (or the original Prospectus, as previously supplemented) is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus supplement is August 14, 2007.

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2007

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)

Delaware	**33-0264467**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

30452 Esperanza
Rancho Santa Margarita, CA 92688
(address of principal executive office, zip code)

Registrant s telephone number, including area code: **(949) 635-2100**

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 x No o

Indicate by check whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

As of August 7, 2007, there were 44,631,768 shares of the registrant s common stock, $0.001 par value, outstanding.

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LIQUIDMETAL TECHNOLOGIES, INC.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2007

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

PART I

FINANCIAL INFORMATION

Item 1 Financial Statements

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	June 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,288	$ 144
Restricted cash	2,083	
Trade accounts receivables, net of allowance for doubtful accounts of $215 and $82	5,150	3,934
Inventories	2,143	3,765
Prepaid expenses and other current assets	1,177	830
Total current assets	12,841	8,673
Property, plant and equipment, net	10,845	12,095
Idle equipment	173	194
Other intangibles, net	1,144	1,170
Investment in joint venture	306	3
Other assets	1,235	109
Total assets	$ 26,544	22,244
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current liabilities:		
Accounts payable and accrued expenses	9,797	9,802
Deferred revenue	423	202
Short-term debt	3,212	2,669
Long-term debt, current portion, net of debt discounts of $481 and $3,636	12,707	14,480
Warrant liabilities	2,977	2,662
Conversion feature liabilities	3,271	1,838
Other liabilities, current portion	143	177
Total current liabilities	32,530	31,830
Long-term debt, net of current portion and debt discounts of $11,167 and $0	5,133	225
Other long-term liabilities, net of current portion	547	552
Total liabilities	37,890	32,607
Shareholders' deficiency:		
Common stock, $0.001 par value; 100,000,000 shares authorized and 44,631,768 issued and outstanding at June 30, 2007 and 44,311,768 issued and outstanding at December 31, 2006	45	44
Additional paid-in capital	136,949	136,031
Accumulated deficit	(151,546)	(149,047)
Accumulated other comprehensive income	2,886	2,609
Total shareholders' deficiency	(11,666)	(10,363)
Total liabilities and shareholders' deficiency	$ 26,544	$ 22,244

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

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LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(in thousands, except per share data)

(unaudited)

	For the Three Months Ended June 30, 2007	2006	For the Six Months Ended June 30, 2007	2006
Revenue	$ 8,331	$ 7,090	$ 13,398	$ 13,645
Cost of sales	7,686	5,564	14,127	10,888
Gross profit (loss)	645	1,526	(729)	2,757
Operating expenses				
Selling, general, and administrative	2,495	2,368	5,027	5,073
Research and development	293	281	556	484
Total operating expenses	2,788	2,649	5,583	5,557
Loss from operations	(2,143)	(1,123)	(6,312)	(2,800)
Loss from extinguishments of debt			(648)	
Change in value of warrants, gain (loss)	564	(1,426)	4,256	(2,715)
Change in value of conversion feature, gain (loss)	1,168	(2,137)	5,512	(3,920)
Other income	49	92	49	572
Interest expense	(2,700)	(3,277)	(5,463)	(5,059)
Interest income	46	7	107	9
Loss from continuing operations	(3,016)	(7,864)	(2,499)	(13,913)
Net Loss	(3,016)	(7,864)	(2,499)	(13,913)
Other comprehensive income (loss):				
Foreign exchange translation gain	499	28	277	127
Comprehensive loss	$ (2,517)	$ (7,836)	$ (2,222)	$ (13,786)
Net loss per share basic and diluted:				
Loss per share basic and diluted	$ (0.07)	$ (0.18)	$ (0.06)	$ (0.32)
Number of weighted average shares - basic and diluted	44,632	44,075	44,778	43,446

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

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LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS DEFICIENCY

For the Six Months Ended June 30, 2007

(in thousands, except per share data)

(unaudited)

	Common Shares	Common Stock	Additional Paid-in Capital	Accumu-lated Deficit	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2006	44,311,768	$ 44	$ 136,031	$ (149,047)	$ 2,609	(10,363)
Conversion of notes payable	320,000	1	516			517
Stock-based compensation			402			402
Foreign exchange translation gain					277	277
Net loss				(2,499)		(2,499)
Balance, June 30, 2007	44,631,768	$ 45	$ 136,949	$ (151,546)	$ 2,886	$ (11,666)

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

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LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, except per share data)

(unaudited)

	For the Six Months Ended June 30, 2007	2006
Operating activities:		
Net income (loss)	$ (2,499)	$ (13,912)
Adjustments to reconcile loss from operations to net cash used for operating activities:		
Gain on disposal of asset	(49)	(92)
Depreciation and amortization	1,734	1,765
Loss on extinguishment of debt	648	
Amortization of debt discount	3,371	2,925
Stock-based compensation	403	535
Bad debt (recovery) expense	131	60
Warranty expense	261	107
Loss (gain) from change in value of warrants	(4,256)	2,715
Loss (gain) from change in value of conversion feature	(5,512)	3,920
Changes in operating assets and liabilities:		
Trade accounts receivable	(1,047)	(2,038)
Inventories	1,622	(568)
Prepaid expenses and other current assets	(471)	(646)
Other assets	(1,386)	65
Accounts payable and accrued expenses	61	2,523
Deferred revenue	221	(801)
Other liabilities	330	(167)
Net cash used for operating activities	(6,438)	(3,609)
Investing Activities:		
Purchases of property and equipment	(882)	(693)
Proceeds from the sale of property and equipment	100	106
Investment in patents and trademarks	(34)	(65)
Investment in joint venture	(303)	
Net cash used for investing activities	(1,119)	(652)
Financing Activities:		
Proceeds from borrowings	24,789	12,042
Repayment of borrowings	(12,779)	(6,744)
Repayment of other liabilities		57
Restricted cash	(2,083)	
Net cash provided by financing activities	9,927	5,355
Effect of foreign exchange translation	(226)	(261)
Net increase (decrease) in cash and cash equivalents	2,144	833
Cash and cash equivalents at beginning of period	144	1,392
Cash and cash equivalents at end of period	$ 2,288	$ 2,225
Supplemental cash flow information		
Interest paid	$ 1,017	$ 602
Taxes paid	$	$

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

LIQUIDMETAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - continued

(in thousands, except per share data)

(unaudited)

During the six months ended June 30, 2007, $400 of the Company s 7% senior convertible notes due July 2007 was converted into 320,000 shares of the Company s common stock at a conversion price of $1.25 per share.

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

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LIQUIDMETAL TECHNOLOGIES AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Six Months Ended June 30, 2007 and 2006

(in thousands, except 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. All intercompany balances and transactions have been eliminated. Operating results for the six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for any future periods or the year ending December 31, 2007. 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 16, 2007.

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 (see Note 9). 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. 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.

<u>Stock-based compensation</u>

The Company previously applied 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. As permitted, the Company had previously elected to adopt provisions of Statement of Financial Accounting Standard (SFAS) No. 123, *Accounting for Stock-Based Compensation* for options granted to non-employees who perform services for the Company and the disclosure-only provisions of options granted to employees.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, (SFAS 123) and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB 25). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Under SFAS 123R, the Company is required to measure the cost of employee services received in exchange for stock options and similar awards based on the grant-date fair value of the award and recognize this cost in the income statement over the period during which an employee is required to provide service in exchange for the award. The pro forma disclosures previously permitted under SFAS 123 are no longer an alternative to financial statement recognition. The Company adopted SFAS 123R on January 1, 2006 using the modified prospective method and recorded $173 and $402 for the three and six months ended June 30, 2007, respectively, and $311 and $535 for the three and six months ended June 30, 2006, respectively, of non-cash charges for stock compensation related to amortization of the fair value of restricted stock and unvested stock options representing an increase from the stock compensation that would have been recorded under APB 25 and SFAS 123. Under this method, the Company will recognize compensation cost, on a prospective basis, for the portion of outstanding awards for which the requisite service has not yet been rendered as of January 1, 2006 and any new grants, based upon the grant-date fair value of those awards calculated under SFAS 123 for pro forma disclosure purposes. Accordingly, we have not restated prior period amounts.

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, 2007 and 2006, respectively: expected volatility of approximately 100% for all periods; dividend yield of 0% for all periods; expected option life of approximately 5 years; and a risk-free interest rate ranging from 2.57% to 6.22%.

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 our Korean subsidiary have been translated based upon Korean Won as the functional currency. Our Korean subsidiary 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).

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159), which permits entities to choose to measure many financial instruments and certain other items at fair value. The effective date of SFAS 159 will be the first quarter of 2008. The Company is currently evaluating the provisions of SFAS 159 and does not expect the adoption of this new standard to have a material impact on its consolidated financial statements.

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 our company s present or future consolidated financial statements.

3. Liquidity

The Company has experienced losses from continuing operations during the last three fiscal years and has an accumulated deficit of $151,546 as of June 30, 2007. Cash used for operations for the six months ended June 30, 2007 was $6,438 and cash flow from operations will likely be negative throughout fiscal year 2007. As of June 30, 2007, the Company s principal sources of liquidity are $2,288 of cash and $5,150 of trade accounts receivable. Such conditions raise substantial doubt that the Company will be able to continue as a going concern. These operating results occurred while the Company was developing and continues to develop, commercialize, and manufacture products from an entirely new and unique technology. These factors have placed a significant strain on the financial resources of the Company. The ability of the Company to overcome these challenges depends on its ability to correct its production inefficiencies, reduce its operating costs, generate higher revenue, achieve positive cash flow from continuing operations and continued sources of debt and equity financing. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

Further, the Company borrowed $8,563, which was offset by repayments of $7,019, under a factoring, loan, and security agreement executed on April 21, 2005 to fund its working capital requirements during the six months ended June 30, 2007.

On January 3, 2007, the Company completed a private placement of $16,300 in principal amount of 8% Convertible Subordinated Notes due January 2010 (the January 2010 Notes). The January 2010 Notes were issued for aggregate cash in the amount of $12,850, in payment of a total of $3,377 in principal and accrued but unpaid interest under our previously issued 7% Senior Secured Convertible Notes due August 2007 and our 8% Unsecured Subordinated Notes, and $73 cash discount (see Note 7).

In June 2007, we entered into an equipment sale and licensing agreement with Grace Metal, a South Korean corporation, providing for $2,000 in exchange for die casting machines and vacuum induction melters, and a 10-year exclusive license to manufacture Liquidmetal alloys for customers whose principal headquarters or major operations are based in South Korea. The principal purpose of the transactions with Grace Metal was to raise capital for the next-generation casting equipment and to shift the cost and burden of our manufacturing operations to a third party. Grace Metal was formed by an investor group that includes the former Founder and director of our company, James Kang, who is also the brother of John Kang, Chairman of the Board of our company (see Note 12).

In July 2007, we completed an $11,095 financing transaction that provided funding to repay senior convertible notes previously issued were scheduled to become due in July and August 2007. We transferred substantially all of the assets of Liquidmetal Coatings business to a newly formed, newly capitalized subsidiary named Liquidmetal Coatings, LLC, a Delaware limited liability company (LMC), and LMC assumed substantially all of the liabilities of the Division (the Assumed Liabilities). LMC was capitalized through a $6,500 subordinated debt and equity investment by C 3 Capital Partners and a $5,000 senior credit facility with Bank Midwest, N.A., both out of Kansas City, Missouri (see Note 13).

We anticipate that the funds raised in the January 2007 private placement, equipment sale and licensing agreement with Grace Metal, and recapitalization of our coatings business will be sufficient to pursue our current operating plan only through the third quarter of 2007, and we will therefore require additional funding at or prior to that time. As a result of the foregoing, we are actively seeking additional sources of capital and seeking to restructure and/or modify existing indebtedness. The amount of funding that we seek and the timing of such fundraising efforts will depend on the extent to which we are able to increase revenues through obtaining additional purchase orders for our products and/or the extent to which we can restructure or modify our debt. Because we cannot be certain that we will be able to obtain adequate funding from debt, equity, or other traditional financing sources, we are also actively exploring several strategic financing options, including the possible sale of our manufacturing plant in South Korea (which would then be replaced with a smaller facility) and additional licensing and outsourcing of our manufacturing operations.

Additionally, we have approximately $3,259 of principal and accrued interest outstanding under the 8% unsecured subordinated notes (Notes) which will become due August 17, 2007 as of June 30, 2007. We intend to fully repay the amounts due under Notes. However, as of the filing of this document we do not have sufficient funds to repay the Notes by the August 17, 2007 due date. As a result, we will be in default with the holders of the 8% unsecured subordinated notes if we do not satisfy the amounts due under the Notes, unless we receive a waiver of such default. Such a default may have material adverse effect on our operations, financial condition, and results of operations.

We cannot guarantee that adequate funds will be available when needed, and if we do not receive sufficient capital, we may be required to alter or reduce the scope of our operations.

4. Inventories

Inventories are accounted for using the moving average basis and at standard cost, which approximate cost on a first-in, first-out basis and are valued at the lower of cost or market. Inventories were comprised of the following:

	June 30, 2007 (Unaudited)	December 31, 2006
Raw materials	$ 1,070	$ 966
Work in process	154	1,729
Finished goods	919	1,070
Total inventories	$ 2,143	$ 3,765

5. Idle Equipment

Idle equipment consists of certain equipment held by the Company for use in expansion of bulk alloy parts manufacturing. 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. Total amount of idle equipment remaining was $173 and $194 as of June 30, 2007 and December 31, 2006, respectively.

During the quarter ended June 30, 2007, the Company disposed of $7 of its idle equipment as part of the equipment purchase agreement and transfer agreement regarding Weihai operations with Grace Metal (see Note 12). During the quarter ended June 30, 2006, the Company disposed of $12 of its idle equipment for proceeds of $104. The resulting gain of $92 is included in other income.

6. Product Warranty

Management estimates product warranties as a percentage of certain bulk alloy product sales earned during the period. As of June 30, 2007, the Company used 5% of bulk alloy product sales as an estimate of warranties to be claimed. The percentage is based on industry averages and historical information. During the three and six months ended June 30, 2007, the Company recorded $54 and $261 of warranty expense, respectively. During the three and six months ended June 30, 2006, the Company recorded $32 and $106, respectively, of warranty expense. The product warranty accrual balance is included in accounts payable and accrued expenses.

7. Notes Payable

Senior Convertible Note

On March 3, 2004, the Company issued $9,924 of 6% 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. The conversion and warrant exercise price are subject to price adjustments for anti-dilution purposes. 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 was 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 $5,460 in aggregate principal amount of the March Notes have been exchanged for an aggregate of (i) $2,730 of 6% Senior Secured Notes Due 2007 (the July 2007 Notes) and (ii) $2,730 of 10% Senior Secured Notes Due 2005 (the July 2005 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 July 2005 Notes had 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 July 2005 Notes have been exchanged and redeemed subsequent to the close of the second quarter of 2005 (see 2005 Senior Convertible Notes below). The July 2007 Notes have a maturity date of July 29, 2007, and a conversion price of $1.00 per share. The conversion prices of the July 2007 Notes and July 2005 Notes are subject to price adjustments for anti-dilution purposes. 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. The convertible price of the Exchange Notes is subject to price adjustment for anti-dilution purposes. As of June 30, 2007, the convertible price of the July 2007 Notes remained unchanged at $1.00 per share. Holders of the July 2007 Notes also have the right to call for repayment of the July 2007 Notes prior to maturity at any time after the second anniversary of the closing of the exchange offer. The July 2007 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 2005 Senior Convertible Notes below).

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. There are no outstanding warrants at June 30, 2007.

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 $1,919 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 (July 2007 Notes) and $125 was paid in the form of short-term notes which is due in 2005 with interest rate of 10% per annum (July 2005 Notes). The July 2005 and July 2007 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 of $250 notes issued to Placement Agents 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

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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% 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% of the purchase price of the unconverted note balance.

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 of June 30, 2007, the Company has complied with all scheduled interest payments.

On August 9, 2005, the July 2005 Notes, accrued interest and late registration fees were redeemed in cash and exchanged for 7% Convertible Secured Promissory Notes due August 2007 (see 2005 Senior Convertible Notes below).

During the year ended December 31, 2006, $286 of the July 2007 Notes were converted into 285,750 of the Company s common stock at a conversion price of $1.00 per share.

The Company s gross outstanding loan balance of the July 2007 Notes totaled $2,083, as of June 30, 2007 and December 31, 2006, respectively. As of June 30, 2007 and December 31, 2006, un-amortized discounts for conversion feature and warrants totaled $56 and $391, respectively, and other asset debt issuance costs totaled $2 and $14, respectively. Interest expense for the amortization of debt issuance cost and discount on note was $173 and $347 for the three and six ended June 30, 2007, respectively, $193 and $416 for the three and six months ended June 30, 2006, respectively. As of June 30, 2007, the effective interest rate of the July 2007 Notes was 34.5%.

Pursuant to Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, the Company is required to report a value of the conversion liability as a fair value and record the fluctuation to the fair value of the conversion feature liability to current operations. The change in the fair value of the conversion feature liability resulted in a gain of $1,164 and $1,195 for the three and six months ended June 30, 2007, respectively, and a loss of $947 and $1,748 for the three and six months ended June 30, 2006, respectively. The fair value of conversion features outstanding at June 30, 2007 and December 31, 2006 was $24 and $1,218, respectively. The fair value of conversion features of outstanding at June 30, 2007 was computed using the Black-Scholes model under the following assumptions: (1) 0.08 years; (2) volatility of 55%; (3) risk free interest of 4.28% and (4) dividend rate of 0%.

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 warrant liability. 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 fair value of warrants resulted in a loss of $15 and $18 for the three and six months ended June 30, 2006. The warrant has expired as of December 31, 2006.

Convertible Notes

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

The June 2006 Notes issued by the Company in the June 2005 Private Placement are unsecured and was 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 June 2006 Notes are interest-only, with interest payments due quarterly, at the rate of 10% per year. The June 2006 Notes can be prepaid by the Company at any time without penalty. If, within 120 days following the issue date of the June 2006 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 June 2006 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 immediately preceding the conversion date. A Qualified Financing is defined in the June 2006 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 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 July 2007 Notes held by them or (ii) exchange their July 2007 Notes for new securities in the financing transaction. On August 9, 2005, the Company successfully completed Qualified Financing, which resulted in exchange and redemption of the Convertible Notes (see 2005 Senior Convertible Notes below). As a result, the June 2006 Notes never became convertible.

As a part of the June 2005 Private Placement, the Company issued warrants to the purchasers of the June 2006 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 original 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 July 2005 Notes), 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 and are subject to exercise price adjustment for anti-dilution purposes. The exercise price of the warrants was reduced to $1.75 per share and total number of warrants was increased 1,021,434 as of June 30, 2007 as a result of our January 2007 private placement (see Convertible Subordinated Notes below).

The original 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.

On August 9, 2005, the June 2006 Notes were redeemed in cash and exchanged for 7% Convertible Secured Promissory Notes due August 2007 (see 2005 Senior Convertible Notes below). The exchange offer was treated as an extinguishment of the June 2006 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 $1,247 loss from extinguishment of the June 2006 Notes as of December 31, 2005, which consists of write down of $240 of deferred issue costs in other assets, $92 of contra liability deferred issuance costs, and $915 of debt discount as a result of the change in carrying value of exchanged notes.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock , the original fair values of the warrants of $1,160 have been recorded as warrant liability. 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 $35 and $316 for the three and six months ended June 30, 2007, respectively. The change in the fair value of the warrants resulted in a loss of $321 and $623 for the three and six months ended June 30, 2006, respectively. The fair value of warrants outstanding at June 30, 2007 and December 31, 2006 was $171 and $487, respectively. The fair value of warrants outstanding at June 30, 2007 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 2.95 years; (2) volatility of 47%, (3) risk free interest of 4.89% and (4) dividend rate of 0%.

2005 Senior Convertible Notes

On August 9, 2005, the Company completed a private placement (the August 2005 Private Placement) of $9,878 in

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principal amount of new 7% Convertible Secured Promissory Notes due August 2007 (the August 2007 Notes). The issuance consisted of $5,000 cash, exchange of $1,284 in principal amount of the July 2005 Notes, the exchange of $2,996 in principal amount of the June 2006 Notes, satisfaction of accrued interest and late registration fees in the amount of $589 on the July 2005 Notes, and satisfaction of accrued interest of $9 on the June 2006 Notes. The August 2007 Notes were issued pursuant to a Securities Purchase Agreement dated effective as of August 2, 2005 among the Company, the purchasers of the August 2007 Notes, and the holders of July 2005 Notes and June 2006 Notes of the Company.

Interest payments are due quarterly, and failure to make timely interest payments will result in increase in interest rates to 14% per annum on the August 2007 Notes (Default Rates). As of June 30, 2007, the Company has made timely interest payments.

The August 2007 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 convertible price of the August 2007 Notes is subject price adjustment for anti-dilution purposes. As of June 30, 2007, the convertible price of the August 2007 Notes was reduced to $1.75 per share.

Further, 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 $4,808 have been recorded as conversion feature liability as the debt is considered nonconventional convertible debt. The original fair value was computed using the Black-Scholes model under the following assumptions: (1) expected life of 2 years; (2) volatility of 93%; (3) risk free interest of 4.06% and dividend rate of 0%. In addition, the Company is required to report a value of the conversion liability as a fair value and record the fluctuation to the fair value of the conversion feature liability to current operations. The change in the fair value of the conversion feature liability resulted in a gain of $12 and $354 for the three and six months ended June 30, 2007, respectively. The change in the fair value of the conversion feature liability resulted in a loss of $1,190 and $2,171 for the three and six months ended June 30, 2006. The fair value of conversion features outstanding at June 30, 2007 and December 31, 2006 was $0 and $619, respectively. The fair value of conversion feature outstanding at June 30, 2007 was computed using the Black-Scholes model under the following assumptions: (1) 0.09 year; (2) volatility of 55%, (3) risk free interest of 4.28% and (4) dividend rate of 0%.

The August 2007 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 July 2007 Notes, purchase money asset financing, trade creditors in the ordinary course of business, and any inventory or receivables-based credit facility that the Company may obtain in the future, provided that the amount of the credit facility does not exceed 50% of eligible inventory and 80% of eligible receivables. The August 2007 Notes will automatically convert into common stock if the Company s common stock has an average closing price of more than $5.00 per share during 30 consecutive trading days.

The Company also issued warrants to the purchasers of the August 2007 Notes and placement agents giving them the right to purchase up to 2,469,470 and 414,495 shares of Company common stock, respectively, with an exercise price of $2.00 per share, which is subject to price adjustment for anti-dilution purposes . As of June 30, 2007, the exercise price of the warrants was reduced to $1.75 per share and total number of warrants was increased to 3,295,975. The warrants will expire on August 2, 2010.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock , the original fair values of the warrants of $4,068 have been recorded as warrant liability, which 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 4.17% and dividend rate of 0%. 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 $261 and $1,179 for the three and six months ended June 30, 2007, respectively. The change in the fair value of the warrants resulted in a net loss of $1,047 and $2,032 for the three and six months ended June 30, 2006, respectively. The fair value of warrants outstanding at June 30, 2007 and December 31, 2006 was $433 and $1,612, respectively. The fair value of the warrants outstanding at June 30, 2007 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 3.09 years; (2) volatility of 47%; (3) risk free interest of 4.89% and dividend rate of 0%.

In connection with the August 2005 Private Placement, the Company entered into an amended and restated registration rights agreement with the holders of the July 2007 Notes, the holders of the August 2007 Notes, and the holders of the above-described outstanding warrants. This amended and restated registration rights agreement replaced all other registration rights agreements previously entered into by us in connection with the private sale by us of convertible notes and warrants. Under the amended and restated registration rights agreement, the Company is required to file a resale registration statement for the shares underlying all of our outstanding convertible notes and warrants, as described above, by October 31, 2005, to enable the resale of such shares by the selling stockholders on a delayed or continuous basis under Rule 415 of the Securities Act. The Company is then required to cause such registration statement to become effective within 60 days after we receive the first written comments on the registration statement from the SEC, or if the SEC notifies us 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. Specifically, if the Company does not file the registration statement on a timely basis, we will be obligated to pay a late filing fee to the selling stockholders in the amount of 3% of the warrant exercise price on each of the warrants held by them plus 3% of the principal amount of the outstanding notes held by them. This fee will be payable for each period of 30 business days that the filing of the registration statement is made past the required filing date, and the payments will be due 10 business days following the end of each 30-day period. If the registration statement has not been declared effective by the required effective date, the Company will be obligated to pay a monthly late registration fee to the selling stockholders in the amount of 2% of the aggregate warrant exercise prices and aggregate note principal amounts for the first 30 business days after the required effective date, and 1% for each 30-business day period thereafter until the registration statement is declared effective. Notwithstanding the foregoing, the late filing fees and late registration fees will not exceed 18% of the aggregate warrant exercise prices and aggregate note principal amounts.

The Company filed its Registration Statement on December 9, 2005 and on August 7, 2006, the registration statement became effective. As of June 30, 2007, the Company has accrued $1,657 and paid $923 of the late filing and registration fees and the remaining $734 is included in accounts payable and accrued liabilities.

On January 3, 2007 as part of a private placement offer, as amended, $2,290 of August 2007 Notes and $116 of late registration fees were exchanged for 8% Convertible Subordinated Notes due January 2010 (see Convertible Subordinated Notes below). Further, during the quarter ended March 31, 2007, the Company entered into conversion agreements with the holders of August 2007 Notes totaling $400 of principal providing for the conversion of such notes at a reduced conversion price of $1.25 per share.

As of June 30, 2007 and December 31, 2006, our gross outstanding loan balance of the August 2007 Notes totaled $7,188 and $9,878, respectively. As of June 30, 2007 and December 31, 2006, un-amortized discounts for embedded conversion feature and warrants totaled $268 and $2,441, respectively, and other asset debt issuance costs totaled $15 and $139, respectively, and contra liability debt issuance cost totaled $68 and $172, respectively. Interest expense for the amortization of debt issuance cost and discount on note was $850 and $1,812 for the three and six months ended June 30, 2007, respectively. Interest expense for the amortization of debt issuance cost and discount on note was $1,036 and $2,214 for the three and six months ended June 30, 2006, respectively. As of June 30, 2007, the effective interest rate for the August 2007 Notes was 17.5%.

<u>Subordinated Promissory Note</u>

On March 17, 2006, the Company issued a $1,000 10% subordinated promissory note due October 16, 2006 (the October 2006 Note) to Atlantic Realty Group, Inc., a company controlled by Jack Chitayat, a former director of the Company. On September 30, 2006, the October 2006 Note was amended to mature on November 15, 2006 and was subsequently amended again to mature on November 30, 2006. The October 2006 Note is unsecured and subordinated to all prior indebtedness of

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the Company. All accrued interest and unpaid principal under the note were due November 30, 2006. The proceeds from the October 2006 Note is to be used solely for working capital purposes. In connection with the October 2006 Note, the Company issued warrants to purchase an aggregate amount of up to 125,000 shares of common stock, exercisable at $2.00 per share. The warrants will expire on March 17, 2009, and include price adjustment provisions for anti-dilution purposes. As of June 30, 2007, the exercise price of the warrants remained unchanged at $2.00 per share. There are no registration rights of the shares issuable from the exercise of the warrants. Further, cashless exercise of the warrants is permitted.

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 warrants of $84 have been recorded as warrant liability as the warrant holders can elect to settle the warrants in cash, which was computed using Black-Scholes pricing model under the following assumptions: (1) expected life of 2.96 years; (2) volatility of 84%; (3) risk free interest of 4.64% and dividend rate of 0%. In addition, the Company is required to report a value of the warrants 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 $7 and $42 for the three and six months ended June 30, 2007, respectively. The change in the fair value of the warrants resulted in a loss of $40 for the three and six months ended June 30, 2006. The fair value of warrants outstanding at June 30, 2007 and December 31, 2006 was $8 and $50, respectively. The fair value of warrants outstanding at June 30, 2007 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 1.71 years; (2) volatility of 55%, (3) risk free interest of 4.87% and dividend rate of 0%. Interest expense for the amortization of discount on the note was $0 for the three and six months ended June 30, 2007, respectively, and interest expense for the amortization of discount on the note was $ 28 and $41 for the three and six months ended June 30, 2006, respectively.

During the quarter ended March 31, 2007, $1,000 of October 2006 Note was redeemed in cash (see Convertible Subordinated Notes below).

Unsecured Subordinated Notes

On May 17, 2006, the Company completed a private placement of 8% unsecured subordinated notes (the May 2006 Private Placement) in the aggregate principal amount of $3,625 (the August 2007 Subordinated Notes), together with warrants to purchase up to an aggregate of 705,233 shares of the Company s common stock. On September 21, 2006 and December 1, 2006, the Company completed an additional private placement under the terms of the May 2006 Private Placement in the aggregate principal amount of $500 and $459, respectively, together with warrants to purchase up to an aggregate of 96,900 and 88,857 shares of the Company s common stock, respectively.

The August 2007 Subordinated Notes are unsecured and will become due on the earlier of August 17, 2007 or the consummation of a follow-on equity or debt offering pursuant to which the Company receives gross proceeds of at least $6,000 to be used for working capital purposes and repayment of debt, but excluding financings for the purpose of purchasing capital assets (a Follow-On Financing). Interest on the unpaid principal balance of each August 2007 Subordinated Note accrues at the rate of 8% per annum until maturity date. The August 2007 Subordinated Notes can be prepaid by the Company at any time without penalty.

The August 2007 Subordinated Notes is subordinate in right of payment and in all other respects to the July 2007 Notes, the August 2007 Notes, and any other notes that may be issued by the Company after May 17, 2006 in exchange for or in satisfaction of any July 2007 Notes or August 2007 Notes (collectively, the Senior Notes). Notwithstanding the maturity date of the August 2007 Subordinated Notes, the Company will not make any payments of principal, interest or otherwise under the August 2007 Subordinated Notes until all amounts due and payable under the Senior Notes have been satisfied in full (whether through cash payments or conversion).

The August 2007 Subordinated Notes also gives the investors the opportunity to participate in a Follow-On Financing at a discounted rate. If a holder of the August 2007 Subordinated Notes elects to participate in a Follow-On Financing, the holder of the Note will be entitled to purchase the securities being offered in the Follow-On Financing at a discount of 7% of the gross per share purchase price (in the case of an offering of common stock or preferred stock) or 7% of the face amount of the security being sold (in the case of an offering of debt securities).

As part of the May 2006 Private Placement, the Company issued warrants to the purchasers of the Notes giving them right to purchase up to an aggregate of 892,247 shares of the Company s common stock. In addition, warrants to purchase 80,717 shares of the Company s common stock were issued to the placement agent in the transaction. The warrants have an exercise price of $2.58 per share, which is subject to price adjustment for anti-dilution purposes. The exercise price of the warrants was reduced to $2.13 per share and total amount of warrants was increased to 1,178,651 as of June 30, 2007. The warrants will expire on May 17, 2011.

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 warrants of $905 for the May 17, 2006 placement have been recorded as warrant liability, as the warrant holders can elect to settle the warrants in cash, which was computed using Black-Scholes pricing model under the following assumptions: (1) expected life of 5.00 years; (2) volatility of 80%; (3) risk free interest of 5.03% and dividend rate of 0%. The original fair value of the warrants of $89 for the September 21, 2006 placement have been recorded as warrant liability, as the warrant holders can elect to settle the warrants in cash, which was computed using Black-Scholes pricing model under the following assumptions: (1) expected life of 4.65 years; (2) volatility of 76%; (3) risk free interest of 4.60% and dividend rate of 0%. The original fair value of the warrants of $59 for the December 1, 2006 placement have been recorded as warrant liability, as the warrant holders can elect to settle the warrants in cash, which was computed using Black-Scholes pricing model under the following assumptions: (1) expected life of 4.46 years; (2) volatility of 67%; (3) risk free interest of 4.39% and dividend rate of 0%.

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 $95 and $356 for the three and six months ended June 30, 2007, respectively. The change in the fair value of the warrants resulted in a loss of $2 for the three and six months ended June 30, 2006. The fair value of warrants outstanding at June 30, 2007 and December 31, 2006 was $157 and $513. The fair value of the warrants outstanding at June 30, 2007 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 3.88 years; (2) volatility of 47%; (3) risk free interest of 4.92% and dividend rate of 0%.

On January 3, 2007 as part of a private placement offer, as amended, $925 of August Subordinated 2007 Notes and $45 of accrued interest were exchanged for 8% Convertible Subordinated Notes due January 2010 (see Convertible Subordinated Notes below). Additionally, $650 of August Subordinated 2007 Notes and $26 of accrued interest were redeemed in cash during the first quarter of 2007.

Our gross outstanding loan balance of the August 2007 Subordinated Notes totaled $3,009 and $4,585 as of June 30, 2007 and December 31, 2006, respectively. As of June 30, 2007, un-amortized discounts for warrants totaled $138 and other asset deferred issuance costs totaled $35. Interest expense for the amortization of discount on the note and deferred issuance cost was $240 and $458 for the three and six months ended June 30, 2007, respectively. Interest expense for the amortization of discount on the note and deferred issuance cost was $98 for the three and six months ended June 30, 2006. As of June 30, 2007, the effective interest rate for the August 2007 Subordinated Notes was 37.6%.

Convertible Subordinated Notes

On January 3, 2007, the Company completed a private placement of 8% Convertible Subordinated Notes due January 2010 (the January 2010 Notes). As a result of an April 2007 amendment to this transaction, the Company ultimately issued $16,300 in principal amount of January 2010 Notes. The January 2010 Notes were issued for aggregate cash in the amount of $12,850, in payment of a total of $3,377 in principal and accrued but unpaid interest under our previously issued 7% Senior Secured Convertible notes due August 2007 (August 2007 Notes) and our 8% Unsecured Subordinated notes (the August 2007 Subordinated Notes), and $73 cash discount.

The payment of the previously issued notes was treated as an extinguishment of the debt in accordance with Emerging Issues Task Force No. 96-19, Debtors Accounting for a Modification or Exchange of Debt Instruments. The placement resulted in a $648 loss from extinguishment of debt, which consisted of write down of $64 of deferred issue costs, $733 of debt discount, and decrease of $149 in conversion feature liability as a result of the change in carrying value of exchanged notes.

The January 2010 Notes were originally convertible into the Company s common stock at $1.55 per share. 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 5,257,921 shares of our common stock at an exercise price of $1.93 per share. In connection with the private placement, the Company also issued to the placement agent for the transaction warrants to purchase an aggregate of 248,710 shares of our common stock at an exercise price of $1.55 per share. The warrants will expire on January 3, 2012 and are subject to exercise price adjustment for anti-dilution purposes. The Company is required to set aside $2,083 of the proceeds from the private placement for payment of the 6% Senior Secured Convertible notes due July 2007 (the July 2007 Notes).

The January 2010 Notes were issued pursuant to a Securities Purchase Agreement, dated January 3, 2007, between the Company and the purchasers of the January 2010 Notes (the January Purchase Agreement). Under the terms of the original January Purchase Agreement, the Company agreed to repay or otherwise satisfy, within 5 days after the closing of the private placement, approximately $15,461 of the Company s outstanding debt under previously issued promissory notes, including the August 2007 Notes, the October 2006 Note, and August 2007 Subordinated Notes (the Debt Satisfaction Covenant). The Company originally agreed to this covenant based on assurances that a substantial number of holders of the August 2007 Notes would elect to convert their August 2007 Notes at a reduced conversion price following the private placement under a note conversion agreement proposed by the Company, but most of such holders ultimately elected not to proceed with such conversion. Accordingly, in an effort to preserve funds, the Company has not yet repaid the indebtedness as required by the original January Purchase Agreement, and in April 2007, the Company entered into an amendment to the January Purchase Agreement providing that the Company will have until October 1, 2007 (or such earlier date on which the indebtedness to be repaid is due) to comply with the Debt Satisfaction Covenant.

On April 23, 2007, the Company and the purchasers of the Notes entered into an Amendment No. 1 to the Securities Purchase Agreement to provide for the following: (1) The Company will have until October 1, 2007 (or such earlier date on which the indebtedness to be repaid is due) to comply with the Debt Repayment Covenant; (2) The schedule of investors in the Private Placement was finalized to show a total of $16,300 in principal amount of Notes was issued in the Private Placement; (3) The conversion price of the Notes was decreased from $1.55 to $1.10, the warrant exercise price for the warrants issued in the Private Placement was decreased from $1.93 to $1.55, and the number of shares subject to such warrants issued in the Private Placement was increased to equal 50% of the principal amount of Notes purchased divided by 1.10; (4) the purchasers of the Notes will have the right to require the Company to redeem the Notes early in the event that the Company sells its Liquidmetal Coatings business unit, sells its manufacturing facility in South Korea, and/or engages in debt or equity financing, provided that the foregoing transactions result in aggregate cumulative proceeds of $25,000,000; and (5) the purchasers of the Notes consented to the Company granting a security interest in its South Korean manufacturing plant to purchasers of convertible notes in a subsequent offering, provided a pari passu security interest is granted to the purchasers of the Notes.

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 $6,205 have been recorded as conversion feature liability as the debt is considered nonconventional convertible debt. The original fair value was computed using the Black-Scholes model under the following assumptions: (1) expected life of 1.6 to 3 years; (2) volatility of 55%; (3) risk free interest of 4.69% to 4.76% and dividend rate of 0%. The original fair value of the additional embedded conversion feature of $1,005 resulting from reduced conversion price under the amended Securities Purchase Agreement, have been recorded as conversion feature liability. The value was computed using the Black-Scholes model under the following assumptions: (1) expected life of 1.3 to 2.7 years; (2) volatility of 55%; (3) risk free interest of 4.6% to 4.9% and dividend rate of 0%. In addition, the Company is required to report a value of the conversion liability as a fair value and record the fluctuation to the fair value of the conversion feature liability to current operations.

The change in the fair value of the conversion feature liability resulted in a loss of $8 and a gain of $3,963 for the three and six months ended June 30, 2007, respectively. The fair value of conversion feature outstanding at June 30, 2007 of $3,247 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 1.1 to 2.5 years; (2) volatility of 55%, (3) risk free interest of 4.874% to 4.91% and dividend rate of 0%.

Pursuant to EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock , the original fair values of the warrants of $3,964 have been recorded as warrant liability, which was computed using the Black-Scholes pricing model under the following assumptions: (1) expected life of 5 years; (2) volatility of 55%; (3) risk free interest of 4.68% and (4) dividend rate of 0%. The original fair values of the warrants of $608 from the additional warrants issued under the amended Securities Purchase Agreement, have been recorded as additional warrant liability, which was computed using the Black-Scholes pricing model under the following assumptions: (1) expected life of 4.70 years; (2) volatility of 50%; (3) risk free interest of 4.51% and (4) dividend rate of 0%.

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 $166 and $2,363 for the three and six months ended June 30, 2007, respectively. The fair value of the warrants outstanding at June 30, 2007 of $2,209 was computed using the Black-Scholes model under the following assumptions: (1) expected life of 4.51 years; (2) volatility of 55%; (3) risk free interest of 4.92% and dividend rate of 0%.

The original fair value of the embedded conversion feature of $7,210 was recorded as discounts of the convertible note. The original fair value of the 7,408,881 warrants issued to investors of $4,372, the original fair value of 248,710 warrants issued to Placement Agents of $200, and $73 cash discount were recorded as discounts of the convertible note. In addition, $2,069 direct costs incurred relating to issuance of the convertible note was recorded as debt issuance cost in other assets.

The January 2010 Notes bear interest at 8% per annum with interest payable quarterly in arrears in cash, or, at our option, in the form of additional January 2010 Notes (in which case the interest rate will be 10% per annum). The ability to pay interest with additional January 2010 Notes is subject to specified conditions, including the existence of an effective registration statement covering the resale of the shares issued in payment of interest and certain minimum trading volumes in the stock to be issued. From and after an event of default under the January 2010 Notes and for so long as the event of default is continuing, the January 2010 Notes will bear default interest at a rate of 12% per annum (or 15% per annum if we elect to pay interest with additional January 2010 Notes).

Beginning July 31, 2008 and at the end of each month thereafter, the Company will be required to redeem 1/36th of the principal amount of the January 2010 Notes in cash or, at the Company s election, with shares of our common stock. The ability to pay the redemption amounts with shares of common stock will be subject to specified conditions, including the existence of an effective registration statement covering the resale of the shares issued in payment of the redemption amount and certain minimum trading volumes in the stock to be issued. Any unconverted January 2010 Notes will become due on December 31, 2009, although the Company will have the right at any time after 18 months following the issuance of the January 2010 Notes to redeem the January 2010 Notes in whole or in part for a cash redemption price of 105% of the portion of the principal amount being redeemed plus all accrued and unpaid interest thereon. The January 2010 Notes are unsecured and are subordinate to the July 2007 Notes and to certain secured financing from commercial lenders incurred by the Company in the future. The terms of the 2010 Notes also provide that the Company will be required to maintain a sufficient bank balance to provide for the timely repayment of our July 2007 Notes.

In connection with the January 2007 private placement, the Company entered into a Registration Rights Agreement with the purchasers of the January 2010 Notes under which the Company is required, on or before 45 days after the closing of the private placement, to use commercially reasonable efforts to file a registration statement with the SEC covering the resale of the shares of the common stock issuable pursuant to the January 2010 Notes and warrants and to use commercially reasonable efforts to have the registration declared effective at the earliest date (but in no event later than 90 days after filing if there is no SEC review of the registration statement, or 120 days if there is an SEC review). The Company will be subject to monetary penalties up to a maximum amount of 18% of the aggregate amount of Notes sold in the Private Placement if the registration statement is not filed or does not become effective on a timely basis. The monetary penalties will accrue at the rate of 1% per month of the then-outstanding principal amount of the January 2010 Notes. In the event that the Company is unable to include in the registration statement all shares of our common stock issuable pursuant to the January 2010 Notes and warrants, then we will be required to file up to two additional registration statements to register the resale of any shares excluded from the originally filed registration statement and to pay the foregoing monetary penalties on the January 2010

Notes convertible into the excluded shares until the resale of such excluded shares is covered by an effective registration statement or until such shares can be sold under SEC Rule 144. As of June 30, 2007, an aggregate of $128 in monetary penalties under the Registration Rights Agreement had already been paid to investors, while an additional $584 in such penalties were accrued but unpaid.

On March 22, 2007, one of the purchasers of the January 2010 Notes (holding January 2010 Notes in the aggregate amount of $2.0 million) sent the Company an event of default notice (Event of Default Notice) indicating that the Company had defaulted under the January Purchase Agreement (and therefore under the January 2010 Note) by failing to comply with the Debt Satisfaction Covenant. This holder did not execute the April 2007 amendment to the January Purchase Agreement. In general, upon a breach of the January 2010 Notes or January Purchase Agreement, a holder of the January 2010 Notes may require us to redeem the January 2010 Notes at a price equal to the greater of (i) the conversion amount to be redeemed and (ii) the product of (A) the conversion rate with respect to such conversion amount in effect at such time as the purchaser of the January 2010 Note delivers an Event of Default Redemption Notice (as defined below) and (B) the closing sale price of our common stock on the date immediately preceding such event of default. Under the terms of the January 2010 Notes and January Purchase Agreement, the Company has ten (10) business days after the receipt of an Event of Default Notice to cure a default. On April 6, 2007, the holder which sent the Event of Default Notice further sent us an event of default redemption notice (Event of Default Redemption Notice). The Event of Default Redemption Notice states that the holder has elected to require the Company to redeem its January 2010 Note for a price equal to $2,000 (the amount of the January 2010 Note) plus accrued and unpaid interest. On April 16, 2007, the Company was served with a complaint filed by the holder in the Federal District Court in Minnesota to collect this amount. Subsequent to June 30, 2007, the Company received a notice that the action against the Company was dismissed by the purchaser with prejudice (see Note 13).

In addition, because the Company repaid $1,763 of principal and interest under the October 2006 Note and certain August 2007 Subordinated Notes in January and February 2007 without first repaying the August 2007 Notes and July 2007 Notes, the Company may also be in breach of the August 2007 Notes and July 2007 Notes.

The Company s gross outstanding loan balance of the January 2010 Notes totaled $16,300 as of June 30, 2007. As of June 30, 2007, un-amortized discounts for conversion feature, warrants, and cash discount totaled $11,167, and other asset debt issuance costs totaled $1,085. Interest expense for the amortization of debt issuance cost and discount on note was $373 and $754 for the three and six months ended June 30, 2007, respectively. As of June 30, 2007, the effective interest rate of the January 2010 Notes was 74%.

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. In January 2007, the Company entered into a second amendment to the Agreement to provide for increased borrowings against non-approved receivables assigned of 80%. Borrowings made against non-approved receivables assigned are limited to $1,000 and total borrowings made on approved and non-approved receivables assigned are limited to $5,000. Further, the amendment provides for interest charges of 0.5% plus prime rate of interest less 2%. The agreement will continue until February 1, 2008 and will renew annually thereafter. 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 0.55% to 1.5% 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 SFAS No. 140 Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities.

For the six months ended June, 2007, the Company borrowed $8,563 and repaid $7,019 under the Agreement. The total outstanding advance made under the agreement is $3,212 and $1,669 as of June 30, 2007 and December 31, 2006, respectively, which is presented as short-term debt. The weighted average rate of interest for borrowings made under the

Agreement was 8.92% for the six months ended June 30, 2007. As of June 30, 2007, the Company s availability for future borrowing under the agreement is $1,788 which is contingent on approval of eligible receivables by the financing company.

In February 2007, the Company entered into an agreement to deposit cash of $2,083 with a rate of prime rate of interest less 2% with the financing company. The agreement is effective until July 27, 2007 and the cash deposit will be used to pay down principal amount of the July 2007 Notes. Additionally, the financing company reserves the right to offset outstanding advances against the cash deposit. As a result, the $2,083 cash deposit is presented as restricted cash as of June 30, 2007.

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. As of June 30, 2007, the interest rate was increased to 9.2% from delayed interest payments made. 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 through February 2008. Principal payments made to Kookmin Bank totaled $894 for the six months ended June 30, 2007, which includes $7 of foreign exchange translation loss. The outstanding loan balance totaled $909 and $1,796, of which $909 and $225 is included in current portion of long-term debt, as of June 30, 2007 and December 31, 2006, respectively.

8. Stock Compensation Plan

During the three and six months ended June 30, 2007, 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 granted options to purchase 70,000 of the Company s common shares for an average exercise price of $1.53. 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 329,903 and 429,653 options during the three and six months ended June 30, 2007, respectively, for terminated employees and options expired.

9. 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 4 to the consolidated financial statements included in the Company s Form 10-K filed with the Securities and Exchange Commission on March 16, 2006, as amended by Form 10-K/A filed on March 16, 2007.

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, 2007			
Revenue to external customers	$ 3,065	$ 5,266	$ 8,331
Gross profit (loss)	1,304	(659)	645
Income (loss) before interest expense and discontinued operations	1,091	(1,522)	(431)
Total identifiable assets at end of period	1,931	19,049	20,980
Three Months Ended June 30, 2006			
Revenue to external customers	$ 1,743	$ 5,347	$ 7,090
Gross profit	674	852	1,526
Income (loss) before interest expense and discontinued operations	477	31	508
Total identifiable assets at end of period	1,002	19,584	20,586
Six Months Ended June 30, 2007			
Revenue to external customers	$ 5,789	$ 7,609	$ 13,398
Gross profit	2,563	(3,292)	(729)
Income (loss) before interest expense and discontinued operations	1,886	(4,266)	(2,380)
Total identifiable assets at end of period	1,931	19,049	20,980
Six Months Ended June 30, 2006			
Revenue to external customers	$ 4,127	$ 9,518	$ 13,645
Gross profit (loss)	1,664	1,094	2,758
Income (loss) before interest expense and discontinued operations	1,282	(355)	927
Total identifiable assets at end of period	1,002	19,584	20,586

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,	
	2007	2006	2007	2006
Total segment (loss) income before minority interest, interest expense	$ (431)	$ 508	$ (2,380)	$ 927
General and administrative expenses, excluded	(1,663)	(1,539)	(3,883)	(3,155)
Consolidated loss before interest, other income, income taxes, minority interest	(2,094)	(1,031)	(6,263)	(2,228)
Loss from extinguishments of debt			(648)	
Change in value of warrants, net	564	(1,426)	4,256	