

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

NOCOPI TECHNOLOGIES INC/MD/
Form 10KSB
April 14, 2003

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

FORM 10-KSB

(Mark One)

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

For the fiscal year ended December 31, 2002

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

For the transition period from _____ to _____

Commission file number 0-20333

Nocopi Technologies, Inc.

(Name of small business issuer in its charter)

Maryland

87-0406496

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identifi

537 Apple Street, West Conshohocken, PA

19428

(Address of principal executive offices)

(Zip Code)

Issuer's telephone number (610) 834-9600

Securities registered under Section 12(b) of the Exchange Act:

Title of each class

Name of each exchange on which registered

None

Not Applicable

Securities registered under section 12(g) of the Exchange Act:

Common Stock \$.01 par value

(Title of class)

(Title of class)

Check whether the issuer (1) filed all reports required to be filed by
Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such
shorter period that the registrant was required to file such reports), and (2)

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

has been subject to such filing requirements for the past 90 days. Yes X No .

Check if no disclosure of delinquent filers in response to Item 405 of Regulation S-B is contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

State issuer's revenues for its most recent fiscal year. \$736,800.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the issuer. \$1,450,000 at March 31, 2003.

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date. 45,972,241 shares of Common Stock, \$.01 par value at March 31, 2003.

DOCUMENTS INCORPORATED BY REFERENCE

None

Transitional Small Business Disclosure Format (Check one): Yes No

PART I

ITEM 1. BUSINESS

Background

Nocopi Technologies, Inc. (hereinafter "Nocopi", "Registrant" or the "Company") was organized in 1983 to exploit a technology developed by its founders for impeding the reproduction of documents on office copiers. In its early stages of development, Nocopi's business consisted primarily of selling copy resistant paper to protect corporate documents and information. More recently, Registrant has increasingly focused on developing and marketing technologies for document and product authentication which can reduce losses caused by fraudulent document reproduction and by product counterfeiting and/or diversion. Registrant derives revenues by licensing its technologies, both to end-users and to value-added resellers, and by selling products incorporating its technologies and technical support services.

The decline in Registrant's financial condition has not stabilized or been reversed. By the end of 2002, this decline had led to a severe working capital deficiency and adverse liquidity that threatened and continues to threaten to require the imminent cessation of Registrant's operations. During 2002, Registrant received new capital investments totaling \$411,000 from a variety of sources including existing and new stockholders and received \$160,400 in loans from three individuals including the Company's Chairman of the Board. The funds invested have permitted Registrant to continue in operation in the near term. However, Registrant believes that, to continue to conduct business operation in the immediate future, it must obtain additional capital immediately to fund continuing operating deficits. Additional capital is also needed to fund

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

programs and activities designed to increase Registrant's operating revenues to levels that will sustain its operations.

Registrant is currently involved in a substantial dispute with Euro-Nocopi, S.A., its former European licensee, the cost of which has contributed substantially to Registrant's continuing losses, working capital deficit and adverse liquidity. Expenses associated with this dispute increased during 2002. It remains highly uncertain whether Registrant can achieve positive cash flow before its adverse liquidity forces it to cease or suspend operations. Registrant's management intends to seek additional capital, if possible, and may continue to explore possible business combination opportunities if such opportunities are presented.

Anti-Counterfeiting and Anti-Diversion Technologies and Products

Continuing developments in copying and printing technologies have made it ever easier to counterfeit a wide variety of documents. Lottery tickets, gift certificates, event and transportation tickets, travelers' checks and the like are all susceptible to counterfeiting, and Registrant believes that losses from such counterfeiting have increased substantially with improvements in these technologies. Product counterfeiting has long caused losses to manufacturers of brand name products, and Registrant believes these losses have also increased as the counterfeiting of labeling and packaging has become easier.

Registrant's document authentication technologies are useful to businesses desiring to authenticate a wide variety of printed materials and products. These include a technology with the ability to print invisibly on certain areas of a document. The invisible printing can be activated or revealed by use of a special highlighter pen when authentication is required. This technology is marketed under the trademark COPIMARK(TM). Other variations of the COPIMARK(TM) technology involve multiple color responses from a common pen, visible marks of one color that turn another color with the pen or visible and invisible marks that turn into a multicolored image. A related technology is Nocopi's RUB & REVEAL(R) system, which permits the invisible printing of an authenticating symbol or code that can be revealed by rubbing a fingernail over the printed area. These technologies provide users with the ability to authenticate documents and detect counterfeit documents. Applications include the authentication of documents having intrinsic value, such as merchandise receipts, checks, travelers' checks, gift certificates and event tickets, and the authentication of product labeling and packaging. When applied to product labels and packaging, such technologies can be used to detect counterfeit products whose labels and packaging would not contain the authenticating marks invisibly printed on the packaging or labels of the legitimate product, as well as to combat product diversion (i.e. sale of legitimate products through unauthorized distribution channels or in unauthorized markets). Registrant's

1

related invisible inkjet technology permits manufacturers and distributors to track the movement of products from production to ultimate consumption when coupled with proprietary software. Management believes that the "track and trace" capability provided by this technology should be attractive to brand owners and marketers.

Document Security Products

Registrant continues to offer a line of burgundy colored papers that deter photocopying and transmission by facsimile. This colored paper inhibits

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

photocopier reproduction at the cost of loss of easy legibility to the reader. Registrant currently offers its copy resistant papers in three grades, each balancing improved copy resistance against diminished legibility. Registrant also sells user defined, pre-printed forms on which selected areas are colored to inhibit reproduction. An example is a doctor's prescription form with the signature area protected. This product line is called SELECTIVE NOCOPI(TM). Registrant also offers several inks that impede photocopying by color copiers. This technology is called COLORBLOC(R).

Since late 1999, Registrant has, in addition to marketing its own technologies and products, acted as a distributor for a line of Pantograph security paper. This patented product, complementary to the Registrant's line of security paper, produces a message, such as "unauthorized copy", when a copy of an original document that was printed or typed on the Pantograph paper, is reproduced on a photocopier. This product line is called COPI-ALERT.

The following table illustrates the approximate percentage of Registrant's revenues accounted for by each type of its products for each of the two last fiscal years:

	Year Ended December
Product Type	2002
-----	----
Anti-Counterfeiting & Anti-Diversion Technologies and Products	79%
Document Security Products	21%

Marketing

The marketing approach of Registrant is to offer sufficient flexibility in its products and technologies so as to provide cost effective solutions to a wide variety of counterfeiting, diversion and copier fraud problems. As a technology company, Registrant generates revenues primarily by collecting license fees from market-specific manufacturers who incorporate Registrant's technologies into their manufacturing process and their products. Registrant also licenses its technologies directly to end-users.

Registrant has identified a number of major markets for its technologies and products, including security printers, manufacturers of labels and packaging materials and distributors of brand name products. Within each market, key potential users have been identified, and several have been licensed. Within North America, sales efforts include direct selling by company personnel to create end user demand and selling through licensee sales forces and sales agents with support from company personnel. Registrant has determined that technical sales support by its personnel is of great importance to increasing its licensees' sales of products incorporating Registrant's technologies and, therefore, seeks to maintain, to the extent permitted by its limited resources, its commitment to providing such support.

Since 1999, Registrant's management has refocused the company's marketing efforts somewhat in view of the limited resources available to the Company for marketing and the need to improve the Registrant's cash flow. Current marketing efforts are focused on Registrant's more mature technologies that can be utilized by customers with relatively less development efforts.

As continued improvements in color copier and desktop publishing technology make counterfeiting and fraud opportunities less expensive and more available, Registrant intends, to the extent feasible, to maintain an interactive product development and enhancement program with the combined efforts of marketing,

Edgar Filing: NOCOPi TECHNOLOGIES INC/MD/ - Form 10KSB

applications engineering and research and development. Registrant's objective is to concentrate its efforts on developing market-ready products with the most beneficial ratios of market potential to development time and cost.

2

Except in Europe, Registrant has historically sought to market its technologies through its own employees and through independent sales representatives. In 1994, the Registrant formed a European company, Euro-Nocopi, S.A., to market the Company's technologies in Europe under an exclusive licensing arrangement. The Registrant owns approximately an 18% interest in Euro-Nocopi, S.A. In December 2000, Registrant terminated its licensing arrangement with Euro-Nocopi, S.A. due to its commencement of proceedings to liquidate and dissolve and to its failure to pay license fees and other amounts due to Registrant under the licensing arrangement. Registrant currently is seeking to exploit the European market for its technologies directly and through its association with another licensee.

Registrant has taken several steps to improve the marketing of its technologies. These include the implementation of a new web site and online store designed both to more effectively promote the Company's products and to provide for smoother online ordering of certain products, and the establishment of programs to expand its network of authorized dealers and sales agents.

Major Customers

During 2002, Registrant made sales or obtained revenues equal to 10% or more of Registrant's 2002 total revenues from one non-affiliated customer, Nashua Corporation, which accounted for approximately 16% of 2002 revenues.

Outside Sales Agents

Registrant has engaged outside sales agents who are paid commissions on sales to various customers of Registrant and may also receive retainers and reimbursement for certain expenses. During 2001 the total payments to outside sales agents was approximately \$26,000. No commissions were paid to outside sales agents in 2002.

Manufacturing

Registrant has a small facility for the manufacture of its security inks. Except for this facility, Registrant does not maintain manufacturing facilities. Registrant presently subcontracts the manufacture of its applications (mainly printing and coating) to third party manufacturers and expects to continue such subcontracting. Because some of the processes that Nocopi uses in its applications are based on relatively common manufacturing technologies, there appears to be no technical or economic reason for Registrant to invest capital in its own manufacturing facilities.

Registrant has established a quality control program that currently entails laboratory analysis of developed technologies. When warranted, Registrant's specially trained technicians travel to third party production facilities to install equipment, train client staff and monitor the manufacturing process.

Patents

Nocopi has received various patents and/or has patents pending in the United States, Canada, South Africa, Saudi Arabia, Australia, New Zealand, Japan, France, the United Kingdom, Belgium, the Netherlands, Germany, Austria, Italy, Sweden, Switzerland, Luxembourg, and Liechtenstein. Patent applications for Registrant's technology (including improvements in the technology) have also been filed in numerous other jurisdictions where commercial usage is foreseen, including other countries in Europe, Japan, Australia, and New Zealand, and the

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

rights under such applications have been assigned to Registrant. Registrant's patent counsel, which conducted the appropriate searches in Canada and the United States, has reviewed the results of searches conducted in Europe and advised management that effective patent protection for Registrant's technology should be obtainable in all countries in which the patent applications have been filed. There can be no assurance, however, that such protection will be obtained.

When a new product or process is developed, the developer may seek to preserve for itself the economic benefit of the product or process by applying for a patent in each jurisdiction in which the product or process is likely to be exploited. Generally speaking, in order for a patent to be granted, the product or process must be new and be inventively different from what has been previously patented or otherwise known anywhere in the world. Patents generally

3

have a duration of 17 years from the date of grant or 20 years from the date of application depending on the jurisdiction concerned, after which time any person is free to exploit the product or process covered by a patent. A person who is the owner of a patent has, within the jurisdiction in which the patent is granted, the exclusive right to exploit the patent either directly or through licensees, and is entitled to prevent any person from infringing on the patent.

The granting of a patent does not prevent a third party from seeking a judicial determination that the patent is invalid. Such challenges to the validity of a patent are not uncommon and are occasionally successful. There can be no assurance that a challenge will not be filed to one or more of Registrant's patents and that, if filed, such challenge(s) will not be successful.

In the United States and Canada, the details of the product or process that is the subject of a patent application are not publicly disclosed until a patent is granted. However, in some other countries, patent applications are automatically published at a specified time after filing.

Research and Development

Nocopi has been involved in research and development since its inception. Although Registrant's deteriorating financial condition has forced it to reduce funding for research and development in recent years, it intends to continue its research and development activities in three areas, to the extent feasible. First, Registrant will seek to continue to refine its present family of products. Second, Registrant will seek to develop specific customer applications. Finally, Registrant will seek to expand its technology into new areas of implementation. There can be no assurances that Registrant will be able to obtain funds necessary to continue its research and development activities.

During the years ended December 31, 2002, and 2001, Nocopi expended approximately \$254,100 and \$251,600 respectively, on research and development.

Competition

In the area of document and product authentication and serialization, Registrant is aware of other technologies, both covert and overt surface marking techniques, requiring decoding implements or analytical methods to reveal the relevant information. These technologies are offered by other companies for the same anti-counterfeiting and anti-diversion purposes the Registrant markets its covert technologies. These include, among others, biological DNA codes, microtaggants, thermochronic, UV and infrared inks as well as encryption, 2D symbology and laser engraving. Registrant believes its patented and proprietary technologies provide a unique and cost-effective solution to the problem of

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

counterfeiting and gray marketing in the document and product authentication markets it has traditionally sought to exploit. Registrant knows of one large company that recently began to offer an expanding portfolio of product security solutions, some of which may be competitive with Registrant's authentication technologies. In order both to minimize the adverse effect of this new competition and to participate in the competitor's success, it has entered into a license agreement with this competitor so that products incorporating Registrant's technologies can be offered as part of this portfolio.

Registrant is not aware of any competitors that market paper which functions in the same way as Nocopi security papers, although management is aware of a limited number of competitors which are attempting different approaches to the same problems which Registrant's products address. Registrant is aware of a Japanese company that has developed a film overlay that is advertised as providing protection from photocopying. Registrant has examined the film overlay and believes that it has a limited number of applications. Nocopi security paper is also considerably less expensive than the film overlay.

Other indirect competitors are marketing products utilizing the hologram and copy void technologies. The hologram, which has been incorporated into credit cards to foil counterfeiting, is considerably more costly than Registrant's technology. Copy void is a security device that has been developed to indicate whether a document has been photocopied. Registrant also markets a product that has similar features to the copy void technology.

4

Registrant currently has extremely limited resources, and there can be no assurance that other businesses with greater resources than Registrant will not enter Registrant's markets and compete successfully with Registrant.

Euro-Nocopi, S.A.

Registrant formed Euro-Nocopi, S.A. in 1994, to market the Company's technologies in Europe under an exclusive licensing arrangement. Registrant currently owns approximately an 18% interest in Euro-Nocopi, S.A. During 2000, there arose between Registrant and Euro-Nocopi, S.A. a number of areas of conflict and dispute, leading each party to the licensing arrangement to assert informally that the other was in breach of its obligations under that arrangement. The parties initially sought to resolve their differences by negotiating a transaction in which Euro-Nocopi, S.A. would have purchased from Registrant its entire equity interest as well as the paid-up European rights to Registrant's technologies. These negotiations terminated without agreement early in December 2000.

Following the termination of the transaction negotiations, Registrant was informed by Euro-Nocopi, S.A. that it had adopted resolutions to liquidate and dissolve. In December 2000, Registrant terminated its license agreement with Euro-Nocopi, S.A. in accordance with its terms and discontinued the provision of support (including the sale of proprietary inks) to Euro Nocopi, S.A. and its customers. Euro-Nocopi S.A. responded by denying that Registrant's termination of the licensing agreement was permissible or effective, and by asserting a claim that, as a result of alleged breaches of the licensing arrangement by Registrant, it was entitled to a royalty-free license to exploit Registrant's technologies in Europe.

Promptly thereafter, Euro-Nocopi, S.A. commenced an action before a court in Paris, France in which it sought the entry of an order, in the nature of a preliminary injunction, to compel Registrant to honor the license agreement pending judicial or arbitral resolution of the dispute between the parties under the license agreement. Notably, in the French litigation, Euro-Nocopi S.A. did

Edgar Filing: NOCOPi TECHNOLOGIES INC/MD/ - Form 10KSB

not seek an adjudication on the merits of the underlying dispute. In March 2001, the Emergency Judge hearing the action issued a decision denying the relief requested by Euro-Nocopi, S.A. and the shareholders. The decision, which does not purport to be a final adjudication of the merits of the controversy but only of Euro-Nocopi's request for preliminary relief, held that Euro-Nocopi S.A. was not entitled to the requested order because Registrant had validly terminated the licensing arrangement in mid-December, and also ordered Euro-Nocopi, S.A. to pay into escrow the approximately \$125,000 that Registrant claimed was due and owing under the licensing arrangement.

In March 2001, Euro-Nocopi, S.A. commenced an arbitration proceeding before the American Arbitration Association in New York, NY against Registrant. In this proceeding, Euro-Nocopi, S.A. has not asserted a claim for damages but has asserted a claim for an award in the nature of a declaratory judgment to the effect that, because Registrant has (allegedly) breached the license agreement, Euro-Nocopi, S.A. is entitled to a perpetual royalty-free license to exploit Registrant's technologies in Europe. These proceedings are described below under the heading "Legal Proceedings."

Following its termination of the licensing arrangement with Euro-Nocopi, S.A., Registrant moved to directly exploit the European marketplace for its technologies.

Employees

At March 31, 2003, Registrant had four full-time and three part-time employees. Registrant believes that its relations with its employees are good.

Financial Information about Foreign and Domestic Operations

Certain information concerning Registrant's foreign and domestic operations is contained in Note 9 to Registrant's Financial Statements included elsewhere in this Annual Report on Form 10-KSB.

ITEM 2. PROPERTIES

Registrant's corporate headquarters, research and ink production facilities are currently located at 537 Apple Street, West Conshohocken, Pennsylvania 19428. Its telephone number at that location is (610) 834-9600. These premises consist of approximately 14,800 square feet of space leased from an unaffiliated third party under a lease that expired in February 2003. Registrant is renting the

premises on a month-to-month basis until it relocates to new premises. Registrant currently plans to complete this relocation during the second quarter of 2003. Current monthly rent under this lease is \$9,000. Registrant is also responsible for the operating costs of the building.

In March 2003 Registrant negotiated a five year lease with an unaffiliated third party, commencing in April 2003, for 5,000 square feet of space in a multi-tenant building at 9 Portland Road, West Conshohocken, Pennsylvania 19428. Initial monthly rent at this location is \$2,813 escalating four percent on each anniversary date of the lease. Registrant is also responsible for its pro-rata share of the operating costs of the building. Registrant anticipates that it will incur leasehold improvement expenditures of approximately \$20,000 before occupying the space in the second quarter of 2003. Registrant believes that the

Edgar Filing: NOCOPi TECHNOLOGIES INC/MD/ - Form 10KSB

newly leased space will be adequate for its current needs due to the loss of customers over the past years and the reduction in its number of employees and that its operating expenses will be lowered as a result.

ITEM 3. LEGAL PROCEEDINGS

Except as set forth below, Registrant is not aware of any material pending litigation (other than ordinary routine litigation incidental to its business where, in management's view, the amount involved is less than 10% of Registrant's current assets) to which Registrant is or may be a party, or to which any of its properties is or may be subject, nor is it aware of any pending or contemplated proceedings against it by any governmental authority. Registrant knows of no material legal proceedings pending or threatened, or judgments entered against, any director or officer of Registrant in his capacity as such.

In December 2000, Euro-Nocopi, S.A, Registrant's former European licensee, commenced proceedings against Registrant in a court in Paris, France. These proceedings are described above under the heading "Euro-Nocopi, S.A." In March 2001, Euro-Nocopi, S.A. commenced arbitration proceedings against Registrant before the American Arbitration Association in New York, NY. In these proceedings, Euro-Nocopi, S.A. has sought an award in the nature of a declaratory judgment to the effect that, due to alleged breaches by Registrant of the licensing arrangement between Registrant and Euro-Nocopi, S.A., it is entitled to a royalty-free license to exploit Registrant's technologies in Europe. Euro-Nocopi, S.A. has not sought an award of money damages. Euro-Nocopi's demand appears to allege that Registrant has committed numerous breaches of the licensing arrangement between the parties, notably by failing to disclose certain technical information, by failing to provide technical support, services and products to Euro-Nocopi, S.A. and by entering into a licensing agreement with a third party allegedly violating the exclusivity provisions of the Euro-Nocopi, S.A. licensing arrangement.

Registrant has filed a response to Euro-Nocopi's demand denying that Euro-Nocopi is entitled to the relief requested and has filed a counter-demand contending that it has validly terminated the Euro-Nocopi licensing arrangement and seeking to recover in excess of \$125,000 owed to it by Euro-Nocopi, S.A. under the terminated licensing arrangement. Registrant intends to defend itself against Euro-Nocopi's claims and to assert its counterclaim vigorously. The parties are currently engaged in discussions relating to the settlement of the arbitration, and all related matters, and the arbitration hearing on the merits has been postponed pending such discussions.

In March 2001 certain shareholders of Euro-Nocopi, S.A. filed suit in a court in Paris, France against certain current and former officers and directors of Registrant, and against a licensee of Registrant. Registrant is not named as a defendant in the suit. The suit seeks damages in excess of \$7 million from the defendants for various alleged acts of oppression, self-dealing and fraud in connection with the organization and capitalization of Euro-Nocopi, S.A., the management of that company and Registrant's management of its relationship with that company. The defendants in this litigation have denied any liability to the plaintiffs and have claimed indemnification from the Company in connection with the lawsuit, and Registrant has advanced certain funds toward payment of the costs of defense.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of the fiscal year ended December 31, 2002, no matters were submitted to a vote of Registrant's security holders.

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

PART II

ITEM 5. MARKET PRICE OF AND DIVIDENDS ON REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Registrant's Common Stock is traded on the over-the-counter market and quoted on the NASD over-the-counter Bulletin Board under the symbol "NNUP". The table below presents the range of high and low bid quotations of Registrant's Common Stock by calendar quarter for the last two full fiscal years and for a recent date, as reported by the National Quotation Bureau, Inc. The quotations represent prices between dealers and do not include retail markup, markdown, or commissions; hence, such quotations do not represent actual transactions.

	High Bid	Low Bid
	-----	-----
January 1, 2001 to March 31, 2001	\$.20	\$.11
April 1, 2001 to June 30, 2001	\$.15	\$.08
July 1, 2001 to September 30, 2001	\$.15	\$.06
October 1, 2001 to December 31, 2001	\$.14	\$.05
January 1, 2002 to March 31, 2002	\$.16	\$.10
April 1, 2002 to June 30, 2002	\$.11	\$.07
July 1, 2002 to September 30, 2002	\$.08	\$.05
October 1, 2002 to December 31, 2002	\$.08	\$.05
January 1, 2003 to March 31, 2003	\$.07	\$.03

As of March 31, 2003, 45,972,241 shares of Registrant's Common Stock were outstanding. The number of holders of record of Registrant's Common Stock was approximately 1,100. However, Registrant estimates that it has a significantly greater number of Common Stockholders because a number of shares of Registrant's Common Stock are held of record by broker-dealers for their customers in street name. In addition to the 45,972,241 shares of Common Stock which are outstanding, Registrant, at March 31, 2003, has reserved for issuance 2,700,000 shares of its Common Stock which underlie outstanding options to purchase Common Stock of the Registrant. Under the terms of a Subscription Agreement under which 3,333,333 shares of Registrant's common stock were purchased from the Registrant by an investment partnership in late 2002, one of whose partners is a director of Registrant, Registrant has agreed to issue 40,000,000 warrants, at varying prices ranging from \$.10 per share to \$.25 per share, exercisable during various periods through year-end 2003 through year-end 2006, subject to partial rollover and extension, to the partnership. The issuance of the warrants are subject to the negotiation and agreement of the Registrant and the investors on the definitive terms thereof and also to the approval by the Registrant's common stockholders of an amendment to the Registrant's charter to increase its authorized capital to a number of shares sufficient to permit exercise of the warrants.

Registrant has paid no cash dividends on its Common Stock and does not anticipate paying any such dividends in the foreseeable future.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Forward-Looking Information

The information in this Management's Discussion and Analysis of Results of Operations and Financial Condition contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

or industry results to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Such factors include those described in "Uncertainties That May Affect the Company, its Operating Results and Stock Price." The forward-looking statements included in this report may prove to be inaccurate. In light of the

7

significant uncertainties inherent in these forward-looking statements, you should not consider this information to be a guarantee by us or any other person that our objectives and plans will be achieved. The Company does not undertake to publicly update or revise its forward-looking statements even if experience or future changes make it clear that any projected results (expressed or implied) will not be realized.

Results of Operations

The Company's revenues are derived from royalties paid by licensees of the Company's technologies, fees for the provision of technical services to licensees and from the direct sale of products incorporating the Company's technologies, such as inks, security paper and pressure sensitive labels, and equipment used to support the application of the Company's technologies, such as ink-jet printing systems. Royalties consist of guaranteed minimum royalties payable by the Company's licensees in certain cases and additional royalties which typically vary with the licensee's sales or production of products incorporating the licensed technology. Service fee and sales revenues vary directly with the number of units of service or product provided.

Because the Company has a relatively high level of fixed costs, its operating results are substantially dependent on revenue levels. Because revenues derived from licenses and royalties carry a much higher gross profit margin than other revenues, operating results are also significantly affected by changes in revenue mix.

Both the absolute amounts of the Company's revenues and the mix among the various sources of revenue are subject to substantial fluctuation. The Company has a relatively small number of substantial customers rather than a large number of small customers. Accordingly, changes in the revenue received from a significant customer can have a substantial effect on the Company's total revenue and on its revenue mix and overall financial performance. Such changes may result from a customer's product development delays, engineering changes, changes in product marketing strategies and the like. In addition, certain customers have, from time to time, sought to renegotiate certain provisions of their license agreements and, when the Company agrees to revise terms, revenues from the customer may be affected.

Revenues for 2002 were \$736,800, a decline of 5%, or \$35,300, from \$772,100 in 2001. Licenses, royalties and fees declined in 2002 by 11% to \$441,100 from \$498,300 in 2001. The reduction in licenses, royalties and fees is due primarily to the termination or non-renewal of license arrangements with three licensees, including the Company's largest 2001 customer, during 2002 offset in part by the addition of two new licensees. Product and other sales increased by \$21,900, or 8% to \$295,700 in 2002 from \$273,800 in 2001. The increase in product sales reflects higher level of sales of the Company's line of security papers in 2002 compared to 2001.

Gross profit declined to \$358,000 or 49% of revenues in 2002 from \$405,900 or 53% of revenues in 2001. Licenses, royalties and fees have historically carried a higher gross profit than product sales, which generally consist of supplies or

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

other manufactured products which incorporate the Company's technologies or equipment used to support the application of its technologies. These items (except for inks which are manufactured by the Company) are generally purchased from third-party vendors and resold to the end-user or licensee and carry a lower gross profit than licenses, royalties and fees. The 2002 gross profit and gross profit percentage was negatively impacted by the decline in revenues from licenses, royalties and fees as well higher expenditures for paper purchased for resale and higher production costs incurred in the manufacture of the Company's line of security inks.

Research and development expenses of \$254,100 in 2002 approximated the \$251,600 incurred in 2001.

Sales and marketing expenses increased to \$269,900 in 2002 from \$251,700 in 2001. The increase reflects the hiring of a sales executive in the fourth quarter of 2001 offset in part by a reduction in fees paid to sales agents and consultants and lower travel expenses during 2002.

General and administrative expenses (exclusive of legal expenses) decreased to \$269,600 in 2002 from \$376,400 in 2001 as the Company was forced to strictly limit its expenditures to conserve its cash resources. The decline in 2002 compared to 2001 relates to lower audit fees, consulting fees and costs involved in the acquisition of new patents and the maintenance of existing patents in 2002 compared to 2001.

8

Legal expenses increased to \$479,600 in 2002 from \$313,900 in 2001. Significant legal expenses have been incurred since early 2001 as a result of the arbitration proceedings and other litigation in both the United States and France between the Company and Euro-Nocopi, S.A., its former European licensee. The increase 2002 compared to 2001 results primarily from higher arbitration related expenses as the arbitration proceedings accelerated during the year. While the arbitration was scheduled to be heard by the arbitrators in December 2002, the arbitration has been suspended at the request of the parties as attorneys seek to negotiate a settlement. There can be no assurances that a settlement acceptable to both parties will be concluded.

Related party expenses of \$42,500 in 2001 consisted of consulting services provided by a firm employing an officer of the Company. There were no such expenses incurred in 2002.

Other income (expense) includes interest income on funds invested and, in 2002, interest expense on the Demand Loans. The decline in interest income to \$300 in 2002 compared to \$3,400 in 2001 resulted from lower levels of cash invested.

The net loss increased to \$924,500 in 2002 from \$828,600 in 2001. The \$95,600 increase in the net loss in 2002 from the prior year resulted primarily from reductions in revenue and gross profit as the Company's business has continued to contract and higher legal fees incurred in litigation and arbitration proceedings with this former licensee.

Plan of Operation, Liquidity and Capital Resources

The Company's cash and cash equivalents increased to \$139,000 at December 31, 2002 from \$100 at December 31, 2001. During 2002, the Company sold 6,850,000 shares of its common stock to affiliated and non-affiliated individual investors for \$411,000, received loans of \$160,400 from three individuals, including \$48,400 from the Chairman of the Board of the Company and used \$432,500 to fund operations.

The loss of a number of customers during the past three years and the termination of the Company's exclusive European licensee in 2000 has had a material adverse effect on the Company's results of operations and upon its liquidity and capital resources. The Company believes that the conditions arising from these circumstances will make it impossible for the Company to continue in operation as a going concern unless it receives substantial new capital investment in the immediate future. During 2002, the receipt of funds in conjunction with the sale of approximately 18% of the Company's common stock as was outstanding at December 31, 2001 and loans of \$160,400 has permitted the Company to continue in operation. The Company's illiquidity has forced it to follow a policy of deferring payment to its vendors, even where such deferral has not been agreed to by the vendors. As a result, the Company's trade payables have increased to \$649,200 at December 31, 2002 from \$237,400 at December 31, 2001. Accordingly, the Company is currently in default of the payment terms extended by certain of its professional service providers and other vendors, some of which have suspended providing services and/or credit to the Company and may require payment in advance. Management of the Company believes that, to survive, it must obtain additional capital immediately to reduce its substantial obligations, fund continuing operating deficits and fund investment needed to increase its operating revenues to levels that will sustain its operations. If the Company fails to significantly increase its cash balances through further equity investment, for which it has no commitments and only very limited prospects, it will be forced to cease operations due to a lack of cash early in the second quarter of 2003. There can be no assurance that the Company will be able to secure additional equity investment before it is forced to cease operations.

The Company, in response to the ongoing adverse liquidity situation, has maintained a cost reduction program including staff reductions, where possible, and curtailment of discretionary research and development and sales and marketing expenses.

The Company plans to spend approximately \$20,000 in leasehold improvements at its newly leased premises during the second quarter of 2003.

Uncertainties That May Affect the Company, its Operating Results and Stock Price

The Company's operating results and stock price are dependent upon a number of factors, some of which are beyond the Company's control. These include:

Inability to Continue in Operation Without Immediate New Capital Investment. The Company had a negative working capital of \$994,700 at December 31, 2002 and experienced negative cash flow from operations of \$432,500 in the year ended December 31, 2002. The Company currently has insufficient cash to conduct its business operations in the ordinary course without substantial regard for the effect of a contemplated activity or transaction on its liquidity. Cash received from the sale of common stock and the issuance of demand loans during 2002 have allowed the Company to continue in operation to the current date but have not been sufficient to offset the Company's ongoing cash deficits resulting in the continuing deterioration of the Company's financial condition. Management does not believe the Company can significantly improve its negative cash flow in the near future. If it does not obtain a substantial cash infusion, (through capital investment or otherwise) in the very near term, it will be forced to cease operations due to a lack of cash by early in the second quarter of 2003. It is uncertain whether the Company's assets will retain any value if the Company ceases operations. There are no assurances that the Company will be able to

Edgar Filing: NOCOPi TECHNOLOGIES INC/MD/ - Form 10KSB

secure additional capital investment before it is forced to cease operations.

Continuing Euro-Nocopi Litigation. The Company is currently expending sums representing a substantial portion of its revenues for professional fees and costs relating to legal disputes between the Company and its former affiliate, Euro-Nocopi, S.A. as described under the heading "Litigation". Management believes that successful resolution of the disputes between it and Euro-Nocopi is necessary for the Company to be able to license its technologies to European users. If Euro-Nocopi succeeds in asserting its rights to a paid-up European license, it will be entitled to license European end users of the Company's technologies with no payment of license fees (by Euro-Nocopi or such users) to the Company, and the Company will not be entitled to grant licenses or collect license fees from European users or to grant worldwide licenses. The Company cannot continue to pay the costs of this dispute unless it can obtain substantial new capital investment, of which there can be no assurances, and the Company will not prevail in this dispute if it cannot continue to pay such costs. Even if the Company is able to continue its dispute with Euro-Nocopi through resolution, or complete the settlement discussions currently underway, there can be no assurance that the resolution will be a successful one for the Company or that it will have a material positive effect on the financial condition of the Company.

Possible Inability to Develop New Business. Even if the Company is able to raise cash through additional capital investment or otherwise, it must quickly improve its operating cash flow. Because the Company has already significantly reduced its operating expenses, Management believes that any significant improvement in the Company's cash flow must result from increases in its revenues from traditional sources and from new revenue sources. The Company's ability to develop new revenues may depend on the extent of both its marketing activities and its research and development activities. There are no assurances that the resources the Company, even with additional investment, can devote to marketing and to research and development will be sufficient to increase the Company's revenues to levels resulting in positive cash flow.

Inability to Obtain Raw Materials and Products for Resale. The Company's adverse financial condition has required it to significantly defer payments due vendors who supply raw materials and other components of the Company's security inks, security paper that the Company purchases for resale and professional and other services. As a result, the Company is on credit hold with certain of its suppliers and is required to pay cash in advance of shipment to others. Delays in shipments to customers caused by the Company's inability to obtain materials on a timely basis and the possibility that certain current vendors may permanently discontinue to supply the Company with needed products could impact the Company's ability to service its customers and adversely affect its customer and licensee relationships. Management of the Company believes that, without significant capital investment in the very near term, the Company will not be able to maintain acceptable relationships with its vendors and professional service providers. There are no assurances that the Company will be able to secure sufficient capital investment to maintain its vendor accounts on satisfactory terms.

10

Uneven Pattern of Quarterly and Annual Operating Results. The Company's revenues, which are derived primarily from licensing and royalties, are difficult to forecast due to the long sales cycle of the Company's technologies, the potential for customer delay or deferral of implementation of the Company's technologies, the size and timing of inception of individual license agreements, the success of the Company's licensees and strategic partners in exploiting the market for the licensed products, modifications of customer budgets, and uneven patterns of royalty revenue and product orders. As the Company's revenue base is

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

not substantial, delays in finalizing license contracts, implementing the technology to initiate the revenue stream and customer ordering decisions can have a material adverse effect on the Company's quarterly and annual revenue expectations and, as the Company's operating expenses are substantially fixed, income expectations will be subject to a similar adverse outcome.

Volatility of Stock Price. The market price for the Company's common stock has historically experienced significant fluctuations and may continue to do so. The Company has, since its inception, operated at a loss and has not produced revenue levels traditionally associated with publicly traded companies. The Company's common stock is not listed on a national or regional securities exchange and, consequently, the Company receives limited publicity regarding its business achievements and prospects, nor do securities analysts and traders extensively follow it. The market price may be affected by announcements of new relationships or modifications to existing relationships. The stock prices of many developing public companies, particularly those with small capitalizations, have experienced wide fluctuations not necessarily related to operating performance. Such fluctuations may adversely affect the market price of the Company's common stock.

Intellectual Property. The Company relies on a combination of protections provided under applicable international patent, trademark and trade secret laws. It also relies on confidentiality, non-analysis and licensing agreements to establish and protect its rights in its proprietary technologies. While the Company actively attempts to protect these rights, the Company's technologies could possibly be compromised through reverse engineering or other means. In addition, the Company's ability to enforce its intellectual property rights through appropriate legal action has been and will continue to be limited by the Company's adverse liquidity. There can be no assurances that the Company will be able to protect the basis of its technologies from discovery by unauthorized third parties or to preclude unauthorized persons from conducting activities that infringe on the Company's rights. The Company's adverse liquidity situation has also impacted its ability to obtain patent protection on its intellectual property and to maintain protection on previously issued patents. The Company has been advised by its patent counsel that patent maintenance fees approximating \$20,000 will be due during 2003. The Company has not yet made a decision on keeping any or all of these patents in force. There can be no assurances that the Company will be able to continue to prosecute new patents and maintain issued patents. As a result, the Company's customer and licensee relationships could be adversely affected and the value of the Company's technologies and intellectual property (including their value upon a liquidation of the Company) could be substantially diminished.

Recently Issued Accounting Standards

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("Statement 144"), effective in fiscal years beginning after December 15, 2001, with early adoption permitted, and in general are to be applied prospectively. Statement 144 establishes a single accounting model for the impairment or disposal of long-lived assets, including discontinued operations. Statement 144 superseded Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The Company adopted SFAS No. 144 effective January 1, 2002. The adoption of this standard had no effect on the Company's financial statements.

The following recently issued accounting pronouncements are currently not applicable to the Company.

In April 2002, the FASB issued Statement No. 145, "Rescission of FASB Statements

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Correction." This Statement eliminates extraordinary accounting treatment for reporting gain or loss on debt extinguishment, and amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions.

11

In November 2002, the FASB issued Interpretation 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This Interpretation expands the disclosures to be made by a guarantor about its obligations under certain guarantees and requires that, at the inception of a guarantee, a guarantor recognize a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements are effective immediately. The initial recognition and measurement provisions of this Interpretation are effective for guarantees issued or modified after December 31, 2002.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock Based Compensation - Transition and Disclosure - an Amendment to SFAS 123". SFAS No. 148 provides two additional transition methods for entities that adopt the preferable method of accounting for stock based compensation. Further, the statement requires disclosure of comparable information for all companies regardless of whether, when, or how an entity adopts the preferable, fair value based method of accounting. These disclosures are now required for interim periods in addition to the traditional annual disclosure. The amendments to SFAS No. 123, which provides for additional transition methods are effective for periods ending after December 15, 2002, although earlier application is permitted. The amendments to the disclosure requirements are required for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002.

ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Financial Statements of Registrant meeting the requirements of Regulation S-B (except section 228.310 and Article 11 of Regulation S-X thereof) are included herein beginning at page F-1 of this Annual Report on Form 10-KSB.

For information required with respect to this Item 7, see "Financial Statements and Schedules on pages F-1 through F-13 of this report.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

On March 23, 2002, Registrant engaged the accounting firm Cogen Sklar, LLP to audit Registrant's financial statements for the year ended December 31, 2001. The engagement of BDO Seidman, LLP which had been engaged by Registrant to audit its financial statements for prior years was not renewed. Such firm had not submitted a resignation, nor had it formally declined to stand for re-election as Registrant's auditor. This event is more fully described in 8-K and 8-K/A filings dated March 23, 2002 and April 3, 2002, respectively, which are incorporated herein by reference.

PART III

The information required by Part III, items 9 through 12 inclusive, of Form 10-KSB either (a) is incorporated by reference to Registrant's Definitive Proxy Statement for the Annual Meeting of Stockholders if filed by April 30, 2003 or (b) will be furnished by amendment to this Form 10-KSB to be filed by that date.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following Financial Statements are filed as part of this Annual Report on Form 10-KSB

	PAGE

Report of Independent Certified Public Accountants	F-1
Balance Sheet as of December 31, 2002	F-2
Statements of Operations for the Years ended December 31, 2002 and 2001	F-3
Statements of Stockholders' Equity (Deficiency) for the Years ended December 31, 2002 and 2001	F-4
Statements of Cash Flows for the Years ended December 31, 2002 and 2001	F-5
Notes to Financial Statements	F-6 to F-13

(b) The Exhibit Index begins on Page 15 of this Annual Report on Form 10-KSB.

No Current Reports on Form 8-K have been filed by the Registrant during the quarter ended December 31, 2002.

ITEM 14. CONTROLS AND PROCEDURES

Within 90 days prior to the filing date of this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures provide reasonable assurance that material information required to be included in our periodic SEC reports is recorded, processed, summarized and reported within the time periods specified in the relevant SEC rules and forms.

In addition, we reviewed our internal controls, and there have been no significant changes in our internal controls or in other factors that could significantly affect those controls subsequent to the date of their last evaluation.

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NOCOPI TECHNOLOGIES, INC.

Registrant

Dated: April 11, 2003

By: /s/ Michael A. Feinstein, M.D.

Michael A. Feinstein, M.D.
Chairman of the Board

Dated: April 11, 2003

By: /s/ Rudolph A. Lutterschmidt

Rudolph A. Lutterschmidt
Vice President, Chief Financial Officer
and Chief Accounting Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: April 11, 2003

/s/ Michael A. Feinstein, M.D.

Michael A. Feinstein, M.D.,
Chairman of the Board

Date: April 11, 2003

Franco Harris, Director

Date: April 11, 2003

/s/ Stanley G. Hart

Stanley G. Hart, Director

Date: April 11, 2003

/s/ Richard Levitt

Richard Levitt, Director

Date: April 11, 2003

/s/ Waldemar Maya, Jr.

Waldemar Maya, Jr., Director

Date: April 11, 2003

/s/ Claude Nash

Claude Nash, Director

Date: April 11, 2003

John F. O'Brien III, Director

Date: April 11, 2003

Alan Rihm, Director

Date: April 11, 2003

/s/ Michael Solomon

Michael Solomon, Director

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

14

The following Exhibits are filed as part of this Annual Report on Form 10-KSB:

Exhibit Number -----	Description -----
3.1	Articles of Incorporation (1)
3.2	Bylaws (1)
3.3	Articles of Amendment to Articles of Incorporation (3)
3.4	Article of Amendment to Articles of Incorporation (5)
3.5	Amendments to Bylaws (6)
10.1	Summary Plan Description for Nocopi Technologies, Inc. 401(k) Profit Sharing Plan (2)
10.2	Nocopi Technologies, Inc. 1996 Stock Option Plan (3)
10.3	Employment Agreement between Registrant and Dr. A. Gundjian (4)
10.4	Form of Common Stock Purchase Warrant (4)
10.5	Lease Agreement dated February 17, 1998 relating to premises at 537 Apple Street, West Conshohocken, PA 19428 (4)
10.6	Nocopi Technologies, Inc. 1999 Stock Option Plan (5)
10.7	Amended Summary Plan Description for Nocopi Technologies, Inc. 401(k) Profit Sharing Plan (5)
10.8	Director Indemnification Agreement (6)
10.9	Officer Indemnification Agreement (6)
10.10	License Agreement with Westvaco Brand Security, Inc. (7)
10.11	Amendment to Westvaco License Agreement (7)
10.12	Amendment (No. 2) to Westvaco License Agreement (7)
10.13	Stock Purchase Agreement with Westvaco Brand Security, Inc. (7)
10.14	Registration Rights Agreement with Westvaco Brand Security, Inc. (7)
10.15	Collateral Assignment of Patent Rights to Westvaco Brand Security, Inc. (7)
10.16	Escrow Agreement with Westvaco Brand Security, Inc. (7)
10.17	Amendment (No. 3) to Westvaco License Agreement
10.18	Subscription Agreement with Entrevest I Associates
10.19	Lease Agreement dated March 19, 2003 relating to premises at 9 Portland

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

Road, West Conshohocken, PA 19428

- 16.1 Letter dated March 27, 2002 from BDO Seidman, LLP re: Change in Certifying Accountant (8)
- 99.1 Certificates of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

15

- (1) Incorporated by reference to Registrant's Registration Statement on Form 10, as filed with the Commission on or about August 19, 1992
- (2) Incorporated by reference to Registrant's Annual Report on Form 10-K for the Year Ended December 31, 1993
- (3) Incorporated by reference to Registrant's Annual Report on Form 10-K for the Year Ended December 31, 1996
- (4) Incorporated by reference to Registrant's Annual Report on Form 10-K for the Year Ended December 31, 1997
- (5) Incorporated by reference to Registrant's Annual Report on Form 10-KSB for the Year Ended December 31, 1998
- (6) Incorporated by reference to Registrant's Quarterly Report on Form 10-QSB for the Three Months Ended September 30, 1999
- (7) Incorporated by reference to Registrant's Annual Report on Form 10-KSB for the Year Ended December 31, 2000
- (8) Incorporated by reference to Registrant's Current Report on Form 8-K/A dated April 3, 2002

16

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors
of Nocopi Technologies, Inc.
West Conshohocken, Pennsylvania

We have audited the accompanying balance sheet of Nocopi Technologies, Inc. as of December 31, 2002 and the related statements of operations, stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2002. The financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Nocopi Technologies, Inc. at December 31, 2002, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 11 to the financial statements, the Company has suffered recurring losses from operations that raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 11. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

COGEN SKLAR, LLP

Bala Cynwyd, Pennsylvania
February 25, 2003

F-1

Nocopi Technologies, Inc.
Balance Sheet

	December 31 2002 -----
Assets	
Current assets	
Cash and cash equivalents	\$139,000
Accounts receivable less \$15,000 allowance for doubtful accounts	39,100
Prepaid and other	31,000

Total current assets	209,100
Fixed assets	
Leasehold improvements	39,500
Furniture, fixtures and equipment	476,200

	515,700

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

Less: accumulated depreciation and amortization	501,700

	14,000
Other assets	
Investment in unconsolidated affiliate - net	110,600

	\$333,700
	=====

Liabilities and Stockholders' Deficiency

Current liabilities	
Demand loans	\$160,400
Accounts payable	649,200
Accrued expenses	273,500
Deferred revenue	120,700

Total current liabilities	1,203,800
Commitments and contingencies	
Stockholders' deficiency	
Series A preferred stock \$1.00 par value	
Authorized - 300,000 shares	
Issued and outstanding - none	
Common stock, \$.01 par value	
Authorized - 75,000,000 shares	
Issued and outstanding - 45,972,241 shares	459,700
Paid-in capital	11,141,100
Accumulated deficit	(12,470,900)

	(870,100)

	\$333,700
	=====

The accompanying notes are an integral part of these financial statements.

F-2

Nocopi Technologies, Inc.
Statements of Operations

	Years ended December 31	
	2002	2001
	-----	-----
Revenues		
Licenses, royalties and fees	\$441,100	\$498,300
Product and other sales	295,700	273,800
	-----	-----
	736,800	772,100
	-----	-----
Cost of sales		
Licenses, royalties and fees	187,700	215,800
Product and other sales	191,100	150,400

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

	-----	-----
	378,800	366,200
	-----	-----
Gross profit	358,000	405,900
	-----	-----
Operating expenses		
Research and development	254,100	251,600
Sales and marketing	269,900	251,700
General and administrative (exclusive of legal expenses)	269,600	376,400
Legal expenses	479,600	313,900
Related party expenses		42,500
	-----	-----
	1,273,200	1,236,100
	-----	-----
Loss from operations	(915,200)	(830,200)
	-----	-----
Other income (expenses)		
Interest income	300	3,400
Interest and bank charges	(9,600)	(1,800)
	-----	-----
	(9,300)	1,600
	-----	-----
Net loss	(\$924,500)	(\$828,600)
	=====	=====
Basic and diluted loss per common share	(\$.02)	(\$.02)
Weighted average common shares outstanding	42,516,686	37,386,574

The accompanying notes are an integral part of these financial statements.

F-3

Nocopi Technologies, Inc.
Statements of Stockholders' Equity (Deficit)
For the Period January 1, 2001 through December 31, 2002

	Common stock		Paid-in	Accumulated
	Shares	Amount	Capital	Deficit
	-----	-----	-----	-----
Balance - January 1, 2001	33,817,332	\$338,200	\$10,434,600	\$(10,717,800)
Sales of common stock, net of expenses	5,304,909	53,000	364,000	

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

Net loss				(828,600)
Balance - December 31, 2001	39,122,241	391,200	10,798,600	(11,546,400)
Sales of common stock	6,850,000	68,500	342,500	
Net loss				(924,500)
Balance - December 31, 2002	45,972,241	\$459,700	\$11,141,100	(\$12,470,900)

The accompanying notes are an integral part of these financial statements.

F-4

Nocopi Technologies, Inc.
Statements of Cash Flows

	Years ended December 31	
	2002	2001
	-----	-----
Operating Activities		
Net loss	(\$924,500)	(\$828,600)
Adjustments to reconcile net loss to cash used in operating activities		
Depreciation	18,700	23,000
Allowance for doubtful accounts, net	(6,200)	(1,000)
	-----	-----
	(912,000)	(806,600)
(Increase) decrease in assets		
Accounts receivable	6,700	33,000
Prepaid and other	(8,300)	16,000
Increase in liabilities		
Accounts payable and accrued expenses	423,400	133,000
Deferred revenue	57,700	18,000
	-----	-----
	479,500	202,000
	-----	-----
Cash used in operating activities	(432,500)	(603,600)
Financing Activities		
Issuance of common stock, net	411,000	417,000
Demand loans	160,400	
	-----	-----
Cash provided by financing activities	571,400	417,000
	-----	-----
Increase (decrease) in cash and cash equivalents	138,900	(186,600)
Cash and cash equivalents		
Beginning of year	100	186,600
	-----	-----

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

End of year

\$139,000

=====

\$
=====

The accompanying notes are an integral part of these financial statements.

F-5

NOCOPI TECHNOLOGIES, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 2002 and 2001

1. Organization of the Company

Nocopi Technologies, Inc. (the Company) is organized under the laws of the State of Maryland. Its main business activities are the development and distribution of document security products and the licensing of its patented authentication technologies in the United States and foreign countries. The Company operates in one principal industry segment.

2. Significant Accounting Policies

Estimates - The preparation of the financial statements in conformity with Accounting Principles Generally Accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the dates of financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

Cash and cash equivalents - Cash equivalents consist principally of time deposits and highly liquid investments with an original maturity of three months or less placed with major banks and financial institutions. Cash equivalents are carried at the lower of cost, plus accrued interest, or market value and are held in money market accounts at a local bank. At December 31, 2002, Nocopi's investments in money market accounts amounted to \$124,200.

Concentration of credit risk involving cash - At December 31, 2002, the Company has deposits with a major financial institution that exceed Federal Deposit Insurance limits. This financial institution has a strong credit rating, and Management believes that credit risk related to these deposits is minimal.

Fixed assets are carried at cost less accumulated depreciation and amortization. Furniture, fixtures and equipment are generally depreciated on the straight-line method over their estimated service lives. Leasehold improvements are amortized on a straight-line basis over the shorter of five years or the term of the lease. Major renovations and betterments are capitalized. Maintenance, repairs and minor items are expensed as incurred. Upon disposal, assets and related depreciation are removed from the accounts and the net amount, less proceeds from disposal, is charged or credited to income.

Investment in Affiliate - The Company's investment, approximately 18%, in Euro-Nocopi, S.A. (Euro) was accounted for under the equity method through September 30, 2000 due to the technical dependence of Euro on the Company.

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

The Company changed its method of accounting for its investment in Euro to the cost method effective October 1, 2000 and recorded the carrying value at that date as the cost of its investment. During the fourth quarter of 2000, the Company wrote down its investment in Euro by \$110,000 due to the uncertainty of its recoverability. (See note 9).

Patent costs are charged to expense as incurred due to the uncertainty of their recoverability as a result of the Company's adverse liquidity situation.

F-6

Revenues, consisting primarily of license fees and royalties, are recorded as earned over the license term. Product sales are recognized upon shipment of products.

Income taxes - Deferred income taxes are provided for all temporary differences and net operating loss and tax credit carryforwards. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Fair value - The carrying amounts reflected in the balance sheets for cash, cash equivalents, accounts receivable, and accounts payable approximate fair value due to the short maturities of these instruments. The fair values represent estimates of possible value that may not be realized in the future. The carrying value of the Demand Loans approximates the fair market value since the interest rate associated with the debt approximates the current market interest rate.

Loss per share - The Company follows Statement of Financial Accounting Standards No. 128, "Earnings Per Share" resulting in the presentation of basic and diluted earnings per share. Because the Company reported a net loss in 2002 and 2001, common stock equivalents, including stock options and warrants were anti-dilutive.

Comprehensive income (loss) - The Company follows Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income". Since the Company has no items of comprehensive income (loss), Comprehensive income (loss) is equal to net income (loss).

Recently Issued Accounting Standards

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("Statement 144"), effective in fiscal years beginning after December 15, 2001, with early adoption permitted, and in general are to be applied prospectively. Statement 144 establishes a single accounting model for the impairment or disposal of long-lived assets, including discontinued operations. Statement 144 superseded Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The adoption of this standard had no effect on the Company's financial statements.

The following recently issued accounting pronouncements are currently not applicable to the Company.

In April 2002, the FASB issued Statement No. 145, "Rescission of FASB

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Correction." This Statement eliminates extraordinary accounting treatment for reporting gain or loss on debt extinguishment, and amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions.

F-7

In November 2002, the FASB issued Interpretation 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This Interpretation expands the disclosures to be made by a guarantor about its obligations under certain guarantees and requires that, at the inception of a guarantee, a guarantor recognize a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements are effective immediately. The initial recognition and measurement provisions of this Interpretation are effective for guarantees issued or modified after December 31, 2002.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock Based Compensation - Transition and Disclosure - an Amendment to SFAS 123". SFAS No. 148 provides two additional transition methods for entities that adopt the preferable method of accounting for stock based compensation. Further, the statement requires disclosure of comparable information for all companies regardless of whether, when, or how an entity adopts the preferable, fair value based method of accounting. These disclosures are now required for interim periods in addition to the traditional annual disclosure. The amendments to SFAS No. 123, which provides for additional transition methods are effective for periods ending after December 15, 2002, although earlier application is permitted. The amendments to the disclosure requirements are required for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002.

3. Demand Loans

During 2002, the Company received unsecured loans from three individuals, including \$48,400 from the Company's Chairman of the Board, totaling \$160,400. The loans bear interest at seven per cent per year and are payable on demand. The loans were used to finance the Company's working capital requirements.

4. Stockholders' Equity

During January 2002, the Company sold 2,316,667 shares of its common stock to investors, including affiliates of the Company, for \$139,000. In May 2002, the Company sold 1,200,000 shares of its common stock to non-affiliated investors for \$72,000. One of the individuals who invested in May 2002 was later appointed to the Company's Board of Directors in late May 2002.

In mid-November, 2002, the Company entered into a subscription agreement with a partnership composed of Michael Solomon, a director of the Company, and three other persons pursuant to which the partnership agreed to acquire, in return for a subscription payment of \$200,000, a total of 3,333,333 shares of the Company's common stock, together with warrants to purchase an additional 40,000,000 shares of common stock in the aggregate at exercise prices ranging from \$0.10 to \$0.25 per share, during various periods through year-end 2003 through year-end 2006, subject to partial rollover and extension. The warrants are subject to the negotiation and

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

agreement of the Company and the investors on the definitive terms thereof and also to the approval by the Company's common stockholders of an amendment to the Company's charter to increase its authorized capital to a number of shares sufficient to permit exercise of the warrants. This transaction was approved by the Company's board of directors with Mr. Solomon abstaining. The Company received the partnership's \$200,000 subscription payment in early December 2002.

F-8

5. Income Taxes

At December 31, 2002, the Company had net operating loss carryforwards ("NOL's") approximating \$12,000,000. These operating losses are available to offset future taxable income through the year 2022. As a result of the sale of the Company's common stock in an equity offering in late 1997 and the issuance of additional shares, the amount of the NOL's carryforwards may be limited. Additionally, the utilization of these NOL's if available, to reduce the future income taxes will depend on the generation of sufficient taxable income prior to their expiration. There were no temporary differences for the years ended December 31, 2002 and 2001. The Company has established a 100% valuation allowance of approximately \$4,900,000 at December 31, 2002 for the deferred tax assets due to the uncertainty of their realization.

6. Related Party Transactions

Expenses aggregating \$42,500 in 2001 were incurred by the Company for consulting services provided by a firm employing an officer of the Company. There were no such expenses incurred in 2002.

7. Commitments and Contingencies

The Company conducts its operations in leased facilities and leases equipment under non-cancelable operating leases expiring at various dates to 2008.

Future minimum lease payments under non-cancelable operating leases with initial or remaining terms of one year or more at December 31, 2002 are: \$43,700 - 2003; \$34,800 - 2004; \$36,100 - 2005; \$37,600 - 2006 and \$39,100 - 2007.

Total rental expense under operating leases was \$104,500 and \$103,600 in 2002 and 2001, respectively.

The Company had a consulting agreement with a former executive officer and director, the term of which expired at December 31, 2002. The Board of Directors of the Company, in mid-2000, suspended cash payments to the consultant as a potential offset to certain payments made to the consultant by a licensee of the Company. All other provisions of the agreement remained in force throughout the term of the agreement. At December 31, 2002, unpaid consulting fees totaling \$166,300 were included in Accrued Expenses on the Balance Sheet.

From time to time, the Company may be subject to legal proceedings and claims that arise in the ordinary course of its business. During late 2000 and early 2001, as described in Note 9, several legal and arbitration proceedings were commenced by the Company's former European exclusive

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

licensee and certain of its shareholders against the Company, certain former and present directors of the Company and against a licensee of the Company.

8. Stock Options and 401(k) Savings Plan

The 1996 and 1999 Stock Option Plans provide for the granting of up to 2,700,000 incentive and non-qualified stock options to employees, non-employee directors, consultants and advisors to the Company. In the case of options designated as incentive stock options, the exercise price of the options granted must be not less than the fair market value of such shares on the date of grant. Non-qualified stock options may be granted at any amount established by the Stock Option Committee or, in the case of Discounted Options issued to non-employee directors in lieu of any portion of an Annual Retainer, in accordance with a formula designated in the Plan.

F-9

A summary of stock options under the Company's stock option plans follows:

	Number of Shares -----	Exercise Price Range Per Share -----
Outstanding at December 31, 2000	647,000	\$.30 to \$4
Options canceled during 2001	(122,000)	.30 to 4
	-----	-----
Outstanding at December 31, 2001 and 2002	525,000	\$.30 and \$
	=====	=====
	Option Shares -----	Exercise Price Range Per Share -----
Exercisable at year end:		
2001 and 2002	525,000	\$.30 and \$
Options available for future grant under all plans:		
2001 and 2002	2,175,000	

The following table summarizes information about stock options outstanding at December 31, 2002:

Range of exercise prices	\$.30 to \$.45 -----
Number outstanding at December 31, 2002	525,000 -----
Weighted average remaining contractual life	

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

(years)	3.09

Weighted average exercise price	\$.36

Exercisable options:	
Number outstanding at December 31, 2002	525,000

Weighted average remaining Contractual life (years)	3.09

Weighted average exercise price	\$.36

F-10

No options were granted in 2002 or 2001.

The Company continues to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". Compensation cost for stock options, if any, is measured as the excess of the quoted market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock. Compensation costs for shares issued under performance share plans are recorded based upon the current market value of the Company's stock at the end of each period. The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock Based Compensation" for employees and employee-directors as defined in SFAS No. 123. Compensation costs for grants to employees and directors would be determined based on the fair value at the date of grant in accordance with SFAS No. 123 and would be amortized over the vesting period of the option, which is generally two years. Had compensation cost for the Company's stock option grants to employees and employee-directors been determined based on the fair value at the date of grants in accordance with the provisions of SFAS No. 123, the Company would have amortized the cost over the vesting period of the option. There was no pro forma effect on the Company's net loss or the net loss per share applicable to common shares for 2002 and 2001, since no options were granted during these periods.

At December 31, 2002, the Company has reserved 2,700,000 shares of common stock for possible future issuance upon exercise of stock options. The Company sponsors a 401(k) savings plan, covering substantially all employees, providing for employee and employer contributions. Employer contributions are made at the discretion of the Company. There were no contributions charged to expense during 2002 or 2001.

9. Affiliate

The Company organized Euro-Nocopi, S.A. (Euro) in 1994 to market the Company's technologies in Europe under an exclusive license arrangement. Euro was capitalized through a European private placement. The Company holds an approximately 18% interest in Euro. During 2000, there arose between Euro and the Company a number of areas of conflict and dispute, leading each party to the licensing arrangement to assert informally that the other was in breach of its obligations under that arrangement. The parties initially sought to resolve their differences by negotiating a transaction in which Euro would have purchased from the Company its entire equity interest as well as the paid-up European rights to the Company's technologies. These negotiations terminated without agreement early in

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

December 2000. Following the termination of the transaction negotiations, the Company was informed by Euro that it had adopted resolutions to liquidate and dissolve. In mid-December 2000, the Company terminated its license agreement with Euro in accordance with its terms and discontinued the provision of support (including the sale of proprietary inks) to Euro and its customers. As a result of the license termination the technological dependency of Euro on the Company ceased and the Company was no longer permitted to account for its investment in Euro on the equity method. Accordingly, the Company, effective October 1, 2000, changed its method of accounting for its investment in Euro to the cost method and recorded the carrying value at that date as the cost of its investment. During the fourth quarter of 2000, the Company wrote down its investment in Euro by \$110,000 due to the uncertainty of its recoverability and recorded a charge of \$68,600 resulting from the transfer of foreign currency translation adjustments to net income.

F-11

Euro responded to the license termination by denying that the Company's action was permissible, or effective, and by asserting a claim that, as a result of alleged breaches of the licensing agreement by the Company, it was entitled to a royalty-free license to exploit the Company's technologies in Europe.

Promptly thereafter, Euro commenced an action before a court in Paris, France in which it sought the entry of an order, in the nature of a preliminary injunction, to compel the Company to honor the license agreement pending judicial or arbitral resolution of the dispute between the parties under the license agreement. In the French litigation, Euro did not seek an adjudication on the merits of the underlying dispute. Certain shareholders of Euro subsequently joined in the proceedings commenced by Euro. In March 2001, the Emergency Judge hearing the action issued a decision denying the relief requested by Euro and the shareholders. The decision, which does not purport to be a final adjudication of the merits of the controversy but only of Euro's request for preliminary relief, held that Euro was not entitled to the requested order because the Company had validly terminated the licensing arrangement in mid-December, and also ordered Euro to pay into escrow the approximately \$125,000 that the Company claimed was due and owing under the licensing arrangement.

In March 2001, Euro commenced an arbitration proceeding before the American Arbitration Association in New York, NY against the Company. In this proceeding, Euro has not asserted a claim for damages but has asserted a claim for an award in the nature of a declaratory judgment to the effect that, because the Company has (allegedly) breached the license agreement, Euro is entitled to a royalty-free license to exploit the Company's technologies in Europe. The Company has filed a response denying that Euro is entitled to the relief requested, asserting that it has validly terminated Euro's license agreement, and seeking damages for Euro's breaches of the licensing agreement. The parties are currently engaged in discussions relating to the settlement of the arbitration, and all related matters, and the arbitration hearing on the merits has been postponed pending such discussions.

In March 2001 certain shareholders of Euro filed suit in a court in Paris, France against certain current and former officers and directors of the Company and against a licensee of the Company. The Company is not named as a defendant in the suit. The suit seeks damages in excess of \$7 million from the defendants for various alleged acts of oppression, self-dealing and fraud in connection with the organization and capitalization of Euro,

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10KSB

the management of that company and the Company's management of its relationship with that company. The defendants have denied any liability to the plaintiffs and have sought indemnification from the Company in connection with the lawsuit. The Company has advanced certain costs of defense for the benefit of the named defendants.

10. Major Customer Information

The Company's largest non-affiliate customers accounted for approximately 16% of revenues in both 2002 and 2001 and 34% of accounts receivable at December 31, 2002. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. The Company also maintains allowances for potential credit losses.

F-12

11. Going Concern

Since its inception, the Company has incurred significant losses and, as of December 31, 2002, had accumulated losses of \$12,470,900. For the years ended December 31, 2002 and 2001, the Company's net losses were \$924,500 and \$828,600, respectively. In addition, the Company had negative working capital of \$994,700 at December 31, 2002 and experienced negative cash flow from operations of \$432,500 and \$603,800, respectively, for the years ended December 31, 2002 and 2001. The Company may incur further operating losses and experience negative cash flow in the future. Achieving profitability and positive cash flow depends on the Company's ability to generate and sustain significant increases in revenues and gross profits from its traditional business. There can be no assurances that the Company will be able to generate sufficient revenues and gross profits to achieve and sustain profitability and positive cash flow in the future.

During 2002, the Company sold 6,850,000 shares of its common stock to affiliated and non-affiliated individual investors for \$411,000, received loans of \$160,400 from three individuals, including \$48,400 from the Chairman of the Board of the Company and used \$432,500 to fund operations. The receipt of these funds has permitted the Company to continue in operation to the current date. Management of the Company believes that, to survive, it must obtain additional capital immediately both to fund continuing operating deficits and to fund investments needed to increase its operating revenues to levels that will sustain its operations. There can be no assurances that the Company will be successful in obtaining sufficient additional capital, or if it does, that the additional capital will enable the Company to improve its business so as to have a material positive effect on the Company's operations and cash flow. The Company believes that without substantial immediate investment, it will be forced to cease operations early in the second quarter of 2003. Further, the Company requires investment to fund the ongoing arbitration with Euro-Nocopi, S.A. There are no assurances that, even if funding, for which the Company has no commitments and only limited prospects, is arranged, the Company will prevail in the arbitration.

The Company's independent certified public accountants have included a "going concern" explanatory paragraph in their audit report accompanying the 2002 financial statements. The paragraph states that the Company's recurring losses from operations raise substantial doubt about the Company's ability to continue as a going concern and cautions that the financial statements do not include any adjustments that might result from the outcome of this uncertainty.

