

SUPERCONDUCTOR TECHNOLOGIES INC

Form 10-Q

May 12, 2008

Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 29, 2008

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

For the transition period from _____ to _____

**Commission File Number 0-21074
SUPERCONDUCTOR TECHNOLOGIES INC.
(Exact name of registrant as specified in our charter)**

Delaware
(State or other jurisdiction of
incorporation or organization)

77-0158076
(IRS Employer
Identification No.)

**460 Ward Drive,
Santa Barbara, California 93111-2356**
(Address of principal executive offices & zip code)

(805) 690-4500
(Registrant's telephone number including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

The registrant had 15,612,775 shares of the common stock outstanding as of the close of business on May 1, 2008.

SUPERCONDUCTOR TECHNOLOGIES INC.
INDEX TO FORM 10-Q
Three Months Ended March 29, 2008

<u>SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS</u>	1
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	1
<u>PART I FINANCIAL INFORMATION</u>	
<u>ITEM 1. Financial Statements</u>	
<u>Condensed Consolidated Statement of Operations</u>	2
<u>Condensed Consolidated Balance Sheets</u>	3
<u>Condensed Consolidated Statement of Cash Flows</u>	4
<u>Notes to Unaudited Interim Condensed Consolidated Financial Statements</u>	5
<u>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>ITEM 3. Quantitative and Qualitative Disclosures About Market Risk</u>	21
<u>ITEM 4. Controls and Procedures</u>	21
<u>PART II OTHER INFORMATION</u>	
<u>ITEM 1. Legal Proceedings</u>	21
<u>ITEM 1A. Risk Factors</u>	21
<u>ITEM 2. Unregistered Sales of Equity Securities</u>	21
<u>ITEM 4. Submission of Matters to a Vote of Security Holders</u>	22
<u>ITEM 5. Other Information</u>	22
<u>ITEM 6. Exhibits</u>	22
<u>SIGNATURE</u>	23
<u>EXHIBIT 31.1</u>	
<u>EXHIBIT 31.2</u>	
<u>EXHIBIT 32.1</u>	
<u>EXHIBIT 32.2</u>	

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. You can find many (but not all) of these statements by looking for words such as approximates, believes, expects, anticipates, estimates, intends, plans would, may or other similar expressions in this Report. We claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995. We caution investors that any forward-looking statements presented in this Report, or which we may make orally or in writing from time to time, are based on the beliefs of, assumptions made by, and information currently available to, us. Such statements are based on assumptions and the actual outcome will be affected by known and unknown risks, trends, uncertainties and factors that are beyond our control or ability to predict. Although we believe that our assumptions are reasonable, they are not guarantees of future performance and some will inevitably prove to be incorrect. As a result, our actual future results can be expected to differ from our expectations, and those differences may be material. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on known results and trends at the time they are made, to anticipate future results or trends.

Some of the risks and uncertainties that may cause our actual results, performance or achievements to differ materially from those expressed or implied by forward-looking statements include the following: limited assets and a history of losses; limited number of potential customers; limited number of suppliers for some of our components; no significant backlog from quarter to quarter; and our market is characterized by rapidly advancing technology. For further discussion of these and other factors see Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations and Part II, Item 1A. Risk Factors in this Report and in our 2007 Annual Report on Form 10-K.

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

WHERE YOU CAN FIND MORE INFORMATION

As a public company, we are required to file annual, quarterly and special reports, proxy statements and other information with the SEC. You may read and copy any of our materials on file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Judiciary Plaza, Washington, DC 20549, as well as at the SEC's regional office at 5757 Wilshire Boulevard, Suite 500, Los Angeles, California 90036. Our filings are available to the public over the Internet at the SEC's website at <http://www.sec.gov>. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. We also provide copies of our Forms 8-K, 10-K, 10-Q, Proxy and Annual Report at no charge to investors upon request and make electronic copies of our most recently filed reports available through our website at www.supotech.com as soon as reasonably practicable after filing such material with the SEC.

Table of Contents

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	Three Months Ended	
	March 31, 2007	March 29, 2008
Net revenues:		
Commercial product revenues	\$ 3,534,000	\$ 1,993,000
Government and other contract revenues	649,000	1,479,000
Total net revenues	4,183,000	3,472,000
Costs and expenses:		
Cost of commercial product revenues	3,902,000	2,019,000
Contract research and development	445,000	1,243,000
Other research and development	913,000	408,000
Selling, general and administrative	1,901,000	2,200,000
Total costs and expenses	7,161,000	5,870,000
Loss from operations	(2,978,000)	(2,398,000)
Interest income	52,000	99,000
Interest expense	(11,000)	(9,000)
Net loss	\$ (2,937,000)	\$ (2,308,000)
Basic and diluted loss per common share	\$ (0.24)	\$ (0.17)
Weighted average number of common shares outstanding	12,483,367	13,636,083

See accompanying notes to the condensed consolidated financial statements

Table of Contents

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

	December 31, 2007	March 29, 2008
	(See Note)	(Unaudited)
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 3,939,000	\$ 11,708,000
Accounts receivable, net	2,413,000	1,886,000
Inventory, net	3,415,000	5,380,000
Prepaid expenses and other current assets	442,000	414,000
Total Current Assets	10,209,000	19,388,000
Property and equipment, net of accumulated depreciation of \$19,129,000 and \$18,857,000, respectively	3,961,000	3,711,000
Patents, licenses and purchased technology, net of accumulated amortization of \$1,722,000 and \$1,805,000, respectively	2,236,000	2,228,000
Other assets	219,000	226,000
Total Assets	\$ 16,625,000	\$ 25,553,000
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	\$ 1,467,000	\$ 2,080,000
Accrued expenses	1,405,000	945,000
Proceeds for shares to be issued	4,000,000	
Current portion of capitalized lease obligations and long term debt	45,000	46,000
Total Current Liabilities	6,917,000	3,071,000
Other long term liabilities	518,000	546,000
Total Liabilities	7,435,000	3,617,000
Commitments and contingencies-Notes 6 and 7		
Stockholders Equity:		
Preferred stock, \$.001 par value, 2,000,000 shares authorized, 611,523 shares issued and outstanding		1,000
Common stock, \$.001 par value, 250,000,000 shares authorized, 12,511,414 and 15,612,775 shares issued and outstanding, respectively	12,000	15,000
Capital in excess of par value	209,163,000	224,213,000
Accumulated deficit	(199,985,000)	(202,293,000)
Total Stockholders Equity	9,190,000	21,936,000

Total Liabilities and Stockholders Equity	\$ 16,625,000	\$ 25,553,000
--	----------------------	----------------------

See accompanying notes to the condensed consolidated financial statements
Note-December 31, 2007 balances were derived from audited financial statements

3

Table of Contents

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

	Three Months Ended	
	March 31,	March 29,
	2007	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (2,937,000)	\$ (2,308,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	617,000	396,000
Warrants-Options	90,000	118,000
Provision for excess and obsolete inventories	90,000	
Changes in assets and liabilities:		
Accounts receivable	(440,000)	525,000
Inventory	1,292,000	(1,965,000)
Prepaid expenses and other current assets	(405,000)	28,000
Patents, licenses and purchased technology	(36,000)	(76,000)
Other assets	6,000	(6,000)
Accounts payable, accrued expenses and other long- term liabilities	(583,000)	208,000
 Net cash used in operating activities	 (2,306,000)	 (3,080,000)
 CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(45,000)	(62,000)
Proceeds from sale of PP&E	18,000	
 Net cash used in investing activities	 (27,000)	 (62,000)
 CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term obligations	(5,000)	
Proceeds from preferred and common stock		10,911,000
 Net cash provided by (used in) financing activities	 (5,000)	 10,911,000
 Net increase (decrease) in cash and cash equivalents	 (2,338,000)	 7,769,000
Cash and cash equivalents at beginning of period	5,487,000	3,939,000
 Cash and cash equivalents at end of period	 \$ 3,149,000	 \$ 11,708,000

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

SUPERCONDUCTOR TECHNOLOGIES INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. General

Superconductor Technologies Inc. (together with our subsidiaries, we or us) was incorporated in Delaware on May 11, 1987 and we maintain our headquarters in Santa Barbara, California. We operate in a single industry segment, the research, development, manufacture and marketing of high-performance infrastructure products for wireless voice and data applications. Our commercial products are divided into three product offerings: SuperLink (high-temperature superconducting filters), AmpLink (high performance, ground-mounted amplifiers) and SuperPlex (high performance multiplexers). Our research and development contracts are used as a source of funds for our commercial technology development. From 1987 to 1997, we were engaged primarily in research and development and generated revenues primarily from government research contracts.

We continue to be involved as either contractor or subcontractor on a number of contracts with the United States government. These contracts have been and continue to provide a significant source of revenues for us. For the three months ended March 29, 2008 and March 31, 2007, government related contracts account for 43% and 16%, respectively, of our net revenues.

The unaudited consolidated financial information furnished herein has been prepared in accordance with generally accepted accounting principles and reflects all adjustments, consisting only of normal recurring adjustments, which in the opinion of management, are necessary for a fair statement of the results of operations for the periods presented.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates and such differences may be material to the financial statements. This quarterly report on Form 10-Q should be read in conjunction with our Form 10-K for the year ended December 31, 2007. The results of operations for the three months ended March 29, 2008 are not necessarily indicative of results for all of 2008.

2. Summary of Significant Accounting Policies

Basis of Presentation

In 2007, we incurred a net loss of \$9.1 million and negative cash flows from operations of \$5.4 million. For the quarter ended March 29, 2008, we incurred a net loss of \$2.3 million and negative cash flows from operations of \$3.1 million.

Our principal sources of liquidity consist of existing cash balances and funds expected to be generated from future operations. On August 17, 2007, we entered into an investment agreement with Hunchun BaoLi Communication Co. Ltd. (BAOLI) and on February 27, 2008, the transactions contemplated by that agreement closed and, in exchange for \$15.0 million in cash, we issued to BAOLI and two related purchasers a total of (a) 3,101,361 shares of our common stock and (b) 611,523 shares of our Series A Preferred Stock (convertible into 6,115,230 shares of our common stock).

We believe one of the key factors to our liquidity in the next twelve months will be our ability to successfully execute on our plans to increase sales levels. Our cash requirements will also depend on numerous other variable factors, including the rate of growth of sales, the timing and levels of products purchased, payment terms and credit limits from manufacturers, the timing and level of accounts receivable collections and the timing and levels of new product development.

We cannot assure you that if we need additional financing (public or private) that it will be available on acceptable terms or at all. If we issue additional equity securities to raise funds, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise any needed funds, we might be forced to make further substantial reductions in our operating expenses, which could adversely affect our ability to implement our current business plan and our viability as a company.

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

Table of Contents

Principles of Consolidation

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

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less. Cash and cash equivalents are maintained with quality financial institutions and from time to time exceed FDIC limits.

Accounts Receivable

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

Revenue Recognition

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

Revenue Recognition/Contract Accounting

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

We generate almost all of our revenue from two different types of contractual arrangements: cost-plus-fee contracts, and fixed-price contracts. Revenue on cost-plus-fee contracts is recognized to the extent of allowable costs incurred plus an estimate of the applicable fees earned. We consider fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs incurred in performance of the contract.

Our fixed price contracts have historically been fixed unit price type contracts. Revenue on fixed unit price contracts, where specified units of output under service arrangements are delivered, is recognized as units and are delivered based on the specified price per unit.

All payments to us for work performed on contracts with agencies of the United States government are subject to adjustment upon audit by the Defense Contract Audit Agency. Based on historical experience and review of current projects in process, management believes that the audits will not have a significant effect on our financial position, results of operations or cash flows. The Defense Contract Audit Agency audits of us are complete through 2003.

Table of Contents

Warranties

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

Guarantees

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

Research and Development Costs

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

Inventories

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

Property and Equipment

Property and equipment are recorded at cost. Equipment is depreciated using the straight-line method over their estimated useful lives ranging from three to five years. Leasehold improvements and assets financed under capital leases are amortized over the shorter of their useful lives or the lease term. Furniture and fixtures are depreciated over seven years. Expenditures for additions and major improvements are capitalized. Expenditures for minor tooling, repairs and maintenance and minor improvements are charged to expense as incurred. When property or equipment is retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts. Gains or losses from retirements and disposals are recorded in selling, general and administration expenses. During the quarter ending March 29, 2008, we disposed of \$592,000 of older, fully depreciated equipment. There was no gain or loss on said disposition.

Patents, Licenses and Purchased Technology

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

Long-Lived Assets

The realizability of long-lived assets is evaluated periodically as events or circumstances indicate a possible inability to recover the carrying amount. Long-lived assets that will no longer be used in business are written off in the period identified since they will no longer generate any positive cash flows for us. Long lived assets that will continue to be used by us are periodically evaluated for recoverability. Such evaluation is based on various analyses, including

cash flow and profitability projections. The analyses necessarily involve significant management judgment. In the event the projected undiscounted cash flows are less than net book value of the assets, the carrying value of the assets are written down to their estimated fair value. We tested our long lived assets for recoverability during 2007 and did not believe that there was any impairment.

Table of Contents*Loss Contingencies*

In the normal course of our business we are subject to claims and litigation, including allegations of patent infringement. Liabilities relating to these claims are recorded when it is determined that a loss is probable and the amount of the loss can be reasonably estimated. The costs of our defense in such matters are expensed as incurred. Insurance proceeds recoverable are recorded when deemed probable.

Income Taxes

We account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109), which requires that we recognize deferred tax liabilities and assets based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit (expense) results from the change in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all deferred tax assets will not be realized.

In July 2006, the FASB issued Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements in accordance with SFAS 109. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. We adopted FIN 48 effective January 1, 2007, and the provisions of FIN 48 have been applied to all income tax positions commencing from that date. There was no material impact from this adoption. As of December 31, 2007, we had net operating loss carryforwards for federal and state income tax purposes of approximately \$285.1 million and \$154.7 million, respectively. We are currently evaluating the potential limitations on our ability to utilize our net operating loss carryforwards as a result of the recent investment by BAOLI. Due to the uncertainty surrounding their realization, we recorded a full valuation allowance against our net deferred tax assets. Accordingly, no deferred tax asset has been recorded in the accompanying balance sheet.

Marketing Costs

All costs related to marketing and advertising our products are expensed as incurred or at the time the advertising takes place. Advertising costs were not material in each of the quarters ended March 29, 2008 and March 31, 2007.

Net Loss Per Share

Basic and diluted net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding in each period. Potentially dilutive shares are not included in the calculation of diluted loss per share because their effect is anti-dilutive.

Stock-based Compensation

For the quarters ended March 29, 2008 and March 31, 2007, the weighted average fair value of options we granted was estimated as of the date of the grant using the Black-Scholes option-pricing model. The following are the significant weighted average assumptions used for estimating the fair value under our stock option plans:

	Three months ended	
	March	March 31,
	29, 2008	2007
Expected life in years	4.0	4.0
Risk free interest rate	2.4%	4.8%
Expected volatility	110%	95%
Dividend yield	0%	0%

The expected life was based on the contractual term of the options and the expected employee exercise behavior. Typically, options to our employees have a 3 or 4 year vesting term and a 10 year contractual term. The risk-free interest rate is based on the U. S. Treasury zero-coupon issues with a remaining term equal to the expected option life assumed at the grant date. The future volatility is based on our 4 year historical volatility. We used an expected dividend yield of 0%

Table of Contents

because we have never paid a dividend and do not anticipate paying dividends. We assumed a 10% forfeiture rate based on our historical stock option cancellation rates over the last 4 years.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The significant estimates in the preparation of the financial statements relate to the assessment of the carrying amount of accounts receivable, inventory, intangibles, goodwill, estimated provisions for warranty costs, accruals for restructuring and lease abandonment costs, income taxes and litigation. Actual results could differ from those estimates and such differences may be material to the financial statements.

Fair Value of Financial Instruments

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

Comprehensive Income (Loss)

We have no items of other comprehensive income (loss) in any period other than our net loss.

Segment Information

We operate in a single business segment, the research, development, manufacture and marketing of high performance products used in cellular base stations to maximize the performance of wireless telecommunications networks by improving the quality of uplink signals from mobile wireless devices. Net commercial product revenues are primarily derived from the sales of our SuperLink, AmpLink and SuperPlex products. We currently sell most of our products directly to wireless network operators in the United States. Net revenues derived principally from government research and development contracts are presented separately on the statement of operations for all periods presented.

Certain Risks and Uncertainties

We have continued to incur operating losses. Our long-term prospects and execution of our business plan are dependent upon the continued and increased market acceptance for the product.

We currently sell most of our products directly to wireless network operators in the United States and our product sales have historically been concentrated in a small number of customers. In 2007, we had three customers that represented 40%, 14% and 7% of total net revenues. At December 31, 2007, these three customers together represented 43% of accounts receivable. In the three months ended March 29, 2008, we had one customer that represented 52% of total net revenues. At March 29, 2008, this customer represented 34% of accounts receivable. The loss of or reduction in sales, or the inability to collect outstanding accounts receivable, from any of these customers could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We currently rely on one supplier for purchases of high quality substrates for growth of high-temperature superconductor films and a limited number of suppliers for other key components of our products. The loss of any of these suppliers could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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

Recent Accounting Pronouncements

In February 2008, the FASB issued FSP 157-2 Partial Deferral of the Effective Date of Statement 157 (FSP 157-2). FSP 157-2 delays the effective date of SFAS No. 157, for all non-financial assets and non-financial liabilities, except

those

Table of Contents

that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. The adoption of SFAS No. 157 did not have a material impact on our consolidated results or operations or financial condition and we are currently evaluating the potential impact of adopting FSP FAS 157-2 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*, which requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, at their fair values as of that date. We will be required to adopt SFAS No. 141R as of January 1, 2009. We are currently evaluating the impact of SFAS No. 141R on our financial condition, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51, which clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. We will be required to adopt SFAS No. 160 as of January 1, 2009. We are currently evaluating the impact of SFAS No. 160 on our financial condition, results of operations and cash flows.

3. Short Term Borrowings

We have a line of credit with a bank. The line of credit expires in July 2008 and is structured as a sale of accounts receivable. The agreement provides for the sale of up to \$5.0 million of eligible accounts receivable, with advances to us totaling 80% of the receivables sold. Advances under the agreement are collateralized by all our assets. Under the terms of the agreement, we continue to service the sold receivables and are subject to recourse provisions. Advances bear interest at the prime rate (5.25% at March 29, 2008) plus 2.50% subject to a minimum monthly charge. There was no amount outstanding under this borrowing facility at March 29, 2008.

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

4. Stockholders Equity

Stock Options

We currently have one active stock option plan, 2003 Equity Incentive Plan. Under the 2003 Equity Incentive Plan, stock awards may consist of stock options, stock appreciation rights, restricted stock awards, performance awards, and performance share awards. Stock awards may be made to directors, key employees, consultants, and non-employee directors. Stock options granted under these plans must be granted at prices no less than 100% of the market value on the date of grant. Generally, stock options become exercisable in installments over a minimum of three years, beginning one year after the date of grant, and expire not more than ten years from the date of grant, with the exception of 10% or greater stockholders which may have options granted at prices no less than the market value on the date of grant, and expire not more than five years from the date of grant. We expect to issue new shares to cover stock option exercises and have no plans to repurchase shares. There were no stock option exercises during the three months ended March 29, 2008 and no stock option exercises for the three months ended March 31, 2007.

As a result of adopting SFAS 123R, the impact to the Consolidated Statements of Operations for the quarter ended March 29, 2008 on net income was \$23,000 and none on basic and diluted earnings per share and for the quarter ended

Table of Contents

March 31, 2007 the impact was \$34,000 and none on basic and diluted earnings per share. No stock compensation cost was capitalized during either period. The weighted-average fair value at the grant date for options issued in the first quarter of 2008 was \$5.00 per share versus \$1.30 per share in the first quarter of 2007. The total compensation cost related to non-vested awards not yet recognized is \$1.8 million and the weighted-average period over which the cost is expected to be recognized is 3.8 years in the first quarter of 2008 versus \$190,000 and 1.2 years in the first quarter of 2007.

The following is a summary of stock option transactions under our stock option plans at March 29, 2008:

	Number of Shares	Price Per Share	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
Balance at December 31, 2007	741,858	\$ 1.43 - \$493.75	\$34.24	663,174	\$37.87
Granted	499,590	\$ 3.74 - \$6.08	\$ 5.00		
Exercised					
Canceled	(6,759)	\$ 6.90 - \$66.40	\$26.30		
Balance at March 29, 2008	1,234,689	\$ 1.43 - \$493.75	\$22.45	663,376	\$37.63

The outstanding options expire on various dates through the end of March 2018. The weighted-average contractual term of options outstanding is 6 years and the weighted-average contractual term of stock options currently exercisable is slightly less than 6 years. The exercise prices for these options range from \$1.43 to \$493.75 per share, for an aggregate exercise price of approximately \$27.7 million. At March 29, 2008, 147,400 shares of outstanding stock options and 36,929 exercisable options had an exercise price less than the current market value and had an intrinsic value of \$494,000 and \$132,000, respectively.

Restricted Stock Awards

In July 2006 we issued restricted stock awards. A total of 331,000 shares were granted and will fully vest in one single installment on the second anniversary of the grant date in July 2008. The per share weighted average grant-date fair value was \$1.50. A 10% forfeiture rate was assumed.

The impact to the Consolidated Statements of Operations for the quarters ended March 29, 2008 and March 31, 2007 was an expense of \$56,000 and none on basic and diluted earnings per share, respectively. No stock compensation cost was capitalized during the period. The total compensation cost related to non-vested awards not yet recognized was \$83,000 and the weighted-average period over which the cost is expected to be recognized was 4 months.

Warrants

The following is a summary of outstanding warrants at March 29, 2008:

	Total and Currently Exercisable	Common Shares Price per Share	Expiration Date	
Warrants related to the issuance of common stock	116,279	29.00	June 27, 2008 *	
	342,466	7.08	August 16, 2010*	**
Warrants related to April 2004 Bridge Loans	10,000	18.50	April 28, 2011*	

Total 468,745

* The terms of these warrants contain net exercise provisions, wherein instead of a cash exercise holders can elect to receive common stock equal to the difference between the exercise price and the average closing sale price for common shares over 10-30 days immediately preceding the exercise date.

** These warrants contain anti-dilution adjustment provisions.

Table of Contents**5. Earnings Per Share**

The computation of per share amounts for the three month periods ended March 29, 2008 and March 31, 2007 is based on the average number of common shares outstanding for the period. Options and warrants to purchase 1,703,434 and 1,935,908 shares of common stock during the quarters ended March 29, 2008 and March 31, 2007, respectively, were not considered in the computation of diluted earnings per share because their inclusion would be anti-dilutive.

6. Commitments and Contingencies*Operating Leases*

We lease our offices and production facilities under a non-cancelable operating lease that expires in November 2011. This lease contains escalation clauses for increases in annual renewal options and requires us to pay utilities, insurance, taxes and other operating expenses.

For the three months ended March 29, 2008 and March 31, 2007, rent expense was \$282,000 and \$273,000, respectively.

Capital Leases

We leased certain property and equipment under a capital lease arrangement that expired in 2007.

Patents and Licenses

We have entered into various licensing agreements requiring royalty payments ranging from 0.13% to 2.5% of specified product sales. Certain of these agreements contain provisions for the payment of guaranteed or minimum royalty amounts. In the event that we fail to pay minimum annual royalties, these licenses may automatically become non-exclusive or be terminated. These royalty obligations terminate at various times from 2009 to 2020. For the three months ended March 29, 2008 and March 31, 2007, royalty expense totaled \$38,000 and \$59,000, respectively. Under the terms of certain royalty agreements, royalty payments made may be subject to audit. There have been no audits to date and we do not expect any future audit adjustments to be significant.

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

Year ending December 31,	Licenses	Operating Leases
Remainder of 2008	\$ 150,000	\$ 1,050,000
2009	150,000	1,474,000
2010	150,000	1,525,000
2011	150,000	1,436,000
2012	150,000	9,000
Thereafter	1,050,000	1,000
Total payments	\$ 1,800,000	\$ 5,495,000

7. Contractual Guarantees and Indemnities

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

Table of Contents

Warranties

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

Intellectual Property Indemnities

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

Director and Officer Indemnities and Contractual Guarantees

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

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

General Contractual Indemnities/Products Liability

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

Short Term Borrowings

We have a line of credit with a bank. Advances under the line of credit are collateralized by all our assets. Under the terms of the agreement, we continue to service the sold receivables and are subject to recourse provisions. Under the terms of the agreement, if the bank determines that there is a material adverse change in our business, it may declare a default and exercise all our rights and remedies under the agreement. There was no amount outstanding under this facility at March 29, 2008. *See Note 3 Short Term Borrowings.*

Contractual Contingency

We have a contract to deliver several custom products to a government contractor. We are unable to manufacture the products for technical reasons. We have discussed the problem with the contractor and our government customer. They are considering the problem, and further discussions are expected. We do not believe that a loss, if any, is reasonably estimable at this time and therefore have not recorded any liability relating to this matter. We will periodically reassess our potential liability as additional information becomes available. If we later determine that a loss is probable and the amount reasonably estimable, we will record a liability for the potential loss. All costs have been expensed and no revenues recognized on this contract.

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

	December 31, 2007	March 29, 2008
Accounts receivable:		
Accounts receivable-trade	\$ 1,242,000	\$ 819,000
United States government accounts receivable-billed	1,246,000	1,142,000
Less: allowance for doubtful accounts	(75,000)	(75,000)
	\$ 2,413,000	\$ 1,886,000

	December 31, 2007	March 29, 2008
Inventories:		
Raw materials	\$ 1,934,000	\$ 2,685,000
Work-in-process	679,000	1,323,000
Finished goods	1,817,000	2,272,000
Less inventory reserve	(1,015,000)	(900,000)
	\$ 3,415,000	\$ 5,380,000

	December 31, 2007	March 29, 2008
Property and Equipment:		
Equipment	\$ 15,951,000	\$ 15,429,000
Leasehold improvements	6,732,000	6,732,000
Furniture and fixtures	407,000	407,000
	23,090,000	22,568,000
Less: accumulated depreciation and amortization	(19,129,000)	(18,857,000)
	\$ 3,961,000	\$ 3,711,000

At December 31, 2007 and March 29, 2008, equipment includes \$237,000 of assets financed under capital lease arrangements, net of \$237,000 of accumulated amortization. Depreciation expense amounted to \$272,000 and \$535,000 for the three month periods ended March 29, 2008 and March 31, 2007, respectively.

	December 31, 2007	March 29, 2008
Patents and Licenses:		
Patents pending	\$ 705,000	\$ 770,000
Patents issued	983,000	993,000
Less accumulated amortization	(345,000)	(361,000)

Edgar Filing: SUPERCONDUCTOR TECHNOLOGIES INC - Form 10-Q

Net patents issued	638,000	632,000
Licenses	563,000	563,000
Less accumulated amortization	(134,000)	(142,000)
Net licenses	429,000	421,000
Purchased technology	1,706,000	1,706,000
Less accumulated amortization	(1,242,000)	(1,301,000)
Net purchased technology	464,000	405,000
	\$ 2,236,000	\$ 2,228,000

Amortization expense related to these items totaled \$83,000 and \$82,000, for the three month periods ended March 29, 2008 and March 31, 2007, respectively. Amortization expenses are expected to total \$249,000 for the remainder of 2008, \$350,000 in each of the years 2008, 2009 and \$119,000 in 2010 and 2011, respectively.

Table of Contents

	December 31, 2007	March 29, 2008
Accrued Expenses and Other Long Term Liabilities:		
Salaries Payable	\$ 307,000	\$ 197,000
Compensated Absences	371,000	422,000
Compensation related	369,000	43,000
Warranty reserve	380,000	307,000
Deferred Rent	373,000	362,000
Other	123,000	206,000
	1,923,000	1,537,000
Less current portion	(1,405,000)	(991,000)
Long term portion	\$ 518,000	\$ 546,000

	For the three months ended,	
	March 31, 2007	March 29, 2008
Warranty Reserve Activity:		
Beginning balance	\$ 428,000	\$ 380,000
Additions	28,000	12,000
Deductions	(33,000)	(85,000)
Ending balance	\$ 423,000	\$ 307,000

Lease Abandonment Costs:		
Beginning balance	\$ 8,000	
Additions		
Deductions		
Ending balance	\$ 8,000	\$

Product Line Exit Costs:		
Beginning balance	\$ 319,000	
Additions		
Deductions		
Ending balance	\$ 319,000	\$

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

General

We design, manufacture, market and sell high performance infrastructure products for wireless voice and data applications. Our products are utilized in major wireless networks which support voice and data communications by use of cell phones and other wireless communication devices.

Our products help maximize the performance of wireless telecommunications networks by improving the quality of uplink signals from mobile wireless devices. Our products increase capacity utilization, lower dropped and blocked calls, extend coverage, and enable higher wireless data throughput all while reducing capital and operating costs. SuperLink incorporates patented high-temperature superconductor (HTS) technology to create a receiver front-end that enhances network performance. We are leveraging our expertise and proprietary technology in radio frequency (RF) engineering to expand our product line beyond HTS technology. We believe our RF engineering expertise provides us with a significant competitive advantage in the development of high performance, cost-effective solutions for the front end of wireless telecommunications networks.

Table of Contents

We have three product offerings:

SuperLink. In order to receive uplink signals from wireless handsets, base stations require a wireless filter system to eliminate, or filter out, out-of-band interference. SuperLink combines HTS filters with a proprietary cryogenic cooler and a cooled low-noise amplifier. The result is a highly compact and reliable receiver front-end that can simultaneously deliver both high selectivity (interference rejection) and high sensitivity (detection of low level signals). SuperLink delivers significant performance advantages over conventional filter systems.

AmpLink. AmpLink is designed specifically to address the sensitivity requirements of wireless base stations. AmpLink is a ground-mounted unit which includes a high-performance amplifier and up to six dual duplexers. The enhanced uplink provided by AmpLink improves network coverage immediately and avoids the installation and maintenance costs associated with tower mounted alternatives.

SuperPlex. SuperPlex is our line of multiplexers that provides extremely low insertion loss and excellent cross-band isolation. SuperPlex high-performance multiplexers are designed to eliminate the need for additional base station antennas and reduce infrastructure costs. Relative to competing technologies, these products offer increased transmit power delivered to the base station antenna, higher sensitivity to subscriber handset signals, and fast and cost-effective network overlays.

We currently sell most of our commercial products directly to wireless network operators in the United States. Our primary customers to date include ALLTEL, AT&T Mobility, Sprint Nextel, T-Mobile, U.S. Cellular and Verizon Wireless. We have a concentrated customer base. Verizon Wireless accounted for more than 10% of our commercial revenues in 2008 and Verizon Wireless and AT&T Mobility each accounted for more than 10% of our commercial revenues in 2007. We plan to expand our customer base by selling directly to other wireless network operators and manufacturers of base station equipment, but we cannot assure that this effort will be successful.

We also generate significant revenues from government contracts. We primarily pursue government research and development contracts which compliment our commercial product development. We undertake government contract work which has the potential to add to or improve our commercial product line. These contracts often yield valuable intellectual property relevant to our commercial business. We typically own the intellectual property developed under these contracts, and the Federal Government receives a royalty-free, non-exclusive and nontransferable license to use the intellectual property for the United States.

We sell most of our products to a small number of wireless carriers, and their demand for wireless communications equipment fluctuates dramatically and unpredictably. We expect these trends to continue and that may cause significant fluctuations in our quarterly and annual revenues.

The wireless communications infrastructure equipment market is extremely competitive and is characterized by rapid technological change, new product development, product obsolescence, evolving industry standards and price erosion over the life of a product. We face constant pressures to reduce prices. Consequently, we expect the average selling prices of our products will continue decreasing over time. We have responded in the past by successfully reducing our product costs, and expect further cost reductions over the next twelve months. However, we cannot predict whether our costs will decline at a rate sufficient to keep pace with the competitive pricing pressures.

Recent Developments

BAOLI Investment

Under an agreement entered into in 2007, on February 27, 2008, we issued to Hunchun BaoLi Communication Co. Ltd. (BAOLI) and two associated purchasers a total of (a) 3,101,361 shares of our common stock (of which 953,065 must be voted in accordance with the votes of our other shares, effectively giving the holder no voting power over such shares) and (b) 611,523 shares of our Series A Convertible Preferred Stock (convertible under certain conditions into 6,115,230 shares of our common stock). We received \$15.0 million in cash, of which \$4.0 million was funded in 2007 and the \$11.0 million balance was funded in January 2008.

Subject to the terms and conditions of our Series A Preferred and to customary adjustments to the conversion rate, each share of our Series A Preferred is convertible into ten shares of our common stock so long as the number of shares of our common stock beneficially owned by the holder and related persons following such conversion does not exceed 9.9% of our outstanding common stock. Except for a preference on liquidation of \$.01 per share, each share of Series A Preferred is the economic equivalent of the ten shares of common stock into which it is convertible. Except

as required by law, the Series A Preferred will not have any voting rights.

BAOLI Joint Venture.

We continue to pursue manufacturing and marketing STI's SuperLin® interference elimination solution in the China market. As previously announced, our joint venture agreements provide that BAOLI will provide the manufacturing expertise

Table of Contents

and working capital in exchange for 55 percent of the equity and we will provide an exclusive license in the China market of the enabling technology in exchange for 45 percent of the equity and a royalty on sales. In the first quarter of 2008, we received orders from the joint venture for our new TD-SCDMA solution to perform lab trial and field trial activities in China. The lab trial was still ongoing at the end of the first quarter. The current schedule is to complete the lab trial and perform the field trial during the second quarter of 2008. STI will recognize any revenue from these trials in future periods as appropriate.

The commencement of manufacturing and the transfer of our processes to the joint venture will be driven by product demand from the China market. The joint venture's activities remain subject to successful field trial results and other product marketing efforts in addition to a number of other conditions including certain critical approvals from the Chinese and United States governments. In particular, we are in discussions with the Committee on Foreign Investment in the United States (or CFIUS), an inter-agency committee of the United States government that reviews the national security implications of foreign acquisitions of U.S. companies regarding our joint venture with and investment from BAOLI. There continues to be no assurance that these conditions will be met, or that all required approvals (if obtained) will be obtained on a timely basis. Even if these conditions are met and the approvals received, the results from our joint venture will be subject to a number of significant risks associated with international operations and new ventures (which are similar to those involved in acquisitions), some of which are set out in our public filings, including in particular the Risk Factors included in Item 1A of our 2007 Annual Report on Form 10-K.

Critical Accounting Policies and Estimates

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

In addition, we identified certain critical accounting policies which affect certain of our more significant estimates and assumptions used in preparing our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2007. We have not made any material changes to these policies.

Backlog

Our commercial backlog consists of accepted product purchase orders with scheduled delivery dates during the next twelve months. We had commercial backlog of \$192,000 at March 29, 2008, as compared to \$352,000 at December 31, 2007.

Results of Operations*Quarter Ended March 29, 2008 as compared to the Quarter Ended March 31, 2007*

Net revenues decreased by \$711,000, or 17%, from \$4.2 million in the first quarter of 2007 to \$3.5 million in the first quarter of 2008. Net revenues consist primarily of commercial product revenues and government contract revenues.

Net commercial product revenues decreased to \$2.0 million in the first quarter of 2008 from \$3.5 million in the first quarter of 2007, a decrease of \$1.5 million, or 44%. The decrease is primarily the result of lower sales volume for our SuperLink product due to customer program delays. The average sales prices for our products were unchanged. Our three largest customers accounted for 97% of our total net commercial product revenues in the first quarter of 2008, compared to 95% in the first quarter of 2007. These customers generally purchase products through non-binding commitments with minimal lead-times. Consequently, our commercial product revenues can fluctuate dramatically from quarter to quarter based on changes in our customers' capital spending patterns.

Government contract revenues increased by \$830,000, or 128% to \$1.5 million in the first quarter of 2008 from \$649,000 in the first quarter of 2007. This increase is primarily attributable to an increased number of government contracts.

Cost of commercial product revenues includes all direct costs, manufacturing overhead, provision for excess and obsolete inventories and restructuring and impairment charges relating to the manufacturing operations. The cost of commercial product revenue decreased by \$1.9 million or 49% to \$2.0 million for the first quarter of 2008 compared to \$3.9 million for the first quarter of 2007. The lower costs resulted principally from lower production as a result of lower sales. There was no additional provision for obsolete inventories in the first quarter of 2008 as compared to \$90,000 in the first quarter of 2007. There was a

Table of Contents

\$74,000 reduction in a specific warranty provision in the first quarter of 2008 on the expiration of a warranty. There was no such warranty expense reduction in the first quarter of 2007.

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

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

	For the quarters ended			
	March 31, 2007			March 29, 2008
	(Dollars in thousands)			
Net commercial product sales	\$ 3,534	100.0%	\$ 1,993	100.0%
Total cost of commercial product sales	3,902	110.4%	2,019	101.3%
Gross profit	\$ (368)	(10.4%)	\$ (26)	(1.3%)

We had a negative gross profit of \$26,000 in the first quarter of 2008 from the sale of our commercial products as compared to a negative gross profit of \$368,000 in the first quarter of 2007. We experienced negative gross profit in the first quarters of 2008 and 2007 because the reduced level of commercial sales was insufficient to cover our fixed manufacturing overhead costs. Gross margin in the first quarter of 2008 was not impacted by the sale of previously written-off inventory, while the same quarter last year included a gain of \$126,000 from such sales. We regularly review inventory quantities on hand and provide an allowance for excess and obsolete inventory based on numerous factors including sales backlog, historical inventory usage, forecasted product demand and production requirements for the next twelve months.

Contract research and development expenses totaled \$1.2 million in the first quarter of 2008 as compared to \$445,000 in the first quarter of 2007. This increase was the result of higher expenses associated with performing a greater number of government contracts.

Other research and development expenses relate principally to development of new wireless commercial products. We also incur design expenses associated with reducing the cost and improving the manufacturability of our existing products. These expenses totaled \$408,000 in the first quarter of 2008 as compared to \$913,000 in the same quarter of the prior year. This decrease in commercial research and development is due to the increases in government contract efforts using relatively more of our limited engineering resources.

Selling, general and administrative expenses totaled \$2.2 million in the first quarter of 2008, as compared to \$1.9 million in the first quarter of the prior year. The lower expenses in 2007 resulted primarily from reversal of a \$610,000 reserve. Excluding this litigation item, 2008 expenses are lower as a result of lower insurance premiums, fewer repairs and maintenance charges, and lower consulting expenses.

Interest income increased in the first quarter of 2008 as compared to the prior year period, because we had more cash available for investment partially offset by lower interest rates in 2008.

Interest expense in the first quarter of 2008 decreased to \$9,000, as compared to \$11,000 in the prior year period, because of lower borrowings.

Edgar Filing: SUPERCONDUCTOR TECHNOLOGIES INC - Form 10-Q

We had a net loss of \$2.3 million for the quarter ended March 29, 2008, as compared to a net loss of \$2.9 million in the same period last year.

The net loss available to common shareholders totaled \$0.17 per common share in the first quarter of 2008, as compared to a net loss of \$0.24 per common share in the same period last year.

Table of Contents

Liquidity and Capital Resources

Cash Flow Analysis

As of March 29, 2008, we had working capital of \$16.3 million, including \$11.7 million in cash and cash equivalents, as compared to working capital of \$3.3 million at December 31, 2007, which included \$3.9 million in cash and cash equivalents. We currently invest our excess cash in short-term, investment-grade, money-market instruments with maturities of three months or less. We do not own any auction rate securities. We believe that all of our cash investments would be readily available to us should the need arise.

Cash and cash equivalents increased by \$7.8 million from \$3.9 million at December 31, 2007 to \$11.7 million at March 29, 2008. Cash was provided by the final \$11.0 million payment from the BAOLI investment, partly offset by cash used in operations and for the purchase of property and equipment.

Cash used in operations totaled \$3.1 million in the first quarter of 2008. We used \$1.8 million to fund the cash portion of our net loss. We also used cash to fund a \$2.0 million increase in inventory, partially offset by cash generated from a \$761,000 decrease in accounts receivable, prepaid expenses and other assets, as well as an increase in accounts payable and accrued expenses.

Net cash used in investing activities totaled \$62,000 in the first quarter of 2008 as compared to \$27,000 in the first quarter of last year. The expenditure relates to purchases of property and equipment.

Net cash provided by financing activities totaled \$10.9 million in the first quarter of 2008. The cash was provided by \$11.0 million from the \$15.0 million BAOLI investment, net of \$89,000 in expenses. Net cash used in financing activities totaled \$5,000 in the first quarter of 2007 and was used to pay down our long term debt.

Financing Activities

We have historically financed our operations through a combination of cash on hand, cash provided from operations, equipment lease financings, available borrowings under bank lines of credit and both private and public equity offerings. We have effective registration statements on file with the SEC covering the public resale by investors of common stock issued in our private placements, as well as any common stock acquired upon exercise of their warrants.

Under an agreement entered into in 2007, on February 27, 2008, we issued to BAOLI and two associated purchasers a total of (a) 3,101,361 shares of our common stock (of which 953,065 must be voted in accordance with the votes of our other shares, effectively giving the holder no voting power over such shares) and (b) 611,523 shares of our Series A Convertible Preferred Stock (convertible under certain conditions into 6,115,230 shares of our common stock). We received \$15.0 million in cash, of which \$4.0 million was funded in 2007 and the \$11.0 million balance was funded in January 2008.

We also have an existing line of credit from a bank. It is a material source of funds for our business. The line of credit expires in July, 2008. The loan agreement is structured as a sale of our accounts receivable and provides for the sale of up to \$5.0 million of eligible accounts receivable, with advances to us totaling 80% of the receivables sold. Advances bear interest at the prime rate (5.25% at March 29, 2008) plus 2.50% subject to a minimum monthly charge. There was no amount outstanding under this borrowing facility at March 29, 2008 or December 31, 2007. Advances are collateralized by a lien on all of our assets. Under the terms of the agreement, we continue to service the sold receivables and are subject to recourse provisions.

Contractual Obligations and Commercial Commitments

During the first quarter of 2008, there were no material changes outside the ordinary course of our business in the information regarding specified contractual obligations contained in our Annual Report on Form 10-K for the year ended December 31, 2007.

Capital Expenditures

We plan to invest approximately \$600,000 in fixed assets during the remainder of 2008.

Future Liquidity

Our principal sources of liquidity consist of existing cash balances and funds expected to be generated from future operations. We believe one of the key factors to our liquidity will be our ability to successfully execute on our plans to increase sales levels in a highly concentrated industry where we experience significant fluctuations in sales from quarter to quarter. Our cash requirements will also depend on numerous other variable factors, including the rate of

growth of sales, the timing and levels of products purchased, payment terms and credit limits from manufacturers, and the timing and level of accounts receivable collections.

For the quarter ended March 29, 2008, we incurred a net loss of \$2.3 million and had negative cash flows from operations of \$3.1 million. In 2007, we incurred a net loss of \$9.1 million and had negative cash flows from operations of

Table of Contents

\$5.4 million. Our independent registered public accounting firm has included in their audit reports for 2007 and 2006 an explanatory paragraph expressing doubt about our ability to continue as a going concern.

At March 29, 2008 we had \$11.7 million in cash. We believe this cash, combined with our customer base in North America, our new joint venture for sales and manufacturing in China, our aggressive sales plan for 2008 and our continued emphasis on cost reduction should fund our business for at least the next twelve months. We cannot assure you that additional financing would be available on acceptable terms or at all if actual cash flows deviate significantly from forecasted amounts or if we believe operations require additional funding.

Net Operating Loss Carryforward

As of December 31, 2007, we had net operating loss carryforwards for federal and state income tax purposes of approximately \$285.1 million and \$154.7 million, respectively, which expire in the years 2008 through 2027. Of these amounts \$88.3 million and \$23.5 million, respectively, resulted from the acquisition of Conductus. Included in the net operating loss carryforwards are deductions related to stock options of approximately \$24.1 million and \$13.1 million for federal and California income tax purposes, respectively. To the extent net operating loss carryforwards are recognized for accounting purposes the resulting benefits related to the stock options will be credited to stockholders equity. In addition, we had research and development and other tax credits for federal and state income tax purposes of approximately \$2.7 million and \$1.3 million, respectively, which expire in the years 2008 through 2027. Of these amounts \$661,000 and \$736,000, respectively resulted from the acquisition of Conductus.

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

Section 382 of the Internal Revenue Code imposes an annual limitation on the utilization of net operating loss carryforwards based on a statutory rate of return (usually the applicable federal funds rate, as defined in the Internal Revenue Code) and the value of the corporation at the time of a change of ownership as defined by Section 382. We had changes in ownership in August 1999 and December 2002, and are evaluating the effect of the recent investment by BAOLI. Therefore, the ability to utilize net operating loss carryforwards of \$97.3 million incurred prior to the ownership changes will be subject in future periods to an annual limitation of \$1.3 million. In addition, we acquired the right to Conductus net operating losses, which are also subject to the limitations imposed by Section 382. Conductus underwent three ownership changes, which occurred in February 1999, February 2001 and December 2002. Therefore, the ability to utilize Conductus net operating loss carryforwards of \$88.3 million incurred prior to the ownership changes will be subject in future periods to annual limitation of \$700,000. Net operating losses incurred by us subsequent to the ownership changes totaled \$99.5 million and are not subject to this limitation.

Recent Accounting Pronouncements

In February 2008, the FASB issued FSP 157-2 Partial Deferral of the Effective Date of Statement 157 (FSP 157-2). FSP 157-2 delays the effective date of SFAS No. 157, for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. The adoption of SFAS No. 157 did not have a material impact on our consolidated results or operations or financial condition and we are currently evaluating the potential impact of adopting FSP FAS 157-2 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, which requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, at their fair values as of that date. We will be required to adopt SFAS No. 141R as of October 1, 2009. We are currently evaluating the impact of SFAS No. 141R on our financial condition, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51, which clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. We will be required to adopt SFAS No. 160 as of October 1, 2009. We are currently evaluating the impact of SFAS No. 160 on our financial condition, results of operations and cash flows.

Forward-Looking Statements

This report contains forward-looking statements that involve risks and uncertainties. We have made these statements in reliance on the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Our forward-looking statements relate to future events or our future performance and include, but are not limited to, statements concerning our business strategy, future commercial revenues, market growth, capital requirements, new product introductions, expansion plans and the adequacy of our funding. Other statements contained in this report that are not historical facts are also forward-looking statements. We

Table of Contents

have tried, wherever possible, to identify forward-looking statements by terminology such as may, will, could, should, expects, anticipates, intends, plans, believes, seeks, estimates and other comparable terminology.

Forward-looking statements are not guarantees of future performance and are subject to various risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially from those expressed in forward-looking statements. They can be affected by many factors, including, but not limited to the following:

fluctuations in product demand from quarter to quarter which can be significant,

the impact of competitive filter products, technologies and pricing,

manufacturing capacity constraints and difficulties,

market acceptance risks, and

general economic conditions.

Please read the section in our 2007 Annual Report on Form 10-K entitled Item 1A *Risk Factors* for a description of additional uncertainties and factors that may affect our forward-looking statements. Forward-looking statements are based on information presently available to senior management, and we do not assume any duty to update our forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We do not believe that there was a material change in our exposure to market risk at March 29, 2008 as compared with our market risk exposure on December 31, 2007. See *Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk* in our 2007 Annual Report on Form 10-K.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit, is recorded, processed, summarized and reported, within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms, and such information is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosures.

Our Chief Executive Officer and Controller have evaluated our disclosure controls and procedures and have concluded, as of March 29, 2008, that they are effective as described above.

Changes in Internal Controls

There have been no changes in our internal control over financial reporting during the first quarter of 2008 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Because of our inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

A description of the risk factors associated with our business is contained in Item 1A, *Risk Factors*, of our 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 27, 2008 and incorporated herein by reference. We are not aware of any material changes to those risk factors.

Item 2. Unregistered Sales of Equity Securities.

We did not conduct any offerings of equity securities during the first quarter of this year that were not registered under the Securities Act of 1933. However, on February 27, 2008 we consummated the previously discussed issuances of common stock and Series A Convertible Preferred Stock pursuant to a private placement that was not registered under the Securities Act

Table of Contents

of 1933 in reliance on the exemption from registration provided by Section 4(2) of such Act and Rule 506 promulgated thereunder. The bases for claiming such exemptions include, among other factors, BAOLI's representations to us as to its status as an accredited investor. Under an agreement entered into in 2007, we issued to BAOLI and two associated purchasers a total of (a) 3,101,361 shares of our common stock (of which 953,065 must be voted in accordance with the votes of our other shares, effectively giving the holder no voting power over such shares) and (b) 611,523 shares of our Series A Convertible Preferred Stock (convertible under certain conditions into 6,115,230 shares of our common stock). We received \$15.0 million in cash, of which \$4.0 million was funded in 2007 and the \$11.0 million balance was funded in January 2008.

We did not repurchase any shares of our common stock during the first quarter of this year.

Item 4. Submission of Matters to a Vote of Security Holders.

We did not submit any matters submitted to a vote of security holders during the first quarter of this year.

Item 5. Other Information.

(a) Additional Disclosures.

None.

(b) Stockholder Nominations.

There have been no material changes to the procedures by which stockholders may recommend nominees to our board of directors during the quarter ended March 29, 2008. Please see the discussion of our procedures in our most recent proxy statement.

Item 6. Exhibits.

Number	Description of Document
31.1	Statement of CEO Pursuant to 302 of the Sarbanes-Oxley Act of 2002*
31.2	Statement of CFO Pursuant to 302 of the Sarbanes-Oxley Act of 2002*
32.1	Statement of CEO Pursuant to 906 of the Sarbanes-Oxley Act of 2002*
32.2	Statement of CFO Pursuant to 906 of the Sarbanes-Oxley Act of 2002*

* Filed herewith.

Table of Contents

SIGNATURES

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

**SUPERCONDUCTOR
TECHNOLOGIES INC.**

Dated: May 12, 2008

/s/ William J. Buchanan
William J. Buchanan
Controller

/s/ Jeffrey A. Quiram
Jeffrey A. Quiram
President and Chief Executive Officer