

SUPERCONDUCTOR TECHNOLOGIES INC

Form 10-Q

November 04, 2011

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

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended October 1, 2011**

**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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

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  No

We had 33,494,457 shares of our common stock outstanding as of the close of business on November 1, 2011.



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Three and Nine Months Ended October 1, 2011

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**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

*This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995 for these forward looking statements. Our forward-looking statements relate to future events or our future performance and include, but are not limited to, statements concerning our business strategy, future commercial revenues, market growth, capital requirements, new product introductions, expansion plans and the adequacy of our funding. Other statements contained in this Report that are not historical facts are also forward-looking statements. We have tried, wherever possible, to identify forward-looking statements by terminology such as may, will, could, should, expects, anticipates, intends, plans, believes, seeks, estimates and other comparable terminology.*

*We caution investors that any forward-looking statements presented in this Report, or that we may make orally or in writing from time to time, are based on the beliefs of, assumptions made by, and information currently available to, us. Such statements are based on assumptions, and the actual outcome will be affected by known and unknown risks, trends, uncertainties and factors that are beyond our control or ability to predict. Although we believe that our assumptions are reasonable, they are not guarantees of future performance and some will inevitably prove to be incorrect. As a result, our actual future results can be expected to differ from our expectations, and those differences may be material. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on known results and trends at the time they are made, to anticipate future results or trends.*

*Some of the risks and uncertainties that may cause our actual results, performance or achievements to differ materially from those expressed or implied by forward-looking statements include the following:*

- limited cash and a history of losses;*
- the current worldwide recession;*
- our need to raise additional capital for our business;*
- limited number of potential customers;*
- rapidly advancing technology in our target markets;*
- our need to overcome additional technical challenges necessary to develop and commercialize HTS wire;*
- the impact of competitive products, technologies and pricing;*
- limited number of suppliers for some of our components;*
- no significant backlog from quarter to quarter;*
- fluctuations in sales and product demand from quarter to quarter can be significant;*
- our proprietary rights, while important to our business, are difficult and costly to protect;*
- manufacturing capacity constraints and difficulties; and*
- cost and uncertainty from compliance with environmental regulations.*

*For further discussion of these and other factors see, Management's Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors in our Annual Report on Form 10-K for 2010.*

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

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**PART I**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>October 1, 2011</b>	<b>October 2, 2010</b>	<b>October 1, 2011</b>	<b>October 2, 2010</b>
Net revenues:				
Net commercial product revenues	\$ 470,000	\$ 1,830,000	\$ 3,174,000	\$ 5,901,000
Government and other contract revenues	9,000	144,000	41,000	1,857,000
<b>Total net revenues</b>	<b>479,000</b>	<b>1,974,000</b>	<b>3,215,000</b>	<b>7,758,000</b>
Costs and expenses:				
Cost of commercial product revenues	1,093,000	2,110,000	4,027,000	6,464,000
Cost of government and other contract revenue	9,000	86,000	39,000	1,095,000
Research and development	1,065,000	1,507,000	4,414,000	3,998,000
Selling, general and administrative	1,658,000	1,622,000	4,993,000	5,338,000
<b>Total costs and expenses</b>	<b>3,825,000</b>	<b>5,325,000</b>	<b>13,473,000</b>	<b>16,895,000</b>
<b>Loss from operations</b>	<b>(3,346,000)</b>	<b>(3,351,000)</b>	<b>(10,258,000)</b>	<b>(9,137,000)</b>
Other Income and Expense:				
Adjustments to fair value of derivatives		2,000		171,000
Interest income	16,000	2,000	20,000	4,000
Interest expense	1,000	(7,000)	(13,000)	(21,000)
<b>Net loss</b>	<b>\$ (3,329,000)</b>	<b>\$ (3,354,000)</b>	<b>\$ (10,251,000)</b>	<b>\$ (8,983,000)</b>
<b>Basic and diluted loss per common share</b>	<b>\$ (0.10)</b>	<b>\$ (0.14)</b>	<b>\$ (0.33)</b>	<b>\$ (0.40)</b>
Weighted average number of common shares outstanding	32,224,901	23,335,955	31,538,181	22,334,644

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





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

	<b>October 1, 2011</b>	<b>December 31, 2010</b>
	(Unaudited)	(See Note)
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 9,656,000	\$ 6,069,000
Accounts receivable, net	86,000	108,000
Inventory, net	2,338,000	2,230,000
Prepaid expenses and other current assets	327,000	344,000
<b>Total Current Assets</b>	<b>12,407,000</b>	<b>8,751,000</b>
Property and equipment, net of accumulated depreciation of \$22,363,000 and \$21,948,000, respectively	2,806,000	1,334,000
Patents, licenses and purchased technology, net of accumulated amortization of \$2,315,000 and \$2,494,000, respectively	1,397,000	2,274,000
Other assets	184,000	210,000
<b>Total Assets</b>	<b>\$ 16,794,000</b>	<b>\$ 12,569,000</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 1,413,000	\$ 548,000
Accrued expenses	799,000	517,000
Current portion of capitalized lease obligations and long term debt	6,000	31,000
<b>Total Current Liabilities</b>	<b>2,218,000</b>	<b>1,096,000</b>
Other long term liabilities	603,000	577,000
<b>Total Liabilities</b>	<b>2,821,000</b>	<b>1,673,000</b>
<b>Commitments and contingencies-Notes 6 and 7</b>		
<b>Stockholders Equity:</b>		
Preferred stock, \$.001 par value, 2,000,000 shares authorized, 564,642 shares issued and outstanding	1,000	1,000
Common stock, \$.001 par value, 250,000,000 shares authorized, 33,494,457 and 27,217,408 shares issued and outstanding, respectively	33,000	28,000
Capital in excess of par value	261,823,000	248,500,000
Accumulated deficit	(247,884,000)	(237,633,000)
<b>Total Stockholders Equity</b>	<b>13,973,000</b>	<b>10,896,000</b>

<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 16,794,000</b>	<b>\$ 12,569,000</b>
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See accompanying notes to the unaudited interim condensed consolidated financial statements.

Note December 31, 2010 balances were derived from audited consolidated financial statements.

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

	<b>Nine Months Ended</b>	
	<b>October 1, 2011</b>	<b>October 2, 2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (10,251,000)	\$ (8,983,000)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation and amortization	634,000	766,000
Stock-based compensation expense	1,229,000	822,000
Write-off of intangibles	844,000	
Provision for excess and obsolete inventories	63,000	270,000
Fair value of derivatives		(171,000)
Changes in assets and liabilities:		
Accounts receivable	22,000	212,000
Inventories	(170,000)	(22,000)
Prepaid expenses and other current assets	17,000	(48,000)
Patents and licenses	(34,000)	(154,000)
Other assets	26,000	8,000
Accounts payable, accrued expenses and other current liabilities	1,148,000	873,000
Net cash used in operating activities	(6,472,000)	(6,427,000)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(2,040,000)	(309,000)
Net cash used in investing activities	(2,040,000)	(309,000)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repurchase of common shares for withholding obligations	(303,000)	(573,000)
Net proceeds from the sale of common stock	12,402,000	5,219,000
Net cash provided by financing activities	12,099,000	4,646,000
Net increase (decrease) in cash and cash equivalents	3,587,000	(2,090,000)
Cash and cash equivalents at beginning of period	6,069,000	10,365,000
Cash and cash equivalents at end of period	\$ 9,656,000	\$ 8,275,000

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



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**SUPERCONDUCTOR TECHNOLOGIES INC.**

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

**1. General**

Superconductor Technologies Inc. (together with our subsidiaries, we or us ) was incorporated in Delaware on May 11, 1987. We maintain our headquarters in Santa Barbara, California. We develop and produce high temperature superconducting (HTS) materials and associated technologies. We have generated more than 100 patents and patent applications as well as proprietary trade secrets and manufacturing expertise, providing interference elimination and network enhancement solutions to the commercial wireless industry. In addition, we are now leveraging our key enabling technologies, including radio frequency filtering, HTS materials and cryogenics, to pursue emerging opportunities in the electrical grid and in equipment platforms that utilize electrical circuits.

From 1987 to 1997, we were engaged primarily in research and development and generated revenues primarily from government research contracts. Since then, we have provided solutions for wireless infrastructure in the telecommunications industry. Our commercial product offerings are divided into the following three areas:

SuperLink® (high-temperature superconducting filters), AmpLink® (high performance, ground-mounted amplifiers) and SuperPlex (high performance multiplexers). In addition, we have strategic initiatives for an HTS wire platform, RF filters and cryocoolers.

For the nine months ended October 1, 2011 and October 2, 2010, commercial revenues accounted for 99% and 76%, respectively, of our net revenues.

Our research and development contracts are used as a source of funds for our commercial technology development. We continue to be involved as either contractor or subcontractor on a number of contracts with the U.S. government. For the nine months ended October 1, 2011 and October 2, 2010, government related contracts accounted for 1% and 24%, respectively, of our net revenues.

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

The preparation of the condensed consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and the accompanying notes. Actual results could differ from those estimates and such differences may be material to the condensed consolidated financial statements. This quarterly report on Form 10-Q should be read in conjunction with our Form 10-K for 2010. The results of operations for the nine months ended October 1, 2011 are not necessarily indicative of the results for of the full year 2011.

**2. Summary of Significant Accounting Policies**

*Basis of Presentation*

For the nine months ended October 1, 2011, we incurred a net loss of \$10.3 million and negative cash flows from operations of \$6.5 million. For of the full year 2010, we incurred a net loss of \$12.0 million and had negative cash flows from operations of \$9.4 million.

At October 1, 2011, we had \$9.7 million in cash and cash equivalents. We believe our cash resources may not be sufficient to fund our planned operations for at least the next twelve months. We believe the key factors to our liquidity will be our ability to successfully use our expertise and our technology to generate revenues in various ways, including commercial operations, government contracts, joint ventures and licenses. Because of the uncertainty of these factors, we may need to raise funds to meet our working capital needs. If we require additional financing, we cannot assure you that additional financing will be available on acceptable terms or at all. If we issue additional equity securities to raise funds, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise any needed funds, we might be forced to make further substantial reductions in our operating expenses, which could adversely affect our ability to implement our current business plan and ultimately our viability as a company. Our condensed consolidated financial statements do not include any adjustments that might result from this uncertainty and have been prepared assuming that we will continue as a going concern.



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### *Principles of Consolidation*

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

### *Cash and Cash Equivalents*

Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less. Cash and cash equivalents are maintained with what we believe to be quality financial institutions and from time to time exceed FDIC limits. Historically, we have not experienced any losses due to such concentration of credit risk.

### *Accounts Receivable*

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

### *Revenue Recognition*

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

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

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

### *Shipping and Handling Fees and Costs*

Shipping and handling fees billed to customers are included in net commercial product revenues. Shipping and handling fees associated with freight are generally included in cost of commercial product revenues.

### *Warranties*

We offer warranties generally ranging from one to five years, depending on the product and negotiated terms of purchase agreements with our customers. Such warranties require us to repair or replace defective product returned to us during such warranty period at no cost to the customer. 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 our 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.



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*Research and Development Costs*

Research and development costs are charged to expense 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 government and other contract expense.

*Inventories*

Inventories are stated at the lower of cost or market, with costs primarily determined using standard costs, which approximate actual costs utilizing the first-in, first-out method. We review inventory quantities on hand and on order and record, on a quarterly basis, a provision for excess and obsolete inventory and/or vendor cancellation charges related to purchase commitments. If the results of the review determine that a write-down is necessary, we recognize a loss in the period in which the loss is identified, whether or not the inventory is retained. Our inventory reserves establish a new cost basis for inventory and are not reversed until we sell or dispose of the related inventory. Such provisions are established based on historical usage, adjusted for known changes in demands for such products, or the estimated forecast of product demand and production requirements. Costs associated with idle capacity are charged to expense 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 seven years. Leasehold improvements and assets financed under capital leases are amortized over the shorter of their useful lives or the lease term. Furniture and fixtures are depreciated over seven years. Expenditures for additions and major improvements are capitalized. Expenditures for minor tooling, repairs and maintenance and minor improvements are charged to expense as incurred. When property or equipment is retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts. Gains or losses from retirements and disposals are recorded in selling, general and administrative expenses.

*Patents, Licenses and Purchased Technology*

Patents and licenses are recorded at cost and are amortized using the straight-line method over the shorter of their estimated useful lives or approximately seventeen years. Purchased technology acquired through the acquisition of Conductus, Inc. in 2002 was recorded at our estimated fair value and was amortized using the straight-line method over seven years ending in 2009.

*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 is written down to its estimated fair value. We tested our long lived assets for recoverability during 2010 and did not believe that there was any impairment.

While we believe the expected cash flows from these long-lived assets, including intangible assets, exceed the carrying amounts, materially different assumptions regarding future performance and discount rates could result in future impairment losses. In particular, if we no longer believe we will achieve our long-term projected sales or operating expenses, we may conclude, in connection with any future impairment tests, that the estimated fair value of our long-lived assets, including intangible assets, is less than the book value and recognize an impairment charge. Any impairment charge would adversely affect our earnings.

*Other Investments*

From time to time we may pursue joint ventures with other entities to commercialize our technology. In 2007, we formed a joint venture with Hunchun BaoLi Communication Co. Ltd. to manufacture and sell our SuperLink interference elimination solution in China. We use the equity method of accounting for our 45 percent joint venture interest. The joint venture agreement called for our joint venture partner to supply the capital and local expertise, and for us to provide a license of certain technology and supply key parts for manufacturing. Since 2007, we have been conducting lab and field trials in the existing China 2G market using our TD-SCDMA and SuperLink solutions.

Although those activities continue, the parties have not completed their contributions to the joint venture, including most of the funding and our license, within the two year period specified by the agreement and Chinese law. The future of the joint venture, including any commencement of manufacturing and the transfer of our processes, will depend on product demand in China, completion of funding by our joint venture partner, as well as a number of other conditions, including certain critical approvals from the Chinese and U.S. governments. There continues to be no assurance that these conditions will be met. We incurred no expenses in the nine months ended October 1, 2011 or in the full year 2010 as a result of this joint venture.

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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 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. The guidance further clarifies the accounting for uncertainty in income taxes and sets a consistent framework to determine the appropriate level of tax reserve to maintain for uncertain tax positions. This interpretation uses a two-step approach wherein a tax benefit is recognized if a position is more-likely-than-not to be sustained. The amount of the benefit is then measured to be the highest tax benefit that is greater than 50% likely to be realized and sets out disclosure requirements to enhance transparency of our tax reserves. The adoption of this guidance has not had a material impact on our consolidated financial statements, as we concluded our tax positions are highly certain of being settled at 100% of the benefit claimed. Guidance is also provided on the accounting for the related interest and penalties, financial statement and disclosure. We are currently not under examination by any taxing authority nor have we been notified of an impending examination. The oldest tax year that remains open to possible evaluation and interpretation of our tax position is 1996.

As of December 31, 2010, we had net operating loss carryforwards for federal and state income tax purposes of approximately \$303.1 million and \$191.9 million, respectively, which expire in the years 2011 through 2030. However, during 2010 we concluded that under the Internal Revenue Code change of control limitations, a maximum of \$81.9 million and \$55.0 million, respectively, would be available for reduction of taxable income and reduced both the deferred tax asset and valuation allowance accordingly. 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 condensed consolidated balance sheets.

*Marketing Costs*

All costs related to marketing and advertising our products are charged to expense as incurred or at the time the advertising takes place. Advertising costs were not material in each of the three and nine months ended October 1, 2011 and October 2, 2010.

*Net Loss Per Share*

Basic and diluted net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding in each year. Outstanding stock options and unvested restricted stock awards are not included in the calculation of diluted loss per share because their effect is anti-dilutive.

*Stock-based Compensation*

We grant both restricted stock awards and stock options to our key employees, directors and consultants. For the three and nine months ended October 1, 2011 and October 2, 2010, the weighted average fair value of options was estimated at 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:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>October</b>	<b>October 2,</b>	<b>October</b>	<b>October 2,</b>
	<b>1, 2011</b>	<b>2010</b>	<b>1, 2011</b>	<b>2010</b>
Expected life in years			4.0	4.0
Risk free interest rate			1.52%	2.04%
Expected volatility			111%	117%
Dividend yield			0%	0%



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The expected life was based on the contractual term of the options and expected employee exercise behavior. Typically, options to our employees have a 2 to 4 year vesting term and a 10 year contractual term. The risk-free interest rate is based on 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% 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.

The stock-based compensation expense for our restricted stock awards is measured at fair value on the date of grant based on the number of shares expected to vest and the quoted market price of our common stock. We also assumed a 10% forfeiture rate for our restricted stock awards based on our historical cancellation rates over the last 4 years.

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

	Three months ended		Nine months ended	
	October 1, 2011	October 2, 2010	October 1, 2011	October 2, 2010
Cost of revenue	\$ 5,000	\$ 5,000	\$ 13,000	\$ 16,000
Research and development	127,000	89,000	371,000	226,000
Selling, general and administrative	279,000	212,000	845,000	580,000
Total stock-based compensation expense	\$ 411,000	\$ 306,000	\$ 1,229,000	\$ 822,000

*Use of Estimates*

The preparation of the condensed consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. The significant estimates in the preparation of the condensed consolidated financial statements relate to the assessment of the carrying amount of accounts receivable, inventory, fixed assets, intangibles, estimated provisions for warranty costs, contract revenues, income taxes and disclosures related to litigation. Actual results could differ from those estimates, and such differences may be material to the condensed consolidated financial statements.

*Fair Value of Financial Instruments*

We have estimated the fair value amounts of our financial instruments using the available market information and valuation methodologies considered appropriate. We determined the book value of our cash and cash equivalents, accounts receivable, inventory, prepaid expenses, other current assets and other current liabilities as of October 1, 2011 approximate fair value.

*Comprehensive Income*

We have no items of other comprehensive income in any period and consequently have not included a Statement of Comprehensive Income.

*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. We currently derive net commercial product revenues primarily 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 condensed consolidated statement of operations for all periods presented.

*Certain Risks and Uncertainties*

Our long-term prospects are dependent upon the continued and increased market acceptance for our products.

We currently sell most of our products directly to wireless network operators in the United States and our product sales have historically been concentrated in a small number of customers. During the nine months ending October 1, 2011, we had two customers that represented 80% and 14% of total net revenues and 89% of accounts receivable. In 2010, these two customers represented 58% and 12% of total net revenues and 31% 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.

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We currently rely on a limited number of suppliers for 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 indemnity obligations because of the uncertainty as to whether a claim might arise and how much it might total.

**3. Short Term Borrowings**

We had a line of credit with a bank. The agreement was structured as a sale of accounts receivable and provided for the sale of up to \$3.0 million of eligible accounts receivable, with advances to us totaling 80% of the receivables sold. We had not used this line of credit for several years and therefore allowed it to expire without renewal on July 11, 2011.

**4. Stockholders Equity**

The following is a summary of stockholders equity transactions for the nine months ended October 1, 2011:

	Convertible Preferred Stock		Common Stock		Capital in Excess of Par Value	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
<b>Balance at December 31, 2010</b>	611,523	\$ 1,000	27,217,408	\$ 28,000	\$ 248,500,000	\$(237,633,000)	\$ 10,896,000
Issuance of common stock, net			5,443,000	5,000	12,397,000		12,402,000
Conversion of Preferred Stock to Common Stock	(46,881)		468,810				
Repurchase of common stock to satisfy tax withholding obligations			(179,636)		(303,000)		(303,000)
Issuance of awards and stock based compensation			544,875		1,229,000		1,229,000
Net loss						(10,251,000)	(10,251,000)
<b>Balance at October 1, 2011</b>	564,642	\$ 1,000	33,494,457	\$ 33,000	\$ 261,823,000	\$(247,884,000)	\$ 13,973,000

*Equity Offering*

In a registered direct offering completed in February 2011 we raised proceeds of \$12.4 million, net of offering costs of \$933,000, from the sale of 5,443,000 shares of common stock at \$2.45 per share based on a negotiated discount to market.

*Stock Options*

At October 1, 2011, we had three equity award option plans, the 1998 and 1999 Stock Option Plans and the 2003 Equity Incentive Plan (collectively, the "Stock Option Plans") although we can only grant new options under the 2003 Equity Incentive Plan. Under the 2003 Equity Incentive Plan, stock awards may be made to our directors, key employees, consultants, and non-employee directors and may consist of stock options, stock appreciation rights, restricted stock awards, performance awards, and performance share awards. Stock options must be granted at prices no less than the market value on the date of grant. There were no stock option exercises during the three or nine months ended October 1, 2011 or during the three or nine months ended October 2, 2010.

The impact to the condensed consolidated statements of operations was \$190,000 and \$552,000 and \$0.01 and \$0.02 on basic and diluted earnings per share for the three and nine months ended October 1, 2011, respectively, compared to \$142,000 and \$406,000 and \$0.01 and \$0.02 on basic and diluted earnings per share for the three and nine months ended October 2, 2010, respectively. No stock compensation cost was capitalized during either period. The total compensation cost related to nonvested awards not yet recognized was \$1.1 million and the weighted-average period over which the cost is expected to be recognized was 1.5 years at October 1, 2011.



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The following is a summary of stock option transactions under our stock option plans at October 1, 2011:

	<b>Number of Shares</b>	<b>Price Per Share</b>	<b>Weighted Average Exercise Price</b>	<b>Number of Options Exercisable</b>	<b>Weighted Average Exercise Price</b>
Balance at December 31, 2010	1,083,366	\$ 1.43 - \$79.38	\$ 6.43	830,552	\$ 7.57
Granted	618,932	1.58 - 2.86	1.81		
Exercised					
Canceled	(94,033)	1.58 - 79.38	7.46		
Balance at October 1, 2011	1,608,265	\$ 1.43 - \$74.50	\$ 4.59	884,871	\$ 6.78

The outstanding options expire on various dates through the end of January 2021. The weighted-average contractual term of options outstanding is 6.2 years, and the weighted-average contractual term of stock options currently exercisable is 4.6 years. The exercise prices for these options range from \$1.43 to \$74.50 per share, for an aggregate exercise price of approximately \$7.4 million. At October 1, 2011, outstanding options covering 600 shares, with an intrinsic value of less \$100, had an exercise price less than the current market value, and all were exercisable.

*Restricted Stock Awards*

The grant date fair value of each share of our restricted stock awards is equal to the fair value of our common stock at the grant date. Shares of restricted stock under awards all have service conditions and vest over one to four years. Some of our grants also have performance conditions. The following is a summary of our restricted stock award transactions at October 1, 2011:

	<b>Number of Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Balance nonvested at December 31, 2010	720,723	\$ 1.84
Granted	596,932	1.69
Vested	(466,611)	1.34
Forfeited	(52,055)	2.21
Balance nonvested at October 1, 2011	798,989	\$ 1.99

For the majority of restricted stock awards granted, the number of shares issued on the date the restricted stock awards vest is net of the minimum statutory withholding requirements that we pay in cash to the appropriate taxing authorities on behalf of our employees. During the three months ended October 1, 2011 we withheld no shares, and during the nine months ended October 1, 2011 we withheld 179,636 shares to satisfy \$303,000 of employees' tax obligations. During the three months ended October 2, 2010 we withheld no shares, and during the nine months ended October 2, 2010 we withheld 181,982 shares to satisfy \$573,000 of employees' tax obligations.

The impact to the condensed consolidated statements of operations was \$221,000 and \$676,000 and \$0.01 and \$0.02 on basic and diluted earnings per share for the three and nine months ended October 1, 2011, respectively, and \$164,000 and \$416,000 and \$0.01 and \$0.02 on basic and diluted earnings per share for the three and nine months ended October 2, 2010, respectively. No stock compensation cost was capitalized during the period. The total compensation cost related to nonvested awards not yet recognized was \$734,000, and the weighted-average period over which the cost is expected to be recognized was 10 months.

*Warrants*

We had no warrants outstanding at October 1, 2011.

**5. Earnings Per Share**

Basic and diluted earnings (loss) per share is based on the weighted-average number of common shares outstanding. Since their impact would be anti-dilutive, our loss per common share does not include the effect of the assumed exercise or vesting of the following shares:

	<b>October 1, 2011</b>	<b>October 2, 2010</b>
Outstanding stock options	1,608,265	1,133,331
Unvested restricted stock awards	798,989	720,730
Outstanding warrants		10,000
Total	2,407,254	1,864,061

**Table of Contents****6. Commitments and Contingencies***Operating Leases*

We lease our offices and production facilities under a non-cancelable operating lease that expires in November 2016. This lease contains escalation clauses for increases in annual renewal options and requires us to pay utilities, insurance, taxes and other operating expenses.

For the three and nine months ended October 1, 2011 rent expense was \$273,000 and \$824,000, respectively, and for the three and nine months ended October 2, 2010 rent expense was \$277,000 and \$822,000, respectively.

*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 2011 to 2018. Royalty expense totaled \$44,000 and \$132,000 in the three and nine months ended October 1, 2011, respectively, compared to \$46,000 and \$137,000 in the three and nine months ended October 2, 2010, 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 future audit adjustments to be significant.

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

<b>Years ending December 31,</b>	<b>Licenses</b>	<b>Operating Leases</b>
Remainder of 2011	\$	\$ 328,000
2012	25,000	1,337,000
2013	25,000	1,368,000
2014	30,000	1,407,000
2015	45,000	1,448,000
Thereafter	135,000	1,364,000
Total payments	\$ 260,000	\$ 7,252,000

In March 2011, we decided to use certain of our own technologies, and as a result we voluntarily terminated a patent license we had with a third party along with certain other related intangible assets. As a result, capitalized cost of \$0.8 million was charged to expense during our first quarter and a \$1.35 million license obligation was terminated.

The above table reflects that termination.

**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 condensed consolidated financial statements.

*Warranties*

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

*Intellectual Property Indemnities*

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

to determine the maximum amount of losses that we could incur related to such indemnities.

**Table of Contents***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 indemnities 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 indemnities. Historically, any amounts payable pursuant to such director and officer indemnities 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. During the three and nine months ended October 1, 2011 we accrued \$105,000 under terms of these agreements. No such expense accrued for the same period in 2010.

*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, we are unable to determine the maximum amount of losses that we could incur relating to such indemnities. Historically, any amounts payable pursuant to such indemnities 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.

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

	<b>October 1, 2011</b>	<b>December 31, 2010</b>
<b>Accounts receivable:</b>		
Accounts receivable-trade	\$ 78,000	\$ 36,000
U.S. government accounts receivable-billed	10,000	74,000
Less: allowance for doubtful accounts	(2,000)	(2,000)
	<b>\$ 86,000</b>	<b>\$ 108,000</b>
	<b>October 1, 2011</b>	<b>December 31, 2010</b>
<b>Inventories:</b>		
Raw materials	\$ 1,149,000	\$ 1,499,000
Work-in-process	343,000	511,000
Finished goods	1,980,000	1,316,000
Less inventory reserve	(1,134,000)	(1,096,000)
	<b>\$ 2,338,000</b>	<b>\$ 2,230,000</b>
	<b>October 1, 2011</b>	<b>December 31, 2010</b>

**Property and Equipment:**

Equipment	\$ 17,952,000	\$ 16,092,000
Leasehold improvements	6,821,000	6,786,000
Furniture and fixtures	396,000	404,000
	25,169,000	23,282,000
Less: accumulated depreciation and amortization	(22,363,000)	(21,948,000)
	<b>\$ 2,806,000</b>	<b>\$ 1,334,000</b>

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Depreciation expense amounted to \$205,000 and \$568,000, respectively, for the three and nine month periods ended October 1, 2011 and \$230,000 and \$684,000, respectively, for the three and nine month periods ended October 2, 2010.

	<b>October 1, 2011</b>	<b>December 31, 2010</b>
<b>Patents and Licenses:</b>		
Patents pending	\$ 502,000	\$ 1,110,000
Patents issued	1,503,000	1,382,000
Less accumulated amortization	(608,000)	(554,000)
Net patents issued	895,000	828,000
Licenses Pending		7,000
Licenses Issued		563,000
Less accumulated amortization		(234,000)
Net licenses		329,000
Purchased technology	1,706,000	1,706,000
Less accumulated amortization	(1,706,000)	(1,706,000)
Net purchased technology		
	<b>\$ 1,397,000</b>	<b>\$ 2,274,000</b>

Amortization expense related to these items totaled \$19,000 and \$66,000, respectively, for the three and nine month periods ended October 1, 2011 and \$48,000 and \$82,000, respectively, for the three and nine month periods ended October 2, 2010. Amortization expenses are expected to total \$25,000 for the remainder of 2011 and \$89,000 in each of 2012 and 2013.

	<b>October 1, 2011</b>	<b>December 31, 2010</b>
<b>Accrued Expenses and Other Long Term Liabilities:</b>		
Salaries payable	\$ 150,000	\$ 116,000
Compensated absences	293,000	246,000
Compensation related	59,000	27,000
Warranty reserve	258,000	289,000
Deferred rent	416,000	391,000
Other	232,000	56,000
	<b>1,408,000</b>	<b>1,125,000</b>
Less current portion	<b>(805,000)</b>	<b>(548,000)</b>

Long term portion	\$ 603,000	\$ 577,000
	<b>For the nine months ended,</b>	
	<b>October 1,</b>	
	<b>2011</b>	<b>October 2, 2010</b>
<b>Warranty Reserve Activity:</b>		
Beginning balance	\$ 289,000	\$ 255,000
Additions	25,000	66,000
Deductions	(56,000)	(8,000)
Ending balance	\$ 258,000	\$ 313,000

**9. Subsequent Events**

We evaluated subsequent events through the date the accompanying condensed consolidated financial statements were issued. Pursuant to the requirements of Accounting Standards Codification 855, *Subsequent Events*, we have included all accounting and disclosure requirements related to subsequent events in our condensed consolidated financial statements.



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

We are a leading company in high temperature superconductor (HTS) materials and related technologies. HTS materials have the unique ability to conduct various signals or energy (e.g., electrical current or radio frequency (RF) signals) with little or no resistance when cooled to critical temperatures. Electric currents that flow through conventional conductors encounter resistance that requires power to overcome and generates heat. HTS materials can substantially improve the performance characteristics of electrical systems, reducing power loss, lowering heat generation and decreasing electrical noise. Circuits designed to remove interference inherent in some RF signals can also be made from HTS materials. Commercial use of HTS materials requires a number of cutting edge technologies, including development of HTS materials, specialized manufacturing expertise to create uniform thin layers of these materials, expert designs of circuits optimized for HTS materials, and technologies to maintain an extremely low temperature environment for HTS applications (although the critical temperatures for HTS are high compared with traditional superconductors, they are still extremely cold by other standards).

**Strategic Initiatives**

In addition to our ongoing design, manufacture, and sale of high performance infrastructure products for wireless voice and data applications described below, we have created several unique capabilities and an HTS manufacturing system that we are seeking to strategically deploy. Currently, our core strategic initiative is the development of a new wire platform.

*Wire Platform.* Following a review of our technical capabilities and core competencies, we determined that extending our HTS materials production into a new wire platform for power applications offers an attractive strategic business opportunity. Our second generation (2G) HTS wire product development is focused on large markets where the advantages of HTS wire are recognized by the industry. Our initial product roadmap targets three important applications:

*Superconducting High Power Transmission Cables:* HTS advanced power transmission cable transmits five to twenty times the electrical power of traditional copper or aluminum cables with much improved efficiency.

*Superconducting Fault Current Limiters (SFCL):* SFCLs act like powerful surge protectors, preventing harmful faults from taking down costly substation equipment. SFCLs enable the energy efficient connections of distributed power sources to the grid, fast reliable grid protection, and utilize smart grid design criteria.

*Superconducting Wind Turbine Generators:* Superconducting wind turbines allow utilities to add more power per tower by significantly reducing turbine size and weight and improving power generation efficiency.

While substantial technical challenges and business challenges remain before we have a commercially successful product introduction, we recently announced that we successfully produced 2G HTS wire samples that meet requirements specified by customers for HTS AC power cable, SFCLs and HTS wind turbine applications. We also announced high-magnetic-field test results for our 2G HTS wire. In an ongoing collaborative research and development agreement with Los Alamos National Laboratory (LANL), we and LANL produced a 2G HTS wire sample that demonstrates exceptional in-field critical current values. This current-carrying capability in high magnetic field demonstrates the effectiveness of our HTS fabrication process at producing 2G HTS wire for demanding applications such as superconducting fault current limiters and high-power wind turbine generators.

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In addition to our core strategic initiative relating to a new wire platform, we also have on-going business activities relating to RF filters and cryocoolers.

*RF Filters.* Conventional RF filters are fabricated primarily from aluminum blocks with hollow cavities, resonators, and tuning elements incorporated to make a frequency specific filter. Our filter structures resemble a circuit on a semiconductor using a circuit that is etched into HTS materials that are deposited on a wafer. Our unique and innovative circuits allow us to utilize the characteristics of the HTS materials for this application. We have also developed unique tuning methods that allow us to produce a frequency specific filter.

*Cryocoolers.* HTS circuits need to be cooled to the critical temperature that enables the superconducting properties of the materials to be utilized. To meet this need, we developed a unique cryocooler that can efficiently and reliably cool the circuit to the critical temperature (77 degrees Kelvin). As a result, our wireless products are maintenance free and reliable enough to be deployed for many years.

### **Our HTS Manufacturing System**

We consider our unique manufacturing systems to be significant to our business plan and competitive positioning, especially for our wire platform initiative. We have developed a proprietary Reactive Co-Evaporation and Cyclical Deposition Reaction (RCE-CDR), or simply RCE, deposition technique that allows us to precisely control growth rates, the relative proportions of metals and the chamber temperature. The process further allows us to precisely control and make the refinements necessary for a high-yield, high-output manufacturing. After extensive evaluation of a number of HTS compounds that include one or more of these HTS elements we chose yttrium barium copper oxide (YBCO) as the compound with the best properties for the applications we were pursuing. Utilizing this tightly controlled process and revolutionary RCE deposition method we increased production yield of our YBCO wafers to over 95%. In addition, because we can control the factors that determine the structure of the HTS crystal being grown, we are able to make innovative changes to the crystal to optimize its performance for various applications.

### **Our Proprietary Technology**

Our development efforts over the last 24 years have yielded an extensive patent portfolio as well as critical trade secrets, unpatented technology and proprietary knowledge. We enter into confidentiality and non-disclosure agreements with our employees, suppliers and consultants to protect our proprietary information.

As discussed above, we are currently focusing our development efforts on adapting our unique HTS materials deposition techniques to deliver energy efficient, cost-effective and high performance 2G HTS wire technology for next generation power applications. We have identified several large initial target markets for our 2G HTS wire including energy (wind turbines, smart grid) and industrial (motors, generators) applications. To accelerate development and manufacturing processes for our 2G HTS wire, we are partnering with HTS industry leaders such as the United States National Labs and the U.S. Department of Energy. In May 2010, we renewed our two year Cooperative Research and Development Agreement with Los Alamos National Laboratory. These technological interchanges will help us meet the technical challenges and performance metrics for both high performance and cost effective 2G HTS wire.

Our development efforts (including those described above under Strategic Initiatives) can take a significant number of years to commercialize, and we must overcome significant technical barriers and deal with other significant risks, some of which are described in our other filings with the Securities and Exchange Commission.

### **Our Wireless Business**

Our current revenue comes from the design, manufacture, and sale of high performance infrastructure products for wireless voice and data applications. We have three current product lines, all of which relate to wireless base stations:

SuperLink, a highly compact and reliable receiver front-end HTS wireless filter system to eliminate out-of-band interference for wireless base stations, combining filters with a proprietary cryogenic cooler and a cooled low-noise amplifier.

AmpLink, a ground-mounted unit for wireless base stations that includes a high-performance amplifier and up to six dual duplexers.

SuperPlex, a high-performance multiplexer that provides extremely low insertion loss and excellent cross-band isolation designed to eliminate the need for additional base station antennas and reduce

infrastructure costs.

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We sell most of our current commercial products to a small number of wireless carriers in the United States, including AT&T Mobility, Sprint Nextel, T-Mobile and Verizon Wireless. Verizon Wireless and AT&T Mobility each accounted for 10% or more of our commercial revenues in the three and nine months ended October 1, 2011 and for all of 2010. We continue to experience challenges to revenue growth in the commercial wireless market. Demand for wireless communications equipment fluctuates dramatically and unpredictably. The wireless communications infrastructure equipment market is extremely competitive and is characterized by rapid technological change, new product development, product obsolescence, evolving industry standards and price erosion over the life of a product. We face constant pressures to reduce prices. Consequently, we expect the average selling prices of our products will continue decreasing over time. We expect these trends to continue and may cause significant fluctuations in our quarterly and annual revenues. Our commercial operations are subject to a number of significant risks, some of which are described in our other filings with the Securities and Exchange Commission.

### *Other Investments*

From time to time we may pursue business relationships with other entities to commercialize our technology. In 2007, we formed a joint venture with Hunchun BaoLi Communication Co. Ltd. to manufacture and sell our SuperLink interference elimination solution in China. We use the equity method of accounting for our 45 percent joint venture interest. The joint venture agreement called for our joint venture partner to supply the capital and local expertise, and for us to provide a license of certain technology and supply key parts for manufacturing. Since 2007, we have been conducting lab and field trials in the existing China wireless market using our TD-SCDMA and SuperLink solutions. Although those activities continue, the parties have not completed their contributions to the joint venture, including most of the funding and our license, within the two year period specified by the agreement and Chinese law. The future of the joint venture, including any commencement of manufacturing and the transfer of our processes, will depend on product demand in China, completion of funding by our joint venture partner, as well as a number of other conditions, including certain critical approvals from the Chinese and U.S. governments. There continues to be no assurance that these conditions will be met.

### *Licenses*

From time to time we grant licenses for our technology to other companies. Specifically, we have granted licenses to, among others, (1) Bruker for Nuclear Magnetic Resonance application, (2) General Dynamics for government applications and (3) Star Cryoelectronics for Superconducting Quantum Interference Device applications.

## **Government Contracts**

We generate revenues from government contracts, however, recently such revenues have been a much less significant part of our business. We typically own the intellectual property developed under these contracts, and grant the U.S. government a royalty-free, non-exclusive and nontransferable license to use it. As a result, our government contracts can not only generate a profit for us, but we can also make additional money through exploiting of the resulting technology in our commercial operations as well as government products, or through licenses or joint ventures. Contracts with the U.S. government contain provisions, and are subject to laws and regulations, that give the government rights and remedies not typically found in commercial contracts, including rights that allow the government to:

- terminate existing contracts for convenience, which affords the U.S. government the right to terminate the contract in whole or in part any time it wants for any reason or no reason, as well as for default;
- reduce or modify contracts or subcontracts, if its requirements or budgetary constraints change;
- cancel or reduce multi-year contracts and related orders, if funds for contract performance for any subsequent year become unavailable;
- adjust reimbursable contract costs and fees on the basis of audits completed by its agencies through exercise of its oversight rights; and
- control or prohibit the export of products.

Compensation in the event of a termination, if any, is limited to compensation for work completed at the time of termination. In the event of termination for convenience, we may receive a certain allowance for profit on the work performed. Rather than pursuing new government contracts, we are currently concentrating our engineering resources on our new wire platform.

## **Results of Operations**

*Quarter and nine months ended October 1, 2011 compared to the quarter and nine months ended October 2, 2010*  
Net revenues decreased by \$1.5 million, or 75%, to \$0.5 million in the third quarter of 2011 from \$2.0 million in the third quarter of 2010. Net revenues decreased by \$4.6 million, or 59%, to \$3.2 million in the first nine months of 2011 from \$7.8 million in the same period of 2010. Net revenues consist primarily of commercial product revenues and government contract revenues.

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Net commercial product revenues decreased by \$1.3 million, or 72%, to \$0.5 million in the third quarter of 2011 from \$1.8 million in the third quarter of 2010. The decrease is due to lower sales volume for our SuperLink products. For the first nine months of 2011, net commercial product revenue decreased to \$3.2 million from \$5.9 million in the same period of 2010, a decrease of \$2.7 million, or 46%. The decrease in the nine month period was the result of lower sales of both our SuperLink and AmpLink products. The average sales prices for our products were unchanged. Our three largest customers accounted for 99% of our total net commercial product revenues in the first nine months of 2011 and 97% in the same period of 2010. These customers generally purchase products through non-binding commitments with minimal lead-times. We also continue to experience challenges to revenue growth in the commercial wireless market. Recent customer deployments in newer wireless bands have initially not required the substantial interference elimination our filters provide. Consequently, our commercial product revenues can fluctuate dramatically from quarter to quarter based on changes in our customers' capital spending patterns, and revenues may continue to be impacted by such challenges.

Government contract and other revenues decreased by \$135,000 from \$144,000 in the third quarter of 2010 to \$9,000 in the third quarter of 2011. For the first nine months of 2011, government contract revenues decreased to \$41,000 from \$1.9 million, a decrease of more than \$1.8 million, or 98%. This decrease is attributable to the completion of a major contract in 2010 and our current use of our relatively fixed engineering resources for research and development instead of pursuing government contracts.

Cost of commercial product revenues includes all direct costs, manufacturing overhead and provision for excess and obsolete inventories. The cost of commercial product revenues decreased to \$1.1 million in the third quarter of 2011 compared to \$2.1 million for the third quarter of 2010, a decrease of \$1.0 million or 48%. For the first nine months of 2011, the cost of commercial product revenues totaled \$4.0 million compared to \$6.5 million for the first nine months of 2010, a decrease of \$2.5 million, or 38%. The lower costs resulted principally from lower production as a result of lower sales. Our expense provision for obsolete inventories in the first nine months of 2011 was \$63,000 compared to \$180,000 in the first nine months of 2010.

Our cost of commercial 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 loss:

<i>Dollars in thousands</i>	<b>Three Months Ended</b>				<b>Nine Months Ended</b>			
	October 1, 2011		October 2, 2010		October 1, 2011		October 2, 2010	
Net commercial product sales	\$ 470	100%	\$ 1,830	100%	\$ 3,174	100%	\$ 5,901	100%
Cost of commercial product sales	1,093	233%	2,110	115%	\$ 4,027	127%	6,464	110%
Gross loss	\$ (623)	(133%)	\$ (280)	(15)%	\$ (853)	(27)%	\$ (563)	(10)%

We had a gross loss of \$623,000 in the third quarter of 2011 from the sale of our commercial products compared to a gross loss of \$280,000 in the third quarter of 2010. We experienced a gross loss in the third quarters of 2011 and 2010

because the level of commercial sales was insufficient to cover our fixed manufacturing overhead costs. We regularly review inventory quantities on hand and provide an allowance for excess and obsolete inventory based on numerous factors including sales backlog, historical inventory usage, forecasted product demand and production requirements for the next twelve months. There were no sales of previously written-off inventory in the third quarters or first nine months of 2011 and 2010.

Cost of government and other contract revenues totaled \$9,000 in the third quarter of 2011 compared to \$86,000 in the third quarter of 2010 and \$39,000 in the first nine months of 2011 compared to \$1.1 million in the first nine months of 2010. This decrease was the result of lower expenses associated with less revenue from government contracts.

Because these contracts are generally priced on a cost plus basis, decreases in revenue generally result in decreases in associated costs. As a percentage of government and other contract revenues, these costs increased to 95% in the first nine months of 2011 compared to 59% in the first nine months of 2010 because of the very low level of sales in the first nine months of 2011.

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Research and development expenses relate principally to development of new products, including our wireless commercial products, HTS wire products, and our other products as well as expenses associated with reducing the cost and improving the manufacturability of our existing products. These expenses totaled \$1.1 million and \$4.4 million, respectively, in the three and nine months ended October 1, 2011 compared to \$1.5 million and \$4.0 million in the three and nine months ended October 2, 2010. Additionally, in April 2011 we decided to use certain of our own technologies and we therefore voluntarily terminated a patent license we had with a third party along with certain other related intangible assets. As a result, capitalized cost of \$0.8 million was expensed during the nine months ended October 1, 2011. Taking into account the aforementioned expense, research and development expenses decreased for both the three and nine months as the result of reduced efforts for improving the manufacturability of our wireless products.

Selling, general and administrative expenses totaled \$1.6 million and \$5.0 million, respectively, in the three and nine months ended October 1, 2011 compared to \$1.6 million and \$5.3 million in the three and nine months ended October 2, 2010. During the three months ending October 1, 2011 we incurred \$0.1 million in severance expense offset by an equal reduction of sales expense. The reduction for the nine months ended October 1, 2011 was primarily from lower sales expenses.

Other expense included the adjustment of the fair value of 608,237 warrants that were exercisable for common stock in 2010. The warrants expired in August 2010, so there were no such charges in the first nine months of 2011.

Interest income for the three and nine months ended October 1, 2011 was \$16,000 and \$20,000, respectively, compared to \$2,000 and \$4,000, respectively, in the three and nine months ended October 2, 2010. These increases resulted from our higher cash balance and interest received on a utility deposit refund.

Interest expense in the three and nine months ended October 1, 2011 was a credit of \$1,000 and \$13,000, respectively, compared to \$7,000 and \$21,000, respectively, in the three and nine months ended October 2, 2010. The decrease was the result of not renewing our bank line of credit.

We had a net loss of \$3.3 million for the quarter ended October 1, 2011, compared to a net loss of \$3.4 million in the same period of 2010. For the nine months ended October 1, 2011 our net loss totaled \$10.3 million compared to a net loss of \$9.0 million for the nine months ended October 2, 2010.

The net loss attributable to common stockholders was \$0.10 per common share in the third quarter of 2011, compared to a net loss of \$0.14 per common share in the same period of 2010. The net loss attributable to common stockholders was \$0.33 per common share in the first nine months of 2011 compared to \$0.40 per common share in the first nine months of 2010.

## **Liquidity and Capital Resources**

### *Cash Flow Analysis*

As of October 1, 2011, we had working capital of \$10.2 million, including \$9.7 million in cash and cash equivalents, compared to working capital of \$7.7 million at December 31, 2010, which included \$6.1 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.

Cash and cash equivalents increased by \$3.6 million from \$6.1 million at December 31, 2010 to \$9.7 million at October 1, 2011. Cash was provided by financing activities, offset by uses in operations and by purchases of property and equipment.

Net cash used in operations totaled \$6.5 million in the first nine months of 2011. We used \$7.5 million to fund the cash portion of our net loss. We also used \$0.2 million to fund increases in inventories and patents, offset by \$1.2 million provided by decreases in accounts receivables, prepaid expenses and other assets, as well as an increase in accounts payable and accrued expenses.

Net cash used in investing activities totaled \$2.0 million in the first nine months of 2011 compared to \$309,000 in the first nine months of 2010. In both periods the cash was used to purchase property and equipment.

We used \$303,000 in financing activities in the first nine months of 2011 compared to \$573,000 in the first nine months of 2010. In both periods the cash was used to repurchase common shares from our employees to satisfy tax withholding obligations that arose upon the vesting of restricted stock awards.

### *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.

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Net cash provided by financing activities in the first nine months of 2011 totaled \$12.1 million, net of \$933,000 in expenses, from the registered direct sale of 5.4 million shares of common stock at \$2.45 per share in February 2011. During the first nine months of 2011 we also used \$303,000 to repurchase common shares from our employees to satisfy withholding taxes due upon the vesting of their restricted stock awards.

We had a line of credit with a bank. The agreement was structured as a sale of accounts receivable and provided for the sale of up to \$3.0 million of eligible accounts receivable, with advances to us totaling 80% of the receivables sold. At July 11, 2011 we were in compliance with all covenants of the agreement and there was no amount outstanding under this facility. We had not used this line of credit for a number of years and therefore allowed it to expire without renewal on July 11, 2011.

### *Contractual Obligations and Commercial Commitments*

We have not had any material changes outside of the ordinary course of business in our contractual obligations as disclosed in our Annual Report on Form 10-K for 2010.

### *Capital Expenditures*

We plan to invest approximately \$2.0 million in fixed assets during the remainder of 2011 as we expand our HTS materials production.

### *Future Liquidity*

For the first nine months of 2011, we incurred a net loss of \$10.3 million and had negative cash flows from operations of \$6.5 million. In the full 2010 year, we incurred a net loss of \$12.0 million and had negative cash flows from operations of \$9.4 million. Our independent registered public accounting firm has included in their audit reports for 2010 and 2009 an explanatory paragraph expressing doubt about our ability to continue as a going concern.

At October 1, 2011, we had \$9.7 million in cash and cash equivalents. We believe our cash resources may not be sufficient to fund our business for at least the next twelve months. We believe the key factors to our liquidity will be our ability to successfully use our expertise and our technology to generate revenues in various ways, including commercial operations, government contracts, joint ventures and licenses. These factors leave substantial doubt about our ability to continue as a going concern. Because of the uncertainty of these factors, we may need to raise funds to meet our working capital needs. If we require additional financing, we cannot assure you that additional financing will be available on acceptable terms or at all. If we issue additional equity securities to raise funds, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise any needed funds, we might be forced to make further substantial reductions in our operating expenses, which could adversely affect our ability to implement our current business plan and ultimately our viability as a company.

### **Net Operating Loss Carryforward**

As of December 31, 2010, we had net operating loss carryforwards for federal and state income tax purposes of approximately \$303.1 million and \$191.9 million, respectively, which expire in the years 2011 through 2030. However, during 2010 we concluded that under the Internal Revenue Code change of control limitations, a maximum of \$81.9 million and \$55.0 million, respectively, would be available for reduction of taxable income and reduced both the deferred tax asset and valuation allowance accordingly. Due to the uncertainty surrounding their realization, we recorded a full valuation allowance against our net deferred tax assets. Accordingly, no deferred tax asset has been recorded in the accompanying balance sheets.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our historical financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these condensed consolidated 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 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.

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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 2010. 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. Our 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, and revenues may continue to be impacted by such challenges. We had commercial backlog of \$4,000 at October 1, 2011 compared to \$342,000 at December 31, 2010.

**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 October 1, 2011 compared with our market risk exposure on December 31, 2010. See *Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk* in our Annual Report on Form 10-K for 2010.

**Item 4. Controls and Procedures.**

We have established disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). As of the end of the period covered by this report we carried out an evaluation under the supervision and with the participation of our management, including the our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities and Exchange Act of 1934, as amended. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

There were no changes in our internal controls over financial reporting during the quarter ended October 1, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We do not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

**PART II**  
**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

From time to time, we are party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of our business. Excluding ordinary, routine litigation incidental to our business, we are not currently a party to any legal proceedings that we believe would reasonably be expected to have a material adverse effect on our business, financial condition or results of operation or cash flow.

**Item 1A. Risk Factors.**

A description of the risk factors associated with our business is contained in Item 1A, *Risk Factors*, of our Annual Report on Form 10-K for 2010 filed with the Securities and Exchange Commission on March 21, 2011 and has been updated in our Form 10-Q for the quarter ended April 2, 2011 filed with the Securities and Exchange Commission on May 9, 2011. We are not aware of any material changes to those risk factors.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

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**Item 4. Removed and Reserved.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

Number	Description of Document
10.1	At-the-market Equity Offering Sales Agreement, dated August 9, 2011, between Superconductor Technologies Inc. and Citadel Securities LLC (incorporated by reference to the registrant's Form 8-K filed on August 10, 2011).
31.1	Certification of CEO Pursuant to 302 of the Sarbanes-Oxley Act of 2002*
31.2	Certification of CFO Pursuant to 302 of the Sarbanes-Oxley Act of 2002*
32.1	Certification of CEO Pursuant to 906 of the Sarbanes-Oxley Act of 2002*
32.2	Certification of CFO Pursuant to 906 of the Sarbanes-Oxley Act of 2002*

\* Filed herewith.

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**SIGNATURES**

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

**SUPERCONDUCTOR TECHNOLOGIES  
INC.**

Dated: November 4, 2011

/s/ William J. Buchanan  
William J. Buchanan  
Chief Financial Officer

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