

Cambridge Display Technology, Inc.

Form 10-Q

November 09, 2005

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2005

or

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: __ - _____

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

13-4085264
(IRS Employer
Identification No.)

c/o Cambridge Display Technology Limited

2020 Cambourne Business Park

Cambridge CB3 6DW, United Kingdom

(Address of principal executive offices)

011-44-1954-713-600

(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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

The number of outstanding shares of the registrant's Common Stock, par value \$0.01 per share, was 19,485,483, as of November 5, 2005.

Table of Contents

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

INDEX

| | <u>Page</u> |
|---|--------------------|
| <u>PART I: FINANCIAL INFORMATION</u> | |
| Item 1. <u>Financial Statements</u> | 1 |
| <u>Consolidated Balance Sheets</u> | 1 |
| <u>Consolidated Statements of Operations</u> | 2-3 |
| <u>Consolidated Statements of Cash Flows</u> | 4 |
| <u>Notes to Condensed Consolidated Financial Statements</u> | 5 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 11 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 31 |
| Item 4. <u>Controls and Procedures</u> | 31 |
| <u>PART II: OTHER INFORMATION</u> | |
| Item 1. <u>Legal Proceedings</u> | 33 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 33 |
| Item 6. <u>Exhibits</u> | 33 |
| <u>Signatures</u> | 34 |

Table of Contents

CAUTIONARY STATEMENT
CONCERNING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. This Quarterly Report on Form 10-Q also contains information relating to us that is based on the beliefs of our management, as well as assumptions made by, and the information currently available to, our management. Among other things, these statements include, but are not limited to, the statements in this Quarterly Report on Form 10-Q regarding:

the outcomes of our ongoing and future research and development activities, and those of our licensees, related to our P-OLED technology referred to below;

the potential commercial applications of our P-OLED technology and of OLED products in general;

our ability to form and continue strategic relationships with manufacturers of P-OLED materials and displays;

successful commercialization of products including our P-OLED technology by our licensees;

the willingness of these manufacturers and licensees to continue to develop, manufacture and sell commercial products integrating our technology;

future demand for products using our P-OLED technology;

the comparative advantages and disadvantages of our technology versus competing technologies currently on the market;

the nature and potential advantages of any competing technologies that may be developed in the future;

our ability to compete against third parties with resources greater than ours;

our ability to maintain and improve our competitive position following the expiration of our fundamental patents;

the adequacy of protections afforded to us by the patents that we own or license and the cost to us of enforcing those protections;

our ability to obtain, expand and maintain patent protection in the future and to protect our unpatentable intellectual property;

the payments that we expect to receive in the future under our existing contracts and the terms that we are able to enter into with new licensees of our technology;

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

exposure of our international operations and those of our licensees to significant risks;

our future capital requirements and our ability to obtain additional financing when needed; and

our future P-OLED technology licensing and other revenues and results of operations.

In addition, when used in this Quarterly Report on Form 10-Q, including the documents incorporated by reference, the words estimate, project, believe, intend, propose and expect as well as similar expressions involving potential future developments are intended to identify forward-looking statements. All of these forward-looking statements reflect our current views with respect to future events and are subject to risks and uncertainties that will cause actual results to differ, perhaps materially, from those contemplated by the statements, including those risks discussed in this Quarterly Report on Form 10-Q.

You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q or, in the case of information incorporated by reference herein, the date we file such information with the SEC, as the case may be. Except for special circumstances in which a duty to update arises when prior disclosure becomes materially misleading in light of subsequent events, we do not intend to update any of these forward-looking statements to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unexpected events.

In this Quarterly Report on Form 10-Q, the terms the Company, our company, CDT, we, us and our refer to Cambridge Display Technology, Inc. and its subsidiaries, unless the context otherwise requires.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CAMBRIDGE DISPLAY TECHNOLOGY, INC.****Consolidated Balance Sheets**

(in thousands, except share information)

| | September 30, 2005 | December 31, 2004 |
|---|-----------------------|----------------------|
| | (unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 5,700 | \$ 26,892 |
| Marketable securities | 585 | 1,151 |
| Accounts receivable, net | 2,164 | 1,458 |
| Due from affiliates | 14 | 107 |
| Taxes receivable | 2,963 | 3,984 |
| Investments in affiliates | 1,824 | |
| Prepaid expenses and other current assets | 6,313 | 6,903 |
| | <u>19,563</u> | <u>40,495</u> |
| Total current assets | 19,563 | 40,495 |
| Property, equipment and leasehold improvements, net | 14,672 | 15,995 |
| Investments in affiliates | 888 | 2,574 |
| Goodwill | 65,612 | 65,612 |
| Other intangible assets, net | 3,292 | 4,477 |
| | <u>104,027</u> | <u>129,153</u> |
| Total assets | \$ 104,027 | \$ 129,153 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$ 6,140 | \$ 8,604 |
| Deferred revenue | 4,591 | 6,936 |
| Due to affiliate | 3 | 109 |
| Deferred proceeds on sale of subsidiary stock | 5,785 | |
| | <u>16,519</u> | <u>15,649</u> |
| Total current liabilities | 16,519 | 15,649 |
| Deferred revenue | 800 | 800 |
| Deferred proceeds on sale of subsidiary stock | | 5,785 |
| Other liabilities | 574 | 480 |
| Commitments and contingencies (Note 7) | | |
| Common shareholders' equity: | | |
| Preferred stock, voting \$0.01 par value, 46,667 authorized, none issued or outstanding | | |
| Common stock, \$0.01 par value, 100,000,000 shares authorized 19,485,483 issued and outstanding | 195 | 195 |

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

| | | |
|---|-------------------|-------------------|
| Additional paid-in capital | 273,012 | 273,079 |
| Deferred compensation | (6,965) | (9,266) |
| Common stock subscribed | (1,167) | (3,163) |
| Accumulated other comprehensive loss | (1,080) | (514) |
| Accumulated deficit | (177,861) | (153,892) |
| | <u>86,134</u> | <u>106,439</u> |
| Total common shareholders equity | | |
| | <u>\$ 104,027</u> | <u>\$ 129,153</u> |
| Total liabilities and shareholders equity | | |

See accompanying notes.

Table of Contents**CAMBRIDGE DISPLAY TECHNOLOGY, INC.****Consolidated Statements of Operations**

(in thousands, except per share amounts)

(unaudited)

| | Three Months Ended September 30, | |
|--|---|-------------|
| | 2005 | 2004 |
| Operating revenues: | | |
| License fees and royalties | \$ 110 | \$ 263 |
| Technology services and development | 2,785 | 1,382 |
| Equipment and supplies | 3,670 | |
| Total operating revenues | 6,565 | 1,645 |
| Cost of sales: | | |
| License fees and royalties | 2 | 110 |
| Technology services and development | 916 | 604 |
| Equipment and supplies | 2,756 | |
| Total cost of sales | 3,674 | 714 |
| Gross profit | 2,891 | 931 |
| Operating expenses: | | |
| Research and development expenses | 4,116 | 3,732 |
| Selling, general and administrative expenses | 5,813 | 3,679 |
| Amortization of intangibles acquired | 395 | 395 |
| Total operating expenses | 10,324 | 7,806 |
| Loss from operations | (7,433) | (6,875) |
| Other (expense) / income: | | |
| Equity in loss of Litrex | (1,194) | (1,299) |
| Equity in loss of Add-Vision | (70) | |
| Foreign currency transaction (loss)/profit | (276) | 19 |
| Other income | 91 | |
| Interest income | 3 | 56 |
| Total other (expense) / income | (1,446) | (1,224) |
| Loss before benefit for income taxes | (8,879) | (8,099) |
| Benefit for income taxes | (288) | (561) |
| Net loss | (8,591) | (7,538) |
| Accretion of preferred stock | | (1,752) |

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

| | | |
|--|-------------------|-------------------|
| Net loss attributable to common shareholders | <u>\$ (8,591)</u> | <u>\$ (9,290)</u> |
| Net loss per common share attributable to common shareholders, basic and diluted | <u>\$ (0.44)</u> | <u>\$ (0.56)</u> |
| Weighted average number of common shares outstanding, basic and diluted | <u>19,485</u> | <u>16,563</u> |

See accompanying notes.

Table of Contents**CAMBRIDGE DISPLAY TECHNOLOGY, INC.****Consolidated Statements of Operations**

(in thousands, except per share amounts)

(unaudited)

| | Nine Months Ended September 30, | |
|---|--|-----------------|
| | 2005 | 2004 |
| Operating revenues: | | |
| License fees and royalties | \$ 1,233 | \$ 2,136 |
| Technology services and development | 5,895 | 3,233 |
| Equipment and supplies | 3,670 | 150 |
| Total operating revenues | 10,798 | 5,519 |
| Cost of sales: | | |
| License fees and royalties | 15 | 127 |
| Technology services and development | 2,040 | 1,000 |
| Equipment and supplies | 2,756 | 91 |
| Total cost of sales | 4,811 | 1,218 |
| Gross profit | 5,987 | 4,301 |
| Operating expenses: | | |
| Research and development expenses | 12,280 | 10,480 |
| Selling, general and administrative expenses | 14,196 | 9,358 |
| Amortization of intangibles acquired | 1,185 | 1,185 |
| Total operating expenses | 27,661 | 21,023 |
| Loss from operations | (21,674) | (16,722) |
| Other (expense) / income: | | |
| Equity in loss of Litrex | (2,435) | (2,251) |
| Equity in loss of Add-Vision | (239) | |
| Foreign currency transaction (loss) / gain | (370) | 213 |
| Other (expense)/income | (698) | 33 |
| Interest income | 364 | 265 |
| Total other (expense) / income | (3,378) | (1,740) |
| Loss before benefit for income taxes | (25,052) | (18,462) |
| Benefit for income taxes | (1,083) | (1,590) |
| Loss before cumulative effect of accounting change | (23,969) | (16,872) |

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

| | | |
|--|-------------|-------------|
| Cumulative effect of accounting change | | (12,200) |
| Net loss | (23,969) | (29,072) |
| Accretion of preferred stock | | (5,254) |
| Net loss attributable to common shareholders | \$ (23,969) | \$ (34,326) |
| Net loss per common share attributable to common shareholders before cumulative effect of accounting change, basic and diluted | \$ (1.23) | \$ (1.33) |
| Net loss per common share due to cumulative effect of accounting change, basic and diluted | | \$ (0.74) |
| Net loss per common share attributable to common shareholders, basic and diluted | \$ (1.23) | \$ (2.07) |
| Weighted average number of common shares outstanding, basic and diluted | 19,485 | 16,563 |

See accompanying notes.

Table of Contents**CAMBRIDGE DISPLAY TECHNOLOGY, INC.****Consolidated Statements of Cash Flows**

(in thousands)

(unaudited)

| | Nine months ended September 30, 2005 | Nine months ended September 30, 2004 |
|---|--|--|
| Operating activities | | |
| Net loss | \$ (23,969) | \$ (29,072) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization of property, equipment and leasehold improvements | 4,221 | 4,701 |
| Gain on sale of property, equipment and leasehold improvements | (14) | |
| Amortization of other intangible assets | 1,185 | 1,185 |
| Impairment of promissory notes | 1,996 | |
| Acquired in process R & D | | 12,200 |
| Amortization of deferred compensation | 2,301 | 1 |
| Equity in Loss of Litrex | 2,435 | 2,251 |
| Equity in Loss of Add Vision | 239 | |
| Stock options granted | | 27 |
| Changes in operating assets and liabilities: | | |
| Accounts and tax receivable | 315 | (1,882) |
| Due from affiliates | (13) | 36 |
| Prepaid expenses and other current assets | 590 | (2,761) |
| Accounts payable and accrued expenses | (2,464) | 373 |
| Deferred revenue | (2,345) | 3,424 |
| Other current and non-current liabilities | 27 | 184 |
| Net cash used in operating activities | (15,496) | (9,333) |
| Investing activities | | |
| Acquisition of property, equipment and leasehold improvements | (2,905) | (2,235) |
| Disposal of property, equipment and leasehold improvements | 21 | |
| Loans advanced to affiliate (Litrex) | (1,715) | |
| Investment in affiliate (Add Vision) | (1,097) | |
| Cash of consolidated equity - CDT Oxford | | 1,564 |
| Net cash used in investing activities | (5,696) | (671) |
| Financing activities | | |
| Receipt of loan | | 2,500 |
| Net cash used in financing activities | | 2,500 |
| Net decrease in cash | (21,192) | (7,504) |
| Cash and cash equivalents beginning of period | 26,892 | 10,400 |
| Cash and cash equivalents end of period | \$ 5,700 | \$ 2,896 |

Supplemental disclosures of cash flow information

Interest paid

Taxes paid

(144)

(250)

See accompanying notes.

4

Table of Contents**Cambridge Display Technology, Inc.****Notes to Consolidated Financial Statements****1. Basis of Presentation**

The accompanying unaudited consolidated balance sheet at September 30, 2005 and audited consolidated balance sheet at December 31, 2004, the related unaudited consolidated statements of operations for the three and nine months ended September 30, 2005 and 2004 and statements of cash flows for the nine months ended September 30, 2005 and 2004 include, in the opinion of management, all adjustments (consisting of only normal recurring adjustments) considered necessary for a fair presentation. The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (US GAAP) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly certain information and footnote disclosures normally included in financial statements required by US GAAP have been omitted. Operating results for interim periods presented are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2005. It is suggested that these unaudited consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes for the fiscal year ended December 31, 2004 included in the Company's Annual Report on Form 10-K.

2. Other Comprehensive Loss

An unrealized loss of \$0.6 million was reported in the nine months ended September 30, 2005 due to the revaluation of marketable securities held by the Company. The securities are quoted in British pounds and, therefore, the revaluation includes an element of exchange rate fluctuation as well as decrease in the stock price.

| | Nine Months Ended September 30, | |
|--|--|-------------|
| | 2005 | 2004 |
| | in thousands | |
| Net Loss | \$ (23,969) | \$ (34,326) |
| Other comprehensive loss: | | |
| Unrealized losses on marketable securities | (482) | |
| Foreign currency translation adjustments | (84) | |
| Other comprehensive loss: | (566) | |
| Comprehensive loss | \$ (24,535) | \$ (34,326) |

3. Investments in Affiliates

Litrex

The Company loaned \$2.0 million to Litrex Corporation during the nine months ended September 30, 2005, of which \$1.7 million remained outstanding at the date. \$1.5 million of this balance is repayable on January 31, 2006 or earlier upon a change in Litrex ownership, except that if the Company sells its remaining 50% equity interest in Litrex to Ulvac, Inc., the other joint venture partner in Litrex, and Ulvac agrees to guarantee the loan at that time, the repayment date will remain at January 31, 2006. The remaining \$0.2 million is repayable on November 15, 2005 or earlier upon a change in Litrex ownership. The loans are interest bearing at a rate of between 5.25% and 5.50% depending on the date of the advance. The loans are included within *Due from affiliates* in the accompanying balance sheet at September 30, 2005.

In July 2005 the Company purchased ink jet printing equipment from Litrex for \$0.4 million which had previously been on loan to the Company for demonstration purposes.

On September 2, 2005, pursuant to the Sale and Purchase Agreement between the Company and Ulvac, the Company gave notice to Ulvac that it was exercising its *Put Option* under the terms of which, within 90 days of this notice having been given, Ulvac is required to purchase the Company's remaining shareholding in Litrex for a consideration of \$10 million. Ulvac acknowledged receipt of this notice effective September 5, 2005 and is obliged to complete the purchase by December 4, 2005. The transaction was completed on November 4, 2005.

Table of Contents

Add-Vision

In March 2005, the Company invested \$1.0 million in Add-Vision, Inc., a company located in California that researches and develops flexible, low cost, low resolution displays, in return for preferred stock with a 17% voting interest. It also granted Add-Vision a license to its intellectual property in return for preferred stock with a 22% voting interest. As a result of these transactions, the Company has, in aggregate, a 39% voting interest in Add-Vision and has appointed two directors to its board. The Company has valued this investment at \$1.1 million, comprising the amount invested in cash plus associated expenses. It has not assigned any additional value to the preferred stock issued in return for the license. The Company does not control Add-Vision and is accounting for its investment using the equity method. The Company has agreed to grant Add-Vision a license to additional intellectual property at a future date but does not expect this to result in the Company owning more than a 50% voting interest in Add-Vision.

4. Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards (SFAS) 123 (revised 2004), Share-Based Payment (SFAS 123R), which replaces SFAS 123 and supersedes Accounting Principles Board (APB) Opinion No. 25. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first interim period after December 15, 2005. SFAS 123R will cause expense (similar to the amounts in the Company's pro forma footnote disclosure) related to options vesting after the date of initial adoption to be recognized as a charge to results of operations over the remaining vesting period. The Company is evaluating the requirements of SFAS 123R and has not yet determined the method of adoption or the effect that adopting SFAS 123R will have on its consolidated financial statements. However, the effect of adopting SFAS 123R will be to increase recorded stock compensation expense.

In December 2004, the FASB issued SFAS 153, Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions (SFAS 153). The amendments made by SFAS 153 are based on the principle that exchanges of nonmonetary assets should be based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005 with earlier adoption permitted. The provisions of SFAS 153 will be applied prospectively. The Company's adoption of SFAS 153 is not expected to have a material impact on the Company's consolidated results of operations, financial position or cash flows.

In May 2005, the FASB issued SFAS 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and SFAS 3. Under the terms of this statement, voluntary changes in accounting principles or other changes where the enacting literature does not include transitional provisions, will result in retro-active restatements of prior periods where such restatement is practicable. This statement is effective for changes which will be made in fiscal years commencing after December 15, 2005 with early adoption permitted. The Company is evaluating the impact of this statement but does not currently anticipate that it will make any changes in accounting principles which will be subject to the provisions of this statement.

5. Income Taxes

Income taxes are a benefit for the nine months ended September 30, 2005 and 2004 reflecting tax credits to be received for research and development costs net of Delaware franchise tax payments.

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

The Taxes receivable balance of \$3.0 million at September 30, 2005 consists of \$1.5 million of income tax refunds due for the year ended December 31, 2004 and \$1.1 million for the nine months ended September 30, 2005. The balance represents anticipated United Kingdom value added tax recoveries. The Company's claim for an income tax refund of \$ 2.1 million in relation to 2003 was reviewed by the U. K. tax authorities with respect to whether or not the Company met the criteria of being a small or medium-sized enterprise. This review was concluded in May 2005 and no adjustment was deemed necessary to this claim which was settled in full in June 2005. A claim for repayment of \$1.5 million in relation to the year ended December 31, 2004 was made in the third quarter of 2005 and was settled in full in October 2005.

Table of Contents**6. Stock-Based Compensation**

The Company follows APB Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations in accounting for stock options awarded to employees. Accordingly the Company has recognized no compensation expense with respect to options granted to employees. Had compensation cost been determined based upon the fair value at grant date for awards consistent with the methodology prescribed by SFAS 123 Accounting for Stock-Based Compensation, the Company's net loss for the three and nine months ended September 30, 2005 and 2004 would have been the pro forma amounts indicated below:

| | Three Months Ended September 30, 2005 | |
|---|--|--------------------|
| | 2005 | 2004 |
| | in thousands | |
| Net loss as reported | \$ (8,591) | \$ (7,538) |
| Less: accretion of preferred stock | | (1,752) |
| Add back: APB 25 expense | 765 | |
| Less: total stock-based employee compensation expense under the fair value method | (845) | (360) |
| Net loss attributable to common shareholders - pro forma | \$ (8,671) | \$ (9,650) |
| Net loss per share: | | |
| Basic and diluted as reported | \$ (0.44) | \$ (0.56) |
| Basic and diluted pro forma | \$ (0.44) | \$ (0.58) |
| | Nine Months Ended September 30, 2005 | |
| | 2005 | 2004 |
| | in thousands | |
| Net loss as reported | \$ (23,969) | \$ (29,072) |
| Less: accretion of preferred stock | | (5,254) |
| Add back: APB 25 expense | 2,302 | 1 |
| Less: total stock-based employee compensation expense under the fair value method | (2,650) | (409) |
| Net loss attributable to common shareholders - pro forma | \$ (24,317) | \$ (34,734) |
| Net loss per share: | | |
| Basic and diluted as reported | \$ (1.23) | \$ (2.07) |
| Basic and diluted pro forma | \$ (1.25) | \$ (2.10) |

As any options granted in the future will also be subject to the fair value pro forma calculations, the pro forma results for the periods ended September 30, 2005 and 2004 may not be indicative of the results for future years.

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

In September 2005, six officers of the company voluntarily surrendered, in aggregate, 365,447 options with strike prices of between \$17.82 and \$27.60. At September 30, 2005 there were a total of 780,702 options and warrants of the company's stock outstanding after reflecting the cancellation of options referred to above. These officers were all recipients of significant awards of restricted stock units under the terms of the special bonus plan described below and believed that it would be beneficial to the company for the potentially dilutive effect of these stock options to be eliminated.

In December 2004, the Company allocated awards under its special bonus plan to officers and employees. These awards were made from a bonus pool with a value of \$14.4 million, based on the initial public offering price for our common stock of \$12.00 per share. All awards under this plan made with respect to this offering were made in restricted stock units representing a right to receive, in the aggregate, 1,200,000 shares of our common stock. Such awards will vest in three equal installments on

Table of Contents

each of the first three anniversaries of the public offering. However, if Kelso & Company, the Company's largest shareholder, sells, in the aggregate, more than 25% of its shares of our common stock, such awards will vest in full upon such sale. Except as discussed below in relation to the award made to the company's chief executive officer, the company is expensing the value of these awards over a three-year period commencing December 2004, subject to acceleration in the event of a Kelso sale.

Substantially all awards made under this plan will be subject to U.K. employer's national insurance tax, which is currently 12.8% of the value of the awards and which would be payable by the Company based on the market value of the stock on the date it becomes available for sale. The accrued charge for the U.K. employer's national insurance tax will depend on the market price of our common stock when it is delivered and will be subject to variability upon fluctuations in our stock price until such time as all shares of our common stock have been delivered to recipients of awards under this plan. The U. K. national insurance tax will have to be paid at the time the stock is issued to the award holders.

The award to the Company's chief executive officer, representing 35% of the bonus pool, or restricted stock units with a value of \$5.0 million at the initial public offering price of \$12.00 per share, will vest whether or not he remains employed by the Company unless (a) he is terminated for cause (as defined in his employment agreement), (b) his employment agreement is not extended for cause or (c) he terminates his employment in circumstances that justify termination for cause. The value of the award to the Company's chief executive officer, plus the U.K. estimated employer's national insurance tax of 12.8% payable by the Company, was expensed in December 2004.

In the three months ended September 30, 2005 the Company charged \$0.8 million to operating expenses in relation to awards to bonus holders other than the Company's chief executive officer. There was a reduction of the liability which had been accrued at June 30, 2005 for UK national insurance tax on special bonus plan awards due to a decline in the Company's share price between June 30, 2005 and September 30, 2005 and a charge in relation to U.K. national insurance tax on awards which were expensed in the three months ended September 30, 2005. The net of these two amounts was zero and so no net charge was made in relation to UK national insurance tax on special bonus plan awards in the three months ended September 30, 2005.

In the nine months ended September 30, 2005 the Company charged \$2.3 million to operating expenses in relation to awards to bonus holders other than the Company's chief executive officer. A net benefit of \$0.1 million was recognized in relation to the potential U. K. employer's national insurance tax liability. This benefit consisted of a revaluation of the liability which had been accrued at December 31, 2004 due to a decline in the Company's share price partially offset by a charge related to expensing of awards in the nine months ended September 30, 2005.

The U.K. national insurance tax accrual on special bonus plan awards will continue to vary depending on the share price at the end of each quarter, the vesting schedule, the current U. K. employer's national insurance tax rate and whether or not award holders become subject to, or continue to be subject to, U.K. national insurance tax.

7. Commitments and Contingencies

Included within Other intangible assets, net at September 30, 2005 and December 31, 2004 is a license for intellectual property which is valued, net of accumulated amortization, at \$1.1 million and \$1.8 million, respectively. The licensor has advised the Company that this license is terminated, on grounds which the Company believes are not well founded. The licensor has been in negotiation with the Company with a view to resolving this dispute such that the Company would retain its rights to this intellectual property, and the Company believes that this dispute will be resolved satisfactorily without recourse to legal action. In the event that these discussions are not successful, the Company could incur material expenditures on legal proceedings against the licensor and might have to write off the net value of this asset.

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

When the Company acquired Opsys Limited in December 2004, there was an arbitration action being conducted in California to settle a claim by a former employee in the amount of \$0.3 million. These arbitration proceedings are continuing and the Company believes that they will ultimately be concluded favorably to it without any material effect on its results of operations.

In January 2005, Sunnyside Development Company filed a complaint against Opsys Limited and a company named by Sunnyside Development as CDT Limited, which is presumably intended to refer to one of the Company's subsidiaries, Cambridge Display Technology Limited, in California Supreme Court alleging breach of contract and fraud arising out of an alleged property lease agreement between Opsys Limited and Sunnyside Development. Cambridge Display Technology Limited was not party to the lease. Sunnyside Development seeks compensatory damages that it claims exceed \$10 million and punitive damages in the amount of \$25 million. In October 2002, Opsys Limited and Sunnyside Development executed an Assignment of Lease and Consent of Lessor, which included a release of Opsys Limited by Sunnyside Development. In February 2005, the action was removed to the United States District Court for the Northern District of California. The Company believes that the

Table of Contents

claim has no merit and filed a motion to dismiss the case. In April 2005, the United States District Court dismissed all the claims against CDT Limited and the claim for fraud against Opsys Limited, but gave Sunnyside permission to amend all its claims. On May 11, 2005, Sunnyside filed an amended complaint reasserting a fraud claim against both Opsys Limited and CDT Ltd. The Company made a further application to dismiss the claims and on August 8, 2005 the amended claims against CDT Limited and Opsys Limited were dismissed with prejudice and with no leave to amend, except for the claim for breach of contract against Opsys Limited which is still being pursued by Sunnyside Development.

When the Company acquired Opsys Limited for stock in December 2004, a proportion of the stock consideration was issued to the former owners of Opsys Limited but was held in escrow. In the event that the Company suffers a loss in relation to either of the claims against Opsys Limited described above, shares currently held in escrow will be forfeited to the value of the loss, as measured at the December 2004 initial public offering price of \$12.00 per share. The value of the 422,610 shares held in escrow, based on the market price of \$6.58 per share at September 30, 2005, is \$2.8 million. The escrow shares are authorized and issued in the accompanying financial statements. Costs that the Company incurs in relation to the claims described above are charged to operating expense as incurred and in the first nine months of 2005 have amounted to \$0.1 million.

On the basis of facts presently known, the Company is not involved in any other legal proceedings which could have a material adverse effect on the Company's financial condition, liquidity or results of operations.

Under the terms of a contract between Covion Organic Semiconductors and the Company, the Company is obligated to provide the equivalent of 10 full-service equivalent scientists and engineers to work on research and development projects related to P-OLED materials until December 2006. The Company receives royalties from Covion based on the revenues for all Covion's sales of P-OLED materials, whether or not those materials were developed by the project team. Through September 30, 2005, the royalties received from Covion were less than the costs of funding the project team and such excess costs have been expensed. Since royalties will continue to be payable after the obligation to provide research services has concluded, the Company anticipates that the contract will be profitable and accordingly has not included a loss provision. The Company is currently renegotiating the terms of this contract with Covion.

Under the terms of the Sale and Purchase Agreement with Ulvac, the Company is required to fund 50% of the Exit Bonus Plan in which all employees of Litrex are eligible to participate. The liability under this plan is related to the cash flow performance of Litrex and will not exceed \$1.3 million. The Company will only become liable under this plan when it sells its remaining 50% equity interest in Litrex. This amount will be withheld from the purchase price to be paid by Ulvac to the Company for its 50% equity stake in Litrex, which the Company expects to sell to Ulvac in the fourth quarter of 2005, in addition to the other amounts to be held in escrow under the terms of the Sale and Purchase Agreement. The Company does not expect to incur any liability with respect to this plan.

Ulvac and the Company have executed a Retention Bonus Plan for Litrex. Under the terms of this plan, a bonus pool of between \$0.2 million and \$1.0 million will be paid to eligible employees of Litrex in April 2006. The size of the bonus pool will be based on the performance of Litrex during the period January through July 2005. The Company is liable for 50% of the cost of this plan. This liability will be paid into an escrow account by the Company when it sells its remaining 50% equity stake in Litrex to Ulvac. Litrex is accruing its expected liability under the terms of this plan. The Company expects to be liable for a contribution of \$0.3 million to this plan.

Litrex led a consortium developing ink jet printing technology under a project which was funded by the U.S. Government. Up until August 2003, when the Company sold 50% of its equity interest in Litrex, \$1.5 million had been received by Litrex in grant funding for that project, of which \$1.0 million was passed on to other consortium members. Under the terms of this arrangement, should Litrex be sold to a non-U.S. company, previously received grant income may have to be reimbursed. The Company anticipates that it will sell its remaining 50% equity interest in Litrex on November 4, 2005 to Ulvac Inc, a Japanese company. In the event that Litrex is obligated to repay any or all of the \$1.5 million, the Company has agreed that it will reimburse the amount which has to be repaid. Although the maximum potential liability is \$1.5

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

million, the Company believes that it is unlikely that Litrex will be required to reimburse the \$1.0 million which was passed to other consortium members in which case its maximum liability would be \$0.5 million.

The Company has a line of credit that was entered into in July 2004 providing for a maximum amount of \$15.0 million, of which \$0.5 million cannot be drawn, and which was not drawn upon at September 30, 2005. This line of credit was originally available for a minimum of one year, renewable for two further years, and is secured by a letter of credit issued by Wells Fargo Bank, which, in turn, is secured by the Company's patents, trademarks and copyrights and associated license revenues. In July 2005, the line of credit was renewed for a second year to cover the period to June 30, 2006. In addition to certain fixed fees payable regardless of whether or not the line of credit is utilized, which amount to approximately 3% of the total amount of the line of credit per year, the Company will be liable to pay interest and charges of 3.75% above the U.S. dollar London Inter-Bank Offer Rate on any drawing under this line of credit. Under the terms of this line of credit, any draw down requires the Company to certify that it continues to satisfy certain financial covenants: specifically its Consolidated Total Net Worth, as defined, must

Table of Contents

exceed \$75.0 million, and its current assets less current liabilities, but excluding deferred revenue, must not be less than minus \$15.0 million. In addition, the Company is required to report the filing of any new patents, trademarks and copyrights and add those to the existing intellectual property portfolio which has been assigned as security to IPI Financial Services, a company which specializes in arranging loan guarantees secured with intellectual property portfolios and which arranged the letter of credit. The Company is obligated to maintain the validity of all of its patents and only to license such patents to third parties under terms which are within the parameters of its customary licensing practices or to which IPI Financial Services has provided its consent. The Company believes that it is in compliance with the covenants required under this line of credit and, therefore, that this line of credit is available for use.

8. Subsequent Events

On November 4, 2005 the Company entered into a Second Sale and Purchase Agreement with Ulvac and Litrex under the terms of which Ulvac completed its purchase of 50% of the equity of Litrex from the Company. Under the terms of this agreement, Ulvac paid the Company a consideration of \$9.7 million being the previously agreed purchase price of \$10.0 million less \$0.3 million being the Company's agreed contribution to the Litrex's Retention Bonus Plan. Of the proceeds, \$1.0 million, or 10% of this consideration, has been put into escrow for a period of one year. This escrow amount is held as security in the event that Ulvac makes a claim against the Company for breach of warranty or breach of covenant including Litrex becoming liable to repay any of the grants which it received from the U. S. Government pursuant to the arrangements described in note 7 above. The escrow period may be extended for a further year if the status of the potential liability in relation to the U. S. Government grant has not been settled by November 2006. Pursuant to the 2003 Sale and Purchase Agreement, \$1.4 million had been held in escrow since the sale of the first 50% of Litrex in 2003 and this amount has been released to the Company. Litrex has agreed to repay to the Company \$1.7 million of loans advanced by the Company to them by December 2005, plus accrued interest. On November 3, 2005, the Company entered into an agreement with Philips Electronics N. V. of the Netherlands under the terms of which it paid \$1.0 million to Philips, of which \$0.6 million had originally been paid in 2004 and was being held in escrow and \$0.4 million was paid in cash in November 2005, in consideration for Philips entering into a license agreement with Litrex in settlement of a claim for rights to certain intellectual property which had been made by Philips Electronics N. V. against Litrex.

The total net gain to be recognized in the fourth quarter of 2005 is approximately \$15 million. The gain is higher than the proceeds received during the November transaction due to the 2003 deferral of the gain on the sale of the initial 50% interest in Litrex. The investment in Litrex has been combined with the loans in current assets and the deferred gain reclassified as current on the accompanying balance sheet to reflect the consummation of this transaction. The Company has not recognized any gain with respect to the \$1.0 million which remains in escrow and will not do so unless and until this amount is released.

Table of Contents

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

The following discussion of our financial condition and results of operations should be read together with the consolidated financial statements and related notes that are included elsewhere in this Quarterly Report on Form 10-Q. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those expected in these forward-looking statements as a result of various factors, including those set forth under Factors That May Affect Our Operating Results or elsewhere in this Quarterly Report on Form 10-Q.

Overview

We are a pioneer in the development of Polymer Organic Light Emitting Diodes, or P-OLEDs, and their use in next-generation flat panel displays and other applications. Since our inception in 1992, we have focused on continuing research and development related to the production, manufacturing and commercialization of P-OLED technology in the flat panel display and other industries. Our revenues are primarily generated from the licensing of rights to use our intellectual property, or IP, portfolio, from ongoing product royalties, from fees generated from transfer of technology and joint technology development agreements and from the sale of ink-jet printing equipment (manufactured by our former 50% owned joint venture, Litrex) and polymer inks for use in this equipment.

While we have made significant progress over the past few years in advancing our P-OLED technology into a number of display licenses, we have incurred significant losses and will continue to do so unless our P-OLED technology becomes more widely adopted and commercialized by flat panel display manufacturers. At September 30, 2005, we had an accumulated deficit of approximately \$178 million in large part due to the research and development expenditures we have incurred. Our total research and development expenditures since 1999 exceed \$84 million.

Our business objective is to license our technology to leading display manufacturers and to generate royalties based on the sales of their products. As a pre-cursor to our licensing and royalty business we sell technology services, development services, ink jet printing equipment and polymer inks to companies working on P-OLED technology. We market our P-OLED IP and technology by building relationships with established and new entrant flat panel display manufacturers. This may involve developing relationships at a senior level over a period of years. Some manufacturers purchase a license from us at an early stage in their P-OLED development program. Other manufacturers begin their efforts to develop products using our P-OLED technology by working with us through a series of informal meetings, then by entering, either publicly or confidentially, into a formal technology development or technology transfer program which may culminate in the purchase of a license from us.

In order to accommodate our many current and potential Asian licensees and partners, we maintain a representative office in Taiwan. Our senior executives also travel frequently from our corporate offices to Asia and other destinations in order to develop our relationships with both existing and potential new licensees.

Management monitors performance by reference to internal and external technology developments. We continue to develop our technology to increase the lifetimes and efficiencies of our P-OLED materials. We have announced that our blue material, which is the most challenging technically, has achieved a lifetime of 100,000 hours at an initial brightness of 100 candelas per square meter (with lifetime defined as the time a test display decays to 50% of its initial brightness). We have also announced that our red phosphorescent material has achieved a lifetime of 250,000 hours and an efficiency of 5.6 candelas per amp, based on the testing conditions described above. This result was achieved, in partnership with Sumitomo Chemical, using our next generation dendrimer technology, which we acquired from Opsys in 2002. This technology has the potential to produce significantly more power efficient materials than we currently have, which is particularly important for the red color which is currently the least power efficient color. The lifetimes of commercial displays using P-OLED materials depend on a number of factors

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

including the presence, or not, of a front-face polarizer, the aperture ratio and relative pixel areas. Measured lifetimes in test cells, quoted here, do not include a number of these variables and are not, therefore, representative of service lifetimes although the results may be used in models which make assumptions regarding the variables to indicate likely services lifetimes. We are actively supporting the development of international OLED standards to enable meaningful comparisons between competing OLED technologies.

In May 2005, we announced our intention to form a joint venture, to be called Sumation KK, with Sumitomo Chemical of Japan, to develop, manufacture, market and sell P-OLED materials. Sumitomo has purchased the Lumation® P-OLED material business of Dow Chemical and rights to use the acquired intellectual property will be licensed to this joint venture, together with intellectual property rights from Sumitomo and ourselves and access to dedicated research teams at both Sumitomo and CDT facilities. We already have a strong research relationship with Sumitomo and we believe that the strengthening of our relationship through the formation of this joint venture will be the most effective way of accelerating P-OLED material development in the future as well as giving CDT a longer-term stake in the business of P-OLED material sales. We expect that the joint venture will be formed and operations will commence in November 2005.

Table of Contents

We believe that two recently apparent industry trends could be beneficial for the adoption of our P-OLED technology. Firstly, with the advent of third generation mobile telephone technology, real-time streaming video services are becoming available on mobile handsets. In order to be most attractive to consumers, the display screens on handsets need to offer high contrast picture quality and a fast video rate to provide a satisfying viewing experience. High contrast and fast video rate are key features of our P-OLED technology.

Secondly, in recent years the display industry substantially reduced unit costs by investing in manufacturing plants which can process ever larger glass substrate sizes. We believe that the display industry is coming to the conclusion that LCD plants currently under construction, which can process glass substrates up to approximately two meters by two meters, or Generation 7, will achieve the maximum unit cost reduction possible due to economies of scale and that attempting to build plants to process larger glass substrate sizes will not result in further reduction in unit costs. In the future, we believe that significant reductions in display manufacturing costs will require reductions in bill of material costs. Compared to the incumbent LCD technology, displays manufactured using our P-OLED technology do not require either backlights or color filters which together, for a large LCD panel display, comprise up to 50% of the manufactured cost. We believe that manufacturers of large display panels, for example for television applications, view the potential for bill of materials cost reduction as a key attraction of our P-OLED technology as they continue to strive for ever lower display manufacturing costs.

In reading our financial discussions, you should be aware of the following factors and trends that our management believes are important in understanding our financial performance:

Because our license fees may consist of large one-time payments and our royalties for the foreseeable future are expected to be smaller, recurring payments, we expect fluctuations in these revenues depending on the periods in which we enter into new licenses.

We have and will continue to invest significant resources in research and development in order to develop and effectively demonstrate our technology so that it can be commercialized in a growing number of applications. Our total research and development expenditures in the year end December 31, 2004 were \$14.2 million and in the nine months ended September 30, 2005 were \$12.3 million.

The extent to which we continue to enter into new technology development agreements and existing technology development partners enter into commercial licenses for use of our P-OLED technology impacts our future revenues.

The extent to which our existing licensees expand the use of our P-OLED technology in commercial applications in their consumer electronic products impacts our future revenues.

Management

In September 2005, we strengthened our management team by appointing Daniel Abrams, formerly Finance Director of Xenova Group plc, a British company, as our Chief Financial Officer.

Table of Contents**Results of Operations****Comparison of Three Months Ended September 30, 2005 and September 30, 2004****Operating revenues***(in thousands)*

| | Three months ended September 30, | Three months ended September 30, | |
|-------------------------------------|-------------------------------------|-------------------------------------|----------------------------|
| | 2005 | 2004 | % Increase / (Decrease) |
| License fees and royalties | \$ 110 | \$ 263 | (58)% |
| Technology services and development | 2,785 | 1,382 | 102% |
| Equipment and supplies | 3,670 | | N/A |
| Operating revenues | \$ 6,565 | \$ 1,645 | 299% |

Revenues from License fees and royalties fell by \$0.2 million, or 58%, from \$0.3 million in the third quarter of 2004 to \$0.1 million in the third quarter of 2005. License fee revenues in the third quarter of 2004 were less than \$0.1 million, and were comprised of the recognition of deferred revenues from one existing licensee. There were no license fee revenues in the third quarter of 2005 and no further license fee stage payments under existing licenses are expected during the remainder of 2005. We are working closely with several potential licensees, but there can be no certainty that any new license negotiations will be concluded during 2005. Royalty revenues were \$0.2 million from six different companies in the third quarter of 2004 and \$0.1 million from six different companies in the third quarter of 2005. This reduction is due to the discontinuance of production of monochrome displays by Philips. Dow Chemicals, one of our licensees for the production and sale of polymer materials, has assigned its license from us to Sumitomo Chemical as a result of which royalties due under the terms of this license are no longer received from Dow but are received from Sumitomo Chemical. We will discontinue receiving royalties on these sales upon the establishment of our proposed joint venture with Sumitomo Chemical.

Technology services and development revenues grew from \$1.4 million in the third quarter of 2004 to \$2.8 million in the third quarter of 2005, an increase of \$1.4 million, or 102%. This growth was due to the technology services component of a large contract for the supply of ink jet printing equipment and technology services which was recognized in the third quarter of 2005 and also due to an increase in the number of technology transfer and development contracts from six in the third quarter of 2004 to eight in the third quarter of 2005. We have recognized revenue following the completion of a large contract with Delta Opto of Taiwan which included the supply of ink jet printing equipment as well as technology transfer in the third quarter of 2005.

Equipment and supplies revenues grew from zero in the third quarter of 2004 to \$3.7 million in the third quarter of 2005. The majority of this revenue related to the sale of three ink jet printers under the terms of the large contract with Delta Opto for equipment and technology transfer described above. We also sold a printer to another customer, some test equipment and a quantity of polymer ink.

We are continuing to promote the sales of ink jet printers, technology transfer and polymer ink and we believe that these revenue lines have the potential for continued revenue growth in the future.

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

Total operating revenues increased by \$4.9 million from \$1.6 million in the third quarter of 2004 to \$6.6 million in the third quarter of 2005, an increase of 299%.

Given the nature of our business and the current stage of our development, including the factors and trends described at the end of Overview above, revenues fluctuate significantly from quarter to quarter and will continue to do so in the future.

Sumitomo Chemical, and associated companies, and Delta Opto each accounted for in excess of 10% of our revenues for the third quarter of 2005. Sumitomo Chemical is a shareholder of CDT, owning less than 10% of our common stock. Following the establishment of our proposed joint venture with Sumitomo Chemical, we will discontinue receiving royalty or technology services revenues from them.

Table of Contents**Cost of Sales***(in thousands)*

| | Three months ended September 30, | % of | Three months ended September 30, | % of |
|-------------------------------------|-------------------------------------|------------|-------------------------------------|------------|
| | 2005 | Revenues * | 2004 | Revenues * |
| License fees and royalties | \$ 2 | 2% | \$ 110 | 42% |
| Technology services and development | 916 | 33% | 604 | 44% |
| Equipment and supplies | 2,756 | 75% | | |
| Cost of sales | \$ 3,674 | 56% | \$ 714 | 43% |

* the percentages shown in these columns represent each Cost of sales figure divided by the corresponding Revenue figure from the Operating Revenues table above

Cost of sales related to License fees and royalties was 42% of related sales for the third quarter of 2004 and 2% for the third quarter of 2005. The primary component for both quarters was payments to third parties from whom we have acquired intellectual property, although the percentage reported in the third quarter of 2004 was higher because of a payment made to the University of Cambridge pursuant to a renegotiation of the level of payments due to them. We expect that cost of sales for License fees and royalties will average between 1% and 2% of related sales in the future. Cost of sales related to Technology services and development fell from 44% for the third quarter of 2004 to 33% for the third quarter of 2005. The higher cost of sales percentage in the third quarter of 2004 was due to costs in relation to sponsored university research which we were required to fund under the terms of one of our technology development contracts. Cost of sales related to Equipment and supplies revenues was 75% of related sales for the third quarter of 2005. There were no revenues or cost for Equipment and supplies in the third quarter of 2004.

We account for cost of sales on an incremental cost basis and, therefore, relatively high margins are required, particularly for Technology services and development, in order for these contracts to make a contribution to our fixed costs. The margins achieved in 2005 are likely to be more representative of future periods than the margins achieved in 2004.

Research and development*(in thousands)*

| | Three months ended September 30, | Three months ended September 30, | % Increase / (Decrease) |
|-----------------------------------|-------------------------------------|-------------------------------------|----------------------------|
| | 2005 | 2004 | |
| Research and development expenses | \$ 4,116 | \$ 3,732 | 10% |

Our research and development expenses increased by \$0.4 million from \$3.7 million in the third quarter of 2004 to \$4.1 million in the third quarter of 2005. Half of this increase was due to grant receipts that were received in the third quarter of 2004 versus zero in the third quarter of 2005. The remaining \$0.2 million increase was due to charges related to awards of restricted stock units which were made in the fourth quarter of 2004.

In addition to the expenditures on research and development in the third quarters of both 2004 and 2005, \$0.7 million of expense was incurred on activities which were similar in nature to research and development but which directly supported revenue-generating projects and were not therefore classified as research and development expenses. A portion of these expenditures was charged to cost of sales in the current period and the remainder was held on the balance sheet in Prepaid expenses and other current assets to be charged to cost of sales on recognition of the corresponding revenues.

Research and development expenses will continue to vary from quarter to quarter due to the specific requirements of the projects being carried out in any quarter.

Selling, general and administrative expenses

(in thousands)

| | Three months ended September 30, <u>2005</u> | Three months ended September 30, <u>2004</u> | <u>% Increase / (Decrease)</u> |
|--|--|--|------------------------------------|
| Selling, general and administrative expenses | \$ 5,813 | \$ 3,679 | 58% |

Table of Contents

Our selling, general and administrative expenses increased by \$2.1 million from \$3.7 million in the third quarter of 2004 to \$5.8 million in the third quarter of 2005. \$2.0 million of this increase was due to the impairment of promissory notes held by us. These notes were issued in 1999 to two parties which had acquired stock from us and the promissory notes were secured by the stock. The promissory notes were due to be repaid in September 2005 but the noteholders have defaulted on their repayment obligations and we do not believe that we will be able to recover the funds due. At September 30, 2005, the value of the promissory notes exceeds the value of the stock by \$2.0 million. If our stock price falls below the price at September 30, 2005, a further impairment charge may be recognized. There was a \$0.5 million increase in expenditures due to a charge related to the fourth quarter 2004 awards of restricted stock units and a \$0.4 million decrease due to certain one-time expenditures which were incurred in the third quarter of 2004. These expenditures related to the establishment of our line of credit, costs incurred in preparation for our initial public offering in December 2004 and an accrual related to stock options issued to a former officer of the company. We believe that we will continue to incur significant general and administrative expenses in 2005, as well as in future periods, associated with being a public company.

Our amortization of intangibles acquired remained constant at \$0.4 million for the third quarter of 2004 and the third quarter of 2005.

Other income (expense)

(in thousands)

| | Three months ended September 30, 2005 | Three months ended September 30, 2004 |
|--|---|---|
| Equity in loss of Litrex | \$ (1,194) | \$ (1,299) |
| Equity in loss of Add-Vision | (70) | |
| Foreign currency transaction (loss) / income | (276) | 19 |
| Other income | 91 | |
| Interest income | 3 | 56 |
| Total Other expense | \$ (1,446) | \$ (1,224) |

Equity in loss of Litrex improved from a loss of \$1.3 million in the third quarter of 2004 to a loss of \$1.2 million in the third quarter of 2005 due to the recognition of revenue and profit in relation to equipment deliveries. We expect Litrex to report further losses as it continues to invest in ink jet printer development and we will report 50% of those losses while we continue to hold a 50% equity interest. On September 2, 2005, pursuant to the Sale and Purchase Agreement, we gave notice to Ulvac that we were exercising our Put Option under the terms of which, within 90 days of this notice having been given, Ulvac is required to purchase our remaining shareholding in Litrex for a consideration of \$10 million. The transaction closed on November 4, 2005 and is described in more detail under Liquidity and Capital Resources below.

The Equity in loss of Add-Vision includes our portion of its loss for the third quarter of 2005. We expect a similar level of loss to continue in future periods as Add-Vision incurs research and development expenditures on its disposable, flexible display technology. Our proportion of the loss of Add-Vision will increase if, as expected, we increase our equity stake in Add-Vision when we issue an additional license to Add-Vision in the future.

Currency losses in 2005 primarily resulted from the revaluing of assets and liabilities denominated in currencies other than U.S. dollars. We would expect a gain from such revaluations in 2005 if the U.S. dollar weakens versus the British pound during the year and a loss if it

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

strengthens since our British pound assets exceed our British pound liabilities.

Other income of \$0.1 million in the third quarter of 2005 relates to an unrealized gain in the value of forward exchange contracts, which we have taken out in order to economically hedge future British pound expenses.

Interest income was lower in the third quarter of 2005 than in the third quarter of 2004 because we have reversed the interest income which we had previously recognized for the impaired promissory notes described under Selling, general and administrative expenses above. Unless interest rates fall, we expect higher interest income in 2005 due to our higher cash balance following our initial public offering.

Our benefit for income taxes was \$0.6 million for the third quarter of 2004 compared to \$0.3 million for the third quarter of 2005. This benefit is shown because we surrendered tax losses which related to certain research and development expenditures to the UK tax authorities in return for a cash payment. The amount of benefit we can accrue is reduced to the extent that such expenses support revenue-generating contracts.

Table of Contents

Our net loss increased by \$1.1 million from \$7.5 million in the third quarter of 2004 to \$8.6 million in the third quarter of 2005. Our net loss attributable to common shareholders decreased by \$0.7 million from \$9.3 million in the third quarter of 2004 to \$8.6 million in the third quarter of 2005. The most significant reason for the increase in the loss was higher operating expenses incurred, as described above, although we also achieved a significantly higher gross profit. We recorded a \$1.8 million charge for accretion of our preferred stock in the third quarter of 2004 but, following the conversion of all of our preferred stock into common stock immediately prior to our initial public offering in December 2004, we no longer have any preferred stock outstanding and accretion charges will not be recorded in 2005.

Comparison of Nine Months Ended September 30, 2005 and September 30, 2004**Operating revenues**

(in thousands)

| | Nine months ended September 30, 2005 | Nine months ended September 30, 2004 | % Increase / (Decrease) |
|-------------------------------------|--|--|----------------------------|
| License fees and royalties | \$ 1,233 | \$ 2,136 | (42)% |
| Technology services and development | 5,895 | 3,233 | 82% |
| Equipment and supplies | 3,670 | 150 | 2347% |
| Operating revenues | \$ 10,798 | \$ 5,519 | 96% |

Revenues from License fees and royalties fell by \$0.9 million, or 42%, from \$2.1 million in the first nine months of 2004 to \$1.2 million in the first nine months of 2005. License fee revenues in the first nine months of 2004 were \$0.6 million, and consisted of revenues from two existing licensees. There were no license fee revenues in the first nine months of 2005. Royalty revenues were \$1.5 million from six different companies in the first nine months of 2004 and \$1.2 million from seven different companies in the first nine months of 2005.

Technology services and development revenues grew by \$2.7 million from \$3.2 million in the first nine months of 2004 to \$5.9 million in the first nine months of 2005, an increase of 82%. This growth is due to the technology services component of a large contract for the supply of ink jet printing equipment and technology services which was recognized in the third quarter of 2005 and an increase in the number of technology transfer and development contracts from nine in the first nine months of 2004 to ten in the first nine months of 2005.

Equipment and supplies revenues grew by \$3.5 million from \$0.2 million in the first nine months of 2004 to \$3.7 million in the first nine months of 2005 due to the recognition of revenue for ink jet printing equipment supplied under the terms of the large contract described above as well as revenue for an additional ink jet printer sold to another customer and revenues for the supply of polymer inks.

Sumitomo Chemical, and associated companies, and Delta Opto each accounted for in excess of 10% of our revenues for the first nine months of 2005. Sumitomo Chemical is a shareholder of CDT, owning less than 10% of our common stock. Following the establishment of our proposed joint venture with Sumitomo Chemical we will discontinue receiving royalty or technology services revenues from them.

Cost of Sales*(in thousands)*

| | Nine months ended September 30, 2005 | % of Revenues * | Nine months ended September 30, 2004 | % of Revenues * |
|-------------------------------------|---|----------------------------|---|----------------------------|
| License fees and royalties | \$ 15 | 1% | \$ 127 | 6% |
| Technology services and development | 2,040 | 35% | 1,000 | 31% |
| Equipment and supplies | 2,756 | 75% | 91 | 61% |
| Cost of sales | \$ 4,811 | 45% | \$ 1,218 | 22% |

* the percentages shown in these columns represent each Cost of sales figure divided by the corresponding Revenue figure from the Operating Revenues table above

Table of Contents

Cost of sales related to License fees and royalties was 6% of related sales for the first nine months of 2004 and 1% the first nine months of 2005. The primary component for both periods was payments to third parties from whom we have acquired intellectual property but the percentage reported in the third quarter of 2004 was higher because of a payment made to the University of Cambridge pursuant to a renegotiation of the level of payments due to them. Cost of sales related to Technology services and development rose from 31% for the first nine months of 2004 to 35% for the first nine months of 2005. This increase was due to a technology development contract for which we recognized revenue in the second nine months of 2004 which had very low associated costs and due to delivery under a contract in the second nine months of 2005 which required us to purchase a significant quantity of polymer materials from a third party supplier.

We account for cost of sales on an incremental cost basis and, therefore, relatively high margins are required, particularly for Technology services and development, in order for these contracts to make a contribution to our fixed costs. The margins achieved in 2005 are likely to be more representative of future periods than the margins achieved in 2004.

Research and development

(in thousands)

| | Nine months ended September 30, 2005 | Nine months ended September 30, 2004 | % Increase / (Decrease) |
|-----------------------------------|--|--|----------------------------|
| Research and development expenses | \$ 12,280 | \$ 10,480 | 17% |

Our research and development expenses increased by \$1.8 million from \$10.5 million in the first nine months of 2004 to \$12.3 million in the first nine months of 2005. \$1.2 million of this increase was due to a reduction in grant receipts, which we offset against research and development costs, in the first nine months of 2005 compared to the first nine months of 2004. The remaining \$0.6 million of the increase was due to a charge which was recorded in the first nine months of 2005 for the grant of restricted stock units issued under our special bonus plan.

In addition to the \$12.3 million expenditure on research and development in the first nine months of 2005, \$2.4 million was incurred on activities which were similar in nature to research and development but which directly supported revenue-generating projects and were not therefore charged to cost of sales in the current period. \$1.3 million was spent on such activities in the first nine months of 2004. A portion of these expenditures is charged to cost of sales in the current period and the remainder is held on the balance sheet in Prepaid expenses and other current assets to be charged to cost of sales on recognition of the corresponding revenues.

Selling, general and administrative expenses

(in thousands)

| | Nine months ended September 30, 2005 | Nine months ended September 30, 2004 | % Increase / (Decrease) |
|--|--|--|----------------------------|
| Selling, general and administrative expenses | \$ 14,196 | \$ 9,358 | 52% |

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

Our selling, general and administrative expenses increased by \$4.8 million from \$9.4 million in the first nine months of 2004 to \$14.2 million in the first nine months of 2005. \$2.0 million of this increase was due to the impairment of promissory notes held by us. These notes were issued in 1999 to two parties which had acquired stock from us and the promissory notes were secured by the stock. The promissory notes were due to be repaid in September 2005 but the noteholders have defaulted on their repayment obligations and we do not believe that we will be able to recover the funds due. The value of the promissory notes exceeds the value of the stock by \$2.0 million. In addition \$1.7 million of this increase was due to a charge related to awards of restricted stock units which were made in the fourth quarter of 2004. The primary reasons for the remainder of the increase were the costs of our line of credit, increased costs of patent filing, increased cost of directors and officers insurance and other costs associated with being a public company.

Our amortization of intangibles acquired remained constant at \$1.2 million for the first nine months of 2004 and the first nine months of 2005.

Table of Contents**Other income (expense)***(in thousands)*

| | Nine months ended September 30, 2005 | Nine months ended September 30, 2004 |
|--|--|--|
| Equity in loss of Litrex | \$ (2,435) | \$ (2,251) |
| Equity in loss of Add-Vision | (239) | |
| Foreign currency transaction (loss)/gain | (370) | 213 |
| Other (expense)/income | (698) | 33 |
| Interest income | 364 | 265 |
| Other expense | \$ (3,378) | \$ (1,740) |

Equity in loss of Litrex increased from \$2.3 million in the first nine months of 2004 to \$2.4 million in the first nine months of 2005 due to an increase in development costs incurred by Litrex to develop printers for larger glass sizes.

The Equity in loss of Add-Vision includes our portion of seven months of its losses since we acquired our equity stake in Add-Vision at the start of March 2005. Our proportion of the loss of Add-Vision will increase if, as expected, we increase our equity stake in Add-Vision when we issue an additional license to Add-Vision in the future.

Currency gains and losses primarily result from the revaluing assets and liabilities denominated in currencies other than U.S. dollars. We would expect a gain from such revaluations in 2005 if the U.S. dollar weakens versus the British pound during the year and a loss if it strengthens since our British pound assets exceed our British pound liabilities.

Other expense of \$0.7 million in the first nine months of 2005 relates to an unrealized loss in the value of forward exchange contracts, which we have taken out in order to economically hedge future British pound expenses.

Interest income was higher in the first nine months of 2005 than in the first nine months of 2004 due to higher average cash balances. Unless interest rates fall, we expect higher interest income in 2005 due to our higher cash balance following our initial public offering.

Our benefit for income taxes was \$1.6 million for the first nine months of 2004 compared with \$1.1 million for the first nine months of 2005. This benefit is shown because we surrendered tax losses which related to certain research and development expenditures to the UK tax authorities in return for a cash payment. The amount of benefit we can accrue is reduced to the extent that such expenses support revenue-generating contracts.

Our loss before cumulative effect of accounting change increased by \$7.1 million from \$16.9 million in the first nine months of 2004 to \$24.0 million in the first nine months of 2005. Our net loss to common shareholders decreased by \$10.3 million from \$34.3 million in the first nine

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

months of 2004 to \$24.0 million in the first nine months of 2005. This decrease reflects the effect of a \$12.2 million cumulative effective of accounting change in the first quarter of 2004 due to the consolidation of CDT Oxford on January 1, 2004. We achieved a higher gross profit in the first nine months of 2005 compared to the first nine months of 2004, but incurred increased operating expenses and increased losses due to currency fluctuations. We recorded a \$5.3 million charge for accretion of our preferred stock in the first nine months of 2004 but, following the conversion of all of our preferred stock into common stock immediately prior to our initial public offering in December 2004, we no longer have any preferred stock outstanding and accretion charges will not be recorded in 2005.

We have reported other comprehensive loss of \$0.6 million in relation to a revaluation of stock we hold in Micro-Emissive Displays, or MED, one of our licensees. In June 2005, MED announced to the London Stock Exchange that its directors were not yet satisfied with the yields of its manufacturing process however, in September 2005 MED further announced that they expected to commence commercial production by late 2005 or early 2006.

Liquidity and Capital Resources

Our cash balance was \$5.7 million at September 30, 2005. Net cash used in operating activities was \$15.5 million for the nine months ended September 30, 2005 and \$9.3 million for the nine months ended September 30, 2004. \$2.9 million of the \$7.4 million increase in cash used was due to the increase in loss from operations plus \$3.3 million due to changes in working capital, primarily due to changes in our deferred revenue balance attributable in turn to the recognition of revenue under a major contract in September 2005 versus having increased as stage payments were invoiced for this and other contracts during 2004. We have no outstanding borrowings under our credit facility and are not currently planning to draw down under this facility.

Table of Contents

Our accounts receivable increased from \$1.5 million at December 31, 2004 to \$2.2 million at September 30, 2005 due to invoices we issued in the third quarter of 2005 for the sale of ink jet printing equipment, polymer inks and technology development services. Our prepaid and other assets fell from \$6.9 million at December 31, 2004 to \$6.3 million at September 30, 2005 due to the recognition of costs related to the major contract for which we recognized revenue in September 2005. Our current deferred revenue balance decreased from \$6.9 million at December 31, 2004 to \$4.6 million at September 30, 2005 because we recognized revenue with respect to a major contract in the third quarter of 2005. We expect to realize, during 2005, the majority of our currently deferred revenue at September 30, 2005 but, given that it is our objective to enter into further such contracts in 2005, we would expect significant balances to remain in both prepaid and other assets and deferred revenue at the end of 2005.

Net cash used by investing activities for the nine months ended September 30, 2004 was \$0.7 million consisting of a \$1.6 million opening cash balance of CDT Oxford which was consolidated effective January 1, 2004 less \$2.2 million of capital expenditures for the nine month period. Net cash used in investing activities for the nine months ended September 30, 2005 was \$5.7 million, primarily consisting of \$1.1 million for the acquisition of an equity interest in Add-Vision, \$2.9 million for the acquisition of fixed assets, including \$0.4 million for the purchase of ink jet printing equipment from Litrex, and \$1.7 million (net) advanced to Litrex. Total funding provided to Litrex in 2005 which remains outstanding is \$1.7 million which we expect to be repaid in December 2005. On September 2, 2005, pursuant to our agreement with Ulvac, we gave notice to Ulvac that we were exercising our Put Option under the terms of which, within 90 days of this notice having been given, Ulvac is required to purchase our remaining shareholding in Litrex for a consideration of \$10 million.

On November 4, 2005 we entered into a Second Sale and Purchase Agreement with Ulvac and Litrex under the terms of which Ulvac completed its purchase of 50% of the equity of Litrex from the Company. Under the terms of this agreement, Ulvac paid us a consideration of \$9.7 million being the previously agreed purchase price of \$10.0 million less \$0.3 million being our agreed contribution to Litrex's Exit Bonus Plan. \$1.0 million, or 10% of this consideration, has been put into escrow for a period of one year. This escrow period may be extended for a further year if the status of our potential liability in relation to the U. S. Government grant described in note 7 to our interim financial statements has not been settled by November 2006. Pursuant to the 2003 Sale and Purchase Agreement, \$1.4 million had been held in escrow since the sale of the first 50% of Litrex in 2003 and this amount has been released to the Company. Litrex has agreed to repay to the Company \$1.7 million of loans advanced by the Company to them by December 2005, plus accrued interest. In November 2005, the Company made a payment of \$0.4 million to Philips Electronics N. V. of the Netherlands in consideration for them entering into a license agreement with Litrex in settlement of a claim for rights to certain intellectual property which had been made by Philips Electronics N. V. against Litrex. As a result of these transactions, we will receive a net total of \$11.4 million in 2005 and a further \$1.0 million when, and to the extent that, the remaining escrow amount is released.

Capital expenditures rose from \$2.2 million for the first nine months of 2004 to \$2.9 million for the first nine months of 2005 due the acquisition by us of a piece of equipment for our technology development centre which we require to develop fabrication techniques involving a transparent cathode layer, which could enable displays to operate more efficiently and with longer lifetimes. Our property, equipment and leasehold improvements balance fell from \$16.0 million at December 31, 2004 to \$14.7 million at September 30, 2005 due to the continuing depreciation of the assets which comprise our Technology Development Centre.

We expect, based on our internal forecast and assumptions relating to our operations (including, among others, assumptions regarding our working capital requirements, the progress of our research and development efforts and revenues and the purchase price for our remaining shareholding in Litrex, which we received in November 2005) that we have sufficient cash to meet our obligations for at least the next twelve months. We have a line of credit that we entered into in July 2004 providing for a maximum amount of \$15.0 million, which was not drawn upon at September 30, 2005 and of which \$0.5 million may not be borrowed. This line of credit is provided by Lloyds TSB Bank in the UK and is available for a minimum of one year, renewable for two further years. It is secured by a letter of credit issued by Wells Fargo Bank, the reimbursement obligations of which are secured by our patents, trademarks and copyrights and associated license revenues. In addition to certain fixed fees payable regardless of whether or not the facility is utilized and which amount to approximately 3% of the total amount of the facility per year, we will be liable to pay interest and charges of 3.75% above the U.S. dollar London Inter-Bank Offer Rate on any drawing under this facility. Under the terms of this facility, any draw down requires us to certify that we continue to satisfy certain financial covenants: specifically our Consolidated Total Net Worth, as defined, must exceed \$75.0 million, and our current assets less current liabilities, but excluding deferred revenue, must not be less than minus \$15.0 million. In addition, we are required to report the filing of any new patents, trademarks and copyrights and add those to the existing intellectual property portfolio which has been assigned as security to IPI Financial Services which

arranged the letter of credit. We are obligated to

Table of Contents

maintain the validity of all of our patents and only to license such patents to third parties under terms which are within the parameters of our customary licensing practices or to which IPI Financial Services has provided its consent. At September 30, 2005 \$14.5 million was available to be drawn down under this facility and we believe that we were in compliance with the terms of the agreements described above and will continue to be in the future. This line of credit will expire at the end of June 2007, subject to it being renewed in July 2006. IPI Financial Services is obliged to use its best efforts to secure the renewal of the Wells Fargo letter of credit or its replacement by a letter of credit from a suitable alternative bank in July 2006. We believe that Lloyds TSB will renew the line of credit in July 2006 provided that a suitable letter of credit is provided to them.

In March 2005, we invested \$1.0 million in Add-Vision, a company located in California that researches and develops flexible, low cost, low resolution displays and incurred \$0.1 million of costs associated with this investment. We also granted Add-Vision a fully paid-up license to our intellectual property in return for additional equity and may grant a further license for additional intellectual property in return for additional equity. As a result of these transactions, we currently have a voting interest in Add-Vision of approximately 39%. This interest will increase if we grant the additional license described above, but is not expected to exceed 50%. Add-Vision may require additional funding in the future, and we may contribute to such funding, but we do not anticipate investing further funds in Add-Vision during 2005.

During 2004 we entered into a number of forward exchange contracts to sell U.S. dollars and buy British pounds in order to fund our U. K. operating expenses during 2005 and during 2005 have continued to enter into such contracts to cover U. K. operating expenses in 2006. We entered into fixed rate contracts for each of the months from January to April 2005 for an aggregate amount of \$6.0 million at exchange rates ranging from 1.83 to 1.85. We entered into further contracts for each of the months from May to December at an exchange rate of no higher than 1.96 and for an aggregate amount of \$14.0 million. Under the terms of the later-dated contracts, if the spot exchange rate as each contract matures is higher than 1.96 we will sell the U.S. dollars at a rate of 1.96. If the spot exchange rate as each contract matures is lower than 1.96 we will sell half of the contracted U.S. dollars at a rate of 1.96 and half at the spot exchange rate. The purpose of these transactions is to limit the risk of adverse exchange rate fluctuations while retaining some benefit in the event of favorable fluctuations. We have entered into similar contracts covering each of the months January to July 2006 each for an amount of \$1.75 million and at exchange rates of 1.91, 1.89, 1.86, 1.83, 1.79, 1.91 and 1.83 respectively. We may enter into similar transactions in the future. These contracts were not designated as hedging instruments and, therefore, gains and losses are recognized immediately in earnings during the period.

Table of Contents

Factors That May Affect Our Operating Results

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below together with all of the other information included in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K before making an investment decision. If any of the following risks actually occurs, our business, financial condition or results of operations could suffer. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. This Quarterly Report on Form 10-Q also contains forward-looking statements that involve risks and uncertainties. Our actual results will differ, perhaps materially, from those expected in those forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K.

Risks Relating to Our Business and Industry

We have a history of losses, do not expect to be profitable in the foreseeable future and may never be profitable.

Since inception, we have generated limited revenues while incurring significant losses. We expect to incur losses for the foreseeable future until such time, if ever, as we are able to achieve sufficient levels of revenue from the commercial exploitation of our Polymer Organic Light Emitting Diode, or P-OLED, technology to support our operations. You should note that:

P-OLED technologies may never be broadly commercially adopted;

markets for flat panel displays, or FPDs, using P-OLED technologies may be limited; and

we may never generate sufficient revenues from the commercial exploitation of our P-OLED technology to become profitable.

We license our P-OLED technology to P-OLED materials manufacturers and display manufacturers, which then incorporate our technology into the materials and products they sell. Even if we and our display manufacturer licensees develop commercially viable applications for our P-OLED technologies, we may never recover our research and development expenses. We had net losses of \$22.8 million, \$22.6 (exclusive of the effect of an accounting change) and \$24.0 million for the years ended December 31, 2003 and December 31, 2004 and the nine months ended September 30, 2005, respectively, and as of September 30, 2005, we had an accumulated deficit of \$177.8 million. We expect to report net losses in future periods. We cannot predict what impact continued net losses might have on our ability to finance our operations in the future or on the market value of our common stock.

Because we are at an early stage of development and have a limited operating history, our future results are unpredictable.

Our future success is uncertain because we have a limited operating history and face many risks and uncertainties. If we are unsuccessful in addressing these risks and uncertainties, we may be unable to generate sufficient revenue growth to support ongoing operations. We were formed in 1992 to research and develop P-OLED technology. We began licensing P-OLED technology to original equipment manufacturers, or OEMs, in 1996, and in 2002 this technology was initially commercialized. Accordingly, there is only a limited amount of past experience upon

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

which to evaluate our business and prospects, and a potential investor should consider the challenges, expenses, delays and other difficulties involved in the development of our business, including the continued development of our P-OLED technology, refinement of processes and components for commercial products using our P-OLED technology, formation of additional commercial relationships and achievement of market acceptance for products using P-OLED technology.

If our P-OLED technology is not feasible for broad-based product applications, we may never generate revenues sufficient to support ongoing operations.

Before display manufacturers will agree to use our P-OLED technology for wide-scale commercial production, they will likely require us to demonstrate to their satisfaction that our P-OLED technology is feasible for their particular product applications. This, in turn, would require additional advances in our research and development efforts, as well as those of others, for applications in a number of areas, including:

device reliability;

the development of P-OLED materials with sufficient lifetimes, brightness and color coordinates for full-color P-OLED displays in more demanding applications, such as televisions; and

issues related to scalability and cost-effective fabrication technologies for product applications.

Currently, P-OLED displays are being used or tested for small- to medium-sized product applications such as mobile phones, PDAs, or personal digital assistants, digital cameras and camcorders (including electronic viewfinders), portable DVD

Table of Contents

players, electric shavers, MP3 players, in-car entertainment and navigation displays and other applications. P-OLED displays have not yet been commercially introduced in larger applications such as laptop computers, desktop computer monitors or televisions other than in prototypes. To date, we have not attained the service lifetimes required by the manufacturers of these more demanding larger applications.

Our research and development efforts remain subject to all of the risks associated with the development of new products based on emerging and innovative technologies, including, for example, unexpected technical problems or the possible insufficiency of funds for completing development of these products. Technical problems may result in delays in the implementation of our technologies in specific applications and cause us to incur additional expenses that would increase our losses. If we cannot complete research and development of our P-OLED technology successfully, or if we experience delays in completing research and development of our P-OLED technology for use in potential commercial applications, particularly after incurring significant expenditures, our business may fail.

Even if our P-OLED technology is technically feasible, it may not be adopted by display manufacturers.

The potential size, timing and viability of market opportunities targeted by us through our display manufacturer licensees are uncertain at this time. Market acceptance of our P-OLED technology will depend, in part, upon this technology providing benefits comparable to or greater than those provided by cathode ray tube display and liquid crystal display, or LCD, technology (the current standard display technologies) at an advantageous cost to manufacturers, and the adoption of products incorporating this technology by consumers.

Display manufacturers make the determination during their product development programs whether to incorporate our P-OLED technology or pursue other alternatives, and they may be forced to make significant investments of time and cost well before they introduce their products incorporating our technology to the consumer market and before they can be sure that they will generate any significant sales to recover their investment. Moreover, certain existing licensees and potential licensees of our P-OLED technology currently manufacture FPDs using competing technologies, and they may, therefore, be reluctant to redesign their products or manufacturing processes or invest in new or converted facilities to incorporate our P-OLED technology.

During a display manufacturer licensee's entire product development process, we face the risk that our technology will fail to meet our licensee's technical, performance or cost requirements or will be replaced by a competing product or alternative technology. For example, we are aware that some of our licensees have entered into arrangements with our competitors regarding the development of competing technologies, including the potential production of OLED displays by ink jet printing using phosphorescent materials. Even if we offer technology that is satisfactory to a display manufacturer licensee, they may choose to delay or terminate their product development efforts for reasons unrelated to our technology. The occurrence of any of these events would adversely affect our royalty revenues and may make it difficult to attract additional licensees.

There are alternatives to P-OLEDs for FPDs, which may limit our ability to commercialize our P-OLED technology.

The FPD market is currently, and will likely continue to be for some time, dominated by displays based on LCD technology. Numerous companies have made and are continuing to make substantial investments in, and are conducting research to improve the characteristics of LCDs. Several other FPD technologies have been, or are being, developed, including technologies for the production of field emission, inorganic electroluminescence and gas plasma. Advances in LCD technology or any of these other technologies may overcome their current limitations and permit them to remain or become more attractive technologies for FPDs, either of which could limit the potential market for FPDs using our P-OLED technology. This, in turn, would cause display manufacturers to avoid entering into commercial relationships with us, or to renegotiate, terminate or not renew their existing relationships with us, which may cause our business strategy to fail.

Other OLED technologies may be more successful than ours, which may limit the commercial adoption of our P-OLED technology.

Other companies have developed OLED technologies that differ from and compete with our P-OLED technology. Certain of these competing OLED technologies entered the marketplace prior to ours and may become entrenched in the flat panel industry before our P-OLED technologies have a chance to become widely adopted. Moreover, competitors may succeed in developing new OLED technologies or new manufacturing techniques that are more cost-effective or have fewer limitations than our P-OLED technology or other existing OLED technologies. If our P-OLED technology is unable to capture a substantial portion of the OLED display market, our business strategy may fail.

Because we do not manufacture or sell any products to end users, we depend on the manufacturing capabilities of our display manufacturer licensees. Any difficulties or delays affecting their manufacturing processes or any decision to terminate or reduce their display manufacturing businesses could harm our business.

We license our P-OLED technology to display manufacturers, who then incorporate our technology into the products that they sell. Because we do not manufacture any commercial products, our success depends on the ability and willingness of our

Table of Contents

licensees to develop, manufacture and sell commercial products integrating our technology. Any significant disruption or increase in cost of the manufacturing processes of our display manufacturer licensees or a decision by any of our display manufacturer licensees to terminate or reduce their efforts to manufacture or sell displays would adversely affect our royalty revenues and thus our business.

Philips has discontinued manufacture of monochrome P-OLED displays and has sold their P-OLED manufacturing development facility to OTB of the Netherlands. We have received \$543 thousand (which includes \$533 thousand received by Litrex), \$33 thousand and \$70 thousand in revenues from Philips in, respectively, fiscal years 2002, 2003 and 2004 and \$16 thousand for the nine months ended September 30, 2005. We do not expect that Philips will pay us significant royalties in the near future. We do not expect these actions to have any material impact on our financial results in fiscal year 2005. Philips has retained its license from us to manufacture P-OLED display and lighting devices.

Mass production of P-OLED displays will require the availability of suitable manufacturing equipment, components and materials. Equipment is currently available for many of the required process steps, but the processes and equipment that will be required to deposit P-OLED materials for large-sized, full-color displays are still under development. High precision ink jet printing equipment that could be used to deposit P-OLED materials is being developed by some companies, but, to our knowledge, is only being made available for sale at this time by Litrex Corporation, our former 50%-owned joint venture. The availability of suitable ink jet printing equipment will be contingent on the continued technical success of and sufficient funding for Litrex's or another manufacturer's development program. In addition, certain of the components, such as low temperature poly silicon backplanes, used in the production of our licensees' display products are available only from a limited number of suppliers.

If display manufacturers are unable to obtain ink jet printing or other suitable P-OLED deposition equipment or are unable to source other key equipment for the manufacture of large panel sizes, or if they experience unexpected difficulties, expenses or delays with respect to additional required technologies, components or other materials, they may experience increased costs or manufacturing delays and may not be able to manufacture larger-sized, full-color P-OLED displays, or may exit the display manufacturing business entirely. This would adversely affect our license fees or royalty payments from them, and we may not be able to increase our revenues and achieve profitability.

We expect to derive an increasing portion of our revenues from royalties on sales of products commercialized by our licensees that incorporate our technology. Our display manufacturer licensees operate in a highly competitive environment, and they may not be able to achieve and sustain market position. If they fail to compete successfully, our royalties will decrease or be eliminated.

Because we do not sell any products to end-users, our success depends upon the ability and continuing willingness of our display manufacturer licensees to market commercial products integrating our technology and the widespread acceptance of those products. Any slowdown in the demand for our licensees' products would adversely affect our royalty revenues and thus our business. The markets for our display manufacturer licensees' products are highly competitive, with pressure on prices and profit margins due largely to additional and growing capacity from FPD industry competitors. The principal elements affecting our licensees' competitive performance in the market for end-user products include their abilities to:

access required capital;

conduct research and development;

reduce time-to-market;

reduce production costs;

offer a competitive price;

offer attractive product features and quality;

offer customer service, including product design support; and

provide sufficient quantity of products to fulfill end-user demand.

Success in the market for end-user products that may integrate our P-OLED technology also depends on factors beyond the control of our licensees and us, including the cyclical and seasonal nature of the end-user markets that our licensees serve, as well as industry and general economic conditions. If our licensees fail or otherwise reduce their efforts to commercialize products that incorporate our technology or exit the display manufacturing business entirely, our business strategy may fail.

Table of Contents

Many of our competitors have greater resources, which may make it difficult for us to compete successfully against them.

The FPD industry is characterized by intense competition. Many of our LCD and OLED competitors have better name recognition and greater financial and personnel resources and technical, marketing and research capabilities than us, and because of these differences, we may never be able to compete successfully in the FPD market.

LCD is currently the dominant technology in the FPD market. Many of the leading LCD panel manufacturers, such as AU Optronics, Chunghwa Picture Tubes, LG.Philips, Samsung Electronics and Sharp, are large, established companies with global marketing capabilities, widespread brand recognition and extensive financial resources.

Eastman Kodak Company, or Kodak, is our principal competitor in the OLED industry, with several licensees already in commercial production of displays incorporating its passive matrix small molecule OLED, or AMOLED, technology. In addition, Kodak manufactures active matrix AMOLED displays under a joint venture with Sanyo Electric.

The leading LCD panel manufacturers, who use competing technologies but are also potential licensees of our P-OLED technology, are considerably larger and more established companies, and have global marketing capabilities and substantially greater financial resources to devote to research and development than we have. If our technology does not compete effectively with these and other display technologies, our business strategy may fail.

If our materials supplier licensees fail to make advances in their research, or if they exit that business or otherwise terminate or elect not to renew their relationships with us, we might not succeed in commercializing our P-OLED technology.

Research and development of commercially viable applications for our P-OLED technology depends substantially on the success of work relating to P-OLED materials, including resolution of issues relating to materials lifetimes and efficiencies at the brightness levels required for large panel applications. We cannot be certain that we or our materials supplier licensees will make sufficient additional advances in the research and development of P-OLED materials to satisfy these requirements. Moreover, if our materials supplier licensees are unable to meet the requirements of our display manufacturer licensees, or if they exit the P-OLED materials supply business or otherwise terminate or elect not to renew their relationships with us and no viable successor can be found, our business strategy may fail.

If we cannot form and maintain lasting business relationships with P-OLED display manufacturers, our business strategy will fail.

Our business strategy depends upon our development and maintenance of commercial licensing relationships with high-volume manufacturers of P-OLED displays. As of September 30, 2005, we had entered into nine licenses with display manufacturers, and have seven other relationships with manufacturers which are limited to technology development and the evaluation of our P-OLED technology for possible use in commercial production. Any of these relationships may fail to result in the display manufacturers entering into a licensing arrangement or, subsequently, commercial production, as applicable, of devices using our P-OLED technology on a scale sufficient for our business strategy to succeed. Moreover, if a licensee is no longer using our technology, it can generally terminate the license agreement upon notice and without further payment to us.

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

Under our existing technology development and evaluation agreements, we are working with display manufacturers to incorporate our technology into their products for the commercial production of P-OLED displays. However, these technology development and evaluation agreements typically last for limited periods of time, and these relationships may never lead to development of products and entry into license agreements.

Currently, and for the foreseeable future, a significant portion of our revenues are and will be derived from a concentrated number of licensees. In 2003, 2004 and the first nine months of 2005, 10, five and two customers accounted for, respectively, 74%, 66% and 64% of our revenues. Furthermore, in 2003, 2004 and the first nine months of 2005, two, four and two licensees accounted individually for more than 10% of our revenues. Our future success will depend upon our ability to establish and maintain relationships with key licensees and to attract new licensees. If our royalty revenues are derived from a concentrated few licensee relationships, our operating results will be harmed if those licensees experience operating difficulties or curtail or terminate their use of our licensed technology, and we are not able to obtain replacement royalty sources. Replacement royalty sources may be difficult to obtain because of the lengthy periods required to attract and sign-up new licensees and have them enter commercial production.

Our ability to enter into additional commercial licenses, or to maintain our existing technology development and evaluation relationships, may require us to make financial or other commitments. We might not be able, for financial or other reasons, to enter into or continue these relationships on commercially acceptable terms, or at all. Failure to do so would cause our business strategy to fail.

Table of Contents

Conflicts may arise with our licensees or joint development partners, resulting in renegotiation or termination of, or litigation related to, our agreements with them. This would adversely affect our revenues.

Conflicts could arise between us and our licensees or joint development partners as to royalty rates, milestone payments or other commercial terms. Similarly, the parties may disagree as to which party owns or has the right to commercialize intellectual property that is developed during the course of the relationship or as to other non-commercial terms. If such a conflict were to arise, a licensee or joint development partner might attempt to compel renegotiation of certain terms of their agreement or terminate their agreement entirely, and we might lose the royalty revenues and other benefits of the agreement. Either we or the licensee or joint development partner might initiate litigation to determine commercial obligations, establish intellectual property rights or resolve other disputes under the agreement. Such litigation could be costly to us and require substantial attention of management. If we were unsuccessful in such litigation, we could lose the commercial benefits of the agreement, be liable for other financial damages and suffer losses of intellectual property or other rights that are the subject of dispute. Any of these adverse outcomes could cause our business strategy to fail. Some of our licenses contain most favored nation provisions. These provisions give licensees the right to reduced royalty rates or refunds of upfront fees in the event that we issue new licenses which have more favorable upfront fee or royalty rates than the existing licenses which contain these most favored nation provisions, but are otherwise similar in their terms.

If we do not receive additional financing in the future, we might not be able to continue the research, development and commercialization of our P-OLED technology.

Our capital requirements have been, and will continue to be, significant. Substantial additional funds will be required in the future to maintain current levels of expenditure for research, development and commercialization of our P-OLED and related technologies, to obtain and maintain patents and other intellectual property, or IP, rights in these technologies, and for working capital and other purposes, the timing and amount of which are difficult to forecast. Our total research and development expenditures were \$16.8 million in 2003, \$14.2 million in 2004 and \$12.3 million for the nine months ended September 30, 2005. Our cash on hand will not be sufficient to meet all of our future needs. When we need additional funds, such funds may not be available on commercially reasonable terms, or at all. If we cannot obtain more money when needed, we might be forced to cut back our current activities and our business might fail. In July 2004, we secured a line of credit in a maximum amount of \$15.0 million, of which \$0.5 million may not be borrowed, available for one year and extendible for up to two additional years to meet our short term capital requirements. There are financial costs associated with maintaining and accessing this facility. In addition, any borrowing under this facility is secured by a letter of credit issued by Wells Fargo Bank, the reimbursement obligations of which are secured by our IP portfolio and results in the imposition of certain financial and operating restrictions by the lender. We renewed this line of credit for a further year in July 2005.

We have sold Litrex to Ulvac, Inc. of Japan. Under the terms of this agreement, Ulvac is obliged to continue to support Litrex's development of ink jet printers for the display manufacturer industry. If it does not fulfill this obligation, we may exercise our rights under a fallback license to obtain the necessary IP to develop, manufacture and supply ink jet printing equipment for use by manufacturers using our P-OLED technology independent of Litrex. In any such circumstance, we may incur substantial additional costs in order to ensure that ink jet printing equipment is made available for P-OLED display manufacturers. We have the right, but no obligation, to fund ink jet printing development programs at Litrex and may incur costs in doing so if we believe this is necessary for the furtherance of our P-OLED technology.

If we are unable to meet our currently projected liquidity requirements from our existing resources, we may need to borrow money or issue additional equity or debt securities. We may not be able to borrow money on commercially reasonable terms or at all. If we attempt to raise money in an offering of shares of our common stock, preferred stock, warrants or debt securities, or if we engage in acquisitions involving the issuance of such securities, our then-existing stockholders may be diluted. If we are unable to obtain required financing on reasonable terms, our business may fail.

We or our licensees may incur substantial costs or lose important rights as a result of litigation or other proceedings relating to our patent and other intellectual property rights.

In recent years, there has been significant litigation involving patents and other IP rights in many technology-related industries, including our own. Until recently, many patent applications were retained in secrecy by the United States Patent Office until and unless a patent issued. As a result, there may be United States patent applications pending that may be infringed by the use of our technology or a part thereof, thus substantially interfering with the future conduct of our or our licensees' business. In addition, there may be issued patents in the United States or other countries that are pertinent to our or our licensees' business of which we are not aware. Our licensees could be sued by other parties for patent infringement in the future. Such lawsuits could subject them to liability for damages or require our licensees to obtain additional licenses that could increase the cost of their products, which might have an adverse affect on their sales and thus our royalties or cause them to seek to renegotiate our royalty rates.

Table of Contents

In addition, in the future we may assert our IP rights by instituting legal proceedings against others. We cannot assure you that we will be successful in enforcing our patents in any lawsuits we may commence. Defendants in any litigation we may commence to enforce our patents may attempt to establish that our patents are invalid or are unenforceable. Thus, any patent litigation we commence could lead to a determination that one or more of our patents are invalid or unenforceable. If a third party succeeds in invalidating one or more of our patents, that party and others could compete more effectively against us. Our ability to derive licensing revenues from products or technologies covered by these patents could also be adversely affected.

Whether our licensees are defending the assertion of third-party IP rights against their businesses arising as a result of the use of our technology, or we are asserting our own IP rights against others, such litigation can be complex, costly, protracted and highly disruptive to our or our licensees' business operations by diverting the attention and energies of management and key technical personnel. As a result, the pendency or adverse outcome of any IP litigation to which we or our licensees are subject could disrupt business operations, require the incurrence of substantial costs and subject us or our licensees to significant liabilities, each of which could severely harm our business.

Plaintiffs in IP cases often seek injunctive relief. Any IP litigation commenced against our licensees could force them to take actions that could be harmful to their business and thus to our royalties, including the following:

stop selling their products that incorporate or otherwise use technology that contains our allegedly infringing IP;

attempt to obtain a license to the relevant third-party IP, which may not be available on reasonable terms or at all; or

attempt to redesign their products to remove our allegedly infringing IP to avoid infringement of the third-party IP.

If our licensees are forced to take any of the foregoing actions, they may be unable to manufacture and sell their products that incorporate our technology at a profit or at all. Furthermore, the measure of damages in IP litigation can be complex, and is often subjective or uncertain. If our licensees were to be found liable for infringement of proprietary rights of a third party, the amount of damages they might have to pay could be substantial and is difficult to predict. Decreased sales of our licensees' products incorporating our technology would adversely affect our royalty revenues under existing licenses. Any necessity to procure rights to the third-party technology might cause our existing licensees to renegotiate the royalty terms of their license with us to compensate for this increase in their cost of production or, in certain cases, to terminate their license with us entirely. Were this renegotiation to occur, certain of our license agreements that contain most favored nation provisions, requiring that we offer at least as favorable terms to the holder of such a license as we offer to any other licensee, would be affected and we would also receive reduced royalties from those licenses. These developments would also harm our ability to compete for new licensees and would adversely affect the terms of the royalty arrangements we could enter into with any new licensees.

As is commonplace in technology companies, we employ individuals who were previously employed at other technology companies. To the extent our employees are involved in research areas that are similar to those areas in which they were involved at their former employers, we may be subject to claims that such employees or we have, inadvertently or otherwise, used or disclosed the alleged trade secrets or other proprietary information of the former employers. Litigation may be necessary to defend against such claims. The costs associated with these actions or the loss of rights critical to our or our licensees' business could negatively impact our revenues or cause our business to fail.

If we cannot obtain and maintain appropriate patent and other intellectual property rights protection for our P-OLED technology, our business will suffer.

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

The value to us of our P-OLED and related technologies is dependent on our ability to secure and maintain appropriate patent and other IP rights protection. Although we own or license many patents covering our technology that have already been issued, there can be no assurance that additional patents applied for will be obtained, or that any of these patents, once issued, will afford commercially significant protection for our technology, or will be found valid if challenged. Moreover, we have not obtained patent protection for some of our technology in all foreign countries in which P-OLED displays or materials might be manufactured or sold. In any event, the patent laws and enforcement regimes of other countries may differ from those of the United States as to the patentability of our P-OLED and related technologies and the degree of protection afforded.

The strength of our current IP position results primarily from the essential nature of our fundamental patents covering the P-OLED device and its manufacturing process and electroluminescent devices containing conjugated polymers. These patents expire in 2010 and 2011. While we hold a wide range of additional patents and patent applications whose expiration dates extend (and in the case of patent applications, will extend) well beyond 2011, many of which are also of key importance in the OLED industry, none are of an equally essential nature as our fundamental patents, and therefore our competitive position after 2011 may be less certain.

We may become engaged in litigation to protect or enforce our patent and other IP rights or in International Trade Commission proceedings to abate the importation of goods that would compete unfairly with those of our licensees. In addition,

Table of Contents

we may have to participate in interference or reexamination proceedings before the U.S. Patent and Trademark office, or in opposition, nullity or other proceedings before foreign patent offices, with respect to our patents or patent applications. All of these actions would place our patents and other IP rights at risk and may result in substantial costs to us as well as a diversion of management attention. Moreover, if successful, these actions could result in the loss of patent or other IP rights protection for the key P-OLED and related technologies on which our business strategy depends.

In addition, we rely in part on unpatented proprietary technology, and others may independently develop the same or similar technology or otherwise obtain access to our unpatented technology. To protect our trade secrets, know-how and other proprietary information, we require employees, consultants, financial advisors and strategic partners to enter into confidentiality agreements. These agreements may not ultimately provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of those trade secrets, know-how or other proprietary information. In particular, we may not be able to fully or adequately protect our proprietary information as we conduct discussions with potential strategic partners. If we are unable to protect the proprietary nature of our technology, it will harm our business.

We are exposed to currency fluctuations, which may have an adverse effect on us.

A substantial majority of our licensing revenues are denominated in U.S. dollars. These licensing revenues include royalties based on revenues or production costs of our licensees that may be denominated in U.S. dollars or other currencies. Where such revenues or production costs of our licensees are denominated in other currencies, they are converted to U.S. dollars for the purpose of calculating any licensing royalties due to us. Our licensing royalty revenues may decrease as a result of any appreciation of the U.S. dollar against these other currencies. The majority of our current expenditures are incurred in British pounds in order to fund our operations in the United Kingdom. If the U.S. dollar depreciates versus the British pound, additional U.S. dollars will be required to fund our operations in the United Kingdom.

We take out forward currency contracts to cover future projected currency conversions. We engage in hedging activities, but there is no guarantee that these will be successful in reducing the risks to us of our exposure to foreign currency fluctuations and these fluctuations may adversely affect our results of operations, financial condition or cash flows.

We are a holding company with no significant independent operations, and we therefore rely on our subsidiaries to make funds available to us.

We are a holding company with no significant independent operations and no significant assets other than the capital stock of our subsidiaries. We, therefore, will be dependent upon the receipt of dividends or other distributions from our subsidiaries. The declaration of dividends by our subsidiaries will be subject to the discretion of their boards of directors and will depend on a number of factors, including their results of operations, financial condition, liquidity requirements and indebtedness and restrictions imposed by applicable law. Our inability to receive funds from our operating subsidiaries would adversely affect our ability to meet our obligations and to make dividend payments and other distributions, if any, to holders of our common stock.

Due to our significant level of international operations, we are subject to international operational, financial, legal and political risks which may negatively impact our operations.

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

A substantial part of our operations are in the United Kingdom, and many of our licensees have a majority of their operations in countries other than the United States. Risks associated with our doing business outside of the United States include:

compliance with a wide variety of foreign laws and regulations, particularly labor, environmental and other laws and regulations that govern our operations in the United Kingdom;

legal uncertainties regarding taxes, tariffs, quotas, export controls, export licenses and other trade barriers;

economic instability in the countries of our licensees, particularly in the Asia-Pacific region, causing delays or reductions in orders for their products and therefore our royalties;

political instability in the countries in which our licensees operate, particularly in South Korea relating to its disputes with North Korea and in Taiwan relating to its disputes with China;

difficulties in collecting accounts receivable and longer accounts receivable payment cycles; and

potentially adverse tax consequences.

Any of these factors could harm our or our licensees' existing international operations and business and impair our or our licensees' ability to continue expanding into international markets.

Table of Contents

A significant portion of our assets, certain of our directors and most of our executive officers are located outside of and are not residents of the United States. As a result, it may be difficult or impossible for U.S. investors to effect service of process upon such non-resident directors or officers within the United States or to realize against them in the United States upon judgment of courts of the United States predicated upon civil liabilities under the federal securities laws of the United States or the securities or blue sky laws of any state within the United States. In addition, courts of another country may not enforce judgments of United States courts obtained in actions against us, our directors or our officers predicated upon the civil liability provisions of the United States federal securities laws or the securities or blue sky laws of any state within the United States or enforce, in original actions, liabilities against us, our directors or our officers predicated upon the United States federal securities laws or any state securities or blue sky laws.

Our agreements with our licensees and joint development partners are subject to regulation by the European Commission, and particularly to antitrust provisions of such regulations, which could result in fines to us or in those agreements being declared void in whole or in part, either of which would negatively impact our revenues.

Our IP licensing agreements and joint development agreements fall under the antitrust provisions of the Treaty of Rome, and related regulations. While our display license agreements are generally non-exclusive and without geographic restriction, and while our licensing and joint development relationships generally represent lower market shares than would result in the application of the regulations' remedies, any violation of the regulations could result in the anti-competitive provisions or the entire relevant agreement being declared void and unenforceable. In addition, we could be subject to a fine of up to 10% of the income of our worldwide group.

If we cannot keep our key employees or hire other talented persons as we grow, our business might not succeed.

Our performance is substantially dependent on the continued services of senior management, particularly our Chief Executive Officer, who has been principally responsible for establishing and maintaining many of our most important commercial relationships, and our Chief Technology Officer, who was one of the inventors of our fundamental P-OLED technology and helps direct our technology development program, and on our ability to offer competitive salaries and benefits to our employees. We do not carry key person life insurance on any of our senior management or other key personnel. If we lose the services of key senior management personnel, we may not be able to find suitable replacements in a timely manner or at all, which would seriously harm our business. Additionally, competition for highly skilled technical, managerial and other personnel is intense. We might not be able to attract, hire, train, retain and motivate the highly skilled managers and employees that we might need to be successful. If we fail to attract and retain the necessary technical and managerial personnel, our business will suffer and might fail. We currently have fewer than 130 employees, and we may encounter increasing difficulty in attracting enough qualified personnel as our operations expand and the demand for their services increases. This difficulty could impede the attainment of our research and development objectives and cause our business strategy to fail.

Our Technology Development Center and our research and development laboratories are critical to our success.

Our Technology Development Center in Godmanchester, England and our research and development laboratories are critical to our success. These facilities currently house our principal research, development, engineering and design operations. Our research and development activities involve the controlled use of a small amount of hazardous substances as well as other potentially harmful materials, waste and chemicals, which could cause interruption of our research and development efforts or injury to our employees, resulting in liabilities under federal, state, local or foreign laws or regulations governing the use, storage and disposal of these materials. While to date we have not had any issues relating to the use of hazardous materials, any event that causes a disruption of the operation of these facilities for even a relatively short period of time would adversely affect our ability to conduct research and development operations and to provide technical support for our licensees, which would negatively affect our revenues.

If we acquire or invest in any companies or technologies or enter into joint ventures in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value or have an adverse effect on our results of operations.

We intend to expand our business primarily through internal growth, but from time to time we may consider strategic acquisitions or other investments, as well as joint ventures, to develop P-OLED materials and displays. Any future acquisition, investment or joint venture would involve numerous risks, including:

potential disruption of our ongoing business and distraction of management;

difficulty integrating the operations and products of the acquired business;

unexpected expenses related to technology integration;

Table of Contents

exposure to unknown liabilities, including litigation against the companies we may acquire or in which we invest or the joint ventures we form;

future losses or failure of the acquired business resulting in the impairment of the carrying value of any investment;

additional costs due to differences in culture, geographic locations and duplication of key talent; and

potential loss of key employees or customers of the acquired company.

We have made investments in Add-Vision, which we valued at \$1.1 million and Micro-Emissive Displays, or MED, which we currently value at \$0.9 million. These types of investments may result in acquisition-related accounting charges that may affect our balance sheet and results of operations going forward. We may not be successful in addressing these risks or any other problems encountered in connection with any acquisitions or other investments. For example, in June 2005 MED issued a trading statement to the London Stock Exchange in which it reported poor yield in its manufacturing process and a delay in commercialization of its products until 2006. If MED is not successful in achieving its business objectives the value of their stock may fall and we might have to write down the value of our investment.

In addition, the failure to consummate any such acquisition, investment or joint venture after it has been announced and negotiations commenced may have an adverse effect on our business, including the diversion of our management's time and attention, the negative impact on our business prospects or a decline in the market price for shares of our common stock. For example, in May 2005, we announced our intention to form a joint venture with Sumitomo Chemical of Japan to develop and sell P-OLED materials. We already have a strong research relationship with Sumitomo and we believe that the strengthening of our relationship through the formation of this joint venture will be the most effective way of accelerating P-OLED material development in the future. Although we have signed a non-binding memorandum of understanding with Sumitomo to form this joint venture and are currently negotiating the detailed contractual arrangements, there can be no guarantee that we will conclude these negotiations successfully. Failure to conclude these negotiations successfully could have an adverse impact on us due to the possible adverse publicity and diversion of management time.

Risks Relating to our Financial Results

Our operating results may have significant period-to-period fluctuations, which would make it difficult to predict our future performance.

Due to the current stage of commercialization of our technology and the significant development and manufacturing objectives that we and our licensees must achieve to be successful, our quarterly operating results will be difficult to predict and may vary significantly from quarter to quarter.

We believe that period-to-period comparisons of our operating results are not a reliable indicator of our future performance at this time. Among other factors affecting our period-to-period results, our license fees often consist of large one-time payments in the period during which we enter into a new license, followed by smaller recurring payments in later periods, resulting in significant fluctuations in our revenues. If, in some future period, our operating results or business outlook fall below the expectations of securities analysts or investors, our stock price would be likely to decline and investors in our common stock may not be able to resell their shares at or above the initial public offering price. Broad market, industry and global economic factors may also materially reduce the market price of our common stock, regardless of our operating performance.

The market price of our common stock may be highly volatile.

The market price of our common stock has been highly volatile, as has been the case with the securities of many other emerging growth companies. Factors such as the following may have a significant impact on the market price of our common stock in the future:

our operating results and capital resources;

announcements by us or our competitors of technological developments, new product applications or license arrangements; and

other factors affecting the FPD and related industries in general.

In addition, the stock market in general has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies like us.

Table of Contents

A few stockholders own significant amounts of our common stock. If the ownership of our common stock continues to be highly concentrated, it will prevent you and other stockholders from influencing significant corporate decisions.

Affiliates of Kelso & Company, or Kelso, and affiliates of Hillman Capital Corporation, or Hillman Capital, beneficially own, respectively, approximately 44% and 22% of the outstanding shares of our common stock. Kelso is also represented on our board. As a result, Kelso and Hillman Capital exercise significant control over matters requiring stockholder approval. The concentrated holdings of Kelso and Hillman Capital may result in the delay or deterrence of possible changes in control of our company, which may negatively impact the market price of our common stock. The interests of these and other of our existing stockholders may conflict with the interests of our other stockholders.

Because we do not intend to pay dividends, stockholders will benefit from an investment in our common stock only if it appreciates in value.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain our future earnings, if any, to finance the operation and growth of our business and do not expect to pay any cash dividends in the foreseeable future. As a result, the success of an investment in our common stock will depend upon any future appreciation in its value. There is no guarantee that our common stock will appreciate in value or even maintain the price at which stockholders have purchased their shares.

Our share price may decline due to the large number of shares eligible for future sale.

Sales of substantial amounts of common stock, or the possibility of such sales, may adversely affect the price of our common stock and impede our ability to raise capital through the issuance of equity securities.

As of September 30, 2005, there were 19,485,483 shares of common stock outstanding. In addition, we may in the future issue additional shares of our common stock that might become freely salable, including shares that may be issued upon the exercise of warrants and options. The 2,500,000 shares of common stock which were sold in our initial public offering are freely transferable without restriction or further registration under the Securities Act of 1933. 2,331,069 shares are freely tradeable pursuant to Rule 144(k) under the Securities Act and another 14,654,414 shares are eligible for resale under Rule 144, subject to the volume, manner of sale, holding period and other limitations of Rule 144.

In addition, stockholders currently representing all of the shares of our common stock have certain registration rights. We have filed a registration statement covering shares of our common stock issuable under our incentive plans. Once we register these shares, they can be freely sold.

The price of our common stock can be expected to decrease if we issue additional shares of our common stock that might be or become freely salable, including shares that would be issued pursuant to our plans and other agreements, or upon the exercise of warrants or options.

We can issue shares of preferred stock that may adversely affect your rights as a shareholder of our common stock.

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

Our certificate of incorporation authorizes us to issue up to 46,667 shares of preferred stock with designations, rights and preferences determined from time-to-time by our board of directors. Accordingly, our board of directors is empowered, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting or other rights superior to those of stockholders of our common stock. For example, an issuance of shares of preferred stock could:

adversely affect the voting power of the stockholders of our common stock;

make it more difficult for a third party to gain control of us;

discourage bids for our common stock at a premium;

limit or eliminate any payments that the stockholders of our common stock could expect to receive upon our liquidation; or

otherwise adversely affect the market price of our common stock.

We may issue additional shares of authorized preferred stock at any time in the future.

We are incurring increased costs as a result of being a public company.

We are facing increased legal, accounting, administrative and other costs and expenses as a public company that we did not incur as a private company. The Sarbanes-Oxley Act of 2002, as well as new rules subsequently implemented by the SEC, the Public Company Accounting Oversight Board and the Nasdaq National Market require changes in the corporate governance

Table of Contents

practices of public companies. These new rules and regulations are resulting in both a significant initial cost, as we initiate certain internal controls and other procedures designed to comply with the requirements of the Sarbanes-Oxley Act, and in an ongoing increase in our legal, audit and financial compliance costs, which is diverting management attention from operations and strategic opportunities and to making legal, accounting and administrative activities more time-consuming and costly. We are incurring substantially higher costs to maintain directors and officers insurance. We are currently experiencing increased annual costs following our initial public offering and we expect to continue to incur additional costs during 2005 and future years in implementing and verifying internal control procedures as required by section 404 of the Sarbanes-Oxley Act of 2002, and the rules and regulations thereunder, and in connection with preparing our financial statements on a timely basis to meet the SEC's requirements.

In addition, we are required under these new rules and regulations to attract and retain additional independent directors to serve on our board of directors. We may encounter difficulty in attracting qualified independent directors to serve on our board of directors and our audit committee, in particular, within the phase-in periods specified in these rules. If we fail to attract and retain independent directors within these phase-in periods, we may be subject to SEC enforcement proceedings and delisting by the Nasdaq National Market.

Our certificate of incorporation, bylaws and Delaware law may discourage takeovers and business combinations that our stockholders might consider in their best interests.

Provisions in our certificate of incorporation and by-laws may delay, defer, prevent or render more difficult a takeover attempt that our stockholders might consider in their best interests. These provisions may prevent our stockholders from receiving the benefit from any premium to the market price of our common stock offered by a bidder in a takeover context. Even in the absence of a takeover attempt, the existence of these provisions may adversely affect the prevailing market price of our common stock if they are viewed as discouraging takeover attempts in the future.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

A substantial majority of our licensing revenues are denominated in U.S. dollars. These licensing revenues include royalties based on revenues or production costs of our licensees that may be denominated in U.S. dollars or other currencies. Where such revenues or production costs of our licensees are denominated in other currencies, they are converted to U.S. dollars for the purpose of calculating any licensing royalties due to us. Our licensing royalty revenues may decrease as a result of any appreciation of the U.S. dollar against these other currencies.

The majority of our current expenditures are incurred in British pounds in order to fund our operations in the United Kingdom. If the U.S. dollar depreciates versus the British pound, additional U.S. dollars will be required to fund our operations in the United Kingdom. For example, a change in the rate at which we exchange U.S. dollars to British pounds from 1.8 to 1.9 would, at the current rate of expenditure, cost us approximately an additional \$1 million per year.

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet, and management believes that they meet, reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that, subject to the limitations noted above, our disclosure controls and procedures were effective to ensure that material information relating to us, including our consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

Table of Contents

(b) *Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with the evaluation described in Item 4(a) above that occurred during the quarter ended September 30, 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

When we acquired Opsys Limited in December 2004, there was an arbitration action being conducted in California to settle a claim by a former employee in the amount of \$0.3 million. We believe that this will be concluded favorably to us without any material effect on our results of operations. In the event that we lose the arbitration or settle this claim, shares currently held in escrow and owned by the former shareholders of Opsys will be forfeited to the value of the award or settlement.

In January 2005, Sunnyside Development Company filed a complaint against Opsys Limited and a company named by Sunnyside Development as CDT Limited, which is presumably intended to refer to one of our subsidiaries, Cambridge Display Technology Limited, in California Supreme Court alleging breach of contract and fraud arising out of an alleged property lease agreement between Opsys Limited and Sunnyside Development. Cambridge Display Technology Limited was not party to the lease. Sunnyside Development seeks compensatory damages that it claims exceed \$10 million and punitive damages in the amount of \$25 million. In October 2002, Opsys Limited and Sunnyside Development executed an Assignment of Lease and Consent of Lessor, which included a release of Opsys Limited by Sunnyside Development. In February 2005, the action was removed to the United States District Court for the Northern District of California. We believe that the claim have no merit and have filed a motion to dismiss the case. In April 2005, the United States District Court dismissed all the claims against CDT Limited and the claim for fraud against Opsys Limited, but gave Sunnyside permission to amend all its claims. On May 11, 2005, Sunnyside filed an amended complaint reasserting a fraud claim against both Opsys Limited and CDT Ltd. We made a further application to dismiss the claims and on August 8, 2005 the amended claims against CDT Limited and Opsys Limited were dismissed with prejudice and with no leave to amend, except for the claim for breach of contract against Opsys Limited which is still being pursued by Sunnyside Development.

Item 2. Unregistered Sales of Equity Securities and Used of Proceeds

At December 31, 2004 we had not used any of the \$25.0 million proceeds of our initial public offering in December 2004. At September 30, 2005, we had used \$19.3 million of these proceeds, \$1.6 million for the acquisition of fixed assets, \$1.1 million for costs related to the acquisitions of CDT Oxford and Opsys Limited and the settlement of the liabilities of Opsys Limited, \$1.1 million for the acquisition of an equity interest in Add-Vision, \$1.7 million for loans to Litrex and \$13.8 million for working capital requirements. We expect to use the remaining \$5.7 million for general corporate purposes, including working capital and capital expenditures. We may also use a further portion of the net proceeds to acquire businesses, technologies or other assets.

Item 6. Exhibits**Exhibit**

| Number | Description of Document |
|---------------|---|
| 10.49 | Second Sale Stock Purchase Agreement, dated November 4, 2005, between Cambridge Display Technology, Inc., Ulvac Inc. and Litrex Corporation |
| 10.50 | Agreement, dated November 3, 2005, between Cambridge Display Technology Inc, and Koninklijke Philips Electronics N.V |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350) |

Edgar Filing: Cambridge Display Technology, Inc. - Form 10-Q

- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)
- 32.1 *Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)
- 32.2 *Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)
-

* In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the material contained in Exhibits 32.1 and 32.2 is furnished and not deemed filed with the SEC, and is not to be incorporated by reference into any filing of the registrant under the Securities Act of 1933 or the Exchange Act whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing, except to the extent that the registrant specifically incorporates it by reference.

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 its behalf by the undersigned thereunto duly authorized.

CAMBRIDGE DISPLAY TECHNOLOGY, INC.

Dated: November 9, 2005

By: /s/ DAVID FYFE

DAVID FYFE

Chief Executive Officer

(Principal Executive Officer)

Dated: November 9, 2005

By: /s/ DANIEL ABRAMS

DANIEL ABRAMS

Chief Financial Officer

(Principal Financial Officer)