

NOCOPI TECHNOLOGIES INC/MD/

Form 10-Q

November 16, 2009

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**United States
Securities and Exchange Commission
Washington, D.C. 20549
Form 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2009.

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: 000-20333

NOCOPI TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

MARYLAND

87-0406496

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

9C Portland Road, West Conshohocken, PA

19428

(Address of principal executive offices)

(Zip Code)

(610) 834-9600

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 54,072,296 shares of common stock, par value \$.01, as of November 1, 2009.

NOCOPI TECHNOLOGIES, INC.
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Nocopi Technologies, Inc.
*Statements of Operations**
(unaudited)

	Three Months ended		Nine Months ended	
	September 30		September 30	
	2009	2008	2009	2008
Revenues				
Licenses, royalties and fees	\$ 81,400	\$ 105,600	\$ 247,200	\$ 409,700
Product and other sales	94,600	92,300	229,900	297,500
	176,000	197,900	477,100	707,200
Cost of revenues				
Licenses, royalties and fees	22,300	21,900	65,600	68,800
Product and other sales	73,900	63,800	187,300	202,000
	96,200	85,700	252,900	270,800
Gross profit	79,800	112,200	224,200	436,400
Operating expenses				
Research and development	41,000	41,000	124,100	123,100
Sales and marketing	67,400	49,500	237,000	183,000
General and administrative	90,400	158,100	288,300	407,000
	198,800	248,600	649,400	713,100
Net loss from operations	(119,000)	(136,400)	(425,200)	(276,700)
Other income (expenses)				
Reversal of accounts payable and accrued expenses			69,100	37,500
Interest income		500		2,800
Interest expense and bank charges	(1,100)	(500)	(2,100)	(1,600)
	(1,100)		67,000	38,700
Net loss before income taxes	(120,100)	(136,400)	(358,200)	(238,000)
Income taxes				900
Net loss	\$ (120,100)	\$ (136,400)	\$ (358,200)	\$ (238,900)
Basic and diluted net loss per common share	\$ (.00)	\$ (.00)	\$ (.01)	\$ (.00)

Basic and diluted weighted average common shares outstanding	53,447,295	52,285,837	52,758,059	52,281,948
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* See accompanying notes to these financial statements.

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Nocopi Technologies, Inc.
*Balance Sheets**

	September 30 2009 (unaudited)	December 31 2008 (audited)
<i>Assets</i>		
Current assets		
Cash and cash equivalents	\$ 35,800	\$ 87,200
Accounts receivable less \$5,000 allowance for doubtful accounts	100,500	167,100
Inventory	66,300	97,200
Prepaid and other	17,000	35,900
Total current assets	219,600	387,400
Fixed assets		
Leasehold improvements	72,500	72,500
Furniture, fixtures and equipment	184,900	184,900
	257,400	257,400
Less: accumulated depreciation and amortization	240,000	233,100
	17,400	24,300
Total assets	\$ 237,000	\$ 411,700
<i>Liabilities and Stockholders Equity (Deficiency)</i>		
Current liabilities		
Line of credit	\$ 100,000	
Accounts payable	253,000	\$ 272,200
Accrued expenses	129,000	117,100
Deferred revenue	10,900	10,000
Total current liabilities	492,900	399,300
Stockholders equity (deficiency)		
Common stock, \$.01 par value		
Authorized - 75,000,000 shares		
Issued and outstanding		
2009 - 53,551,462 shares; 2008 - 52,285,837 shares	535,500	522,900
Paid-in capital	12,209,600	12,132,300
Accumulated deficit	(13,001,000)	(12,642,800)
Total stockholders equity (deficiency)	(255,900)	12,400
Total liabilities and stockholders equity (deficiency)	\$ 237,000	\$ 411,700

* **See
accompanying
notes to these
financial
statements.**

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Nocopi Technologies, Inc.
Statements of Cash Flows*
(unaudited)

	Nine Months ended September 30	
	2009	2008
Operating Activities		
Net loss	\$ (358,200)	\$ (238,900)
Adjustments to reconcile net loss to cash used in operating activities		
Depreciation and amortization	6,900	9,900
Reversal of accounts payable and accrued expenses	(69,100)	(37,500)
Compensation expense stock option grants	13,900	76,100
	(406,500)	(190,400)
(Increase) decrease in assets		
Accounts receivable	66,600	93,300
Inventory	30,900	(7,300)
Prepaid and other	18,900	24,100
Increase (decrease) in liabilities		
Accounts payable and accrued expenses	61,800	(24,400)
Accrued income taxes		(800)
Deferred revenue	900	5,000
	179,100	89,900
Net cash used in operating activities	(227,400)	(100,500)
Investing Activities		
Additions to fixed assets		(3,400)
Net cash used in investing activities		(3,400)
Financing Activities		
Net borrowings under line of credit	100,000	
Issuance of common stock	76,000	
Exercise of warrants		2,200
Net cash provided by financing activities	176,000	2,200
Decrease in cash and cash equivalents	(51,400)	(101,700)
Cash and cash equivalents at beginning of year	87,200	263,600
Cash and cash equivalents at end of period	\$ 35,800	\$ 161,900

Supplemental disclosure of cash flow information

Cash paid for interest	\$	1,200	\$	2,700
Cash paid for income taxes			\$	2,000

* See accompanying notes to these financial statements.

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NOCOPI TECHNOLOGIES, INC.
NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

Note 1. Financial Statements

The accompanying unaudited condensed financial statements have been prepared by Nocopi Technologies, Inc. (the Company). These statements include all adjustments (consisting only of normal recurring adjustments) which management believes necessary for a fair presentation of the statements and have been prepared on a consistent basis using the accounting policies described in the summary of Accounting Policies included in the Company's 2008 Annual Report on Form 10-K. Certain financial information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the accompanying disclosures are adequate to make the information presented not misleading. The Notes to Financial Statements included in the 2008 Annual Report on Form 10-K should be read in conjunction with the accompanying interim financial statements. The interim operating results for the three and nine months ended September 30, 2009 may not be necessarily indicative of the operating results expected for the full year.

Note 2. Going Concern

Since its inception, the Company has incurred significant losses and, as of September 30, 2009, had accumulated losses of \$13,001,000. For the nine months ended September 30, 2009, the Company had a net loss from operations of \$425,200 and negative cash flow from operations of \$227,400. At September 30, 2009, the Company had negative working capital of \$273,300 and a stockholders' deficiency of \$255,900. For the year ended December 31, 2008, the Company's net loss from operations was \$362,300. Due in part to the recession that has and is continuing to negatively impact the country's economy, the Company, which is substantially dependent on its licensees to generate licensing revenues, may incur further operating losses and experience negative cash flow in the future. Achieving profitability and positive cash flow depends on the Company's ability to generate and sustain significant increases in revenues and gross profits from its traditional business and its retail loss prevention activities. There can be no assurances that the Company will be able to generate sufficient revenues and gross profits to return to and sustain profitability and positive cash flow in the future.

In 2008, the Company negotiated a \$100,000 revolving line of credit with a bank as an additional potential source of capital. During the first nine months of 2009, the Company borrowed the entire \$100,000 under the line of credit to fund its operating activities. There can be no assurances that the bank will continue to make the line of credit available in the future. During the first nine months of 2009, the Company raised \$76,000 in a private placement whereby 1,265,625 shares of the Company's common stock were sold to three non-affiliated individual investors. Management of the Company is continuing to seek potential investors to fund investments needed to increase its operating revenues to levels that will sustain its operations, to fund new sales and marketing activities and to fund operating deficits that it anticipates will continue until revenues from traditional product lines increase and revenues from new product initiatives can be realized. There can be no assurances that the Company will be successful in obtaining sufficient additional capital, or if it does, that the additional capital will enable the Company to impact its revenues so as to have a material positive effect on the Company's operations and cash flow. The Company believes that without additional capital, whether in the form of debt, equity or both, it may be forced to cease operations in the near future.

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Note 3. Stock Based Compensation

The Company follows FASB ASC 718, Stock Compensation, and uses the Black-Scholes option pricing model to calculate the grant-date fair value of an award.

In February 2009, the Board of Directors of the Company, under the Company's 1999 Stock Option Plan, granted options to acquire 200,000 shares of its common stock to five employees of the Company, options to acquire 75,000 shares of its common stock to two consultants and options to acquire 50,000 shares of its common stock to an officer of the Company at \$.12 per share. The options vest after one year and expire after five years. In accordance with the fair value method as described in accounting requirements of FASB ASC 718, compensation expense of approximately \$22,900 is being recognized over the vesting period of the options through February 2010 to account for the cost of services received by the Company in exchange for the grant of stock options. During the three months and nine months ended September 30, 2009, compensation expense of approximately \$6,000 and \$13,900, respectively, was recognized. As of September 30, 2009, the unrecognized portion of compensation expense was approximately \$9,000.

On April 30, 2008, under the Company's directors' option plan (the Plan), options to acquire 100,000 shares of the Company's common stock were granted to each of the five members of the Board of Directors of the Company, including one member who is also an executive officer of the Company, at \$.45 per share. Under the terms of the Plan, the options (i) vested on January 1, 2009 and (ii) will expire five years from the date of grant. In accordance with the fair value method as described in accounting requirements of FASB ASC 718, compensation expense of approximately \$121,700 was recognized during 2008 to account for the cost of employee and director services received by the Company in exchange for the grant of stock options. During the three months and nine months ended September 30, 2008, compensation expense of approximately \$45,600 and \$76,100, respectively, was recognized.

The Company's 1999 Stock Option Plan terminated in February 2009 and no further stock options can be granted under the plan; however, options granted before the termination date may be exercised through their expiration date.

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The following table summarizes all stock option activity of the Company since December 31, 2008:

	Number of Shares	Exercise Price		Weighted Average Exercise Price
Outstanding options December 31, 2008	2,250,000	\$.10 to \$.45	\$.23
Issued	325,000	\$.12	\$.12
Canceled	950,000	\$.17	\$.17
Outstanding options September 30, 2009	1,625,000	\$.10 to \$.45	\$.24
Weighted average remaining contractual life (years)	2.54			
Exercisable options September 30, 2009	1,300,000	\$.10 to \$.45	\$.27
Weighted average remaining contractual life (years)	2.07			

Note 4. Line of Credit

In August 2008, the Company negotiated a \$100,000 revolving line of credit with a bank to provide a source of working capital. The line of credit is secured by all the assets of the Company and bears interest at the bank's prime rate plus .5%. At September 30, 2009, the interest rate applicable to the Company's line of credit was 3.75%. The line of credit is subject to an annual review and quiet period. The Company presently is required to pay interest only on borrowings under the line of credit. During the nine months ended September 30, 2009, the Company borrowed the entire \$100,000 available under the line of credit.

Note 5. Stockholders' Equity (Deficiency)

During the first nine months of 2009, the Company sold 1,265,625 shares of its common stock to three non-affiliated investors for a total of \$76,000 pursuant to a private placement. During the first nine months of 2008, a non-affiliated warrant holder exercised warrants to acquire 10,000 shares of common stock of the Company at \$.22 per share.

Note 6. Other Income (Expenses)

Other income (expenses) includes, for the nine months ended September 30, 2009, the reversal of \$69,100 of accounts payable related to invoices received from 2001 through 2003 from a business for consulting services that the Company, with legal counsel, has determined to be no longer statutorily payable as the statute of limitations to bring a claim has expired. Other income (expenses) included, for the nine months ended September 30, 2008, the reversal of \$37,500 of accounts payable and accrued expenses that the Company, with legal counsel, determined to be no longer statutorily payable as the statute of limitations to bring a claim had expired.

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There is no income tax benefit for the three months and nine months ended September 30, 2009 and September 30, 2008 because the Company has determined that the realization of the net deferred tax asset is not assured. The Company has created a valuation allowance for the entire amount of such benefits. The Company recorded an income tax expense of \$900 in the nine months ended September 30, 2008 for certain state income taxes due for 2007 in excess of the tax liability recorded in that year.

There was no change in unrecognized tax benefits during the period ended September 30, 2009 and there was no accrual for uncertain tax positions as of September 30, 2009.

Tax years from 2006 through 2008 remain subject to examination by U.S. federal and state jurisdictions.

Note 8. Loss per Share

In accordance with FASB ASC 260, Earnings per Share, basic earnings (loss) per common share is computed using net earnings divided by the weighted average number of common shares outstanding for the periods presented. Diluted earnings per common share assumes that outstanding common shares were increased by shares issuable upon exercise of those stock options and warrants for which the market price exceeds the exercise price, less shares that could have been purchased by the Company with related proceeds. Because the Company reported a net loss for the three months and nine months ended September 30, 2009 and September 30, 2008, common stock equivalents, consisting of stock options and warrants, were anti-dilutive.

Note 9. Major Customer and Geographic Information

The Company's revenues, expressed as a percentage of total revenues, from non-affiliated customers that equaled 10% or more of the Company's total revenues were:

	Three Months ended September 30		Nine Months ended September 30	
	2009	2008	2009	2008
Customer A	26%	38%	32%	45%
Customer B	29%	23%	26%	22%
Customer C	18%	23%	18%	18%

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The Company's non-affiliate customers whose individual balances amounted to more than 10% of the Company's net accounts receivable, expressed as a percentage of net accounts receivable, were:

	September 30 2009	December 31 2008
Customer A	45%	65%
Customer B	28%	
Customer C	22%	28%

The Company performs ongoing credit evaluations of its customers and generally does not require collateral. The Company also maintains allowances for potential credit losses.

The Company's revenues by geographic region are as follows:

	Three Months ended September 30		Nine Months ended September 30	
	2009	2008	2009	2008
North America	\$ 125,500	\$ 152,100	\$ 352,200	\$ 547,400
Other	50,500	45,800	124,900	159,800
	\$ 176,000	\$ 197,900	\$ 477,100	\$ 707,200

Note 10. Subsequent Event

In early October 2009, the Company sold 260,417 shares of its common stock to a non-affiliated investor for \$25,000 and 260,417 shares of its common stock to William P. Curtis, Jr., a Director, for \$25,000 in a private placement.

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Item 2.

NOCOPI TECHNOLOGIES, INC.
Management's Discussion and Analysis
of Financial Condition and Results of Operations

Forward-Looking Information

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, regarding, among other things, anticipated improvements in operations, the Company's plans, earnings, cash flow and expense estimates, strategies and prospects, both business and financial. All statements other than statements of current or historical fact contained in this report are forward-looking statements. The words believe, expect, anticipate, should, plan, will, may, intend, estimate, potential, continue and similar expressions, as they relate to the Company, are intended to identify forward-looking statements.

The Company has based these forward-looking statements largely on its current expectations and projections about future events, financial trends, market opportunities, competition, and the adequacy of the Company's available cash resources, which the Company believes may affect its financial condition, results of operations, business strategy and financial needs. This Form 10-Q also contains forward-looking statements attributed to third parties. All such statements can be affected by inaccurate assumptions, including, without limitation, with respect to risks, uncertainties, anticipated operating efficiencies, new business prospects and the rate of expense increases. In light of these risks, uncertainties and assumptions, the forward-looking statements in this report may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements. For these reasons, and because of the uncertainty relating to the current financial crisis in today's economic environment and the potential reduction in demand for the Company's products, you should not consider this information to be a guarantee by the Company or any other person that its objectives and plans will be achieved. When you consider these forward-looking statements, you should keep in mind the Risk Factors and other cautionary statements set forth in this Item 2 and elsewhere in this Form 10-Q. The Company's forward-looking statements speak only as of the date made. The Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Condensed Financial Statements and related notes included elsewhere in this report as well as with the Company's audited Financial Statements and Notes thereto for the year ended December 31, 2008 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2009, and keeping in mind this entire cautionary statement regarding forward-looking information.

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Results of Operations

The Company's revenues are derived from (i) royalties paid by licensees of the Company's technologies, (ii) fees for the provision of technical services to licensees and (iii) the direct sale of (a) products incorporating the Company's technologies, such as inks, security paper and pressure sensitive labels, and (b) equipment used to support the application of the Company's technologies, such as ink-jet printing systems. Royalties consist of guaranteed minimum royalties payable by the Company's licensees and/or additional royalties, which typically vary with the licensee's sales or production of products incorporating the licensed technology. Technical services, in the form of on-site or telephone consultations by members of the Company's technical staff, may be offered to licensees of the Company's technologies. The consulting fees are billed at agreed upon per diem or hourly rates at the time the services are rendered. Service fees and sales revenues vary directly with the number of units of service or product provided.

The Company recognizes revenue on its lines of business as follows:

- a) License fees and royalties are recognized when the license term begins. Upon inception of the license term, revenue is recognized in a manner consistent with the nature of the transaction and the earnings process, which generally is ratably over the license term;
- b) Product sales are recognized (i) upon shipment of products; (ii) when the price is fixed or determinable and (iii) when collectability is reasonably assured; and
- c) Fees for technical services are recognized when (i) the service has been rendered; (ii) an arrangement exists; (iii) the price is fixed or determinable based upon a per diem or hourly rate; and (iv) collectability is reasonably assured.

The Company believes that, as fixed cost reductions beyond those it has achieved in recent years may not be achievable, its operating results are substantially dependent on revenue levels. Because revenues derived from licenses and royalties carry a much higher gross profit margin than other revenues, operating results are also substantially affected by changes in revenue mix.

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

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Revenues for the third quarter of 2009 were \$176,000 compared to \$197,900 in the third quarter of 2008, a decrease of \$21,900, or approximately 11%. Licenses, royalties and fees decreased by \$24,200, or approximately 23%, to \$81,400 in the third quarter of 2009 from \$105,600 in the third quarter of 2008. The decrease in licenses, royalties and fees is due primarily to lower licensing revenues derived from three licensees in the entertainment and toy products business and lower royalties from a licensee in the retail receipt and document fraud market resulting from the conversion of an exclusive license to a non-exclusive license at a lower royalty rate at the beginning of 2009 offset in part by revenues from two licenses signed in late 2008 and early 2009. The conversion to a non-exclusive license with this licensee in the retail receipt and document fraud market enables the Company to expand its presence in this market through the licensing of other printers who serve this market segment. During 2009, the Company has licensed four printers who sell security receipt products. Product and other sales increased by \$2,300, or approximately 2%, to \$94,600 in the third quarter of 2009 from \$92,300 in the third quarter of 2008. Sales of ink declined nominally in the third quarter of 2009 compared to the third quarter of 2008 but were more than offset by higher sales of security paper and retail loss prevention products in the third quarter of 2009 compared to the third quarter of 2008. Retail loss prevention products were not available for sale in the third quarter of 2008. The Company derived revenues of approximately \$98,500 from licensees and their printers in the entertainment and toy products market in the third quarter of 2009 compared to approximately \$119,600 in the third quarter of 2008.

For the first nine months of 2009, revenues were \$477,100, \$230,100, or approximately 33%, lower than revenues of \$707,200 in the first nine months of 2008. Licenses, royalties and fees of \$247,200 in the first nine months of 2009 were \$162,500, or approximately 40%, lower than \$409,700 in the first nine months of 2008, due primarily to the same factors that caused the revenue decline in the third quarter of 2009 compared to the third quarter of 2008. Product and other sales declined by \$67,600, or approximately 23%, to \$229,900 in the first nine months of 2009 from \$297,500 in the first nine months of nine months 2008. The lower level of ink sales in the first nine months of 2009 compared to the first nine months of 2008 is due primarily to lower ink requirements of the third party printers of the Company's major licensee in the entertainment and toy products business related to the licensee's declines in sales during the current period of economic decline. The Company derived revenues of approximately \$284,100 from licensees and their printers in the entertainment and toy products market in the first nine months of 2009 compared to approximately \$473,100 in the first nine months of 2008. Additionally, ink sales to the Company's formerly exclusive licensee in the retail receipt and document fraud market declined in the first nine months of 2009 compared to the first nine months of 2008. The Company also experienced a decline in sales of its security papers in the first nine months of 2009 compared to the first nine months of 2008.

The Company's gross profit decreased to \$79,800 in the third quarter of 2009 or approximately 45% of revenues from \$112,200 or approximately 57% of revenues in the third quarter of 2008. Licenses, royalties and fees have historically carried a higher gross profit than product and other sales, which generally consist of supplies or other manufactured products which incorporate the Company's technologies or equipment used to support the application of its technologies. These items (except for inks which are manufactured by the Company) are generally purchased from third-party vendors and resold to the end-user or licensee and carry a lower gross profit than licenses, royalties and fees. The lower gross profit in the third quarter of 2009 compared to the third quarter of 2008 results primarily from lower gross revenues from licenses, royalties and fees and product and other sales in the third quarter of 2009 compared to the third quarter of 2008.

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For the first nine months of 2009, the gross profit was \$224,200, or approximately 47% of revenues, compared to \$436,400, or approximately 62% of revenues, in the first nine months of 2008. The decrease in the gross profit in absolute dollars and as a percentage of revenues in the first nine months of 2009 compared to the first nine months of 2008 resulted from lower gross revenues of both licenses, royalties and fees and product and other sales in the first nine months of 2009 compared to the first nine months of 2008.

As the variable component of cost of revenues related to licenses, royalties and fees is a low percentage of these revenues and the fixed component is not substantial, period to period changes in revenues from licenses, royalties and fees can significantly affect both the gross profit from licenses, royalties and fees as well as the overall gross profit. Primarily due to the decrease in revenues from licenses, royalties and fees in the third quarter of 2009 compared to the third quarter of 2008, the gross profit from licenses, royalties and fees decreased to approximately 73% of revenues from licenses, royalties and fees in the third quarter of 2009 from approximately 79% in the third quarter of 2008 and to approximately 73% of revenues from licenses, royalties and fees in the first nine months of 2009 from approximately 83% in the first nine months of 2008.

The gross profit, expressed as a percentage of revenues, of product and other sales is dependent on both the overall sales volumes of product and other sales and on the mix of the specific goods produced and/or sold. As a result of both the mix of ink sales and lower margins on sales of certain loss prevention products sold in the third quarter of 2009 compared to the third quarter of 2008, the gross profit from product and other sales declined to approximately 22% of revenues in the third quarter of 2009 compared to approximately 31% of revenues from product and other sales in the third quarter of 2008. As both sales of ink and paper sales declined in the first nine months of 2009 compared to the first nine months of 2008, the gross profit from product and other sales declined to approximately 19% of revenues from product and other sales in the first nine months of 2009 compared to approximately 32% of revenues from product and other sales in the first nine months of 2008.

Research and development expenses of \$41,000 and \$124,100 in the third quarter and first nine months of 2009 were equal or comparable to \$41,000 and \$123,100 in the third quarter and first nine months of 2008.