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NOCOPI TECHNOLOGIES INC/MD/
Form 10QSB
May 16, 2005

U.S. Securities and Exchange Commission
Washington, D.C. 20549

Form 10-QSB

(Mark One)

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

For the quarterly period ended March 31, 2005.

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

For the transition period from _____ to _____

Commission file number 0-20333

NOCOPI TECHNOLOGIES, INC.
(Exact name of small business issuer as
specified in its charter)

MARYLAND
(State or other jurisdiction
of incorporation or organization)

87-0406496
(IRS Employer Identification No.)

9C Portland Road, West Conshohocken, PA 19428
(Address of principal executive offices)

(610) 834-9600
(Issuer's telephone number)

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of May 1, 2005: Common stock, par value \$.01 per share: 50,586,181 shares.

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

NOCOPI TECHNOLOGIES, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months ended March 31 2005	2004
	-----	-----
Revenues		
Licenses, royalties and fees	\$79,600	\$77,600
Product and other sales	42,500	63,000
	-----	-----
	122,100	140,600
Cost of sales		
Licenses, royalties and fees	28,800	31,900
Product and other sales	23,500	30,600
	-----	-----
	52,300	62,500
	-----	-----
Gross profit	69,800	78,100
Operating expenses		
Research and development	38,900	52,000
Sales and marketing	34,400	45,000
General and administrative (exclusive of legal expenses)	63,300	55,700
Legal expenses	20,500	33,400
	-----	-----
	157,100	186,100
	-----	-----
Loss from operations	(87,300)	(108,000)
Other income (expenses)		
Interest income	100	--
Interest and bank charges	(600)	(3,400)

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	-----	-----
	(500)	(3,400)
	-----	-----
Net loss	(\$87,800)	(\$111,400)
	=====	=====
Basic and diluted loss per common share	(\$.00)	(\$.00)
Weighted average common shares outstanding	50,586,181	45,972,241

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

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Nocopi Technologies, Inc.
Balance Sheet*
(unaudited)

	March 31
	2005

Assets	
Current assets	
Cash and cash equivalents	\$23,100
Accounts receivable less \$15,000 allowance	77,100
Arbitration settlement receivable	50,000
Prepaid and other	40,500

Total current assets	190,700
Fixed assets	
Leasehold improvements	71,200
Furniture, fixtures and equipment	476,200

	547,400
Less: accumulated depreciation	499,600

	47,800
Other assets	
Arbitration settlement receivable	50,000

Total assets	\$288,500
	=====
Liabilities and Stockholders' Deficiency	
Current liabilities	
Accounts payable	\$416,200
Accrued expenses	271,700
Deferred revenue	36,200

Total current liabilities	724,100
Stockholders' deficiency	
Common stock, \$.01 par value	
Authorized - 75,000,000 shares	
Issued and outstanding - 50,586,181 shares	505,900
Paid-in capital	11,497,400
Accumulated deficit	(12,438,900)

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	----- (435,600) -----
Total liabilities and stockholders' deficiency	\$288,500 =====

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

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

	Three Months ended March 31 2005	2004
	-----	-----
Operating Activities		
Net loss	(\$87,800)	(\$111,400)
Adjustment to reconcile net loss to cash used in operating activities		
Depreciation	4,200	5,100
	-----	-----
	(83,600)	(106,300)
(Increase) decrease in assets		
Accounts receivable	26,400	(14,200)
Arbitration settlement receivable	50,000	50,000
Prepaid and other	(11,300)	17,200
Increase (decrease) in liabilities		
Accounts payable and accrued expenses	6,300	(4,500)
Deferred revenue	11,300	(20,000)
	-----	-----
	82,700	28,500
	-----	-----
Net cash used in operating activities	(900)	(77,800)
Investing Activities		
Additions to fixed assets	--	(800)
	-----	-----
Net cash used in investing activities	--	(800)
	-----	-----
Decrease in cash and cash equivalents	(900)	(78,600)
Cash and cash equivalents - beginning of period	24,000	89,900
	-----	-----
Cash and cash equivalents - end of period	\$23,100	\$11,300
	=====	=====

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

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NOCOPI TECHNOLOGIES, INC.

NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

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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 2004 Annual Report on Form 10-KSB. 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 2004 Annual Report on Form 10-KSB should be read in conjunction with the accompanying interim financial statements. The interim operating results for the three months ended March 31, 2005 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 March 31, 2005, had accumulated losses of \$12,438,900. For the years ended December 31, 2004 and 2003, the Company's losses from operations were \$328,500 and \$441,300, respectively. In addition, the Company had negative working capital of \$533,400 at March 31, 2005. The Company may incur further operating losses and experience negative cash flow in the future. Achieving profitability and positive cash flow depends on the Company's ability to generate and sustain significant increases in revenues and gross profits from its traditional business. There can be no assurances that the Company will be able to generate sufficient revenues and gross profits to achieve and sustain profitability and positive cash flow in the future.

During 2004, the Company raised \$161,000 (\$152,100 net of offering expenses) in a private placement whereby 1,610,000 shares of the Company's common stock were sold to three non-affiliated individual investors pursuant to a valid private placement. These investments, combined with the receipt of \$900,000 in June 2003 in conjunction with the settlement of its arbitration proceedings with Euro-Nocopi, S.A. and annual payments of \$50,000 in 2004 and 2005 in accordance with the settlement agreement, have permitted the Company to continue in operation to the current date. As a result of the settlement, the significant legal fees incurred in the arbitration have been eliminated. Additionally, the Company has reduced staff and, in 2003, completed its relocation to a new facility

that it believes will enable the Company to further reduce its operating expenses. Management of the Company believes that it will need to obtain additional capital in the immediate future both to fund investments needed to increase its operating revenues to levels that will sustain its operations and to fund operating deficits that it anticipates will continue until revenue increases 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 improve its business 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

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both, it may be forced to cease operations at an undetermined future date.

Note 3. Income Taxes

There is no income tax benefit for the losses for the three months ended March 31, 2005 and March 31, 2004 since Management has determined that the realization of the net deferred tax asset is not assured and has created a valuation allowance for the entire amount of such benefits.

Note 4. Loss per Share

Because the Company reported a net loss for the three months ended March 31, 2005 and March 31, 2004, common stock equivalents, consisting of stock options, were anti-dilutive.

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Item 2.

NOCOPI TECHNOLOGIES, INC.

Management's Discussion and Analysis of Financial Condition and Results of Operation

Forward-Looking Information

The following Management's Discussion and Analysis of Results of Operations and Financial Condition should be read in conjunction with our audited Financial Statements and Notes thereto for the year ended December 31, 2004 included in our Annual Report on Form 10-KSB filed with the Securities and Exchange Commission.

The information in this discussion contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Such factors include those described in "Risk Factors." The forward-looking statements included in this report may prove to be inaccurate. In light of the significant uncertainties inherent in these forward-looking statements, you should not consider this information to be a guarantee by us or any other person that our objectives and plans will be achieved. The Company does not undertake to publicly update or revise its forward-looking statements even if experience or future changes make it clear that any projected results (expressed or implied) will not be realized.

Results of Operations

The Company's revenues are derived from royalties paid by licensees of the Company's technologies, fees for the provision of technical services to licensees and from the direct sale of products incorporating the Company's technologies, such as inks, security paper and pressure sensitive labels, as well as 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

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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:

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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 upon shipment of products, when the price is fixed or determinable and collectibility 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) collectibility is reasonably assured.

While the Company's fixed costs have been reduced as a result of its relocation to a new location in 2003 and because the Company believes that further fixed cost reductions 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.

Revenues for the first quarter of 2005 were \$122,100 compared to \$140,600 in the first quarter of 2004, a 13% decrease. Licenses, royalties and fees increased by \$2,000, or 3%, in the first quarter of 2005 to \$79,600 from \$77,600 in the first quarter of 2004. The increase in licenses, royalties and fees is due primarily to royalties received under a new license arrangement with a customer during the April 2004 to March 2005 period offset in part by the non-renewal of one license agreement during the same period. Product sales were \$42,500 in the first quarter of 2005 compared to \$63,000 in the first quarter of 2004, a decrease of \$20,500 or 33%. The decrease in product sales results primarily from lower levels of sales of the Company's security papers in the first quarter of 2005 compared to the first quarter of 2004.

The Company's gross profit decreased to \$69,800 in the first quarter of 2005 or 57% of revenues from \$78,100 or 56% of revenues in the first quarter of 2004. Licenses, royalties and fees have historically carried a higher gross profit than product sales, which generally consist of supplies or other manufactured products which incorporate the Company's technologies or equipment

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used to support the application of its technologies. These items (except for inks which

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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 first quarter 2005 gross profit, in absolute dollars, was negatively impacted by the decline in revenues from product and other sales.

Research and development expenses decreased to \$38,900 in the first quarter of 2005 compared to \$52,000 in the first quarter of 2004 due to a reduction of staff during the third quarter of 2004.

Sales and marketing expenses decreased to \$34,400 in the first quarter of 2005 from \$45,000 in the first quarter of 2004. The decrease reflects lower travel, sales promotion and business show expense as certain expenses associated with the introduction of the Company's new Rub-n-Color product for the Educational and Toy Market in the first quarter of 2004 were not incurred in the first quarter of 2005.

General and administrative expenses (exclusive of legal expenses) increased by \$7,600 in the first quarter of 2005 to \$63,300 from \$55,700 in the first quarter of 2004. The increase results primarily from higher patent acquisition costs in the first quarter of 2005 compared to the first quarter of 2004 due to patent activity relating to its new Rub-n-Color product.

Legal expenses declined to \$20,500 in the first quarter of 2005 from \$33,400 in the first quarter of 2004 resulting from a lower level of legal counseling required by the Company in its compliance with securities regulations and other matters.

Other income (expense) decreased in the first quarter of 2005 compared to the first quarter of 2004 as interest expense on the demand loans was eliminated due to their conversion to common stock of the Company in September 2004.

The net loss of \$87,800 in the first quarter of 2004 compared to the net loss of \$111,400 in the first quarter of 2004 results primarily from a staff reduction during 2004 as well as lower marketing expenses and lower legal expense offset in part by lower gross profit during the first three months of 2005 compared to the first three months of 2004.

Plan of Operation, Liquidity and Capital Resources

The Company's cash and cash equivalents decreased to \$23,100 at March 31, 2005 from \$24,000 at December 31, 2004. The cash was used to fund operations over the three-month period.

The loss of a number of customers during the past three years and the loss of periodic fees under the license agreement with Euro-Nocopi, S.A. commencing in 2000 have had a material adverse effect on the Company's revenues and results of operations and upon its liquidity and capital resources. During 2004, the Company raised \$161,000 (\$152,100 net of offering expenses) in a private placement whereby 1,610,000 shares of the Company's common stock

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were sold to three non-affiliated individual investors pursuant to a valid private placement. This investment, combined with the receipt of \$900,000 in June 2003 in conjunction with the settlement of its arbitration proceedings with Euro-Nocopi, S.A. and annual payments of \$50,000 in 2004 and 2005 in accordance with the settlement agreement, have permitted the Company to continue in operation to the current date. As a result of the settlement, a significant ongoing expense for related legal fees has been eliminated. Additionally, the Company has reduced staff and, during the third quarter of 2003, completed its relocation to a new facility that it believes will enable the Company to further reduce its operating expenses. Management of the Company believes that it will need to obtain additional capital in the future both to fund investments needed to increase its operating revenues to levels that will sustain its operations and to fund operating deficits that it anticipates will continue until revenue increases 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 improve its business so as to have a material positive effect on the Company's operations and cash flow. The Company believes that without additional investment, it may be forced to cease operations at an undetermined future date.

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

Risk Factors

The Company's operating results, financial condition and stock price are subject to certain risks, some of which are beyond the Company's control. These risks could cause actual operating and financial results to differ materially from those expressed in the Company's forward looking statements, including the risks described below and the risks identified in other documents which are filed and furnished with the SEC:

Inability to Continue in Operation Without New Equity Investment. The Company had a negative working capital of \$533,400 at March 31, 2005 and experienced negative cash flow from operations of \$900 in the three months ended March 31, 2005. Additionally, it experienced negative cash flow from operations of \$217,200 in the year ended December 31, 2004. Management of the Company believes that while certain staff reductions initiated in 2003 and continuing into 2004 as well as the move of the Company's operations to a new facility in 2003, will reduce the Company's negative cash flow, it anticipates that the negative cash flow will continue until it can achieve revenue increases. Management believes that it will need to obtain additional capital in the future both to fund investments needed to increase its operating revenues to levels that will sustain its operations and to fund operating deficits that it anticipates will continue until revenue increases 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 improve its business so as to have a material positive effect on the Company's operations and cash flow. The Company believes that without additional

investment, it may be forced to cease operations at an undetermined future date. It is uncertain whether the Company's assets will retain any value if the Company ceases operations. There are no assurances that the Company will be able to secure additional equity investment before it may be forced to cease operations.

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Inability to Obtain Raw Materials and Products for Resale. The Company's adverse financial condition has required it to significantly defer payments due vendors who supply raw materials and other components of the Company's security inks and security paper that the Company purchases for resale and professional and other services. As a result, the Company is required to pay cash in advance of shipment to certain of its suppliers. Delays in shipments to customers caused by the Company's inability to obtain materials on a timely basis and the possibility that certain current vendors may permanently discontinue to supply the Company with needed products could impact the Company's ability to service its customers and adversely affect its customer and licensee relationships. While receipt of funds in conjunction with the settlement of the arbitration with Euro-Nocopi, S.A. and sales of shares of the Company's common stock in 2004 have allowed the Company to continue in operation to the current date, there can be no assurances that the Company will be able to maintain its vendor relationships in an acceptable manner.

Uneven Pattern of Quarterly and Annual Operating Results. The Company's revenues, which are derived primarily from licensing and royalties, are difficult to forecast due to the long sales cycle of the Company's technologies, the potential for customer delay or deferral of implementation of the Company's technologies, the size and timing of inception of individual license agreements, the success of the Company's licensees and strategic partners in exploiting the market for the licensed products, modifications of customer budgets, and uneven patterns of royalty revenue and product orders. As the Company's revenue base is not substantial, delays in finalizing license contracts, implementing the technology to initiate the revenue stream and customer ordering decisions can have a material adverse effect on the Company's quarterly and annual revenue expectations and, as the Company believes that further reductions in the fixed component of the Company's operating expenses may not be achievable, income expectations will be subject to a similar adverse outcome.

Volatility of Stock Price. The market price for the Company's common stock has historically experienced significant fluctuations and may continue to do so. The Company has, since its inception, operated at a loss and has not produced revenue levels traditionally associated with publicly traded companies. The Company's common stock is not listed on a national or regional securities exchange and, consequently, the Company receives limited publicity regarding its business achievements and prospects, few securities analysts and traders follow it and it is thinly traded. The market price may be affected by announcements of new relationships or modifications to existing relationships. The stock prices of many developing public companies, particularly those with small capitalizations, have experienced wide fluctuations not necessarily related to operating performance. Such fluctuations may adversely affect the market price of the Company's common stock.

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Intellectual Property. The Company relies on a combination of protections provided under applicable international patent, trademark and trade secret laws. It also relies on confidentiality, non-analysis and licensing agreements to establish and protect its rights in its proprietary technologies. While the Company actively attempts to protect these rights, the Company's technologies could possibly be compromised through reverse engineering or other means. In addition, the Company's ability to enforce its intellectual property rights through appropriate legal action has been and will continue to be limited by the Company's adverse liquidity. There can be no assurances that the Company will be able to protect the basis of its technologies from discovery by unauthorized third parties or to preclude unauthorized persons from conducting activities that infringe on the Company's rights. The Company's adverse liquidity situation has also impacted its ability to obtain patent protection on its intellectual

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property and to maintain protection on previously issued patents. The Company has been advised by its patent counsel that patent maintenance fees approximating \$12,000 will be due during 2005. The Company has not yet made a decision on keeping any or all of these patents in force. There can be no assurances that the Company will be able to continue to prosecute new patents and maintain issued patents. As a result, the Company's customer and licensee relationships could be adversely affected and the value of the Company's technologies and intellectual property (including their value upon a liquidation of the Company) could be substantially diminished.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

Recently Issued Accounting Pronouncements

In December 2004, the FASB revised SFAS 123, "Accounting for Stock-Based Compensation" to require all companies to expense the fair value of employee stock options. SFAS 123R is effective for the first period ending after December 15, 2005 for a small business issuer.

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

In January 2003, subsequently revised December 2003, the FASB issued FASB Interpretation No. 46R ("FIN 46R"), Consolidation of Variable Interest Entities - An Interpretation of AARB N. 51. FIN 46R requires that if any entity has a controlling financial interest in a variable interest entity, the assets, liabilities and results of activities of the variable interest entity should be included in the consolidated financial statements of the entity. FIN 46R provisions are effective for all arrangements entered into after January 31, 2003. FIN 46R provisions are required to be adopted for the first period ending after December 15, 2004 for a small business issuer.

FAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, requires financial instruments within its scope to be classified as liabilities (or assets

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in some circumstances). The Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise effective at the beginning of the first interim period beginning after June 15, 2003, except for certain mandatorily redeemable financial instruments. It is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. Restatement is not permitted. The effective date of certain provisions of Statement 150 for certain mandatorily redeemable financial instruments has been deferred by FSP FAS 150-3. Under the FSP, certain mandatorily redeemable shares are subject to the provisions of Statement 150 for the first fiscal period beginning after December 15, 2004. Other mandatorily redeemable shares are deferred indefinitely but may be subject to classification or disclosure provisions of the Statement. A table indicating the revised effective dates of Statement 150 for particular kinds of entities and instruments is available on the FASB website.

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Item 3. Disclosure Controls and Procedures

The Company's disclosure controls and procedures are designed to provide reasonable assurance that material information required to be included in its periodic SEC reports is recorded, processed, summarized and reported within the time periods specified in the relevant SEC rules and forms. The Company has carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded, as of the end of the period covered by this report, that the Company's disclosure controls and procedures are effective.

There have been no changes in the Company's internal controls during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Not Applicable

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

Not Applicable

Item 3. Defaults Upon Senior Securities

Not Applicable

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

Not Applicable

Item 5. Other Information

Not Applicable

Item 6. Exhibits

(a) Exhibits

- 31.1 Certificate of Chief Executive Officer required by Rule 13a-14(a).
- 31.2 Certificate of Chief Financial Officer required by Rule 13a-14(a).
- 32. Certificate of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

NOCOPI TECHNOLOGIES, INC.

DATE: May 16, 2005

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

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

DATE: May 16, 2005

/s/ Rudolph A. Lutterschmidt

Rudolph A. Lutterschmidt
Vice President & Chief Financial Officer