

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

NOCOPI TECHNOLOGIES INC/MD/
Form 10QSB
November 15, 2004

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
EXCHANGE ACT OF 1934.

For the quarterly period ended September 30, 2004

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

For the transition period from _____ to _____

Commission file number 0-20333

NOCOPI TECHNOLOGIES, INC.

(Exact name of small business issuer as specified in its charter)

MARYLAND

87-0406496

(State or other jurisdiction
of incorporation or organization)

(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 November 1, 2004: Common stock, par value \$.01 per
share: 50,586,181 shares.

Transitional Small Business Disclosure Format (check one)

Yes No

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

NOCOPI TECHNOLOGIES, INC.

INDEX

	PAGE
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
Statements of Operations for Three and Nine Months Ended September 30, 2004 and September 30, 2003	1
Balance Sheet at September 30, 2004	2
Statements of Cash Flows for Nine Months Ended September 30, 2004 and September 30, 2003	3
Notes to Financial Statements	4-7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	8-14
Item 3. Disclosure Controls and Procedures	14
PART II. OTHER INFORMATION	
Item 2. Changes in Securities and use of Proceeds	15
Item 6. Exhibits and Reports on Form 8-K	15-16
SIGNATURES	17
EXHIBIT INDEX	18

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
NOCOPI TECHNOLOGIES, INC.
STATEMENTS OF OPERATIONS*
(UNAUDITED)

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2004	2003	2004	2003
	-----	-----	-----	-----
REVENUES				
LICENSES, ROYALTIES AND FEES	\$ 101,800	\$ 82,700	\$ 274,700	\$ 200,000
PRODUCT AND OTHER SALES	63,200	45,200	175,200	175,200
	-----	-----	-----	-----
COST OF SALES	165,000	127,900	449,900	449,900

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

LICENSES, ROYALTIES AND FEES	36,400	48,800	97,000	
PRODUCT AND OTHER SALES	34,300	37,700	87,200	
	-----	-----	-----	-----
	70,700	86,500	184,200	
	-----	-----	-----	-----
GROSS PROFIT	94,300	41,400	265,700	
OPERATING EXPENSES				
RESEARCH AND DEVELOPMENT	40,400	54,000	134,400	
SALES AND MARKETING	25,300	30,700	108,300	
GENERAL AND ADMINISTRATIVE (EXCLUSIVE OF LEGAL EXPENSES)	52,100	49,000	212,600	
LEGAL EXPENSES	31,700	18,000	94,000	
	-----	-----	-----	-----
	149,500	151,700	549,300	
	-----	-----	-----	-----
LOSS FROM OPERATIONS	(55,200)	(110,300)	(283,600)	(
OTHER INCOME (EXPENSES)				
INTEREST INCOME	--	200	--	
	-----	-----	-----	-----
INTEREST AND BANK CHARGES	(3,200)	(3,300)	(9,900)	
NET PROCEEDS FROM ARBITRATION SETTLEMENT	--	34,100	--	
	-----	-----	-----	-----
	(3,200)	31,000	(9,900)	
	-----	-----	-----	-----
NET EARNINGS (LOSS)	(\$ 58,400)	(\$ 79,300)	(\$ 293,500)	\$
	=====	=====	=====	=====
BASIC AND DILUTED EARNINGS (LOSS) PER COMMON SHARE	(\$.00)	(\$.00)	(\$.01)	\$
BASIC AND DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	47,510,221	45,972,241	46,484,901	45,

*SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS.

1

NOCOPI TECHNOLOGIES, INC.
BALANCE SHEET*
(UNAUDITED)

SEPTEMBER 30
2004

ASSETS

CURRENT ASSETS	
CASH AND CASH EQUIVALENTS	\$ 98,100
ACCOUNTS RECEIVABLE LESS \$15,000 ALLOWANCE	81,500
ARBITRATION SETTLEMENT RECEIVABLE	50,000

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

PREPAID AND OTHER	23,700

TOTAL CURRENT ASSETS	253,300
FIXED ASSETS	
LEASEHOLD IMPROVEMENTS	71,200
FURNITURE, FIXTURES AND EQUIPMENT	476,200

	547,400
LESS: ACCUMULATED DEPRECIATION	490,400

	57,000
OTHER ASSETS	
ARBITRATION SETTLEMENT RECEIVABLE	100,000

TOTAL ASSETS	\$ 410,300
	=====
LIABILITIES AND STOCKHOLDERS' DEFICIENCY	
CURRENT LIABILITIES	
ACCOUNTS PAYABLE	\$ 417,000
ACCRUED EXPENSES	264,600
DEFERRED REVENUE	39,000

TOTAL CURRENT LIABILITIES	720,600
STOCKHOLDERS' DEFICIENCY	
COMMON STOCK, \$.01 PAR VALUE	
AUTHORIZED - 75,000,000 SHARES	
ISSUED AND OUTSTANDING - 50,586,181 SHARES	505,900
PAID-IN CAPITAL	11,489,400
ACCUMULATED DEFICIT	(12,305,600)

	(310,300)

TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY	\$ 410,300
	=====

*SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS.

2

NOCOPI TECHNOLOGIES, INC.
STATEMENTS OF CASH FLOWS*
(UNAUDITED)

NINE MONTHS ENDED SE
2004

OPERATING ACTIVITIES

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

NET EARNINGS (LOSS)	(\$293,500)
ADJUSTMENTS TO RECONCILE NET EARNINGS	
(LOSS) TO CASH FROM OPERATING ACTIVITIES	
DEPRECIATION	15,300
COMPENSATION EXPENSE - STOCK OPTION GRANTS	67,000

	(211,200)
(INCREASE) DECREASE IN ASSETS	
ACCOUNTS RECEIVABLE	(41,700)
ARBITRATION SETTLEMENT RECEIVABLE	50,000
PREPAID AND OTHER	16,500
INCREASE (DECREASE) IN LIABILITIES	
ACCOUNTS PAYABLE AND ACCRUED EXPENSES	75,800
DEFERRED REVENUE	(32,500)

	68,100

NET CASH PROVIDED BY (USED IN) OPERATING	
ACTIVITIES	(143,100)
INVESTING ACTIVITIES	
ADDITIONS TO FIXED ASSETS	(800)
INVESTMENT IN AFFILIATE	--

NET CASH PROVIDED BY (USED IN) INVESTMENT ACTIVITIES	(800)
FINANCING ACTIVITIES	
ISSUANCE OF COMMON STOCK, NET	152,100
DEMAND LOANS	--
DEMAND LOAN REPAYMENT	--

NET CASH PROVIDED BY (USED IN)	
FINANCING ACTIVITIES	152,100

INCREASE IN CASH AND CASH EQUIVALENTS	8,200
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	89,900

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 98,100
	=====
SUPPLEMENTAL DISCLOSURE OF NON CASH INVESTING AND FINANCING ACTIVITIES	
CONVERSION OF DEMAND LOANS AND ACCRUED INTEREST TO COMMON STOCK	
DEMAND LOANS	(149,900)
ACCRUED INTEREST	(25,500)
COMMON STOCK	17,500
PAID-IN CAPITAL	157,900

*SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS.

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

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 2003 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 2003 Annual Report on Form 10-KSB should be read in conjunction with the accompanying interim financial statements. The interim operating results for the three and nine months ended September 30, 2004 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, 2004, had accumulated losses of \$12,305,600. For the years ended December 31, 2003 and 2002, the Company's losses from operations were \$441,300 and \$915,200, respectively. In addition, the Company had negative working capital of \$467,300 at September 30, 2004. 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. 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. The Company believes that without additional capital, whether in the form of debt, equity or both, it may be forced to cease operations at an undetermined future date.

NOTE 3. SETTLEMENT OF ARBITRATION WITH AFFILIATE

In June 2003, the Company settled its arbitration proceeding commenced by Euro-Nocopi, S.A. (Euro). Under the terms of the settlement, Euro paid \$900,000 to Nocopi and will pay an additional \$200,000 in the future for back royalties and all other matters in dispute between the two companies, as well as the termination of Nocopi's 18% ownership of Euro. As part of the Settlement, the Company and Euro entered into an amended and restated license pursuant to which the Company has agreed that Euro may continue to market the Company's technologies in Europe. The \$200,000 will be paid in four equal annual installments commencing in March 2004. The Company recorded a net gain of \$34,100 and \$909,400, respectively, in the third quarter and first nine months of 2003 representing the proceeds of the settlement net of the Company's \$110,600 investment in Euro and legal expenses incurred during the 2003 related to the arbitration. During the third quarter of 2003 the Company received a \$36,900 refund of fees previously paid to the arbitration panel as a result of the termination of the arbitration proceedings.

For the first quarter of 2003 arbitration related legal expense of \$57,400 was reclassified from legal expenses to net proceeds from arbitration settlement.

NOTE 4. DEMAND LOANS AND STOCKHOLDERS' DEFICIENCY

During the third quarter of 2004, the Company sold 1,610,000 shares of its common stock to three non-affiliated individual investors for \$161,000 (\$152,100 net of offering expenses) pursuant to a valid private placement.

In September 2004, Nocopi Technologies, Inc. entered into an Agreement of Terms with Entrevest I Associates pursuant to which, as consideration for the release of certain stock option rights to purchase up to 40,000,000 shares of the Company's common stock and the release of the right to designate a member to the board of directors, the Company agreed to issue 1,250,000 shares of restricted common stock in the Company to Entrevest pursuant to a valid private placement, which were valued at par. Prior to the transaction, Entrevest I Associates owned 3,333,333 shares of common stock of the Company. Also, as part of the Agreement, Michael Solomon has resigned from the Board of Directors.

In September 2004, the Company entered into a Conversion Agreement with three individuals whereby Demand Loans in the aggregate principal amount of \$149,900 together with \$25,500 of accrued interest on the Demand Loans were converted into shares of restricted common stock of the Company. As a result, an aggregate of 1,753,940 shares of restricted common stock were issued including 449,080 shares to Michael A. Feinstein, M.D., the Company's Chairman of the Board.

NOTE 5. INCOME TAXES

There is no provision for income taxes for the three months and nine months ended September 30, 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 6. STOCK OPTIONS

On April 30, 2004, the company granted options to two consultants to purchase a total of 300,000 shares of its common stock at an exercise price of \$0.17 per share, vesting after one year, and expiring in five years. In accordance with the fair value method as described in accounting requirements of SFAS No. 123, the Company recognized consulting expense of \$28,000 during the nine months ended September 30, 2004.

On April 30, 2004, the Company granted options to four directors to purchase 50,000 shares each of its common stock at an exercise price of \$0.17 per share, vesting immediately, and expiring in five years. In accordance with the fair value method as described in accounting requirements of SFAS No. 123, the Company recognized consulting expense of \$18,000 during the nine months ended September 30, 2004.

On April 30, 2004, the Company granted options to three directors to purchase 100,000 shares each of its common stock at an exercise price of \$0.17 per share, vesting on January 1, 2005, and expiring in five years from vesting date. The options are contingent on the directors attending a certain percentage of Board of Directors meetings during 2004. In accordance with the fair value method as described in accounting requirements of SFAS No. 123, the options were valued at \$38,000. The Company is recognizing this expense prorata on a quarterly basis. The Company recognized expense of \$9,000 and \$21,000 for the three months and nine months ended September 30, 2004.

On April 30, 2004, the Company granted options to two officers to purchase a total of 250,000 shares of its common stock at an exercise price of \$0.17 per share, which was the market price on grant date, expiring in five years and vesting at various dates through April 30, 2005.

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for the issuance of its stock options. Accordingly, no compensation cost has been recognized for its stock options issued during the nine months ended September 30, 2004. Had compensation cost for the Company's issuance of vested stock options been determined based on the fair value at grant dates for options consistent with the method of SFAS No. 123, the Company's net loss would have been increased to the pro forma amounts indicated below. The net loss per share would not change. Fair value amounts were estimated using the Black-Scholes model with the following assumptions: no dividend yield, expected volatility of 60%, and a risk-free interest rate of 4% for the three and nine months ended September 30, 2004. There were no options issued for the nine months ended September 30, 2003.

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

		Three Months Ended September 30, 2004 -----	Nine Months September 3 -----
Net loss	As reported	(\$58,400)	(\$2
	Pro forma	(\$58,400)	(\$3
Net loss per share	As reported	(\$.00)	
	Pro forma	(\$.00)	

7

ITEM 2.

NOCOPI TECHNOLOGIES, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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, 2003 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 "Uncertainties That May Affect the Company, its Operating Results and Stock Price." 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, and equipment used to support the application of the Company's technologies, such as ink-jet printing systems. Royalties consist of guaranteed minimum royalties

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

payable by the Company's licensees in certain cases and additional royalties which typically vary with the licensee's sales or production of products incorporating the licensed technology. Service fees and sales revenues vary directly with the number of units of service or product provided.

Because the Company has a relatively high level of fixed costs, 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.

8

Revenues for the third quarter of 2004 were \$165,000 compared to \$127,900 in the third quarter of 2003, a 29% increase. Licenses, royalties and fees increased by \$19,100, or 23%, to \$101,800 in the third quarter of 2004 from \$82,700 in the third quarter of 2003. The increase in licenses, royalties and fees is due primarily to the inception during the first nine months of 2004 of license arrangements with two customers offset in part by the termination of one license agreement during the fourth quarter of 2003. Product and other sales were \$63,200 in the third quarter of 2004 compared to \$45,200 in the third quarter of 2003, a 40% increase due to higher sales of the Company's security inks offset in part by lower sales of its security papers. The relocation to a new facility in the third quarter of 2003 impacted its ink production capabilities during that period. For the first nine months of 2004, revenues were \$449,900, 5% higher than revenues of \$426,800 in the first nine months of 2003. Licenses, royalties and fees of \$274,700 in the first nine months of 2004 increased by \$20,900, or 8%, from \$253,800 in the first nine months of 2003 as license fees and royalties from new licensees offset those lost from terminated or discontinued license arrangements. Product and other sales of \$175,200 in the first nine months of 2004 approximated the \$173,000 recorded in the first nine months of 2003.

The Company's gross profit increased to \$94,300 in the third quarter of 2004 or 57% of revenues from \$41,400 or 32% of revenues in the third quarter of 2003. Licenses, royalties and fees have historically carried a substantially higher gross profit than product 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 significantly lower gross profit than licenses, royalties and fees. The higher gross profit in the third quarter of 2004 compared to the third quarter of 2003 results principally from an increase in revenues represented by licenses, royalties and fees as well as lower costs of production of the ink products used by licensees and paper purchased for resale. Additionally, the Company experienced lower rent and occupancy costs resulting from the move of the

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

facility in the second half of 2003.

For the first nine months of 2004, the gross profit was \$265,700, or 59% of revenues compared to \$193,800, or 45% of revenues, in the first nine months of 2003. The increase in the gross profit in both absolute dollars and percentage of revenues in the first nine months of 2004 compared to the first nine months of 2003 resulted from the same factors as those described above with respect to the third quarter results.

Research and development expenses decreased to \$40,400 in the third quarter of 2004 from \$54,000 in the third quarter of 2003. For the first nine months of 2004, research and development expenses were \$134,400 compared to \$152,600 in the first nine months of 2003. The decrease in both the third quarter and first nine months of 2004 relates primarily to lower rent, occupancy and employee benefit expenses in 2004 compared to 2003.

9

Sales and marketing expenses were \$25,300 in the third quarter of 2004 compared to \$30,700 in the third quarter of 2003. For the first nine months of 2004, sales and marketing expenses were \$108,300 compared to \$148,800 in the first nine months of 2003. The decrease in the third quarter of 2004 compared to the third quarter of 2003 results primarily from lower rent and occupancy expenses. The lower selling expenses in the first nine months of 2004 compared to the first nine months of 2003 relate primarily to the departure of a sales executive late in the first quarter of 2003 and lower consulting fees as well as lower rent and occupancy costs in the first nine months of 2004 compared to the first nine months of 2003 offset in part by marketing costs associated with the introduction of the Company's new Rub-n-Color product for the Educational and Toy Market

General and administrative expenses (exclusive of legal expenses) increased modestly to \$52,100 in the third quarter of 2004 from \$49,000 in the third quarter of 2003. For the first nine months of 2004, general and administrative expenses increased to \$212,600 from \$193,100 in the first nine months of 2003. The increase for the first nine months of 2004 compared to the first nine months of 2003 is due primarily to \$67,000 in expenses recorded in connection with the issuance to members of the Company's Board of Directors and two consultants of options to purchase shares of the Company's common stock during the second quarter of 2004 offset in part by lower rent, occupancy and public relations costs.

Legal expenses increased to \$31,700 and \$94,000, respectively, in the third quarter and first nine months of 2004 from \$18,000 and \$66,800 in the third quarter and first nine months of 2003. The increases in legal expenses relate to compliance with recently enacted securities legislation and regulations and, in the third quarter of 2004, to legal fees incurred in structuring agreements related to the conversion of the Company's Demand Loans into common stock and the release of certain stock option rights. Legal fees for the third quarter and first nine months of 2003 associated with the Euro-Nocopi, S.A. arbitration proceedings that were settled in June 2003 were offset against the settlement proceeds.

Other income (expense) includes interest income on funds invested and interest expense on the Demand Loans. Net proceeds from arbitration settlement includes the net gain of \$909,400 in the first nine months of 2003 representing the proceeds of the arbitration settlement with Euro-Nocopi, S.A., net of the Company's \$110,600 investment in Euro-Nocopi, S.A. and legal expenses incurred during 2003 related to the arbitration. The net proceeds of the arbitration settlement of \$34,100 recognized in the third quarter of 2003 included a \$36,900 refund of fees previously paid to the arbitration panel as a result of the

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

termination of the arbitration proceedings.

The net loss of \$58,400 and \$293,500, respectively, in the third quarter and first nine months of 2004 compared to a net loss of \$79,300 and net earnings of \$532,200 in the third quarter and first nine months of 2003 results primarily from the settlement of the arbitration proceedings with Euro-Nocopi, S.A. during the second quarter of 2003, the expense associated with the issuance of stock options to Directors and consultants during 2004, lower rent and occupancy costs due to the move to a new facility in 2003 and staff reductions during 2003.

PLAN OF OPERATION, LIQUIDITY AND CAPITAL RESOURCES

The Company's cash and cash equivalents increased to \$98,100 at September 30, 2004 from \$89,900 at December 31, 2003. During the first nine months of 2004, the Company sold 1,610,000 shares of its common stock to three non-affiliated individual investors for \$161,000 (\$152,100 net of offering expenses) and used \$143,900 to fund operations over the nine-month period.

10

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. The receipt of \$152,100 of net proceeds from the sale of common stock of the Company in 2004 and \$900,000 in June 2003 in conjunction with the settlement of its arbitration proceedings with Euro-Nocopi, S.A. 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, 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.

UNCERTAINTIES THAT MAY AFFECT THE COMPANY, ITS OPERATING RESULTS AND STOCK PRICE

The Company's operating results and stock price are dependent upon a number of factors, some of which are beyond the Company's control. These include:

Possible Inability to Continue in Operation Without New Capital Investment. The Company had a negative working capital of \$467,300 at September 30, 2004 and experienced negative cash flow from operations of \$143,100 in the nine months ended September 30, 2004. Additionally, it experienced negative cash flow from operations of \$78,800 (including \$900,000 received in settlement of its arbitration proceedings with Euro-Nocopi, S.A.) in the year ended December 31, 2003. Management of the Company believes that while certain staff reductions initiated in 2003 and the move of the Company's operations to a new facility, which was completed during 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

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

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, in the form of debt, equity or both, 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.

Possible Inability to Develop New Business. Even if the Company is able to raise cash through additional capital or otherwise, it must quickly improve its operating cash flow. Because the Company has already significantly reduced its operating expenses, Management believes that any significant improvement in the Company's cash flow must result from increases in its revenues from traditional sources and from new revenue sources. The Company's ability to develop new revenues may depend on the extent of both its marketing activities and its research and development activities. There are no assurances that the resources the Company can devote to marketing and to research and development, even with additional capital, will be sufficient to increase the Company's revenues to levels resulting in positive cash flow.

11

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, security paper that the Company purchases for resale and professional and other services. As a result, the Company is on credit hold with certain of its suppliers and is required to pay cash in advance of shipment to others. 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. Management of the Company believes that, without significant capital investment in the very near term, the Company will not be able to maintain acceptable relationships with its vendors and professional service providers. There are no assurances that the Company will be able to secure sufficient capital investment to maintain its vendor accounts on satisfactory terms.

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

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

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.

12

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 property and to maintain protection on previously issued patents. The Company has paid approximately \$7,000 in patent maintenance fees that are due during 2004 as advised by its patent counsel. 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 2002, the FASB issued Statement of Financial Accounting Standard No. 148 ("SFAS 148), Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS 148 provides alternative methods of transition for voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS 148 also requires prominent disclosure in the "Summary of Significant Accounting Policies" of both annual and interim financial statements about the method used on reported results. The Company has adopted the disclosure requirements of SFAS 148 for the 2003 fiscal year. Adoption of this statement has affected the location of the Company's disclosure in the consolidated financial statements, but will not impact the Company's results of operation or financial position unless the Company changes to the fair value method of accounting for stock-based employee compensation.

On April 22, 2003, the FASB announced its decision to require all companies to expense the fair value of employee stock options. Companies will be required to measure the cost according to the fair value of the options. Although the new guidelines have not yet been released, it is expected that they will be finalized soon and be effective in 2004. When final rules are announced, the Company will assess the impact to its financial statements.

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

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. 46 ("FIN 46"), Consolidation of Variable Interest Entities - An Interpretation of AARB No. 51. FIN 46 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 46 provisions are effective for all arrangements entered into after January 31, 2003. FIN 46 provisions are required to be adopted for the first period ending after December 15, 2004 for a small business issuer.

13

In May 2003, the FASB issued Statement of Financial Accounting Standard No. 150 ("SFAS 150"), Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity. SFAS 150 clarifies the accounting for certain financial instruments with characteristics of both liabilities and equity and requires those instruments be classified as liabilities on the balance sheet. Previously, many of those financial statements were classified as equity. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003.

ITEM 3. DISCLOSURE CONTROLS AND PROCEDURES

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 that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company that is required to be included in the Company's periodic filings with the Securities and Exchange Commission. There have been no significant changes in the Company's internal controls over financial reporting or, to the Company's knowledge, in other factors that could significantly affect those internal controls subsequent to the date the Company carried out its evaluation.

14

PART II - OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES

During September 2004, Registrant sold an aggregate of 1,610,000 shares of its Common Stock, par value \$.01 per share, to three individual investors (who were acquainted with members of Registrant's Board of Directors) for \$161,000, or \$.10 per share, in private transactions exempt from registration pursuant to Section 4(2) of the Securities Act. No underwriters were involved in the transactions or received any commissions or other compensation. Proceeds of the sales were used to fund working capital requirements.

In September 2004, Nocopi Technologies, Inc. entered into an Agreement of Terms with Entrevest I Associates pursuant to which, as consideration for the

Edgar Filing: NOCOPI TECHNOLOGIES INC/MD/ - Form 10QSB

release of certain stock option rights to purchase up to 40,000,000 shares of the Company's common stock and the release of the right to designate a member to the board of directors, the Company agreed to issue 1,250,000 shares of restricted common stock in the Company, par value \$.01 per share, to Entrevest pursuant to a valid private placement. Prior to the transaction, Entrevest I Associates owned 3,333,333 shares of common stock of the Company. Also, as part of the Agreement, Michael Solomon has resigned from the Board of Directors. As a result of this transaction, the potential issuance of 40,000,000 common shares and the resultant dilution have been eliminated. No underwriters were involved in the transactions or received any commissions or other compensation.

In September 2004, the Company entered into a Conversion Agreement with three individuals whereby Demand Loans in the aggregate principal amount of \$149,900 together with \$25,500 of accrued interest on the Demand Loans were converted into shares of restricted common stock of the Company. As a result, an aggregate of 1,753,940 shares of restricted common stock, par value \$.01 per share, were issued including 449,080 shares to Michael A. Feinstein, M.D., the Company's Chairman of the Board. The conversion eliminated \$175,400 of short-term obligations.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

- 10.1 Agreement of Terms with Entrevest I Associates, filed as Exhibit 99.1 to the Report on Form 8-K filed with the SEC on September 16, 2004, and incorporated herein by reference.
- 10.2 Conversion Agreement
- 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).
- 32.1 Certificate of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

15

(b) The Registrant filed the following Current Reports on Form 8-K during the quarter ended September 30, 2004:

- July 15, 2004 - Press Release dated July 15, 2004 regarding Industry Awards received.
- September 16, 2004 - Entry into a Material Definitive Agreement with Entrevest I Associates.
- September 21, 2004 - Press Release dated September 21, 2004 regarding the Agreement of Terms with Entrevest I Associates.
- September 30, 2004 - Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers.

16

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: November 15, 2004

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

Michael A Feinstein, M.D.
Chairman of the Board & Chief Executive Officer

DATE: November 15, 2004

/s/ Rudolph A. Lutterschmidt

Rudolph A. Lutterschmidt
Vice President & Chief Financial Officer

EXHIBIT INDEX

10.2	Conversion Agreement
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).
32.1	Certificate of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002