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Capital Management

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Liquidmetals Stock Is Likely To Melt

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About Liquidmetals

Liquidmetals (OTCQB:LQMT) is a materials technology company that develops and commercializes products made from amorphous alloys. Their Liquidmetal® family of alloys consists of a variety of proprietary bulk alloys and composites that utilize the advantages offered by amorphous alloy technology. They design, develop and sell products and components from bulk amorphous alloys to customers in various industries. They also partner with third-party manufacturers and licensees to develop and commercialize Liquidmetal alloy products.

Situation Overview

LQMT is a highly promoted penny stock with a market cap that exceeds $125 million, and highly speculative business prospects. However, a little due diligence reveals a company with a troubled past, as highlighted in an earlier article written by StreetSweeper in 2010, a convoluted capital structure, and a virtually insolvent business. The sexy story comes from the association of their technology with Apple (AAPL). On August 5, 2010, LQMT entered into a license transaction with Apple Inc. pursuant to which, for a one-time licensing fee of $20 million, they granted to Apple a perpetual, worldwide, fully-paid, exclusive license to commercialize all of the company's intellectual property in the field of consumer electronic products. (See page 7 of the 10-k linked above.) As a result, they will not be able to pursue applications of their bulk Liquidmetal alloys in the consumer electronics field with other companies.

The current rumors propelling the stock are that Apple may use the Liquidmetal technology in the iPhone 5. While this is certainly nice to hear, it will have no material impact on LQMT's financials going forward since they received a one-time payment almost 2 years ago, and will receive no ongoing royalties.

Furthermore, LQMT does not have sufficient infrastructure, property, or equipment to manufacture bulk production for any orders of size that Apple might need in the future, so hopes of additional production revenue or cash flow can likely be dismissed. As indicated in the table below, LQMT's balance sheet includes depreciated plant and equipment valued at just $162,000. Furthermore, their patents which the market is ascribing a $125 million value for are marked on the company's books at under $1 million dollars.

Liquidmetal's Property, Plant and Equipment

$ in millions	2011	2010
Machine and Equipment	$1.10	$1.11
Computer Equipment	0.07	0.73
Office Equipment/Furnishings	0.19	0.14
Total	$1.36	$1.99
Accumulated Depreciation	($1.19)	($1.95)
Total Net PP&E	$0.16	$0.04

Source: LQMT 10-k

Liquidmetal's Patent and Trademarks

$ in millions	2011	2010
Purchased and Licensed Patents	$0.57	$0.57
Internally Developed Patents	1.66	1.66
Trademarks	0.09	0.09
Total	$2.32	$2.32
Accumulated Amortization	($1.35)	($1.22)
Net Patent and Trademarks	$0.97	$1.11

Source: LQMT 10-k

Meanwhile, a more pressing issue for LQMT is its near-term financial insolvency. The money that was received from Apple has already been used to fund operations and retire debt. The company currently has a going concern warning in their 10-k that they were likely to run out of cash as of April 30, 2012. The table below shows LQMT's income statement for the past two years. With no revenues, no cash and high fixed expenses, the company currently has solvency issues.

Liquidmetal Income Statement			
$ in millions	2011	2010	Comment
			1 Time
Products	$0.6	$0.6	Non-recurring
Licensing/Royalties	0.4	20.0	Apple Payment
Total Revenue	$1.0	$20.6	
Cost of Sales	$0.4	$0.3	
Gross Profit	$0.6	$20.3	
Operating Expenses			
Sales, marketing and admin.	$4.2	$4.5	High Fixed
R&D	1.1	1.1	Costs w/No
Settlement Expense	1.7	2.8	Clear Revenue
Total Operating Expenses	$7.1	$8.4	Catalyst
Operating Loss	($6.5)	$11.9	Losses will
			Continue in 2012
Source: LQMT 10-K			

My best estimate of the capital structure is as follows:

Liquidmetal Technologies Capital Structure	Rate	Preferred Stock Outstanding	Preferred Conversion Ratio	Common Stock Outstanding	Conversion Strike
Shares Outstanding				160.1	
Preferred Series A-1	8.0%	0.25	50.00	12.3	$0.10
Preferred Series A-2	8.0%	1.05	22.70	23.9	$0.22
Options				4.6	$0.41
Warrants				47.3	$0.49
Fully Diluted Shares Outstanding				**248.2**	
Stock Price				$0.60	
Market Capitalization				**$148.9**	
Note due to SAGA				$1.7	
Bridge Notes	8%-15%			$1.1	
Pro forma Cash (Assuming Warrants/Option Exercise)				$25.1	
Enterprise Value				**$126.6**	
Source: LQMT 10k					

Other Negative Factors Investors Should Consider Before Buying LQMT

1. The company only had $1 million of sales in 2011, yet total operating expenses were $7 million. The company only has 13 employees.
2. Death Financing - The company recently had to take a bridge loan twice both here and here on onerous terms reaching a maximum of 15% to continue operations
3. Non-Reliance on Financials / Material Weakness
4. Recent Auditor Change
5. Insiders appear to be converting preferred and exiting common
6. Plenty of related party transactions - see Note 19 of the 10-K for the laundry list of deals
7. Legal issues - The company and its executives have had numerous legal issues in the past which are also discussed in the 10-K

Summary

With LQMT, buy the rumor, sell the facts.

The facts are that the company is virtually insolvent and has limited prospects for future liquidity. Absent another IP sale or licensing agreement, the company will have to dilute shareholders even further by either 1) new stock sales; 2) get the large warrant or option holders to exercise their positions, or 3) issue a type of convertible debt.

All of these scenarios include significant dilution which will weigh heavily on the stock price. Meanwhile the preferred holders can also convert and sell the stock at market, and it appears they are currently doing so. Once the latest hoopla over the iPhone 5 news passes, the cold reality of a nearly insolvent company will unfold. Maybe this time is different, and LQMT will be able pull together another blockbuster deal from a company in a different industry. The initial Apple deal did not preclude them from licensing the technology to companies in other industries. However, I remain very skeptical given the company's long track record of not producing any significant industrial applications. The current implied enterprise value of $125m is 6x higher than the $20m deal they got from Apple and 125x their 2011 revenues. At the current share price, investors would be wise to think twice before purchasing shares.