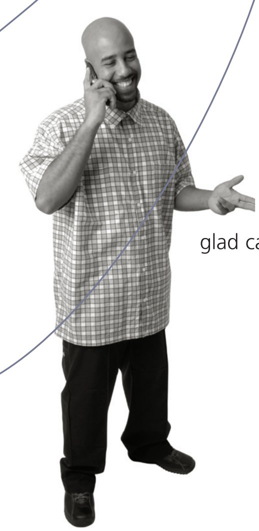
SUPERCONDUCTOR TECHNOLOGIES
Improving the Quality of Wireless®

2003 Annual Report

One caller

two callers



glad caller

new caller

Improving the Quality of Wireless®

Father caller

mother caller

sister caller

brother caller

Rhyme and Reason. It is both beauty in expression and having something smart to say. It is the quality of your voice and the technology to deliver it—wirelessly. It's about making sense. At Superconductor Technologies, we are making sense of wireless—having mastered the use of high-temperature superconducting (HTS) technology to dramatically improve the quality of wireless networks.

This one's calling from afar.

We call it Total Link℠ Enhancement and it works in absolute harmony with existing network infrastructures, teaming our field-proven HTS solutions with high-performance multiplexers and multi-carrier power amplifiers to significantly increase both capacity and coverage in wireless networks. With more than one billion global subscribers now demanding landline quality mobile services, that's poetry to everyone's ears.

This one's calling from a car.

Hey, what a lot of wireless calls there are!

Strong Measures. It's anticipating the changing rhythm of our markets to increase the tempo of our business. It's enhancing the patterns of our speech, but even more so—it's our actions that speak louder than words. At Superconductor Technologies, we are taking action—having shipped more than 3,800 of our SuperLink™ Rx systems worldwide, logging in excess of 42 million hours of cumulative operation. Still, it's our field-proven reliability, with a Mean Time Between Failure (MTBF) of more than 500,000 hours, that's been our real measure of success.

Yes, some call two times, and some call four.

Some call six times, and some call more!

So how else are we measuring up? Once again STI was named to Deloitte & Touche's prestigious Los Angeles Technology Fast 50 program. We more than doubled our revenues, yielding a two-year Compound Annual Growth Rate (CAGR) of over 100 percent. In 2003, we also had our first full year with a positive commercial gross margin. And it was positive by more than $10 million. Last but not least, we achieved yet another milestone for the company: our first profitable quarter was the fourth quarter of 2003.

Where they are calling, we cannot say. But they are using wireless, every second of the day!

Loud Refrain. They're familiar words echoing a recurring theme. It's what our customers are saying over and over. It's the idea beyond all the talk—increasing network traffic while continuously improving network performance. At Superconductor Technologies, we're listening and it's a refrain we've heard loud and clear. Which is why we offer wireless carriers the only solution that delivers both interference protection and increased sensitivity—significantly reducing the incidence of dropped and blocked calls, dramatically improving quality and coverage, and markedly enhancing data throughput.

Now here are some who like to roam.

They send photos with their phone.

And with the advent of Wireless Local Number Portability suddenly removing the main barrier to switching service providers, ours is a network solution that will help retain customers. Superior performance means happy customers; happy customers mean less churn. Now more than ever, network operators are under tremendous pressure to perfect network quality while offering the latest in innovative services—including the dynamic new world of wireless data. Fortunately, no other company can provide a stronger link between a wireless operator's customers and its network. And that's a refrain worth repeating!

Oh dear! Oh my! Oh dear! Oh my!

Millions and millions giving wireless a try!

They send from here
They send from there
Voice and data
From everywhere.

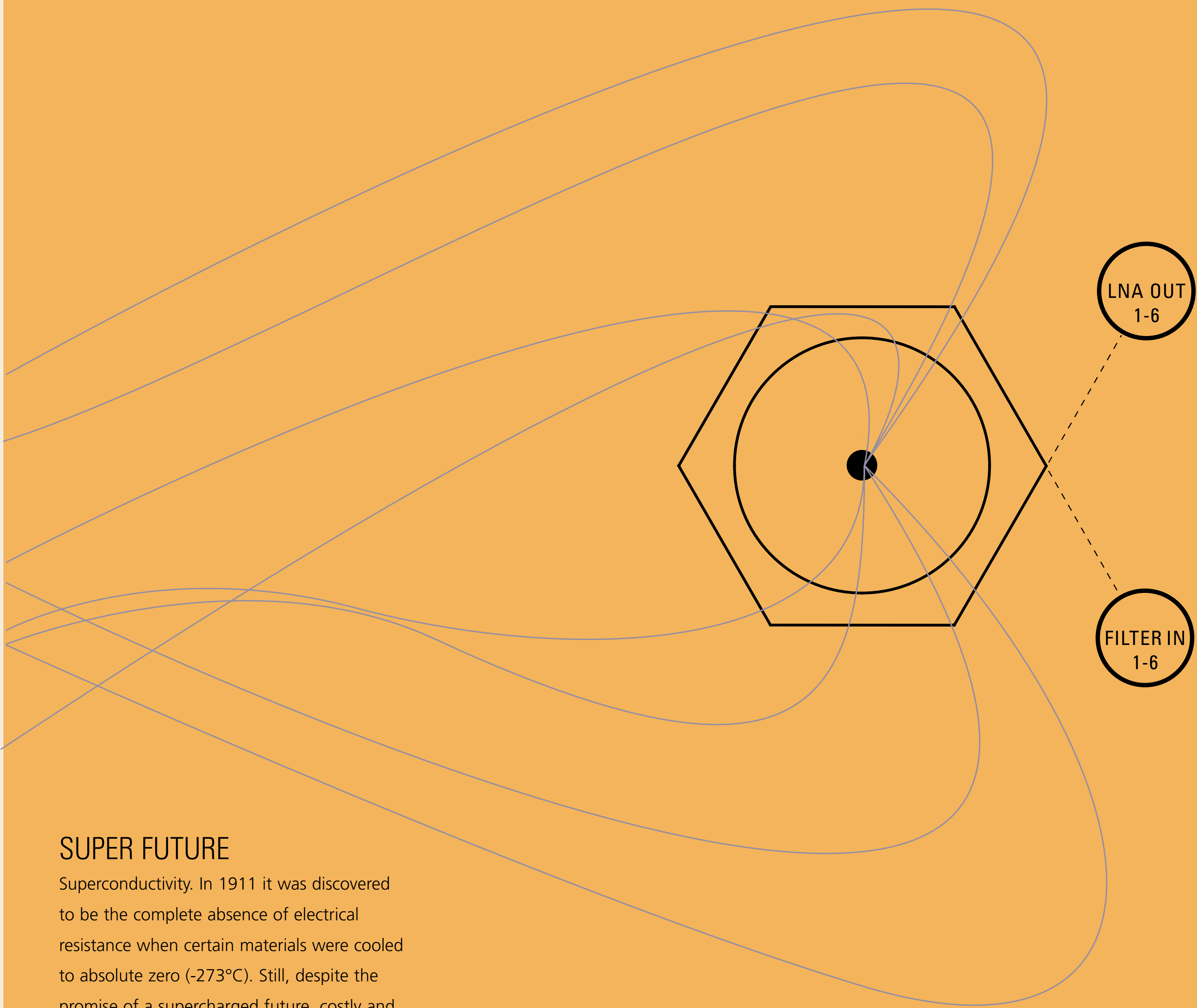
They call all morning
They call all night
Expecting their service
To be just right!

But say by chance
Their call goes bust?
Changing networks,
Would be a must.

So listen now, and you will learn,
The only way to stop your churn,
A bit of magic, courtesy STI,
That really works, just give it a try!

And just how does it work,
You'd like to know?
We'll tell you precisely,
What makes it go.

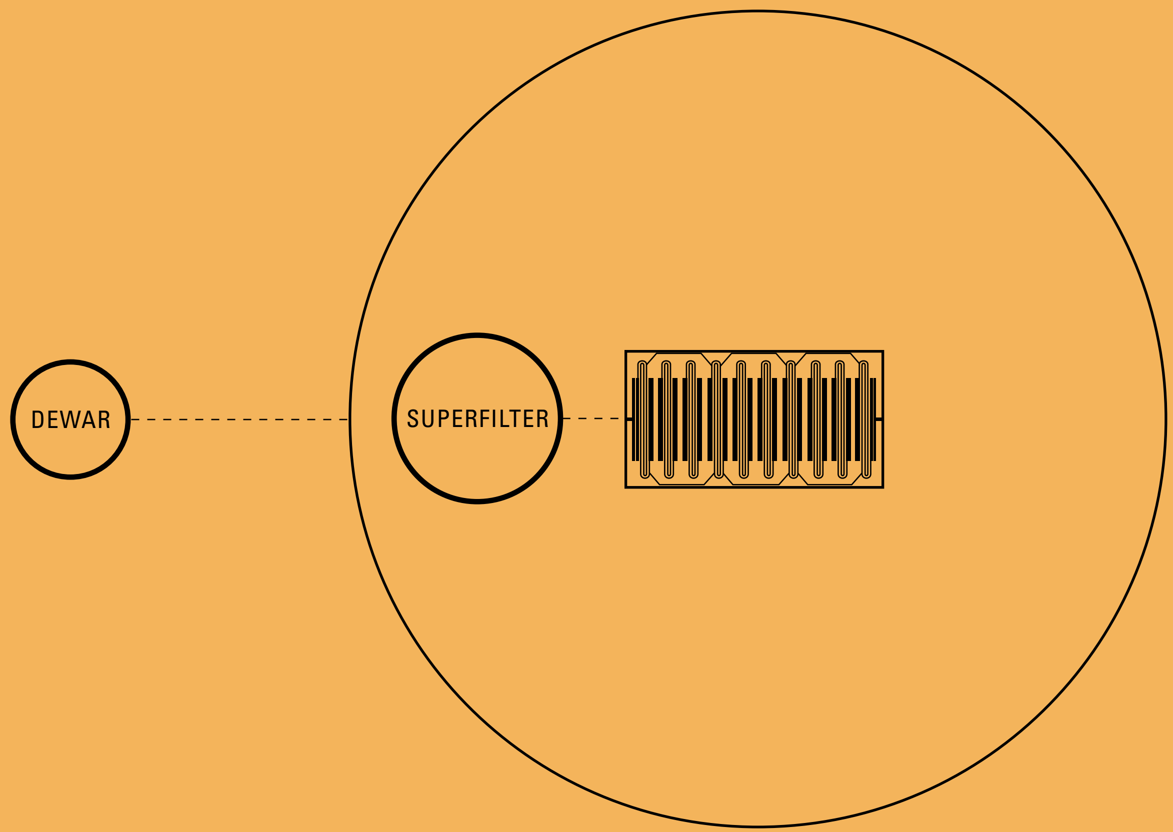
Our signal comes in.



SUPER FUTURE

Superconductivity. In 1911 it was discovered to be the complete absence of electrical resistance when certain materials were cooled to absolute zero (-273°C). Still, despite the promise of a supercharged future, costly and complex refrigeration techniques rendered any commercial or practical use impossible.

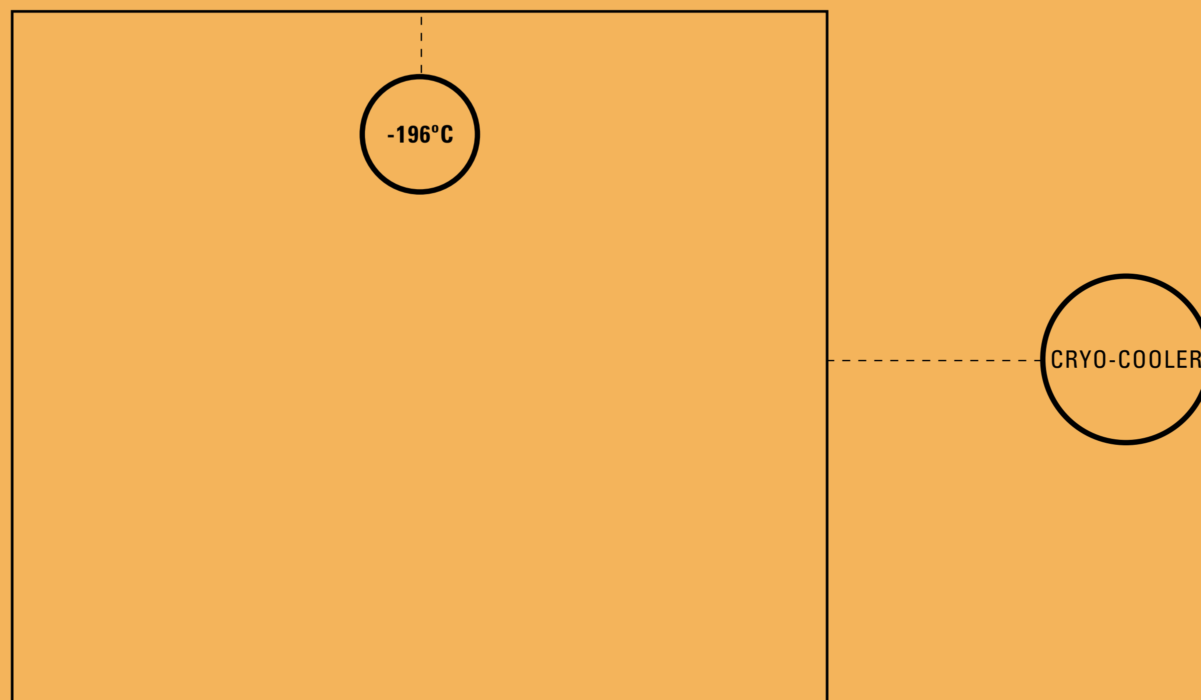
Our signal shoots out.



CRITICAL TEMPERATURES

Then in 1986, new materials were discovered with critical temperatures of just 90 Kelvin (-183°C). This was High-Temperature Superconductivity (HTS). But it would still take another 10 years of R&D before the wireless industry would emerge as the technology's first major opportunity.

It starts as a whisper,



CORE ISSUES

At the core of this breakthrough was STI's patented "thin-film" microelectronics and cryo-cooler technologies developed by our research team that included Nobel Laureate, J. Robert Schrieffer. Our new cryogenic receiver front-end (CRFE) would soon prove to be the best possible enhancement to any wireless uplink.

And leaves as a shout!

SUPER RECEIVER

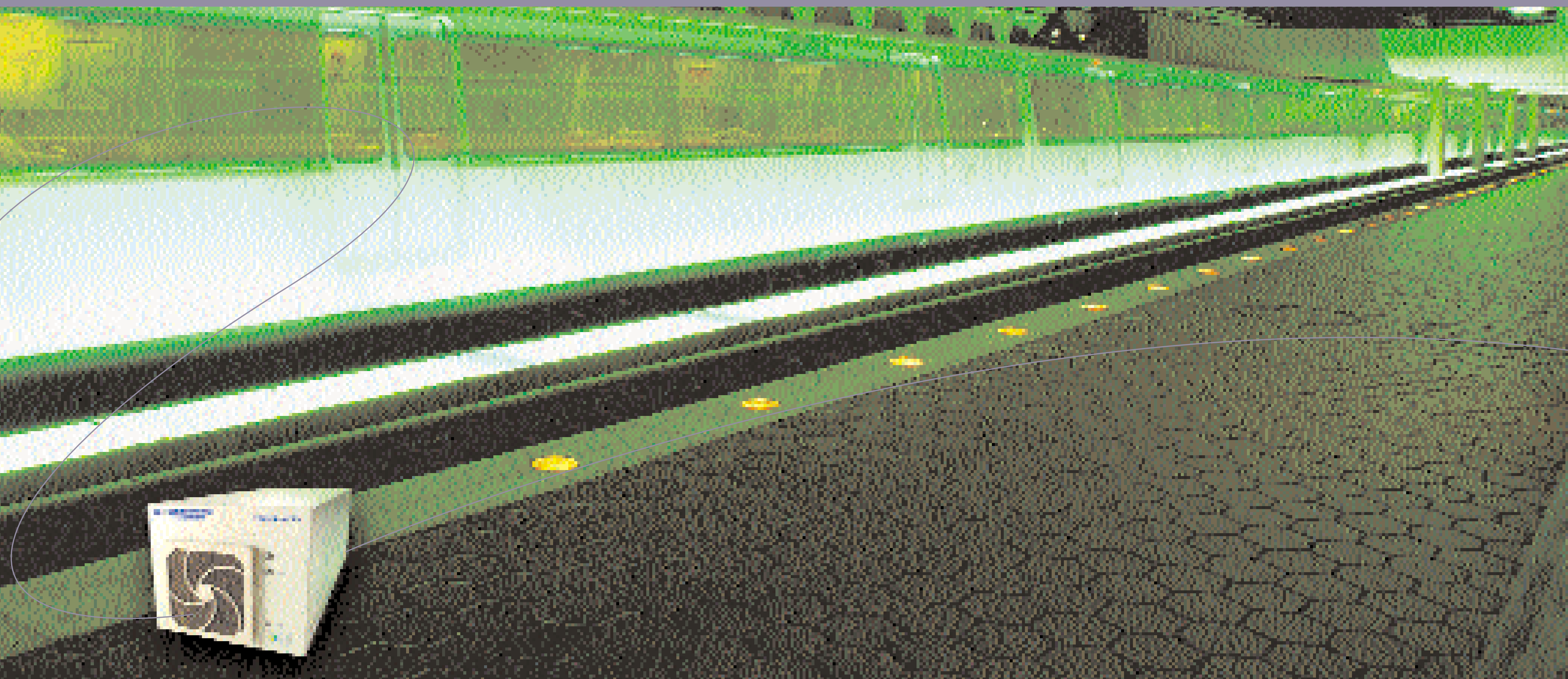
Today, our SuperLink Rx is the closest thing to a perfect receiver, allowing 100 percent of the desired signals and nothing else. Extreme sensitivity, unmatched selectivity and superior dynamic range—all in a package no bigger than a breadbox and requiring no more power than a single light bulb.

Every day,
From increased sensitivity,
To interference that’s less,
We’re improving
the quality of wireless!

The Perfect Receiver. Now, boosting network performance can be easier and more cost-effective than ever with our family of SuperLink™Solutions—beginning with our flagship model, SuperLink™Rx 850, the most compact state-of-the-art cryogenic receiver front-end in the industry, as well as SuperLink™Rx1900, an integrated cryogenic receiver front-end (CRFE) for the PCS wireless market. Think of them both as a highly-selective hearing aid for wireless networks.

A million calls converge like a funnel.

But no dropped calls, even dialing from a tunnel!

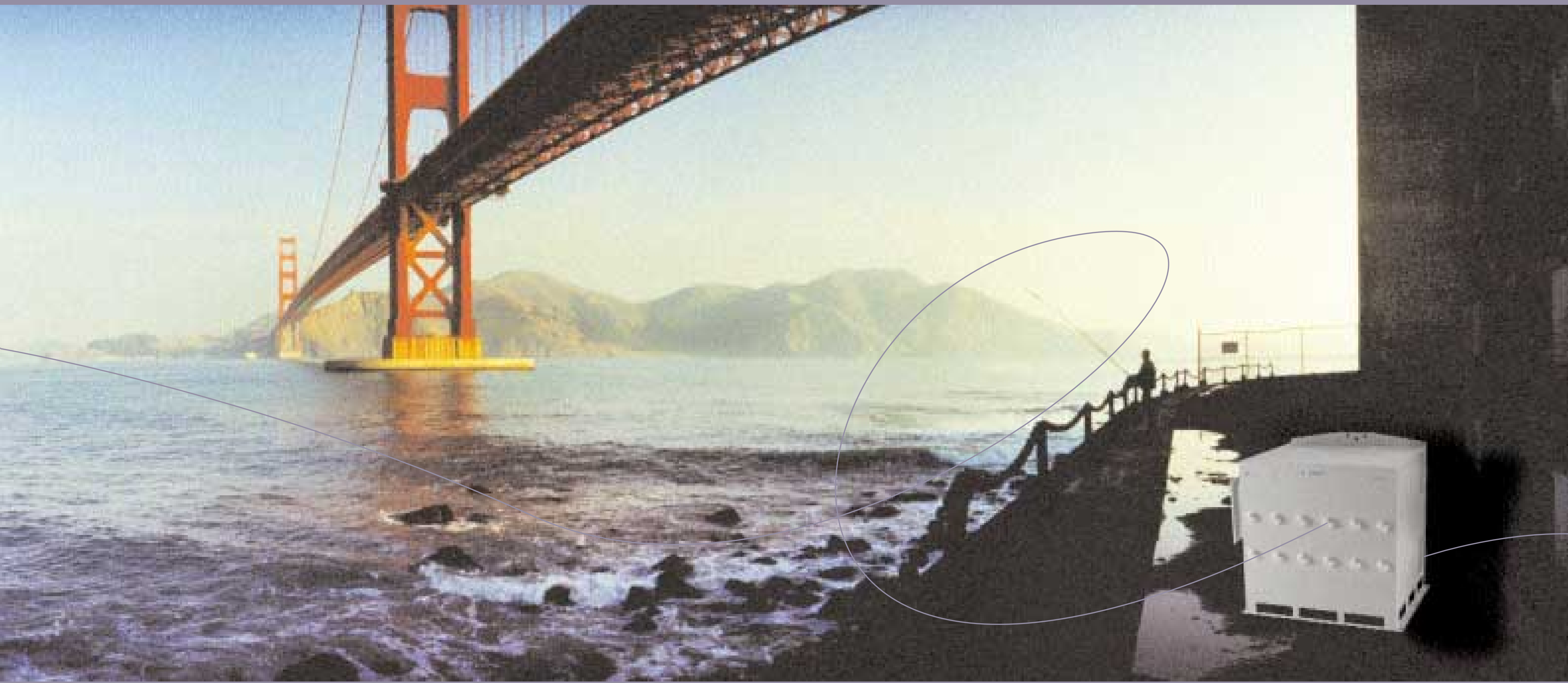


SuperLink™Rx 850

Other technologies may protect against interference. Others still, may enhance sensitivity. But STI offers the only solution that does both at once—amplifying the desired signal while eliminating any and all interference. It is performance without compromise. What does that mean for the wireless carrier? How about a reduction in dropped calls by 40 percent and blocked calls by 20 percent—enabling operators to improve the performance of their existing networks without having to make significant upgrades. SuperLink Rx from STI—"the ultimate uplink."

And then for those with so much to say,

Our SuperLink Solutions will span the bay!

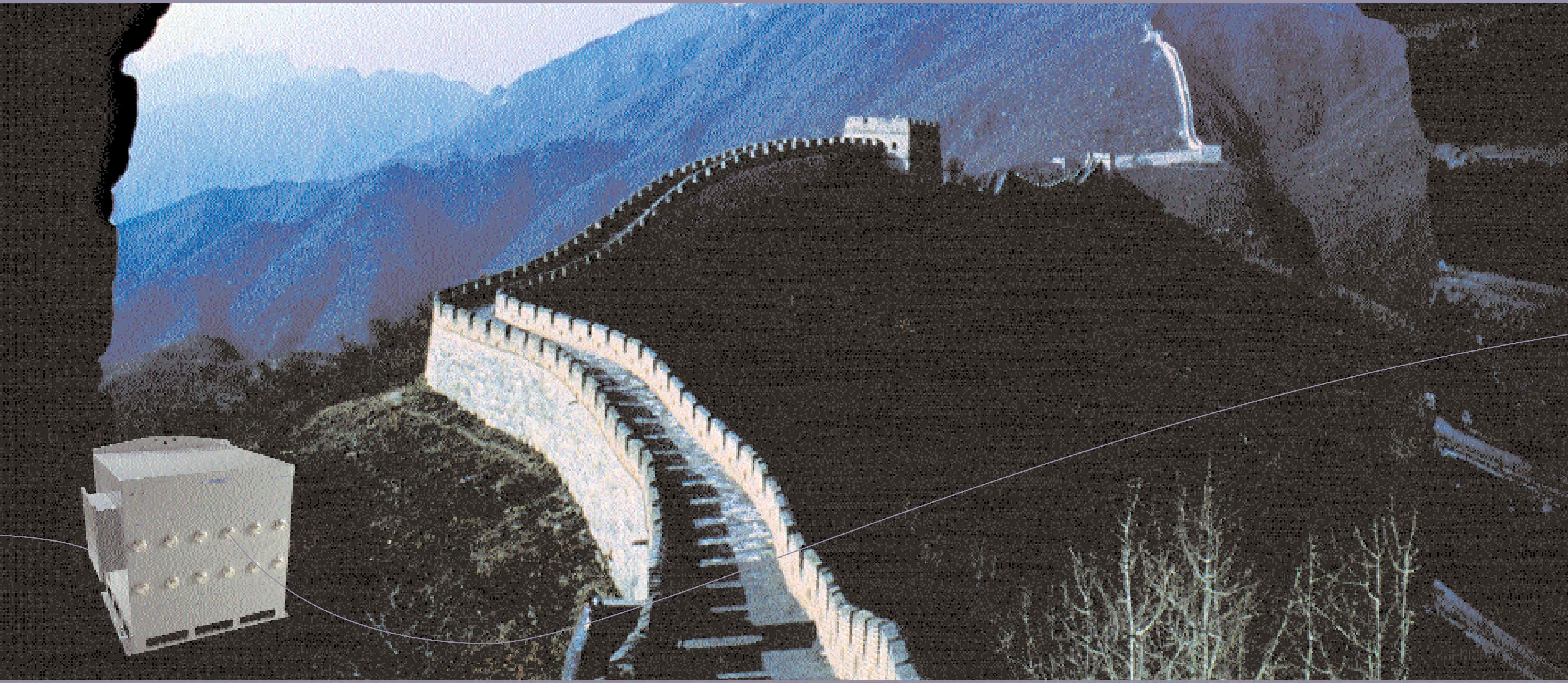


SuperLink™ Rx 1900

Latest Milestone. It's AmpLink™Rx 1900 and it's our first sensitivity-only link enhancement product—the direct result of listening to and addressing the needs of wireless operators and made possible by our comprehensive understanding of the issues of interference and network performance. Designed to include a high-performance amplifier and up to six duplexers, and upgradeable to include a highly-selective SuperLink Rx front-end, AmpLink Rx 1900 provides the best ground-based sensitivity solution on the market today—while "future-proofing" the next generation data networks of tomorrow.

So, from wherever in this world you make that call,

We provide *Total Link Enhancement*, even calling from a wall!



AmpLink™Rx 1900

Zoning & Customer Friendly. SuperPlex™ Solutions, our offering of HTS-Ready premium mutiplexers, were internally developed to enable fast and effective overlays while providing premium performance. Their very low transmit and receive insertion loss—in conjunction with their excellent cross-band isolation—means reducing the need for additional antennas as we efficiently combine transmit and receive signals. Something we call "antenna sharing without compromise."

And because our solutions are truly Plug-N-Play,

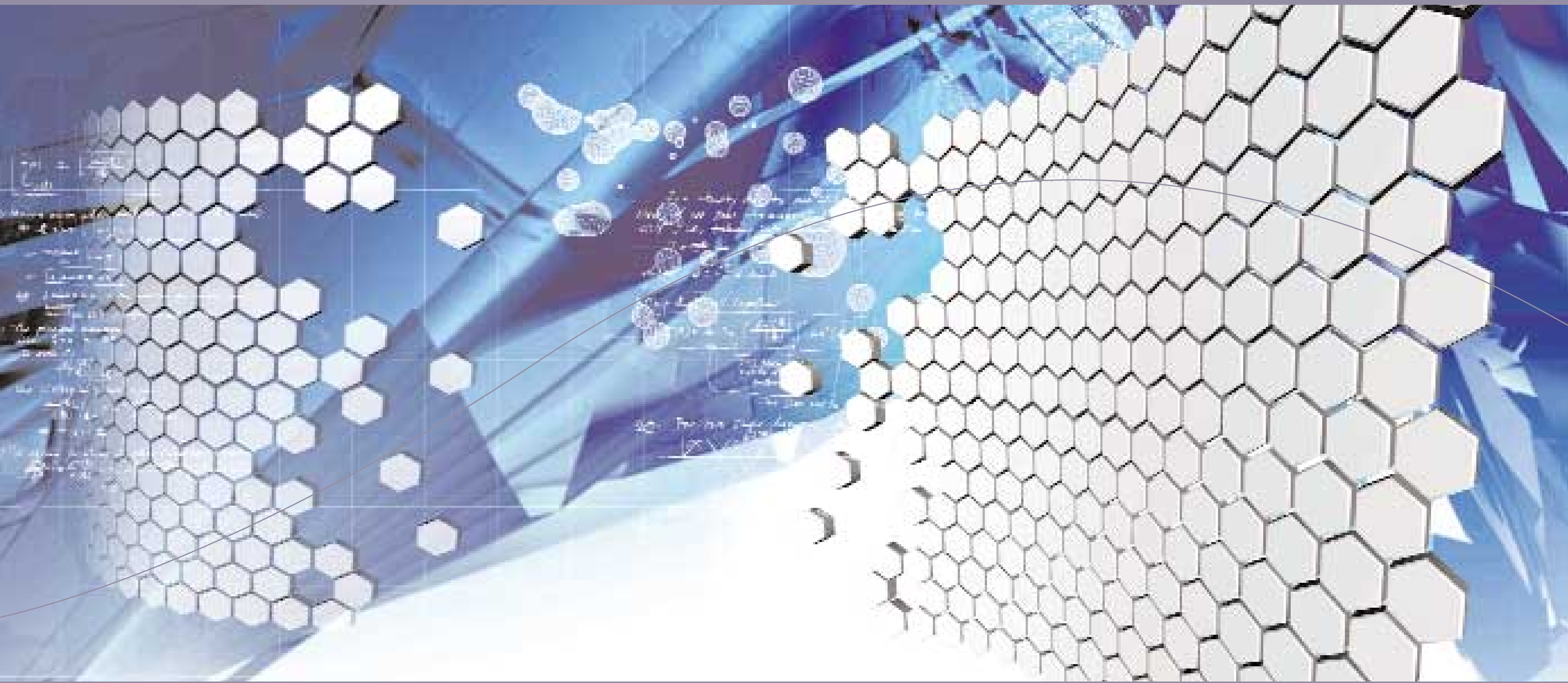
They'll work with any network, anyhow, anyway!

HTS-Ready™ Duplexer

The Next Verse. It's both where we go from here and what's to come. It's knowing what to expect and being ready for change. It's tomorrow. At Superconductor Technologies, we're helping to shape the wireless world of tomorrow—a world where more than one million base stations now serve more than one billion wireless customers. In the U.S. alone, some 150,000 base stations service nearly 150 million subscribers—a number that is still growing by double digits and translates to more than 600 billion minutes of use (MOU) annually.

At the core you'll recall it's all about cold.

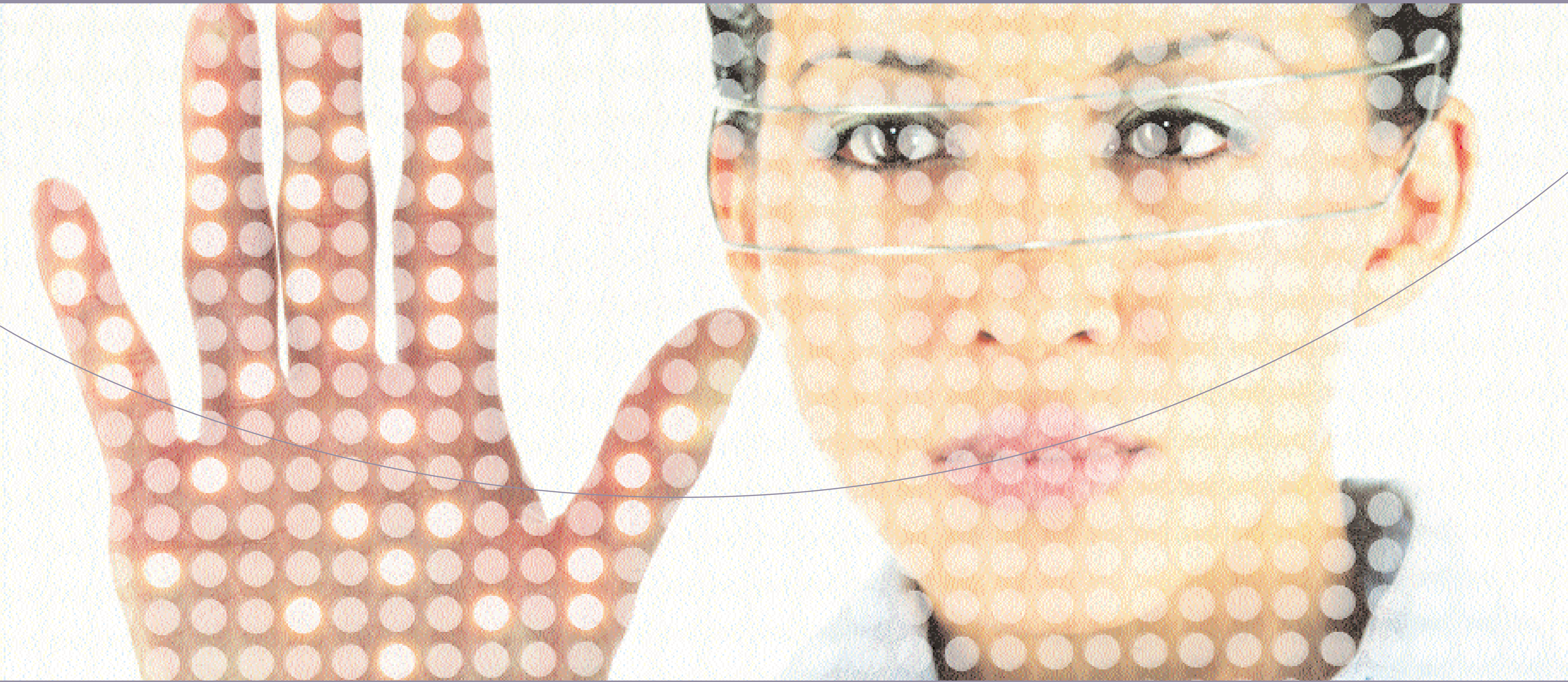
A cold that will have your customers sold.



What then is the next verse? It's 3G and it's finally coming and it's faster than we can imagine—the complete blending of voice, video and data, third-generation capabilities that wireless carriers are rushing to provide their customers. But to truly deliver on this promise will require both new networks and a significant increase in the quality and coverage of existing ones. So, what is the solution for tomorrow? It's HTS technology from STI and it's improving the quality of wireless communications even as we speak.

A claim we can make no matter how bold.

And now we can say our story's all told.



M. Peter Thomas
President & Chief Executive Officer

To Our Shareholders:

I am pleased to report that 2003 was yet another record year for Superconductor Technologies Inc. (STI). For the twelve months ended December 31, 2003, we achieved revenues of $49.4 million, more than doubling the $22.4 million reported for 2002 and bringing our two-year compound annual growth rate (CAGR) to over 100 percent.

STI also reaped the benefit of continued manufacturing efficiency improvements and product cost reductions, leading to the company's first profitable period in the fourth quarter of 2003.

I believe much of STI's success can be attributed to our customer focus. Our business is Improving the Quality of Wireless®, and we help wireless operators meet network challenges head on. No other company can provide a stronger link between a wireless operator's customers and its network. STI's cryogenic receiver front-end systems (CRFEs) – known commercially as SuperLink Rx – have become the industry standard and are enabling wireless operators worldwide to improve network performance. SuperLink Rx units now provide interference protection and higher sensitivity to thousands of base stations, saving millions of potential dropped and blocked calls every year.

Over the last twelve months, STI has continued its evolution into a fully market-driven company. In August 2003, we launched SuperLink Rx 1900, an integrated CRFE designed specifically for the PCS wireless market. The weatherized unit includes a SuperLink Rx front-end, the company's flagship product, and up to six dual duplexers in an outdoor enclosure. In late March 2004, STI introduced AmpLink Rx 1900, our first sensitivity-only link enhancement product. AmpLink Rx 1900 is upgradeable to include a highly selective SuperLink Rx front-end, allowing PCS operators to meet today's requirements while preparing for rising interference levels in the future. With Amplink Rx, our customers pay for only the benefits they currently need and can defer—without penalty—the cost of future performance enhancements. This is yet another example of how we at STI anticipate and meet the needs of our customers.

We are positioned for increased growth in the future as a result of an expected upturn in global CAPEX spending. Wireless local number portability has put North American operators under tremendous pressure to renew their focus on network quality and improve the end-user experience. Budgets remain tight, however, and STI's cost-effective network enhancement products are ideally suited to meet operator demands.

STI is also set to exploit the arrival of wireless data, which after years of hype has finally appeared on the shoulders of some of the most influential industry players, including Verizon Wireless in the United States and Vodafone in Europe.

Finally, we expect to benefit from Asia's continued surge in wireless subscribers, which is driving increasing demand for wireless infrastructure.

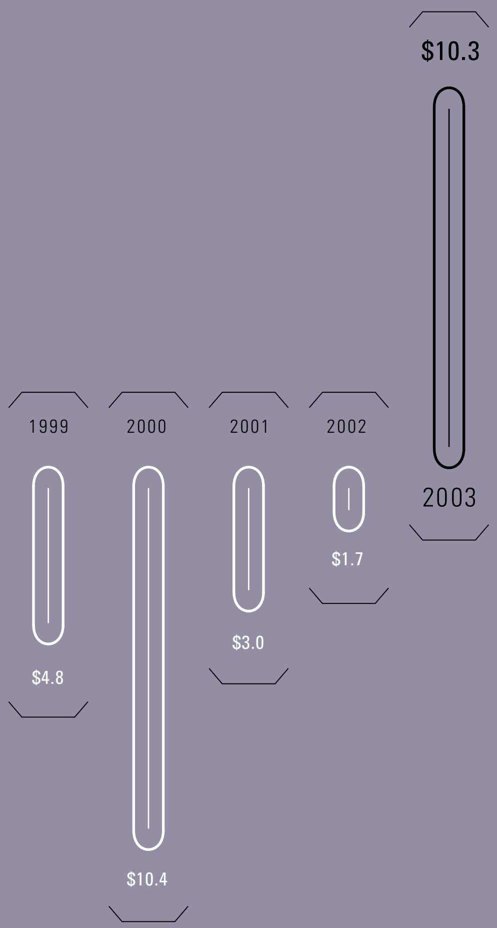
Over the last few years, STI has become a global leader in RF uplink enhancement solutions. We are a strong company that is growing stronger every day. As we move forward into 2004, I am often reminded that the secret of our success is not complicated – it is through the hard work and dedication of our employees, the support of our shareholders, and the loyalty of our customers that we have been able to come so far.

Best regards,

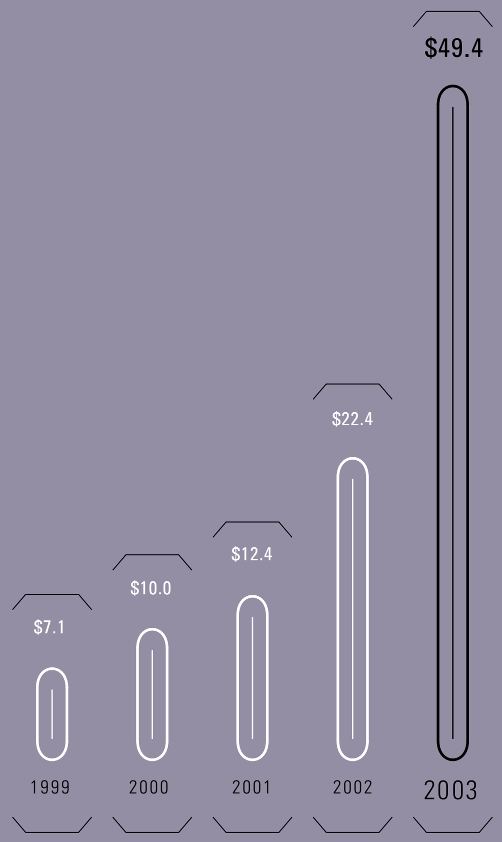
M. Peter Thomas

M. Peter Thomas

Commercial Gross Margin
(in millions)



STI Net Revenues
(in millions)



STI Senior Management Team

M. Peter Thomas
President and
Chief Executive Officer

Ken Barry
Vice President,
Human Resources

Richard R. Conlon
Senior Vice President,
Sales and Marketing

Robert B. Hammond, Ph.D.
Senior Vice President and
Chief Technical Officer

Robert L. Johnson
President,
STI Products Group

Martin S. McDermut
Senior Vice President,
Chief Financial Officer
and Secretary

Financial Table of Contents

Financial Information

DESCRIPTION OF BUSINESS

We develop, manufacture and market high performance products to service providers, systems integrators and original equipment manufacturers in the commercial wireless telecommunications industry. Our innovative products, known commercially as SuperLink™ Solutions, maximize the performance of wireless networks by improving the quality of "uplink" signals from subscriber terminals (wireless handsets or mobile wireless devices) to network base stations and of "downlink" signals from network base stations to subscriber terminals. These premium products are built around our flagship, SuperLink™Rx, and work in concert to provide Total Link℠ Enhancement, combining the benefits of our complementary solutions to meet the growing demand of the wireless telecommunications industry for improved capacity, reduced interference and greater coverage for their network base stations.

SAFE HARBOR STATEMENT

This report contains forward-looking statements that involve risks and uncertainties. We have made these statements in reliance on the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Our forward-looking statements relate to future events or our future performance and include, but are not limited to, statements concerning our business strategy, future commercial revenues, market growth, capital requirements, new product introductions, expansion plans and the adequacy of our funding. Other statements contained in this report that are not historical facts are also forward-looking statements. We have tried, wherever possible, to identify forward-looking statements by terminology such as "may," "will," "could," "should," "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and other comparable terminology.

Forward-looking statements are not guarantees of future performance and are subject to various risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially from those expressed in forward-looking statements. They can be affected by many factors, including, but not limited to the following:

- fluctuations in product demand,
- the impact of competitive filter products, technologies and pricing,
- manufacturing capacity constraints and difficulties,
- market acceptance risks, and
- general economic conditions.

The Company refers interested persons to its 2003 Annual Report on Form 10-K and its other SEC filings for a description of additional uncertainties and factors that may affect our forward-looking statements. Forward-looking statements are based on information presently available to senior management, and we do not assume any duty to update our forward-looking statements.

INVESTOR INFORMATION

All reports filed by the Company with the SEC are available free of charge via EDGAR through the SEC website at www.sec.gov. In addition, the public may read and copy materials filed by the Company with the SEC at the SEC's public reference room located at 450 Fifth St., N.W., Washington, D.C., 20549. You can obtain information about the operation of the SEC's Public Reference Room by calling the SEC at 1-800-SEC-0330. The Company also provides copies of its Forms 8-K, 10-K, 10-Q, Proxy, Annual Report and press releases at no charge to investors upon request and makes electronic copies of such reports and press releases available through its website at www.suptech.com as soon as reasonably practical after filing such material with the SEC. Requests should be sent to the Company, attention: Investor Relations or to invest@suptech.com.

Worldwide Web Address: www.suptech.com

MARKET FOR COMMON STOCK

We had approximately 402 holders of record of our common stock as of March 5, 2004. We estimate that there are more than 18,000 round lot beneficial owners of our common stock. We have never paid dividends and intend to employ all available funds in the development of our business. We do not expect to pay any cash dividends for the foreseeable future.

The Company's common stock is listed on The NASDAQ Stock Market under the symbol "SCON." The following table sets forth for the periods indicated the high and low intraday sales prices for our common stock as reported on The NASDAQ Stock Market®.

2002	High	Low
Quarter ended April 1, 2002	$ 6.79	$ 3.90
Quarter ended July 1, 2002	$ 5.09	$ 1.55
Quarter ended October 1, 2002	$ 1.93	$ 0.93
Quarter ended December 31, 2002	$ 1.60	$ 0.94
2003		
Quarter ended March 29, 2003	$ 1.20	$ 0.95
Quarter ended June 28, 2003	$ 3.67	$ 0.75
Quarter ended September 27, 2003	$ 5.25	$ 2.05
Quarter ended December 31, 2003	$ 7.65	$ 3.64

Selected Financial Data

The information set forth below is not necessarily indicative of results of future operations and should be read in conjunction with the Company's Financial Statements and Notes appearing elsewhere in this Annual Report and "Management's Discussion and Analysis of Financial Condition and Results of Operations." We acquired Conductus, Inc. on December 18, 2002. The results of Conductus, Inc. are included in the consolidated financial statements for 13 days in 2002 following its acquisition through December 31, 2002 and for the entire year of 2003.

Year Ended December 31, (In thousands, except per share data)	1999	2000	2001	2002	2003
STATEMENT OF OPERATIONS DATA:					
Net revenues:					
Net commercial product revenues	$ 2,053	$ 5,303	$ 7,601	$ 17,601	$ 38,577
Government contract revenues	5,059	4,643	4,782	4,785	10,759
Sub license royalties	10	10	10	10	58
Total net revenues	7,122	9,956	12,393	22,396	49,394
Costs and expenses:					
Cost of commercial product revenues	6,848	15,710	10,626	19,286	28,24
Contract research and development	3,427	4,235	3,359	2,531	6,899
Other research and development	1,747	2,633	4,606	4,489	4,697
Selling, general and administrative	5,664	8,357	11,907	14,976	20,567
Write off of in-process research and development	–	–	–	700	–
Total costs and expenses	17,686	30,935	30,498	41,982	60,412
Loss from operations	(10,564)	(20,979)	(18,105)	(19,586)	(11,018)
Other income (expense), net	(311)	323	904	73	(327)
Net loss	(10,875)	(20,656)	(17,201)	(19,513)	(11,345)
Less deemed and cumulative preferred stock Dividends	(1,364)	(2,203)	(2,603)	(1,756)	–
Net loss available to common stockholders before cumulative effect of accounting change	(12,239)	(22,859)	(19,804)	(21,269)	(11,345)
Cumulative effect of accounting change on preferred stock beneficial conversion feature	–	(10,612)	–	–	–
Net loss available to common stockholders	$ (12,239)	$ (33,471)	$ (19,804)	$ (21,269)	$ (11,345)
Basic and diluted net loss per share:					
Net loss per common share before cumulative effect of accounting change	$ (1.58)	$ (1.42)	$ (1.10)	$ (0.89)	$ (0.18)
Cumulative effect of accounting change	–	(0.67)	–	–	–
Net loss per common share	$ (1.58)	$ (2.09)	$ (1.10)	$ (0.89)	$ (0.18)
Weighted average number of shares Outstanding	7,744	16,050	17,956	24,020	62,685

December 31, (In thousands)	1999	2000	2001	2002	2003
BALANCE SHEET DATA:					
Cash and cash equivalents	$ 66	$ 31,824	$ 15,205	$ 18,191	$ 11,144
Working capital (deficit)	(13)	36,186	18,753	16,503	15,576
Total assets	11,085	46,761	30,161	65,326	68,12
Long-term debt, including current portion	961	751	509	2,123	721
Redeemable preferred stock	17,125	–	–	–	–
Total stockholders' equity (deficit)	(11,656)	38,409	23,663	49,524	52,220

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

GENERAL

We develop, manufacture and market high performance products to service providers, systems integrators and original equipment manufacturers in the commercial wireless telecommunications industry. Our products, known commercially as SuperLink Solutions, maximize the performance of wireless networks by improving the quality of "uplink" signals from subscriber terminals (wireless handsets or mobile wireless devices) to network base stations and of "downlink" signals from network base stations to subscriber terminals. These premium products are built around our flagship product, SuperLink Rx, and work in concert to provide Total Link Enhancement, combining the benefits of our complementary solutions to meet the growing demand of the wireless telecommunications industry for improved capacity, reduced interference, and greater coverage for their network base stations.

SuperLink Solutions consist of two unique product families: SuperLink Rx Solutions and SuperPlex Solutions. Together, these solutions allow service providers to benefit from lower capital and operating costs. They also increase the minutes of use because subscribers experience better call quality, fewer dropped calls and higher speed data transmissions.

> *SuperLink Rx*. In order to receive uplink signals from wireless terminals, base stations require a wireless filter system to eliminate, or filter out, out-of-band interference. To address this need, we offer SuperLink Rx. Deployed in base stations, these solutions combine specialized filters using high-temperature superconducting (HTS) technology with a proprietary cryogenic cooler and a low-noise amplifier. The result is the ultimate uplink, a highly compact and reliable cryogenic receiver front-end that can simultaneously deliver both high selectivity (interference rejection) and high sensitivity (detection of low level signals). SuperLink Rx products thereby offer significant advantages over conventional filter systems.
>
> *SuperPlex.*™ For antenna sharing without compromise, we offer SuperPlex, a line of multiplexers that provide extremely low insertion loss and excellent cross-band isolation.

During 2002 and 2003, we were marketing a power amplifier product called the SuperLink Tx manufactured by another company. The SuperLink Tx was for wireless networks that suffer from insufficient transmit power on the downlink signal path. This problem is particularly prevalent after the uplink has been improved by using SuperLink Rx. Our supplier for this product was acquired by a competitor of ours in November 2003. We have not had significant sales of the SuperLink Tx product to date. We are evaluating whether we can and should develop an alternative source of power amplifiers.

Net commercial product revenues are derived from the following products:

For the year ended December 31,	2001	2002	2003
SuperLink Rx product	$ 6,966,000	$ 15,195,000	$ 34,544,000
SuperPlex multiplexer	635,000	2,262,000	3,434,000
SuperLink Tx	–	–	88,000
Other	–	144,000	511,000
Total	$ 7,601,000	$ 17,601,000	$ 38,577,000

From 1987 to 1997, we were engaged primarily in research and development and generated revenues primarily from government research contracts. We began full-scale commercial production of the SuperFilter® in 1997 and shipped 1,884 units in 2003. Our focus is now fully on our commercial products, and we expect commercial revenues to continue increasing as a percentage of our total revenues. We have incurred cumulative losses of $116 million from inception to December 31, 2003.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to bad debts, inventories, intangible assets, income taxes, warranty obligations, contingencies and our loss contract with U.S. Cellular. We base our estimates on historical experience and on various other assumptions that we believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of the financial statements. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Our net sales consist of revenue from sales of products net of trade discounts and allowances. We recognize revenue when evidence of an arrangement exists, contractual obligations have been satisfied, title and risk of loss have been transferred to the customer and collection of the resulting receivable is reasonably assured. At the time revenue is recognized, we provide for the estimated cost of product warranties if allowed for under contractual arrangements. Our warranty obligation is effected by product failure rates and service delivery costs incurred in correcting a product failure. Should such failure rates or costs differ from these estimates, accrued warranty costs would be adjusted.

In connection with the sales of its commercial products, the Company indemnifies, without limit or term, its customers against all claims, suits, demands, damages, liabilities, expenses, judgments, settlements and penalties arising from actual or alleged infringement or misappropriation of any intellectual property relating to its products or other claims arising from its products. The Company cannot reasonably develop an estimate of the maximum potential amount of payments that might be made under its guarantee because of the uncertainty as to whether a claim might arise and how much it might total.

Contract revenues are principally generated under research and development contracts. Contract revenues are recognized utilizing the percentage-of-completion method measured by the relationship of costs incurred to total estimated contract costs. If the current contract estimate were to indicate a loss, utilizing the funded amount of the contract, a provision would be made for the total anticipated loss. Revenues from research related activities are derived primarily from contracts with agencies of the United States Government. Credit risk related to accounts receivable arising from such contracts is considered minimal. These contracts include cost-plus, fixed price and cost sharing arrangements and are generally short-term in nature.

All payments to the Company for work performed on contracts with agencies of the U.S. Government are subject to adjustment upon audit by the Defense Contract Audit Agency. Based on historical experience and review of current projects in process, management believes that the audits will not have a significant effect on the financial position, results of operations or cash flows of the Company.

In connection with the acquisition of Conductus we recognized $20 million of goodwill. During the fourth quarter of 2003 we tested the goodwill for possible impairment and determined that there was no impairment. This goodwill will again be tested for impairment in the fourth quarter of 2004 or earlier if events occur which require an earlier assessment. If the carrying amount exceeds its implied fair value, an impairment loss will be recognized equal to the excess.

As permitted under Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock-Based Compensation," the Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" in accounting for its stock options and other stock-based employee awards. Pro forma information regarding net loss and loss per share, as calculated under the provisions of SFAS 123, are disclosed in the notes to the financial statements. The Company accounts for equity securities issued to non-employees in accordance with the provision of SFAS 123 and Emerging Issues Task Force 96-18.

If the Company had elected to recognize compensation expense for employee awards based upon the fair value at the grant date consistent with the methodology prescribed by SFAS 123, the Company's net loss and net loss per share would have been increased to the pro forma amounts indicated below:

	2001	2002	2003
Net Loss:			
As reported	$ (17,201,000)	$ (19,513,000)	$ (11,345,000)
Stock-based compensation included in net loss	–	–	–
Stock-based compensation expense determined under fair value method	(3,970,000)	(4,056,000)	(5,435,000)
Pro forma	$ (21,171,000)	$ (23,569,000)	$ (16,780,000)
Basic and diluted loss per share:			
As reported	$ (1.10)	$ (0.89)	$ (0.18)
Stock compensation expense	(0.22)	(0.17)	(0.09)
Pro forma	$ (1.32)	$ (1.06)	$ (0.27)

Our valuation allowance against the deferred tax assets is based on our assessments of historical losses and projected operating results in future periods. If and when we generate future taxable income in the U.S. against which these tax assets may be applied, some portion or all of the valuation allowance would be reversed and an increase in net income would consequently be reported in future years.

BACKLOG

Our commercial backlog consists of accepted product purchase orders scheduled for delivery within 24 months and consists of purchase orders for both dollar and unit purchase commitments. The exact dollar commitment for unit commitments may vary depending on the exact units purchased. Based on past purchasing patterns and expected purchasing trends of customers with unit commitments, we estimate our backlog at December 31, 2003 to be $250,000, as compared to $1.4 million at December 31, 2002.

RESULTS OF OPERATIONS

Acquisition of Conductus

We acquired Conductus, Inc. on December 18, 2002. Conductus is located in Sunnyvale California and was a competing supplier of high-temperature superconducting technology for wireless networks. We discontinued their competing commercial product line (the ClearSite) and are incorporating their technology into our commercial product line (the SuperLink). We are also using their technical resources in Sunnyvale to supplement ours. The results of Conductus are included in the consolidated financial statement for 13 days in 2002 following its acquisition and for the entire year of 2003. The acquisition did not have a significant impact on the results of operations for the year ended December 31, 2002.

Recent Developments and Trends for 2004

We are a manufacturer of equipment to a relatively small number of customers and are highly sensitive to any changes experienced by our customers. We are currently experiencing the downside of such changes with two customers that we consider important for our revenues in 2004. One of our customers is being acquired. We believe that this customer has stopped work temporarily on certain infrastructure projects because of the acquisition. Some of these projects involved our products. We also believe that another customer meanwhile has decided to greatly accelerate a project to roll out a new third generation technology that has diverted their resources. This is delaying some projects to deploy our product for improvements to their existing network. We believe these are temporary impediments but cannot be certain of their duration. We are also aggressively pursuing efforts to have our product incorporated into our customers' new third generation wireless networks. We believe our product sales will, in the long run, continue to be driven by the need for efficient capital spending and improved network performance of both the existing wireless technologies and the new third generation wireless technologies such as 1X-EVDO, EDGE and W-CDMA.

We also expect increased competition in 2004 from vendors of other interference solutions such as tower mount amplifiers and conventional filters. We expect this will increase customer pressure on our product pricing in 2004. Our product pricing has always been influenced by this competition, and we have responded by continually and substantially reducing our product costs. We expect our product costs will continue to decline in 2004, but we cannot predict whether they will decline at a rate sufficient to keep pace with the competitive pricing pressure. This could adversely affect our net commercial product revenues and gross margins in 2004.

2003 Compared to 2002

Total net revenues increased by $27.0 million, or more than 100%, from $22.4 million in 2002 to $49.4 million for 2003. This increase is primarily due to higher commercial product sales and government and other contract revenues, including the government contract and other revenue from our acquisition of Conductus in December 2002.

We generate commercial revenues primarily from sales of our SuperLink Rx product line which combines specialized filters using high-temperature superconducting (HTS) technology with a proprietary cryogenic cooler and a low-noise amplifier in highly compact systems. We also started selling significant quantities of a new multiplexer product line starting in February 2001. Net commercial product revenue consists of gross commercial product sales proceeds less sales discounts and the allocation of certain sales proceeds to a warrant issued to one customer in 1999 under a long-term supply agreement. The following table summarizes the calculation of net commercial product revenue for 2003 and 2002:

For the year ended December 31, (In thousands)	2002	2003
Gross commercial product sales proceeds	$ 20,040	$ 38,964
Less allocation of proceeds to warrants issued to		
U.S. Cellular	(2,283)	(90)
Less sales discounts	(156)	(297)
Net commercial product revenues	$ 17,601	$ 38,577

Net commercial product revenues increased to $38.6 million in 2003 from $17.6 million in 2002, an increase of $21.0 million, or more than 100%. This increase is primarily the result of an increase in sales of our SuperLink Rx products of $17.2 million, increased sales of our multiplexer product of $1.2 million and a $2.3 million decrease in sales proceeds allocated to warrants issued to U.S. Cellular. The average selling price for the SuperLink Rx decreased 7% on our SIX-Pak units and increased 1% on our TWO-Pak units. Our two largest customers accounted for 85% of our net commercial revenues in 2003 and 92% in 2002.

Government contract revenues increased by $6.0 million, or more than 100%, from $4.8 million in 2002 to $10.8 million in 2003. This increase results primarily from the acquisition of Conductus which totaled $4.6 million and the remainder to a modest increase in other government contracts at our Santa Barbara facility. In our business model, we use government contracts as a source of funds for our commercial technology development. We primarily pursue government research and development contracts which complement our commercial product development. In other words, we undertake government contract work which has the potential to add to or improve our commercial product line. These contracts often yield valuable intellectual property relevant to our commercial business. Under the terms of our government contracts, we retain exclusive rights to this technology for commercial applications and the federal government has a non-exclusive license to exploit the technology for government applications.

Cost of commercial product revenue includes all direct costs, manufacturing overhead and related start-up costs. The cost of commercial product revenues totaled $28.2 million for 2003. For 2002, cost of commercial products revenues totaled $19.3 million, and was reduced by amortization credits of $2.0 million for the accrual of a non-cash contract loss on the purchase order from U.S. Cellular. Please read the discussion on page 33 entitled "Non-Cash Charges for Warrants Issued to U.S. Cellular." For 2002, excluding these amortization credits, the cost of commercial revenues totaled $21.3 million compared to $28.2 million in 2003. Increased costs resulting from increased unit shipments and higher costs associated with ramping up our manufacturing capacity were offset by lower material and labor costs per unit and the effect of increased manufacturing efficiencies.

We generated positive commercial gross margins of $10.3 million in 2003 from the sale of our commercial products, as compared to negative gross margins of $1.7 million for 2002. The improvement is due to increased commercial product revenues and decreased manufacturing cost per unit.

Contract research and development expenses totaled $6.9 million in 2003 and $2.5 million in 2002. The increase is primarily from the acquisition of Conductus. The remainder is attributable to a modest increase in government contract revenues at our Santa Barbara facility.

Other research and development expenses are for internally funded development of our commercial products. These expenses increased to $4.7 million in 2003, and are comparable to $4.5 million in 2002.

Selling, general and administrative expenses totaled $20.6 million in 2003 as compared to $15.0 million in 2002. This increase results primarily from increased domestic and international marketing and sales efforts, higher expenses related to the acquired Conductus operations and higher ISCO litigation expenses. ISCO litigation expenses totaled $4.8 million in 2003, as compared to $3.1 million in 2002. ISCO has appealed their loss in the trial court, and we expect ongoing but modest litigation expenses in 2004 for the appeal process.

Interest income decreased in 2003 as compared to 2002 due to decreased levels of cash available for investment and the decline in interest rates.

Interest expense increased in 2003 as compared to 2002 and resulted from the increased debt incurred in the fourth quarter of 2002, from short-term borrowings in 2003 and accretion of long term liabilities recorded in the Conductus acquisition.

We had a net loss of $11.3 million for 2003 as compared to $19.5 million in 2002.

The net loss available to common shareholders totaled $11.3 million in 2003, or $0.18 per common share, as compared to $21.3 million, or $0.89 per common share, in 2002. The amounts for 2002 include a charge of $1.8 million for a non-cash deemed distribution on preferred stock.

2002 Compared to 2001

Total net revenues increased by $10.0 million, or more than 81%, from $12.4 million for 2001 to $22.4 million for 2002. The increase is primarily due to higher commercial product sales. The following table summarizes the calculation of net commercial product revenue for 2002 and 2001. (Please read the discussion on page 33 under the caption "Non-Cash Charges for Warrants Issued To U.S. Cellular" for a discussion of the allocation to warrants.)

For the year ended December 31, (In thousands)	2001	2002
Gross commercial product sales proceeds	$ 9,907	$ 20,040
Less allocation of proceeds to warrants issued to U.S. Cellular	(2,238)	(2,283)
Less sales discounts	(68)	(156)
Net commercial product revenues	$ 7,601	$ 17,601

Net commercial product revenues increased to $17.6 million in 2002 from $7.6 million in 2001, an increase of $10.0 million, or more than 100%. This increase is primarily the result of an increase in sales of our SuperLink Rx products of $8.2 million-and increased sales of our new multiplexer product of $1.6 million. The average selling price for the SuperLink Rx decreased 19% on our SIX-Pak units and decreased 2% on our TWO-Pak units. The SIX-Pak price decrease followed a discount on a large order of product in December 2001. Our two largest customers accounted for 92% of our net commercial revenues in 2002 and 85% in 2001.

Government contract revenues totaled $4.8 million in 2002 and are comparable to the prior year.

Cost of commercial product revenue includes all direct costs, manufacturing overhead and related start-up costs. The cost of commercial product revenues totaled $19.3 million for 2002, and was reduced by amortization credits of $2.0 million relating to the accrual for non-cash contract loss on the purchase order from U.S. Cellular. Please read the subsection below entitled "Non-Cash Charges for Warrants Issued To U.S. Cellular". For 2002, excluding these amortization credits, the cost of commercial revenues totaled $21.3 million as compared to $12.9 million in 2001. This increase resulted from increased unit shipments and higher costs associated with ramping up the Company's manufacturing capacity, partially offset by lower material and labor costs per unit and the effect of increased manufacturing efficiencies.

For the year ended December 31, 2002 we generated negative gross margins on our commercial products at current sales levels primarily due to fixed manufacturing overhead costs. However, in the fourth quarter of 2002 we generated positive gross margins of $112,000 from net commercial sales of $4.3 million..

Contract research and development expenses totaled $2.5 million in 2002 as compared to $3.4 million in the prior year and included subcontract expenses of $93,000 and $1.4 million, respectively. Excluding subcontract expenses, contract research and development expenses decreased to $2.4 million in 2002, as compared to $2.0 million last year. This decrease results from the increased focus on commercial research efforts.

Other research and development expenses relate to development of our commercial products. These expenses totaled $4.5 million in 2002 and are comparable to the prior year.

Write off of in-process research and development (IPR&D) totaled $700,000 and resulted from the acquisition of Conductus. The amount of the purchase price allocated to purchased IPR&D was expensed upon acquisition, because the technological feasibility of products under development has not been established and no alternative future uses existed. The IPR&D relates to technologies representing processes and expertise employed to make new high temperature superconducting materials technology and device design and cryopackaging and systems integration technology. At the time of the acquisition, the products under development were about 50% complete and it was expected that the remaining efforts would be completed by the end of 2004 at a cost of approximately $2.5 million. The remaining efforts include completion of development processes, manufacturing processes, final product integration and testing. All of the IPR&D projects are subject to the normal risks and uncertainties.

Selling, general and administrative expenses totaled $15.0 million in 2002 as compared to $11.9 million in 2001. This increase results primarily from increased domestic and international marketing and sales efforts and ISCO litigation expenses. ISCO litigation expenses totaled $3.1 million for 2002 as compared to $976,000 in 2001.

Interest income decreased in 2002 as compared to 2001 due to decreased levels of cash available for investment and the decline in interest rates.

Interest expense in 2002 was comparable to the prior year.

We had a net loss of $19.5 million in 2002 as compared to $17.2 million in 2001.

The net loss available to common shareholders totaled $21.3 million in 2002, or $0.89 per common share, as compared to $19.8 million, or $1.10 per common share, in 2001. The amounts for 2002 and 2001 include a $1.8 million and $2.6 million, respectively, non-cash deemed distribution on preferred stock.

Liquidity and Capital Resources

We continue to depend on equity transactions for a significant portion of the financing for our operations. The following summarizes our equity transactions since January 1, 2000:

> On February 11, 2000, we completed a public offering of 2,473,701 shares of common stock, priced at $3.25 per share, of which 2,319,855 shares of common stock were sold for a cash payment totaling $7,540,000 and 153,846 shares of common stock were exchanged for short-term indebtedness of $500,000. We received net proceeds totaling $7.4 million. Concurrent with the offering, the holders of the Series A-2, A-3 and C Redeemable Convertible Preferred Stock converted their holdings into 2,458,391 shares of common stock. As an inducement to convert the preferred shares, we issued the preferred stockholders warrants to purchase 250,000 shares of common stock at $3.58 per share. Also during the year ended December 31, 2000, the holders of the outstanding Series B-1 and D preferred shares elected to convert their holdings into 3,175,409 shares of common stock.
>
> On September 29, 2000, we completed a private placement of 37,500 shares of Series E Convertible Preferred Stock and warrants to purchase up to an additional 1,044,568 shares of common stock. We received net proceeds totaling $35,155,000. The preferred stock was non-voting, had a stated value and a liquidation preference of $1,000 per share, and was convertible into common stock at the lower of $17.95 per common share or the market price of the common stock at the time of conversion, subject to an implicit floor.
>
> During 2001, preferred stockholders converted 3,000 Series E preferred shares into 625,093 shares of common stock, and we issued 51,212 shares of common stock to pay for the conversion premium. During 2002, preferred stockholders converted the remaining 34,500 shares of Series E preferred stock into 2,878,351 shares of common stock. We paid the associated conversion premium of $4,686,000 with $3.0 million in cash and an eighteen-month $1.7 million subordinated note.
>
> The subordinated note carries eight percent interest with interest only payable for the first six months and monthly amortization of principal and interest for the remaining twelve months.
>
> In connection with the sale of the Series E preferred stock, we also issued two five-year warrants to purchase shares of common stock at an exercise price of $21.54 per share. The first warrant is for the purchase of 313,370 shares and the second warrant is for the purchase of up to 731,198 additional shares of common stock. Both warrants are currently exercisable and contain "weighted average" anti-dilution provisions which adjust the warrant exercise price and number of shares in the event the Company sells equity securities at a discount to then prevailing market prices. The amount of the adjustment depends on the size of the below-market transaction and the amount of the discount to the market price. The warrant exercise price cannot be reduced below a minimum of $18.91 as the result of adjustments under this provision. As a result of the issuance of common shares during 2002 and 2003, the warrant exercise prices were reduced to $19.28 and the aggregate number of shares increased to 1,166,477.
>
> In March 2002, we raised net proceeds of $12,122,000 from the private sale of 3,714,286 shares of common stock at $3.50 per share based on a negotiated discount to market and 5-year warrants to purchase an additional 557,143 shares of common stock exercisable at $5.50 per share. In conjunction with this equity issuance, we also issued to the placement agent 5-year warrants to purchase up to 213,571 shares of common stock at an exercise price of $5.50 per share.
>
> In connection with the acquisition of Conductus, Inc. in December 2002, we raised net proceeds of $19,704,000 from the private sale of 21,096,954 shares of common stock at $0.95 per share based on a negotiated discount to market and 5-year warrants to purchase an additional 5,274,240 shares of common stock exercisable at $1.19 per share.
>
> In June 2003, we raised net proceeds of $10.1 million from the private sale of 5,116,278 shares of common stock at $2.15 per share and 5-year warrants to purchase an additional 1,279,069 shares of common stock at $2.90 per share.

We have effective registration statements on file with the SEC covering the public resale by investors of all the common stock issued in our private placements, as well as any common stock acquired upon the exercise of their warrants.

Cash and cash equivalents decreased by $7.1 million, from $18.2 million at December 31, 2002 to $11.1 million at December 31, 2003. Cash used in operations and investing activities during 2003 was partially offset by cash received from the sale of common stock and warrants in a private placement, exercises of warrants and options and a net increase in borrowings. Cash and cash equivalents increased by $3.0 million, from $15.2 million at December 31, 2001 to $18.2 million at December 31, 2002. Cash used in operations and investing activities during 2002 was offset by cash received from the sale of common stock and warrants in a private placement during the first and fourth quarters.

Net cash used in operations totaled $14.7 million in 2001, $20.0 million in 2002 and $18.5 million in 2003. The increase in cash used in operations in 2002 is primarily the result of the $1.5 million increased cash portion of our net loss and to a $3.8 million net increase in accounts receivable, inventories and other current and non current assets and paydown of accounts payable and accrued liabilities. The decrease in cash used in operations in 2003 is primarily due the decrease in cash loss of $8.6 million, partially offset by increased cash used in other operating assets and liabilities over that in 2002. Depreciation and amortization expense increased in the year ended December 31, 2003 due to increased amortization related to the acquired technology in the Conductus acquisition and increased fixed assets expenditures in the prior year.

Net cash used in investing activities totaled $1.9 million in 2001, $5.5 million in 2002 and $4.4 million in 2003. It related in each year primarily to purchases of manufacturing equipment and facilities improvements. In 2003, cash of $500,000 was used to pay upfront license fees for a new technology license. In 2002, cash of $429,000 was used in the acquisition of Conductus, Inc. and $374,000 was provided by the release of restrictions on $374,000 of cash obtained through the Conductus acquisition.

Net cash provided by (used in) financing activities totaled ($24,000) in 2001, $28.4 million in 2002 and $15.8 million in 2003. The net cash provided by financing activities in 2003 primarily resulted from the sales of common stock and warrants for $10.1 million in June 2003, $3.8 million from the exercise of warrants in December 2003 and, net borrowings against our credit facility totaling $3.3 million. These sources of funds were partially offset by the reduction in long-term borrowings of $1.4 million. The net cash provided by financing activities in 2002 primarily resulted from the sale of common stock and warrants for $12.2 million in March 2002 and for $19.7 million in December 2002 relating to the Conductus acquisition. These amounts were partially offset by the payments on long-term debt and $3.0 million premium paid on the conversion of the Series E convertible preferred stock. In 2001, cash used in financing operations resulted from the exercise of stock options, which totaled $218,000 and was offset by the net reduction in borrowings of $242,000.

We have a line of credit from a bank. It is a material source of funds for our business. We recently renewed the line of credit for an additional year until March 17, 2005. The line of credit is structured as a sale of our accounts receivable. The loan agreement provides for the sale of up to $5.0 million of eligible accounts receivable, with advances to us totaling 80% of the receivables sold. Advances bear interest at the prime rate (4.00% at December 31, 2003) plus 2.50% subject to a minimum monthly charge. Outstanding amounts under this borrowing facility at December 31, 2003 totaled $3,308,000. The amount outstanding is repayable upon collection of the underlying accounts receivable. Advances are secured by a lien on all of our assets. Under the terms of the agreement, we continue to service the sold receivables and are subject to recourse provisions. In connection with this agreement, we issued seven year warrants to the bank for the purchase of 94,340 shares of common stock at $1.06 per share.

At December 31, 2003, we had the following cash commitments:

	Payments Due by Period				
Contractual Obligations	Total	Less than 1 year	2-3 years	4-5 years	After 5 years
Capital lease obligations	$ 174,000	$ 85,000	$ 74,000	$ 15,000	$ –
Principal and interest payments on subordinated note payable	587,000	587,000	–	–	–
Operating leases	13,399,000	2,466,000	3,877,000	2,730,000	4,326,000
Minimum license commitment	3,150,000	270,000	540,000	540,000	1,800,000
Fixed asset purchase commitments	817,000	817,000	–	–	–
Total contractual cash obligations	$18,127,000	$ 4,225,000	$ 4,491,000	$ 3,285,000	$ 6,126,000

We plan to invest approximately $2.0 to 5.0 million in fixed assets during 2004 to continue to expand manufacturing ability depending on market demand for our product. This plan is contingent on our ability to raise additional capital later this year.

Our auditors have included in their report for the 2003 year an explanatory paragraph expressing doubt about our ability to continue as a going concern due to past losses and negative cash flows. They included a similar explanatory paragraph in their audit report for 2002. In 2003, we incurred a net loss of $11,345,000 and negative cash flows from operations of $18,458,000. We are also experiencing lower than expected revenues in the first quarter of 2004. In response, we are adjusting our inventory build plan, reducing direct labor, cutting certain fixed costs and implementing a reduced work week. We believe these steps will provide us with sufficient capital resources to continue normal operations until we can complete a financing transaction. We will need additional financing in the short term, but we have not yet made any decision concerning our fund raising plans.

We cannot give assurance that additional financing (public or private) will be available on acceptable terms or at all. If we issue additional equity securities to raise funds, the ownership percentage of its existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise any needed funds, we would also be forced to make further substantial reductions in its operating expenses, which could adversely affect our ability to implement our current business plan and ultimately our viability as a company.

Our financial statements have been prepared assuming that we will continue as a going concern. The factors described above raise substantial doubt about our ability to continue as a going concern. These financial statements do not include any adjustments that might result from this uncertainty.

NON-CASH CHARGES FOR WARRANTS ISSUED TO U.S. CELLULAR

In August 1999, we entered into a warrant agreement with United States Cellular Corporation ("U.S. Cellular") where the exercise of a warrant to purchase up to 1,000,000 shares of common stock was conditioned upon future product purchases by U.S. Cellular. Under the terms of the warrant, U.S. Cellular vests in the right to purchase one share of common stock at $4 per share for every $25 of SuperFilter systems purchased. The warrant is immediately exercisable with respect to any vested shares and expires August 27, 2004. For accounting purposes, we are allocating proceeds from sales under this agreement between commercial product revenues and the estimated value of the warrants vesting in connection with those sales. The estimated fair value of the warrants in excess of the related sales, when applicable, is recorded in cost of commercial product revenues.

In September 2000, we received a $7.8 million noncancelable purchase order from U.S. Cellular for SuperFilter" systems to be shipped over the next nine quarters. In consideration for the purchase order, we amended the August 1999 warrant agreement and vested 312,000 warrants to U.S. Cellular. The vested warrants are immediately exercisable, not subject to forfeiture, and U.S. Cellular has no other purchase obligations.

We estimated the fair value of the warrants vesting upon receipt of this order at $5,635,000 using the Black-Scholes option-pricing model and recorded this amount as a deferred warrant charge in the statement of stockholders' equity. As SuperFilter systems are shipped under this purchase order, the related sales proceeds will be allocated between stockholders' equity and commercial product revenue using the percentage relationship which existed between the fair value of the warrants as recorded in September 2000 and the amount of the non-cancelable purchase order. During 2001and 2002 sales proceeds of $2,237,000 and $2,280,000, respectively, for shipments pursuant to this purchase order were allocated to the deferred warrant charge and proceeds of $879,000 and $967,000, respectively, were recorded as commercial product revenues under this purchase order.

After the allocation of sales proceeds under the $7.8 million purchase order to the related warrants, the estimated cost of providing products under the purchase order exceeded related revenue by $5.3 million. The resulting loss was reflected in the results of operations for the year ended December 31, 2000. During the years ending December 31, 2001 and 2002, $2,243,000 and $1,998,000, respectively, of this reserve was reversed against the cost of product delivered under this purchase order.

During the fourth quarter of 2002, deliveries under the $7.8 million purchase order were completed. For accounting purposes proceeds from subsequent sales to U.S. Cellular under this agreement are again being allocated between commercial product revenue and the estimated value of the warrants vesting using the Black-Scholes option-pricing model. For subsequent product sales in the fourth quarter of 2002 and the year ended December 31, 2003, U.S. Cellular vested in the right to exercise the warrant and purchase a total of 22,540 and 38,088 shares of common stock and sales proceeds allocated to warrants vesting in 2002 and 2003 totaled $3,000 and $90,000, respectively.

As of December 31, 2003, U.S. Cellular had 524,932 unvested warrants that can be earned from future product orders through August 27, 2004.

NET OPERATING LOSS CARRYFORWARD

As of December 31, 2003, the Company has net operating loss carryforwards for federal and state income tax purposes of approximately $215.1 million and $90.6 million, respectively, which expire in the years 2003 through 2023. Of these amounts $93.9 million and $30.2 million, respectively resulted from the acquisition of Conductus. Included in the net operating loss carryforwards are deductions related to stock options of approximately $24.0 million and $13.0 million for federal and California income tax purposes. To the extent net operating loss carryforwards are recognized for accounting purposes the resulting benefits related to the stock options will be credited to stockholders' equity. In addition, the Company has research and development and other tax credits for federal and state income tax purposes of approximately $2.6 million and $2.3 million, respectively, which expire in the years 2003 through 2023. Of these amounts $972,000 and $736,000, respectively resulted from the acquisition of Conductus.

Due to the uncertainty surrounding their realization, the Company has recorded a full valuation allowance against its net deferred tax assets. Accordingly, no deferred tax asset has been recorded in the accompanying balance sheet.

Section 382 of the Internal Revenue Code imposes an annual limitation on the utilization of net operating loss carryforwards based on a statutory rate of return (usually the "applicable federal funds rate", as defined in the Internal Revenue Code) and the value of the corporation at the time of a "change of ownership" as defined by Section 382. Recently, the Company completed an analysis of its equity transactions and determined that it had a change in ownership in August 1999 and December 2002. Therefore, the ability to utilize net operating loss carryforwards incurred prior to the change of ownership totaling $101.6 million will be subject in future periods to an annual limitation of $1.3 million. In addition, the Company acquired the right to Conductus' net operating losses, which are also subject to the limitations imposed by Section 382. Conductus underwent three ownership changes which occurred in February 1999, February 2001 and December 2002. Therefore, the ability to utilize Conductus' net operating loss carryforwards of $93.9 million incurred prior to the ownership changes will be subject in future periods to annual limitation of $700,000. Net operating losses incurred by the Company subsequent to the ownership changes totaled $19.5 million and are not subject to this limitation.

FUTURE ACCOUNTING REQUIREMENTS

In June 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"), which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes Emerging Issues Task Force ("EITF") Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF Issue 94-3, a liability for an exit cost as defined in EITF Issue 94-3 was recognized at the date of an entity's commitment to an exit plan. SFAS 146 also establishes that the liability should initially be measured and recorded at fair value. The Company adopted the provisions of SFAS 146 effective January 1, 2003 and such adoption did not have a material impact on the consolidated financial statements.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others ("FIN 45"). FIN 45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The Company adopted the disclosure provisions of FIN 45 during the fourth quarter of 2002 and the recognition provisions of FIN 45 effective January 1, 2003. Such adoption did not have a material impact on the consolidated financial statements.

In January 2003, FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities ("FIN 46"). In general, a variable interest entity is a corporation, partnership, trust or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights nor (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The Company adopted the provisions of FIN 46 effective February 1, 2003 and such adoption did not have an impact on its consolidated financial statements since it currently has no variable interest entities. In December 2003, the FASB issued FIN 46R with respect to variable interest entities created before January 31, 2003, which among other things, revised the implementation date to the first year or interim period ending after March 15, 2004, with the exception of Special Purpose Entities ("SPE). The consolidation requirements apply to all SPE's in the first year or interim period beginning after December 15, 2003. The Company adoption of the provisions of FIN 46R is not expected to have a material impact on the Company's its consolidated financial statements since it currently has no SPE's.

In April 2003, FASB issued Statement of Financial Accounting Standards No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities ("SFAS 149"). SFAS 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS 133. SFAS 149 is effective for contracts and hedging relationships entered into or modified after June 30, 2003. The Company adopted the provisions of SFAS 149 effective June 30, 2003 and such adoption did not have an impact on its consolidated financial statements since the Company has not entered into any derivative or hedging transactions.

In May 2003, FASB issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity ("SFAS 150"). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both debt and equity and requires an issuer to classify the following instruments as liabilities in its balance sheet:

A financial instrument issued in the form of shares that is mandatorily redeemable and embodies an unconditional obligation that requires the issuer to redeem it by transferring its assets at a specified or determinable date or upon an event that is certain to occur;

A financial instrument, other than an outstanding share, that embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and requires the issuer to settle the obligation by transferring assets; and

A financial instrument that embodies an unconditional obligation that the issuer must settle by issuing a variable number of its equity shares if the monetary value of the obligation is based solely or predominantly on (1) a fixed monetary amount, (2) variations in something other than the fair value of the issuer's equity shares, or (3) variations inversely related to changes in the fair value of the issuer's equity shares.

In November 2003, FASB issued FASB Staff Position No. 150-3 which deferred the effective dates for applying certain provisions of SFAS 150 related to mandatorily redeemable financial instruments of certain non-public entities and certain mandatorily redeemable non-controlling interests for public and non-public companies. For public entities, SFAS 150 is effective for mandatorily redeemable financial instruments entered into or modified after May 31, 2003 and is effective for all other financial instruments as of the first interim period beginning after June 15, 2003. For mandatorily redeemable non-controlling interests that would not have to be classified as liabilities by a subsidiary under the exception in paragraph 9 of SFAS 150, but would be classified as liabilities by the parent, the classification and measurement provisions of SFAS 150 are deferred indefinitely. The measurement provisions of SFAS 150 are also deferred indefinitely for other mandatorily redeemable non-controlling interests that were issued before November 4, 2003. For those instruments, the measurement guidance for redeemable shares and non-controlling interests in other literature shall apply during the deferral period.

We adopted the provisions of SFAS 150 effective June 30, 2003, and such adoption did not have an impact on our consolidated financial statements.

MARKET RISK

We are exposed to various market risks, including changes in interest rates. Market risk is the potential loss arising from adverse changes in market rates and prices. We do not enter into derivatives or other financial instruments for trading or speculation purposes.

At December 31, 2003, we had approximately $10.6 million invested in a money market account yielding approximately 0.9%. Assuming a 0.9% decrease in the yield on this money market account and no liquidation of principal for the year, our total interest income would decrease by approximately $95,000 per annum. Also, at December 31, 2003 we had $3.3 million outstanding under a bank borrowing arrangement bearing interest at the prime rate (4.00% at December 31, 2003) plus 2.50%. Assuming a 1% increase in the prime rate interest and that the amount was outstanding for the entire year, interest expense would increase $33,000.

INFLATION

We do not foresee any material impact on our operations from inflation.

Report of Independent Auditors

TO THE BOARD OF DIRECTORS
AND STOCKHOLDERS OF
SUPERCONDUCTOR TECHNOLOGIES INC.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Superconductor Technologies Inc. and subsidiaries at December 31, 2002 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has had recurring losses and used $18.5 million in cash for operations in 2003. These matters raise a substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

PricewaterhouseCoopers LLP

Los Angeles, California
February 27, 2004

Consolidated Balance Sheet

ASSETS

December 31,	2002	2003
Current Assets:		
Cash and cash equivalents	$ 18,191,000	$ 11,144,000
Accounts receivable, net	3,405,000	8,809,000
Inventory	6,347,000	8,802,000
Prepaid expenses and other current assets	555,000	760,000
Total Current Assets	28,498,000	29,515,000
Property and equipment, net of accumulated depreciation of $12,648,000 and $15,061,000, respectively	11,091,000	12,534,000
Patents, licenses and purchased technology, net of accumulated amortization of $2,368,000 and $3,173,000, respectively	5,141,000	5,367,000
Goodwill	20,107,000	20,107,000
Other assets	489,000	600,000
Total Assets	$ 65,326,000	$ 68,123,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Line of credit	$ –	$ 3,308,000
Accounts payable	5,888,000	5,154,000
Accrued expenses	4,557,000	4,832,000
Current portion of capitalized lease obligations and long term debt	1,550,000	645,000
Total Current Liabilities	11,995,000	13,939,000
Capitalized lease obligations and long term-debt	573,000	76,000
Other long term liabilities	3,234,000	1,888,000
Total Liabilities	15,802,000	15,903,000
Commitments and contingencies - Note 10 and 11		
Stockholders’ Equity:		
Preferred stock, $.001 par value, 2,000,000 shares authorized,none issued and outstanding	–	–
Common stock, $.001 par value, 125,000,000 shares authorized, 59,823,553 and 68,907,109 shares issued and outstanding, respectively	60,000	69,000
Capital in excess of par value	154,744,000	168,776,000
Notes receivable from stockholder	(820,000)	(820,000)
Accumulated deficit	(104,460,000)	(115,805,000)
Total Stockholders' Equity	49,524,000	52,220,000
Total Liabilities and Stockholders' Equity	$ 65,326,000	$ 68,123,000

See accompanying notes to the consolidated financial statements

Consolidated Statement of Operations

For the Year Ended December 31,	2001	2002	2003
Net revenues:			
Net commercial product revenues	$ 7,601,000	$ 17,601,000	$ 38,577,000
Government and other contract revenues	4,782,000	4,785,000	10,759,000
Sub license royalties	10,000	10,000	58,000
Total net revenues	12,393,000	22,396,000	49,394,000
Costs and expenses:			
Cost of commercial product revenues	10,626,000	19,286,000	28,249,000
Contract research and development	3,359,000	2,531,000	6,899,000
Other research and development	4,606,000	4,489,000	4,697,000
Selling, general and administrative	11,907,000	14,976,000	20,567,000
Write off of in-process research and development	–	700,000	–
Total costs and expenses	30,498,000	41,982,000	60,412,000
Loss from operations	(18,105,000)	(19,586,000)	(11,018,000)
Interest income	1,050,000	218,000	177,000
Interest expense	(146,000)	(145,000)	(504,000)
Net loss	(17,201,000)	(19,513,000)	(11,345,000)
Less:			
Deemed distribution attributable to preferred stock	(2,603,000)	(1,756,000)	–
Net loss available to common stockholders for computation of loss per common share	$ (19,804,000)	$ (21,269,000)	$ (11,345,000)
Basic and diluted net loss per common share	$ (1.10)	$ (0.89)	$ (0.18)
Weighted average number of common shares outstanding	17,955,553	24,019,542	62,685,292

See accompanying notes to the consolidated financial statements

Consolidated Statement of Stockholders' Equity

	Convertible Preferred Stock		Common Stock		Capital in	Deferred	Receivable		
					Excess of	Warrant	From	Accumulated	
	Shares	Amount	Shares	Amount	Par Value	Charges	Stockholder	Deficit	Total
Balance at December 31, 2000	37,500	$ –	17,823,164	$ 18,000	$110,654,000	$ (4,517,000)	$ –	$ (67,746,000)	$ 38,409,000
Conversion of convertible preferred stock	(3,000)		676,305	1,000	(1,000)				–
Exercise of stock options			79,691		218,000				218,000
Amortization of deferred warrant charges						2,237,000			2,237,000
Net loss								(17,201,000)	(17,201,000)
Balance at December 31, 2001	34,500	–	18,579,160	19,000	110,871,000	(2,280,000)	–	(84,947,000)	23,663,000
Conversion of convertible preferred stock	(34,500)		2,878,351	3,000	(3,000)				–
Exercise of stock options			26,473		83,000				83,000
Issuance of common stock for cash			24,811,240	25,000	31,801,000				31,826,000
Acquisition of Conductus, Inc.			13,528,329	13,000	16,678,000		(820,000)		15,871,000
Amortization of deferred warrant charges						2,280,000			2,280,000
Payment of convertible preferred stock conversion premium				(4,686,000)				(4,686,000)	
Net loss								(19,513,000)	(19,513,000)
Balance at December 31, 2002	–	–	59,823,553	60,000	154,744,000	–	(820,000)	(104,460,000)	49,524,000
Exercise of stock options			56,687		173,000				173,000
Issuance of common stock and warrants for cash			5,116,278	5,000	10,060,000				10,065,000
Exercise of warrants			3,910,591	4,000	3,618,000				3,622,000
Issuance of options and warrants					181,000				181,000
Net loss								(11,345,000)	(11,345,000)
Balance at December 31, 2003	–	$ –	68,907,109	$ 69,000	$168,776,000	$ –	$ (820,000)	$(115,805,000)	$ 52,220,000

See accompanying notes to the consolidated financial statements.

Consolidated Statement of Cash Flows

For the Year Ended December 31,	2001	2002	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	$ (17,201,000)	$ (19,513,000)	$ (11,345,000)
Adjustments to reconcile net loss to net cash used for operating activities:			
Depreciation and amortization	2,141,000	1,931,000	3,277,000
Accrued loss and amortization of accrued loss on sales contract	(2,243,000)	(1,998,000)	–
Warrants and options charges	2,237,000	2,283,000	104,000
Purchase of in process research and development	–	700,000	–
Changes in assets and liabilities:			
Accounts receivable	2,241,000	(1,655,000)	(5,404,000)
Inventory	(1,959,000)	(613,000)	(2,455,000)
Prepaid expenses and other current assets	(95,000)	160,000	(184,000)
Patents and licenses	(259,000)	(553,000)	(531,000)
Other assets	(190,000)	(75,000)	(114,000)
Accounts payable and accrued expenses	631,000	(618,000)	(1,806,000)
Net cash used in operating activities	(14,697,000)	(19,951,000)	(18,458,000)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	(1,898,000)	(5,398,000)	(3,855,000)
Decrease in restricted cash	–	374,000	–
Payment of up front license fee	–	–	(500,000)
Cash used in acquisition of Conductus, Inc.	–	(429,000)	–
Net cash used in investing activities	(1,898,000)	(5,453,000)	(4,355,000)
CASH FLOW FROM FINANCING ACTIVITIES:			
Proceeds from borrowings	–	–	7,234,000
Payments on short term borrowings	–	–	(3,926,000)
Payments on long-term obligations	(242,000)	(519,000)	(1,402,000)
Net proceeds from sale of common stock and exercise of warrants and options	218,000	31,909,000	13,860,000
Payment of preferred stock conversion premium	–	(3,000,000)	–
Net cash provided by (used in) financing activities	(24,000)	28,390,000	15,766,000
Net increase (decrease) in cash and cash equivalents	(16,619,000)	2,986,000	(7,047,000)
Cash and cash equivalents at beginning of year	31,824,000	15,205,000	18,191,000
Cash and cash equivalents at end of year	$ 15,205,000	$ 18,191,000	$ 11,144,000

See accompanying notes to the consolidated financial statements.

Notes to Consolidated Financial Statements

NOTE 1 – THE COMPANY

Superconductor Technologies Inc. was incorporated in Delaware on May 11, 1987 and maintains its headquarters in Santa Barbara, California. The Company has operated in a single industry segment, the research, development, manufacture and marketing of high-performance filters to service providers and original equipment manufacturers in the mobile wireless communications industry. The Company's principal commercial product, the SuperLink Rx, combines high-temperature superconductors with cryogenic cooling technology to produce a filter with significant advantages over conventional filters. From 1987 to 1997, the Company was engaged primarily in research and development and generated revenues primarily from government research contracts. The Company began full-scale commercial production of the SuperLink Rx" in 1997 and shipped 438 units in 2001, 927 units in 2002 and 1,884 units in 2003.

The Company continues to be involved as either contractor or subcontractor on a number of contracts with the United States government. These contracts have been and continue to provide a significant source of revenues for the Company. For the years ended December 31, 2001, 2002, and 2003, government related contracts account for 39%, 21%, and 22% respectively, of the Company's net revenues.

On December 18, 2002, the Company acquired 100 percent of the outstanding shares of Conductus, Inc. The results of Conductus, Inc. are included in the 2002 consolidated financial statements for 13 days following its acquisition through December 31, 2002 and for the entire year of 2003.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation During 2003, the Company incurred a net loss of $11,345,000 and negative cash flows from operations of $18,458,000. The Company is also are experiencing lower than expected revenues in the first quarter of 2004. In response, the Company is currently adjusting its inventory build plan, reducing direct labor, cutting certain fixed costs and implementing a reduced work week. The Company plans to pursue a financing transaction in 2004.

The Company cannot give assurance that additional financing (public or private) will be available on acceptable terms or at all. If the Company issues additional equity securities to raise funds, the ownership percentage of its existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of common stock. If the Company cannot raise any needed funds, it would be forced to make further substantial reductions in its operations, which could adversely affect the Company's ability to implement its current business plan and ultimately its viability as a company.

The Company's financial statements have been prepared assuming that the Company will continue as a going concern. The factors described above raise substantial doubt about the Company's ability to continue as a going concern. These financial statements do not include any adjustments that might result from this uncertainty.

Principles of Consolidation The consolidated financial statements include the accounts of Superconductor Technologies Inc. and its wholly owned subsidiaries (the "Company"). All significant intercompany transactions have been eliminated from the consolidated financial statements.

Cash and Cash Equivalents Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less. Cash and cash equivalents are maintained with quality financial institutions and from time to time exceed FDIC limits.

Accounts Receivable The Company sells predominantly to entities in the wireless communications industry and to entities of the United States government. The Company grants uncollateralized credit to its customers. The Company performs ongoing credit evaluations of its customers before granting credit. Credit risk related to accounts receivable arising from such contracts is considered minimal.

Revenue Recognition Commercial revenues are principally derived from the sale of the Company's SuperLink Rx products and are recognized once all of the following conditions have been met: a) an authorized purchase order has been received in writing, b) customer's credit worthiness has been established, c) shipment of the product has occurred, d) title has transferred, and e) if stipulated by the contract, customer acceptance has occurred and all significant vendor obligations, if any, have been satisfied.

Contract revenues are principally generated under research and development contracts. Contract revenues are recognized utilizing the percentage-of-completion method measured by the relationship of costs incurred to total estimated contract costs. If the current contract estimate were to indicate a loss, utilizing the funded amount of the contract, a provision would be made for the total anticipated loss. Revenues from research related activities are derived primarily from contracts with agencies of the United States Government. Credit risk related to accounts receivable arising from such contracts is considered minimal. These contracts include cost-plus, fixed price and cost sharing arrangements and are generally short-term in nature.

All payments to the Company for work performed on contracts with agencies of the U.S. Government are subject to adjustment upon audit by the Defense Contract Audit Agency. Based on historical experience and review of current projects in process, management believes that the audits will not have a significant effect on the financial position, results of operations or cash flows of the Company.

Warranties The Company offers warranties generally ranging from one to five years, depending on the product and negotiated terms of purchase agreements with its customers. Such warranties require the Company to repair or replace defective product returned to the Company during such warranty period at no cost to the customer. An estimate by the Company for warranty related costs is recorded by the Company at the time of sale based on its actual historical product return rates and expected repair costs. Such costs have been within management's expectations.

Guarantees In connection with the sales of its commercial products, the Company indemnifies, without limit or term, its customers against all claims, suits, demands, damages, liabilities, expenses, judgments, settlements and penalties arising from actual or alleged infringement or misappropriation of any intellectual property relating to its products or other claims arising from its products. The Company cannot reasonably develop an estimate of the maximum potential amount of payments that might be made under its guarantee because of the uncertainty as to whether a claim might arise and how much it might total.

Research and Development Costs Research and development costs are expensed as incurred and include salary, facility, depreciation and material expenses. Research and development costs incurred solely in connection with research and development contracts are charged to contract research and development expense. Other research and development costs are charged to other research and development expense.

Inventories Inventories are stated at the lower of cost or market, with costs primarily determined using standard costs, which approximate actual costs utilizing the first-in, first-out method. Provision for potentially obsolete or slow moving inventory is made based on management's analysis of inventory levels and sales forecasts.

Property and Equipment Property and equipment are recorded at cost. Equipment is depreciated using the straight-line method over their estimated useful lives ranging from three to five years. Leasehold improvements and assets financed under capital leases are amortized over the shorter of their useful lives or the lease term. Furniture and fixtures are depreciated over seven years. Expenditures for additions and major improvements are capitalized. Expenditures for minor tooling, repairs and maintenance and minor improvements are charged to expense as incurred. When property or equipment is retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts. Gains or losses from retirements and disposals are recorded as other income or expense.

Patents, Licenses and Purchased Technology Patents and licenses are recorded at cost and are amortized using the straight-line method over the shorter of their estimated useful lives or approximately seventeen years. Purchased technology acquired through the acquisition of Conductus, Inc. is recorded at its estimated fair value and is amortized using the straight-line method over seven years.

Goodwill Goodwill represents the excess of purchase price over fair value of net assets acquired. Goodwill is tested for impairment annually in the fourth quarter after the annual planning process, or earlier if events occur which require an impairment analysis be performed. The first step of the impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying value, goodwill of the reporting unit is considered not impaired. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test shall be performed to measure the amount of impairment loss. The second step of the goodwill impairment test, used to measure the amount of impairment loss, compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

Long-Lived Assets The realizability of long-lived assets is evaluated periodically as events or circumstances indicate a possible inability to recover the carrying amount. Such evaluation is based on various analyses, including cash flow and profitability projections. The analyses necessarily involve significant management judgment. In the event the projected undiscounted cash flows are less than net book value of the assets, the carrying value of the assets will be written down to their estimated fair value.

Loss Contingencies In the normal course of business the Company is subject to claims and litigation, including allegations of patent infringement. Liabilities relating to these claims are recorded when it is determined that a loss is probable and the amount of the loss can be reasonably estimated. The costs of defending the Company in such matters are expensed as incurred.

Income Taxes The Company accounts for income taxes under the provisions of Statement of Financial Accounting Standards No. 109 ("SFAS 109"), "Accounting for Income Taxes." SFAS 109 utilizes an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. In estimating future tax consequences, SFAS 109 generally considers all expected future events other than enactments of changes in the tax laws or rates. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Marketing Costs All costs related to marketing and advertising the Company's products are expensed as incurred or at the time the advertising takes place. Advertising costs were not material in each of the three years in the period ended December 31, 2003.

Net Loss Per Share Basic and diluted net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding in each year. Net loss available to common stockholders is computed after deducting accumulated dividends on cumulative preferred stock, deemed dividends and accretion of redemption value on redeemable preferred stock for the period and beneficial conversion features on issuance of convertible preferred stock. Common stock equivalents are not included in the calculation of diluted loss per share because their effect is antidilutive.

Stock-based Compensation As permitted under Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation", the Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" in accounting for its stock options and other stock-based employee awards. Pro forma information regarding net loss and loss per share, as calculated under the provisions of SFAS 123, are disclosed in the notes to the financial statements. The Company accounts for equity securities issued to non-employees in accordance with the provision of SFAS 123 and Emerging Issues Task Force 96-18.

If the Company had elected to recognize compensation expense for employee awards based upon the fair value at the grant date consistent with the methodology prescribed by SFAS 123, the Company's net loss and net loss per share would have been increased to the pro forma amounts indicated below:

For the year ended December 31,	2001	2002	2003
Net Loss:			
As reported	$ (17,201,000)	$ (19,513,000)	$ (11,345,000)
Stock-based employee compensation included in net loss	–	–	–
Stock-based compensation expense determined under fair value method	(3,970,000)	(4,056,000)	(5,435,000)
Pro forma	$ (21,171,000)	$ (23,569,000)	$ (16,780,000)
Basic and Diluted Loss per Share:			
As reported	$ (1.10)	$ (0.89)	$ (0.18)
Stock-based compensation expense determined under fair value method	(0.22)	(0.17)	(0.09)
Pro forma	$ (1.32)	$ (1.06)	$ (0.27)

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The significant estimates in the preparation of the financial statements relate to the assessment of the carrying amount of accounts receivable, inventory, intangibles, estimated provisions for warranty costs, accruals for restructuring and lease abandonment costs in connection with the Conductus acquisition, income taxes and disclosures related to the litigation with ISCO International, Inc. Actual results could differ from those estimates and such differences may be material to the financial statements.

Fair Value of Financial Instruments The carrying amount of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value due to the short-term nature of these instruments. The Company estimates that the carrying amount of the debt approximates fair value based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Comprehensive Income The Company has no items of other comprehensive income in any period and consequently does not report comprehensive income.

Segment Information The Company operates in a single business segment, the development, manufacture and marketing of high performance products to service providers, systems integrators and original equipment manufacturers in the commercial wireless telecommunications industry. The Company's principal commercial product, the SuperLink Rx combines high-temperature superconductors with cryogenic cooling technology to produce a filter with significant advantages over conventional filters. We currently sell most of our product directly to wireless network operators in the United States. Net revenues derived principally from government research and development contracts are presented separately on the statement of operations for all periods presented. Management views its government research and development contracts as a supplementary source of revenue to fund its development of high temperature superconducting products.

Net commercial product revenues are derived from the following products:

For the year ended December 31,	2001	2002	2003
SuperLink Rx product	$ 6,966,000	$ 15,195,000	$ 34,544,000
SuperPlex multiplexer	635,000	2,262,000	3,434,000
SuperLink Tx	–	–	88,000
Other	–	144,000	511,000
Total	$ 7,601,000	$ 17,601,000	$ 38,577,000

Reclassifications Certain reclassifications have been made to the 2001 and 2002 financial statements to conform to the 2003 presentation.

Certain Risks and Uncertainties During the three year period ended December 31, 2003, the Company sold 3,203 SuperLink Rx units, but the Company has continued to incur operating losses. The Company's long-term prospects are dependent upon the continued and increased market acceptance for the product.

The Company currently sells most of its products directly to wireless network operators in the United States. In 2001 U.S. Cellular and ALLTEL accounted for 44% and 41% of our net commercial revenues, respectively. In 2002 U.S. Cellular and ALLTEL accounted for 8% and 84% of our net commercial revenues, respectively, and 19% and 24% of accounts receivable, respectively. In 2003 ALLTEL and Verizon Wireless, our two largest customers, accounted for 70% and 15% of our net commercial revenues, respectively, and 21% and 25% of accounts receivable, respectively.

The Company currently relies on two suppliers for purchases of high quality substrates for growth of high-temperature superconductor films.

In connection with the sales of its commercial products, the Company indemnifies, without limit or term, its customers against all claims, suits, demands, damages, liabilities, expenses, judgements, settlements and penalties arising from actual or alleged infringement or misappoprriation of any intellectual property relating to its products or other claims arising from its products. The Company cannot reasonably develop an estimate of the maximum potential amount of payments that might be made under its guarantee because of the uncertainty as to whether a claim might arise and how much it might total.

Recent Accounting Pronouncements In June 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"), which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes Emerging Issues Task Force ("EITF") Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF Issue 94-3, a liability for an exit cost as defined in EITF Issue 94-3 was recognized at the date of an entity's commitment to an exit plan. SFAS 146 also establishes that the liability should initially be measured and recorded at fair value. The Company adopted the provisions of SFAS 146 effective January 1, 2003 and such adoption did not have a material impact on the consolidated financial statements.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others ("FIN 45"). FIN 45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The Company adopted the disclosure provisions of FIN 45 during the fourth quarter of fiscal 2002 and the recognition provisions of FIN 45 effective January 1, 2003. Such adoption did not have a material impact on the consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities ("FIN 46"). In general, a variable interest entity is a corporation, partnership, trust or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The Company adopted the provisions of FIN 46 effective February 1, 2003 and such adoption did not have an impact on its consolidated financial statements since it currently has no variable interest entities. In December 2003, the FASB issued FIN 46R with respect to variable interest entities created before January 31, 2003, which among other things, revised the implementation date to the first fiscal year or interim period ending after March 15, 2004, with the exception of Special Purpose Entities ("SPE"). The consolidation requirements apply to all SPE's in the first fiscal year or interim period beginning after December 15, 2003. The adoption of the provisions of FIN 46R is not expected to have have an impact on the Company's consolidated financial statements since it currently has no SPE's.

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities ("SFAS 149"). SFAS 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS 133. SFAS 149 is effective for contracts and hedging relationships entered into or modified after June 30, 2003. The Company adopted the provisions of SFAS 149 effective June 30, 2003 and such adoption did not have an impact on its consolidated financial statements since the Company has not entered into any derivative or hedging transactions.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity ("SFAS 150"). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both debt and equity and requires an issuer to classify the following instruments as liabilities in its balance sheet:

> A financial instrument issued in the form of shares that is mandatorily redeemable and embodies an unconditional obligation that requires the issuer to redeem it by transferring its assets at a specified or determinable date or upon an event that is certain to occur;
>
> A financial instrument, other than an outstanding share, that embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and requires the issuer to settle the obligation by transferring assets; and
>
> A financial instrument that embodies an unconditional obligation that the issuer must settle by issuing a variable number of its equity shares if the monetary value of the obligation is based solely or predominantly on (1) a fixed monetary amount, (2) variations in something other than the fair value of the issuer's equity shares, or (3) variations inversely related to changes in the fair value of the issuer's equity shares.

In November 2003, FASB issued FASB Staff Position No. 150-3 which deferred the effective dates for applying certain provisions of SFAS 150 related to mandatorily redeemable financial instruments of certain non-public entities and certain mandatorily redeemable non-controlling interests for public and non-public companies. For public entities, SFAS 150 is effective for mandatorily redeemable financial instruments entered into or modified after May 31, 2003 and is effective for all other financial instruments as of the first interim period beginning after June 15, 2003. For mandatorily redeemable non-controlling interests that would not have to be classified as liabilities by a subsidiary under the exception in paragraph 9 of SFAS 150, but would be classified as liabilities by the parent, the classification and measurement provisions of SFAS 150 are deferred indefinitely. The measurement provisions of SFAS 150 are also deferred indefinitely for other mandatorily redeemable non-controlling interests that were issued before November 4, 2003. For those instruments, the measurement guidance for redeemable shares and non-controlling interests in other literature shall apply during the deferral period.

The Company adopted the provisions of SFAS 150 effective June 30, 2003 and such adoption did not have an impact on its consolidated financial statements.

NOTE 3-ACQUISITION OF CONDUCTUS, INC.

On December 18, 2002, the Company acquired 100 percent of the outstanding shares of Conductus, Inc. ("Conductus"). Conductus was a competing supplier of high-temperature superconducting technology for wireless networks. The results of Conductus' operations have been included in the 2002 consolidated financial statements for the 13-day period following its acquisition through December 31, 2002 and for the entire year of 2003. Concurrent with the acquisition and contingent upon completion of the acquisition, the Company also raised approximately $20 million in a private placement of its common stock (see Note 7). The primary reasons for the acquisition of Conductus and the primary factors that contributed to a purchase price that results in recognition of goodwill are:

The combined company presented a more attractive investment opportunity and enabled it to raise needed capital on more favorable terms than either company could individually.

Addition of Conductus to the combined entity would help the Company compete more effectively.

The resulting Company will have the talents, technologies and assets of the two pioneers of commercial wireless and government applications of superconducting technologies.

Conductus operations would deliver accelerated earnings prospects and potential strategic and other benefits.

The combined Company would have a stronger balance sheet, improving its access to capital.

Combining the two company's operations would produce significant cost savings.

The aggregate purchase price was $17,620,000 consisting of 13,528,000 shares of common stock valued at $15,286,000, assumption of warrants to purchase 1,464,749 shares of common stock valued at $805,000, assumption of options to purchase 1,673,582 shares of common stock valued at $600,000 and acquisition costs of $928,000. The value of the common stock was determined based on the average market price of the Company's common stock over the 3-day period before and after the terms of the acquisition were agreed to and announced. The fair value of the common stock options and warrants assumed was determined using a Black-Scholes option pricing model with the following assumptions: volatility ranging from 80% to 128% , expected life ranging from 3 months to 10 years, dividend rate of 0% and risk free rate ranging from 1% to 4%.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition of Conductus.

Current assets	$ 921,000
Property and equipment	1,867,000
Intangible assets	3,900,000
Goodwill	20,107,000
Notes receivable	820,000
Other assets	516,000
Total assets acquired	28,131,000
Current liabilities	4,717,000
Long term debt	17,000
Unfavorable lease commitment	1,140,000
Accrued costs for exit activities	4,637,000
Total liabilities assumed	10,511,000
Net assets acquired	$ 17,620,000

Current assets primarily consisted of cash, accounts receivable and prepaid expenses and were value at stated value. Property and equipment was valued at estimated replacement cost.

Of the $3,900,000 of acquired intangible assets, $3,200,000 was assigned to completed technology, which is being amortized over 7 years, and $700,000 was assigned to in-process research and development (IPR&D), which was written off at the date of acquisition. The amount of the purchase price allocated to purchased IPR&D was expensed upon acquisition, because the technological feasibility of products under development has not been established and no alternative future uses existed. The IPR&D relates to technologies representing processes and expertise employed to make new high temperature superconducting materials technology and device design and cryopackaging and systems integration technology. At the time of the acquisition, the products under development were about 50% complete and it was expected that the remaining efforts would be completed by the end of 2004 at a cost of approximately $2.5 million. During 2003 we spent approximately $1.4 million completing this technology. It is now expected that development of the products will be completed by the end of 2005 at additional cost of $1.4 million.

The remaining efforts include completion of development processes, manufacturing processes, final product integration and testing. All of the IPR&D projects are subject to the normal risks and uncertainties. The fair value of the acquired intangible assets and IPR&D was estimated by management, with the assistance of an independent appraisal firm, using the cost approach or the the cost savings approach.

Goodwill represents the excess of the fair value of acquired net assets over cost and is not expected to be deductible for tax purposes.

Other assets consisted primarily of restricted cash and other miscellaneous assets and were value at stated value. Current liabilities consisted of accounts payable and the present value of the current portion of long term debt. Accounts payable was value at its stated value. Long term debt was valued at its present value.

The Company also assumed an unfavorable operating lease totaling $1,140,000. This amount represents the present value of the difference between the stated rental rate and the estimated fair market value rental rate over the remaining term of the lease discounted at 6.75%. In connection with the acquisition, the Company incurred $4,637,000 of restructuring costs as a result of severance of Conductus' workforce, the elimination of excess facilities and product line exit costs.

These restructuring costs consisted of employee termination benefits of $1,600,000, lease abandonment costs of $1,995,000, and product line exits costs of $1,042,000. Accrued employee termination benefits represent severance and benefits to be paid to involuntarily terminated employees of Conductus and was estimated to be paid within 150 days following the acquisition. Lease abandonment costs represent the present value of minimum rentals and estimated executory costs due under noncancellable facility and equipment lease commitments of Conductus, entered into prior to the merger, that had no further economic benefit to the combined entity. Product line exit costs represent the present value of estimated costs, to be incurred under a contractual obligation with a customer to support commercial product units previously purchased from Conductus for a period of five years. The Company has recognized such costs as a liabilities assumed as of the acquisition date, resulting in additional goodwill. These accrued liabilities amounted to $285,000, $1,329,000 and $913,000, respectively at December 31, 2003 (see Note 14).

The following unaudited proforma information presents certain operating results as if the acquisition had taken place on January 1, 2001:

	2001	2002
Revenue	$ 19,017,000	$ 27,742,000
Net loss	$ 35,134,000	$ 36,306,000
Net loss available to common stockholders	$ 37,737,000	$ 38,062,000
Net loss per share	$ 1.20	$ 1.03

These proforma results have been prepared for comparative purposes only and include certain adjustments such as additional amortization expense as a result of purchased technology and lower depreciation expense resulting from lower fixed assets costs. The proforma results are not necessarily indicative of the results of operations that actually would have resulted had the acquisition been in effect at January 1, 2001 or those of future periods.

NOTE 4-SHORT TERM BORROWINGS

On March 28, 2003, the Company entered into an accounts receivable purchase agreement with a bank. The agreement provides for the sale of up to $5 million of eligible accounts receivable, with advances to the Company totaling 80% of the receivables sold. Advances bear interest at the prime rate (4.00% at December 31, 2003) plus 2.50% subject to a minimum monthly charge. The agreement terminates on March 17, 2005. Outstanding amounts under this borrowing facility at December 31, 2003 totaled $3,308,000 and are repayable upon collection of the underlying receivables sold.

Advances under the agreement are collateralized by all the Company's assets. Under the terms of the agreement, the Company continues to service the sold receivables and is subject to recourse provisions. In connection with this agreement the Company issued seven year warrants for the purchase of 94,340 shares of common stock at $1.06 per share and were valued at $78,000. The fair value of the warrants issued in connection with this agreement was calculated using the Black-Scholes option-pricing model utilizing a volatility factor of 115%, risk-free interest rate of 3.46% and expected life of 7 years. The value is accounted for as debt issuance costs and amortized over the term of the agreement.

NOTE 5-RECEIVABLE FROM STOCKHOLDERS

The Company made a 5-year, interest-free loan of $150,000 to the Company's Chief Executive Officer, in connection with his compensation during 2001 and is included in Other assets.

Conductus made two (2) loans to its President and Chief Executive Officer, in connection with his compensation and exercise of stock options during 2002 and 2001. The outstanding principal balance of $820,000 plus any accrued interest on his two loans with Conductus are to be paid in full in December 2005 and August 2006. These notes bear interest at 5.87% and 4.99%, are full recourse and are collateralized by 151,761 shares of the Company's common stock and are included in Stockholders' Equity.

NOTE 6 – INCOME TAXES

The Company has incurred a net loss in each year of operation since inception resulting in no current or deferred tax expense for the years ended December 31, 2001, 2002 and 2003.

The benefit for income taxes differs from the amount obtained by applying the federal statutory income tax rate to loss before benefit for income taxes for the years ended December 31, 2001, 2002 and 2003 as follows:

For the year ended December 31,	2001	2002	2003
Tax benefit computed at Federal statutory rate	34.0%	34.0%	34.0%
Increase (decrease) in taxes due to:			
Change in valuation allowance	(41.3)	(39.8)	(39.8)
State taxes, net of federal benefit	7.0	5.8	5.8
Other	0.3	–	–
	–%	–%	–%

The significant components of deferred tax assets (liabilities) at December 31 are as follows:

For the year ended December 31,	2001	2002	2003
Loss carryforwards	$ 31,008,000	$ 59,414,000	$ 78,428,000
Capitalized research			
and development	4,475,000	6,406,000	7,373,000
Warrant charges	2,047,000	2,955,000	36,000
Accrued loss on contract	796,000	–	–
Depreciation	1,762,000	1,942,000	3,365,000
Tax credits	1,330,000	3,013,000	4,083,000
Inventory	246,000	2,307,000	320,000
Purchase accounting adjustments	–	883,000	1,146,000
Acquired intellectual property	–	(1,553,000)	(1,346,000)
Other	264,000	991,000	1,171,000
Less: valuation allowance	(41,928,000)	(76,358,000)	(94,576,000)
	$ –	$ –	$ –

The valuation allowance increased by $7,468,000, $35,983,000 and $8,934,000 in 2001, 2002 and 2003, respectively.

As of December 31, 2003, the Company has net operating loss carryforwards for federal and state income tax purposes of approximately $215.1 million and $90.6 million, respectively, which expire in the years 2003 through 2023. Of these amounts $93.9 million and $30.2 million, respectively resulted from the acquisition of Conductus. Included in the net operating loss carryforwards are deductions related to stock options of approximately $24.0 million and $13.0 million for federal and California income tax purposes. To the extent net operating loss carryforwards are recognized for accounting purposes the resulting benefits related to the stock options will be credited to stockholders' equity. In addition, the Company has research and development and other tax credits for federal and state income tax purposes of approximately $2.6 million and $2.3 million, respectively, which expire in the years 2003 through 2023. Of these amounts $972,000 and $736,000, respectively resulted from the acquisition of Conductus.

Due to the uncertainty surrounding their realization, the Company has recorded a full valuation allowance against its net deferred tax assets. Accordingly, no deferred tax asset has been recorded in the accompanying balance sheet.

Section 382 of the Internal Revenue Code imposes an annual limitation on the utilization of net operating loss carryforwards based on a statutory rate of return (usually the "applicable federal funds rate", as defined in the Internal Revenue Code) and the value of the corporation at the time of a "change of ownership" as defined by Section 382. Recently the Company completed an analysis of it's equity transactions and determined that it had a change in ownership in August 1999 and December 2002. Therefore, the ability to utilize net operating loss carryforwards incurred prior to the change of ownership totaling $101.6 million will be subject in future periods to an annual limitation of $1.3 million. In addition, the Company acquired the right to Conductus' net operating losses, which are also subject to the limitations imposed by Section 382. Conductus underwent three ownership changes which occurred in February 1999, February 2001 and December 2002. Therefore, the ability to utilize Conductus' net operating loss carryforwards of $93.9 million incurred prior to the ownership changes will be subject in future periods to annual limitation of $700,000. Net operating losses incurred by the Company subsequent to the ownership changes totaled $19.5 million and are not subject to this limitation.

NOTE 7 – STOCKHOLDERS' EQUITY

Preferred Stock Pursuant to the Company's Certificate of Incorporation, the Board of Directors is authorized to issue up to 2,000,000 shares of preferred stock (par value $.001 per share) in one or more series and to fix the rights, preferences, privileges, and restrictions, including the dividend rights, conversion rights, voting rights, redemption price or prices, liquidation preferences, and the number of shares constituting any series or the designation of such series.

Convertible Preferred Stock On September 29, 2000, the Company issued in a private placement 37,500 shares of a newly created Series E Convertible Preferred Stock and warrants to purchase up to an additional 1,044,568 shares of common stock. Proceeds, net of issuance costs, totaled approximately $35,155,000.

The preferred stock is non-voting, has a stated value and a liquidation preference of $1,000 per share, and is convertible into common stock at the lower of $17.95 per common share or the market price of the common stock at the time of conversion, subject to an implicit floor. The preferred stock automatically converts into common stock on the third anniversary of the closing and has no antidilution features. The optional and automatic conversions of preferred stock are limited to an aggregate maximum of 3,554,656 shares of common stock. Any preferred shares not converted through optional and the automatic conversions due to the limit on the number of shares that can be issued will be cancelled without any other obligation except to pay any accumulated conversion premium through the automatic conversion date. The preferred stock carries a 7% conversion premium, payable upon conversion in cash or common stock subject to certain limitations, at the Company's option. The conversion premium is being included in the calculation of net loss available to common shareholders over the period it is earned by the preferred stockholder.

During 2001, 3,000 Series E preferred shares were converted into 625,093 shares of common stock and 51,212 shares of common stock were issued in connection with the conversion premium. During 2002 the remaining 34,500 shares were converted into 2,878,351 shares of common stock. The associated conversion premium totaled $4,686,000 and was paid with $3.0 million in cash and an eighteen-month $1.7 million subordinated note. The subordinated note carries eight percent interest with interest only payable for the first six months and monthly amortization of principal and interest for the remaining twelve months.

In connection with the sale of the preferred stock, the Company also issued two five-year warrants to purchase shares of common stock at an exercise price of $21.54 per share. The first warrant is for the purchase of 313,370 shares and the second warrant is for the purchase of up to 731,198 additional shares of common stock. Both warrants are currently exercisable and contain "weighted average" antidilution provisions which adjust the warrant exercise price and number of shares in the event the Company sells equity securities at a discount to then prevailing market prices. The amount of the adjustment depends on the size of the below-market transaction and the amount of the discount to the market price. The warrant exercise price cannot be reduced below a minimum of $18.91 as the result of adjustments under this provision. As a result of the issuance of common shares during 2002 and 2003 the exercise price and the number of shares issuable under the warrant was adjusted to $19.28 and 1,166,477, respectively.

Common Stock In June 2003 the Company raised net proceeds of $10,065,000 from the private sale of 5,116,278 shares of common stock at $2.15 per share based on a negotiated discount to market and 5-year warrants to purchase an additional 1,279,069 shares of common stock exercisable at $2.90 per share. The warrants became exercisable on December 24, 2003. The common shares issued and underlying the warrants were subsequently registered.

In March 2002 the Company raised net proceeds of $12,122,000 from the private sale of 3,714,286 shares of common stock at $3.50 per share based on a negotiated discount to market and 5-year warrants to purchase an additional 557,143 shares of common stock exercisable at $5.50 per share. In conjunction with this equity issuance, the Company also issued to the placement agent 5-year warrants to purchase up to 213,571 shares of common stock at an exercise price of $5.50 per share. These warrants became exercisable on September 10, 2002. The common shares issued and underlying the warrants were subsequently registered.

In connection with the acquisition of Conductus, Inc. in December 2002 the Company raised net proceeds of $19,704,000 from the private sale of 21,096,954 shares of common stock at $0.95 per share based on a negotiated discount to market and 5-year warrants to purchase an additional 5,274,240 shares of common stock exercisable at $1.19 per share. The warrants became exercisable on June 17, 2003. The common shares issued and underlying the warrants were subsequently registered.

Stock Options The Company has five stock option plans, the 1992 Stock Option Plan, the nonstatutory 1992 Directors Stock Option Plan, 1998 and 1999 Stock Option Plans and the 2003 Equity Incentive Plan (collectively, the "Stock Option Plans"). The 1988 Stock Option Plan expired in 1998 and the 1992 Stock Option Plan and the nonstatutory 1992 Directors Stock Option Plan expired in 2002. During 2003 the 1998 and 1999 Stock Option Plans were replaced by the 2003 Equity Incentive Plan. Under the 2003 Equity Incentive Plan, stock awards may consist of stock options, stock appreciation rights, restricted stock awards, performance awards, and performance share awards. Stock awards may be made to directors, key employees, consultants, and non-employee directors of the Company. Stock options granted under these plans must be granted at prices no less than 100% of the market value on the date of grant. Only stock options have been granted under these plans. Generally, stock options become exercisable in installments over a minimum of four years, beginning one year after the date of grant, and expire not more than ten years from the date of grant, with the exception of 10% or greater stockholders which may have options granted at prices no less than the market value on the date of grant, and expire not more than five years from the date of grant. The original grant provisions for 2,000,000 options issued during 2003 allowed for accelerated vesting if certain performance criteria were met during 2003. In January 2004, the Company's Board of Directors determined that the performance criteria were met and that 50% of these options vest on January 1, 2004 and 50% on January 1, 2005.

In connection with the acquisition of Conductus, Inc., each Conductus option holder received an equivalent option to purchase the Company's common shares on the same terms and conditions. The number of shares of the Company's common stock was adjusted by multiplying the number of Conductus securities times the exchange ratio of 0.6 and dividing the exercise price by the exchange ratio of 0.6.

At December 31, 2003, 3,670,561 shares of common stock were available for future grants and 7,545,321 options had been granted but not yet exercised. Option activity during the three years ended December 31, 2003 was as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding at December 31, 2000	1,889,101	$ 12.40
Granted	853,500	5.783
Canceled	(112,422)	7.834
Exercised	(79,691)	3.392
Outstanding at December 31, 2001	2,550,488	10.67
Granted	851,975	5.005
Assumed	1,673,777	7.610
Canceled	(253,523)	8.311
Exercised	(26,473)	3.128
Outstanding at December 31, 2002	4,796,244	8.761
Granted	3,116,007	2.6611
Canceled	(310,243)	10.21
Exercised	(56,687)	2.703
Outstanding at December 31, 2003	7,545,321	$ 6.283

The following table summarizes information concerning currently outstanding and exercisable stock options at December 31, 2003:

Range of Exercise Prices	Number Outstanding	Average Remaining Contractual Life Weighted	Weighted Average Exercise Price	Number Exercisable	Average Exercise Price
$ 0.830 - $ 2.940	1,120,454	8.160	$ 1.500	297,256	$ 2.351
$ 3.000 - $ 3.050	2,189,227	9.380	$ 3.050	9,918	$ 3.00
$ 3.063 - $ 5.225	,856,108	6.928	$ 4.374	1,250,728	$ 4.289
$ 5.290 - $ 28.000	2,039,732	6.420	$ 9.812	1,632,324	$ 10.198
$ 29.500 - $ 49.375	339,800	6.320	$ 32.129	78,668	$ 36.493
	7,545,321	7.313	$ 6.342	3,268,894	$ 8.120

The number of options exercisable and weighted average exercise price at December 31, 2001 and 2002 totaled 1,036,812 and $7.56 and 2,463,945 and $8.384, respectively.

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, ("SFAS 123"), "Accounting for Stock-Based Compensation." Accordingly, no compensation cost has been recognized for the stock-based compensation other than for non-employees.

The fair value of these options for purposes of the pro forma amounts in Note 2 was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for the years ended December 31, 2001, 2002 and 2003, respectively: dividend yields of zero percent each year; expected volatilities of 65%, 65% and 65 %; risk-free interest rates of 4.375%, 3.46% and 2.80%; and expected life of 4.0, 4.0, and 4.0 years. The weighted average fair value of options granted in 2001, 2002 and 2003 for which the exercise price equals the market price on the grant date was $3.05, $2.60 and $1.37, respectively.

Warrants In connection with the acquisition of Conductus, Inc., each Conductus warrant holder received an equivalent warrant to purchase the Company's common shares on the same terms and conditions. The number of shares of the Company's common stock was adjusted by multiplying the number of Conductus securities times the exchange ratio of 0.6 and dividing the exercise price by the exchange ratio of 0.6. Certain warrants contain call provisions on behalf of the Company.

The following is a summary of outstanding warrants at December 31, 2003:

	Common Shares			
	Total	Currently Exercisable	Price per Share	Expiration Date
Warrant related to issuance of Series E Preferred Stock	1,166,477	1,166,477	$ 19.28	September 29, 2005
Warrants related to issuance of common stock	440,714	440,714	5.50	March 10, 2007
	1,406,581	1,406,581	1.19	December 17, 2007*
	1,162,790	1,162,790	2.90	June 24, 2008*
Warrants related to bank borrowings	62,500	62,500	3.00	June 18, 2004*
	33,333	33,333	3.00	December 1, 2004*
	27,692	27,692	3.25	January 12, 2005*
Warrants related to sales agreements	1,000,000	475,068	4.00	August 27, 2004
Warrants assumed in connection with the Conductus, Inc. acquisition	219,690	219,690	6.667	December 10, 2004*
	72,756	72,756	22.383	August 7, 2005
	1,095,000	1,095,000	4.583	September 27, 2007
	6,000	6,000	31.25	September 1, 2007
Total	6,693,533	6,168,601		

* The terms of these warrants contain net exercise provisions, wherein investors can elect to receive common stock equal to the difference between the exercise price and the average closing sale price for common shares over 10-30 days immediately preceeding the exercise date and call provisions.

During 2003 the following warrants were exercised:

	Warrants		Common Shares Issued	
	Warrants Exercised	Price per Share	For Cash	In Accordance With Net Exercise Provisions
Warrants related to bank borrowings	94,340	1.06	–	75,140
Warrants related to issuance of common stock	330,000	5.50	330,000	–
	3,867,659	1.19	1,254,500	2,613,159
	116,279	2.90	116,279	–
Total	4,408,278		1,700,779	2,688,299

NOTE 8 – WARRANTS ISSUED TO U.S. CELLULAR

In August 1999, the Company entered into a warrant agreement with United States Cellular Corporation ("U.S. Cellular") where the exercise of a warrant to purchase up to 1,000,000 shares of common stock was conditioned upon future product purchases by U.S. Cellular. Under the terms of the warrant, U.S. Cellular vests in the right to purchase one share of common stock at $4 per share for every $25 of SuperFilter systems purchased from the Company. The warrant is immediately exercisable with respect to any vested shares and expires August 27, 2004. For accounting purposes proceeds from sales to U.S. Cellular under this agreement are allocated between commercial product revenue and the estimated value of the warrants vesting using the Black-Scholes option-pricing model. The estimated fair value of the warrants in excess of the related sales, when applicable is recorded in cost of commercial product revenues.

In September 2000, the Company received a $7.8 million non-cancelable purchase order from U.S. Cellular for SuperFilter systems to be shipped over the next nine quarters. In consideration for the purchase order, the Company amended the August 1999 warrant agreement and vested 312,000 warrants to U.S. Cellular. The vested warrants are immediately exercisable, not subject to forfeiture, and U.S. Cellular has no other obligations to the Company.

The estimated fair value of the warrants vesting upon receipt of this order was calculated to be $5,635,000 using the Black-Scholes option-pricing model and has been recorded as a deferred warrant charge in the statement of stockholders' equity. As SuperFilter systems are shipped under this purchase order, the related sales proceeds will be allocated between stockholders' equity and commercial product revenue using the percentage relationship which existed between the fair value of the warrants as recorded in September 2000 and the amount of the non-cancelable purchase order. The fair value of the warrants was calculated utilizing a volatility factor of 85%, risk-free interest rate of 6.01%, and an expected life of 3.92 years. During fiscal 2001and 2002 sales proceeds of $2,237,000 and $2,280,000, respectively, for shipments pursuant to this purchase order were allocated to the deferred warrant charge and proceeds of $879,000 and $967,000, respectively, were recorded as commercial product revenues under this purchase order.

After the allocation of sales proceeds under the $7.8 million purchase order to the related warrants, the estimated cost of providing products under the purchase order exceeded related revenue by $5.3 million. The resulting loss was reflected in the results of operations for the year ended December 31, 2000. During the years ending December 31, 2001 and 2002, $2,243,000 and $1,998,000, respectively, of this reserve was reversed against the cost of product delivered under this purchase order.

During the fourth quarter of 2002, deliveries under the $7.8 million purchase order were completed. For accounting purposes, proceeds from subsequent sales to U.S. Cellular under this agreement are again being allocated between commercial product revenue and the estimated value of the warrants vesting using the Black-Scholes option-pricing model. For subsequent product sales, in the fourth quarter of 2002 and the year ended December 31, 2003, U.S. Cellular vested in the right to exercise the warrant and purchase a total of 22,540 and 38,088 shares of common stock, respectively, and sales proceeds allocated to warrants vesting in 2002 and 2003 totaled $3,000 and $90,000, respectively. As of December 31, 2003, U.S. Cellular has 524,932 unvested warrants that can be earned from future product orders through August 27, 2004.

NOTE 9 – EMPLOYEE SAVINGS PLAN

In December 1989, the Board of Directors approved a 401(k) savings plan (the "401(k) Plan") for the employees of the Company that became effective in 1990. Eligible employees may elect to make contributions under the terms of the 401(k) Plan; however, contributions by the Company are made at the discretion of management. The Company has made no contributions to the Plan.

NOTE 10 – COMMITMENTS AND CONTINGENCIES

Operating Leases The Company leases its offices and production facilities under non-cancelable operating leases that expire at various times over the next ten years. Generally leases contain escalation clauses for increases in annual renewal options and require the Company to pay utilities, insurance, taxes and other operating expenses.

For the years ended December 31, 2001, 2002, and 2003, rent expense was $1,064,000, $1,350,000 and $ 2,288,000, respectively.

Capital Leases The Company leases certain property and equipment under capital lease arrangements that expire at various dates through 2007. The leases bear interest at various rates ranging from 8.56% to 14.95%.

Patents and Licenses The Company has entered into various licensing agreements requiring royalty payments ranging from 0.13% to 2.5% of specified product sales. Certain of these agreements contain provisions for the payment of guaranteed or minimum royalty amounts. In the event that the Company fails to pay minimum annual royalties, these licenses may automatically become non-exclusive or be terminated. These royalty obligations terminate in 2009 to 2020. Royalty expenses totaled $179,000 in 2001, $294,000 in 2002 and $572,000 in 2003. Under the terms of certain royalty agreements, royalty payments made may be subject to audit. There have been no audits to date and the Company does not expect any possible future audit adjustments to be significant.

The minimum lease payments under operating and capital leases and license obligations are as follows:

Year ending December 31,	Licenses	Operating Leases	Capital Leases
2004	$ 270,000	$ 2,466,000	$ 85,000
2005	270,000	2,383,000	52,000
2006	270,000	1,494,000	22,000
2007	270,000	1,345,000	15,000
2008	270,000	1,385,000	–
Thereafter	1,800,000	4,326,000	–
Total payments	$ 3,150,000	$ 13,399,000	174,000
Less: amount representing interest			(30,000)
Present value of minimum lease			144,000
Less current portion			(68,000)
Long term portion			$ 76,000

In connection with the acquisition of Conductus, Inc. as of December 31, 2002 operating leases with remaining commitments totaling $2,044,000 and $1,758,000 have been abandoned or are considered unfavorable, respectively. A liability totaling $1,995,000 representing the present value of the minimum lease payments and executory costs was recorded at December 18, 2002 relating to the abandoned leases. A liability totaling $1,140,000 representing the present value of the difference between the fair market rental and lease commitment was recorded at December 31, 2002 relating to unfavorable leases. As of December 31, 2003 the remaining commitments on these operating leases total $1,422,000 and $1,205,000, respectively. At December 31, 2003, the present value of the remaining liability related to the abandoned leases and unfavorable leases totaled $1,329,000 and 823,000, respectively. These amounts are included in accrued liabilities.

NOTE 11 - CONTRACTUAL GUARANTEES AND INDEMNITIES

Warranties The Company establishes reserves for future product warranty costs that are expected to be incurred pursuant to specific warranty provisions with its customers. The Company's warranty reserves are generally established at the time of sale and updated throughout the warranty period based upon numerous factors including historical warranty return rates and expenses over various warranty periods.

During its normal course of business, the Company makes certain contractual guarantees and indemnities pursuant to which the Company may be required to make future payments under specific circumstances. The Company has not recorded any liability for these contractual guarantees and indemnities in the accompanying consolidated financial statements. A description of significant contractual guarantees and indemnities existing as of December 31, 2003 is included below:

Intellectual Property Indemnities The Company indemnifies certain customers and its contract manufacturers against liability arising from third-party claims of intellectual property rights infringement related to the Company's products. These indemnities appear in development and supply agreements with our customers as well as manufacturing service agreements with our contract manufacturers, are not limited in amount or duration and generally survive the expiration of the contract. Given that the amount of any potential liabilities related to such indemnities cannot be determined until an infringement claim has been made, the Company is unable to determine the maximum amount of losses that it could incur related to such indemnifications.

Director and Officer Indemnities and Contractual Guarantees The Company has entered into indemnification agreements with certain directors and executive officers which require the Company to indemnify such individuals to the fullest extent permitted by Delaware law. The Company's indemnification obligations under such agreements are not limited in amount or duration. Certain costs incurred in connection with such indemnifications may be recovered under certain circumstances under various insurance policies. Given that the amount of any potential liabilities related to such indemnities cannot be determined until a lawsuit has been filed against a director or executive officer, the Company is unable to determine the maximum amount of losses that it could incur relating to such indemnifications. Historically, any amounts payable pursuant to such director and officer indemnifications have not had a material negative effect on the Company's business, financial condition or results of operations.

The Company has also entered into severance and change in control agreements with certain of its executives. These agreements provide for the payment of specific compensation benefits to such executives upon the termination of their employment with the Company.

General Contractual Indemnities/Products Liability During the normal course of business, the Company enters into contracts with customers where it has agreed to indemnify the other party for personal injury or property damage caused by the Company's products. The Company's indemnification obligations under such agreements are not limited in duration and are generally not limited in amount. Historically, any amounts payable pursuant to such contractual indemnities have not had a material negative effect on the Company's business, financial condition or results of operations. The Company maintains product liability insurance as well as errors and omissions insurance which may provide a source of recovery to the Company in the event of an indemnification claim.

NOTE 12-LEGAL PROCEEDINGS

We are engaged in a patent dispute with ISCO International, Inc. relating to U.S. Patent No. 6,263,215 entitled "Cryoelectronically Cooled Receiver Front End for Mobile Radio Systems." ISCO filed a complaint on July 17, 2001 in the United States District Court for the District of Delaware against us and our wholly-owned subsidiary, Conductus, Inc. The ISCO complaint alleged that our SuperFilter product and Conductus' ClearSite® product infringe ISCO's patent. The matter went to trial on March 17, 2003.

On April 3, 2003, the jury returned a unanimous verdict that our SuperFilter III product does not infringe the patent in question, and that ISCO's patent is invalid and unenforceable. The jury also awarded us $3.8 million in compensatory damages based upon a finding that ISCO engaged in unfair competition and acted in bad faith by issuing press releases and contacting our customers asserting rights under this patent.

On April 17, 2003, we filed a Motion for Attorneys' Fees and Disbursements, in which we asked the court to award us our attorneys' fees and other litigation expenses. On the same date, ISCO filed a motion, asking the court to overturn the verdict and grant a new trial. In August 2003, the court rejected ISCO's request to overturn the jury's verdict that the patent is invalid and not infringed by the SuperFilter III product, and accepted the jury's verdict that the patent is unenforceable because of inequitable conduct committed by one of the alleged inventors. ISCO subsequently filed a notice of appeal as to this portion of the court's decision. The court overturned the jury's verdict of unfair competition and bad faith on the part of ISCO and the related $3.8 million compensatory damage award to us, and also denied our request for reimbursement of our legal fees associated with the case. We have filed a notice of appeal as to this portion of the court's decision.

Litigation expenses on the ISCO matter totaled $3.2 million and $4.8 million for the years ended December 31, 2002 and 2003, respectively.

NOTE 13 – EARNINGS PER SHARE

The computation of per share amounts for 2001, 2002 and 2003 is based on the average number of common shares outstanding for the period. Options and warrants to purchase 4,718,581, 14,592,194 and 14,238,854 shares of common stock during 2001, 2002, and 2003 respectively, were not considered in the computation of diluted earnings per share because their inclusion would have been antidilutive. Also, the preferred stock convertible into 2,929,563 shares of common stock at December 31, 2001 was not considered in the computation of diluted earnings per share because inclusion would also have been antidilutive.

NOTE 14 – DETAILS OF CERTAIN FINANCIAL STATEMENT COMPONENTS AND SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION AND NON-CASH ACTIVITIES

Balance sheet data:

December 31,	2002	2003
Accounts receivable:		
Accounts receivable-trade	$ 1,592,000	$ 6,766,000
U.S. government accounts receivable-billed	1,692,000	2,107,000
U.S. government accounts receivable-unbilled	179,000	–
Less: allowance for doubtful accounts	(58,000)	(64,000)
	$ 3,405,000	$ 8,809,000

Unbilled accounts receivable represent costs and profits in excess of billed amounts on contracts-in-progress at year-end. Such amounts are billed based upon the terms of the contractual agreements. Such amounts are substantially collected within one year.

December 31,	2002	2003
Inventories:		
Raw materials	$ 1,841,000	$ 1,941,000
Work-in-process	3,143,000	4,803,000
Finished goods	2,013,000	2,861,000
Less inventory reserves	(650,000)	(803,000)
	$ 6,347,000	$ 8,802,000
Property and Equipment:		
Equipment	$ 18,315,000	$ 21,274,000
Leasehold improvements	5,016,000	5,891,000
Furniture and fixtures	408,000	430,000
	23,739,000	27,595,000
Less: accumulated depreciation and amortization	(12,648,000)	(15,061,000)
	$ 11,091,000	$ 12,534,000

At December 31, 2002 and 2003, equipment includes $1,448,000 and $1,430,000 of assets financed under capital lease arrangements, net of $1,090,000 and $1,220,000 of accumulated amortization, respectively. Depreciation expense amounted to $1,674,000, $1,609,000 and $2,413,000 for the years ended December 31, 2001, 2002 and 2003, respectively.

December 31,	2002	2003
Patents and Licenses:		
Patents pending	$ 599,000	$ 848,000
Patents issued	964,000	1,182,000
Less accumulated amortization	(268,000)	(332,000)
Net patents issued	696,000	850,000
Licenses	2,746,000	3,310,000
Less accumulated amortization	(2,081,000)	(2,322,000)
Net licenses	665,000	988,000
Purchased technology	3,200,000	3,200,000
Less accumulated amortization	(19,000)	(519,000)
Net purchased technology	3,181,000	2,681,000
	$ 5,141,000	$ 5,367,000

Amortization expense related to these items was $314,000, $293,000 and $805,000 in 2001, 2002 and 2003, respectively, and is expected to total $788,000 in 2004, $805,000 in 2005, $825,000 in 2006, $825,000 in 2007 and $825,000 in 2008.

December 31,	2002	2003
Accrued Expenses and Other Long Term Liabilities:		
Compensation related	$ 1,053,000	$ 2,153,000
Warranty reserve	351,000	494,000
Unfavorable lease costs	1,140,000	823,000
Lease abandonment costs	1,995,000	1,329,000
Product line exit costs	1,042,000	913,000
Severance costs	1,600,000	285,000
Other	610,000	723,000
	7,791,000	6,720,000
Less, current portion	(4,557,000)	(4,832,000)
Long term portion	$ 3,234,000	$ 1,888,000

For the years ended, December 31,	2002	2003
Warranty Reserve Activity:		
Beginning balance	$ 242,000	$ 351,000
Additions	340,000	261,000
Deductions	(231,000)	(118,000)
Ending balance	$ 351,000	$ 494,000
Unfavorable Lease Costs:		
Beginning balance	$ –	$ 1,140,000
Additions	1,140,000	–
Deductions	–	(317,000)
Ending balance	$ 1,140,000	$ 823,000

For the years ended, December 31,	2002	2003
Lease Abandonment Costs:		
Beginning balance	$ –	$ 1,995,000
Additions	1,995,000	–
Deductions	–	(666,000)
Ending balance	$ 1,995,000	$ 1,329,000
Product Line Exit Costs:		
Beginning balance	$ –	$ 1,042,000
Additions	1,042,000	–
Deductions	–	(129,000)
Ending balance	$ 1,042,000	$ 913,000
Severance Costs:		
Beginning balance	$ –	$ 1,600,000
Additions	1,600,000	–
Deductions	–	(1,315,000)
Ending balance	$ 1,600,000	$ 285,000

Supplemental Cash Flow Information:

For the years ended, December 31,	Dec. 31, 2001	Dec. 31, 2002	Dec. 31, 2003
Cash paid for interest	$ 146,000	$ 145,000	$ 471,000
Non-cash investing and financing activities:			
Issuance of warrants in connection with debt and lease agreements	–	–	78,000
Conversion of preferred shares into common shares	3,000,000	34,500,000	–
Issuance of note for payment of preferred stock conversion premium	–	1,686,000	–
Non cash items related to the acquisition of Conductus, Inc.			
Estimated fair value of tangible assets acquired	–	3,625,000	–
Goodwill and identifiable intangibles assets acquired	–	24,007,000	–
Liabilities assumed or created	–	10,511,000	–
Value of common stock issued and option and warrants assumed	–	16,691,000	–

Quarterly Financial Data (Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2003				
Net revenues	$ 7,580,000	$ 11,263,000	$ 14,156,000	$ 16,395,000
Loss from operations	(8,295,000)	(2,974,000)	(759,000)	1,010,000
Net (loss) income	(8,343,000)	(3,061,000)	(851,000)	910,000
Basic loss per common share	$ (0.14)	$ (0.05)	$ (0.01)	$ 0.01
Weighted average number of shares outstanding	59,823,553	60,048,444	64,939,896	65,702,315
Diluted loss per common share	$ (0.14)	$ (0.05)	$ (0.01)	$ 0.01
Weighted average number of shares outstanding	59,823,553	60,048,444	64,939,896	72,652,146
2002				
Net revenues	$ 4,616,000	$ 6,070,000	$,739,000	$ 6,971,000
Loss from operations	(5,820,000)	(6,044,000)	(4,858,000)	(2,864,000)
Net loss	(5,779,000)	(5,982,000)	(4,827,000)	(2,925,000)
Basic and diluted loss per common share	$ (0.33)	$ (0.29)	$ (0.23)	$ (0.09)
Weighted average number of shares outstanding	19,427,091	22,318,526	23,043,009	30,867,500

Corporate Information

BOARD OF DIRECTORS

John D. Lockton
Chairman of the Board of the Company
Founder and initial Chairman of IP Wireless, Inc.

M. Peter Thomas
President and Chief Executive Officer
of the Company

H. Vaughan Blaxter, III
Retired Vice President, General Secretary,
Counsel and Director of
The Hillman Company

Robert P. Caren, Ph.D.
Chairman of Compensation Committee
Retired Corporate Vice President,
Science and Engineering
Lockheed Corporation

John F. Carlson
Retired Chairman and
Chief Executive Officer
Cray Research, Inc.

Dennis J. Horowitz
Chairman of Audit Committee
Chairman, President,
Chief Executive Officer and Director
Wolverine Tube, Inc.

Martin A. Kaplan
Chairman of the Board
JDS Uniphase, Inc.
Retired Executive Vice President
Pacific Telesis Group

Robert J. Majteles
Managing Member
Treehouse Capital, LLC

Joseph C. Manzinger
Chairman of Nominating/Governance Committee
Vice President and Director
The Hillman Company

Charles E. Shalvoy
Former President and
Chief Executive Officer
Conductus, Inc.

David L. Short
Retired Vice President, Engineering
AirTouch International

DIRECTOR EMERITUS

J. Robert Schrieffer, Ph.D.
Nobel Laureate
Board Member Emeritus
Chairman of the Technical
Advisory Board of the Company

SENIOR STAFF

M. Peter Thomas
President and Chief Executive Officer
of the Company

Ken Barry
Vice President, Human Resources

Richard R. Conlon
Senior Vice President, Sales & Marketing

Robert B. Hammond, Ph.D.
Senior Vice President and
Chief Technical Officer

Robert L. Johnson
President, STI Products Group

Martin S. McDermut
Senior Vice President,
Chief Financial Officer and Secretary

ANNUAL MEETING

The annual meeting of shareholders
will be held on May 25, 2004 at 11 a.m.
at STI's Corporate Offices

CORPORATE INFORMATION

Corporate Offices
460 Ward Drive
Santa Barbara, CA 93111
Telephone: 805-690-4500
Facsimile: 805-683-9496

TRANSFER AGENT

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016

STOCK EXCHANGE LISTING

Common Stock Trading
NASDAQ National Market System
Symbol: SCON

OUTSIDE COUNSEL

GuthlChristopher LLP
10866 Wilshire Boulevard, Suite 1250
Los Angeles, CA 90024

INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP
350 South Grand Avenue
Los Angeles, CA 90071

INVESTOR RELATIONS

Lippert/Heilshorn & Associates, Inc.
44 Montgomery Street
San Francisco, CA 94104

No other company
can provide a stronger link
between a
wireless operator’s customers
and its network.

Design_McNulty & Company, Thousand Oaks   Editorial_Richard Huvard, Camarillo

SUPERCONDUCTOR TECHNOLOGIES

Improving the Quality of Wireless®