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SIMTEK CORP
Form 10QSB
November 04, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

SIMTEK CORPORATION

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

Colorado

84-1057605

(State or other jurisdiction of incorporation or organization)

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

4250 Buckingham Dr. #100; Colorado Springs, CO 80907

(Address of principal executive offices)

(719) 531-9444

(issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

--- ---

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date.

Class Outstanding at October 29, 2004

(Common Stock, \$.01 par value)

62,863,346

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For Quarter Ended September 30, 2004

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SIMTEK CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

September 30, 20

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(unaudited)

CURRENT ASSETS:	
Cash and cash equivalents.....	\$ 1,705,387
Certificate of deposit, restricted.....	300,000
Accounts receivable - trade, net.....	1,204,716
Inventory, net	1,295,013
Prepaid expenses and other.....	107,560

Total current assets.....	4,612,676
EQUIPMENT AND FURNITURE, net.....	819,955
DEFERRED FINANCING COSTS.....	78,833
OTHER ASSETS.....	39,720

TOTAL ASSETS.....	\$ 5,551,184
	=====
LIABILITIES AND SHAREHOLDERS' EQUITY	

CURRENT LIABILITIES:	
Accounts payable	\$ 1,903,905
Accrued expenses.....	313,832
Accrued wages.....	19,011
Line of credit	-
Accrued vacation payable.....	211,902
Obligation under capital leases.....	49,927

Total current liabilities.....	2,498,577
NOTES PAYABLE.....	-
DEBENTURES.....	3,000,000
OBLIGATION UNDER CAPITAL LEASES.....	25,856

Total liabilities.....	5,524,433
SHAREHOLDERS' EQUITY:	
Preferred stock, \$1.00 par value, 2,000,000 shares authorized and none issued and outstanding	-
Common stock, \$.01 par value, 300,000,000 shares authorized, 57,703,387 and 56,713,352 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively.....	577,034
Additional paid-in capital.....	39,576,270
Treasury Stock.....	(12,504)
Accumulated deficit.....	(40,114,049)

Shareholders' equity.....	26,751

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY.....	\$ 5,551,184
	=====

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

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended September 30,	
	2004	2003
	-----	-----
NET SALES.....	\$ 2,877,575	\$ 3,422,039
Cost of sales.....	2,123,753	2,303,117
	-----	-----
GROSS MARGIN.....	753,822	1,118,922
OPERATING EXPENSES:		
Design, research and development.....	1,448,876	985,755
Administrative.....	226,768	216,749
Marketing.....	435,568	380,105
	-----	-----
Total Operating Expenses.....	2,111,212	1,582,609
NET LOSS FROM OPERATIONS.....	(1,357,390)	(463,687)
	-----	-----
OTHER INCOME (EXPENSE):		
Interest income.....	5,655	5,177
Interest expense.....	(58,889)	(64,724)
Other income (expense), net.....	(887)	10,092
	-----	-----
Total other income (expense).....	(54,121)	(49,455)
	-----	-----
LOSS BEFORE TAXES.....	(1,411,511)	(513,142)
Provision for income taxes.....	-	-
	-----	-----
NET LOSS.....	\$ (1,411,511)	\$ (513,142)
	=====	=====
NET LOSS PER COMMON SHARE:		
Basic and diluted EPS.....	\$ (.02)	\$ (.01)
	=====	=====
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic and diluted.....	57,703,387	54,648,069

The accompanying notes are an integral part of these condensed consolidated financial

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months En
	----- 2004 ----
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss	\$ (3,378,897)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization.....	356,344
Net change in allowance and reserve accounts.....	33,124
Deferred financing fees.....	12,447
Loss on disposal of assets.....	75,110
Changes in assets and liabilities:	
(Increase) decrease in:	
Accounts receivable.....	706,115
Inventory.....	(103,754)
Prepaid expenses and other	21,994
Increase (decrease) in:	
Accounts payable.....	865,271
Accrued expenses.....	(40,151)
Deferred revenue.....	-
Net cash used in operating activities.....	----- (1,452,397) -----
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of equipment and furniture	(370,831) -----
CASH FLOWS FROM FINANCING ACTIVITIES:	
Borrowings on notes payable and lines of credit.....	-
Payments on notes payable and lines of credit.....	(150,000)
Payments on capital lease obligation.....	(109,024)
Exercise of stock options.....	355,960 -----
Net cash provided by financing activities.....	96,936 -----
NET DECREASE IN CASH AND CASH EQUIVALENTS.....	(1,726,292) -----
CASH AND CASH EQUIVALENTS, beginning of period.....	3,431,679 -----
CASH AND CASH EQUIVALENTS, end of period.....	\$ 1,705,387 =====
SUPPLEMENTAL CASH FLOW INFORMATION:	
Purchase of equipment through payables and capital leases.....	\$ -

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Cash paid for interest.....		=====
		\$ 179,357
		=====

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

SIMTEK CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES:

The financial statements included herein are presented in accordance with the requirements of Form 10-QSB and consequently do not include all of the disclosures normally made in the registrant's annual Form 10-KSB filing. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report and Form 10-KSB for Simtek Corporation ("Simtek" or the "Company") filed on March 4, 2004 for fiscal year 2003.

In the opinion of management, the unaudited financial statements reflect all adjustments of a normal recurring nature necessary to present a fair statement of the results of operations for the respective interim periods. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Results of operations for the interim periods are not necessarily indicative of the results of operations for the full fiscal year.

The Company applies APB Opinion 25 and related interpretations in accounting for its stock options which are granted to its employees. Accordingly, no compensation cost has been recognized for grants of options to employees since the exercise prices were not less than the market value of the Company's common stock on the grant dates. Had compensation cost been determined based on the fair value at the grant dates for awards under those plans consistent with the method of the fair value approach, the Company's net loss and Earnings Per Share ("EPS") would have been adjusted to the pro forma amounts indicated below.

	Three Months Ended		
	September 30,		
	2004	2003	200
	----	----	----
Net loss as reported	\$(1,411,511)	\$ (513,142)	\$(3,378
Add: stock based compensation included in reported net loss	-	-	
Deduct: Stock-based compensation cost under the fair value approach	(208,621)	(130,018)	(625

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	-----	-----	-----
Pro Forma net loss	\$ (1,620,132)	\$ (643,160)	\$ (4,004,000)
	=====	=====	=====
Pro forma basic and diluted net loss per share:			
Pro forma shares used in the calculation of pro forma net loss per common share basic and diluted	57,703,387	54,648,069	57,375,000
Reported net loss per common share basic and diluted	\$ (.02)	\$ (.01)	\$ (.01)
Pro forma net loss per common share basic and diluted	\$ (.03)	\$ (.01)	\$ (.01)

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SIMTEK CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2. LINE OF CREDIT:

In April 2004, Simtek renewed its revolving line of credit in the amount of \$250,000 on the existing terms of such line of credit. In September, 2004, Simtek's revolving line of credit was canceled.

3. CONVERTIBLE DEBENTURES:

On July 1, 2002, the Company received \$3,000,000 in a financing transaction with BFSUS Special Opportunities Trust Plc, Renaissance US Growth & Investment Trust Plc and Renaissance Capital Growth & Income Fund III, Inc (collectively, "RENN Capital") pursuant to a Convertible Loan Agreement. RENN Capital is the agent for the three investment funds. One of the Company's directors, Mr. Robert Pearson, holds the position of Senior Vice President of RENN Capital. The \$3,000,000 funding consists of convertible debentures with a 7-year term at a 7.5% per annum interest rate; each of the three investment funds invested \$1,000,000. The holder of the debentures has the right, at any time, to convert all, or in multiples of \$100,000, any part of the debenture into fully paid and nonassessable shares of the Company's common stock. The debentures are convertible into the Company's common stock at \$0.312 per share, which was in excess of the market price per share on July 1, 2002. Based on the conversion rate of \$0.312 per share, it would entitle each investment fund to 3,205,128 shares of the Company's outstanding common stock. Through September 30, 2004, the Company was not in compliance with two of the covenants set forth in the loan agreement which covenants relate to the interest coverage ratio and debt to equity ratio. On October 28, 2004, the Company received a waiver for the two covenants through October 1, 2005. However, significant variances in future actual operations from the Company's current estimates could result in the reclassification of this note to current liabilities.

4. GEOGRAPHIC CONCENTRATION:

Sales of the Company's semiconductor products by location for the three months and nine months ended September 30, 2004 and 2003 were as follows (as a

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percentage of semiconductor product sales only):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
	----	----	----	----
United States	34%	34%	33%	37%
Europe	9%	11%	10%	12%
Far East	51%	50%	46%	45%
All others	6%	5%	11%	6%
	----	----	----	----
	100%	100%	100%	100%

5. BUSINESS SEGMENTS:

The Company has two reportable segments. One segment designs and produces semiconductor devices for sale into the semiconductor market. The second segment specializes in advanced technology research and development for data acquisition, signal processing, imaging and data communications that is supported by government and commercial contracts. Although both segments are managed as part of an integrated enterprise, they are reported herein in a manner consistent with the internal reports prepared for management.

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SIMTEK CORPORATION NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Transactions between reportable segments are recorded at cost. Substantially all operating expenses are identified per each segment. Substantially all of the Company's assets are located in the United States of America.

Description	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
	----	----	----	----
Net Sales:				
Semiconductor Devices	\$ 2,445,916	\$2,858,818	\$ 9,067,197	\$ 9,191,114
Government Contracts	431,659	563,221	1,314,013	1,586,025
	-----	-----	-----	-----
Total	\$ 2,877,575	\$3,422,039	\$10,381,210	\$10,777,139
Net Profit (loss):				
Semiconductor Devices	\$ (1,512,991)	\$ (530,570)	\$ (3,424,480)	\$ (1,912,800)
Government Contracts	101,480	17,428	45,583	(53,730)
	-----	-----	-----	-----

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The decrease in revenue was due to the elimination of revenue from the Company's logic products and an approximate 21% decrease in revenue from the research and development contacts portion of the Company's business. The loss of revenue from the Company's logic products was offset by an increase in revenue from the Company's high end industrial and military products. The loss of revenue from the Company's logic products was a result of the Company's decision to discontinue this product line at the end of 2003. The decrease of revenue for the three and nine month periods ending September 30, 2004 as compared to the same periods in 2003 was the result of a decrease in billable labor and a decrease in materials billed against certain government contracts and an increase in research and development expenditures committed to internal product developments.

Increased operating expenses had an impact on the Company's profitability for the three and nine months ended September 30, 2004 compared to the three and nine months ended September 30, 2003.

RESULTS OF OPERATIONS:

REVENUES - SEMICONDUCTOR DEVICES.

The following table sets forth the Company's net revenues by product markets for the three and nine months ended September 30, 2004 and 2003 (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2004	2003	Variance	2004	2003	Variance
	-----	-----	-----	-----	-----	-----
Commercial	\$1,836	\$2,243	\$ (407)	\$7,243	\$7,344	\$ (101)
High-end industrial and military	\$ 610	\$ 424	\$ 186	\$1,824	\$1,240	\$ 584
Logic products	\$ -	\$ 192	\$ (192)	\$ -	\$ 607	\$ (607)
	-----	-----	-----	-----	-----	-----
Total Semiconductor Revenue	\$2,446	\$2,859	\$ (413)	\$9,067	\$9,191	\$ (124)

Commercial revenues decreased by \$407,000 and \$101,000 for the three and nine months ended September 30, 2004, respectively, when compared to the comparable periods in 2003. The decreases for the three and nine month periods were due to a decrease in product availability of the Company's commercial nonvolatile semiconductor memory products.

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High-end industrial and military product revenues increased by \$186,000 and \$584,000 for the three and nine months ended September 30, 2004, respectively, when compared to the comparable periods in 2003. The increase was primarily due

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to completing shipments of the Company's nonvolatile semiconductor memory products against on-going military contracts.

Revenues from the Company's logic products decreased by \$192,000 and \$607,000 for the three and nine months ended September 30, 2004 as compared to 2003, respectively. The decreases were due to a reduction in demand for this product and the Company's decision to eliminate this product line effective December 31, 2003.

Two distributors and two direct customers accounted for approximately 50% of the Company's semiconductor device product sales for the quarter ended September 30, 2004. Products sold to distributors are re-sold to various end customers.

COST OF SALES AND GROSS MARGIN - SEMICONDUCTOR DEVICES

The Company recorded cost of sales for semiconductor devices of \$1,950,000 and \$6,441,000 for the three and nine months ended September 30, 2004 as compared with the \$1,984,000 and \$6,391,000 for the three and nine months ended September 30, 2003. These costs reflect an approximate 10% and 2% decrease in gross profit margin percentages for the third quarter and nine months ended September 30, 2004 as compared to the third quarter and nine months ended September 30, 2003. Actual gross profit margin percentages for the third quarter and nine month periods ending September 30, 2004 were 20% and 29%, respectively. The decreases in gross margin percentages for the three and nine month periods were due to an increase in production costs.

The Company purchased all of its silicon wafers to produce its 0.8 micron nonvolatile static random access memory products from a single supplier, Chartered Semiconductor Manufacturing Plc. ("Chartered") of Singapore to support sales of its nonvolatile semiconductor memory products. Sales of products built on these wafers accounted for approximately 97% of the Company's semiconductor product revenue for each of the three and nine month periods ending September 30, 2004. The Company purchased its silicon wafers to produce its 1 megabit nonvolatile static random access memory products built on 0.25 micron technology from Dongbu Anam Semiconductor. Sales of the 1 megabit semiconductor products built on these wafers accounted for approximately 3% of the Company's semiconductor product revenue for each of the three and nine month periods ended September 30, 2004.

The Company had an agreement with Chartered to provide wafers through September 1998. Although Chartered continues to provide the Company wafers under the terms defined in this contract the Company does not have a current signed agreement with Chartered. In March 2004, Chartered closed its wafer fabrication facility #1 where the Company's memory wafers were manufactured. The Company received its final shipments from Chartered's facility #1 at the end of March 2004. The Company has been working with Chartered to transfer the process of the manufacturing of its memory wafers to Chartered's facility #2. The Company began receiving its memory wafers manufactured in Facility #2 in the late second quarter of 2004 and through the third quarter 2004. However, with this process being transferred to an alternative manufacturing facility, the Company has seen lower than average production yields, which in turn has lowered its gross margins. The Company is continuing to work with Chartered to improve its production yields. If the Company cannot improve its production yields, it will have a material negative impact on the Company's future revenues and earnings.

Through the middle of the third quarter of 2004, the Company was engaged with X-FAB Texas, Inc. ("X-FAB") of Texas to install the Company's nonvolatile semiconductor memory process. Due to a lack of the Company's and X-FAB's

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resources required to install the Company's nonvolatile semiconductor memory process into X-FAB and the marginal anticipated return-on-investment, the Company ceased the installation of its nonvolatile semiconductor memory process into X-FAB's wafer fabrication facility in August 2004.

RESEARCH AND DEVELOPMENT - SEMICONDUCTOR DEVICES

The Company believes that continued investments into new product development are required for us to remain competitive in the markets we serve. Beginning in the fourth quarter 2001, the Company's research and development department has been focusing its efforts on developing a 3 volt 256 kilobit nonvolatile semiconductor memory and the installation of the Company's process at Dongbu Anam Semiconductor for the development of a 1 megabit 3 volt nonvolatile semiconductor memory. During the first nine months of 2004, the Company continued to see increased demand for its 3 volt 256 kilobit nonvolatile semiconductor memories. Development of the 1 megabit 3 volt nonvolatile semiconductor memory is continuing and the Company began shipping samples of its 1 megabit 3 volt nonvolatile semiconductor during the third quarter of 2003. During the third quarter of 2004, the Company began receiving initial production orders. Sales of the Company's 1 megabit 3 volt products accounted for approximately 3% of the Company's revenue for the three and nine months ended September 30, 2004.

Research and development expenses for the three and nine month periods ending September 30, 2004 have been directly related to the development and qualification of the Company's family of 0.25 micron nonvolatile semiconductor memory products at Dongbu Anam Semiconductor, the transfer of the Company's 3 volt 256 kilobit nonvolatile semiconductor memory into Chartered's facility #2, and the transfer of the Company's 5 volt 64 kilobit and 256 kilobit nonvolatile semiconductor memory products into Chartered's facility #2 and into X-FAB. In August 2004, the Company stopped its transfer of the Company's 5 volt 64 kilobit and 5 volt 256 kilobit nonvolatile semiconductor memory into X-FAB. The Company qualified and began shipping its 3 volt 256 kilobit nonvolatile semiconductor memory product built on silicon wafers received from Chartered's facility #2 in the third quarter of 2004. The Company began shipping its 5 volt 256 kilobit nonvolatile semiconductor memory products, tested to production requirements on a provisional qualification, built on silicon wafers received from Chartered's facility #2 in the third quarter of 2004. The Company's research and development activities related to the 3 volt 256 kilobit nonvolatile semiconductor memory product have been redirected to yield improvement. The Company anticipates that qualification of the 0.25 micron nonvolatile semiconductor memory products from Dongbu Anam Semiconductor and the 5 volt 64 kilobit and 5 volt 256 kilobit nonvolatile semiconductor memory products from Chartered's facility #2 will be completed early in the fourth quarter of 2004. While the qualification of these products is nearing completion, the Company's research and development activities have begun focusing more of its efforts on yield improvements of its 0.25 micron product family and 5 volt 64 kilobit and 5 volt 256 kilobit nonvolatile semiconductor product family memory products, enhancements to the 1 megabit 3 volt product family, and development of its next-generation 0.18 micron nonvolatile memory process.

Total research and development expenses related to the semiconductor portion of the Company's business were \$1,397,000 and \$3,999,000 for the three and nine months ended September 30, 2004 compared to \$917,000 and \$3,037,000 for the three and nine months ended September 30, 2003.

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The \$480,000 increase in research and development expenses for the three month period was related to increases in payroll and payroll overhead costs of \$84,000, product development costs of \$334,000, equipment leases, maintenance agreements for software and depreciation of \$44,000, qualification costs of \$9,000 and miscellaneous expenses of \$9,000. The increase of \$962,000 for the nine month period was related to the net between increases in payroll and payroll costs of \$193,000, product development costs of \$908,000, qualification costs of \$19,000 and a decrease in contract engineering services of \$158,000. The primary increase in payroll costs is related to an increase in employee headcount which is required to meet production schedules of the Company's new products. The primary increase in product development costs was due to an increase in silicon wafer purchases, reticles, assembly and testing of the Company's 1 megabit products from Dongbu Anam Semiconductor, 64 kilobit and 256

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kilobit products from X-FAB and 64 kilobit and 256 kilobit products from Chartered's wafer fabrication facility #2 and an increase in costs related to the commercial development of datacomm products performed by the Company's Q-DOT subsidiary. The increase in product development costs included a one-time write off of capital purchases, of approximately \$61,000, related to the development at X-FAB that ended in August 2004. The increase of \$44,000 in equipment leases, maintenance agreements for software and depreciation for the three month period was due primarily to the renewal of maintenance agreements for software.

ADMINISTRATION - SEMICONDUCTOR DEVICES

Total administration expenses related to the semiconductor portion of the Company's business were \$198,000 and \$729,000 for the three and nine months ended September 30, 2004 as compared to the \$170,000 and \$579,000 for the three and nine months ended September 30, 2003.

The \$28,000 increase for the three month period was due to increases in accounting and legal fees of \$9,000, professional services of \$12,000 and payroll and payroll overhead costs of \$7,000. The \$150,000 increase for the nine month period was due to increases in accounting and legal fees of \$45,000, professional fees of \$57,000, costs associated with the Company's annual meeting of shareholder's of \$47,000 and other miscellaneous expenses including travel of \$21,000 and a decrease in payroll and payroll overhead costs of \$20,000. The increases in legal fees were primarily related to costs incurred in relation to the Company's annual meeting of shareholders and increased legal fees related to the Company's registration statements on Form SB-2 that the Company is contractually obligated to file with the Securities and Exchange Commission. The increase in professional services was primarily due to an increase in fees paid to the Company's Board of Directors and fees paid for financial consulting. The increases in accounting fees were due to increased audit fees related to the Company's registration statements on Form SB-2.

MARKETING - SEMICONDUCTOR DEVICES

Total marketing expenses related to the semiconductor portion of the Company's business were \$359,000 and \$1,161,000 for the three and nine months ended September 30, 2004 as compared to the \$270,000 and \$941,000 for the three and nine months ended September 30, 2003.

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The \$89,000 increase for the three month period ended September 30, 2004 as compared to September 30, 2003 was due primarily to increases in payroll and payroll related costs of \$72,000, travel and other miscellaneous expenses of \$8,000 and advertising expenses of \$13,000, offset by a decrease in sales commissions of \$4,000. The increase of \$220,000 for the nine month period ended September 30, 2004 as compared to September 30, 2003 was due to increases in payroll and payroll related costs of \$172,000, advertising expenses of \$40,000 and travel and other miscellaneous expenses of \$26,000, offset by a decrease in sales commissions of \$18,000. The increase in payroll and payroll overhead costs was a result of increased headcount.

NET LOSS - SEMICONDUCTOR DEVICES

The Company recorded a net loss of \$1,513,000 and \$3,424,000 for the three and nine months ended September 30, 2004 as compared to a net loss of \$530,000 and \$1,913,000 for the three and nine months ended September 30, 2003. The increase in net loss for the three month period was due primarily to decreased revenue, decreased gross margins and increased operating expenses. The decreased revenue was a direct result of product availability and the increase in operating expenses was primarily related to increased research and development expenses. The increase in net loss for the nine month period was due primarily to increased operating expenses which were primarily related to research and development expenses.

REVENUES - GOVERNMENT CONTRACTS

The following table sets forth the Company's net revenues from its government contracts portion of its business for the three and nine months ended September 30, 2004 and 2003 (in thousands):

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	Three Months Ended			Nine Months Ended		
	September 30,			September 30,		
	2004	2003	Variance	2004	2003	Variance
	----	----	-----	----	----	-----
Government Contracts	\$ 432	\$ 563	\$ (131)	\$1,314	\$1,586	\$ (272)

The decrease of revenue for the three and nine month periods ending September 30, 2004 as compared to the same periods in 2003 was the result of a decrease in billable labor and a decrease in materials billed against certain government contracts and an increase in research and development expenditures committed to internal product developments.

COST OF SALES AND GROSS MARGIN - GOVERNMENT CONTRACTS

The cost of sales for the government contracts portion of the Company's business was \$174,000 and \$660,000 for the three and nine months ended September

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30, 2004 as compared to the \$319,000 and \$833,000 for the same periods in 2003. This was equivalent to gross margin percentages of 60% and 50% for the three and nine months ended September 30, 2004 as compared to gross margin percentages of 43% and 47% for the same periods in 2003. The increases in gross margin percentages for the three and nine month periods were primarily due to a decrease in direct labor, materials and services.

RESEARCH AND DEVELOPMENT - GOVERNMENT CONTRACTS

Total research and development expenses related to the government contracts portion of the Company's business were \$52,000 and \$250,000 for the three and nine months ended September 30, 2004 compared to \$69,000 and \$432,000 for the three and nine months ended September 30, 2003.

The \$17,000 decrease in research and development expenses for the three months ended September 30, 2004 as compared to the same period in 2003 was related to increases of \$13,000 in employment related expenses and \$26,000 related to equipment and software maintenance and a decrease of \$56,000 of overhead costs that were transferred to the semiconductor portion of the business. The \$182,000 decrease for the nine month period ending September 30, 2004 as compared to the same period in 2003 was related to decreases of \$15,000 in employment related expenses, \$25,000 in software maintenance contracts and equipment leases, \$8,000 in miscellaneous expenses and \$134,000 of overhead costs that were transferred to the semiconductor portion of the business. The overhead costs that were transferred to the semiconductor portion of the business were related to the labor associated with the commercial development of datacomm products.

ADMINISTRATION - GOVERNMENT CONTRACTS

Total administration expenses related to the government contracts portion of the Company's business were \$29,000 and \$104,000 for the three and nine months ended September 30, 2004 as compared to the \$47,000 and \$114,000 for the three and nine months ended September 30, 2003.

The \$18,000 decrease in administration expenses for the three month period was due to decreases of \$5,000 in employee related expenses and a \$13,000 in overhead costs that were transferred to the semiconductor portion of the business. The \$10,000 decrease in administration expenses for the nine month period was due to an increase in employee related expenses of \$10,000 and miscellaneous expenses of \$5,000 which were offset by a decrease of \$25,000 in overhead costs that were transferred to the semiconductor portion of the business. The overhead costs that were transferred to the semiconductor portion of the business were related to the labor associated with the commercial development of datacomm products.

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MARKETING - GOVERNMENT CONTRACTS

Total marketing expenses related to the government contracts portion of the Company's business were \$77,000 and \$249,000 for the three and nine months ended September 30, 2004 as compared to the \$110,000 and \$259,000 for the three and nine months ended September 30, 2003.

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The decrease of \$33,000 in marketing expenses for the three months ended September 30, 2004 as compared to the same period in 2003 was related to a decrease of \$23,000 in employment related expenses and a \$10,000 decrease of overhead costs that were transferred to the semiconductor portion of the business. The \$10,000 decrease for the nine months ended September 30, 2004 as compared to the same period in 2003 was related to increases in bid and proposal labor of \$15,000 and travel expenses of \$5,000 which were offset by \$25,000 of overhead costs that were transferred to the semiconductor portion of the business. The overhead costs that were transferred to the semiconductor portion of the business were related to the labor associated with the commercial development of datacomm products.

NET INCOME (LOSS) - GOVERNMENT CONTRACTS

The Company recorded a net income of \$101,000 and \$45,000 for the three and nine months ended September 30, 2004 as compared to a net income of \$17,000 and a net loss of \$54,000 for the three and nine months ended September 30, 2003. The increase in net income for the three and nine month periods ending September 30, 2004 was primarily due to a decrease in operating expenses.

FUTURE RESULTS OF OPERATIONS

The Company's ability to be profitable will depend primarily on its ability to continue reducing manufacturing costs and increasing net product sales by increasing the availability of existing products, by the introduction of new products and by expanding its customer base. The Company is also dependent on the overall state of semiconductor industry and the demand for semiconductor products by equipment manufacturers.

The Company is continuing its co-development program with Dongbu Anam Semiconductor to develop a semiconductor process module that combines the Company's nonvolatile technology with Anam's advanced 0.25 micron digital CMOS fabrication line. The module incorporates silicon oxide nitride oxide silicon ("SONOS") technology, which will be used to manufacture both high density SONOS flash and nonvolatile static random access memories, for stand alone and embedded products. The Company began shipping samples of its new 1 megabit 3 volt nonvolatile semiconductor memory product in September 2003. During the third quarter of 2004, the Company began receiving initial production orders. The Company is currently shipping 1 megabit products tested to production requirements on a provisional qualification and plan to have qualification complete early in the fourth quarter of 2004. The Company cannot assure you that the Company will not discover technical problems or manufacturing concerns with this new product, that demand will develop for the new product or that we will be able to sell this new product at a profit.

As of September 30, 2004, the Company had a backlog of unshipped customer orders of approximately \$3,238,000 expected to be filled by March 31, 2005. Orders are cancelable without penalty at the option of the purchaser prior to 30 days before scheduled shipment and therefore are not necessarily a measure of future product revenue.

Chartered closed its wafer fabrication facility #1 in March 2004. The Company has purchased silicon wafers, the raw materials used to produce its nonvolatile semiconductor memory products, from fabrication facility #1. The Company has been working with Chartered to transfer the manufacturing process of

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its memory wafers to Chartered's facility #2. Chartered's facility #2 is newer and more modern than its facility #1, processing 8 inch wafers rather than the older 6 inch wafers that were processed in facility #1. The Company qualified and began shipping its 3 volt 256 kilobit nonvolatile semiconductor memory product built on silicon wafers received from Chartered's facility #2 in the third quarter of 2004. The Company began shipping its 5 volt 256 kilobit nonvolatile semiconductor memory products, tested to production requirements on a provisional qualification, built on silicon wafers received from Chartered's facility #2 in the third quarter of 2004. The Company's research and development activities related to the 3 volt 256 kilobit nonvolatile semiconductor memory product have been redirected to yield improvement. As of September 30, 2004, the Company had received production wafers for its 64 kilobit nonvolatile semiconductor memory products from Chartered's facility #2 suitable for customer shipments. The Company believes its 64 kilobit and 5 volt 256 kilobit nonvolatile semiconductor memory products will be qualified early in the fourth quarter of 2004. If production yields or wafer availability from Chartered's facility #2 do not meet the Company's production requirements, this may have a material negative impact on the Company's future revenues and earnings.

The Company anticipates that qualification of the 0.25 micron nonvolatile semiconductor memory products from Dongbu Anam Semiconductor will be qualified early in the fourth quarter of 2004.

Through the middle of the third quarter of 2004, the Company was engaged with X-FAB to install the Company's nonvolatile semiconductor memory process. Due to a lack of the Company's and X-FAB's resources required to install the Company's nonvolatile semiconductor memory process into X-FAB and the marginal anticipated return-on-investment, the Company ceased the installation of its nonvolatile semiconductor memory process into X-FAB's wafer fabrication facility in August 2004.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2004, the Company had net working capital of \$2,114,099 as compared to a net working capital of \$840,850 as of September 30, 2003.

On October 12, 2004, the Company closed a \$2,500,000 equity financing with three separate investment funds, SF Capital Partners, Ltd., Bluegrass Growth Fund LP and Bluegrass Growth Fund LTD. In exchange for the \$2,500,000, the Company issued 4,127,967 shares of its common stock to SF Capital Partners, Ltd, 515,996 shares of its common stock to Bluegrass Growth Fund LP and 515,996 shares of its common stock to Bluegrass Growth Fund LTD. The purchase price was based on a 15% discount to the closing price of the Company's common stock as reported on the Over-the-Counter Bulletin Board on October 11, 2004, resulting in a price of \$0.4845 per share. In addition to the shares of common stock, SF Capital Partners Ltd., Bluegrass Growth Fund LP, and Bluegrass Growth Fund LTD received warrants to acquire 2,063,984, 257,998, and 257,998 shares of the Company's common stock, respectively. The warrants have a 5-year term with an exercise price of \$0.627 per share. Merriman Curhan Ford & Co., the placement agent for the \$2,500,000 equity financing received a cash payment of \$187,500 and warrants to acquire 386,997 shares of the Company's common stock.

On November 7, 2003, the Company closed a \$1,500,000 equity financing with RENN Capital. In exchange for the \$1,500,000, the Company issued 550,661 shares of its common stock to each of the three investment funds for a total of 1,651,982 shares of the Company's common stock. The purchase price was based on the average closing price of the Company's common stock as reported on the Over-the-Counter Bulletin Board over the five trading days before closing, which average closing price was \$0.908 per share. In addition to the shares of common

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stock, each fund received warrants to acquire 250,000 shares of the Company's common stock. The warrants have a 5-year term with 125,000 shares being exercisable at \$1.25 per share and 125,000 shares being exercisable at \$1.50 per share.

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On July 1, 2002, the Company received \$3,000,000 in a financing transaction with RENN Capital pursuant to a Convertible Loan Agreement. One of the Company's directors holds the position of Senior Vice President of RENN Capital Group. Through September 30, 2004, the Company was not in compliance with two of the covenants set forth in the loan agreement which covenants relate to the interest coverage ratio and debt to equity ratio. On October 28, 2004, the Company received a waiver for the two covenants through October 1, 2005. However, significant variances in future actual operations from the Company's current estimates could result in the reclassification of this note to current liabilities.

The change in cash flows for the nine months ended September 30, 2004 used in operating activities was primarily a result of a net loss of \$3,378,897, which is offset by \$356,344 in depreciation and amortization, decreases in accounts receivable, prepaid expenses and accrued expenses of \$706,115, \$21,994 and \$40,151, respectively and increases in allowance accounts, loss on disposal of assets, inventory and accounts payable of \$33,124, \$75,110, \$103,754 and \$865,271, respectively. The decrease of \$706,115 in accounts receivable was directly related to the decrease in revenue for the third quarter of 2004. The \$865,271 increase in accounts payable was due to the receipt of raw materials at the end of September 2004 that the Company is not obligated to pay until October 2004. The increase in inventory of \$103,754 was primarily due to the timing of receiving raw materials at the end of September 2004 that will be used to support product shipments in the fourth quarter of 2004. The \$75,100 loss on disposal of assets, was primarily related to writing off the capital expenditures purchased for the installation of the Company's process at X-FAB. The change in cash flows used in investing activities of \$370,831 was primarily due to the purchase of equipment required to test the Company's nonvolatile semiconductor memory products and reticles required to produce the Company's wafers. The change in cash flows provided by financing activities of \$96,936 was primarily due to the net effect of payments on a line of credit and capital leases offset by funds received from the exercise of stock options by employees of the Company.

The change in cash flows for the nine months ended September 30, 2003 provided by operating activities was primarily a result of a net loss of \$1,966,530, which is offset by \$361,271 in depreciation and amortization, decreases in accounts receivable, prepaid expenses, accounts payable and deferred revenue of \$692,510, \$113,320, \$390,351 and \$40,500, respectively and increases in inventory and accrued expenses of \$166,239 and \$137,878, respectively. The decrease of \$692,510 in accounts receivable was directly related to certain customers paying invoices within the Company's terms at the end of third quarter 2003. The decrease in accounts payable of \$390,351 was primarily due to the timing of payments for standard operating expenses. The increase in accrued expenses was due primarily to increased vacation payable and accrued wages. These increases have occurred due to certain employees foregoing their vacation time until later in 2003. The change in cash flows used in investing activities of \$402,795 was primarily due to the purchase of equipment

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required to test the Company's nonvolatile semiconductor memory products and software acquired for research and development activities. The cash flows provided by financing activities of \$289,469 was due to borrowings on a line of credit of \$250,000, proceeds of \$150,703 for the exercise of stock options by certain employees of the Company less payments on a capital lease obligation of \$111,187.

Short-term liquidity.

The Company's cash balance at September 30, 2004 was \$1,705,387.

The Company's future liquidity will depend on its revenue growth and its ability to sell its products at positive gross margins and control of its operating expenses. Over the coming twelve months, the Company expects to spend approximately \$9,000,000 for operating expenses assuming revenue growth and no significant change in marketing or product development strategies. The Company expects to meet these capital needs from sales revenues and, to the extent it does not have sufficient revenues, from its existing cash reserves.

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Long-term liquidity.

The Company continues to evaluate its long-term liquidity. The Company's growth plans may require additional funding from outside sources. The Company is in ongoing discussions with investment banking organizations and potential lenders to ensure access to funds as required.

The Company is a party to a lease agreement with Baja Properties, LLC as landlord pursuant to which the Company leases approximately 16,000 square feet of space in Colorado Springs, Colorado. The lease is scheduled to expire on February 28, 2013. The Company's monthly rental payment obligation is approximately \$16,000.

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Item 3: Controls and Procedures

a) Evaluation of disclosure controls and procedures.

Douglas Mitchell, who serves as the Company's chief executive officer, president and chief financial officer (acting), after evaluating the effectiveness of the Company's disclosure controls and procedures as of the filing date of this quarterly report (the "Evaluation Date") concluded that as of the Evaluation Date, the Company's disclosure controls and procedures were adequate and effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported as specified in the SEC's rules and forms.

(b) Changes in internal control over financial reporting.

There were no changes in the Company's internal control over financial reporting during the three and nine months ended September 30, 2004, that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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PART II. OTHER INFORMATION

- Item 1. Legal Proceedings -None
- Item 2. Changes in Securities - None
- Item 3. Defaults upon Senior Securities - None
- Item 4. Matters Submitted to a Vote of Securities Holders - None
- Item 5. Other Information - None
- Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- Exhibit 31 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 32 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

Form 8-K filed August 5, 2004 - Item 5: Other information: Press Release of Simtek Corporation, dated August 5, 2004, Simtek Reports Second Quarter Results.

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SIGNATURES

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

SIMTEK CORPORATION
(Registrant)

November 4, 2004

By /s/Douglas Mitchell

DOUGLAS MITCHELL
Chief Executive Officer, President
and Chief Financial Officer (Acting)