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RESEARCH FRONTIERS INC
Form 10-Q
May 12, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For Quarter Ended March 31, 2006 Commission File No. 1-9399

RESEARCH FRONTIERS INCORPORATED
(Exact name of registrant as specified in charter)

Delaware
(State of incorporation or organization)

11-2103466
(IRS Employer
Identification No.)

240 Crossways Park Drive, Woodbury, N.Y.
(Address of principal executive offices)

11797
(Zip Code)

(516) 364-1902
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of May 12, 2006, there were outstanding 13,812,559 shares of Common Stock, par value \$0.0001 per share.

RESEARCH FRONTIERS INCORPORATED

Consolidated Balance Sheets

Assets	March 31, 2006 (Unaudited) December 31, 2005	
Current assets:		
Cash and cash equivalents	\$ 2,715,919	3,644,685

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Royalty receivables, net of reserves of \$93,674 in 2006 and \$78,674 in 2005	51,250	40,000
Prepaid expenses and other current assets	71,325	138,408
Total current assets	2,838,494	3,823,093
Fixed assets, net	104,235	111,507
Deposits	22,605	22,605
Total assets	\$ 2,965,334	3,957,205
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 70,370	132,584
Deferred revenue	5,000	5,000
Accrued expenses and other	161,816	173,367
Total liabilities	237,186	310,951
Commitments and Contingencies		
Shareholders' equity:		
Capital stock, par value \$0.0001 per share; authorized 100,000,000 shares, issued and outstanding 13,812,559 and 13,812,559 shares, respectively	1,381	1,381
Additional paid-in capital	62,577,771	62,577,771
Accumulated deficit	(59,851,004)	(58,932,898)
Total shareholders' equity	2,728,148	3,646,254
Total liabilities and shareholders' equity	\$ 2,965,334	3,957,205

See accompanying notes to consolidated financial statements.

RESEARCH FRONTIERS INCORPORATED

Consolidated Statements of Operations

(Unaudited)

	Three months ended	
	March 31, 2006	March 31, 2005
Fee income	\$ 26,250	41,250
Operating expenses	636,662	594,915
Research and development	330,900	409,069
	967,562	1,003,984
Operating loss	(941,312)	(962,734)
Net investment income	23,206	22,236
Net loss	\$ (918,106)	(940,498)

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Basic and diluted net loss per common share	\$	(.07)	(.07)
Weighted average number of common shares outstanding		13,812,559	13,323,670

See accompanying notes to consolidated financial statements.

RESEARCH FRONTIERS INCORPORATED

Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended	
	March 31, 2006	March 31, 2005
Cash flows from operating activities:		
Net loss	\$ (918,106)	(940,498)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	8,157	10,812
Changes in assets and liabilities:		
Royalty receivables	(11,250)	(107,750)
Prepaid expenses and other current assets	67,083	2,364
Deferred revenue	--	103,750
Accounts payable and accrued expenses	(73,765)	(29,676)
Net cash used in operating activities	(927,881)	(960,998)
Cash flows from investing activities:		
Purchase of fixed assets	(885)	(8,619)
Net cash used in investing activities	(885)	(8,619)
Cash flows from financing activities:		
Proceeds from issuances of common stock and warrants	--	5,000,000
Net cash provided by financing activities	--	5,000,000
Net increase (decrease) in cash and cash equivalents	(928,766)	4,030,383
Cash and cash equivalents at beginning of year	3,644,685	2,602,063
Cash and cash equivalents at end of period	\$ 2,715,919	6,632,446

See accompanying notes to consolidated financial statements.

RESEARCH FRONTIERS INCORPORATED

Notes to Consolidated Financial Statements

March 31, 2006

(Unaudited)

Basis of Presentation

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In

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the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature. Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2006. For further information, refer to the consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K (Form 10-K) relating to Research Frontiers Incorporated (the Company) for the fiscal year ended December 31, 2005.

Business

The Company operates in a single business segment which is engaged in the development and marketing of technology and devices to control the flow of light. Such devices, often referred to as "light valves" or suspended particle devices (SPDs), use colloidal particles that are either incorporated within a liquid suspension or a film, which is usually enclosed between two sheets of glass or plastic having transparent, electrically conductive coatings on the facing surfaces thereof. At least one of the two sheets is transparent. SPD technology, made possible by a flexible light-control film invented by Research Frontiers, allows the user to instantly and precisely control the shading of glass/plastic manually or automatically. SPD technology has numerous product applications, including: SPD-Smart windows, sunshades, skylights and interior partitions for homes and buildings; automotive windows, sunroofs, sun-visors, sunshades, rear-view mirrors, instrument panels and navigation systems; aircraft windows; eyewear products; and flat panel displays for electronic products. SPD-Smart light control film is now being used in architectural, automotive, marine, aerospace and appliance applications.

Patent Costs

The Company expenses costs relating to the development or acquisition of patents due to the uncertainty of the recoverability of these items.

Revenue Recognition

The Company has entered into a number of license agreements covering its light control technology. The Company receives minimum annual royalties under certain license agreements and records fee income on a ratable basis each quarter. In instances when sales of licensed products by its licensees exceed minimum annual royalties, the Company recognizes fee income as the amounts have been earned. Certain of the fees are accrued by, or paid to, the Company in advance of the period in which they are earned resulting in deferred revenue. Such excess amounts are recorded as deferred revenue and recognized into income in future periods as earned.

Stock-Based Compensation

Prior to January 1, 2006, the Company accounted for stock-based employee compensation under the intrinsic value method as outlined in the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations while disclosing pro-forma net income and net income per share as if the fair value method had been applied in accordance with Statement

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of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." Under the intrinsic value method, no compensation expense was recognized if the exercise price of the Company's employee stock options equaled or exceeded the market price of the underlying stock on the date of grant. Since the Company had issued all stock option grants with exercise prices equal to, or greater than, the market value of the common stock on the date of grant, through December 31, 2005 no compensation cost was recognized in the consolidated statements of operations.

Effective January 1, 2006, the Company adopted SFAS No. 123(R), "Share-based Payment." SFAS No. 123(R) replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS 123(R) requires that all stock-based compensation be recognized as an expense in the financial statements and that such costs be measured at the fair value of the award. This statement was adopted using the modified prospective method, which requires the Company to recognize compensation expense on a prospective basis. Therefore, prior period financial statements have not been restated. Under this method, in addition to reflecting compensation expense for new share-based payment awards, expense is also recognized to reflect the remaining vesting period of awards that had been included in pro-forma disclosures in prior periods. Since all options outstanding as of December 31, 2005 were fully vested, and no new options were granted during the quarter ending March 31, 2006, there was no compensation expense recognized for those options in the consolidated statement of income for the three months ended March 31, 2006. SFAS 123(R) also requires that tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows. For the three months ended March 31, 2006, this new treatment resulted in no change in cash flows from financing activities or cash flows from operating activities. Because there were no options granted during the quarter ended March 31, 2006, there was no impact on net loss for the three months ended March 31, 2006 regardless of whether the Company had consistently measured the compensation cost for the Company's stock option grants under the fair value method adopted in fiscal 2006. The Company expects that the adoption of SFAS No. 123(R) could have a material effect on the Company's consolidated financial statements, depending upon the number and terms of stock options issued by the Company in the future. The adoption of SFAS No. 123(R) had no impact on previously granted options, since all options granted prior to January 1, 2006 are fully vested.

In 1998, the shareholders approved a stock option plan (1998 Stock Option Plan) which provides for the granting of both incentive stock options at the fair market value at the date of grant and nonqualified stock options at or below the fair market value at the date of grant to employees or non-employees who, in the determination of the Board of Directors, have made or may make significant contributions to the Company in the future. The Company may also award stock appreciation rights or restricted stock under this plan. The Company initially reserved 540,000 shares of its common stock for issuance under this plan. In 1999, the Company's shareholders approved an additional 545,000 shares for issuance under this Plan, and in each of 2000 and 2002, the Company's shareholders approved an additional 600,000 shares for issuance under this Plan. As of March 31, 2006, awards for 60,879 shares of common stock were available for issuance under this Plan.

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At the discretion of the Board of Directors, options expire in ten years or less from the date of grant and are generally fully exercisable upon grant but in some cases may be subject to vesting in the future. Full payment of the exercise price may be made in cash or in shares of common stock valued at the fair market value thereof on the date of exercise, or by agreeing with the Company to cancel a portion of the exercised options. When an employee exercises a stock option through the surrender of options held, rather than of cash for the option exercise price, compensation expense is recorded in accordance with APB Opinion No. 25. Accordingly, compensation expense is recorded for the difference between the quoted market value of the Company's common stock at the date of exchange and the exercise price of the option.

The following summarizes the shares of common stock under option for all plans at December 31, 2005 and March 31, 2006, and the activity with respect to options for the three months ended March 31, 2006:

	Number of Shares Subject to Option	Weighted Average Exercise Price
Balance at December 31, 2005	2,690,993	\$ 11.45
Granted	--	--
Cancelled	(45,500)	\$ 11.36
Exercised	--	\$ --
Balance at March 31, 2006	2,645,493	\$ 11.46

The following table summarizes information about stock options at March 31, 2006:

Range of Exercise Price	Options Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Shares Exercisable	Weighted Average Exercise Price
\$3.00 to \$6.00	388,433	7.61	\$ 5.86	388,433	\$ 5.86
\$6.01 to \$7.50	636,750	3.13	\$ 7.12	636,750	\$ 7.12
\$7.51 to \$9.00	457,800	3.19	\$ 8.38	457,800	\$ 8.38
\$9.01 to \$12.00	408,960	5.74	\$10.51	408,960	\$ 10.51
\$12.01 to \$15.00	319,250	5.90	\$13.30	319,250	\$ 13.30
\$15.01 to \$19.00	107,000	4.66	\$18.99	102,000	\$ 19.00
\$19.01 to \$37.03	327,300	4.95	\$27.77	327,300	\$ 27.77
	2,645,493	4.82	\$11.46	2,640,493	\$ 11.44

During 2005, the Company issued options to a consultant to purchase 500 shares of common stock at an exercise price of \$5.60 per share and recorded \$1,483 of non-cash expense in connection with the issuance of these options.

Shareholders' Equity

Issuance of Common Stock

For the three months ended March 31, 2005, the Company received \$5,000,000 of net cash proceeds from the issuance to institutional investors of one million shares of its common stock and the issuance of five-year warrants to purchase 200,000 shares of common stock at an exercise price of \$7.50 per share.

Treasury Stock

The Company did not repurchase any of its stock during the three

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months ended March 31, 2006 or 2005.

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

Accounting Policies

The following accounting policies are important to understanding our financial condition and results of operations and should be read as an integral part of the discussion and analysis of the results of our operations and financial position. For additional accounting policies, see note 2 to our consolidated financial statements, "Summary of Significant Accounting Policies" contained in the Company's Annual Report on Form 10-K.

The Company has entered into a number of license agreements covering potential products using the Company's SPD technology. The Company receives minimum annual royalties under certain license agreements and records fee income on a ratable basis each quarter. In instances when sales of licensed products by its licensees exceed minimum annual royalties, the Company recognizes fee income as the amounts have been earned. Certain of the fees are accrued by, or paid to, the Company in advance of the period in which they are earned resulting in deferred revenue.

The Company expenses costs relating to the development or acquisition of patents due to the uncertainty of the recoverability of these items.

All of our research and development costs are charged to operations as incurred. Our research and development expenses consist of costs incurred for internal and external research and development. These costs include direct and indirect overhead expenses.

The Company has historically used the Black-Scholes option-pricing model to determine the estimated fair value of each option grant. The Black-Scholes model includes assumptions regarding dividend yields, expected volatility, expected lives, and risk-free interest rates. These assumptions reflect our best estimates, but these items involve uncertainties based on market conditions generally outside of our control. As a result, if other assumptions had been used in the current period, stock-based compensation expense could have been materially impacted. Furthermore, if management uses different assumptions in future periods, stock-based compensation expense could be materially impacted in future years.

On occasion, the Company may issue to consultants either options or warrants to purchase shares of common stock of the Company at specified share prices. These options or warrants may vest based upon specific services being performed or performance criteria being met. In accordance with Emerging Issues Task Force Issue 96-18, Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, the Company would be required to record consulting expenses based upon the fair value of such options or warrants on the date that such options or warrants vest as determined using a Black-Scholes option pricing model. Depending upon the difference between the exercise price and the market price of the Company's common stock on the date that such options or warrants vest, the amount of non-cash expenses that

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could be recorded as a result of the vesting of such options or warrants can be material.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. An example of a critical estimate is the full valuation allowance for deferred taxes that was recorded based on the uncertainty that such tax benefits will be realized in future periods.

Results of Operations for the Three Month Periods Ended March 31, 2006 and 2005

The Company's fee income from licensing activities for the first quarter of 2006 was \$26,250, as compared to \$41,250 for the first quarter of 2005. This difference in fee income was primarily the result of the timing and amount of minimum annual royalties paid, and the date of receipt of such payment on certain license agreements, by end-product licensees. Certain license fees, which are paid to the Company in advance of the accounting period in which they are earned resulting in the recognition of deferred revenue for the current accounting period, will be recognized as fee income in future periods. Also, licensees may offset some or all of their royalty payments on sales of licensed products for a given period by applying these advance payments towards such earned royalty payments.

Operating expenses increased by \$41,747 for the first quarter of 2006 to \$636,662 from \$594,915 for the first quarter of 2005. This increase was primarily the result of higher consulting fees and reserves for bad debts, partially offset by lower insurance, marketing, and depreciation expenses, and lower accounting and stock listing fees.

Research and development expenditures decreased by \$78,169 to \$330,900 for the first quarter of 2006 from \$409,069 for the first quarter of 2005. This decrease was primarily the result of decreased payroll, consulting, insurance and depreciation expenses, partially offset by higher equipment rental, travel and materials costs.

The Company's net investment income for the first quarter of 2006 was \$23,206, as compared to net income from its investing activities of \$22,236 for the first quarter of 2005. This difference was primarily due to higher interest rates during 2006 partially offset by lower cash balances available to invest.

As a consequence of the factors discussed above, the Company's net loss was \$918,106 (\$0.07 per common share) for the first quarter of 2006 as compared to \$940,498 (\$0.07 per common share) for the first quarter of 2005.

Financial Condition, Liquidity and Capital Resources

During the first three months of 2006, the Company's cash and cash equivalent balance decreased by \$928,766 principally as a result of cash used to fund the Company's operating activities of \$927,881. At March 31, 2006, the Company had working capital of \$2,601,308 and its shareholders' equity was \$2,728,148.

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The Company occupies premises under an operating lease agreement which expires on January 31, 2014 and requires minimum annual rent which rises over the term of the lease to approximately \$138,269.

In February 2005, the Company raised \$5 million in net proceeds in connection with the registered sale to institutional investors of one million shares of its common stock and the issuance of five-year warrants to purchase 200,000 shares of common stock at an exercise price of \$7.50 per share.

The Company expects to use its cash to fund its research and development of SPD light valves and for other working capital purposes. The Company's working capital and capital requirements depend upon numerous factors, including the results of research and development activities, competitive and technological developments, the timing and cost of patent filings, the development of new licensees and changes in the Company's relationships with its existing licensees. The degree of dependence of the Company's working capital requirements on each of the foregoing factors cannot be quantified; increased research and development activities and related costs would increase such requirements; the addition of new licensees may provide additional working capital or working capital requirements, and changes in relationships with existing licensees would have a favorable or negative impact depending upon the nature of such changes. Based upon existing levels of cash expenditures, existing cash reserves and budgeted revenues, the Company believes that it would not require additional funding until the first quarter of 2007. There can be no assurance that expenditures will not exceed the anticipated amounts or that additional financing, if required, will be available when needed or, if available, that its terms will be favorable or acceptable to the Company. Eventual success of the Company and generation of positive cash flow will be dependent upon the extent of commercialization of products using the Company's technology by the Company's licensees and payments of continuing royalties on account thereof.

New Accounting Standards

In December 2004, the Financial Accounting Standards Board, or FASB, issued SFAS No. 123R "Share Based Payment," which replaces SFAS No. 123 and supersedes APB No. 25. SFAS No. 123R requires that the cost resulting from all share-based payment transactions be recognized in the consolidated financial statements. This statement applies to all share-based payment transactions in which an entity acquires goods or services by issuing its shares, options or other equity instruments. This statement establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value-based measurement method in accounting for share-based payment transactions with employees, except for equity instruments held by employee share ownership plans. This statement is effective as of the beginning of the first annual reporting period that begins after June 15, 2005, which was the Company's first fiscal quarter of 2006. The Company expects that the adoption of SFAS No. 123R could have a material effect on the Company's consolidated financial statements, depending upon the number and terms of stock options issued by the Company in the future. The adoption of SFAS No. 123R had no impact on previously granted options, since all options granted

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prior to January 1, 2006 are fully vested.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The information required by Item 3 has been disclosed in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2005. There has been no material change in the disclosure regarding market risk.

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiary) required to be included in the Company's periodic SEC filings. There were no changes in the Company's internal control over financial reporting during the quarterly period ended March 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Forward Looking Statements

The information set forth in this Report and in all publicly disseminated information about the Company, including the narrative contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" above, includes "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and is subject to the safe harbor created by that section. Readers are cautioned not to place undue reliance on these forward-looking statements as they speak only as of the date hereof and are not guaranteed.

PART II. OTHER INFORMATION

Item 6. Exhibits

- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Robert L. Saxe-Filed herewith.
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Joseph M. Harary-Filed herewith.
- 32.1 Section 1350 Certification of Robert L. Saxe- Filed herewith.
- 32.2 Section 1350 Certification of Joseph M. Harary- Filed herewith.

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 thereunder duly authorized.

RESEARCH FRONTIERS INCORPORATED
(Registrant)

/s/ Robert L. Saxe

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Robert L. Saxe, Chairman
(Principal Executive Officer)

/s/ Joseph M. Harary
Joseph M. Harary, President and Treasurer
(Principal Financial, and Accounting Officer)