

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 the quarterly period ended July 31, 2005

Commission file number 0-11254

COPYTELE, INC.

(Exact name of registrant as specified in its charter)

Delaware

11-2622630

(State or other jurisdiction of
incorporation or organization)

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

900 Walt Whitman Road
Melville, NY

11747

(Address of principal executive offices)

(Zip Code)

(631) 549-5900

(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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

On September 2, 2005, the registrant had outstanding 90,715,448 shares of Common Stock, par value \$.01 per share, which is the registrant's only class of common stock.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Condensed Balance Sheets as of July 31, 2005 (Unaudited) and October 31, 2004	3
Condensed Statements of Operations (Unaudited) for the nine months ended July 31, 2005 and 2004	4
Condensed Statements of Operations (Unaudited) for the three months ended July 31, 2005 and 2004	5

Condensed Statements of Cash Flows (Unaudited) for the
 nine months ended July 31, 2005 and 2004 6

Notes to Condensed Financial Statements (Unaudited) 7 - 13

Item 2. Management's Discussion and Analysis of Financial Condition
 and Results of Operations. 14 - 29

Item 3. Quantitative and Qualitative Disclosures About Market Risk. 29

Item 4. Controls and Procedures. 29

PART II. OTHER INFORMATION

Item 6. Exhibits. 30

SIGNATURES 30

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

<TABLE>
 <CAPTION>

COPYTELE, INC.

CONDENSED BALANCE SHEETS

	(Unaudited)	
ASSETS	July 31, 2005	October 31, 2004*
-----	-----	-----
<S>	<C>	<C>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 581,792	\$ 1,002,777
Short-term investments	398,353	-
Accounts receivable, net	95,314	63,460
Other receivables, net of allowance for doubtful accounts of \$100,171 and \$108,793, respectively	77,627	84,308
Inventories	555,020	999,429
Prepaid expenses and other current assets	12,323	122,482
	-----	-----
Total current assets	1,720,429	2,272,456
PROPERTY AND EQUIPMENT, net	30,438	38,085
OTHER ASSETS	4,888	5,509
	-----	-----
	\$ 1,755,755	\$ 2,316,050
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		

CURRENT LIABILITIES:		
Accounts payable	\$ 231,496	\$ 402,640
Accrued liabilities	38,602	40,480
	-----	-----
Total current liabilities	270,098	443,120
SHAREHOLDERS' EQUITY:		
Preferred stock, par value \$100 per share; 500,000 shares authorized; no shares issued or outstanding	-	-
Common stock, par value \$.01 per share; 240,000,000 shares authorized; 90,478,768 and 85,523,253 shares issued and outstanding, respectively	904,788	855,233
Additional paid-in capital	72,342,772	69,474,058
Accumulated deficit	(71,761,903)	(68,456,361)
	-----	-----
	1,485,657	1,872,930
	-----	-----
	\$ 1,755,755	\$ 2,316,050

=====

</TABLE>

* Derived from audited balance sheet included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2004.

The accompanying notes are an integral part of these condensed balance sheets.

<TABLE>
<CAPTION>

COPYTELE, INC.

CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)

	For the Nine Months Ended July 31,	
	2005	2004
	-----	-----
<S>	<C>	<C>
REVENUE	\$ 391,425	\$ 357,251
COST OF REVENUE	555,259	129,518
	-----	-----
Gross profit (loss)	(163,834)	227,733
	-----	-----
OPERATING EXPENSES		
Research and development expenses	1,725,197	1,732,345
Selling, general and administrative expenses	1,426,936	1,036,901
	-----	-----
Total operating expenses	3,152,133	2,769,246
	-----	-----
LOSS FROM OPERATIONS	(3,315,967)	(2,541,513)
INTEREST INCOME	10,425	3,047
	-----	-----
NET LOSS	\$ (3,305,542)	\$ (2,538,466)
	=====	=====
PER SHARE INFORMATION:		
Net loss per share:		
Basic and Diluted	\$ (0.04)	\$ (0.03)
	=====	=====
Shares used in computing net loss per share:		
Basic and Diluted	87,619,508	82,277,894
	=====	=====

</TABLE>

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

<TABLE>
<CAPTION>

COPYTELE, INC.

CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)

	For the Three Months Ended July 31,	
	2005	2004
	-----	-----

<S>	<C>	<C>
REVENUE	\$ 132,125	\$ 216,447
COST OF REVENUE	354,828	83,220
	-----	-----
Gross profit (loss)	(222,703)	133,227
	-----	-----
OPERATING EXPENSES		
Research and development expenses	485,309	741,166
Selling, general and administrative expenses	415,194	427,352
	-----	-----
Total operating expenses	900,503	1,168,518
	-----	-----
LOSS FROM OPERATIONS	(1,123,206)	(1,035,291)
INTEREST INCOME	4,153	1,079
	-----	-----
NET LOSS	\$ (1,119,053)	\$ (1,034,212)
	=====	=====
PER SHARE INFORMATION:		
Net loss per share:		
Basic and Diluted	\$ (0.01)	\$ (0.01)
	=====	=====
Shares used in computing net loss per share:		
Basic and Diluted	89,344,254	84,048,249
	=====	=====

</TABLE>

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

5

<TABLE>
<CAPTION>

COPYTELE, INC.

CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

	For the Nine Months Ended July 31,	
	2005	2004
	-----	-----
<S>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Payments to suppliers, employees and consultants	\$ (1,675,809)	\$ (1,257,899)
Cash received from customers	369,874	443,612
Interest received	10,425	3,047
	-----	-----
Net cash used in operating activities	(1,295,510)	(811,240)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of short-term investments (certificates of deposit)	(398,353)	-
Purchases of property and equipment	(3,322)	(8,273)
	-----	-----
Net cash used in investing activities	(401,675)	(8,273)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	1,276,200	836,265
	-----	-----
Net cash provided by financing activities	1,276,200	836,265
	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(420,985)	16,752
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,002,777	1,023,531
	-----	-----

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 581,792	\$ 1,040,283
	=====	=====
RECONCILIATION OF NET LOSS TO NET CASH USED IN OPERATING ACTIVITIES:		
Net loss	\$ (3,305,542)	\$ (2,538,466)
Stock option compensation to consultants	44,609	132,252
Stock awards granted to employees and consultants pursuant to stock incentive plans	1,482,088	1,502,150
Restricted stock issued for services rendered	115,372	-
Provision for (Recovery of) doubtful accounts	(3,622)	(73,159)
Provision for excess inventory	437,990	-
Depreciation and amortization	10,969	13,758
Change in operating assets and liabilities:		
Accounts receivable and other receivables	(21,551)	92,190
Inventories	6,419	12,121
Prepaid expenses and other current assets	110,159	29,521
Other assets	621	500
Accounts payable and accrued liabilities	(173,022)	17,893
	-----	-----
Net cash used in operating activities	\$ (1,295,510)	\$ (811,240)
	=====	=====

</TABLE>

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

6

COPYTELE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

1. NATURE AND DEVELOPMENT OF BUSINESS AND FUNDING

Organization and Basis of Presentation

CopyTele, Inc. was incorporated on November 5, 1982. Our principal operations are the development, production and marketing of multi-functional hardware and software based encryption products that provide information security for domestic and international users over virtually every communications media and the development, production and marketing of thin, high brightness, flat panel video displays.

The condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") for interim financial reporting. Accordingly, they do not include all of the information and footnotes required by US GAAP for complete financial statements. The information contained herein is for the nine-month and three-month periods ended July 31, 2005 and 2004. In management's opinion, all adjustments (consisting only of normal recurring adjustments considered necessary for a fair presentation of the results of operations for such periods) have been included herein.

The results of operations for interim periods may not necessarily reflect the results of operations for a full year. Reference is made to the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2004, for more extensive disclosures than contained in these condensed financial statements.

Products

We currently have 18 different products in our line of hardware-based encryption solutions. Our encryption products are multi-functional, hardware based digital encryption systems that provide high-grade voice, fax and data encryption using either the Citadel(TM) CCX encryption cryptographic chip (which is manufactured by the Harris Corporation) or the Triple DES or AES algorithm (algorithms available in the public domain which are used by many U.S. government agencies). In addition, we have developed two software-based security products, one of which uses either the Triple DES or the AES algorithm to encrypt data files and e-mail attachments in both desktop and laptop computers utilizing Microsoft Windows operating systems, and the other of which can encrypt voice and data in cellular and satellite phones, scanners, and printers.

We sell our encryption products directly to end-users and through dealers and distributors.

7

We are also continuing our research and development work on our electron emission display ("Flat CRT") technology. We have been developing a Flat CRT display based on our thin film technology ("TFT") and have produced Flat CRT displays containing TFT color matrix structures.

Funding and Management's Plans

From our inception, we have met our liquidity and capital expenditure needs primarily through the proceeds from sales of common stock in our initial public offering, in private placements, upon exercise of warrants issued in connection with the private placements and public offering, and upon the exercise of stock options. In 2001 and 2002, we also received payments under a technology development agreement. In addition, commencing in the fourth quarter of fiscal 1999, we began to generate cash flows from sales of our encryption products.

During the nine months ended July 31, 2005, our operating activities used approximately \$1,296,000 in cash. This resulted from payments to suppliers, employees and consultants of approximately \$1,676,000, which was offset by cash of approximately \$370,000 received from collections of accounts receivable related to sales of encryption products and approximately \$10,000 of interest income received. In addition, we received approximately \$1,276,000 in cash upon the exercise of stock options, invested approximately \$398,000 in short-term investments consisting of certificates of deposit and purchased approximately \$3,000 of equipment. As a result, our cash and cash equivalents at July 31, 2005 decreased to approximately \$582,000 from approximately \$1,003,000 at the end of fiscal 2004 and short-term investments consisting of certificates of deposit increased to approximately \$398,000 at July 31, 2005 from \$0 at the end of fiscal 2004.

We believe that our existing cash, cash equivalents, short-term investments and accounts receivable, together with cash flows from expected sales of encryption products and flat panel displays, and other potential sources of cash flows, will be sufficient to enable us to continue in operation until at least the end of the third quarter of fiscal 2006. We anticipate that, thereafter, we will require additional funds to continue our marketing, production, and research and development activities, and we will require outside funding if cash generated from operations is insufficient to satisfy our liquidity requirements. However, our projections of future cash needs and cash flows may differ from actual results. If current cash and cash that may be generated from operations are insufficient to satisfy our liquidity requirements, we may seek to sell debt or equity securities or to obtain a line of credit prior to the third quarter of fiscal 2006. The sale of additional equity securities or convertible debt could result in dilution to our stockholders. We currently have no arrangements with respect to additional financing. There can be no assurance that we will generate sufficient revenues in the future (through sales or otherwise) to improve our liquidity or sustain future operations, that our production capabilities will be adequate, that other products will not be produced by other companies that will render our products obsolete, or that other sources of funding would be available, if needed, on favorable terms or at all.

The auditor's report on our financial statements as of October 31, 2004 states that the net loss incurred during the year ended October 31, 2004, our accumulated deficit as of that date, and the other factors described in Note 1 to the Financial Statements included in our Annual Report on Form 10-K for the year ended October 31, 2004, raise substantial doubt about our ability to continue as a going concern. The auditor's report on our financial statements for the year ended October 31, 2003 contained a similar statement. Our financial statements have been prepared assuming we will continue as a going concern and do not include any adjustments that might result from the outcome of this uncertainty.

8

2. STOCK-BASED COMPENSATION

Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" ("SFAS No. 148"), addresses financial accounting and reporting for recording expenses for the fair value of stock options. SFAS No. 148 requires prominent disclosures in financial statements about the effects of stock-based compensation and provides alternative methods of transition for a voluntary change to fair value based method of accounting for stock-based employee compensation. SFAS No. 123 "Accounting for Stock Based Compensation" ("SFAS No. 123") encourages but does not require companies to record compensation cost for stock-based employee compensation plans at fair

value. We account for stock options granted to employees and directors using the intrinsic value method prescribed in Accounting Principles Board ("APB") Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB Opinion No. 25") and comply with the disclosure provisions of SFAS No. 123 and SFAS No. 148. Compensation cost for stock options issued to employees and directors is measured as the excess, if any, of the quoted market price of our stock at the date of grant over the amount an employee or director must pay to acquire the stock. In accordance with APB Opinion No. 25, we have not recognized any compensation cost, as all option grants to employees and directors have been made at the fair market value of our stock on the date of grant.

Had compensation cost for stock options granted to employees and directors been determined at fair value, consistent with SFAS No. 123, our net loss and net loss per share would have increased to the following adjusted amounts:

<TABLE>

<CAPTION>

	For the Nine Months Ended July 31,		For the Three Months Ended July 31,	
	2005	2004	2005	2004
<S>	<C>	<C>	<C>	<C>
Net loss as reported	\$ (3,305,542)	\$ (2,538,466)	\$ (1,119,053)	\$ (1,034,212)
Add: Total stock-based employee compensation expense, determined under fair value based method, for all awards, net of related tax effect	(2,017,510)	(1,272,801)	(287,376)	(910,758)
Net loss as adjusted	\$ (5,323,052)	\$ (3,811,267)	\$ (1,406,429)	\$ (1,944,970)
Net loss per share, basic and diluted:				
As reported	\$ (0.04)	\$ (0.03)	\$ (0.01)	\$ (0.01)
As adjusted	\$ (0.06)	\$ (0.05)	\$ (0.02)	\$ (0.02)

</TABLE>

The fair value of each option grant is estimated at the date of grant using the Black-Scholes option pricing model. The following weighted-average assumptions were used for grants during the nine months ended July 31, 2005 and 2004: risk free interest rates of 3.45% and 2.53%; expected dividend yields of 0% for both periods; expected lives of 2.50 years and 2.48 years; and expected stock price volatility of 109% and 123%. The weighted average fair value of options granted under SFAS No. 123 for the nine months ended July 31, 2005 and 2004 was \$0.38 and \$0.42.

9

During the nine-month periods ended July 31, 2005 and 2004, we granted to employees, directors and consultants options to purchase 5,390,000 shares and 3,340,000 shares, respectively, pursuant to the CopyTele, Inc. 2003 Share Incentive Plan (the "2003 Share Plan"). During the nine-month periods ended July 31, 2005 and 2004, stock options to purchase 2,313,800 shares and 1,706,000 shares, respectively, were exercised, with aggregate proceeds of approximately \$1,276,000 and \$836,000, respectively.

We account for options granted to non-employee consultants using the fair value method required by SFAS No. 123. Consulting expense for options granted to consultants, recognized during the nine-month periods ended July 31, 2005 and 2004, was approximately \$45,000 and \$132,000, respectively, and during the three-month periods ended July 31, 2005 and 2004, was approximately \$0 and \$115,000, respectively. Such consulting expense is included in either research and development expenses or selling, general and administrative expenses, as applicable, in the accompanying statements of operations.

During the nine-month periods ended July 31, 2005 and 2004, we issued 2,417,715 shares and 2,102,250 shares, respectively, of common stock to certain employees for services rendered, principally in lieu of cash compensation, pursuant to the 2003 Share Plan. We recorded compensation expense for the nine-month periods ended July 31, 2005 and 2004 of approximately \$1,453,000 and \$1,175,000, respectively, and for the three-month periods ended July 31, 2005 and 2004 of approximately \$443,000 and \$463,000, respectively, for the shares of common stock issued to employees. In addition, during the nine-month periods ended July 31, 2005 and 2004, we issued 45,000 shares and 628,860 shares, respectively, of common stock to consultants for services rendered pursuant to the 2003 Share Plan. We recorded consulting expense for the nine-month periods ended July 31, 2005 and 2004 of approximately \$30,000 and \$328,000, respectively, and for the three-month periods ended July 31, 2005 and 2004 of approximately \$7,000 and \$91,000, respectively, for the shares of common stock issued to consultants.

As of July 31, 2005, 4,753,414 shares and 45,773 shares, respectively, were available for future grants under the 2003 Share Plan and the CopyTele, Inc. 2000 Share Incentive Plan.

During the nine-month period ended July 31, 2005, we issued 179,000 shares of restricted common stock to our outside legal counsel in satisfaction of outstanding bills for services rendered in the amount of approximately \$115,000.

In December 2004, the FASB issued SFAS No. 123(R), "Accounting for Stock-Based Compensation" ("SFAS No. 123(R)"). SFAS No. 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires that the fair value

10

of such equity instruments be recognized as an expense in the historical financial statements as services are performed. Prior to SFAS No. 123(R), only certain pro forma disclosures of fair value were required. The provisions of this Statement were effective for the first interim reporting period beginning after June 15, 2005. In April 2005, the Securities and Exchange Commission announced a deferral of the effective date of SFAS No. 123(R) until the first interim reporting period of the first fiscal year beginning after June 15, 2005. Accordingly, we will adopt SFAS No. 123(R) commencing with the quarter ending January 31, 2006. We are currently evaluating the effect of SFAS No. 123(R). The adoption of SFAS No. 123(R) is expected to have a material effect on our financial statements.

3. CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject us to concentrations of credit risk consist principally of accounts receivable from sales in the ordinary course of business. Management reviews our accounts receivable and other receivables for potential doubtful accounts and maintains an allowance for estimated uncollectible amounts. Generally, no collateral is received from customers for our accounts receivable. At July 31, 2005, one customer in the Encryption Products and Services Segment represented 96% of net accounts receivable. At October 31, 2004, two customers in the Encryption Products and Services Segment represented 48% and 44%, respectively, of net accounts receivable. During the nine months ended July 31, 2005, one customer in the Encryption Products and Services Segment represented 78% of total net revenues. During the nine months ended July 31, 2004, two customers in the Encryption Products and Services Segment represented 59% and 26%, respectively, of total net revenues.

4. SHORT-TERM INVESTMENTS

Short-term investments represent certificates of deposits, carried at amortized cost, with maturities of less than twelve months. The fair values of the certificates of deposits, including accrued interest, approximate their carrying value due to their short maturities.

5. OTHER RECEIVABLES

In May and June 2002, we received restricted common stock from a customer in connection with an outstanding accounts receivable of approximately \$323,000 and anticipated settling this accounts receivable through the ultimate sale of the common stock. This customer has agreed with us to cure any deficiency between the proceeds from the sale of the common stock and the balance of the outstanding accounts receivable. In addition, the customer's principal shareholder has personally agreed to cure any deficiency in the event that the customer defaults on its agreement to cure such deficiency, up to \$292,000. During the nine months ended July 31, 2005, we received aggregate proceeds of approximately \$15,000 from the sale of a portion of the common stock. As of July 31, 2005, we hold 200,000 shares of such common stock, subject to no restrictions, with a fair value of approximately \$50,000, and we intend to sell the remaining portion of such stock during the next twelve months. This receivable is stated at management's estimate of its net realizable value.

11

6. INVENTORIES

Inventories consist of the following as of:

	July 31, 2005	October 31, 2004
-----	-----	-----

Component parts	\$ 205,402	\$ 304,862
Work-in-process	28,990	114,075
Finished products	320,628	580,492
	-----	-----
	\$ 555,020	\$ 999,429
	=====	=====

7. NET INCOME (LOSS) PER SHARE OF COMMON STOCK

We comply with the provisions of SFAS No. 128, "Earnings Per Share" ("SFAS No. 128"). In accordance with SFAS No. 128, basic net income (loss) per common share ("Basic EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted net income (loss) per common share ("Diluted EPS") is computed by dividing net income (loss) by the weighted average number of common shares and dilutive common share equivalents and convertible securities then outstanding. Diluted EPS for all periods presented is the same as Basic EPS, as the inclusion of the effect of common stock equivalents then outstanding would be anti-dilutive. For this reason, excluded from the calculation of Diluted EPS for the nine-month periods ended July 31, 2005 and 2004, were options to purchase 20,127,246 shares and 16,252,546 shares, respectively.

8. SEGMENT INFORMATION

We follow the provisions of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS No. 131"). Reportable operating segments are determined based on management's approach. The management approach, as defined by SFAS No. 131, is based on the way that the chief operating decision-maker organizes the segments within an enterprise for making operating decisions and assessing performance. While our results of operations are primarily reviewed on a consolidated basis, the chief operating decision-maker also manages the enterprise in two segments: (i) Flat-panel display and (ii) Encryption products and services. The following represents selected financial information for our segments for the nine-month and three-month periods ended July 31, 2005 and 2004:

<TABLE>
<CAPTION>

Segment Data	Flat-Panel Display	Encryption Products and Services	Total
-----	-----	-----	-----
<S>	<C>	<C>	<C>
Nine Months Ended July 31, 2005:			
Revenue	\$ -	\$ 391,425	\$ 391,425
Net loss	(1,310,575)	(1,994,967)	(3,305,542)
Nine Months Ended July 31, 2004:			
Revenue	\$ -	\$ 357,251	\$ 357,251
Net loss	(1,452,496)	(1,085,970)	(2,538,466)

</TABLE>

12

<TABLE>
<CAPTION>

Segment Data	Flat-Panel Display	Encryption Products and Services	Total
-----	-----	-----	-----
<S>	<C>	<C>	<C>
Three Months Ended July 31, 2005:			
Revenue	\$ -	\$ 132,125	\$ 132,125
Net loss	(362,455)	(756,598)	(1,119,053)
Three Months Ended July 31, 2004:			
Revenue	\$ -	\$ 216,447	\$ 216,447
Net loss	(715,151)	(319,061)	(1,034,212)

</TABLE>

13

Item 2. Management's Discussion and Analysis of Financial Condition and Results

of Operations.

Our principal operations are the development, production and marketing of multi-functional hardware and software based encryption products that provide information security for domestic and international users over virtually every communications media and the development, production and marketing of thin, high brightness, flat panel video displays ("Flat CRT").

We currently have 18 different products in our line of hardware-based encryption solutions. Our encryption products are multi-functional, hardware based digital encryption systems that provide high-grade voice, fax and data encryption using either the Citadel(TM) CCX encryption cryptographic chip (which is manufactured by the Harris Corporation) or the Triple DES or AES algorithm (algorithms available in the public domain which are used by many U.S. government agencies). In addition, we have developed two software-based security products, one of which uses either the Triple DES or the AES algorithm to encrypt data files and e-mail attachments in both desktop and laptop computers utilizing Microsoft Windows operating systems, and the other of which can encrypt voice and data in cellular and satellite phones, scanners, and printers. We sell our encryption products directly to end-users and through dealers and distributors.

We have developed modifications of our standard products for specific applications. We have developed and are producing several products for use with the satellite communications network of Thuraya Satellite Telecommunications Company ("Thuraya"), located in Abu Dhabi, United Arab Emirates. The Thuraya network was built by Boeing Satellite Systems, Inc. ("Boeing") and provides communication in Europe, Africa, Russia, the Middle East and Asia. Our products can encrypt voice communication, using a compact encrypted module attached to the Thuraya handset, and automatically encrypt fax communications over the Thuraya network. Our products thus enable the Thuraya network to provide encrypted communications between satellite phones, from satellite phones to desk-based phones, or between desk-based phones. Additionally, we have developed three products to provide satellite and cellular fax encryption between fax machines and between computers and fax machines.

In April 2004, we entered into an agreement with Boeing to provide our encryption products for use over the Thuraya network. Under a September 2004 modification to the agreement, Boeing is the exclusive distributor of eight of our products.

In connection with Boeing becoming the exclusive distributor of some of our products, Boeing authorized us to use its name on our website. Accordingly, customers desiring to purchase such products can find authorized Boeing sales information on the "Encryption Products" page of our website. In January 2005, Boeing introduced, demonstrated and began marketing our encryption products to more than 100 Thuraya service providers. We assisted Boeing with such demonstrations. The products introduced included two new encryption products that we are selling to Boeing, the Thuraya DCS-1400 for voice encryption and the Thuraya USS-900T for fax encryption between fax machines. In February 2005, we started selling to Boeing the USS-900TC, which provides satellite and cellular fax encryption between computers and fax machines. These products contain the brand name of Thuraya and their operating controls are in the Arabic language.

14

Thuraya has included 13 of our encryption solutions sold by Boeing on the Boeing page of Thuraya's website, http://www.thuraya.com/country/int_sp/boeing/products.htm. Our products are also being marketed by another of Thuraya's international service providers, Fort Info Technology FZC, located in Dubai, United Arab Emirates. Our encryption solutions are listed on Fort Info Technology's website, www.forttel.com, under Secure Communications.

We have also developed a method for encrypting Short Message Service ("SMS"), an inexpensive text message communication protocol that is used in many cellular and satellite phones. We will utilize this encryption solution in conjunction with the Thuraya handsets.

Our wireless encryption products are providing secure communications with many different satellite phones, including the Thuraya 7100/7101 handheld terminal ("HHT"), Globalstar GPS-1600 HHT, Telit SAT-550/600 HHT, Globalstar GPS-2800/2900 fixed phone, Iridium 9500/9505 HHT, Inmarsat M4 and Mini "M" HHT units from Thrane & Thrane and Nera. Through the use of our products, encrypted satellite communications are available for many Thuraya docking units, including Teknobli's Next Thuraya Docker, Thuraya Fixed Docking Adapter, APsi's FDU-2500 Fixed Docking Unit, Sattrans' SAT-OFFICE Fixed Docking Unit and SAT-VDA Hands-Free Car Kit.

We also have developed modifications of our standard equipment for other applications. We have provided modifications of our hardware and software encryption solutions to several large organizations which are evaluating our

products in connection with their security requirements. We are supplying to a major U.S. defense contractor our USS-900AF automatic fax encryption product to secure its worldwide fax communication. We have entered into an agreement with another major U.S. company and supplied an initial proof of concept encryption solution utilizing another of our products that has been configured to interface with that company's satellite global positioning system ("GPS") and data communication fleet management network.

We have supplied another major U.S. company our USS-900AF to secure fax communication of personal medical records. We are also providing the DCS-1700 to several U.S. companies to secure the data links between scanners, servers, and printers in multi-functional products.

We are also continuing our research and development work on our Flat CRT electron emission display technology. We have provided our model CTVD-101 Flat CRT display to a potential customer for evaluation of the display's performance in a product which must operate over a wide ambient temperature range in an outdoor environment. After successfully testing our display, the customer ordered a seed quantity of modules containing our display, to replace liquid crystal display ("LCD") modules in our customer's product. We have initially supplied the customer with model CTVD-101 displays. To be able to supply large quantities of displays to this customer and other potential customers, however, we are planning to produce our monochrome CTVD-201 and color CTVD-202 Flat CRT displays, which are based on our more current thin film technology ("TFT"), rather than the CTVD-101. We are planning to replace the CTVD-101 displays previously provided to our customer with CTVD-201 displays for our customer's evaluation.

15

We entered into an agreement, in June 2004, with an Asian company, which currently mass produces TFT LCDs, to jointly produce prototypes of two modified TFT color matrix pixel structures for our Flat CRT display based on our high brightness technology. The two color matrix structures, which are components of our displays, are a 7-inch (diagonal) with 1440 x 234 pixels and a 5.5 inch (diagonal) with 960 x 234 pixels. As part of our TFT color matrix design, each pixel contains memory to achieve high brightness at video rates. We have funded the development of these prototypes, and may enter into a further agreement for commercial production of the structures or the complete color displays. The company has agreed to produce such structures only for us.

We have developed, with the assistance of Volga Svet Ltd. ("Volga"), a Russian display company that we have been working with for approximately eight years, our Model CTVD-201 and Model CTVD-202 displays, which contain the modified TFT color matrix structures we received under our agreement with the Asian company. The Model CTVD-201 display is a 5.5 inch (diagonal) monochrome display with 320 x 234 pixels and the Model CTVD-202 is a 5.5 inch (diagonal) color display with 960 x 234 pixels. We are also completing the assembly of a 7.0 inch (diagonal) prototype color display containing the initial modified TFT color matrix structures with 1,440 x 234 pixels. The Asian company has supplied several hundred of the initial modified TFT color matrix structures for the CTVD-201 and CTVD-202. We produced the CTVD-201 and CTVD-202 displays which contain these initial modified color matrix structures to evaluate the performance and reliability of our displays.

We have successfully tested our display modules under various environmental conditions. This included subjecting our display modules to shock, vibration, and operating temperatures from -40(degree)C to +85(degree). Our display modules are also capable of operating under both sunlight and nighttime conditions. As a result, we believe that our display modules can meet performance requirements for both outdoor and indoor applications. We have also successfully reduced the operating voltage requirements of our display modules to further improve the reliability and extend the life of our displays.

As a result of our reliability testing and evaluation of the display performance characteristics, we have developed a new TFT-based pixel matrix electron control system ("PMECS"). PMECS utilizes our unique low temperature sealing and vacuuming technology, can operate with virtually any type of electron emission system, has gray scale and color capability, and consumes substantially less power than LCD or plasma displays. In addition, PMECS, in conjunction with our electron emission technologies, is applicable to any size display from small hand-held devices to large HDTV products that are being produced in TFT LCD production facilities. We believe that Flat CRT displays with PMECS could potentially have a cost similar to a CRT and thus less than current LCD or Plasma displays.

The Asian company has supplied us with 5.5 inch (diagonal) TFT color matrix structures with 960 x 234 pixels which incorporate PMECS. We are now producing, with the assistance of Volga, both monochrome and color displays with PMECS in combination with our proprietary electron emission technologies. These emission

technologies, which include carbon nanotubes, both reflective and non-reflective planar edge, and thin filaments, are suitable for different display application requirements. In particular, we are incorporating, in our displays, in conjunction with PMECS, our low power carbon nanotube electron emission system. These nanotubes are extremely small carbon elements, approximately 2,500 times thinner than the width of a human hair, that emit electrons under controllable conditions.

In addition to using our own electron emission technologies as a source for a low power electron emission system to be used in conjunction with PMECS, we are also working with two U.S. companies to utilize their carbon nanotube technologies. One company is supplying us with its low power carbon nanotube electron system, which we are incorporating with PMECS to produce a 5.5 inch diagonal display. The other company is developing, exclusively for us, an array of low voltage and power controllable carbon nanotubes for electron emission.

We have also designed PMECS to incorporate chip on glass ("COG") technology, which will be utilized for mass production of these displays. Upon the completion of our display utilizing this design, we believe that Volga will be able to initially supply a limited quantity of production displays. Volga is in the process of evaluating its equipment requirements to mass produce the displays. We anticipate utilizing either the Asian company, Volga or other TFT LCD production companies to mass produce the display for potential users. However, we have not yet entered into any agreement for such mass production, and there can be no assurance that we can do so on commercially acceptable terms or at all.

Earlier this year, we exhibited our Flat CRT display at the Society for Information Display International Symposium, Seminar and Exhibition, the premier international gathering of scientists, engineers, manufacturers and users for the discussion, presentation, viewing and exhibiting of information display technology with more than 250 exhibits. We demonstrated our 5.5 inch (diagonal) display with 320 x 234 pixels and our 5.0 inch (diagonal) display with 320 x 240 pixels to scientists, engineers, manufacturers and users from more than one hundred companies and government agencies. We are following up with a number of companies that expressed an interest in utilizing our displays for their products. In particular, we have demonstrated our 5.5 inch (diagonal) color display with 960 x 234 pixels to two companies and are in discussions with those companies regarding utilizing our display technology.

There can be no assurance that we can produce commercial quality displays, that we can produce such displays in commercial quantities, that we can successfully market our displays, or of the revenue we might derive from sales of our displays.

Our operations and the achievement of our objectives in marketing, production, and research and development are dependent upon an adequate cash flow. Accordingly, in monitoring our financial position and results of operations, particular attention is given to cash and accounts receivable balances and cash flows from operations. Since our initial public offering, our cash flows have been primarily generated through the sales of common stock in private placements and upon exercise of stock options. We also generate cash flows from sales of our encryption products. In an effort to generate sales, we have marketed our encryption products directly to U.S. and international

distributors, dealers and original equipment manufacturers that market our encryption products and to end-users. We have also been working with several large organizations to provide them with both our hardware and software encryption solutions for them to evaluate whether the solutions meet their security requirements and have begun supplying several major U.S. companies with our encryption products. We have also begun to market our flat panel video display products to potential purchasers for incorporation into their products. We anticipate that current cash on hand, cash generated from operations, and cash generated from the exercise of employee options will be adequate to fund our operations at least through the end of the third quarter of fiscal 2006.

CRITICAL ACCOUNTING POLICES

Our financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods.

We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements. For additional discussion on the application of these and other accounting policies, refer to the financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended October 31, 2004.

Revenue Recognition

Sales

Revenues from sales are recorded when all four of the following criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred and title has transferred or services have been rendered; (iii) our price to the buyer is fixed or determinable; and (iv) collectibility is reasonably assured.

Sales Returns and Allowances

Revenues are recorded net of estimated sales returns.

Inventories

Inventories are stated at the lower of cost, including material, labor and overhead, determined on a first-in, first-out basis, or market, which represents our best estimate of market value. We regularly review inventory quantities on hand, particularly finished goods, and record a provision for excess and obsolete inventory based primarily on forecasts of future product demand. During the nine-month period ended July 31, 2005, we recorded a provision for excess inventory due to changes in product requirements of approximately \$438,000. Our net income (loss) is directly affected by management's estimate of the realizability of inventories. To date, sales of our products have been limited. Accordingly, there can be no assurance that we will not be required to reduce the selling price of our inventory below our current carrying value.

18

Stock Based Compensation

We account for stock options granted to employees and directors using the intrinsic value method prescribed in APB Opinion No. 25 "Accounting for Stock Issued to Employees" and comply with the disclosure provision of SFAS No. 123 "Accounting for Stock Based Compensation" and SFAS No. 148 "Accounting for Stock Based Compensation - Transition and Disclosure, an amendment of SFAS No. 123". If we were to include the cost of employee stock option compensation in the financial statements, our net loss for the nine-month periods ended July 31, 2005 and 2004 would have increased by approximately \$2,018,000 and \$1,273,000, respectively, and for the three-month periods ended July 31, 2005 and 2004 would have increased by approximately \$287,000 and \$911,000, respectively, based on the fair value of the stock options granted to employees. See "Impact of Recent Accounting Pronouncements."

RESULTS OF OPERATIONS

Nine months ended July 31, 2005 compared with nine months ended July 31, 2004

Sales

Revenue. Revenue from sales increased by approximately \$34,000 in the nine-month period ended July 31, 2005, to approximately \$391,000, as compared to approximately \$357,000 in the comparable prior-year period. All revenue during both periods was from encryption products and services. The increase in revenue from sales resulted from an increase in revenue from encryption services of approximately \$60,000, offset by a reduction in unit sales of approximately \$26,000. Our encryption sales have been limited and are sensitive to individual large transactions which can vary from period to period. We believe that changes in sales between periods generally represent the nature of the early stage of our product and sales channel development.

Gross Profit (Loss). Gross profit from sales of encryption products and services decreased by approximately \$392,000 in the nine-month period ended July 31, 2005, to a loss of approximately \$164,000, as compared to a gross profit of approximately \$228,000 in the comparable prior-year period. The decrease in gross profit is primarily the result of the provision for excess inventory due to changes in product requirements of approximately \$438,000 recorded in the

nine-month period ended July 31, 2005. Gross profit as a percent of revenue in the nine-month period ended July 31, 2004 was approximately 64%. Gross profit (loss) as a percent of revenue in the nine-month period ended July 31, 2005 is not meaningful due to the inventory adjustment recorded during the period. Because of the limited number of transactions during each of the periods, gross profit percentages, excluding the effect of inventory adjustments, are sensitive to individual transactions.

19

Research and Development Expenses

Research and development expenses decreased by approximately \$7,000 in the nine-month period ended July 31, 2005, to approximately \$1,725,000, from approximately \$1,732,000 in the comparable prior-year period. The decrease in research and development expenses was principally due to a decrease of approximately \$231,000 in outside research and development expense relating to our development of modified TFT technology for our flat panel displays, offset by an increase in employee compensation and related costs of approximately \$221,000, primarily resulting from the grant of employee bonuses.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by approximately \$390,000 to approximately \$1,427,000 in the nine-month period ended July 31, 2005, from approximately \$1,037,000 in the comparable prior-year period. The increase in selling, general and administrative expenses was principally due to an increase in professional fees of approximately \$263,000, approximately \$50,000 of which was incurred with respect to a theft by a former employee (see "-Investigation and Recovery Efforts Regarding Misappropriated Funds" in our Annual Report on Form 10-K for the fiscal year ended October 31, 2004), an increase in employee compensation and related costs of approximately \$96,000 and the recovery in the prior year of previously reserved amounts of approximately \$73,000, offset by a reduction of approximately \$37,000 in consulting expense for stock options issued to consultants.

Interest Income

Interest income was approximately \$10,000 in nine-month period ended July 31, 2005, compared to approximately \$3,000 in the comparable prior-year period. The increase in interest income was the result of an increase in average funds available for investment and an increase in prevailing interest rates.

Three months ended July 31, 2005 compared with three months ended July 31, 2004

Sales

Revenue. Revenue from sales decreased by approximately \$84,000 in the three-month period ended July 31, 2005, to approximately \$132,000, as compared to approximately \$216,000 in the comparable prior-year period. All revenue during both periods was from encryption products and services. The decrease in revenue from sales was principally due to a decrease in unit sales of our encryption products of approximately \$144,000 related to customer procurement delays, offset by an increase in revenue from encryption services of approximately \$60,000. Our encryption sales have been limited and are sensitive to individual large transactions which can vary from period to period. We believe that changes in sales between periods generally represent the nature of the early stage of our product and sales channel development.

Gross Profit (Loss). Gross profit from sales of encryption products and services decreased by approximately \$356,000 in the three-month period ended July 31, 2005, to a loss of approximately \$223,000, as compared to a gross

20

profit of approximately \$133,000 in the comparable prior-year period. The decrease in gross profit is primarily the result of the provision for excess inventory due to changes in product requirements of approximately \$313,000 recorded in the three-month period ended July 31, 2005. Gross profit as a percent of revenue in the three-month period ended July 31, 2004 was approximately 62%. Gross profit (loss) as a percent of revenue in the three-month period ended July 31, 2005 is not meaningful due to the inventory adjustment recorded during the period. Because of the limited number of transactions during each of the periods, gross profit percentages, excluding the effect of inventory adjustments, are sensitive to individual transactions.

Research and Development Expenses

Research and development expenses decreased by approximately \$256,000 in the three-month period ended July 31, 2005, to approximately \$485,000, from approximately \$741,000 in the comparable prior-year period. The decrease in

research and development expenses was principally due to a decrease of approximately \$212,000 in outside research and development expense relating to our development of modified TFT technology for our flat panel displays and a decrease in employee compensation and related costs of approximately \$26,000.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased by approximately \$12,000 to approximately \$415,000 in the three-month period ended July 31, 2005, from approximately \$427,000 in the comparable prior-year period. The decrease in selling, general and administrative expenses was principally due to a reduction in consulting expense of approximately \$89,000, offset by an increase in professional fees of approximately \$34,000, the recovery in the prior year of previously reserved amounts of approximately \$20,000 and an increase in employee compensation and related costs of approximately \$16,000.

Interest Income

Interest income was approximately \$4,000 in three-month period ended July 31, 2005, compared to approximately \$1,000 in the comparable prior-year period. The increase in interest income was the result of an increase in average funds available for investment and an increase in prevailing interest rates.

LIQUIDITY AND CAPITAL RESOURCES

From our inception, we have met our liquidity and capital expenditure needs primarily through the proceeds from sales of common stock in our initial public offering, in private placements, upon exercise of warrants issued in connection with the private placements and public offering, and upon the exercise of stock options. In 2001 and 2002, we also received payments under a technology development agreement. In addition, commencing in the fourth quarter of fiscal 1999, we began to generate cash flows from sales of our encryption products.

21

During the nine months ended July 31, 2005, our operating activities used approximately \$1,296,000 in cash. This resulted from payments to suppliers, employees and consultants of approximately \$1,676,000, which was offset by cash of approximately \$370,000 received from collections of accounts receivable related to sales of encryption products and approximately \$10,000 of interest income received. In addition, we received approximately \$1,276,000 in cash upon the exercise of stock options, invested approximately \$398,000 in short-term investments consisting of certificates of deposit and purchased approximately \$3,000 of equipment. As a result, our cash and cash equivalents at July 31, 2005 decreased to approximately \$582,000 from approximately \$1,003,000 at the end of fiscal 2004 and short-term investments consisting of certificates of deposit increased to approximately \$398,000 at July 31, 2005 from \$0 at the end of fiscal 2004.

Accounts receivable increased by approximately \$32,000 from approximately \$63,000 at the end of fiscal 2004 to approximately \$95,000 at July 31, 2005. The increase in accounts receivable is a result of the timing of collections. During the three months ended July 31, 2005, we applied our reserve for doubtful accounts against the underlying receivable (which related to one slow-paying customer). This had no effect on our net accounts receivable. Other receivables were approximately \$78,000 at July 31, 2005, representing a decrease of approximately \$6,000 from approximately \$84,000 at the end of fiscal 2004. The decrease in other receivables is a result of proceeds received of approximately \$15,000 from the sale of a portion of the common stock received from a customer to settle such customer's accounts receivable, offset by a reduction of the allowance for doubtful accounts related to this accounts receivable of approximately \$9,000. Inventories decreased approximately \$444,000 from approximately \$999,000 at October 31, 2004 to approximately \$555,000 at July 31, 2005, as a result of the timing of shipments, production schedules and the provision for excess inventory due to changes in product requirements of approximately \$438,000 recorded during the nine-month period ended July 31, 2005. Prepaid expenses and other current assets decreased by approximately \$110,000 from approximately \$122,000 at the end of fiscal 2004 to approximately \$12,000 at July 31, 2005. The decrease in prepaid expenses and other assets is primarily due to the receipt of a receivable of approximately \$100,000 from insurance companies related to a theft by a former employee (see "-Investigation and Recovery Efforts Regarding Misappropriated Funds" in our Annual Report on Form 10-K for the fiscal year ended October 31, 2004). Accounts payable and accrued liabilities decreased by approximately \$173,000 from approximately \$443,000 at the end of fiscal 2004 to approximately \$270,000 at July 31, 2005, as a result of the issuance of restricted common stock to settle a liability of approximately \$115,000 and the timing of payments.

As a result of these changes, working capital at July 31, 2005 decreased to approximately \$1,450,000 from approximately \$1,829,000 at the end of fiscal 2004.

Our working capital includes inventory of approximately \$555,000 at July 31, 2005. Management has recorded our inventory at the lower of cost or our current best estimate of net realizable value. To date, sales of our products have been limited. Accordingly, there can be no assurance that we will not be required to reduce the selling price of our inventory below our current carrying value.

22

During the nine-month periods ended July 31, 2005 and 2004, we issued shares of common stock to certain employees for services rendered, principally in lieu of cash compensation. We recorded compensation expense for the nine-month periods ended July 31, 2005 and 2004 of approximately \$1,453,000 and \$1,175,000, respectively, and for the three-month periods ended July 31, 2005 and 2004 of approximately \$443,000 and \$463,000, respectively, for the shares of common stock issued to employees. In addition during the nine-month periods ended July 31, 2005 and 2004, we issued shares of common stock to consultants for services rendered. We recorded consulting expense for the nine-month periods ended July 31, 2005 and 2004 of approximately \$30,000 and \$328,000, respectively, and for the three-month periods ended July 31, 2005 and 2004 of approximately \$7,000 and \$91,000, respectively, for the shares of common stock issued to consultants. During the nine-month period ended July 31, 2005, we also issued 179,000 shares of restricted common stock to our outside legal counsel in satisfaction of outstanding bills for services rendered in the amount of approximately \$115,000.

The auditor's report on our financial statements as of October 31, 2004 states that the net loss incurred during the year ended October 31, 2004, our accumulated deficit as of that date, and the other factors described in Note 1 to the Financial Statements included in our Annual Report on Form 10-K for the year ended October 31, 2004, raise substantial doubt about our ability to continue as a going concern. The auditor's report on our financial statements for the year ended October 31, 2003 contained a similar statement. Our financial statements have been prepared assuming we will continue as a going concern and do not include any adjustments that might result from the outcome of this uncertainty.

We believe that our existing cash, cash equivalents, short-term investments and accounts receivable, together with cash flows from expected sales of encryption products and flat panel displays, and other potential sources of cash flows, will be sufficient to enable us to continue in operation until at least the end of the third quarter of fiscal 2006. We anticipate that, thereafter, we will require additional funds to continue our marketing, production, and research and development activities, and we will require outside funding if cash generated from operations is insufficient to satisfy our liquidity requirements. However, our projections of future cash needs and cash flows may differ from actual results. If current cash and cash that may be generated from operations are insufficient to satisfy our liquidity requirements, we may seek to sell debt or equity securities or to obtain a line of credit prior to the third quarter of fiscal 2006. The sale of additional equity securities or convertible debt could result in dilution to our stockholders. We currently have no arrangements with respect to additional financing. There can be no assurance that we will generate sufficient revenues in the future (through sales or otherwise) to improve our liquidity or sustain future operations, that our production capabilities will be adequate, that other products will not be produced by other companies that will render our products obsolete, or that other sources of funding would be available, if needed, on favorable terms or at all.

We are seeking to improve our liquidity through increased sales or license of products and technology. In an effort to generate sales, we have marketed our encryption products directly to U.S. and international distributors, dealers and original equipment manufacturers that market our encryption products and to end-users. We have been working with several large organizations to provide them with both our hardware and software encryption solutions for them to evaluate whether the solutions meet their security requirements and have begun supplying several major U.S. companies with our encryption products. We have also begun to market our flat panel video display products to potential purchasers for incorporation into their products. During the nine months ended July 31, 2005, we have recognized revenue from sales of encryption products and services of approximately \$391,000.

23

The following table presents our expected cash requirements for contractual obligations outstanding as of July 31, 2005:

<TABLE>
<CAPTION>

Payments Due by Period

Less

Contractual Obligations	than 1 year	1-3 years	4-5 years	After 5 years	Total
<S>	<C>	<C>	<C>	<C>	<C>
Consulting Agreement	\$ 105,000	-	-	-	\$ 105,000
Noncancelable Operating Leases	\$ 217,000	-	-	-	\$ 217,000
Total Contractual Cash Obligations	\$ 322,000	-	-	-	\$ 322,000

IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123(R), "Accounting for Stock-Based Compensation" ("SFAS No. 123(R)"). SFAS No. 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires that the fair value of such equity instruments be recognized as an expense in the historical financial statements as services are performed. Prior to SFAS No. 123(R), only certain pro forma disclosures of fair value were required. The provisions of this Statement were effective for the first interim reporting period beginning after June 15, 2005. In April 2005, the Securities and Exchange Commission announced a deferral of the effective date of SFAS No. 123(R) until the first interim reporting period of the first fiscal year beginning after June 15, 2005. Accordingly, we will adopt SFAS No. 123(R) commencing with the quarter ending January 31, 2006. We are currently evaluating the effect of SFAS No. 123(R). The adoption of SFAS No. 123(R) is expected to have a material effect on our financial statements.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS 154"). SFAS 154 replaces the Accounting Principles Board Opinion No. 20, "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements," to require retrospective application to prior periods' financial statements of changes in accounting principle. The provisions of SFAS 154 are effective for accounting changes made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 is not expected to have a material effect on our financial statements.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets" ("SFAS 153"). SFAS 153 amends Accounting Principles Board Opinion No. 29, "Accounting for Nonmonetary Transactions," to eliminate the exception from fair value measurement for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The provisions of SFAS 153 are effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS 153 is not expected to have a material effect on our financial statements.

FORWARD-LOOKING STATEMENTS

Information included in this Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not statements of historical facts, but rather reflect our current expectations concerning future events and results. We generally use the words "believes," "expects," "intends," "plans," "anticipates," "likely," "will" and similar expressions to identify forward-looking statements. Such forward-looking statements, including those concerning our expectations, involve risks, uncertainties and other factors, some of which are beyond our control, which may cause our actual results, performance or achievements, or industry results, to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. These risks, uncertainties and factors include, but are not limited to, those factors set forth in "General Risks and Uncertainties" below and Note 1 to Condensed Financial Statements. You should read this discussion and analysis along with our Annual Report on Form 10-K for the year ended October 31, 2004 and the condensed financial statements included in this Report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. You are cautioned not to unduly rely on such

forward-looking statements when evaluating the information presented in this Report.

GENERAL RISKS AND UNCERTAINTIES

Our business involves a high degree of risk and uncertainty, including, but not limited to, the following risks and uncertainties:

- o We have experienced significant net losses and negative cash flows from operations and they may continue.

We have had net losses and negative cash flows from operations in each year since our inception and in the nine months ended July 31, 2005, and we may continue to incur substantial losses and experience substantial negative cash flows from operations. We have incurred substantial costs and expenses in developing our encryption and flat panel display technologies and in our efforts

to produce commercially marketable products incorporating our technology. We have had limited sales of products to support our operations from inception through July 31, 2005. We have set forth below our net losses, research and development expenses and net cash used in operations for the nine-month periods ended July 31, 2005 and 2004, and for the fiscal years ended October 31, 2004 and 2003:

<TABLE>
<CAPTION>

	(Unaudited) Nine Months Ended July 31,		Fiscal Years Ended October 31,	
	2005	2004	2004	2003
<S>	<C>	<C>	<C>	<C>
Net loss	\$ 3,305,542	\$ 2,538,466	\$ 3,360,655	\$ 3,114,411
Research and development expenses	\$ 1,725,197	\$ 1,732,345	\$ 2,164,427	\$ 1,807,742
Net cash used in operations	\$ 1,295,510	\$ 811,240	\$ 1,205,122	\$ 958,501

- o We may need additional funding in the future which may not be available on acceptable terms and, if available, may result in dilution to our stockholders, and our auditors have issued a "going concern" audit opinion.

We anticipate that, if cash generated from operations is insufficient to satisfy our requirements, we will require additional funding to continue our research and development activities and market our products. The auditor's report on our financial statements as of October 31, 2004 states that the net loss incurred during the year ended October 31, 2004, our accumulated deficit as of that date, and the other factors described in Note 1 to the Financial Statements included in our Annual Report on Form 10-K for the year ended October 31, 2004, raise substantial doubt about our ability to continue as a going concern. The auditor's report on our financial statements for the year ended October 31, 2003 contained a similar statement. Our financial statements have been prepared assuming we will continue as a going concern and do not include any adjustments that might result from the outcome of this uncertainty.

We believe that our existing cash and accounts receivable, together with cash flows from expected sales of encryption products and flat panel displays, and other potential sources of cash flows, will be sufficient to enable us to continue in operation until at least the end of the third quarter of fiscal 2006. We anticipate that, thereafter, we will require additional funds to continue marketing, production, and research and development activities, and we will require outside funding if cash generated from operations is insufficient to satisfy our liquidity requirements. However, our projections of future cash needs and cash flows may differ from actual results. If current cash and cash that may be generated from operations are insufficient to satisfy our liquidity requirements, we may seek to sell debt or equity securities or to obtain a line of credit prior to the third quarter of fiscal 2006. The sale of additional equity securities or convertible debt could result in dilution to our stockholders. We can give you no assurance that we will be able to generate adequate funds from operations, that funds will be available to us from debt or equity financings or that, if available, we will be able to obtain such funds on favorable terms and conditions. We currently have no arrangements with respect to additional financing.

- o We may not generate sufficient revenues to support our operations in the future or to generate profits.

We are engaged in two principal operations: (i) the development, production and marketing of thin high-brightness flat panel video displays and (ii) the development, production and marketing of multi-functional encryption products that provide information security for domestic and international users over virtually every communications media. We have only recently started to produce monochrome versions of our high-brightness flat panel displays and our encryption products are only in their initial stages of commercial production. Our investments in research and development are considerable. Our ability to generate sufficient revenues to support our operations in the future or to generate profits will depend upon numerous factors, many of which are beyond our control, including:

- o our ability to successfully market our line of thin high-brightness flat panel video displays and encryption products;
- o the capability of Volga to produce thin high-brightness monochrome video displays and supply them to us;
- o our ability to jointly develop with Volga and produce a full-color video display;
- o our ability to develop and produce displays using controllable nanotubes and modified TFT technology;
- o our production capabilities and those of our suppliers as required for the production of our encryption products;
- o long-term performance of our products;
- o the capability of our dealers and distributors to adequately service our encryption products;
- o our ability to maintain an acceptable pricing level to end-users for both our encryption and display products;
- o the ability of suppliers to meet our requirements and schedule;
- o our ability to successfully develop other new products under development;
- o rapidly changing consumer preferences;
- o the possible development of competitive products that could render our products obsolete or unmarketable;
- o our future negotiations with Volga with respect to payments and other arrangements under our Joint Cooperation Agreement with Volga.

Because our revenue is subject to fluctuation, we may be unable to reduce operating expenses quickly enough to offset any unexpected revenue shortfall. If we have a shortfall in revenue in relation to expenses, our operating results would suffer. Our operating results for any particular quarter may not be indicative of future operating results. You should not rely on quarter-to-quarter comparisons of results of operations as an indication of our future performance.

27

- o We are dependent upon a few key executives and the loss of their services could adversely affect us.

Our future success is dependent on our ability to hire, retain and motivate highly qualified personnel. In particular, our success depends on the continued efforts of our Chief Executive Officer, Denis A. Krusos, and our President, Frank J. DiSanto, who founded our company in 1982 and are engaged in the management and operations of our business, including all aspects of the development, production and marketing of our encryption products and flat panel display technology. In addition, Messrs. Krusos and DiSanto, as well as our other skilled management and technical personnel, are important to our future business and financial arrangements. The loss of the services of any such persons could have a material adverse effect on our business and operating results.

- o The small size of our accounting and financial staff has exposed us, and may expose us in the future, to risks relating to our internal control, and may limit our growth.

The small size of our accounting and financial staff has exposed us to risks relating to our internal control over financial reporting. In particular, as discussed in our Annual Report on Form 10-K for the year ended October 31, 2004 under Item 9A, Controls and Procedures, in December 2004, we discovered that an employee in our accounting staff had defrauded us of approximately \$189,000 (of which approximately \$4,000 we believe was replaced) during fiscal 2004 and the first month of fiscal 2005 and approximately \$28,000 during the period from fiscal 2001 through fiscal 2003. While we have recovered approximately \$110,000 of such loss through insurance proceeds and may seek additional recoveries from other parties, and we have taken steps to improve our internal controls to prevent such activity in the future, there can be no assurance that our controls and procedures will prevent all errors or fraud, or that any future such losses would be insured or otherwise recoverable. We may need to recruit additional staff to improve our internal controls or to support

growth of our business, the costs of which would reduce the funds available for research and development and marketing activities.

- o The very competitive markets for our encryption products and flat panel display technology could have a harmful effect on our business and operating results.

The markets for our encryption products and flat panel display technology worldwide are highly competitive and subject to rapid technological changes. Most of our competitors are larger than us and possess financial, research, service support, marketing, manufacturing and other resources significantly greater than ours. Competitive pressures may have a harmful effect on our business and operating results.

- o Our common stock is subject to the SEC's penny stock rules which may make our shares more difficult to sell.

Our stock fits the definition of a penny stock. The SEC rules regarding penny stocks may have the effect of reducing trading activity in our common stock and making it more difficult for investors to sell. The rules require a broker to deliver a risk disclosure document that provides information about penny stocks and the nature and level of risks in the penny stock market. The

28

broker must also give bid and offer quotations and broker and salesperson compensation information to the customer orally or in writing prior to effecting a transaction and in writing with the confirmation. The SEC rules also require a broker to make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction before completion of the transaction. These requirements may result in a lower trading volume of our common stock and lower trading prices.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We have invested a portion of our cash on hand in short term, fixed rate and highly liquid instruments that have historically been reinvested when they mature throughout the year. Although our existing instruments are not considered at risk with respect to changes in interest rates or markets for these instruments, our rate of return on these securities could be affected at the time of reinvestment, if any.

Item 4. Controls and Procedures.

We carried out an evaluation, under the supervision and with the participation of our management including our Chairman of the Board and Chief Executive Officer and our Vice President - Finance and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13-15(b) of the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chairman of the Board and Chief Executive Officer and our Vice President - Finance and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report.

There was no change in our internal control over financial reporting during the quarter ended July 31, 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

29

PART II. OTHER INFORMATION

Item 6. Exhibits.

- 31.1 Certification of Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated September 9, 2005.
- 31.2 Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated September 9, 2005.

- 32.1 Statement of Chief Executive Officer, pursuant to Section 1350 of Title 18 of the United States Code, dated September 9, 2005.
- 32.2 Statement of Chief Financial Officer, pursuant to Section 1350 of Title 18 of the United States Code, dated September 9, 2005.

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.

COPYTELE, INC.

By: /s/ Denis A. Krusos

Denis A. Krusos
Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

September 9, 2005

By: /s/ Henry P. Herms

Henry P. Herms
Vice President - Finance and
Chief Financial Officer (Principal
Financial and Accounting Officer)

September 9, 2005

Exhibit 31.1

CERTIFICATION

I, Denis A. Krusos, Chairman of the Board and Chief Executive Officer of CopyTele, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of CopyTele, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Denis A. Krusos

Denis A. Krusos
Chairman of the Board and
Chief Executive Officer

September 9, 2005

Exhibit 31.2

CERTIFICATION

I, Henry P. Herms, Vice President - Finance and Chief Financial Officer of CopyTele, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of CopyTele, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Henry P. Herms

Henry P. Herms
Vice President - Finance and
Chief Financial Officer

September 9, 2005

Exhibit 32.1

Statement of Chief Executive Officer
Pursuant to Section 1350 of Title 18 of the United States Code

Pursuant to Section 1350 of Title 18 of the United States Code, the undersigned, Denis A. Krusos, the Chairman of the Board and Chief Executive Officer of CopyTele, Inc., hereby certifies that:

1. The Company's Form 10-Q Quarterly Report for the period ended July 31, 2005 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Denis A. Krusos

Denis A. Krusos
Chairman of the Board and
Chief Executive Officer

September 9, 2005

Exhibit 32.2

Statement of Chief Financial Officer
Pursuant to Section 1350 of Title 18 of the United States Code

Pursuant to Section 1350 of Title 18 of the United States Code, the undersigned, Henry P. Herms, the Vice President - Finance and Chief Financial Officer of CopyTele, Inc., hereby certifies that:

1. The Company's Form 10-Q Quarterly Report for the period ended July 31, 2005 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Henry P. Herms

Henry P. Herms
Vice President - Finance and
Chief Financial Officer

September 9, 2005