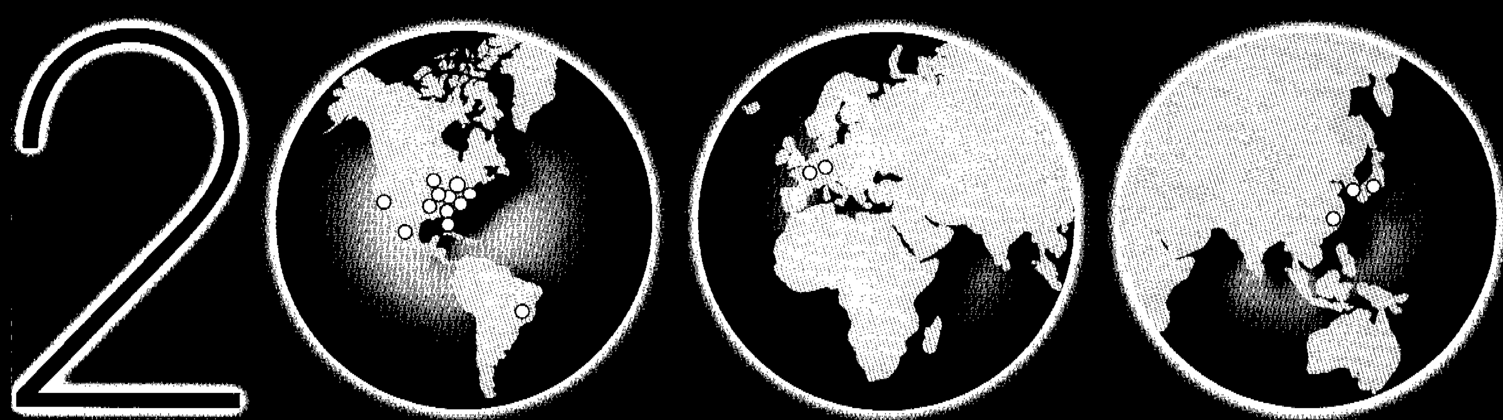
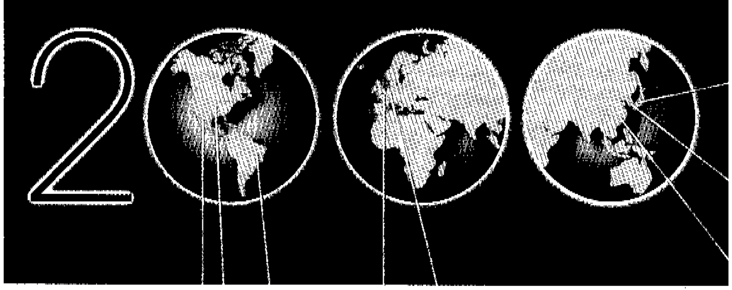
Research Frontiers Annual Report



Our cover shows the locations of Research Frontiers' licensees



Japan
Dainippon Ink and Chemicals Incorporated
Tokyo and Kashima

Hitachi Chemical Co., Ltd.
Tokyo and Ibaraki

Korea
Hankuk Glass Industries Inc.
Seoul and Inchon

Mexico
AP Technoglass Co.
El Salto, Jalisco

Germany
Global Mirror GmbH & Co. KG (Lang-Mekra)
Füürth

China
Global Mirror GmbH & Co. KG (Lang-Mekra)
Shanghai

Belgium
Glaverbel, S.A.
Brussels and Jumet

Brazil
Global Mirror GmbH & Co. KG (Lang-Mekra)
Diadema, Sao Paulo

United States
AP Technoglass Co.
Elizabethtown, Kentucky
Florence, Kentucky
Plymouth, Michigan
Bellefontaine, Ohio

Film Technologies International, Inc.
St. Petersburg, Florida

General Electric Company
Fairfield, Connecticut
Pittsfield, Massachusetts

Global Mirror GmbH & Co. KG (Lang-Mekra)
Ridgeway, South Carolina

Hitachi Chemical Co., Ltd.
Santa Clara, California

InspecTech Aero Service, Inc.
Ft. Lauderdale, Florida

Material Sciences Corporation
San Diego, California
Elk Grove Village, Illinois

Polaroid Corporation
Cambridge, Massachusetts
Waltham, Massachusetts

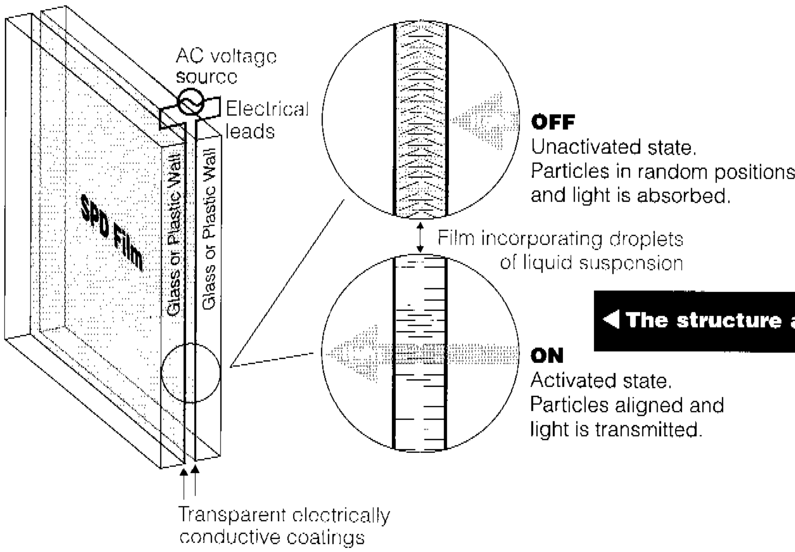
ThermoView Industries, Inc.
Louisville, Kentucky

Vision-Ease Lens Azusa, Inc.
Azusa, California
Ramsey, Minnesota

THE PAST YEAR has been an exceptionally productive one for your Company. Since my last letter to our shareholders, we entered into four significant new non-exclusive license agreements. In May 2000, Research Frontiers and **Polaroid Corporation** entered into an agreement permitting Polaroid to manufacture and sell suspended particle device emulsions and films to our licensees. This agreement has significant historical meaning as well, because the late founder of Polaroid, Dr. Edwin Land, invented and patented in 1934 the predecessor of our SPDs, which he called a "light valve." In February 2001 we signed a license agreement with **AP Technoglass** enabling them to make and sell SPD sunroof glass for sunroofs produced by our licensees. AP Technoglass is North America's leading automotive glass and sunroof glass supplier and a subsidiary of **Asahi Glass Co., Ltd.**, the world's largest automotive glass supplier and Japan's largest glass manufacturer. In March 2001, we also signed a license agreement with **InspecTech Aero Service, Inc.** covering windows, window shades and cabin dividers for aircraft. We regard this as an especially important application because such products should dramatically reduce fuel consumption and other costs of operation of the world's airlines and aircraft operators. SPD aircraft windows will also help to expose a large number of business executives and other prospective customers to SPD technology and the many benefits it can bring to their own company's products. Later in March we licensed **Film Technologies International, Inc.** (FTI) to manufacture and sell SPD film to our licensees. FTI is reported to be the world's fifth largest producer of specialty window film, with extensive international distribution, and is well-regarded for its high-quality film products.

In October we announced that the Company would visit a number of major cities to enable the public to see a variety of SPD products in a tour called *Experience the View of the Future*. Since then we have made very well-received presentations in Toronto, Montreal, Houston, Dallas, Portland, Boston and Chicago.

A highly informative independent market study on the subject of "smart" windows was done for the Company by Townsend Research Group LLC, which interviewed 50 leading U.S. window manufacturers. The study, which we believe to be the first of its kind, found that by 2005 the smart window market penetration is expected to reach 3.6% and 6.2% for residential windows and commercial building windows, respectively.



◀ **The structure and operation of a Suspended Particle Device (SPD).**

These penetration rates indicate that the market potential for smart glass could reach hundreds of millions of square feet in the United States alone by 2005. In dollar terms, such sales could reach billions of dollars annually.

In December **Lang-Mekra North America, LLC**, a subsidiary of our licensee **Global Mirror GmbH & Co. KG**, the world's largest manufacturer of commercial vehicle mirror systems, demonstrated fast-responding SPD mirror prototypes to the automotive industry at the Society of Automotive Engineers International Truck and Bus Meeting and Exposition in Portland, Oregon. Lang-Mekra's customers were impressed and expressed a high degree of interest.

In March of this year the Company participated in a major exposition sponsored by the **National Glass Association** and other groups. A record 370 companies exhibited products, and approximately 6,800 people from the glass and window film industries attended this show, and a constant stream of visitors to Research Frontiers' booth saw and operated SPD film samples plus other product samples using our technology, including smart windows, a smart sunroof, a flat panel display, a truck mirror, and a new automotive sunvisor which switches instantly either automatically or manually to block glare, yet always permits the driver to see the road ahead. Several product samples were powered by ordinary batteries to demonstrate the low current and low power consumption required to run SPD products. The excitement at the Company's booth was electric and this show has already had a tangible impact resulting in new license agreements.

Because of its relatively strong market price, REFR was added to the **Russell 2000 Index** as of July 1, 2000. Institutional ownership of the Company's shares has risen to about 5%, partly as a result of listing on the Index, and partly, we believe, because of growing awareness of the Company's enormous profit potential once commercialization of SPD products takes place. Research Frontiers closed the year 2000 with our stock price appreciating over 18%, as compared to a decline in the Nasdaq of 39% and the Dow Jones Industrial Average being down over 6%.

The Company's net loss for the year 2000 was $7,567,800 ($0.63 per share). However, this figure includes approximately $3.9 million of non-cash accounting charges relating to options and warrants issued by the Company. Without taking into account these non-cash accounting charges, the Company's net loss would have been $3,658,893 ($0.30 per share) for 2000 as compared to $3,061,970 ($0.28 per share) for 1999. The Company has also increased its research and development expenses in order to accelerate R&D activities and to aid our licensees. As of December 31, 2000 the Company's financial position remained strong, with cash, cash equivalents and marketable securities of more than $15.1 million, and no debt.

As you know, in order to commence production, most of our SPD film licensees will require quantities of SPD emulsion. Based on reports from our licensees, we expect larger quantities of emulsion to become available in a few months, and mass-production quantities to be available thereafter.

In January 2001 our licensee, **Hankuk Glass Industries Inc.** (HGI) announced that it was forming a subsidiary called **SPD Inc.** which would be exclusively devoted to the mass production and sale of SPD film and SPD end products. Since then, they have had senior management, a chief technology officer, and a chief marketing person join their company, they completed their acquisition of their new factory building, and publicly announced their product introduction timetable under which mass production of SPD products will commence this year!

We look forward to the coming year with great confidence based on our excellent technology, an outstanding group of hard-working licensees and employees, and strong financial and patent positions. We also have a highly-effective marketing plan in place that has already begun to achieve dramatic results, not only in adding new companies to our growing list of licensees, but also promoting a general awareness about SPD technology and the benefits it can bring to many different products and industries.

Sincerely,

Robert L. Saxe

Robert L. Saxe
President

Common Stock Information

Market Information

The Company's common stock is traded on the NASDAQ National Market. As of March 29, 2001, there were 12,001,083 shares of common stock outstanding.

The following table sets forth the range of the high and low selling prices (as provided by the National Association of Securities Dealers) of the Company's common stock for each quarterly period within the past two fiscal years.

Quarter Ended	Low	High
March 31, 1999	6.7500	11.0000
June 30, 1999	6.8750	10.0000
September 30, 1999	9.0625	13.5625
December 31, 1999	8.5000	15.4375
March 31, 2000	14.6250	40.0000
June 30, 2000	9.6875	32.0000
September 30, 2000	14.7500	31.7500
December 31, 2000	13.7500	22.4375

These quotations may reflect inter-dealer prices, without retail mark-up, mark-down, or commission, and may not necessarily represent actual transactions.

Approximate Number of Security Holders

As of March 29, 2001, there were 562 holders of record of the Company's common stock. The Company estimates that there are over 10,375 beneficial holders of the Company's common stock.

Dividends

The Company did not pay dividends on its common stock in 2000 and does not expect to pay any cash dividends in the foreseeable future. There are no restrictions on the payment of dividends.

Selected Financial Data

The following table sets forth selected data regarding the Company's operating results and financial position. The data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and notes thereto, all of which are contained in this Annual Report to Shareholders.

Year ended December 31	2000	1999	1998	1997	1996
Statement of Operations Data:					
Fee income	$ 333,652	$ 128,096	$ 108,735	$ 60,000	$ 50,000
Operating expenses	3,027,655	1,605,028	1,631,179	1,884,038	1,226,410
Research and development (1)	2,618,567	1,971,341	1,647,448	1,831,397	1,711,634
Non-recurring non-cash compensation expense (2)	3,133,748	671,052	—	—	—
	8,779,970	4,247,421	3,278,627	3,715,435	2,938,044
Operating loss	(8,446,318)	(4,119,325)	(3,169,892)	(3,655,435)	(2,888,044)
Net investment income (3)	878,518	386,303	460,572	425,990	413,206
Other income	—	—	91,379	—	—
Net loss	(7,567,800)	(3,733,022)	(2,617,941)	(3,229,445)	(2,474,838)
Basic and diluted net loss per common share	(.63)	(.34)	(.24)	(.32)	(.25)
Dividends per share	—	—	—	—	—

As of December 31	2000	1999	1998	1997	1996
Balance Sheet Data:					
Total current assets	$15,358,819	$ 9,695,137	$ 6,728,453	$ 9,728,285	$ 8,193,639
Total assets	15,729,127	10,037,063	7,021,291	10,033,663	8,425,141
Long-term debt, including accrued interest	—	—	—	—	—
Total shareholders' equity	14,737,917	9,507,736	6,740,489	9,621,979	8,216,847

(1) Research and development expenses for 1999 include $289,177 paid by the Company for 74 patents and patent applications acquired from Glaverbel, SA.

(2) During 1999, the Company granted 237,800 contingent performance options to employees, which vested only, if a certain performance milestone in the price of the Company's common stock was achieved during 2000. The charges recorded as a result of the issuance of these performance options were calculated based upon changes in the Company's stock price as of the end of each quarter until the vesting date, and are non-cash compensation charges.

(3) Net investment income for 2000, 1999, 1998, 1997, and 1996 includes $0, $95,001, $50,968, $68,810, and $211,360, respectively, of interest income received from officers of the Company upon payment of notes receivable, and $0, $0, $0, ($6,382), and $1,174,643, respectively of unrealized gain (loss) on investments. Prior to July 1997, the Company classified its investments as trading securities which resulted in the unrealized gains and losses recorded in the statement of operations.

Results of Operations

2000 vs. 1999

The Company's fee income from licensing activities for 2000 was $333,652 as compared to fee income of $128,096 for 1999. The increase in fee income was due to the Company entering into additional license agreements during the year and scheduled increases in the minimum annual royalties payable thereunder. 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.

Operating expenses increased by $1,422,627 for 2000 to $3,027,655 from $1,605,028 for 1999. This increase was primarily the result of increased compensation (primarily as a result of certain non-cash charges associated with performance options and warrants issued to consultants described below, the addition of two new employees during the first quarter of 2000, and the payment to employees for certain performance bonuses), marketing, insurance, stock listing fees, depreciation, general expenses, and travel expenses, offset by lower investor and public relations expenses, legal and accounting fees. During 2000, the Company incurred non-cash operating expenses of $598,758 in connection with the issuance of options to certain consultants valued by the Black-Scholes pricing model at $70,560, and a non-cash compensation charge of $528,198 relating to the vesting of certain performance based warrants issued to another consultant for services performed.

Research and development expenditures increased by $647,226 to $2,618,567 for 2000 from $1,971,341 for 1999. This increase was primarily the result of higher research-related salaries and performance bonuses, and higher materials costs, patent and depreciation expenses.

Operating expenses and research and development expenses listed above included amounts accrued under a performance bonus plan of $477,500 and $277,500, respectively. These performance bonuses in the amount accrued for were paid by the Company during the third quarter of 2000 because the applicable performance milestones were achieved. In addition to these performance bonus accruals, the Company also recorded a non-cash compensation charge of $3,133,748 and $671,052 with respect to 2000 and 1999, respectively, which is related to the non-recurring grant of certain contingent performance options issued to employees and directors during 1999.

The Company's net gain from its investing activities for 2000 was $878,518, as compared to a net gain from its investing activities of $291,302 for 1999. This difference was primarily due to a higher level of average investment balances in 2000 compared to the same period in 1999 as a result of proceeds received from the exercise of the Class A Warrant and employee stock options. In addition, during 1999 the Company recorded $95,001 of interest income on notes receivable from one of its officers which was paid through the delivery of shares of common stock to the Company.

As a consequence of the factors discussed above, the Company's net loss was $7,567,800 ($0.63 per share) for 2000 as compared to $3,733,022 ($0.34 per share) for 1999. As more fully described above, during 2000, the Company incurred non-cash accounting charges of $3,908,907 in connection with contingent performance options issued to employees of the Company in 1999 and the issuance of options and warrants to non-employees when these options and warrants vested. Without taking into account these non-cash accounting charges of $3,908,907, the Company's net loss would have been $3,658,893 ($0.30 per share) for 2000 as compared to $3,061,970 ($0.28 per share) for 1999.

1999 vs.1998

The Company's fee income from licensing activities for 1999 was $128,096 as compared to fee income of $108,735 for 1998. 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.

Operating expenses decreased by $26,151 for 1999 to $1,605,028 from $1,631,179 for 1998. This decrease was primarily the result of lower public relations, depreciation, office and consulting expenses, offset by increased compensation, professional fees, insurance, rent, travel and stock listing expenses.

Research and development expenditures (excluding the purchase of patents described below) increased by $323,893 to $1,971,341 for 1999 from $1,647,448 for 1998. This increase was primarily the result of higher research-related compensation and consulting expenses, offset by lower costs for materials.

The Company recorded a non-cash compensation charge of $671,052 with respect to 1999 which is related to the non-recurring grant of certain contingent performance options issued to employees and directors during 1999.

In June of 1999, the Company purchased 74 patents and patent applications from Glaverbel S.A. covering various inventions relating to SPD technology for which a lump-sum payment of $289,177 was made. In accordance with the Company's accounting policy, such amount was expensed.

The Company's net gain from its investing activities for 1999 was $291,302, as compared to a net gain from its investing activities of $409,604 for 1998. This difference was primarily due to a higher level of average investment balances in 1998 compared to the same period in 1999 as a result of the Company receiving $5.0 million towards the end of 1997 in connection with the issuance of the redeemable prepaid warrant. In addition, during 1999 the Company recorded $95,001 of interest income on notes receivable from one of its officers which was paid through the delivery of shares of common stock to the Company.

During 1998, the Company received $135,000 of key man life insurance proceeds payable on the death of its former Executive Vice President, Robert I. Thompson. This resulted in the Company recording non-recurring other income of $91,379 during 1998 representing the difference between the amount received by the Company and the cash surrender value of such life insurance policy that was previously recorded on the Company's balance sheet.

As a consequence of the factors discussed above, the Company's net loss was $3,733,022 ($0.34 per share) for 1999 as compared to $2,617,941 ($0.24 per share) for 1998. Without taking into account the non-cash compensation charges associated with the contingent performance options described above, the Company's net loss would have been $3,061,970 ($0.28 per share) for 1999 as compared to $2,617,941 ($0.24 per share) for 1998.

Financial Condition, Liquidity and Capital Resources

During 2000, the Company's cash and cash equivalent balance decreased by $4,336,397 principally as a result of the $12,394,718 of proceeds received, net of expenses, from the issuance of common stock upon the exercise of options and warrants, the proceeds of which have been invested by the Company primarily in short-term U.S. Treasury money market funds, offset by cash used to fund the Company's operating activities of $3,217,758, and the purchase of 182,600 shares of treasury stock for $3,314,169 (which shares were subsequently retired). At December 31, 2000, the Company had working capital of $14,367,609 and its shareholders' equity was $14,737,917.

On October 1, 1998, the Company announced that Ailouros Ltd., a London-based institutional money management fund, had committed to purchase up to $15 million worth of common stock of Research Frontiers through December 31, 2001. This commitment is in the form of a Class A Warrant issued to Ailouros Ltd. which gives Research Frontiers the option in any three-month period to deliver a put notice to Ailouros requiring them to purchase an amount of common stock specified by Research Frontiers at a price equal to the greater of (A) 92% of the seven-day average trading price per share of common stock, or (B) a minimum or "floor" price per share set by Research Frontiers from time to time. The pricing was initially subject to an overall cap of $15 per share, which cap has now been eliminated by mutual agreement so that the Company may put stock to Ailouros at selling prices in excess of $15 per share. However, Research Frontiers is not required to sell any shares under the agreement. Before the beginning of each of a series of three-month periods specified by the Company, the Company determines the amount of common stock that the Company wishes to issue during such three-month period. The Company also sets the minimum selling or "floor" price, which can be reset by the Company in its sole discretion prior to the beginning of any subsequent three-month period. Therefore, at the beginning of each three-month period, the Company will determine how much common stock, if any, is to be sold (the amount of which can range from $0 to $1.5 million during such three-month period), and the minimum selling price per share. Because of increases in the Company's stock price since Ailouros' original commitment, and the elimination of the $15 per share cap mentioned above, the Company would now be able to raise more money without having to issue more shares than were originally registered with the Securities and Exchange Commission. Therefore, in March 2000, Ailouros agreed to expand its commitment beyond the original $15 million, thereby giving the Company the right to raise additional funds from Ailouros so long as the Company does not have to issue more shares than were originally registered with the Securities and Exchange Commission.

During 1999, the Company granted 237,800 contingent performance options to employees, which vested because a certain performance milestone in the price of the Company's common stock was achieved during 2000. As the Company is required to account for these options as a variable plan under APB Opinion No. 25, compensation expense is recorded each period from the date of grant through the vesting date based on the quoted market price of the stock at the end of each period. The non-cash compensation expense recognized during 2000 and 1999 in connection with these options was $3,133,748 and $671,052. The charges recorded as a result of the issuance of these performance options are calculated based upon changes in the Company's stock price as of the end of each quarter. These compensation expenses are non-cash accounting charges, and do not require the Company to make any payment in cash or otherwise to the option holder.

In December 1999, the Company's Board of Directors approved a performance bonus plan which provides for a bonus to be paid on July 1, 2000 and January 1, 2001 equal to 1% of the increase, if any, in the Company's market value during the first and second halves of 2000. Bonuses are capped at a recipient's salary in the case of employees of the Company, and are currently capped at $55,000 in the case of non-employee directors of the Company. The expense recorded in connection with this bonus plan was $755,000 during 2000. In December 2000, the Company's Board of Directors approved a similar bonus plan for 2001.

The Company expects to use its cash and the proceeds from maturities of its investments 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 expenditures, assumed ten percent annual increases therein, existing cash reserves and budgeted revenues, the Company believes that it would not require additional funding for at least the next three to four years (without giving effect to any new financing raised). 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 commercialization of products using the Company's technology by the Company's licensees and payments of continuing royalties on account thereof.

Inflation

The Company does not believe that inflation has a significant impact on its business.

New Accounting Pronouncement

The Financial Accounting Standards Board has issued Statement No. 133 related to "*Accounting for Derivative Instruments and Hedging Activities*" (Statement 133). Statement 133 established accounting and reporting standards for derivative instruments embedded in other contracts, and for hedging activities. This statement (as amended by Statement 137 and Statement 138) is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. Management of the Company does not believe that the implementation of Statement 133 (as amended by Statement 137 and Statement 138) will have a significant impact on its financial position or results of operations. For each of the years in the three-year period ended December 31, 2000 the Company had no derivative instruments or hedging activities as defined by Statement 133.

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.

Quantitative and Qualitative Disclosure About Market Risk

The Company invests available cash and cash equivalents in short-term U.S. treasury securities with maturities that are generally two years or less. Although the rate of interest paid on such investments may fluctuate over time, each of the Company's investments, other than in money market funds whose interest yield varies, is made at a fixed interest rate over the duration of the investment. Accordingly, the Company does not believe it is materially exposed to changes in interest rates as it holds these treasury securities until maturity.

The Company does not have any sales, purchases, assets or liabilities determined in currencies other than the U.S. dollar, and as such, is not subject to foreign currency exchange risk.

Independent Auditors' Report

The Shareholders and Board of Directors
Research Frontiers Incorporated:

We have audited the accompanying balance sheets of Research Frontiers Incorporated as of December 31, 2000 and 1999, and the related statements of operations, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Research Frontiers Incorporated at December 31, 2000 and 1999 and the results of its operations and cash flows for each of the years in the three-year period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

KPMG LLP
Melville, New York
February 28, 2001

Balance Sheets

December 31	2000	1999
Assets		
Current assets:		
Cash and cash equivalents	$ 3,806,172	8,142,569
Marketable investment securities held-to-maturity	11,307,752	1,246,083
Marketable investment securities-available for sale	3,906	—
Receivable from warrant exercise pending settlement	—	222,549
Salary advance to officer	—	66,445
Prepaid expenses and other current assets	240,989	17,491
Total current assets	15,358,819	9,695,137
Fixed assets, net	347,703	319,321
Deposits and other assets	22,605	22,605
Total assets	$15,729,127	10,037,063
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$203,787	158,702
Deferred revenue	37,502	46,154
Accrued expenses and other	749,921	324,471
Total liabilities	991,210	529,327
Shareholders' equity:		
Common stock, par value $0.0001 per share; authorized 100,000,000 shares, issued and outstanding 12,103,683 and 11,523,900 shares for 2000 and 1999	1,210	1,152
Additional paid-in capital	52,594,293	39,750,276
Accumulated other comprehensive loss	(46,094)	—
Accumulated deficit	(37,658,531)	(30,090,731)
	14,890,878	9,660,697
Notes receivable from officers	(152,961)	(152,961)
Total shareholders' equity	14,737,917	9,507,736
Commitments and contingency		
Total liabilities and shareholders' equity	$15,729,127	10,037,063

See accompanying notes to financial statements.

Statements of Operations

Years ended December 31	2000	1999	1998
Fee income	$ 333,652	128,096	108,735
Operating expenses	3,027,655	1,605,028	1,631,179
Purchase of patents	—	289,177	—
Research and development	2,618,567	1,682,164	1,647,448
Non-recurring non-cash compensation expense	3,133,748	671,052	—
	8,779,970	4,247,421	3,278,627
Operating loss	(8,446,318)	(4,119,325)	(3,169,892)
Net investment income	878,518	291,302	409,604
Other income	—	—	91,379
Interest income on notes receivable from officers	—	95,001	50,968
Net loss	$(7,567,800)	(3,733,022)	(2,617,941)
Basic and diluted net loss per common share	$ (0.63)	(0.34)	(0.24)
Weighted average number of common shares outstanding	12,096,108	11,100,196	10,878,141

See accompanying notes to financial statements.

Statements of Shareholders' Equity

Years ended December 31, 2000, 1999 and 1998

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock, at Cost	Accumulated Other Comprehensive Loss	Notes Receivable	Total
Balance, December 31, 1997	10,342,195	$1,034	34,787,860	(23,739,768)	—	—	(1,427,147)	9,621,979
Issuance of common stock	759,162	76	450,400	—	—	—	—	450,476
Purchase of treasury stock	—	—	—	—	(747,716)	—	—	(747,716)
Repayment of note by officer	—	—	—	—	(545,553)	—	542,186	(3,367)
Retirement of treasury stock	(172,316)	(17)	(1,293,252)	—	1,293,269	—	—	—
Net loss	—	—	—	(2,617,941)	—	—	—	(2,617,941)
Proceeds from the issuance of warrants	—	—	10,000	—	—	—	—	10,000
Issuance of warrants for services performed	—	—	27,058	—	—	—	—	27,058
Balance, December 31, 1998	10,929,041	$1,093	33,982,066	(26,357,709)	—	—	(884,961)	6,740,489
Issuance of common stock	664,214	66	5,805,358	—	—	—	—	5,805,424
Purchase of treasury stock	—	—	—	—	(345,837)	—	—	(345,837)
Repayment of note by officer	—	—	—	—	(482,001)	—	732,000	249,999
Retirement of treasury stock	(78,667)	(8)	(827,830)	—	827,838	—	—	—
Net loss	—	—	—	(3,733,022)	—	—	—	(3,733,022)
Issuance of performance options	—	—	671,052	—	—	—	—	671,052
Issuance of stock and warrants for services performed	9,312	1	119,630	—	—	—	—	119,631
Balance, December 31, 1999	11,523,900	$1,152	39,750,276	(30,090,731)	—	—	(152,961)	9,507,736
Issuance of common stock	758,945	76	12,172,093	—	—	—	—	12,172,169
Purchase of treasury stock	—	—	—	—	(3,314,169)	—	—	(3,314,169)
Retirement of treasury stock	(182,600)	(18)	(3,314,151)	—	3,314,169	—	—	—
Issuance of performance options	—	—	3,133,748	—	—	—	—	3,133,748
Comprehensive loss:								
Net loss	—	—	—	(7,567,800)	—	—	—	(7,567,800)
Unrealized loss on available for sale securities	—	—	—	—	—	(46,094)	—	(46,094)
								(7,613,894)
Issuance of stock and warrants for services performed	3,438	—	852,327	—	—	—	—	852,327
Balance, December 31, 2000	12,103,683	$1,210	52,594,293	(37,658,531)	—	(46,094)	(152,961)	14,737,917

See accompanying notes to financial statements.

Statements of Cash Flows

Years ended December 31	2000	1999	1998
Cash flows from operating activities:			
Net loss	$(7,567,800)	(3,733,022)	(2,617,941)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	109,137	93,472	96,387
Interest income on officer notes receivable	—	(95,001)	(43,367)
Expense relating to issuance of contingent performance options	3,133,748	671,052	—
Marketable securities received as license fee	(50,000)	—	—
Cashless exercise of options and warrants	—	82,481	—
Expense relating to issuance of stock and warrants for services performed	852,327	37,150	27,058
Changes in assets and liabilities:			
Salary advance to officer	66,445	39,122	(105,567)
Prepaid expenses and other current assets	(223,498)	13,875	94,819
Deferred revenue	(8,652)	(10,096)	56,250
Accounts payable and accrued expenses	470,535	258,621	(187,132)
Net cash used in operating activities	(3,217,758)	(2,642,346)	(2,679,493)
Cash flows from investing activities:			
Purchases of held-to-maturity treasury securities	(12,588,032)	(2,461,878)	(5,775,715)
Proceeds from maturities of held-to-maturity treasury securities	2,526,363	2,405,181	12,085,513
Purchases of fixed assets	(137,519)	(143,709)	(137,469)
Net cash provided by (used in) investing activities	(10,199,188)	(200,406)	6,172,329
Cash flows from financing activities:			
Repayment of principal on officer's loans	—	345,000	40,000
Proceeds from issuances of common stock and warrants	12,394,718	5,582,875	460,476
Purchase of treasury stock	(3,314,169)	(345,837)	(747,716)
Net cash provided by (used in) financing activities	9,080,549	5,582,038	(247,240)
Net increase (decrease) in cash and cash equivalents	(4,336,397)	2,739,286	3,245,596
Cash and cash equivalents at beginning of year	8,142,569	5,403,283	2,157,687
Cash and cash equivalents at end of year	$3,806,172	8,142,569	5,403,283

See accompanying notes to financial statements.

1. Business

Research Frontiers Incorporated (the "Company" or "Research Frontiers") 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.

The Company has historically utilized its cash and the proceeds from maturities of its investments 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, and 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 expenditures, existing cash reserves and budgeted revenues, the Company believes that it would not require additional funding for at least the next three to four years. 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 commercialization of products using the Company's technology by the Company's licensees and payments of continuing royalties on account thereof.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents The Company considers securities purchased with original maturities of three months or less to be cash equivalents. Cash equivalents consist of short-term investments in money market accounts at December 31, 2000 and 1999.

Marketable Investment Securities The Company accounts for its investments in marketable securities under the provisions of Statement of Financial Accounting Standards No. 115, "*Accounting for Certain Investment in Debt and Equity Securities*" ("Statement 115"). The Company classifies its securities as held-to-maturity and available-for-sale. Management intends and has the ability to hold held-to-maturity securities until their maturity. In accordance with Statement 115, held-to-maturity securities are recorded at cost and available-for-sale securities are recorded at fair value with unrealized holding gains and losses excluded from earnings and are reported as a separate component of shareholders' equity until realized. Dividend and interest income are recognized when earned. Cost is maintained on a specific identification basis for purposes of determining realized gains and losses on sales of investments.

Fixed Assets Fixed assets are carried at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets.

Fee Income Fee income represents amounts earned by the Company under various license and other agreements (note 10) relating to technology developed by the Company.

Basic and Diluted Loss Per Common Share Basic earnings (loss) per share excludes any dilution. It is based upon the weighted average number of common shares outstanding during the period. Dilutive earnings (loss) per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. The Company's dilutive earnings (loss) per share equals basic earnings (loss) per share for each of the years in the three-year period ended December 31, 2000 because all common stock equivalents (*i.e.*, options and warrants) were antidilutive in those periods. The number of options and warrants that was not included because their effect is antidilutive was 2,224,201, 1,995,363, and 1,801,498 for 2000, 1999 and 1998, respectively.

Research and Development Costs Research and development costs are charged to expense as incurred.

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

Use of Estimates Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

Income Taxes Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Fair Value of Financial Instruments The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties. The carrying amounts of all financial instruments classified as a current asset or current liability are deemed to approximate fair value because of the short maturity of those instruments.

The fair value of the notes receivable from officers approximates the carrying value as their stated interest rate, the broker call rate, is similar to other rates currently offered by local brokerage institutions for loans of similar terms to individuals with comparable credit risk.

Stock Option Plan The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25 "*Accounting for Stock Issued to Employees,*" and related interpretations, in accounting for its fixed plan stock options. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price.

Reclassifications Certain reclassifications have been made to the 1999 and 1998 financial statements to conform to the 2000 presentation.

Comprehensive Income The Company accounts for its comprehensive income under the provisions of Statement of Financial Accounting Standards No. 130, "*Reporting Comprehensive Income.*" (Statement 130). Statement 130 requires that companies disclose comprehensive income, which includes net income, foreign currency translation adjustments, minimum pension liability adjustments, and unrealized gains and losses on marketable securities classified as available-for-sale. The Company did not have any foreign currency translation adjustments, or minimum pension liability adjustments during 2000, 1999 or 1998. The Company did not have unrealized gains or losses on marketable securities classified as available-for-sale during 1999 or 1998. Consequently, comprehensive loss equaled the net loss of $3,733,022 and $2,617,941 for the fiscal years ended December 31, 1999 and 1998, respectively.

Deferred Revenue The Company has entered into a number of license agreements covering potential products. The Company receives minimum annual royalties under certain license agreements and records fee income for the amounts earned by the Company. Certain of the fees are paid to the Company in advance of the period in which they are earned resulting in deferred revenue.

3. Supplemental Cash Flow Information

The following is supplemental information relating to the Company's statement of cash flows:

	2000	1999	1998
Non-cash financing activities:			
Principal payment on officer's note receivable by surrendering of common stock	$ —	387,000	502,186
Receivable from warrant exercise	$ —	222,549	—

4. Marketable Investment Securities

The fair value of marketable investment securities is based upon quoted market prices. The amortized cost, gross unrealized holding gains and fair value for the Company's securities at December 31, 2000 and 1999 were as follows:

	Amortized Cost	Gross Unrealized Holding Gain (Losses)	Fair Value
At December 31, 2000			
U.S. treasury securities (held-to-maturity)	$11,307,752	151,360	11,459,112
Available-for-sale securities	50,000	(46,094)	3,906
At December 31, 1999			
U.S. treasury securities (held-to-maturity)	$ 1,246,083	3,056	1,249,139

Maturities of all U.S. treasury securities were less than two years and less than one year at December 31, 2000 and 1999, respectively.

5. Notes Receivable from Officers

In 1996, the Company loaned several officers an aggregate of $350,000. In March and April 1997, the Company loaned several officers an aggregate of $1,390,000. During 1997, officers made aggregate principal payments of $592,353 against such loans of which $39,810 was paid in cash and $552,543 was paid through the surrender of the Company's common stock. During 1998, officers made aggregate principal payments of $542,186 against such loans of which $40,000 was paid in cash and $502,186 was paid through the surrender of the Company's common stock. During 1999, officers made aggregate principal payments of $732,000 against such loans of which $345,000 was paid in cash and $387,000 was paid through the surrender of the Company's common stock. In connection with the aforementioned loan repayments, the Company recorded $95,001 and $50,968, in interest income in 1999 and 1998, respectively, of which $95,001 and $43,367, was paid through the surrender of the Company's common stock in 1999 and 1998, respectively. It is the Company's policy to record interest income on these notes as received.

In a settlement agreement dated June 30, 1999, the Company settled a declaratory judgment action brought on March 25, 1999 in the Supreme Court of the State of New York, County of Nassau, by Jean Thompson in her individual capacity and as Executrix of the estate of Robert I. Thompson, a former officer and director of the Company. The action did not seek monetary damages and essentially sought a declaration that certain common stock of the Company securing loans made to Mr. Thompson was not available as collateral to secure such loans. Under the settlement agreement, among other things, the parties agreed that Jean Thompson and the estate of Robert I. Thompson would pay the $732,000 in loans made by the Company from 1993 to 1997 by paying the Company $345,000 in cash, and delivering to the Company for cancellation 38,467 shares of common stock and options to purchase 181,447 shares of common stock. This payment and delivery of the shares and stock options for cancellation were made in August 1999, resulting in the payment in full of all outstanding loans, and the Company recording interest income on such loans of $95,001.

Each of the aforementioned loans are due in January 2002. The loans relate to the purchase of common stock of the Company; are collateralized by the pledge of shares of common stock of the Company; may be prepaid in part or in full without notice or penalty; are represented by a promissory note which bears interest at a rate per annum equal to the broker call rate (8.25% at December 31, 2000 and 7.25% at December 31, 1999) in effect on the first day of each calendar quarter; and permit repayment of the loan by delivery of securities of the Company having a fair market value equal to the balance of the loan outstanding.

6. Fixed Assets

Fixed assets and their estimated useful lives, are as follows:

	2000	1999	Estimated useful life
Equipment and furniture	$1,019,324	895,223	5 years
Leasehold improvements	256,590	243,172	Life of lease or estimated life if shorter
	1,275,914	1,138,395	
Less accumulated depreciation and amortization	928,211	819,074	
	$ 347,703	319,321	

7. Accrued Expenses and Other

Accrued expenses consist of the following at December 31, 2000 and 1999:

	2000	1999
Financing expenses	$ —	177,917
Settlement of treasury stock repurchase	509,974	—
Payroll, bonuses and related benefits	73,006	117,481
Professional services	152,167	22,784
Other	14,774	6,289
	$749,921	324,471

8. Income Taxes

There was no income tax expense in 2000, 1999 and 1998 due to losses incurred by the Company.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets at December 31, 2000 and 1999 are presented below:

	2000	1999
Deferred tax assets:		
Net operating loss carryforwards	$11,002,000	9,615,000
Research and other credits	673,000	590,000
Total gross deferred tax assets	11,675,000	10,205,000
Less valuation allowance	11,675,000	10,205,000
	—	—

The Company has recorded a valuation allowance against the deferred tax assets as they will not be realized unless the Company achieves profitable operations in the future.

At December 31, 2000, the Company had a net operating loss carryforward for federal income tax purposes of approximately $27,506,000, varying amounts of which will expire in each year from 2001 through 2020. Research and other credit carryforwards of $673,000 are available to the Company to reduce income taxes payable in future years principally through 2020.

9. Shareholders' Equity

Sale of Common Stock and Warrants During 1998, the Company received $450,476 of net cash proceeds from the issuance of 70,489 shares of common stock from the exercise of options and warrants, as follows: the issuance of 36,600 shares of common stock from the exercise of options resulting in net proceeds of $217,476 and the issuance of 33,889 shares of common stock from the exercise of warrants resulting in net proceeds of $233,000. In addition, the Company issued 688,673 shares of common stock pursuant to the exercise of the remaining outstanding redeemable prepaid warrant (see note 9). The Company also received $10,000 from the issuance of the Class A Warrant and Class B Warrant. (see note 9).

During 1999, the Company received $5,805,424 of net cash proceeds from the issuance of 664,214 shares of common stock from the exercise of options and warrants, as follows: the issuance of 53,025 shares of common stock issued upon the exercise of options resulting in net proceeds of $321,532 and the issuance of 611,189 shares of common stock issued upon the exercise of warrants, principally related to the Class A Warrant, resulting in net proceeds of $5,483,892. In addition, 2,850 shares were issued to an investor relations firm through the cancellation of 33,250 warrants, resulting in public relations expense of $21,820; 6,048 shares were issued to an officer through the cancellation of 17,000 options resulting in compensation expense of $60,661; and 414 shares were issued to a director in payment of $3,000 in directors fees.

The Company recorded a receivable of $222,549 representing a warrant exercise that occurred prior to the end of 1999, that was scheduled to settle in January 2000. The Company received the cash for the settlement of this warrant in January 2000.

During 2000, the Company received $12,172,169 of net cash proceeds from the issuance of 758,945 shares of common stock from the exercise of options and warrants, as follows: the issuance of 95,962 shares of common stock issued upon the exercise of options resulting in net proceeds of $706,299 and the issuance of 662,983 shares of common stock issued upon the exercise of warrants, principally related to the Class A Warrant, resulting in net proceeds of $11,465,870. In addition, 3,438 shares were issued to a director in payment of $68,000 in directors fees.

Options and Warrants / *Options* In 1992, the shareholders approved a stock option plan (1992 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 initially reserved 468,750 shares of its common stock for issuance under this plan. In 1994 and 1996, the Company's shareholders approved an additional 300,000 shares and 450,000 shares, respectively, for issuance under this plan. As of December 31, 2000, no options were available for issuance under this Plan.

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. As of December 31, 2000, awards for 12,872 shares of common stock were available for issuance under this Plan.

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. 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.

Activity in stock options is summarized below:

	Number of Shares Subject to Option	Weighted Average Exercise Price
Balance at December 31, 1997	1,070,911	$8.05
Granted	526,300	7.23
Cancelled	(65,452)	8.53
Exercised	(36,600)	5.94
Balance at December 31, 1998	1,495,159	7.79
Granted	485,600	8.38
Cancelled	(203,023)	8.15
Exercised	(59,073)	6.11
Balance at December 31, 1999	1,718,663	7.98
Granted	332,500	19.80
Cancelled	(6,700)	14.85
Exercised	(95,962)	7.36
Balance at December 31, 2000	1,948,501	$10.00

The following table summarizes information about stock options at December 31, 2000:

Range of Exercise Price	Shares Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Shares Excercisable	Weighted Average Exercise Price
$3.00–$6.00	126,177	5.50	$ 5.75	126,177	$ 5.75
$6.01–$7.50	723,226	6.92	7.27	723,226	7.27
$7.51–$9.00	555,901	7.73	8.35	555,901	8.35
$9.01–$12.00	194,400	5.64	9.82	154,400	9.59
$12.01–$15.00	171,797	7.87	14.24	67,797	13.90
$15.01–$19.00	113,000	9.92	18.99	1,500	18.91
$19.01–$37.03	64,000	9.15	37.03	24,000	37.03
	1,948,501	7.26	$10.00	1,653,001	$ 8.45

Options to purchase 274,800 shares become exercisable during 2001.

During 2000, the Company granted 14,000 options to consultants which vested immediately. In accordance with EITF 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 recorded consulting expenses of $246,961 based upon the fair value of such options on the date the options vested as determined using a Black-Scholes option pricing model.

During 1999, the Company granted 237,800 contingent performance options to employees, which vest only, if a certain performance milestone in the price of the Company's common stock is achieved during 2000. This milestone was achieved during 2000 and these options vested. The Company is required to account for these options as a variable plan under APB Opinion No. 25. Accordingly, from the point in time that it appears probable that such milestone will be achieved, the Company is required to recognize non-cash compensation expense each period from the date of grant through the vesting date based on the quoted market price of the stock at the end of each period. Non-cash compensation expense recognized during 1999 and 2000 in connection with these options was $671,052 and $3,133,748, respectively. The charges recorded as a result of the issuance of these performance options are calculated based upon changes in the Company's stock price as of the end of each quarter, and are non-cash compensation charges.

The per share weighted average fair value of warrants issued to directors and stock options granted during 2000, 1999, and 1998 was approximately $5.88, $3.65, and $3.27, respectively, on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

Grant Date	Expected Dividend Yield	Risk-Free Interest Rate	Expected Stock Volatility	Expected Life in Years
June 2000	0%	6.290%	64.532%	3.62
February 2000	0%	6.600%	56.400%	3.62
December 1999	0%	6.090%	53.698%	3.62
June 1999	0%	5.940%	50.853%	3.60
December 1998	0%	4.540%	57.980%	3.50
August 1998	0%	5.135%	55.330%	3.50
June 1998	0%	5.505%	56.582%	3.50

The Company applies APB Opinion No. 25 in accounting for its stock option plans and, accordingly, no compensation cost has been recognized for its stock options and warrants in the financial statements as the exercise price of such instruments were equal to the fair value of the Company's common stock at the date of grant. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123 *"Accounting for Stock Based Compensation"*, the Company's net loss and net loss per share would have been increased to the pro forma amounts indicated below:

		2000	1999	1998
Net loss	As reported	$(7,567,800)	$(3,733,022)	$(2,617,941)
	Pro forma	$(7,843,116)	$(4,641,784)	$(4,409,868)
Basic and diluted net loss per common share	As reported	$(0.63)	$(0.34)	$(0.24)
	Pro forma	$(0.65)	$(0.42)	$(0.41)

Pro forma net loss reflects only options and warrants granted since January 1, 1995. Therefore, the full impact of calculating compensation cost for stock options and warrants under SFAS No. 123 is not reflected in the pro forma net loss amounts presented above because compensation costs for options and warrants granted prior to January 1, 1995 were not considered.

Options and Warrants / *Warrants* Activity in warrants is summarized below, excluding the effect of the redeemable prepaid warrant (note 9) and the Class A Warrant (note 9):

	Number of Shares Underlying Warrants Granted	Exercise Price
Balance at December 31, 1997	324,728	$5.88–13.50
Exercised	(33,889)	7.00-7.20
Terminated	(50,000)	8.72–11.63
Issued	65,500 (a)	8.25
Balance at December 31, 1998	306,339	$5.88–13.50
Exercised	(49,239)	7.00–11.63
Terminated	(40,400)	7.50–7.67
Issued	60,000 (b)	8.98–21.00
Balance at December 31, 1999	276,700	$5.88–21.00
Exercised	(1,000)	9.00–10.00
Terminated	—	—
Issued	—	—
Balance at December 31, 2000	275,700	$5.88–21.00

(a) Represents Class B Warrant to purchase 65,500 shares at $8.25 per share issued to an institutional investor in a private placement. See note 9.

(b) Represents warrants to purchase 10,000 shares at $8.98 per share issued to two consultants for research and development work performed for the Company, 50% of which is currently vested and 50% of which vests if certain additional milestones are achieved as a result of the work performed by the consultants; and warrants to purchase 10,000 shares at $9.00 per share, 10,000 shares at $10.00 per share, 10,000 shares at $11.00 per share, 10,000 shares at $16.00 per share, and 10,000 shares at $21.00 per share, issued in payment for investor relations services provided to the Company which resulted in public relations expense of $9,168 and $34,150 during 2000 and 1999, respectively, which warrants vest 10,000 shares per quarter commencing April 1, 1999.

Warrants generally expire from two to ten years from the date of issuance. At December 31, 2000, the number of warrants exercisable was 261,700 at a weighted average exercise price of $9.13 per share.

In 1994, the Company granted warrants to a consultant to purchase 25,000 shares of common stock. Such warrants vested during March of 2000, based upon future performance criteria being achieved. In accordance with EITF 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 recorded consulting expense of $528,198 based upon the fair value of such warrants on the date the warrants vested as determined using a Black-Scholes option pricing model.

Treasury Stock During 2000, the Company purchased in the open market and subsequently retired 182,600 shares of treasury stock with an aggregate cost of $3,314,169. During 1999, the Company purchased in the open market and subsequently retired 40,200 shares of treasury stock with an aggregate cost of $345,837. Also during 1999, the Company received 38,467 shares of common stock valued at $482,001 as partial payment of notes receivable from an officer pursuant to a settlement agreement as discussed above. Such shares were also subsequently retired. During 1998, the Company purchased in the open market and subsequently retired 118,600 shares of treasury stock with an aggregate cost of $747,716. Also during 1998, the Company received 53,716 shares of common stock valued at $545,536 as partial payment of notes receivable from an officer. Such shares were also subsequently retired.

Redeemable Prepaid Warrant In October 1997, a group of institutional investors invested $5,000,000 in equity capital through the private placement of a redeemable prepaid common stock warrant. The warrant, which was redeemable by the Company or the investors under certain defined circumstances, was exercisable over its five-year term only in the form of issuance of common stock at an exercise price which fluctuated with market conditions. The net proceeds of the private placement after deducting professional fees of $373,015 were $4,626,985. This redeemable prepaid warrant was fully exercised by the holders by July 22, 1998 and is no longer outstanding. In connection with the redeemable prepaid warrant, 688,673 shares of common stock were issued in 1998.

Class A and Class B Warrants On October 1, 1998, the Company announced that Ailouros Ltd., a London-based institutional money management fund, has committed to purchase up to $15 million worth of common stock of the Company through December 31, 2001. This commitment is in the form of a Class A Warrant issued to Ailouros Ltd. which gives the Company the option in any three-month period to deliver a put notice to Ailouros requiring them to purchase an amount of common stock specified by the Company at a price equal to the greater of (A) 92% of the seven-day average trading price per share of common stock, or (B) a minimum or "floor" price per share set by the Company from time to time. The pricing was initially subject to an overall cap of $15 per share, which cap has now been eliminated by mutual agreement so that the Company may put stock to Ailouros at selling prices in excess of $15 per share. However, the Company is not required to sell any shares under the agreement. Before the beginning of each of a series of three-month periods specified by the Company, the Company determines the amount of common stock that the Company wishes to issue during such three-month period. The Company also sets the minimum selling or "floor" price, which can be reset by the Company in its sole discretion prior to the beginning of any subsequent three-month period. Therefore, at the beginning of each three-month period, the Company will determine how much common stock, if any, is to be sold (the amount of which can range from $0 to $1.5 million during such three-month period), and the minimum selling price per share. In March 2000, Ailouros agreed to expand its commitment beyond the original $15 million, thereby giving the Company the right to raise additional funds from Ailouros so long as the Company does not have to issue more shares than were originally registered with the Securities and Exchange Commission.

In connection with the financing, the Company also issued Ailouros Ltd. a Class B Warrant which expires on September 30, 2008. The Class B Warrant is exercisable at $8.25 per share which represents 120% of the average of the closing bid and ask price of the Company's common stock on the date of the Class B Warrant's issuance. The Class B Warrant is exercisable into 65,500 shares. Ailouros paid the Company $10,000 upon issuance of the Class A Warrant and the Class B Warrant.

10. License Agreements

The Company has entered into a number of license agreements covering potential products using the Company's SPD technology. Although the Company may receive minimum annual royalties under certain of these licenses, to date no products have been sold resulting in earned royalties under these license agreements. The table below summarizes Research Frontiers' existing license agreements and lists the year these agreements were entered into.

Licensees of Research Frontiers who incorporate SPD technology into end products will pay Research Frontiers a royalty of 5-10% of net sales of licensed products under license agreements currently in effect, and may also be required to pay the Company minimum annual royalties. The Company's license agreements typically allow the licensee to terminate the license after some period of time, and give the Company only limited rights to terminate before the license expires. Most licenses are non-exclusive and generally last as long as the Company's patents remain in effect. The license granted to Hankuk Glass Industries is exclusive within Korea for certain applications through December 2004. Vision-Ease's license for eyewear is exclusive during the term of the license. Global Mirror's license restricts new licenses from being granted in the truck mirror original equipment market for a period of time if certain sales milestones are met with respect to commercial vehicles in Classes 5 through 8 with gross vehicle weights in excess of 16,000 pounds.

11. Commitments

The Company has an employment agreement with one of its officers which provides for an annual base salary of $377,400 through December 31, 2001.

In December 2000, the Company's Board of Directors approved a performance bonus plan which provides for a bonus to be paid on or after July 2, 2001 and on or after January 2, 2002 equal to 1% of the increase, if any, in the Company's market value during the first and second halves of 2001. Bonuses are capped at a recipient's salary in the case of employees of the Company, and are currently capped at $56,100 in the case of non-employee directors of the Company. During 2000, the Company had a similar performance plan in place. The Company recorded $755,000 of expenses in connection with this plan for the year ended December 31, 2000.

The Company occupies premises under an operating lease agreement which expires on January 31, 2004 and requires minimum annual rent which rises over the term of the lease to approximately $143,500. Rent expense, including other expenses, amounted to approximately $142,000, $143,000, and $131,000, for 2000, 1999, and 1998, respectively.

12. Selected Quarterly Financial Data (Unaudited)

	Quarter			
2000	**First**	**Second**	**Third**	**Fourth**
Fee income	$98,774	$99,960	$99,959	$34,959
Operating loss (1)	(4,736,168)	(1,539,962)	(767,146)	(1,403,042)
Net loss (1)	(4,547,939)	(1,311,204)	(539,942)	(1,168,715)
Basic and diluted net loss per common share (1)(2)	(.38)	(.11)	(.04)	(.10)
1999	**First**	**Second**	**Third**	**Fourth**
Fee income	$50,625	$40,625	$ 12,500	$24,346
Operating loss	(756,252)	(1,056,286)	(745,270)	(1,561,517)
Net loss	(689,825)	(996,615)	(576,852)	(1,469,730)
Basic and diluted net loss per common share (2)	(.06)	(.09)	(.05)	(.13)

(1) The first quarter of 2000 has been restated to include a non-cash accounting charge of $528,198 relating to a warrant which was issued during 1994 and vested during the first quarter of 2000. (See note 9).

(2) Since per share information is computed independently for each quarter and the full year, based on the respective average number of common shares outstanding, the sum of the quarterly per share amounts does not necessarily equal the per share amounts for the year.

Licensee	Products Covered	Territory
AP Technoglass Co.	Sunroof glass for other licensees (2001)	Worldwide
Dainippon Ink and Chemicals Incorporated	SPD emulsions for other licensees (1999)	Worldwide
Film Technologies International	SPD film for other licensees and prospective licensees (2001)	Worldwide
General Electric Company	SPD film for other licensees and prospective licensees (1995)	Worldwide
Glaverbel, S.A.	Automotive vehicle rear-view mirrors, transportation vehicle sunvisors, and architectural and automotive windows (1996)	Worldwide (except Korea for windows)
Global Mirror GmbH (Lang-Mekra)	Rear-view mirrors and sunvisors (1999)	Worldwide
Hankuk Glass Industries Inc.	Broad range of SPD light control products including windows, flat panel displays, automotive vehicle rear-view mirrors and sunvisors (installed as original equipment on Korean-made cars), and sunroofs; SPD film for licensees and prospective licensees (1997)	Worldwide
Hitachi Chemical Co., Ltd.	SPD emulsions and films for other licensees (1999)	Worldwide
InspecTech Aero Service, Inc.	Aircraft windows and cabin dividers (2001)	Worldwide (except Korea)
Material Sciences Corporation	Architectural and automotive windows, SPD film for other licensees, prospective licensees and architectural and automotive window companies (1997)	Worldwide
Polaroid Corporation	SPD emulsions and films for other licensees (2000)	Worldwide
ThermoView Industries, Inc.	Architectural windows (2000)	Worldwide (except Korea)
Vision-Ease Lens Azusa, Inc.	Eyewear (1997)	Worldwide

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