POWER EFFICIENCY CORP
Form SB-2
October 25, 2005

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As filed with the Securities and Exchange Commission on October 25, 2005

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM SB-2

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

POWER EFFICIENCY CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**22-3337365**
(State or other jurisdiction of incorporation of organization)	(I.R.S. Employer Identification Number)

POWER EFFICIENCY CORPORATION
3900 PARADISE ROAD
SUITE 283
LAS VEGAS, NV 89109
(702) 697-0377

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

STEVEN S. STRASSER
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
POWER EFFICIENCY CORPORATION
3900 PARADISE ROAD
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LAS VEGAS, NV 89109
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(Name, address, including zip code, and telephone number, including area code, of agent for service of process)

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Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the "Securities Act"), other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. ý

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price Per Share(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee(2)
Common Stock, par value $0.001 per share	50,626,399	$0.30	$18,703,511	$2,201

(1) We are registering 50,626,399 shares of Common Stock based on the maximum number of shares that may be sold as described in detail below.

(2) For the purpose of determining the registration fee pursuant to Rule 457(c) under the Securities Act and based upon the average of the high and low prices of the Common Stock reported on the National Association of Securities Dealers Over The Counter Bulletin Board (the "OTC Bulletin Board") on October 18, 2005. Pursuant to Rule 457(eg), in the case of shares to be offered after the exercise of warrants or options, the registration fee has been calculated based on the exercise price thereof if higher than such average.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933, AS AMENDED, OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE SECURITIES AND EXCHANGE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

The information in this prospectus is not complete and may be changed. Neither we nor the selling stockholders may sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and neither we nor the selling stockholders are soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED OCTOBER 25, 2005

PROSPECTUS

POWER EFFICIENCY CORPORATION

50,626,399 SHARES OF COMMON STOCK

This prospectus, or this Registration Statement, relates to the resale of up to 50,626,399 shares of our Common Stock owned by or issuable to the selling stockholders as follows:

(1) 25,200,000 shares issued and issuable upon exercise of stock purchase warrants granted to "accredited investors" and Joseph Stevens & Co., Inc. (the "Placement Agent") in a private placement of our common stock in June through August of 2005 (the "Placement" or the "Offering").

(2) 1,981,517 shares issuable upon exercise of stock purchase warrants granted to the purchasers of Secured Senior Notes of the Company and Pali Capital, Inc. (the "Note Placement Agent") issued in October 2004 and February 2005 in a private offering under Rule 506 of Securities and Exchange Commission Regulation D (the "Secured Senior Notes").

(3) 3,918,848 shares issued to Summit Energy Ventures, LLC ("Summit") and Commonwealth Energy Corporation ("Commonwealth") upon conversion of 4,714,279 shares of the Company's Series A-1 Convertible Preferred Stock (the "Series A-1 Stock") held by Summit and Commonwealth.

(4) 3,134,102 shares issued to Summit and Commonwealth upon exercise of a stock purchase warrant granted to Summit and Commonwealth in connection with its investment in June 2003 and October 2003 in the Series A-1 Stock.

(5) 66,232 shares issuable on exercise of outstanding stock options granted under the Company's 1994 Stock Option Plan (the "1994 Plan").

(6) 15,000,000 shares issuable on exercise of stock options under the Company's 2000 Stock Option and Restricted Stock Plan (the "2000 Plan").

(7) 1,325,700 shares issuable upon exercise of stock purchase warrants granted to private investors and others in October 2004 through August 2005.

Our Common Stock is traded on the National Association of Securities Dealers Over The Counter Bulletin Board (the "OTC Bulletin Board") under the symbol "PEFF." On October 18, 2005, the closing bid price of our Common Stock as reported on the OTC Bulletin Board was $0.30.

THE SHARES OF COMMON STOCK OFFERED HEREBY INVOLVE A HIGH DEGREE OF RISK. IT IS LIKELY THAT THE COMMON STOCK WILL BE SUBJECT TO "PENNY STOCK" RULES, WHICH GENERALLY REQUIRE THAT A BROKER OR DEALER APPROVE A PERSON'S ACCOUNT FOR TRANSACTIONS IN PENNY STOCK AND THE BROKER OR DEALER RECEIVE FROM THE INVESTOR A WRITTEN AGREEMENT TO THE TRANSACTIONS SETTING FORTH THE IDENTITY AND QUANTITY OF THE PENNY STOCKS TO BE PURCHASED BEFORE A TRADE INVOLVING A PENNY STOCK IS EXECUTED. SEE "RISK FACTORS" BEGINNING ON PAGE 3.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this Prospectus is October , 2005

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PROSPECTUS SUMMARY

This section highlights selected information only and may not contain all of the information that may be important to you. Please read this entire prospectus before making your investment decision. This summary, including the summary financial information, is qualified in its entirety by the more detailed information appearing elsewhere in this prospectus. Throughout this prospectus, when we refer to "Power Efficiency" or when we speak of ourselves generally, we are referring to Power Efficiency Corporation unless the context indicates otherwise or as otherwise noted.

THE COMPANY

Our Business

Power Efficiency's management believes companies that provide solutions to the energy shortage facing the world are well positioned to achieve returns substantially higher than the overall market. Issues driving the energy shortage include growth in worldwide electricity demand, high oil and gas prices, and reliance on an outdated power infrastructure, as demonstrated by the August 14, 2003, power blackout in the eastern U.S. The demand for products that reduce energy consumption is growing rapidly. Government mandates to reduce the greenhouse gas emissions caused by power plants are further driving energy conservation.

Our solution reduces energy costs in specific commercial applications, utilizing patented improvements upon National Aeronautics Space Administration ("NASA") developed motor controller technologies. Our products are solid-state AC motor controllers, called Performance Controllers, which reduce the amount of power consumed by alternating current induction motors operating at constant speeds and under variable loads. In more simple terms, the Performance Controller reduces energy consumption on electrical equipment by electronically sensing and controlling the amount of energy the motor consumes on certain applications. The energy savings can range from 15% to over 35%, while the life of the motor is extended because of both the reduced motor operating temperatures and the reduced mechanical stress provided by its "soft start" technology.

There are over a billion AC motors in operation in the U.S. alone. The world market is several times larger. The customer for the Performance Controller will typically be in a high electricity cost environment, may have local utility or governmental incentives to save energy, has energy usage as a significant operating cost, uses constant speed induction motors that are lightly or cyclically loaded, and has motors that run continuously or have frequent on/off cycles. This customer base represents an extremely large market, including target sectors such as elevators, escalators, granulators, oil pump jacks, conveyors and other industrial applications.

Our management believes that no other company produces a product that has the efficiency of the Performance Controller. The efficiency of the Performance Controller has been tested by Oak Ridge National Laboratory, and Medsker Electric, Inc., independent third parties, with positive results.

We market our products directly under brand names such as Power Commander® and Performance Controller, and through other companies under distribution agreements utilizing names such as EcoStart. These companies include the leading elevator and escalator manufactures in the world, such as Otis Elevator Co. (a subsidiary of United Technologies, Inc.) and KONE Inc. The product has achieved technical acceptance in the elevator and escalator industries, which demonstrates its ability to meet demanding reliability standards.

We are now focused on creating distribution channels to take advantage of applicable opportunities given the current conditions in the energy market and how our product meets these needs. Our management believes this multi-channel distribution strategy will allow Power Efficiency to achieve substantial and sustainable revenue growth.

Highlights

Demonstrated Energy Savings More than 3,500 units of our products have been installed at facilities throughout the U.S. These installed units have demonstrated the ability to reduce the energy consumption of AC induction motors, in most cases by 15% to 35%.

Patented Technology Our products incorporate technology developed and patented by NASA. Our own patent encompasses a number of improvements on the NASA technology made by our engineers.

Extensive Engineering Over the last eight years, we have developed a deep understanding of the real-world environment for our products. Our products incorporate substantial trade secret and engineering know-how, which enable them to operate effectively over a broad range of conditions.

Large Potential Market The United States consumes over $200 billion of electricity annually. The Consortium for Energy Efficiency estimates that motor driven systems consume 23% of all electricity in the U.S. More specifically, Kema, a well known international energy consulting firm, estimates that motors account for 59% of all the electricity used in manufacturing. Based on our experience, our product can save up to 35% of the energy consumed by electric AC induction motors in appropriate applications. These applications include most motors that work at constant speed but are variably loaded, such as the AC motors found on many elevators, escalators, granulators, oil pump jacks, crushing machines, saw mills, stamping presses, and other manufacturing equipment.

New Products We have developed and tested several platforms of the present technology that support large potential applications.

Limited Competition We are not aware of any products on the market today that have been certified by CE, CSA and UL and offer the same energy-saving and soft start characteristics as our products.

International Distribution International distribution is important to our success because energy costs are much higher abroad than domestically.

A detailed description of our business strategy is provided under the heading "Business" below.

Our address is 3900 Paradise Road, Suite 283, Las Vegas, Nevada 89109, and our telephone number is 702-697-0377.

Selling Stockholders

The shares of Common Stock covered by this prospectus that are being offered by the selling stockholders consist of up to 46,135,110 shares issued or to be issued (the "Securities") to the selling stockholders within 60 days of August 31, 2005. The full name, address and control persons of the selling stockholders are set forth beginning on page 41 of this prospectus.

THE OFFERING

In June, July and August of 2005, we conducted a private offering of our Common Stock and Placement Warrants, defined below, for the issuance of our Common Stock (the "Placement Securities"). We offered up to 50 Units, at $50,000 each, to individuals or entities who qualified as "accredited investors" as defined in Rule 501 of Regulation D promulgated under the Securities Act. Each Unit consists of (a) a number of shares of Common Stock which is determined by dividing $50,000 by a price equal to 50% of the 5-day average of the closing bid price of the shares of Common Stock on the OTC Bulletin Board on the last trading day immediately prior to the closing of the Placement, with a floor on the purchase price of $0.20 and a ceiling on the purchase price of $0.325; and (b) a warrant (each a "Placement Warrant" and, collectively, the "Placement Warrants") to purchase prior to the fifth (5th) anniversary following the closing a number of shares of Common Stock equal to 50% of the number of shares of Common Stock included within each Unit, at a price which is equal to 200% of the 5-day average of the closing sales price of the shares of Common Stock on the OTC Bulleting Board prior to the closing, per share of Common Stock. The Placement closed on August 31, 2005 and resulted in gross proceeds of $2,900,000. The Placement requires us (a) to file this Registration Statement with the Securities and Exchange Commission (the "SEC" or the "Commission") within 60 days following the final closing of the offering and (b) to use our reasonable best efforts to have such declared effective within 120 days from the final closing of the offering. As part of this Registration Statement, and Placement Securities stemming from the Placement, we are registering 14,500,000 of shares of our Common Stock and 10,700,000 shares of Common Stock reserved for issuance upon exercise of the Placement Warrants.

STOCK OPTIONS

As of August 31, 2005, a total of 66,232 shares of Common Stock option grants have been issued under the 1994 Plan. The 1994 Plan was adopted by our board of directors and our stockholders in 1994, however, at that time no Form S-8 was filed. As part of this Registration Statement we are registering 66,232 shares of Common Stock stemming directly from the 1994 Plan.

As of August 31, 2005, a total of 12,404,989 shares of Common Stock option grants have been issued under the 2000 Plan. The 2000 Plan was adopted by our board of directors and our stockholders in 2000, however, at that time no Form S-8 was filed. As part of this Registration Statement we are registering all 15,000,000 shares of Common Stock stemming directly from the 2000 Plan.

RISK FACTORS

An investment in our company involves a high degree of risk. You should carefully consider the risks below, together with the other information contained in this prospectus, before you decide to invest in our company. If any of the following risks occur, our business, results of operations and financial condition could be harmed, the trading price of our common stock could decline, and you could lose all or part of your investment. The risks and uncertainties described below are intended to be the material risks that are specific to us and to our industry. New risk factors emerge from time to time and it is not possible for us to predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause future actual results to differ materially from those contained in any historical or forward-looking statements.

RISKS RELATED TO OUR BUSINESS

Unless We Achieve Profitability and Related Positive Cash Flow, We May Not Be Able To Continue Operations, And Our Auditors Have Questioned Our Ability To Continue As A "Going Concern".

We have suffered recurring losses from operations, experienced approximately a $1,400,000 deficiency of cash from operations in 2004 and lack sufficient liquidity to continue our operations without external financing. For the year ended December 31, 2003, we had a net loss of $3,016,717. For the year ended December 31, 2004, we had a net loss of $2,465,631. For the three months ended March 31, 2005, we had a net loss of $381,616 and for the six months ended June 30, 2005, we had a net loss of $993,123.

In Note 3 to our December 31, 2004 financial statements included in this prospectus, our auditors have stated that these factors raise substantial doubt about our ability to continue as a "going concern". Our financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amount of liabilities that might be necessary should we be unable to continue in existence.

Our continuation as a "going concern" is dependent upon achieving profitable operations and related positive cash flow and satisfying our immediate cash needs by external financing until we are profitable. Our plans to achieve profitability include developing new products, obtaining new customers and increasing sales to existing customers. We are seeking to raise additional capital through equity issuance, debt financing and other types of financing, but we cannot guarantee that sufficient capital will be raised. In that regard, we have granted the holders of our Senior Secured Notes in the aggregate principal amount of $1,589,806 a first priority security interest in substantially all our assets, except that we may grant a first priority security interest senior to the Senior Secured Noteholders in our accounts receivable and inventory in order to obtain a line of credit in the ordinary course of business.

We Have A Limited Operating History, Have Experienced Recurring Losses And Have Limited Revenue.

To date, and due principally to a lack of working capital, our operations have been limited in scale. Although we have an arrangement with an outsourced production facility, have established relationships with suppliers, and have received contracts for our products, we may experience difficulties in production scale-up, product distribution, and obtaining and maintaining working capital until such time as our operations have been scaled-up to normal commercial levels. We have not had a profitable quarter in the past three years and we cannot guarantee that we will ever operate profitably. We have limited revenue. For the year ended December 31, 2003, our total revenues were $397,673. For the year ended December 31, 2004, our total revenues were $284,373. For the first and second quarter ended June 30, 2005, our total revenues were $145,785.

Our Present Cash Flow Is Not Adequate To Pay Accrued Liabilities.

We had accrued payables, salaries and expenses totaling approximately $600,000 as of June 30, 2005. Approximately $130,000 of these accrued liabilities represents disputed claims, which we expect to partially pay, settle for equity, or dispute entirely. We expect to resolve an additional $110,000 of these accrued liabilities by exchanging them for equity or deferring all payments until we are cash flow positive. We estimate we will need to pay approximately $165,000 toward accrued liabilities, including old trade payables and payments of interest and principal on existing notes, from July 1, 2005 through June 30, 2006, and we intend to use a portion of the proceeds of the Placement for that purpose. The remainder of the accrued payables, salaries and expenses are primarily current trade payables and reserves. However, these figures are only estimates and because we may not be able to negotiate successfully with creditors, creditor claims may cause a restriction in the amount of funds available for our operations.

Our Principal Obligations On Long-Term Debt Total $1,633,724, And This Indebtedness Is Subject To Acceleration.

In addition to the accrued payables, salaries and expenses described immediately above, as of September 30, 2005, we had $1,633,724 in aggregate principal amount of long-term debt outstanding. The specific components of this indebtedness are as follows:

We owe $1,589,806 in Senior Secured Notes. They mature in October 2006 ($1,464,806 in principal amount) and February 2007 ($125,000 in principal amount), bear interest at 15% (paid from funds we have placed in escrow) and are secured by a first lien on substantially all our assets. The entire balance of these notes will become due and payable if we cannot pay any past due amount within 7 days of a written notice that payment is in default. As of September 30, 2005, we do not have any past due payments on these Senior Secured Notes.

We owe Stephen Shulman, a former officer, $30,648. The entire principal balance of this note will be due and payable if we cannot pay any past due amount within 10 days of a written notice that the payment is in default. As of September 30, 2005, we do not have any past due payments on this note.

We owe Richard Koch, a former officer, $13,270. The entire principal balance of this note will be due and payable if we cannot pay any past due amount within 7 days of a written notice that the payment is in default. As of September 30, 2005, we do not have any past due payments on this note.

We owe our former landlord in Livonia, Michigan $50,000 payable in 18 monthly installments of $2,777.77 per month, commencing November 17, 2005 and ending April 17, 2007, in settlement of our lease dispute litigation.

On June 30, 2005, we owed Summit, a related party, $300,000. The entire principal balance of this note was converted into 1,500,000 shares of Common Stock and 750,000 Common Stock warrants in connection with the Placement.

We Do Not Have A Bank Line Of Credit And Substantially All Our Assets Are Pledged.

At the present time, we do not have a bank line of credit. The absence of a line of credit further restricts our financial flexibility and it is unlikely we will be able to obtain a line of credit in the foreseeable future. As noted above, substantially all our assets are subject to existing liens, although we may grant a senior security interest in our accounts receivable and inventory to obtain a line of credit in the ordinary course of business.

We Will Require Additional Funds To Meet Our Cash Operating Expenses And Achieve Our Current Business Strategy.

We continue to have limited working capital and will be dependent upon additional financing to meet our capital needs and repay outstanding debt. We cannot guarantee that any additional financing will be available on acceptable terms, if at all. We also need additional financing to raise the capital required to fully implement our business plan. Our current fixed operating expense level is approximately $150,000 to $175,000 per month, not counting payments to certain creditors, including accrued salaries and expenses, and may increase in the near-term future. We may need to issue additional equity to raise required funds, and as a result existing equity owners would be diluted.

It is anticipated that the net proceeds of $2,232,750 from the Placement will last for up 15 months. When our operations require additional financing, if we are unable to obtain it on reasonable terms, we would be forced to restructure, file for bankruptcy or cease operations, any of which could cause you to lose all or part of your investment in our Common Stock.

Our Management Group Owns Or Controls A Significant Number Of The Outstanding Shares Of Our Common Stock And Will Continue To Have Significant Ownership Of Our Voting Securities For The Foreseeable Future.

Prior to the issuance of shares pursuant to the Placement, our management owned 40% of our issued and outstanding shares of Common Stock and voting equivalents. Now, after the conversion of the Series A-1 Stock and further investment by management in this offering, management will own approximately 29% of our issued and outstanding Common Stock and voting equivalents. As a result, these persons will have the ability, acting as a group, to effectively control our affairs and business, including the election of directors and subject to certain limitations, approval or preclusion of fundamental corporate transactions. This concentration of ownership of our Common Stock may:

delay or prevent a change in the control;

impede a merger, consolidation, takeover, or other transaction involving the Company; or

discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of the Company.

Certain Of Our Management Team Have Relationships Which May Potentially Result In Conflicts Of Interests.

Summit owns twenty-nine percent (29%) of our Common Stock and voting equivalents. Summit is controlled by Steven Strasser, our Chairman and CEO, and he has the right to vote all shares owned by Summit. The remaining equity in Summit is owned by BJ Lackland, our COO and CFO. In addition, we sublease space and obtain office services at market rates from Northwest Power Management, Inc., which is wholly-owned by Mr. Strasser. These relationships are discussed in more detail under "Certain Relationships And Related Party Transactions" herein. As a condition to the closing of the Placement, all of the holders of our Series A-1 Stock, which includes Summit, agreed to convert their shares of Series A-1 Stock into shares of Common Stock. After such conversion and this offering, Summit owns twenty-nine percent (29%) of our Common Stock and voting equivalents.

Our License From NASA Has Expired.

The basic technology upon which our products are based is derived from a patent license agreement by and between us and NASA, which expired on December 16, 2002. The license expired upon expiration of NASA's underlying patents, at which time anyone, including us, became free to use the underlying NASA technology. However, we have also made certain improvements to the basic technology covered by the NASA license and we have obtained a patent on this improved technology that runs through 2017. Management believes this improved technology may place us in a competitively superior position. However, we cannot guarantee that others will not seek to improve the basic technology in a similar manner.

Our Business Depends Upon The Maintenance Of Our Proprietary Technology, And We Rely, In Part, On Contractual Provisions To Protect Our Trade Secrets And Proprietary Knowledge.

We depend upon our proprietary technology. We rely principally upon trade secret and patent law to protect this technology. We also regularly enter into confidentiality agreements with our key employees, customers and potential customers and limit access to and distribution of our trade secrets and other proprietary information. These measures may not be adequate to prevent misappropriation of our technology or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States. We also are subject to the risk of adverse claims and litigation alleging infringement of intellectual property rights.

Confidentiality agreements to which we are party may be breached, and we may not have adequate remedies for any breach. Our trade secrets may also be known without breach of such agreements or may be independently developed by competitors. Our inability to maintain the proprietary nature of our technology and processes could allow our competitors to limit or eliminate any competitive advantages we may have.

We Are Potentially Dependent On Third-Party Suppliers.

Although we believe that most of the key components required for the production of our products are currently available in sufficient production quantities from multiple sources, they may not remain so readily available. It is possible that other components required in the future may necessitate custom fabrication in accordance with specifications developed or to be developed by us. Also, in the event that we, or our contract manufacturer, as applicable, is unable to develop or acquire components in a timely fashion, our ability to achieve production yields, revenues and net income would be adversely affected.

We Are Commercializing Our Technology Which Will Involve Uncertainty And Risks Related To Market Acceptance.

We are commercializing our technology in order to gain market acceptance and demonstrate competitive advantages. Our success is dependent, to a large degree, upon our ability to fully develop and commercialize our technology and gain industry acceptance of our products based upon our technology and its perceived competitive advantages. Accordingly, our prospects must be considered in light of the risks, expenses and difficulties frequently encountered in connection with the establishment of a new business in a highly competitive industry, characterized by frequent new product introductions. We anticipate that we will incur substantial expense in connection with the development and testing of our proposed products and expect these expenses to result in continuing and significant losses until such time, if ever, that we are able to achieve adequate levels of sales or license revenues.

We Are Changing Our Marketing Strategy.

Our products have been distributed primarily through OEMs. We have recently begun pursuing an expanded distribution strategy designed to reduce our reliance on OEMs. Pursuant to this strategy, we are increasing our direct sales and sales through distributors into new markets. Our future growth and profitability will depend upon the successful development of business relationships with additional OEMs, manufacturing representatives and distributors and their ability to penetrate the market with our products.

We Currently Depend On A Small Number Of Customers And Expect To Continue To Do So.

We currently do business with approximately 30 customers. Of this number, four customers accounted for approximately 60% of our gross revenues in 2004. These customers and their respective gross revenue percentages are KONE, Inc.-23%; The George Washington University-11%; The May Department Stores-13%; and Weibermachine-13%. In light of our intentions to focus our business on OEMs in the elevator, oil field pump and manufacturing industries, we are, and may continue to be, dependent upon a small number of customers. Accordingly, the loss of one or more of these customers is likely to have a material adverse effect on our business.

Most Of Our Current And Potential Competitors Have Greater Name Recognition, Financial, Technical And Marketing Resources, And More Extensive Customer Bases And Industry Relationships Than We Do, All Of Which Could Be Leveraged To Gain Market Share To Our Detriment, Particularly In An Environment Of Rapid Technological Change.

We compete against a number of companies, many of which have longer operating histories, established markets and far greater financial, advertising, research and development, manufacturing, marketing, personnel and other resources than we currently have or may reasonably expect to have in the foreseeable future. This competition may have an adverse effect on our ability to expand our operations or operate profitably. The motor control industry is also highly competitive and characterized by rapid technological change. Our future performance will depend in large part upon our ability to become and remain competitive and to develop, manufacture and market acceptable products in these markets. Competitive pressures may necessitate price reductions, which can adversely affect revenues and profits. If we are not competitive in our ongoing research and development efforts, our products may become obsolete, or be priced above competitive levels. However, management believes that, based upon their performance and price, our products are attractive to customers. We cannot guarantee that competitors will not introduce comparable or technologically superior products, which are priced more favorably than our products.

Changes In Retail Energy Prices Could Affect Our Business.

A customer's decision to purchase the Power Commander® is primarily driven by the payback on the investment resulting from the increased energy savings. Although management believes that current retail energy prices support an attractive return on investment for our products, the future retail price of electrical energy may not remain at such levels, and price fluctuations reducing energy expense could adversely affect product demand.

Loss Of Key Personnel Could Have Significant Adverse Consequences.

We currently depend on the services of Steve Strasser, BJ Lackland and Nicholas Anderson. Loss of the services of any of these persons could have an adverse effect on our business. As discussed under "Management", we have entered into long-term employment contracts with Messrs. Strasser, Lackland and Anderson, but such contracts do not guarantee that they will remain with us.

We Do Not Have "Key Man" Life Insurance.

We presently do not have any key man life insurance policies. As soon as practicable following the commencement of profitable operations (which may never occur), we intend to purchase key man life insurance on the lives of our two principal executive officers, Steven Strasser and Nicholas Anderson. Upon purchase of such insurance, we intend to pay the premiums and be the sole beneficiary. The lack of such insurance may have a material adverse effect upon our business.

Delaware Law Limits The Liability Of Our Directors.

Pursuant to our Certificate of Incorporation, our directors are not liable to us or our stockholders for monetary damages for breach of fiduciary duty, except for liability in connection with a breach of the duty of loyalty, for acts or omissions not in good faith or which involved intentional misconduct or a knowing violation of law for dividend payments or stock repurchases illegal under Delaware law or any transaction in which a director has derived an improper personal benefit.

We Have Elected Not To Adopt Various Voluntary Corporate Governance Measures, And As A Result Stockholders May Have Limited Protections Against Interested Director Transactions, Conflicts Of Interest And Similar Matters.

Recent Federal legislation, including the Sarbanes-Oxley Act of 2002, has resulted in the adoption of various corporate governance measures designed to promote the integrity of corporate management and the securities markets. Because our securities are not yet listed on a national securities exchange or NASDAQ, we are not required to adopt these corporate governance measures and have not done so voluntarily in order to avoid incurring the additional costs associated with such measures. However, to the extent we seek to have our Common Stock listed on a national securities exchange or NASDAQ, such legislation will require us to make changes to our current corporate governance practices. Those changes may be costly and time-consuming. Furthermore, the absence of the governance measures referred to above with respect to our Company may leave our stockholders with more limited protection in connection with interested director transactions, conflicts of interest and similar matters.

Potential Product Liability Claims May Not Be Fully Covered By Insurance.

We may be subject to potential product liability claims that could, in the absence of sufficient insurance coverage, have a material adverse impact on us. Presently, we have general liability coverage that includes product liability up to $2,000,000. Any large product liability suits occurring early in our growth may significantly and adversely affect our ability to expand the market for our Power Commander® line of products.

RISKS RELATED TO OUR COMMON STOCK AND CAPITAL STRUCTURE

Trading In Our Common Stock Over The Last 12 Months Has Been Limited, So Investors May Not Be Able To Sell As Many Of Their Shares As They Want At Prevailing Prices.

Shares of our Common Stock are traded on the OTC Bulletin Board. Approximately 2,228 shares were traded on an average daily trading basis for the 12 months ended September 30, 2005. If limited trading in our Common Stock continues, it may be difficult for investors once and if the Securities are registered, to sell the Securities. Also, the sale of a large block of our Common Stock could depress the market price of our Common Stock to a greater degree than a company that typically has a higher volume of trading of its securities.

The Limited Public Trading Market May Cause Volatility In The Company's Stock Price.

Our Common Stock is currently traded on a limited basis on the OTC Bulletin Board under the symbol "PEFF". The quotation of our Common Stock on the OTC Bulletin Board does not assure that a meaningful, consistent and liquid trading market currently exists, and in recent years such market has experienced extreme price and volume fluctuations that have particularly affected the market prices of many smaller companies like us. Our Common Stock is thus subject to this volatility. Sales of substantial amounts of our Common Stock, or the perception that such sales might occur, could adversely affect prevailing market prices of our Common Stock.

An Active And Visible Trading Market For Our Common Stock May Not Develop.

We cannot predict whether an active market for our Common Stock will develop in the future. In the absence of an active trading market:

- Investors may have difficulty buying and selling or obtaining market quotations;

- Market visibility for our Common Stock may be limited; and

A lack of visibility for our Common Stock may have a depressive effect on the market price for our Common Stock.

The OTC Bulletin Board is an unorganized, inter-dealer, over-the-counter market that provides significantly less liquidity than NASDAQ, and quotes for stocks included on the OTC Bulletin Board are not listed in the financial sections of newspapers, as are those for NASDAQ Stock Market. The trading price of the Common Stock is expected to be subject to significant fluctuations in response to variations in quarterly operating results, changes in analysts' earnings estimates, announcements of innovations by the Company or its competitors, general conditions in the industry in which we operate and other factors. These fluctuations, as well as general economic and market conditions, may have a material or adverse effect on the market price of our Common Stock.

Penny Stock Regulations May Impose Certain Restrictions On Marketability On The Company's Securities.

The Commission has adopted regulations which generally define a "penny stock" to be any equity security that has a *market price* of less than $5.00 per share or an *exercise price* of less than $5.00 per share, subject to certain exceptions. As a result, our Common Stock is subject to rules that impose additional requirements on broker-dealers who sell such securities to persons other than established customers and accredited investors (generally those with net worth in excess of $1,000,000 or annual income exceeding $200,000, or $300,000 together with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of such securities and have received the purchaser's written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the rules require the delivery, prior to the transaction, of a risk disclosure document relating to the penny stock market. The broker-dealer must also disclose the commission payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Consequently, the "penny stock" rules may restrict the ability of broker-dealers to sell the Company's securities and may affect the ability of investors to sell the Company's securities in the secondary market and the price at which such purchasers can sell any such securities.

Stockholders should be aware that, according to the Commission, the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include:

- Control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer;
- Manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases;
- "Boiler room" practices involving high pressure sales tactics and unrealistic price projections by inexperienced sales persons;
- Excessive and undisclosed bid-ask differentials and markups by selling broker-dealers; and
- The wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the inevitable collapse of those prices with consequent investor losses.

Our management is aware of the abuses that have occurred historically in the penny stock market.

We May Never Pay Cash Dividends On Our Common Stock.

We have not paid or declared any dividends on our Common Stock and do not anticipate paying or declaring any cash dividends on our Common Stock in the foreseeable future.

Sales Of Common Stock Under Rule 144 May Adversely Affect The Market Price Of Our Common Stock.

Possible Resales under Rule 144. Of the 23,439,266 shares of our Common Stock outstanding on August 31, 2005, 1,596,828 shares are freely trading in the market place (the "Free Trading Shares"). The Free Trading Shares are comprised mostly of shares that were originally issued in transactions that were exempt from registration under the Securities Act; these shares were, over time, resold pursuant to Rule 144 as discussed below.

The remaining 21,842,438 shares of our Common Stock outstanding are restricted securities as defined in Rule 144 and under certain circumstances may be resold without registration pursuant to Rule 144. In addition, we have issued 3,918,848 shares of Common Stock on conversion of our Series A-1 Stock in connection with the closing of the Placement, and such shares will also constitute restricted securities under Rule 144.

In addition, we have approximately 14,057,215 Common Stock purchase warrants outstanding and approximately 12,471,221 Common Stock options outstanding, including the warrants issued in connection with the recent private offer and sale of the Senior Secured Notes. The shares issuable on exercise of the options and warrants may, under certain circumstances, be available for public sale in the open market under the Registration Statement or pursuant to Rule 144, subject to certain limitations.

In general, under Rule 144, a person (or persons whose shares are aggregated) who has satisfied a one-year holding period may, under certain circumstances, sell within any three-month period a number of securities which does not exceed the greater of 1% of the then outstanding shares of common stock or the average weekly trading volume of the class during the four calendar weeks prior to such sale. Rule 144 also permits, under certain circumstances, the sale of securities, without any limitation, by a person who is not an Affiliate, as such term is defined in Rule 144(a)(1), of the Company and who has satisfied a two-year holding period.

Any substantial sale of the Common Stock pursuant to Rule 144 may have an adverse effect on the market price of the Company's shares. If this Registration Statement we are obligated to file in connection with the Placement is declared effective, the selling stockholders hereunder will have an enhanced ability to sell shares, and any such sales may have a similarly adverse effect of the market price of our shares.

Exercise Of Outstanding Options And Warrants Will Dilute Ownership Of Outstanding Shares.

As of September 30, 2005, the Company has reserved 71,429 shares of Common Stock for issuance upon exercise of stock options or similar awards which may be granted pursuant to the 1994 Plan, of which options to purchase an aggregate of 66,232 shares are outstanding. Furthermore, as of the same date we have reserved 15,000,000 shares of our Common Stock for issuance upon exercise of stock options or similar awards which may be granted pursuant to the 2000 Plan, of which options to purchase an aggregate of 12,404,989 shares are outstanding. The outstanding options under the 2000 Plan have a weighted average exercise price of \$0.36. As of September 30, 2005, we have issued warrants exercisable for 14,057,215 shares of Common Stock to financial consultants, investors, former employees and other business partners, having a weighted average exercise price of \$0.44 and expiring on various dates from August 1, 2005 to December 31, 2011.

Exercise of these options and warrants issued by the Company in the future will reduce the percentage of Common Stock held by the public stockholders. Furthermore, the terms on which we could obtain additional capital during the life of the options and warrants may be adversely affected, and it should be expected that the holders of the options and warrants would exercise them at a time when we would be able to obtain equity capital on terms more favorable than those provided for by such options and warrants.

Our Issuance Of "Blank Check" Preferred Stock Could Adversely Affect Our Common Stockholders.

Our Certificate of Incorporation authorizes the issuance of "blank check" preferred stock with such designations, rights and preferences as may be determined from time to time by the board of directors. Accordingly, our Board of Directors is empowered, without stockholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the relative voting power or other rights of the holders of our Common Stock. In the event of issuance, the preferred stock could be used as a method of discouraging, delaying or preventing a change in control of the Company, which could have the effect of discouraging bids for the Company and thereby prevent stockholders from receiving the maximum value for their shares. Although we have no present intention to issue any shares of our preferred stock, there can be no assurance that we will not do so in the future.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus, including the sections entitled "Prospectus Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business," contains forward-looking statements. These statements relate to future events, our future financial performance, growth of our target market and related worldwide markets, future demand for our products, retail electrical energy demand and prices and similar expectations. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. You can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "intends," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "continues" or the negative of these terms or other comparable terminology. These risks and other factors include those listed under "Risk Factors" and elsewhere in this prospectus. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on any forward-looking statements as they reflect our management's view only as of the date of this prospectus. We will not update any forward-looking statements to reflect events or circumstances that occur after the date on which such statement is made.

This prospectus contains statistical data that we obtained from industry sources. These sources generally indicate that they have obtained their information from sources believed to be reliable, but do not guarantee the accuracy or completeness of the information. Although we believe that the industry sources are reliable, we have not independently verified their data.

USE OF PROCEEDS

We will not receive any proceeds from the sale of shares of our Common Stock by the selling stockholders. However, we have received $1,122,288 in net proceeds from the private offer and sale of the Senior Secured Notes, and $2,232,750 in net proceeds from the Placement, and if all outstanding options and warrants in respect of which the offer and sale of shares of Common Stock are being registered hereunder were exercised, we would receive approximately $13,215,000 in proceeds.

We have used the net proceeds from the offer and sale of the Senior Secured Notes for payment of accrued debts, product development, marketing and sales expenses and general working capital required for operations. We currently plan to use any proceeds received from the exercise of options and warrants for the same purposes.

We need at least $150,000 to $175,000 per month to continue our current operations, not including the payment of accrued liabilities. As discussed in "Risk Factors" above, we will need to make payments toward accrued liabilities out of our cash flow for the foreseeable future. Overall, our satisfaction of our cash requirements depends on our ability to raise money from external financing sources and to generate future sales.

PRICE RANGE OF COMMON STOCK

As quoted on the OTC Bulletin Board from January 1, 2003 though July 31, 2005, the following table sets forth the high and low bid prices for our Common Stock for the periods indicated.

	Common Stock Price	
	High	Low
Year Ended December 31, 2003		
First Quarter	$ 8.82	$ 4.90
Second Quarter	$ 9.31	$ 4.97
Third Quarter	$ 8.96	$ 5.46
Fourth Quarter	$ 8.68	$ 3.64
Year Ended December 31, 2004		
First Quarter	$ 5.04	$ 0.90
Second Quarter	$ 1.50	$ 0.61
Third Quarter	$ 0.67	$ 0.28
Fourth Quarter	$ 1.00	$ 0.21
Year Ended December 31, 2005		
First Quarter	$ 0.56	$ 0.20
Second Quarter	$ 0.25	$ 0.19
Third Quarter	$ 0.50	$ 0.22
Fourth Quarter (through October 18, 2005)	$ 0.35	$ 0.30

On October 18, 2005, the last day prior to the date of this prospectus for which information was practicably available, the closing price for our Common Stock was $0.30 per share. As of June 30, 2005, our Common Stock was held by 116 stockholders of record. Through the Offering which closed in two phases, on July 8 and August 31, 2005 we have added 71 new stockholders. The prices reported for the periods set forth above reflect inter-dealer prices without retail markup, mark down or commission, and may not represent actual prices.

DIVIDEND POLICY

We have never declared or paid cash dividends on our capital stock and have no present intention of paying cash dividends in the foreseeable future. Payment of future dividends, if any, will be at the discretion of our board of directors and will depend on our financial condition, results of operations, capital requirements and such other factors as the board of directors deems relevant. It is our board's present policy to retain all earnings to provide for our future growth.

CAPITALIZATION

The following table, as of September 30, 2005 (as adjusted for the subsequent increase in the Company's authorized capital to 100,000,000 shares of Common Stock and 10,000,000 Shares of Preferred Stock), sets forth our capitalization under two scenarios. The first column illustrates our capitalization as of September 30, 2005. The second column illustrates our capitalization assuming all 7,250,000 Placement Warrants, all 3,450,000 Placement Agent warrants issued in connection with the Placement, all 1,981,517 warrants issued in connection with our private offering of Senior Secured Notes, and all 1,375,699 warrants issued to private investors and others were exercised.

	September 30, 2005	
	Actual	**As if Warrants Exercised**
	(Unaudited)	
Stockholders' Equity (Capital Deficit)		
Common Stock, $.001 par value; 100,000,000 shares authorized; 23,439,266 shares issued and outstanding; 37,496,482 shares issued and outstanding if all warrants exercised	$ 23,439	$ 37,496
Preferred Stock, $.001 par value; 10,000,000 shares authorized; 0 shares issued and outstanding		
Additional Paid in Capital	19,603,046	25,527,366
Accumulated Deficit	(17,465,681)	(17,465,681)
Total Stockholders' Equity	$ 2,160,804	$ 8,099,181

In the near future we expect to grant more options and warrants for employees, directors, former employees and creditors. These warrants and options are not included in the above table. Although the exact number of options and warrants to be issued is not presently known, we do not expect to issue more than 1.5 million additional options and warrants in the coming months, unless we are required to do so in connection with future efforts to raise capital.

SELECTED FINANCIAL INFORMATION

The selected statements of operations and balance sheet data for the six months ended June 30, 2004 and 2005 are derived from our unaudited financial statements, which are included elsewhere herein. The financial data presented below is only a summary and should be read in conjunction with the other financial information appearing elsewhere in this prospectus.

	Six months ended June 30,	
	2004	**2005**
Statements of Operations:		
Revenues	$ 154,144	$ 145,785
Cost of Sales:		
Material, labor and overhead	104,323	126,538
Inventory obsolescence	29,484	
Total Cost of Sales	133,807	126,538
Gross Profit	20,337	19,247
Costs and Expenses:		
Research and development	208,297	126,650
Selling, general and administrative	920,298	612,211
Depreciation and amortization	37,502	12,328
Total Costs and Expenses, Net	1,166,097	751,189
Loss from Operations	(1,145,760)	(731,942)
Other income(expense):		
Interest income (expense)	(7,597)	(261,181)
Total Other Expense	(7,597)	(261,181)
Net loss	(1,153,357)	(993,123)
Basic loss per common share	$ (0.28)	$ (0.20)
Weighted average common shares outstanding	5,018,926	5,020,418
Balance Sheet Data:		
Cash	$ 16,140	$ 101,647
Working capital (deficit)	(821,933)	(476,581)
Total assets	2,498,083	2,579,869
Long term liabilities		1,219,268
Total stockholders' equity	2,498,083	408,633

MANAGEMENT'S DISCUSSION AND ANALYSIS
OR PLAN OF OPERATIONS

The following discussion should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this prospectus. In addition to historical information, this discussion includes forward-looking information that involves risks and assumptions which could cause actual results to differ materially from management's expectations. See "Special Note Regarding Forward-Looking Statements" on page 13 of this prospectus.

OVERVIEW

We generate revenues from a single business segment: the design, development, marketing and sale of proprietary solid state electrical components designed to reduce energy consumption in alternating current induction motors.

We began generating revenues from sales of its patented *Power Commander®* line of motor controllers in late 1995. As of June 30, 2005, we had total stockholders' equity of $408,633 primarily due to our sale of 2,785,969 shares of Series A-1 Stock to Summit in June of 2002 and April of 2005, and the conversion of notes payable of approximately $1,047,000 into 982,504 shares of Series A-1 Stock in October of 2003. In addition, in August 2000, we purchased the assets of Percon, formerly the largest distributor of our products. The transaction was accounted for as a purchase and our Statements of Operations includes Percon's results of operations since the date of acquisition. The consolidation of the operations of both entities allowed us to integrate the administrative, sales, marketing and manufacturing operations of Percon. Percon had developed sales contacts with major OEM's in the elevator/escalator industry and transferred those agreements to us as part of the asset sale.

RESULTS OF OPERATIONS: FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2005 AND 2004.

REVENUES

Total revenues for the three months ended June 30, 2005, were approximately $95,000, compared to $65,000 for the three months ended June 30, 2004, an increase of $30,000 or 46%. This increase is mainly attributable to an increase in sales in the elevator and escalator market segment. Sales to a government agency totaled approximately $50,000 during the three months ended June 30, 2005. Revenue of $7,475 was recognized for a government grant received associated with development expenses related to a medium voltage product application during the three months ended June 30, 2004. No government grant income was recognized for the three months ended June 30, 2005.

Total revenues for the six months ended June 30, 2005, were approximately $146,000, compared to $154,000 for the six months ended June 30, 2004, a decrease of $8,000 or 5%. This decrease is mainly attributable to revenue of $12,725 that was recognized for a government grant received associated with development expenses related to a medium voltage product application during the six months ended June 30, 2004. No government grant income was recognized for the three months ended June 30, 2005.

COST OF PRODUCT REVENUES

Total cost of product revenues, which includes material and direct labor, allocated costs, and inventory obsolescence and other write-offs for the three months ended June 30, 2005 were approximately $86,000 compared to $39,000 for the three months ended June 30, 2004 an increase of $47,000 or 121%. As a percentage of product revenues, total cost of revenues increased to approximately 90% for the three months ended June 30, 2005 compared to approximately 69% for the three months ended June 30, 2004. The increase in the costs as a percentage of product revenues was primarily due to an increase in the production of higher costing units in 2005. Also, allocated costs were approximately $13,000 for the three months ended June 30, 2005 and 2004. As a percentage of product revenues, allocated costs were 14% for the three months ended June 30, 2005 compared to 22% for the three months ended June 30, 2004. The allocated costs as a percentage of product revenues decreased as the allocated costs were absorbed by a higher volume of product revenues. Material and labor costs as a percentage of product revenues increased to 78% for the three months ended June 30, 2005 compared to 47% for the three months ended June 30, 2004. Material and labor costs as a percentage of product revenues were approximately 64%. This increase was largely due to the use of a turn-key manufacturer resulting in higher direct labor costs per unit in 2005.

Total cost of product revenues, which includes material and direct labor, allocated costs, and inventory obsolescence and other write-offs for the six months ended June 30, 2005 were approximately $127,000 compared to approximately $134,000 for the six months ended June 30, 2004, a decrease of $7,000 or 5%. As a percentage of product revenues, total costs of product revenues decreased to approximately 87% for the six months ended June 30, 2005 compared to approximately 95% for the six months ended June 30, 2004. The decrease in the costs as a percentage of product revenues was primarily due to no charges to inventory for obsolescence and other write-offs for the six months ended June 30, 2005 compared to $30,000 for the six months ended June 30, 2004, offset by the Company utilizing a turn-key manufacturer for production in 2005. Also, allocated costs were $22,000 for the six months ended June 30, 2005, compared to $37,000 for the six months ended June 30, 2004, a decrease of $15,000 or 41%. As a percentage of product revenue, allocated costs were 15% for the six months ended June 30, 2005 compared to 26% for the six months ended June 30, 2004. The allocated costs as a percentage of product revenues decreased as the allocated costs were absorbed by a higher volume of product revenues and because the Company began the use of a turn-key manufacturer.

OPERATING EXPENSES

Research and Development Expenses

Research and development expenses were approximately $71,000 for the three months ended June 30, 2005, as compared to approximately $94,000 for the three months ended June 30, 2004, a $23,000 or a 24% decrease. This decrease is mainly attributable to the Company's operational change and cost reduction program implemented in August and September of 2004.

Research and development expenses were approximately $126,000 for the six months ended June 30, 2005, as compared to approximately $208,000 for the six months ended June 30, 2004, an $82,000 or a 39% decrease. This decrease is mainly attributable to the Company's restructuring and cost reduction program implemented in August and September of 2004, partially offset by a $26,000 charge during the six months ended June 30, 2004, related to laboratory testing done for further product development.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were approximately $400,000 for the three months ended June 30, 2005, as compared to $472,000 for the three months ended June 30, 2004, a decrease of $72,000 or 15%. The decrease in selling, general and administrative expenses over the prior year was due primarily to a decrease in payroll and payroll related costs, as well as the elimination of some fixed costs related to the reduction in workforce and the Company's decision to restructure its operations in August and September of 2004.

Selling, general and administrative expenses were approximately $607,000 for the six months ended June 30, 2005, as compared to $920,000 for the six months ended June 30, 2004, a decrease of $313,000 or 34%. The decrease in selling, general and administrative expenses over the prior year was due primarily to a decrease in payroll and payroll related costs, as well as the elimination of some fixed costs related to the reduction in workforce and the Company's decision to restructure its operations in August and September of 2004.

Financial Condition, Liquidity, and Capital Resources: For the Six Months Ended June 30, 2005

Since inception, the Registrant has financed its operations primarily through the sale of its equity securities, debt securities and using available bank lines of credit. As of June 30, 2005, the Registrant had cash of $101,647.

Cash used for operating activities for the six months ended June 30, 2005 was $873,099 which consisted of: a net loss of $993,123; less depreciation and amortization of $12,328, amortization of deferred financing costs of $30,882, bad debt expenses of $4,530, amortization of debt discount related to issuance of debt securities of $112,462, warrants issued in connection with the issuance of debt, employment agreements, and consulting fees of $69,859; offset by increases in accounts receivable of $32,827, and prepaid expenses and other current assets of $10,331 and decreases in inventory of $13,542, restricted cash of $95,798, accounts payable and accrued expenses of $142,619 and accrued salaries and payroll taxes of $33,600.

Cash used for operating activities for the six months ended June 30, 2004 was $722,592, which consisted of: a net loss of $1,153,357; less depreciation and amortization of $37,502, bad debt expense of $5,493, inventory obsolescence reserve of $29,484, decreases in accounts receivable of $3,079, inventory of $28,457, increases in accounts payable and accrued expenses of $144,564, customer deposits of $20,907, accrued salaries and payroll taxes of $162,040. In addition, these amounts were partially offset by an increase in prepaid expenses of $761.

Cash used in investing activities for the first half of fiscal 2004 was $21,576. The amount consisted of the purchase of fixed assets.

Net cash provided by financing activities for the first half of fiscal year 2005 was $582,275 which consisted of: proceeds from the issuance of debt securities and notes payable of $125,000 and $300,000, respectively; proceeds from the issuance of equity securities of $255,326, partially offset by repayments of loans to former officers of $37,981 and an increase in deferred financing costs of $60,070.

Net cash provided by financing activities for the six months ended June 30, 2004 was $474,800, which primarily consisted of proceeds of $174,800 from the issuance of equity securities related to the Company's Regulation "S" stock offering and $300,000 of proceeds from the Summit Energy Ventures line of credit.

The Registrant expects to experience growth in its operating expenses, particularly in research and development and selling, general and administrative expenses, for the foreseeable future in order to execute its business strategy. As a result, the Registrant anticipates that operating expenses will constitute a material use of any cash resources.

Since capital resources are insufficient to satisfy the Registrant's liquidity requirements, management intends to sell additional equity or debt securities or obtain debt financing. The Registrant believes it can raise additional funds through private placements of equity. However, there are no assurances that sufficient capital can be raised.

Cash Requirements and Need for Additional Funds

The Registrant anticipates a substantial need for cash to fund its working capital requirements. In accordance with the Registrant's prepared expansion plan, it is the opinion of management that approximately $2.0 million will be required to cover operating expenses, including, but not limited to, marketing, sales and operations during the next twelve months. On July 8, 2005 the Company completed the first closing of the Placement for approximately $2.4 million (see Note 8 to the Financial Statements), which netted approximately $1.8 million. On August 31, 2005 the Company completed the second and final closing of the Placement for $470,000, which netted approximately $400,000.

BUSINESS

General Background

We design, develop and market solid-state motor controllers, called "Performance Controllers," which reduce the amo