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

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended **June 30, 2003**

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: **001-15957**

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**CAPSTONE TURBINE CORPORATION**

(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**95-4180883**  
(I.R.S. Employer  
Identification No.)

**21211 Nordhoff Street, Chatsworth, California 91311**  
(Address of principal executive offices and zip code)

**818-734-5300**  
(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes  No

The number of outstanding shares of the registrant's common stock as of June 30, 2003 was 81,257,247.

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**CAPSTONE TURBINE CORPORATION**

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**PART I — FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****CAPSTONE TURBINE CORPORATION  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)**

	June 30, 2003	December 31, 2002
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 126,369,000	\$ 140,310,000
Accounts receivable, net of allowance for doubtful accounts and sales returns of \$589,000 at June 30, 2003 and \$194,000 at December 31, 2002	2,983,000	4,893,000
Inventory	13,299,000	9,124,000
Prepaid expenses and other current assets	2,484,000	2,331,000
Total current assets	145,135,000	156,658,000
Equipment and Leasehold Improvements:		
Machinery, equipment, and furniture	23,157,000	22,996,000
Leasehold improvements	8,482,000	8,480,000
Molds and tooling	4,281,000	4,350,000
	35,920,000	35,826,000
Less accumulated depreciation and amortization	17,442,000	15,346,000
Total equipment and leasehold improvements, net	18,478,000	20,480,000
Non-Current Portion of Inventory	1,147,000	6,784,000
Intangible Asset, net	1,894,000	2,029,000
Other Assets	500,000	1,240,000
Total	\$ 167,154,000	\$ 187,191,000
<b>Liabilities and Stockholders' Equity</b>		
Current Liabilities:		
Accounts payable	\$ 1,675,000	\$ 4,321,000
Accrued salaries and wages	1,648,000	2,088,000
Other accrued liabilities	1,496,000	1,132,000
Accrued warranty reserve	6,785,000	6,913,000
Deferred revenue	1,252,000	734,000
Current portion of capital lease obligations	1,253,000	1,522,000
Total current liabilities	14,109,000	16,710,000
Long-Term Portion of Capital Lease Obligations	502,000	974,000
Other Long-Term Liabilities	1,199,000	1,325,000
Commitments and Contingencies	—	—
Stockholders' Equity:		
Common stock, \$.001 par value; 415,000,000 shares authorized; 81,808,455 shares issued and 81,257,247 shares outstanding at June 30, 2003; 81,635,035 shares issued and 81,437,822 shares outstanding at December 31, 2002	82,000	82,000
Additional paid-in capital	527,454,000	526,952,000
Accumulated deficit	(375,679,000)	(358,646,000)
Less Treasury stock, at cost; 551,208 shares at June 30, 2003; 197,213 shares at December 31, 2002	(513,000)	(206,000)
Total stockholders' equity	151,344,000	168,182,000
Total	\$ 167,154,000	\$ 187,191,000

See accompanying notes to consolidated financial statements.



**CAPSTONE TURBINE CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Revenues	\$ 4,132,000	\$ 7,408,000	\$ 6,914,000	\$ 11,999,000
Cost of Goods Sold	6,739,000	11,631,000	11,695,000	19,180,000
Gross Loss	(2,607,000)	(4,223,000)	(4,781,000)	(7,181,000)
Operating Expenses:				
Research and development	2,450,000	1,619,000	3,456,000	3,058,000
Selling, general and administrative	4,676,000	9,650,000	9,497,000	18,010,000
Impairment loss on Marketing Rights	—	15,999,000	—	15,999,000
Total operating costs and expenses	7,126,000	27,268,000	12,953,000	37,067,000
Loss from Operations	(9,733,000)	(31,491,000)	(17,734,000)	(44,248,000)
Interest Income	400,000	756,000	839,000	1,579,000
Interest Expense	(64,000)	(105,000)	(137,000)	(219,000)
Other Income (Expense), net	(1,000)	5,000	1,000	25,000
Loss Before Income Taxes	(9,398,000)	(30,835,000)	(17,031,000)	(42,863,000)
Provision for Income Taxes	—	—	2,000	2,000
Net Loss	\$ (9,398,000)	\$ (30,835,000)	\$ (17,033,000)	\$ (42,865,000)
Weighted Average Common Shares Outstanding	81,231,192	77,453,602	81,289,027	77,420,588
Net Loss Per Share of Common Stock – Basic and Diluted	\$ (0.12)	\$ (0.40)	\$ (0.21)	\$ (0.55)

See accompanying notes to consolidated financial statements.

**CAPSTONE TURBINE CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	Six Months Ended June 30,	
	2003	2002
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (17,033,000)	\$ (42,865,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,201,000	6,229,000
Impairment loss on marketing rights	—	15,999,000
Non-cash reversal of administrative expenses	(1,099,000)	—
Provision for doubtful accounts and sales returns	534,000	125,000
Inventory write-down	167,000	2,853,000
Provision for warranty expenses	1,441,000	1,532,000
Loss on disposal of equipment	188,000	86,000
Non-employee stock compensation	7,000	—
Employee and director stock compensation	403,000	528,000
Changes in operating assets and liabilities:		
Accounts receivable	1,376,000	(100,000)
Inventory	1,295,000	2,206,000
Prepaid expenses and other current assets	(153,000)	(1,509,000)
Other assets	—	100,000
Accounts payable	(1,547,000)	1,953,000
Accrued salaries and wages and deferred compensation	(478,000)	466,000
Other accrued liabilities	276,000	(145,000)
Accrued warranty reserve	(1,569,000)	(1,056,000)
Deferred revenue	518,000	(409,000)
Net cash used in operating activities	<u>(12,473,000)</u>	<u>(14,007,000)</u>
<b>Cash Flows from Investing Activities:</b>		
Acquisition of and deposits on fixed assets	(561,000)	(1,289,000)
Proceeds from disposal of fixed assets	26,000	—
Net cash used in investing activities	<u>(535,000)</u>	<u>(1,289,000)</u>
<b>Cash Flows from Financing Activities:</b>		
Repayment of capital lease obligations	(718,000)	(654,000)
Exercise of stock options and employee stock purchases	92,000	208,000
Acquisition of treasury stock	(307,000)	—
Net cash used in financing activities	<u>(933,000)</u>	<u>(446,000)</u>
Net Decrease in Cash and Cash Equivalents	(13,941,000)	(15,742,000)
Cash and Cash Equivalents, Beginning of Period	140,310,000	170,868,000
Cash and Cash Equivalents, End of Period	<u>\$126,369,000</u>	<u>\$155,126,000</u>
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Cash paid during the period for:		
Interest	\$ 137,000	\$ 219,000
Income taxes	\$ 2,000	\$ 2,000

See accompanying notes to consolidated financial statements.



**CAPSTONE TURBINE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. Business and Organization**

Capstone Turbine Corporation (the “Company”) develops, manufactures and sells microturbine generator sets for use in combined heat and power generation, resource recovery, hybrid electric vehicles and other power, heat and cooling applications in the markets for distributed power generation around the world. The Company was organized in 1988 and has been commercially producing its microturbine generators since 1998.

The Company has incurred significant operating losses since its inception. Management anticipates incurring additional losses until the Company can produce sufficient revenues to cover costs and expenses. To date, the Company has funded its activities primarily through private and public equity offerings.

**2. Basis of Presentation**

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”) for interim financial information and with the instructions to Form 10-Q and Regulation S-X promulgated under the Securities Exchange Act of 1934. They do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The balance sheet at December 31, 2002 was derived from audited financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2002. In the opinion of management, the interim financial statements include all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial condition, results of operations, stockholders’ equity and cash flows for such periods. Results of operations for any interim period are not necessarily indicative of results for any other interim period or for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2002.

**3. New Accounting Pronouncements**

In May 2003, SFAS No. 150, “Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity”, was issued. The standard establishes how an issuer classifies and measures certain freestanding financial instruments with characteristics of liabilities and equity and requires that such instruments be classified as liabilities. The standard is effective for financial instruments entered into or modified after May 31, 2003 and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of the standard is not expected to have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

In April 2003, Statement of Financial Accounting Standards (“SFAS”) No. 149, “Amendment of Statement 133 on Derivative Instruments and Hedging Activities”, was issued. The standard amends and clarifies financial reporting for derivative instruments and for hedging activities accounted for under SFAS No. 133 and is effective for contracts entered into or modified, and for hedges designated, after June 30, 2003. Adoption of the standard is not expected to have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

In January 2003, the Emerging Issues Task Force (“EITF”) released EITF 00-21: “Accounting for Revenue Arrangements with Multiple Deliverables.” EITF 00-21 clarifies the timing and recognition of revenue from certain transactions that include the delivery and performance of multiple products or services. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Alternatively, entities may elect to report the change in accounting as a cumulative-effect adjustment in accordance with APB Opinion 20, “Accounting Changes.” If so elected, disclosure should be made in periods subsequent to the date of initial application of this consensus of the amount of the recognized revenue that was previously included in the cumulative-effect adjustments. The adoption of EITF 00-21 did not have a material impact on the Company’s consolidated financial position or results of operations.

**CAPSTONE TURBINE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
**(Unaudited)**

**4. Inventory**

Inventory is stated at the lower of standard cost (which approximates actual cost on the first-in, first-out method) or market and consists of the following:

	June 30, 2003	December 31, 2002
Raw materials	\$10,920,000	\$12,623,000
Work in process	1,989,000	1,831,000
Finished goods	1,537,000	1,454,000
	14,446,000	15,908,000
Less non-current portion	1,147,000	6,784,000
	\$13,299,000	\$ 9,124,000

The non-current portion of inventory represents that portion of the inventory in excess of amounts expected to be sold or used in the next twelve months.

**5. Intangible Asset**

The intangible asset represents the license granted to the Company to use a former supplier's intellectual property for the design and manufacture of licensed product for use in microturbines. Additional information is as follows:

	June 30, 2003	December 31, 2002
Gross carrying amount	\$3,663,000	\$3,663,000
Less accumulated amortization and impairment loss	1,769,000	1,634,000
	\$1,894,000	\$2,029,000

This intangible asset, which was acquired in 2000, is being amortized over its estimated useful life of ten years. Related amortization expense for the quarter and six-month periods ended June 30, 2003 was \$67,000 and \$135,000, respectively, compared with \$93,000 and \$187,000 for the same periods last year. This intangible asset is scheduled to be fully amortized by 2010 with corresponding amortization estimated to be \$132,000, \$267,000, \$267,000, \$267,000, \$267,000 and \$694,000, for the remainder of 2003, calendar years 2004, 2005, 2006 and 2007, and thereafter, respectively.

**6. Stock-Based Compensation**

The following table is presented in accordance with SFAS No. 148 and illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
<b>In Thousands (except per share amounts)</b>				
Net loss, as reported	\$ (9,398)	\$(30,835)	\$(17,033)	\$(42,865)
Add: Stock-based employee and director compensation included in reported net loss	193	263	403	528
Deduct: Total stock-based employee and director compensation expense determined under Black-Scholes Option pricing model	(1,755)	(2,376)	(3,652)	(4,617)
	\$ (10,960)	\$(32,948)	\$(20,282)	\$(46,954)
Pro forma net loss				
Net loss per share – Basic and Diluted:				

As reported	\$ (0.12)	\$ (0.40)	\$ (0.21)	\$ (0.55)
Pro forma	\$ (0.13)	\$ (0.43)	\$ (0.25)	\$ (0.61)

**CAPSTONE TURBINE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
**(Unaudited)**

During 1999 and 2000, the Company granted options at less than the fair value of its common stock. Accordingly, the Company recorded stock-based compensation expense based on the vesting of these grants as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Cost of goods sold	\$ 16,000	\$ 11,000	\$ 25,000	\$ 22,000
Research and development	57,000	69,000	116,000	138,000
Selling, general and administrative	120,000	183,000	262,000	368,000
Total	<u>\$ 193,000</u>	<u>\$ 263,000</u>	<u>\$ 403,000</u>	<u>\$ 528,000</u>

As of June 30, 2003, the Company had \$293,000 in deferred employee and director stock-based compensation, which will be amortized through 2004 based on the vesting period.

On August 1, 2003, the Company issued 2,000,000 non-qualified common stock options outside of the 2000 Equity Incentive Plan (“2000 Plan”) at an exercise price of \$1.18 per share. In addition, on August 4, 2003, the Company sold 500,000 restricted common stock at a price of \$0.001 per share. Both issuances were part of the compensation package for the Company’s new President and Chief Executive Officer. Both issuances are subject to the following vesting provisions: 1/4th vests one year after the issuance date and 1/48th vests on the first day of each full month thereafter, so that all shall be vested on the first day of the 48th month after the issuance date; provided, however, that if he is terminated by the Company other than for cause prior to one-year anniversary of the date of the issuance, 1/48th vests on the one-month anniversary of the issuance date until the termination date.

On June 25, 2003, the Company made a tender offer to eligible employees to exchange options with exercise prices greater than or equal to \$2.00 per share. 610,950 options were tendered by eligible employees in the exchange offer. The tendered options were cancelled on July 25, 2003, and new options will be granted at least six months and one day from cancellation date, with the new grant date expected to be on January 26, 2004. The terms and conditions of the new options will vary from the terms and conditions of the tendered options in several ways, including (a) the exercise price of the new options will be the closing price of our common stock on the date of the new option grant, (b) each new option will be a non-statutory stock option, even if the tendered option was an incentive stock option, and (c) the vesting schedule of each new option will be as follows: 12.5% of the shares subject to the new option will be vested on the new option grant date, and 1/48 of the shares subject to the new option will vest monthly thereafter, subject to the option holder’s continued employment through each relevant vesting date.

On March 20, 2003, the Board of Directors approved an amendment to the 2000 Plan to increase the number of shares of common stock available for grant by 2,500,000 shares. The grants under this increase will be non-statutory stock options. As a result of this amendment, the 2000 Plan now provides for awards of up to 6,200,000 shares, plus the number of shares previously authorized and remaining available under the 1993 Incentive Stock Plan (the “1993 Plan”), plus any shares covered by options granted under the 1993 Plan that are forfeited or expire unexercised.

## 7. Accrued Warranty Reserve

The following table represents the changes in the product warranty liability for the six months ended June 30, 2003:

Balance, January 1, 2003	\$ 6,913,000
Reductions for payments made in cash or in kind	(1,523,000)
Changes for accruals related to warranties issued during the period	821,000
Changes for accruals related to preexisting warranties	620,000
Changes in deferred revenue associated with extended warranties	(46,000)
Balance, June 30, 2003	<u>\$ 6,785,000</u>

## 8. Commitments and Contingencies

As of June 30, 2003, the Company had firm commitments to purchase inventories of approximately \$4,800,000.

In December 2001, a purported shareholder class action lawsuit was filed against the Company, two of its officers, and the underwriters of the Company’s initial public offering. The suit purports to be a class action filed on behalf of purchasers of the Company’s common stock during the period from June 28, 2000 to December 6, 2000. An amended complaint was filed on April 19, 2002. No date has been set for the Company to respond to the complaint. Plaintiffs allege that the underwriter defendants agreed to allocate stock in the Company’s June 28,

2000 initial public offering and November 16, 2000 secondary offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectuses for these two public offerings were false and misleading in violation of the securities laws because they did not disclose these arrangements. A committee of the Company's Board of Directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of the Company and of the individual defendants for the conduct alleged in the action to be wrongful in the Amended Complaint. The Company would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or release certain potential claims the Company may have against its underwriters. Any direct financial impact of the proposed

**CAPSTONE TURBINE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**  
**(Unaudited)**

settlement is expected to be borne by the Company's insurers. The committee agreed to approve the settlement subject to a number of conditions, including the participation of a substantial number of other Issuer Defendants in the proposed settlement, the consent of the Company's insurers to the settlement, and the completion of acceptable final settlement documentation. Furthermore, the settlement is subject to a hearing on fairness and approval by the Court.

The Company is a defendant in a breach of contract lawsuit, brought by a party that conducts business with the Company, claiming damages in excess of \$10 million. The Company intends to vigorously defend against this lawsuit. As with any litigation, the ultimate outcome of this lawsuit is uncertain.

**9. Related Party Transactions**

Mr. Eliot Protsch, the Chairman of the Company's Board of Directors, is the President of Alliant Energy-Interstate Power and Light, and Executive Vice-President of Energy Delivery at Alliant Energy Corporation. Alliant Energy Resources, Inc., a subsidiary of Alliant Energy Corporation, is a distributor for the Company. Sales to Alliant Energy Resources, Inc. for the quarter and six-month periods ended June 30, 2003 were \$25,000 and \$25,000, respectively, compared with \$1,434,000 and \$1,434,000 under a firm purchase contract for the same periods last year.

**10. Selling, General and Administrative Expenses**

As a result of a settlement agreement with a professional services firm, liabilities for \$1,099,000 of administrative expenses recorded in prior years were reversed in the first quarter of 2003.

**11. Net Loss Per Common Share**

Basic loss per common share is computed using the weighted-average number of common shares outstanding for the period. The impact of common stock options has not been included in the computation of diluted loss per common share as their inclusion would have had an anti-dilutive effect on the per-share amounts for the periods presented; therefore, diluted loss per common share is equal to basic loss per common share. Outstanding stock options at June 30, 2003 and 2002 of 9.8 million and 7.9 million, respectively, were excluded because the effect would be anti-dilutive.

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

The following discussion should be read in conjunction with the Financial Statements and Notes included in this Form 10-Q and within the Company's Annual Report on Form 10-K for the year ended December 31, 2002. When used in the following discussion, the words "believes", "anticipates", "intends", "expects", "plans" and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those projected. These risks include those identified under "Other Information - Business Risks" in Item 5 of this Form 10-Q. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We undertake no obligation to revise or update publicly any of the forward-looking statements after the filing of this Form 10-Q to conform such statements to actual results or to changes in our expectations.

#### **Critical Accounting Policies**

The preparation of the Company's financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management believes the most complex and sensitive judgments, because of their significance to the consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Management's Discussion and Analysis and Note 2 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2002, describe the significant accounting policies used in preparation of the Consolidated Financial Statements. Actual results could differ from management's estimates. There have been no significant changes in the Company's critical accounting policies during the six months ended June 30, 2003.

#### **Results of Operations**

##### ***Quarters Ended June 30, 2003 and 2002***

*Revenues.* Revenues for the quarter ended June 30, 2003 decreased \$3.3 million to \$4.1 million from \$7.4 million for the same period last year. Revenues from product shipments for the quarter decreased \$2.1 million to \$3.5 million from \$5.6 million last year. Shipments during the quarter of 4.7 megawatts consisted of 60 units of C30 products and 48 units of C60 products, compared with 7.4 megawatts consisting of 165 units of C30 products and 41 units of C60 products for the same period last year. Revenues from accessories, parts and service for the quarter ended June 30, 2003 decreased \$0.4 million to \$1.4 million from \$1.8 million for the same period last year. Revenues are reported net of sales returns and allowances.

Sales to four customers accounted for approximately 65% of revenues for the second quarter of 2003, compared with 41% of revenues coming from three customers for the same period last year. Each of these customers accounted for 10% or more of revenues.

We exited the period with 5.1 megawatts of outstanding orders scheduled for shipment mostly during the third quarter of 2003.

*Gross Loss.* We had a gross loss of \$2.6 million for the quarter ended June 30, 2003, compared with \$4.2 million for the same period last year. The change in gross loss was largely attributable to a \$1.8 million charge for excess inventories recorded in the second quarter of 2002, \$0.4 million lower production overhead in the current period, a net charge of \$0.4 million for sales returns and allowances in the current quarter and higher warranty charges offset by lower charge for inventory scrap.

Our cost of goods sold has exceeded revenues each period. We expect this trend to continue until such time that we can sell a sufficient number of units to achieve a break-even margin.

*Research and Development ("R&D") Expenses.* R&D expenses were \$2.4 million for the quarter ended June 30, 2003, compared to \$1.6 million for the same period last year. R&D expenses are reported net of benefits from cost sharing programs. These benefits were \$0.1 million for the quarter ended June 30, 2003, compared with \$1.3 million for the same period last year. The benefits from cost sharing programs vary from period-to-period due to timing of allocation of funds from the government. Our gross R&D spending for the second quarter of this year was \$0.4 million lower than our gross R&D spending for the same period a year ago.

*Selling, General, and Administrative ("SG&A") Expenses and Impairment Loss.* SG&A expenses for the quarter ended June 30, 2003 decreased \$5.0 million to \$4.7 million, compared with \$9.7 million for the same period last year. Overall spending was lower in 2003 as a result of our actions to reduce our cost structure. Also, there was no amortization expense from marketing rights in the quarter ended June 30, 2003, compared with \$1.3 million for the same period last year. The marketing rights were fully impaired at the

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end of the second quarter of 2002. An impairment loss of \$16.0 million, representing the remaining carrying value of the marketing rights, was recorded in the second quarter of 2002.

*Interest Income.* Interest income decreased \$0.4 million to \$0.4 million for the quarter ended June 30, 2003, compared with \$0.8 million for the same period last year. The decrease was primarily attributable to lower cash balances and lower interest rates. We expect decreasing cash balances from our use of funds will continue to diminish our interest income.

### **Six Months Ended June 30, 2003 and 2002**

*Revenues.* Revenues for the six months ended June 30, 2003 decreased \$5.1 million to \$6.9 million from \$12.0 million for the same period last year. Revenues from product shipments for the six months ended June 30, 2003 decreased \$4.5 million to \$4.9 million from \$9.4 million last year. Shipments during the first six months of 2003 consisted of 92 units of C30 products and 54 units of C60 products, compared with 264 units of C30 products and 69 units of C60 products for the same period last year. Revenues from accessories, parts and service for the six months ended June 30, 2003 increased \$0.2 million to \$2.8 million from \$2.6 million for the same period last year. Revenues are reported net of sales returns and allowances. Sales to four customers, which individually accounted for 10% or more of revenues, accounted for approximately 55% of revenues in each of the six-month periods.

*Gross Loss.* We had a gross loss of \$4.8 million for the six months ended June 30, 2003, compared with \$7.2 million for the same period last year. The change in gross loss was largely attributable to a \$1.8 million charge for excess inventories last year and \$0.9 million lower charge for inventory scrap in the first six months of 2003.

*R&D Expenses.* R&D expenses were \$3.5 million for the six months ended June 30, 2003, compared to \$3.1 million for the same period last year. R&D expenses are reported net of benefits from cost sharing programs. These benefits were \$1.8 million for the six months ended June 30, 2003, compared with \$2.6 million for the same period last year. The benefits from cost sharing programs vary from period-to-period due to timing of allocation of funds from the government. Our gross R&D spending for the first six months of this year was \$0.4 million lower than last year.

*SG&A Expenses and Impairment Loss.* SG&A expenses for the six months ended June 30, 2003 decreased \$8.5 million to \$9.5 million, compared with \$18.0 million for the same period last year. Overall spending was lower in 2003 as a result of our actions to reduce our cost structure. Other factors include:

- There was no amortization expense from marketing rights in the first six months of 2003, compared with \$2.6 million for the same period last year. An impairment loss of \$16.0 million, representing the remaining carrying value of the marketing rights, was recorded in the second quarter of 2002.
- As a result of a settlement agreement with a professional services firm, liabilities for \$1.1 million of administrative expenses recorded in prior years were reversed in the first quarter of 2003.

*Interest Income.* Interest income decreased \$0.8 million to \$0.8 million for the six months ended June 30, 2003, compared with \$1.6 million for the same period last year. The decrease was primarily attributable to the lower cash balances and lower interest rates.

### **Liquidity and Capital Resources**

Our cash requirements depend on many factors, including our product development activities and our commercialization efforts. While we are working to reduce our cash usage, we expect to continue to devote substantial capital resources to running our business, including continuing the development of our sales and marketing programs and continuing our R&D activities. We have invested our cash in an institutional fund that invests in high quality short-term money market instruments to provide liquidity for operations and for capital preservation.

We used cash of \$13.9 million during six months ended June 30, 2003, compared with \$15.7 million for the same period last year.

Our net cash used in operating activities was \$12.5 million for the first six months of 2003, compared with \$14.0 million for the same period last year. This decrease of \$1.5 million was from a \$3.3 million lower net loss, adjusted on a cash basis, offset by a \$1.8 million higher use for working capital.



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Accounts receivable decreased \$1.9 million to \$3.0 million as of June 30, 2003 from \$4.9 million as of December 31, 2002, as a result of improved collections. Total inventory decreased \$1.5 million to \$14.4 million as of June 30, 2003 from \$15.9 million as of December 31, 2002. At June 30, 2003, non-current inventory of \$1.1 million represents that portion of the inventory in excess of amounts expected to be sold or used in the next twelve months. As of June 30, 2003, the Company had firm commitments to purchase inventories of approximately \$4.8 million.

Net cash used in investing activities for acquisition of fixed assets was \$0.6 million for the six months ended June 30, 2003, compared to \$1.3 million for the same period last year.

Our net cash used in financing activities of \$0.9 million for the six months ended June 30, 2003, compared to \$0.4 million for the same period last year primarily due to purchases of treasury stock of \$0.3 million this year. In October 2002, the Company's Board of Directors approved a stock repurchase program under which the Company may purchase up to \$10 million of the Company's common stock. The Company may purchase shares from time to time through open market and privately negotiated transactions at prices deemed appropriate by management. The program has no termination date. Since the inception of the program, we have repurchased 551,208 shares for an aggregate price of \$0.5 million.

There have been no material changes in the Company's remaining commitments under non-cancelable operating leases and capital leases as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

### **Impact of Recently Issued Accounting Standards**

In May 2003, SFAS No. 150, "Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity" was issued. The standard establishes how an issuer classifies and measures certain freestanding financial instruments with characteristics of liabilities and equity and requires that such instruments be classified as liabilities. The standard is effective for financial instruments entered into or modified after May 31, 2003 and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of the standard is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In April 2003, Statement of Financial Accounting Standards ("SFAS") No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" was issued. The standard amends and clarifies financial reporting for derivative instruments and for hedging activities accounted for under SFAS No. 133 and is effective for contracts entered into or modified, and for hedges designated, after June 30, 2003. Adoption of the standard is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

No material changes have occurred in the quantitative and qualitative market risk disclosure of the Company as presented in its Annual Report on Form 10-K for the year ended December 31, 2002.

### **Item 4. *Controls and Procedures***

#### *Evaluation of Disclosure Controls and Procedures*

An evaluation was performed under the supervision and with the participation of our management team, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures were effective as of June 30, 2003 to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

#### *Changes in Internal Controls*

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2003, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II — OTHER INFORMATION****Item 1. Legal Proceedings**

In December 2001, a purported shareholder class action lawsuit was filed against the Company, two of its officers, and the underwriters of our initial public offering. The suit purports to be a class action filed on behalf of purchasers of our common stock during the period from June 28, 2000 to December 6, 2000. An amended complaint was filed on April 19, 2002. No date has been set for the Company to respond to the complaint. Plaintiffs allege that the underwriter defendants agreed to allocate stock in the Company's June 28, 2000 initial public offering and November 16, 2000 secondary offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectuses for these two public offerings were false and misleading in violation of the securities laws because they did not disclose these arrangements. A committee of the Company's Board of Directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of the Company and of the individual defendants for the conduct alleged in the action to be wrongful in the Amended Complaint. The Company would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or release certain potential claims the Company may have against its underwriters. Any direct financial impact of the proposed settlement is expected to be borne by the Company's insurers. The committee agreed to approve the settlement subject to a number of conditions, including the participation of a substantial number of other Issuer Defendants in the proposed settlement, the consent of the Company's insurers to the settlement, and the completion of acceptable final settlement documentation. Furthermore, the settlement is subject to a hearing on fairness and approval by the Court.

The Company is a defendant in a breach of contract lawsuit, brought by a party that conducts business with the Company, claiming damages in excess of \$10 million. The Company intends to vigorously defend against this lawsuit. As with any litigation, the ultimate outcome of this lawsuit is uncertain.

**Item 4. Submission of Matters to a Vote of Security Holders**

- (a) The annual meeting of stockholders of the Company was held on May 30, 2003.
- (b) All director nominees were elected.
- (c) Certain matters voted upon at the meeting and the votes cast with respect to such matters are as follows:

	Votes Cast			Broker Non-votes
	For	Against	Abstain	
Management Proposals:				
Proposal to approve an amendment to the Company's Certificate of Incorporation to authorize a reverse stock split within the range from one-for-five to one-for-twenty	58,492,777	2,523,916	113,761	-0-

## Election of Directors

Director	For	Withheld
Eliot Protsch	53,552,677	7,577,777
Richard Donnelly	58,974,480	2,155,974
John Jagers	59,075,931	2,054,523
Jean-Rene Marcoux	59,220,756	1,909,698
John G. McDonald	59,725,352	1,405,102
Eric Young	58,848,352	2,282,102

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### **Item 5. Other Information-Business Risks**

This document contains certain forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) pertaining to, among other things, Capstone's future results of operations, R&D activities, sales expectations, our ability to develop markets for our products, sources for parts, federal, state and local regulations, and general business, industry and economic conditions applicable to Capstone. These statements are based largely on Capstone's current expectations, estimates and forecasts and are subject to a number of risks and uncertainties. Actual results could differ materially from these forward-looking statements. Factors that can cause actual results to differ materially include, but are not limited to, those discussed below. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The following factors should be considered in addition to the other information contained herein in evaluating Capstone and its business. We undertake no obligation to revise or update publicly any of the forward-looking statements after the filing of this Form 10-Q to conform such statements to actual results or to changes in our expectations except as required by law.

Investors should carefully consider the risks described below before making an investment decision. In addition, these risks are not the only ones facing our Company. Additional risks we are not presently aware of or that we currently believe are immaterial may also impair our business operations. Our business could be harmed by any of these risks. The trading price of our common stock has and could continue to decline due to any of these risks, and investors may lose all or part of their investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Quarterly Report on Form 10-Q, or in our Annual Report on Form 10-K for the year ended December 31, 2002 and other documents filed by us from time to time.

#### **We have a limited operating history characterized by net losses, we anticipate continued losses and we may never become profitable.**

We have generated cumulative operating losses since inception. We expect this trend to continue through at least 2004. Our business is such that we have relatively few customers and limited repeat business. While the Company commenced a program to decrease expenses, there can be no assurance that expenses have been, or will be, decreased sufficiently for the Company to reach profitability, that the Company will not increase expenses in the future or that the Company will maintain or increase revenues. Even if we do achieve profitability, we may be unable to increase our sales and sustain or increase our profitability in the future.

#### **Our success depends in significant part upon the service of management and key employees.**

Our success depends in significant part upon the service of our executive officers, senior management, and sales and technical personnel. We have undergone numerous personnel changes in all levels of the organization. If our personnel do not execute our strategy, or we are unable to retain appropriate management and personnel, the Company could experience a material adverse effect on its business. If we are unable to develop and implement our strategy in a timely manner, our market penetration may be negatively impacted, which could have a material adverse effect on our business and results of operations. Our success will be dependent on our continued ability to attract, retain and motivate highly skilled employees. There can be no assurance that we can do so.

Our internal control systems are highly dependent on detective controls performed by specific individuals in key positions at the Company. Detective controls are those designed to detect mistakes that have occurred and correct them. Loss of these key people or our inability to replace them with similarly skilled individuals or new processes in a timely manner could adversely impact our internal control mechanisms.

We have reduced our personnel in order to reduce our operating costs. If we have terminated individuals whose skills we subsequently need or if demand for our product significantly exceeds our expectations, our ability to generate revenues and maintain customer relationships could be adversely affected.

#### **The economic downturn has made potential customers hesitant to make capital expenditures.**

The global economic climate has made potential customers hesitant to make capital expenditures. As a result, we have seen reluctance on the part of customers to buy our products. As a result of the economic uncertainty and the desire by companies to tighten capital expenditures, along with fluctuations in energy prices, political disruptions or the risk of higher interest rates, we may not be able to sustain or expand our customer base and sales, which would negatively impact our financial position and results of

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operations. The impact of continued lower capital spending may result in increased risk of excess and obsolete inventories, excess facilities and manufacturing capacity and higher overhead costs as a percentage of revenues.

### **If we do not effectively implement our sales and marketing plans, our sales will not grow and our profitability will suffer.**

Our sales and marketing efforts may not succeed and therefore may not generate the revenues anticipated. We have decided to focus our resources on select vertical markets we believe have near term potential. We may change our focus to other markets or applications in the future. There can be no assurance that our plans will be successful. If we are not able to successfully address markets for our products, we may not be able to grow our business, compete effectively or achieve profitability.

### **A sustainable market for microturbines may never develop or may take longer to develop than we anticipate, which would adversely impact our revenues and profitability.**

Our products represent an emerging market, and we do not know whether our targeted customers will accept our technology or will purchase our products in sufficient quantities to grow our business. If a sustainable market fails to develop or develops more slowly than we anticipate, we may be unable to recover the losses we have incurred to develop our products, we may have further impairment of assets, we may be unable to meet our operational expenses and we may be unable to achieve profitability. The development of a sustainable market for our systems may be impacted by many factors including some that are out of our control. Examples include:

- the cost competitiveness of our microturbines;
- costs associated with the installation and commissioning of our microturbines by third parties;
- maintenance costs associated with our microturbines;
- the future costs and availability of fuels used by our microturbines;
- consumer reluctance to try a new product;
- consumer perceptions of our microturbines' safety and quality;
- regulatory requirements;
- economic downturns and reduction in capital spending; and
- the emergence of newer, more competitive technologies and products.

### **We have limited experience in international sales and may not succeed in growing our international sales.**

We have limited experience in international sales and will depend on our international marketing partners for these sales. If a dispute arises between us and any of our partners, we may not achieve our desired sales results and we may be delayed or completely fail to penetrate some international markets, and our revenue and operations could be materially adversely affected. Any inability to obtain foreign regulatory approvals or quality standard certifications on a timely basis could negatively impact our business and results of operations. Also, as we seek to expand into the international markets, customers may have difficulty or be unable to integrate our products into their existing systems or may have difficulty meeting local standards. As a result, our products may require redesign. Any redesign of the product may delay sales or cause quality issues. In addition, we may be subject to a variety of other risks associated with international business, including:

- delays in establishing international distribution channels;
- difficulties in collecting international accounts receivables;
- difficulties in complying with foreign regulatory and commercial requirements;
- difficulties in recruiting and retaining individuals skilled in international business operations;

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- increased costs associated with maintaining international marketing efforts;
- compliance with U.S. Department of Commerce export controls;
- increases in duty rates;
- the introduction of non-tariff trade barriers;
- fluctuations in currency exchange rates;
- global political and economic instability; and
- difficulties in enforcement of intellectual property rights.

### **Product quality expectations may not be met causing slower market acceptance.**

Despite our continuous quality improvement initiatives, if we do not meet customer expectations, we may experience slower market acceptance of our products. Any significant quality issues with our products could have a material adverse effect on our results of operations and financial position. Moreover, as we develop new configurations for our microturbines or as our customers place existing configurations in commercial use, we may experience product malfunctions that cause our products to perform below expectations. Any significant malfunctions could adversely affect our operating results and financial position and affect the marketability of our products.

### **We depend upon the development of new products and enhancements of existing products.**

Our operating results may depend on our ability to develop and introduce new products, such as the C200 Microturbine, for existing and emerging markets and to reduce the costs to produce existing products. The success of new products is dependent on several factors, including proper new product definition, product cost, timely completion and introduction of new products, differentiation of new products from those of our competitors, meeting changing customer requirements, emerging industry standards and market acceptance of these products. The development of new, technologically advanced products is a complex and uncertain process requiring high levels of innovation, as well as the accurate anticipation of technological and market trends. There can be no assurance that we will successfully identify new product opportunities, develop and bring new products to market in a timely manner, and achieve market acceptance of our products, or that products and technologies developed by others will not render our products or technologies obsolete or noncompetitive.

A key element of the Company's strategy is the development of its C200 Microturbine planned for release in 2004. However, the Company has on occasion experienced delays in the introduction of new products and product enhancements. Such delays may have, and any future delays could have, a material adverse effect on the Company's business, operating results and financial condition. Furthermore, from time to time, the Company may announce new products or product enhancements, capabilities or technologies that have the potential to replace the Company's existing product offerings and that may cause customers to defer purchasing existing Company products. Any failure to introduce new products or product enhancements on a timely basis, customer delays in purchasing products in anticipation of new product introductions or any inability of the Company to respond effectively to product announcements by competitors, technological changes or emerging industry standards could have a material adverse effect on the Company's business, operating results and financial condition.

### **We operate in a highly competitive market and may not be able to compete effectively due to factors affecting the market for our products.**

The market for our products is highly competitive and is changing rapidly. We believe that the primary competitive factors affecting the market for our products include:

- operating efficiency;
- reliability;
- product quality and performance;

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- life cycle costs;
- development of new products and features;
- quality and experience of sales, marketing and service organizations;
- availability and price of fuel;
- product price;
- emissions levels;
- name recognition; and
- quality of distribution channels.

Several of these factors are outside our control. We cannot assure you that we will be able to compete successfully in the future with respect to these or any other competitive factors.

In addition, competing technologies may get certain benefits, like governmental subsidies or promotion, that we do not enjoy or do not benefit from to the same extent. This could enhance their abilities to fund research or penetrate our markets.

**Our competitors, some of which have significantly greater resources than we have, may be able to adapt more quickly to new or emerging technologies or to devote greater resources to the promotion and sale of their products, and we may be unable to compete effectively.**

Our competitors include several well-established companies that have substantially greater resources than we have and worldwide presence. Ingersoll-Rand Company and Elliott Power Systems are competitors of Capstone that benefit from larger corporate resources, including technical and engineering resources, and which have microturbines in various stages of development and commercialization. Ingersoll-Rand Company has commercialized its microturbine units, including a 250-kilowatt product which will directly compete with our C200 product targeted for release in 2004. Many of these companies sell directly to end-users, which we believe may provide some competitive advantages over our sales strategy. Furthermore, many of these companies offer a more comprehensive solution to their customers.

In addition to these competitors, Turbec, a joint venture in Europe of AB Volvo and ABB Ltd., develops, produces and sells microturbines. Turbec's first product, a combined heat and power microturbine, is currently available. A number of other major automotive and industrial companies have in-house microturbine development efforts, including Ishikawajima-Harima Heavy Industries, Turbo Genset Inc., Toyota Motor Corporation and Kawasaki Heavy Industries. Furthermore, we believe that all of these companies will eventually have products that will compete with our microturbines. Some of our competitors are currently developing and testing larger microturbines than Capstone's current MicroTurbine products, ranging up to 280 kilowatts.

Capstone MicroTurbines also compete with other existing technologies, including the electric utility grid, reciprocating engines, fuel cells and photovoltaic systems. Many of the competitors producing these technologies also have greater resources than we have. For instance, reciprocating engine generator sets are produced and sold by, among others, Caterpillar Inc., Interstate Companies, Cummins Inc., Yanmar, Hess and MAN. We cannot assure you that the market for distributed power generation products will not ultimately be dominated by technologies other than ours. Furthermore, electric utility companies may impose fees or other barriers that make microturbines less competitive.

Because of greater resources, some of our competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements, to devote greater resources to the promotion and sale of their products than we can or introduce governmental regulations and policies to create competitive advantage vis-à-vis our products. We believe that developing and maintaining a competitive advantage will require continued investment by us in product development and quality, as well as attention to product performance, our product prices, our conformance to industry standards, manufacturing capability and sales and marketing. In addition, current and potential competitors have established or may in the future establish collaborative relationships among

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themselves or with third parties, including third parties with whom we have business relationships. Accordingly, new competitors or alliances may emerge and rapidly acquire significant market share.

There is no assurance that we will be able to successfully compete against either current or potential competitors or that competition will not have a material adverse effect on our business, operating results and financial condition.

### **Changes in government regulations and the electric utility industry restructuring may affect demand for our microturbines.**

The market for electricity and generation products is heavily influenced by federal and state government regulations and policies. The deregulation and restructuring of the electric industry in the United States and elsewhere may aid the desirability of alternative power sources. However, problems associated with such deregulation and restructuring may cause rule changes that may reduce or eliminate advantages of such deregulation and restructuring. We cannot predict how the deregulation and the restructuring of the electric utility industry will ultimately affect the market for our microturbines. Additional competition from utilities and other power sources that may take advantage of these regulations could diminish the demand for our products. While we have seen some increase in government support for distributed power, we cannot assure that this support will continue or that it will be maintained in its current form or that it will have any near-term impact on our operating results. For example, the California Self Generation Program is due to expire in December 2004 and could be terminated earlier by the California legislature. Changes in regulatory standards or policies could reduce the level of investment in the research and development of alternative power sources, including microturbines or funds from such sources may go solely to technologies other than microturbines. Any reduction or termination of such programs can increase the cost to our potential customers, making our systems less desirable and thereby harm our revenue and potential profitability.

### **We operate in a highly regulated business environment and changes in regulation could impose costs on us or make our products less economical.**

Our products are subject to federal, state, local and foreign laws and regulations, governing, among other things, emissions to air as well as laws relating to occupational health and safety. Regulatory agencies may impose special requirements for implementation and operation of our products (e.g., connection with the electric grid) or may significantly impact or even eliminate some of our target markets. We may incur material costs or liabilities in complying with government regulations. In addition, potentially significant expenditures could be required in order to comply with evolving environmental and health and safety laws, regulations and requirements that may be adopted or imposed in the future. For example, our current products do not comply with the 2007 proposed emission standards of the California Air Resources Board. The deregulation of the utility industry may also create challenges for our marketing efforts. For example, as part of electric utility deregulation, federal, state and local governmental authorities may impose transitional charges or exit fees, which would make it less economical for some potential customers to switch to our products. Further, our ability to penetrate the Japanese market will depend on our receipt of approvals and changes to regulatory requirements surrounding power generation by Japanese regulators. We can provide no assurances that we will be able to obtain these approvals and changes in a timely manner, or at all.

### **Utility companies could place barriers to our entry into the marketplace and we may not be able to effectively sell our product.**

Utility companies may charge additional fees to commercial and industrial customers who reduce the electricity they take from the utility by installing on-site generation and who subsequently use the utility grid for back-up or standby purposes. For example, the New York Public Service Commission is currently in the process of adopting new standby charges and the California Public Utilities Commission is determining new rates for Southern California Edison that could increase standby rates and other utility customer charges while reducing the price of utility supplied power. These charges could reduce the competitiveness of our products, thereby harming our revenue and profitability potential

### **We may not be able to retain or develop additional strategic partners and distributors in our targeted markets, in which case our sales would not increase as expected.**

In order to expand our customer base, we believe that we must enter into strategic sales and marketing alliances or similar collaborative relationships, in which we ally ourselves with companies that have particular expertise in or more extensive access to desirable markets. We believe that developing strategic partners in our targeted markets can improve the rate of adoption as well as reduce the direct financial burden of introducing a new technology and creating a new market. We may provide volume price discounts or otherwise incur significant costs that may reduce the potential profitability of these relationships. We may not be able to retain or develop appropriate distributors or strategic partners on a timely basis, and we cannot assure you that the partners with which

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we form alliances will focus adequate resources on selling our products or will be successful in selling them. In addition, some of the relationships may require that we grant exclusive distribution rights in defined territories. These exclusive distribution arrangements could result in us being unable to enter into other arrangements at a time when the distributor or partner with whom we form a relationship is not successful in selling our products or has reduced its commitment to market our products. We cannot assure you that we will be able to negotiate collaborative relationships on favorable terms or at all. The inability of the Company to develop strategic partners or a lack of success of our strategic partners in marketing our products may adversely affect our financial condition and results of operations.

### **We are subject to risks associated with our strategic alliance with United Technologies Corporation (“UTC”).**

In October 2002, we entered into a strategic alliance with UTC through its UTC Power Division. The strategic alliance between UTC and Capstone is a ten-year agreement that involves the integration, marketing, sales and service of CHP solutions targeted for commercial buildings. The UTC Agreement provides for the combination of our microturbine products with their absorption chillers. We cannot assure that we can complete this integration in a cost effective manner or consistent with UTC’s or our timing expectations. UTC will be the exclusive distributor for the combined Capstone MicroTurbines with UTC absorption chillers, but they will also be a non-exclusive distributor generally for Capstone MicroTurbines. The UTC Agreement is limited to North America and most of Europe. However, this alliance may not be successful and may create channel conflict with our other distributors. If this relationship fails to materialize as expected then this may impede our future growth and a sustainable market may fail to develop. Furthermore, although both parties have certain competitive restrictions, UTC may offer alternative solutions, designed by themselves or third parties. There can be no assurance that UTC will give a high priority to the marketing of the Company’s products as compared to its other products or alternative solutions. Both UTC and Capstone have options to terminate the relationship if the other company fails to meet its development, product purchase or other goals in the UTC Agreement. There can be no assurance that the Company will retain its relationship with UTC. We do not expect short-term operating benefits from the UTC relationship but we have incurred and will incur short-term costs to create this alliance and fulfill our obligations under the UTC Agreement.

As part of the UTC Agreement, UTC purchased 3,994,817 shares of Capstone’s common stock (the “UTC Shares”) in October 2002 for an aggregate price of approximately \$4.0 million. The UTC shares are subject to a lock-up period of nine months subject to certain exceptions provided for in the UTC Agreement. Any sale by UTC of the UTC Shares may be viewed by the investing public as a drawback to the relationship that could have a material adverse effect on the Company’s stock price and financial condition.

### **Our ability to identify and develop Authorized Service Providers (“ASPs”) can significantly impact our success.**

Our ability to identify and develop business relationships with ASPs who can provide quality, cost effective installations and service can significantly impact our success. We need to reduce the total installed cost of our microturbines to enhance market opportunities. Our inability to improve our ASPs’ quality of installation and commissioning standards while reducing associated costs could affect the marketability of our products.

### **Our suppliers and manufacturers may not supply us with a sufficient amount of components or components of adequate quality, and we may not be able to produce our product.**

Although we generally attempt to use standard parts and components for our products, some of our components are currently available only from a single source or limited sources. We may experience delays in production if we fail to identify alternative vendors, or any parts supply is interrupted, each of which could materially adversely affect our business and operations. In order to reduce manufacturing lead times and ensure adequate component supply, we enter into agreements with certain contract manufacturers and supply partners that allow them to procure inventory based upon criteria defined by us. If we fail to anticipate customer demand properly, an oversupply of parts could result in excess or obsolete inventories, which could adversely affect our business. A reduction or interruption in supply, a significant increase in price of one or more components or a decrease in demand of products could materially adversely affect our business and operations and could materially damage our customer relationships. Also, we cannot guarantee that any of the parts or components that we are obligated to purchase will be of adequate quality or that the prices we pay for the parts or components will not increase. Our inability to meet volume commitments with suppliers could affect the availability or pricing of our parts and components. Financial problems of contract manufacturers on whom we rely could limit our supply or increase our costs.



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### **We may not achieve production cost reductions necessary to competitively price our product, which would impair our sales.**

We believe that we will need to reduce the unit production cost of our products over time to maintain our ability to offer competitively priced products. Our ability to achieve cost reductions will depend on our ability to develop low cost design enhancements, to obtain necessary tooling and favorable vendor contracts, as well as to increase sales volumes so we can achieve economies of scale. We cannot assure you that we will be able to achieve any production cost reductions. Our failure to achieve such cost reductions could have a material adverse effect on our business and results of operations.

### **Our products involve a lengthy sales cycle and we may not anticipate sales levels appropriately, which could impair our profitability.**

The sale of our products typically involves a significant commitment of capital by customers, with the attendant delays frequently associated with large capital expenditures. For these and other reasons, the sales cycle associated with our products is typically lengthy and subject to a number of significant risks over which we have little or no control. We expect to plan our production and inventory levels based on internal forecasts of customer demand, which is highly unpredictable and can fluctuate substantially. If sales in any period fall significantly below anticipated levels, our financial condition and results of operations could suffer. If demand in any period increases well above anticipated levels, we may have difficulties in responding, incur greater costs to respond, or be unable to fulfill the demand in sufficient time to retain the order. In addition, our operating expenses are based on anticipated sales levels, and a high percentage of our expenses are generally fixed in the short term. As a result of these factors, a small fluctuation in timing of sales can cause operating results to vary from period to period.

### **We may not effectively expand our production capabilities, which would negatively impact our sales.**

We may experience unanticipated growth in our business operations, which may require expansion of our internal and external production capabilities. We may experience delays or problems in expanding production that could significantly impact our business. Several factors could delay or prevent production expansion, including our:

- inability to purchase parts or components in adequate quantities or sufficient quality;
- failure to increase our assembly and test operations;
- failure to hire and train additional personnel;
- failure to develop and implement manufacturing processes and equipment;
- inability to find and train proper partner companies with whom we can build product distribution, marketing, or development relationships; and
- inability to manufacture recuperator cores or air bearings on schedule, in quantities or with the quality that we require.

### **If we are unable to manufacture recuperator cores internally, our assembly and production of microturbines may suffer delays and interruptions.**

Solar Turbines Incorporated ("Solar") was our sole supplier of recuperator cores, which are heat exchangers that preheat incoming air before it enters the combustion chamber and are an essential component of our microturbines. In 2001, we started to manufacture recuperator cores under contractual rights to use Solar's intellectual property. We cannot assure you that we will be able to successfully implement this technology in developing a sustainable manufacturing process at higher volumes. Inherent in the manufacturing process are a number of risks. Manufacturing of the recuperator cores is a complex process requiring high levels of innovation and skill. At present, we are not aware of any other supplier that could produce these cores to our specifications within our time requirements. Our inability to manufacture recuperator cores could have a material adverse effect on the Company's operating results.

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### **Our business is subject to the risk of earthquake.**

Our Company headquarters and our manufacturing facilities are located in Southern California, a region known for seismic activity. A significant natural disaster, such as an earthquake, could have a material adverse impact on our business, operating results and financial condition.

### **We may not be able to effectively manage our growth or improve our operational, financial and management information systems, which would impair our profitability.**

If we are successful in executing our business plan, we will experience growth in our business that could place a significant strain on our management and other resources. Our ability to manage our growth will require us to continue to improve our operational, financial and management information systems, to implement new systems and to motivate and effectively manage our employees. We cannot assure you that our management will be able to effectively manage this growth.

### **We depend on our intellectual property to make our products competitive and if we are unable to protect our intellectual property, our business will suffer.**

We rely on a combination of patent, trade secret, copyright and trademark law, and nondisclosure agreements to establish and protect our intellectual property rights in our products. In particular, we believe that our patents and patents pending for our air-bearing systems, power electronics and controls and our combustion systems are key to our business. We believe that, due to the rapid pace of technological innovation in turbine products, our ability to establish and maintain a position among the technology leaders in the industry depends on both our patents and other intellectual property and the skills of our development personnel. We cannot assure you that any patent, trademark, copyright or license owned or held by us will not be invalidated, circumvented or challenged, that the rights granted thereunder will provide competitive advantages to us or that any of our future patent applications will be issued with the scope of the claims asserted by us, if at all. Further, we cannot assure you that third parties or competitors will not develop technologies that are similar or superior to our technology, including our air bearing technology, duplicate our technology or design around our patents. Also, another party may be able to reverse engineer our technology and discover our intellectual property and trade secrets. We may be subject to or may initiate proceedings in the U.S. Patent and Trademark Office, which can require significant financial and management resources or require us to develop a non-infringing technology or enter into royalty or license agreements. If we are found to infringe upon the intellectual property rights of others, we may not be able to produce our products or may have to enter into costly license agreements. In addition, the laws of foreign countries in which our products are or may be developed, manufactured or sold may not protect our products and intellectual property rights to the same extent as the laws of the United States. Our inability to protect our intellectual property adequately could have a material adverse effect on our financial condition or results of operations.

### **Potential intellectual property, shareholder or other litigation may adversely impact our business.**

Because of the nature of our business, we may face litigation relating to intellectual property matters, labor matters, product liability and shareholder disputes. Any unfavorable outcome of litigation could have a material adverse effect on the Company's financial position and results of operations.

Our intellectual property is one of our principal assets. A negative outcome in litigation relating to our intellectual property could have a material adverse effect on our business and operating results. An adverse judgment could negatively impact the price of our common stock and our ability to obtain future financing on favorable terms or at all. Any litigation could be costly, divert management attention or result in increased costs of doing business.

### **We may be unable to fund our future operating requirements, which could force us to curtail our operations.**

We are a capital-intensive company and may need additional financing to fund our operations. Our future capital requirements will depend on many factors, including our ability to successfully market and sell our products. To the extent that the funds we now have on hand are insufficient to fund our future operating requirements, we will need to raise additional funds, through further public or private equity or debt financings. These financings may not be available or, if available, may be on terms that are not favorable to us and could result in further dilution to our stockholders. Downturns in worldwide capital markets may also impede our ability to raise additional capital on favorable terms or at all. If adequate capital were not available to us, we would likely be required to significantly curtail or possibly even cease our operations.

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We may encounter greater business risks in the future as we manage cash resources differently. In 2002, we initiated efforts to lower our cash burn rate. As a result of those and ongoing efforts, we may not spend money in areas that ultimately prove important to the business. We may incur greater risks through lower spending rates for insurance, intellectual property protection, total employee compensation and other areas.

### **We face potentially significant fluctuations in operating results, which could impact our stock price.**

As a result of variety of factors discussed herein, operating results for a particular quarter are difficult to predict. Given the continued uncertainty surrounding many variables that may impact the industry in which we operate, our visibility into future periods is limited. Our operating results have been in the past, will continue to be, subject to quarterly and annual fluctuations as a result of a number of factors, including:

- Fluctuations in demand for our products and services;
- The timing of the introduction or enhancement of products by us or our competitors;
- Quality of installation and commissioning of our products by our ASPs and customers;
- Our reliance on a small number of customers;
- The size, timing, shipment and pricing of individual orders;
- Market acceptance of new products;
- Changes in sales channels, the mix of products sold, or product pricing;
- The ability of our suppliers to deliver quality parts when we need them;
- Manufacturing leadtimes;
- Change in management and loss of key personnel;
- Political unrest or changes in the trade policies, tariffs or other regulations in the US and other countries in which we do business that could lower demand for our products;
- Changes in environmental regulations;
- Changes in market prices for natural resources that could lower the desirability of our products; and
- How well we execute our strategy and operating plans.

We expect our order flow to continue to be uneven from period to period. In addition, we have few customers that we can rely on for repeat sales. Because a significant portion of our expenses is fixed, a small variation in the timing of recognition of revenue can cause significant variations in operating results from quarter to quarter. Any of the above factors could have a material adverse effect on our results of operations and financial results.

### **Our announced stock repurchase program may not produce benefits for stockholders.**

Capstone may not purchase the approved maximum \$10 million under the repurchase program announced in October 2002 or may not acquire shares at prices that later appear advantageous. We cannot assure stockholders that using cash for this purpose will result in short-term or long-term benefits for our stockholders.

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### **Item 6. Exhibits and Reports on Form 8-K:**

(a) *Index to Exhibits.*

The following exhibits are filed with, or incorporated by reference into, this Quarterly Report on Form 10-Q:

<b>Exhibit Number</b>	<b>Description</b>
3.1(2)	Second Amended and Restated Certificate of Incorporation of Capstone Turbine.
3.2(1)	Third Amended and Restated Bylaws of Capstone Turbine.
4.1(2)	Specimen stock certificate.
9.1(2)	Investors Rights Agreement.
9.2(2)	Amendment No. 1 to Investors Rights Agreement.
9.3(3)	Amendment No. 2 to Investors Rights Agreement.
9.4(3)	Amendment No. 3 to Investors Rights Agreement.
10.1(2)	Lease between Capstone Turbine and Northpark Industrial — Leahy Division LLC, dated December 1, 1999, for leased premises at 21211 Nordhoff Street, Chatsworth, California.
10.2(2)	1993 Incentive Stock Option Plan.
10.3(2)	Employee Stock Purchase Plan.
10.4(9)	Amended and Restated 2000 Equity Incentive Plan
10.5(4)	Transition Agreement, dated August 2, 2000, by and between Capstone Turbine and Solar Turbines Incorporated.
10.6(4)	Amended and Restated License Agreement, dated August 2, 2000, by and between Solar Turbines Incorporated and Capstone Turbine.
10.7(6)	Lease between Capstone Turbine and AMB Property, L.P., dated September 25, 2000, for leased premises at 16640 Stagg Street, Van Nuys, California.
10.8(6)	Lease between Capstone Turbine and AH Warner Center Properties, Limited Liability Company, dated February 16, 2001, for leased premises at 21700 Oxnard Street, Woodland Hills, California.
10.9(5)	Deferred Compensation Plan of Capstone Turbine
10.10(7)	Executive Incentive Compensation Plan
10.11(7)	Change of Control Severance Plan
10.12(8)	Transition Agreement and Mutual Release between Dr. Ake Almgren and Capstone Turbine Corporation dated October 31, 2002 and February 26, 2003
10.13(8)	The Interim CEO Network Agreement between Emily Liggett and ICN dated November 21, 2002
10.14(9)	Severance Pay Plan and First Amendment to the Severance Pay Plan
31.1(1)	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2(1)	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32(1)	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Filed herewith.

(2) Incorporated by reference to Capstone Turbine's Registration Statement on Form S-1 (File No. 333-33024).

(3) Incorporated by reference to Capstone Turbine's Registration Statement on Form S-1 (File No. 333-48524).

- (4) Incorporated by reference to Capstone Turbine's Current Report on Form 8-K filed on October 16, 2000.
- (5) Incorporated by reference to Capstone Turbine's Registration Statement on Form S-8 (File No. 333-66390).
- (6) Incorporated by reference to Capstone Turbine's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 001-15957).
- (7) Incorporated by reference to Capstone Turbine's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2002 (File No. 001-15957).
- (8) Incorporated by reference to Capstone Turbine's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 001-15957).

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- (9) Incorporated by reference to Capstone Turbine's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2003 (File No. 001-15957).
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(b) *Reports on Form 8-K.*

On April 30, 2003, the Company filed a Report on Form 8-K, furnishing under Item 12 an April 30, 2003 press release announcing its first quarter 2003 financial results. (Such press release is not incorporated by reference herein or deemed "filed" within the meaning of Section 18 of the Securities Act.)

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**SIGNATURES**

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

CAPSTONE TURBINE CORPORATION

Date: August 14, 2003

By: \_\_\_\_\_ /s/ KAREN CLARK

Karen Clark  
*Senior Vice President,*  
*Chief Financial Officer*  
(*Principal Financial and Accounting Officer*)

THIRD AMENDED AND RESTATED BYLAWS

OF

CAPSTONE TURBINE CORPORATION

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AMENDED AND RESTATED BYLAWS

OF

CAPSTONE TURBINE CORPORATION

ARTICLE I

OFFICES

Section 1. *Registered Office.* The registered office of Capstone Turbine Corporation (hereinafter, called the "corporation") shall be in the City of Dover, County of Kent, State of Delaware.

Section 2. *Other Offices.* The corporation may also have offices at such other places both within and without the State of Delaware as the Board of Directors may from time to time determine or the business of the corporation may require.

ARTICLE II

STOCKHOLDERS

Section 1. *Place of Meetings.* Meetings of stockholders shall be held at any place within or outside the State of Delaware designated by the board of directors. In the absence of any such designation, stockholders' meetings shall be held at the principal executive office of the corporation.

Section 2. *Annual Meetings of Stockholders.* The annual meeting of stockholders shall be held each year on a date and time designated by the board of directors. Any previously scheduled annual meeting of the stockholders may be postponed by resolution of the board of directors upon public notice given prior to the date previously scheduled for such annual meeting of the stockholders.

Section 3. *Special Meetings.* A special meeting of the stockholders may be called at any time by the chairman of the board of directors, or by a majority of the directors or by a committee of the board of directors which has been duly designated by the board of directors and whose powers and authority, as provided in a resolution of the board of directors, include the power to call such meetings, but such special meetings may not be called by any other person or persons. Any previously scheduled special meeting of the stockholders may be postponed by resolution of the board of directors upon public notice given prior to the date previously scheduled for such special meeting of the stockholders.

Section 4. *Notice of Stockholders' Meetings.* All notices of meetings of stockholders shall be sent or otherwise given in accordance with Section 5 of this Article II not less than ten (10) nor more than sixty (60) days before the date of the meeting being noticed. The notice shall

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specify the place, date and hour of the meeting and in the case of a special meeting, the general nature of the business to be transacted.

Section 5. *Manner of Giving Notice; Affidavit of Notice.* If mailed, notice shall be deemed to have been given when deposited in the mail, postage prepaid, directed to the stockholder at his address appearing on the books of the corporation or given by the stockholder to the corporation for the purpose of notice. An affidavit of the mailing or other means of giving any notice of any stockholders' meeting shall be executed by the secretary, assistant secretary or any transfer agent of the corporation giving such notice, and shall be filed and maintained in the minute book of the corporation.

Section 6. *Quorum.* The presence in person or by proxy of the holders of a majority of the shares entitled to vote at any meeting of stockholders shall constitute a quorum for the transaction of business. The stockholders present at

a duly called or held meeting at which a quorum is present may continue to do business until adjournment, notwithstanding the withdrawal of enough stockholders to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum.

Section 7. Adjourned Meeting and Notice Thereof. Any stockholders' meeting, annual or special, whether or not a quorum is present, may be adjourned from time to time by the chairman of the meeting, but in the absence of a quorum, no other business may be transacted at such meeting, except as provided in Section 6 of this Article II.

When any meeting of stockholders, either annual or special, is adjourned to another time or place, notice need not be given of the adjourned meeting if the time and place thereof are announced at a meeting at which the adjournment is taken, unless a new record date for the adjourned meeting is fixed, or unless the adjournment is for more than thirty (30) days from the date set for the original meeting. Notice of any such adjourned meeting, if required, shall be given to each stockholder of record entitled to vote at the adjourned meeting in accordance with the provisions of Sections 4 and 5 of this Article II. At any adjourned meeting the corporation may transact any business which might have been transacted at the original meeting.

Section 8. Voting. The stockholders entitled to vote at any meeting of stockholders shall be determined in accordance with the provisions of Section 11 of this Article II. Such vote may be by voice vote or by ballot, at the discretion of the chairman of the meeting. Any stockholder entitled to vote on any matter (other than the election of directors) may vote part of the shares in favor of the proposal and refrain from voting the remaining shares or vote them against the proposal; but, if the stockholder fails to specify the number of shares such stockholder is voting affirmatively, it will be conclusively presumed that the stockholder's approving vote is with respect to all shares such stockholder is entitled to vote. If a quorum is present, the affirmative vote of the majority of the shares represented at the meeting and entitled to vote on any matter shall be the act of the stockholders, unless the vote of a greater number or voting by classes is required by the Delaware General Corporation Law or the certificate of incorporation or the certificate of determination of preferences as to any preferred stock.

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At a stockholders' meeting involving the election of directors, no stockholder shall be entitled to cumulate (i.e., cast for any one or more candidates a number of votes greater than the number of the stockholders shares). The candidates receiving the highest number of votes, up to the number of directors to be elected, shall be elected.

Section 9. Waiver of Notice or Consent by Absent Stockholders. The transactions of any meeting of stockholders, either annual or special, however called and noticed, and wherever held, shall be as valid as though had at a meeting duly held after regular call and notice, if a quorum be present either in person or by proxy, and if, either before or after the meeting, each person entitled to vote, not present in person or by proxy, signs a written waiver of notice or a consent to the holding of the meeting, or an approval of the minutes thereof. The waiver of notice or consent need not specify either the business to be transacted or the purpose of any annual or special meeting of stockholders. All such waivers, consents or approvals shall be filed with the corporate records or made part of the minutes of the meeting.

Attendance of a person at a meeting shall also constitute a waiver of notice of such meeting, except when the person objects, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened, and except that attendance at a meeting is not a waiver of any right to object to the consideration of matters not included in the notice of the meeting if such objection is expressly made at the meeting.

Section 10. No Stockholder Action by Written Consent Without a Meeting. Stockholders may take action only at a regular or special meeting of stockholders.

Section 11. Record Date for Stockholder Notice and Voting. For purposes of determining the holders entitled to notice of any meeting or to vote, the board of directors may fix, in advance, a record date, which shall not be more than sixty (60) days nor less than ten (10) days prior to the date of any such meeting, and in such case only stockholders of record on the date so fixed are entitled to notice and to vote, notwithstanding any transfer of any shares on the books of the corporation after the record date fixed as aforesaid, except as otherwise provided in the Delaware General Corporation Law.

If the board of directors does not so fix a record date, the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the business day next preceding the day on which notice is given or, if notice is waived, at the close of business on the business day next preceding the day on which the meeting is held.

Section 12. Proxies. Every person entitled to vote for directors or on any other matter shall have the right to do so either in person or by one or more

agents authorized by a written proxy signed by the person and filed with the secretary of the corporation. A validly executed proxy which does not state that it is irrevocable shall continue in full force and effect unless (i) revoked by the person executing it, prior to the vote pursuant thereto, by a writing delivered to the corporation stating that the proxy is revoked or by a subsequent proxy executed by, or attendance at the meeting and voting in person by, the person executing the proxy, or (ii) written notice of the death or incapacity of the maker of such proxy is received by the corporation before

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the vote pursuant thereto is counted; provided, however, that no such proxy shall be valid after the expiration of one (1) year from the date of such proxy, unless otherwise provided in the proxy.

Section 13. *Inspectors of Election; Opening and Closing the Polls.* The board of directors by resolution shall appoint one or more inspectors, which inspector or inspectors may include individuals who serve the corporation in other capacities, including, without limitation, as officers, employees, agents or representatives, to act at the meetings of stockholders and make a written report thereof. One or more persons may be designated as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate has been appointed to act or is able to act at a meeting of stockholders, the chairman of the meeting shall appoint one or more inspectors to act at the meeting. Each inspector, before discharging his or her duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of his or her ability. The inspectors shall have the duties prescribed by law.

The chairman of the meeting shall fix and announce at the meeting the date and time of the opening and the closing of the polls for each matter upon which the stockholders will vote at a meeting.

Section 14. *Nomination and Stockholder Business Bylaw.*

(A) *Annual Meetings of Stockholders.*

(1) Nominations of persons for election to the board of directors of the corporation and the proposal of business to be considered by the stockholders may be made at an annual meeting of stockholders (a) pursuant to the corporation's notice of meeting, (b) by or at the direction of the board of directors or (c) by any stockholder of the corporation who was a stockholder of record at the time of giving of notice provided for in this bylaw, who is entitled to vote at the meeting and who complies with the notice procedures set forth in this bylaw.

(2) For nominations or other business to be properly brought before an annual meeting by a stockholder pursuant to clause (c) of paragraph (A) (1) of this bylaw, the stockholder must have given timely notice thereof in writing to the secretary of the corporation and such other business must otherwise be a proper matter for stockholder action. To be timely, a stockholder's notice shall be delivered to the secretary at the principal executive offices of the corporation not less than the close of business on the 120th calendar day in advance of the first anniversary of the date the corporation's proxy statement was released to security holders in connection with the preceding year's annual meeting; provided, however, that if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than thirty (30) calendar days from the date contemplated at the time of the previous year's proxy statement, a proposal shall be received by the corporation no later than the close of business on the tenth day following the day on which notice of the date of the meeting was mailed or public announcement of the date of the meeting was made, whichever comes first. In no event shall the public announcement of an adjournment of an annual meeting commence a new time period for the giving of a stockholder's notice as described above. Such stockholder's notice shall set forth (a) as to each person whom the stockholder proposes to nominate for

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election or reelection as a director all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, in each case pursuant to applicable federal securities laws, including, without limitation, Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 14a-11 thereunder (including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected); (b) as to any other business that the stockholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest in such business of such stockholder and the beneficial owner, if any, on whose behalf the proposal is made; and (c) as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (i) the name and address of such stockholder, as they appear on the corporation's books, and of such beneficial owner and (ii) the class and number of shares of the corporation which are owned beneficially and of record by such stockholder and such beneficial owner.

(3) Notwithstanding anything in the second sentence of paragraph (A) (2)

of this bylaw to the contrary, in the event that the number of directors to be elected to the board of directors of the corporation is increased and there is no public announcement by the corporation naming all of the nominees for director or specifying the size of the increased board of directors at least 70 days prior to the first anniversary of the date of the preceding years annual meeting, a stockholders notice required by this bylaw shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the secretary at the principal executive offices of the corporation not later than the close of business on the 10th day following the day on which such public announcement is first made by the corporation.

(B) *Special Meetings of Stockholders.* Only such business shall be conducted at a special meeting of stockholders as shall be brought before the meeting pursuant to the corporation's notice of meeting. A stockholder's nomination of one or more persons for election to the board of directors shall only be permitted to be made at a special meeting of stockholders if: (i) the corporation's notice of such meeting specified that directors are to be elected at such special meeting; (ii) such stockholder was a stockholder of record entitled to vote at the meeting at the time of giving of notice provided for in this bylaw; and (iii) if such stockholder complies with the notice procedures set forth in this bylaw. In the event the corporation calls a special meeting of stockholders for the purpose of electing one or more directors to the board of directors, any such stockholder may nominate a person or persons (as the case may be), for election to such position(s) as specified in the corporation's notice of meeting, if the stockholder's notice required by paragraph (A) (2) of this bylaw shall be delivered to the secretary at the principal executive offices of the corporation not earlier than the close of business on the 90th day prior to such special meeting and not later than the close of business on the later of the 60th day prior to such special meeting or the 10th day following the day on which public announcement is first made of the date of the special meeting and of the nominees proposed by the board of directors to be elected at such meeting. In no event shall the public announcement of an adjournment of a special meeting commence a new time period for the giving of a stockholder's notice as described above.

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(C) *General.*

(1) Only such persons who are nominated in accordance with the procedures set forth in this bylaw shall be eligible to serve as directors. Except as otherwise provided by law, the certificate of incorporation or these bylaws, the chairman of the meeting shall have the power and authority to determine the procedures of a meeting of stockholders, including, without limitation, the authority to determine whether a nomination or any other business proposed to be brought before the meeting was made or proposed, as the case may be, in accordance with the procedures set forth in this bylaw and, if any proposed nomination or business is not in compliance with this bylaw, to declare that such defective proposal or nomination shall be disregarded.

(2) For purposes of this bylaw, "public announcement" shall mean disclosure in a press release reported by the Dow Jones News Service, Associated Press or comparable national news service or in a document publicly filed by the corporation with the Securities and Exchange Commission pursuant to Section 13, 14 or 15(d) of the Exchange Act.

(3) Notwithstanding the foregoing provisions of this bylaw, a stockholder shall also comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder with respect to the matters set forth in this bylaw. Nothing in this bylaw shall be deemed to affect any rights (i) of stockholders to request inclusion of proposals in the corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act or (ii) of the holders of any series of preferred stock, if any, to elect directors under certain circumstances.

### ARTICLE III

#### DIRECTORS

*Section 1. Powers.* Subject to the provisions of the Delaware General Corporation Law and any limitations in the certificate of incorporation and these bylaws relating to action required to be approved by the stockholders or by the outstanding shares, the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board of directors.

*Section 2. Number and Qualification of Directors.* Until otherwise determined by resolution by the Board of Directors, the number of directors of the corporation shall be six (6).

*Section 3. Election and Term of Office of Directors.* Directors shall be elected at the annual meeting of the stockholders. Each director, including a director elected to fill a vacancy, shall serve for a term ending on the next annual meeting following the annual meeting at which such director was elected and until a successor has been elected and qualified or the earlier of his resignation or removal.

Section 4. Vacancies. Vacancies in the board of directors may be filled by a majority of the remaining directors, though less than a quorum, or by a sole remaining director. Each

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director elected to fill a vacancy shall hold office for the remainder of the term of the person whom he succeeds, and until a successor has been elected and qualified.

A vacancy or vacancies in the board of directors shall be deemed to exist in the case of the death, retirement, resignation or removal of any director, or if the board of directors by resolution declares vacant the office of a director who has been declared of unsound mind by an order of court or convicted of a felony, or if the authorized number of directors be increased, or if the stockholders fail at any meeting of stockholders at which any director or directors are elected, to elect the full authorized number of directors to be voted for at that meeting.

Any director may resign or voluntarily retire upon giving written notice to the chairman of the board, the president, the secretary or the board of directors. Such retirement or resignation shall be effective upon the giving of the notice, unless the notice specifies a later time for its effectiveness. If such retirement or resignation is effective at a future time, the board of directors may elect a successor to take office when the retirement or resignation becomes effective.

No reduction of the authorized number of directors shall have the effect of removing any director prior to the expiration of his term of office.

Section 5. Place of Meetings and Telephonic Meetings. Regular meetings of the board of directors may be held at any place within or without the State of Delaware that has been designated from time to time by resolution of the board. In the absence of such designation, regular meetings shall be held at the principal executive office of the corporation. Special meetings of the board shall be held at any place within or without the State of Delaware that has been designated in the notice of the meeting or, if not stated in the notice or there is no notice, at the principal executive office of the corporation. Any meeting, regular or special, may be held by conference telephone or similar communication equipment, so long as all directors participating in such meeting can hear one another, and all such directors shall be deemed to be present in person at such meeting.

Section 6. Annual Meetings. Immediately following each annual meeting of stockholders, the board of directors shall hold a regular meeting for the purpose of organization, any desired election of officers and transaction of other business. Notice of this meeting shall not be required.

Section 7. Other Regular Meetings. Other regular meetings of the board of directors shall be held at such time as shall from time to time be determined by the board of directors. Such regular meetings may be held without notice provided that notice of any change in the determination of time of such meeting shall be sent to all of the directors. Notice of a change in the determination of the time shall be given to each director in the same manner as for special meetings of the board of directors.

Section 8. Special Meetings. Special meetings of the board of directors for any purpose or purposes may be called at any time by the chairman of the board or the president or any vice president or the secretary or any two directors.

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Notice of the time and place of special meetings shall be delivered personally or by telephone to each director or sent by facsimile, first-class mail or telegram, charges prepaid, addressed to each director at his or her address as it is shown upon the records of the corporation. In case such notice is mailed, it shall be deposited in the United States mail at least four (4) days prior to the time of the holding of the meeting. In case such notice is delivered personally, by telephone, facsimile or telegram, it shall be delivered personally, or by telephone, by facsimile or to the telegraph company at least twenty-four (24) hours prior to the time of the holding of the meeting. Any oral notice given personally or by telephone may be communicated to either the director or to a person at the office of the director who the person giving the notice has reason to believe will promptly communicate it to the director. The notice need not specify the purpose of the meeting nor the place if the meeting is to be held at the principal executive office of the corporation.

Section 9. Quorum. A majority of the authorized number of directors shall constitute a quorum for the transaction of business, except to adjourn as hereinafter provided. Every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present shall be regarded as the act of the board of directors. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for such meeting.

Section 10. *Waiver of Notice.* The transactions of any meeting of the board of directors, however called and noticed or wherever held, shall be as valid as though had at a meeting duly held after regular call and notice if a quorum be present and if, either before or after the meeting, each of the directors not present signs a written waiver of notice, a consent to holding the meeting or an approval of the minutes thereof. The waiver of notice or consent need not specify the purpose of the meeting. All such waivers, consents and approvals shall be filed with the corporate records or made a part of the minutes of the meeting. Notice of a meeting shall also be deemed given to any director who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to such director.

Section 11. *Adjournment.* A majority of the directors present, whether or not constituting a quorum, may adjourn any meeting to another time and place.

Section 12. *Notice of Adjournment.* Notice of the time and place of an adjourned meeting need not be given, unless the meeting is adjourned for more than twenty-four (24) hours, in which case notice of such time and place shall be given prior to the time of the adjourned meeting, in the manner specified in Section 8 of this Article III, to the directors who were not present at the time of the adjournment.

Section 13. *Action Without Meeting.* Any action required or permitted to be taken by the board of directors may be taken without a meeting, if all members of the board shall individually or collectively consent in writing to such action. Such action by written consent shall have the same force and effect as a unanimous vote of the board of directors. Such written consent or consents shall be filed with the minutes of the proceedings of the board.

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Section 14. *Fees and Compensation of Directors.* Directors and members of committees may receive such compensation, if any, for their services and such reimbursement of expenses, as may be fixed or determined by resolution of the board of directors. Nothing herein contained shall be construed to preclude any director from serving the corporation in any other capacity as an officer, agent, employee, or otherwise, and receiving compensation for such services.

#### ARTICLE IV

##### COMMITTEES

Section 1. *Committees of Directors.* The board of directors may, by resolution adopted by a majority of the authorized number of directors, designate one or more committees, including an executive committee, each consisting of two or more directors, to serve at the pleasure of the board. The board may designate one or more directors as alternate members of any committee, who may replace any absent member at any meeting of the committee. Any such committee, to the extent provided in the resolution of the board, shall have all the authority of the board, except with respect to:

(a) the approval of any action which, under the General Corporation Law of Delaware, also requires the approval of the full board of directors, or the stockholders of the outstanding shares;

(b) the filling of vacancies on the board of directors or in any committee;

(c) the fixing of compensation of the directors for serving on the board or on any committee;

(d) the amendment or repeal of bylaws or the adoption of new bylaws;

(e) the amendment or repeal of any resolution of the board of directors which by its express terms is not so amendable or repealable;

(f) a distribution to the stockholders of the corporation, except at a rate or in a periodic amount or within a price range determined by the board of directors; or

(g) the appointment of any other committees of the board of directors or the members thereof.

Section 2. *Meetings and Action of Committees.* Meetings and action of committees shall be governed by, and held and taken in accordance with, the provisions of Article III of these bylaws, Sections 5 (place of meetings), 7 (regular meetings), 8 (special meetings and notice), 9 (quorum), 10 (waiver of notice), 11 (adjournment), 12 (notice of adjournment) and 13 (action without meetings), with such changes in the context of those bylaws as are necessary to substitute the committee and its members for the board of directors and its members, except that the time of regular meetings of committees may be determined by resolution of the board of directors as well as the committee, special meetings of committees may also be called by resolution of the board

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of directors, and notice of special meetings of committees shall also be given to all alternate members, who shall have the right to attend all meetings of the committee. The board of directors may adopt rules for the government of any committee not inconsistent with the provisions of these bylaws.

## ARTICLE V

### OFFICERS

Section 1. *Officers.* The officers of the corporation shall be chosen by the board of directors and shall include a chairman of the board or president, or both, a vice president, a secretary and a chief financial officer. The corporation may also have, at the discretion of the board of directors, a president, one or more additional vice presidents, one or more assistant secretaries, one or more assistant treasurers, and such other officers as may be held by the same person.

Section 2. *Election of Officers.* The officers of the corporation, except such officers as may be appointed in accordance with the provisions of Section 3 or Section 5 of this Article V, shall be chosen annually by the board of directors, and each shall hold his office until he shall resign or be removed or otherwise disqualified to serve or his successor shall be appointed in accordance with the provisions of Section 3 of this Article V. Any number of officers may be elected and qualified.

Section 3. *Subordinate Officers, etc.* The board of directors may appoint, and may empower the chairman of the board to appoint, such other officers as the business of the corporation may require, each of whom shall hold office for such period, have such authority and perform such duties as are provided in the bylaws or as the board of directors may from time to time determine.

Section 4. *Removal and Resignation of Officers.* Any officer may be removed, either with or without cause, by the board of directors, at any regular or special meeting thereof, or, except in case of an officer chosen by the board of directors, by any officer upon whom such power of removal may be conferred by the board of directors.

Any officer may resign at any time by giving written notice to the corporation. Any such resignation shall take effect at the date of the receipt of such notice or at any later time specified therein; and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

Section 5. *Vacancies in Office.* A vacancy in any office because of death, resignation, removal, disqualification, or any other cause shall be filled in the manner prescribed in these bylaws for regular appointments to such office.

Section 6. *Chairman of the Board.* The chairman of the board shall preside at all meetings of the stockholders and of the board of directors. The chairman of the Board shall be responsible for the general management of the affairs of the corporation and shall perform all

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duties incidental to his office which may be required by law and all such other duties as are properly required of him by the board of directors. Except where by law the signature of the president is required, the chairman of the board shall possess the same power as the president to sign all certificates, contracts, and other instruments of the corporation which may be authorized by the board of directors. He shall make reports to the board of directors and the stockholders, and shall perform all such other duties as are properly required of him by the board of directors. He shall see that all orders and resolutions of the board of directors and of any committee thereof are carried into effect.

Section 7. *President.* The president shall act in a general executive capacity and shall assist the chairman of the board in the administration and operation of the corporation's business and general supervision of its policies and affairs. The president shall, in the absence of or because of the inability to act of the chairman of the board, perform all duties of the chairman of the board and preside at all meetings of stockholders and of the board of directors. The president may sign, alone or with the secretary, or an assistant secretary, or any other proper officer of the corporation authorized by the board of directors, certificates, contracts, and other instruments of the corporation as authorized by the board of directors.

Section 8. *Vice Presidents.* In the absence or disability of the president, a vice president designated by the board of directors shall perform all the duties of the president, and when so acting shall have all the powers of, and be subject to all the restrictions upon, the president. The vice presidents shall have such other powers and perform such other duties as from time to time may be prescribed for them respectively by the board of directors or the bylaws.

Section 9. *Secretary.* The secretary shall keep or cause to be kept, at the principal executive office or such other place as the board of directors may order, a book of minutes of all meetings and actions of directors, committees of directors and stockholders, with the time and place of holding, whether regular

or special, and, if special, how authorized, the notice thereof given, the names of those present at directors' and committee meetings, the number of shares present or represented at stockholders' meetings, and the proceedings thereof.

The secretary shall keep, or cause to be kept, at the principal executive office or at the office of the corporation's transfer agent or registrar, as determined by resolution of the board of directors, a stock register, or a duplicate register, showing the names of all stockholders and their addresses, the number and classes of shares held by each, the number and date of certificates issued for the same, and the number and date of cancellation of every certificate surrendered for cancellation.

The secretary shall give, or cause to be given, notice of all meetings of the stockholders and of the board of directors required by the bylaws or by law to be given, and he shall keep the seal of the corporation in safe custody, and shall have such other powers and perform such other duties as may be prescribed by the board of directors or by the bylaws.

Section 10. Chief Financial Officer. The chief financial officer shall keep and maintain, or cause to be kept and maintained, adequate and correct books and records of accounts

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of the properties and business transactions of the corporation, including accounts of its assets, liabilities, receipts, disbursements, gains, losses, capital, retained earnings and shares. The books of account shall be open at all reasonable times to inspection by any director.

The chief financial officer shall deposit all monies and other valuables in the name and to the credit of the corporation with such depositories as may be designated by the board of directors. The chief financial officer shall disburse the funds of the corporation as may be ordered by the board of directors, shall render to the chairman of the board and directors, whenever they request it, an account of all of his transactions as chief financial officer and of the financial condition of the corporation, and shall have other powers and perform such other duties as may be prescribed by the board of directors or the bylaws.

Section 11. Assistant Secretaries and Assistant Treasurers. Any assistant secretary may perform any act within the power of the secretary, and any assistant treasurer may perform any act within the power of the chief financial officer, subject to any limitations which may be imposed in these bylaws or in board resolutions.

#### ARTICLE VI

##### INDEMNIFICATION OF DIRECTORS, OFFICERS, EMPLOYEES AND OTHER AGENTS

Section 1. Indemnification. The corporation shall indemnify, in the manner and to the full extent permitted by law, any person (or the estate of any person) who was or is a party to, or is threatened to be made a party to, any threatened, pending or completed action, suit or proceeding, whether or not by or in the right of the corporation, and whether civil, criminal, administrative, investigative or otherwise, by reason of the fact that such person is a director or officer of the corporation, and at the discretion of the board of directors may indemnify any person (or the estate of any person) who is such a party or threatened to be made such a party by reason of the fact that such person is or was an employee or agent of the corporation or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise. The corporation may, to the full extent permitted by law, purchase and maintain insurance on behalf of any such person against any liability which may be asserted against him and may enter into contracts providing for the indemnification of such person to the full extent permitted by law. To the full extent permitted by law, the indemnification provided herein shall include expenses (including attorneys' fees), judgments, fines and amounts paid in settlement, and, in the manner provided by law, any such expenses may be paid by the corporation in advance of the final disposition of such action, suit or proceeding. The indemnification provided herein shall not be deemed to limit the right of the corporation to indemnify any other person for any such expenses to the full extent permitted by law, nor shall it be deemed exclusive of any other rights to which any person seeking indemnification from the corporation may be entitled under any agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office.

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For the purposes of this Article VI, references to "the corporation" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors or officers so that any person who is or was a director or officer of such constituent corporation, or is or was serving at the request of such constituent corporation as a director



or officer of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under the provisions of this Article VI with respect to the resulting or surviving corporation as he would have with respect to such constituent corporation if its separate existence had continued.

For purposes of this Article VI, references to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on a person with respect to an employee benefit plan; and references to "serving at the request of the corporation" shall include service as a director or officer of the corporation which imposes duties on, or involves services by, such director or officer with respect to an employee benefit plan, its participants or beneficiaries; and a person who acted in good faith and in a manner he reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner "not opposed to the best interests of the corporation" as referred to in this section.

## ARTICLE VII

### GENERAL CORPORATE MATTERS

Section 1. Record Date for Purposes Other Than Notice and Voting. For purposes of determining the stockholders entitled to receive payment of any dividend or other distribution or allotment of any rights or entitled to exercise any rights in respect of any other lawful action, the board of directors may fix, in advance, a record date, which date shall not precede the date upon which the resolution fixing the record date is adopted by the board of directors, and which shall not be more than sixty (60) nor less than ten (10) days prior to any such action, and in such case only stockholders of record on the date so fixed are entitled to receive the dividend, distribution or allotment of rights or to exercise the rights, as the case may be, notwithstanding any transfer of any shares on the books of the corporation after the record date fixed as aforesaid, except as otherwise provided in the Delaware General Corporation Law.

A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the board of directors may fix a new record date for the adjourned meeting. In order that the corporation may determine the stockholders entitled to consent to corporate action in writing without a meeting, the board of directors may fix a record date which shall not be more than ten days after the date upon which the resolution fixing the record date is adopted by the board of directors.

Section 2. Checks, Drafts, Evidences of Indebtedness. All checks, drafts or other orders for payment of money, notes or other evidences of indebtedness, issued in the name of or

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payable to the corporation shall be signed or endorsed by such person or persons and in such manner as, from time to time, shall be determined by resolution of the board of directors.

Section 3. Corporate Contracts and Instruments, How Executed. The board of directors, except as otherwise provided in these bylaws, may authorize any officer or officers, agent or agents, to enter into any contract or execute any instrument in the name of and on behalf of the corporation, and such authority may be general or confined to specific instances; and, unless so authorized or ratified by the board of directors or within the agency power of an officer, no officer, agent or employee shall have any power or authority to bind the corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or to any amount.

Section 4. Stock Certificates. A certificate or certificates for shares of the capital stock of the corporation shall be issued to each stockholder when any such shares are fully paid. All certificates shall be signed in the name of the corporation by the chairman of the board or the president or vice president and by the chief financial officer, the treasurer or an assistant treasurer or the secretary or any assistant secretary, certifying the number of shares and the class or series of shares owned by the stockholder. Any or all of the signatures on the certificate may be facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if such person were an officer, transfer agent or registrar at the date of issue.

Section 5. Lost Certificates. Except as hereinafter in this Section 5 provided, no new stock certificate shall be issued in lieu of an old certificate unless the latter is surrendered to the corporation and canceled at the same time. The board of directors may in case any stock certificate or certificate for any other security is lost, stolen or destroyed, authorize the issuance of a new certificate in lieu thereof, upon such terms and conditions as the board of directors may require, including provision for indemnification of the

corporation secured by a bond or other adequate security sufficient to protect the corporation against any claim that may be made against it, including any expense or liability, on account of the alleged loss, theft or destruction of such certificate or the issuance of such new certificate.

Section 6. Representation of Stock of Other Corporations. The chairman of the board, the president, or any vice president, or any other person authorized by resolution of the board of directors by any of the foregoing designated officers, is authorized to vote on behalf of the corporation any and all stock of any other corporation or corporations, foreign or domestic, standing in the name of the corporation. The authority herein granted to said officers to vote or represent on behalf of the corporation any and all stock by the corporation in any other corporation or corporations may be exercised by any such officer in person or by any person authorized to do so by proxy duly executed by said officer.

Section 7. Construction and Definitions. Unless the context requires otherwise, the general provisions, rules of construction, and definitions in the Delaware General Corporation Law shall govern the construction of the bylaws. Without limiting the generality of the foregoing,

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the singular number includes the plural, the plural number includes the singular, and the term "person" includes both a corporation and a natural person.

Section 8. Fiscal Year. The fiscal year of the corporation shall be fixed by resolution of the board of directors.

#### ARTICLE VIII

##### AMENDMENTS

Section 1. Amendment. The bylaws, or any of them, may be rescinded, altered, amended or repealed, and new bylaws may be made (i) by the board of directors, by vote of a majority of the number of directors then in office as directors, acting at any meeting of the board of directors, or (ii) by the stockholders, by the vote of the holders of sixty-six and two-thirds percent (66-2/3%) of the outstanding voting stock of the corporation, at any annual or special meeting of stockholders, provided that notice of such proposed amendment, modification, repeal or adoption is given in the notice of the annual or special meeting; provided, however, that the bylaws can only be amended if such amendment would not conflict with the certificate of incorporation. Any bylaw made or altered by the requisite number of stockholders may be altered or repealed by the board of directors or may be altered or repealed by the requisite number of stockholders.

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#### CERTIFICATE OF SECRETARY

I, the undersigned, do hereby certify:

(a) That I am the duly elected and acting Secretary of Capstone Turbine Corporation, a Delaware corporation (the "Corporation"); and

(b) That the foregoing Amended and Restated Bylaws constitute the Amended and Restated Bylaws of the Corporation, as duly adopted by the Board of Directors of the Corporation at a meeting duly held on May 30, 2003.

IN WITNESS WHEREOF, I have hereunto subscribed my name as of this 30th day of May, 2003.

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Susan Cayley,  
Secretary

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## CERTIFICATION

I, John Tucker, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended June 30, 2003 of Capstone Turbine Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2003

By: /s/ JOHN TUCKER

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John Tucker  
President and Chief Executive Officer

## CERTIFICATION

I, Karen Clark, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended June 30, 2003 of Capstone Turbine Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2003

By: /s/ KAREN CLARK

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Karen Clark  
Chief Financial Officer

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO  
18 U.S.C. 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, John Tucker, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Capstone Turbine Corporation on Form 10-Q for the quarterly period ended June 30, 2003 fully complies with the requirements of Section 13(a) and 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents in all material respects the financial condition and results of operations of Capstone Turbine Corporation.

Date: August 14, 2003

By: /s/ JOHN TUCKER

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John Tucker  
President and Chief Executive Officer

I, Karen Clark, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Capstone Turbine Corporation on Form 10-Q for the quarterly period ended June 30, 2003 fully complies with the requirements of Section 13(a) and 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents in all material respects the financial condition and results of operations of Capstone Turbine Corporation.

Date: August 14, 2003

By: /s/ KAREN CLARK

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Karen Clark  
Chief Financial Officer