

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark  
One)

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

For the fiscal year ended March 31, 2009

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

**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**  
(Address of principal executive  
offices)

**91311**  
(Zip Code)

**(818)-734-5300**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of exchange on which registered</u>
Common Stock, par value \$.001 per share	<b>NASDAQ Global Market</b>
Series A Preferred Stock Purchase Rights	

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the shares of Common Stock of the registrant held by non-affiliates on September 30, 2008 was approximately \$174.3 million.

As of June 5, 2009, 188,532,363 shares of the registrant's Common Stock were issued and outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive proxy statement relating to the registrant's 2009 annual meeting of stockholders are incorporated by reference into Part III of this report to the extent described therein.

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**CAPSTONE TURBINE CORPORATION**

**FORM 10-K**

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## PART I

### Item 1. Business.

#### Overview

We develop, manufacture, market and service microturbine technology solutions for use in stationary distributed power generation applications, including cogeneration (combined heat and power ("CHP")), integrated combined heat and power ("ICHP"), and combined cooling, heat and power ("CCHP"), resource recovery and secure power. In addition, our microturbines can be used as battery charging generators for hybrid electric vehicle applications. Microturbines allow customers to produce power on-site in parallel with the electric grid or stand alone when no utility grid is available. There are several technologies which are used to provide "on-site power generation" (also called "distributed generation") such as reciprocating engines, solar power, wind powered systems and fuel cells. For customers who do not have access to the electric utility grid, microturbines can provide clean, on-site power with lower scheduled maintenance intervals and greater fuel flexibility than competing technologies. For customers with access to the electric grid, microturbines can provide an additional source of continuous duty power, thereby providing additional reliability and potential cost savings. With our stand-alone feature, customers can produce their own energy in the event of a power outage and can use the microturbines as their primary source of power for extended periods. Because our microturbines also produce clean, usable heat energy, they can provide economic advantages to customers who can benefit from the use of hot water, chilled water, air conditioning and heating. Our microturbines are sold primarily through our distributors. Our distributors, along with our Authorized Service Companies ("ASCs"), install the microturbines. Service is provided directly by us through our Factory Protection Plan ("FPP") or by our distributors and ASCs. Successful implementation of the microturbine relies on the quality of the microturbine, marketability for appropriate applications, and the quality of the installation and support.

We believe we were the first company to offer a commercially available power source using microturbine technology. Capstone Turbine Corporation ("Capstone") offers microturbines from 30 kilowatts up to 1 megawatt in electric power output, designed for commercial, industrial, and utility users. Our 30-kilowatt ("C30") microturbine can produce enough electricity to power a small convenience store. The 60 and 65 kilowatt ("C60 Series") microturbine can produce enough heat to provide hot water to a 100-room hotel while also providing about one-third of its electrical requirements. Our 200-kilowatt ("C200") microturbine is well suited for larger hotels, office buildings, and wastewater treatment plants, among others. By packaging the C200 microturbine power modules into an International Organization for Standardization ("ISO") sized container, Capstone has created a family of microturbine offerings from 600-kilowatts up to one megawatt in a compact footprint. Our 1000-kilowatt ("C1000 Series") microturbines are well suited for utility substations, larger commercial and industrial facilities and remote oil and gas applications. Our microturbines combine patented air-bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and ultra low emission electricity and cooling and heat production systems. Because of our air-bearing technology, our microturbines do not require liquid lubricants. This means they do not require routine maintenance to change and dispose of oil or other liquid lubricants, as do the most common competing products. Capstone microturbines can be fueled by various sources including natural gas, propane, sour gas, renewable fuels such as landfill or digester gas, kerosene, diesel and biodiesel. The C60 Series and C200 microturbines are available with integrated heat exchangers, making them easy to engineer and install in applications where hot water is used. Our products produce exceptionally clean power. Our C60 Series was certified by the California Air Resources Board ("CARB") to meet its stringent 2007 emissions requirements—the same emissions standard used to certify fuel cells and the same emissions levels as a state-of-the-art central power plant. Our C65 Landfill and Digester Gas systems were certified in January 2008 by CARB to meet 2008 waste gas emissions requirements for landfill and digester gas applications.

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We sell complete microturbine units, subassemblies, components and various accessories. We also remanufacture microturbine engines and provide after-market parts and services. Our microturbines are sold primarily through distributors and Original Equipment Manufacturers ("OEMs"). Distributors purchase our products for sale to end users and also provide application engineering and installation support. The distributors are also required to provide a variety of additional services, including engineering the applications in which the microturbines will be used, installation support of the products at the end users' sites, commissioning the installed applications and providing post-commissioning service. Our distributors perform as value-added resellers. OEMs integrate Capstone's products into their own product solutions. Capstone has also established some outside sales representatives who qualify and close customer orders. The order is then booked directly by Capstone.

To assure proper installation of Capstone microturbine systems, we have instituted a Factory Trained Installer ("FTI") training and certification program. Personnel from our distributors and OEMs, as well as design engineering firms, contractors, and end users attend this FTI training. We offer a Conceptual Approval ("CA") process to assist all customers by reviewing their installation designs to confirm that the technical requirements for proper operation have been met, such as electrical interconnections, load requirements, fuel type and pressure, cooling air flow, and turbine exhaust means. As part of the microturbine commissioning process, we also receive a checklist to confirm that the final installation adheres to Capstone technical requirements before we accept any warranty obligations. All this is aimed at providing the end user with a proper installation that will operate as expected for the life of the equipment.

Capstone has a factory direct service offering for commissioning and post-commissioning service. We have added a comprehensive FPP where Capstone charges a fixed annual fee to perform scheduled maintenance, and in some cases unscheduled maintenance as well. Capstone will then perform the required maintenance directly with its own personnel, or will contract with one of its local ASCs to do so. Capstone provides factory and on-site training to certify all personnel that are allowed to perform service on our microturbines. Individuals who are certified are called Authorized Service Providers ("ASPs") and must be employed by an ASC in order to perform work pursuant to a Capstone FPP. The majority of our distributors are ASCs. We also have ASCs who do not sell our products, but only offer service for them.

### **Our Products**

We began commercial sales of our C30 products in 1998, targeting the emerging distributed generation industry that was being driven by fundamental changes in power requirements. In September 2000, we shipped the first commercial unit of our C60 Series microturbine. We began shipping the C60 Integrated CHP solution in 2003 and first shipments of the C65 models occurred during the quarter ended March 31, 2006. The first commercial C200 microturbine was shipped on August 28, 2008. Our C1000 Series product was developed based on Capstone's C200 microturbine engine. The C1000 Series product can be configured into 1,000-kW, 800-kW and 600-kW solutions in a single ISO-sized container. Our C1000 Series product beta testing was successfully implemented during Fiscal 2009 and the first commercial shipment was on December 29, 2008. We are still in the early phases of commercializing the C200 and C1000 Series products and, to date, have not been profitable or generated positive cash flow.

During Fiscal 2009, we booked total orders of \$66.0 million for 673 units, or 76.6 megawatts, compared to \$44.5 million for 760 units, or 46.4 megawatts, during Fiscal 2008. We shipped 494 units with an aggregate of 34.1 megawatts, generating revenue of \$32.4 million compared to 434 units with an aggregate of 22.4 megawatts, generating revenue of \$21.7 million during Fiscal 2008. Total backlog as of March 31, 2009 increased \$33.6 million, or 120%, to \$61.5 million from \$27.9 million as of March 31, 2008. As of March 31, 2009, we had 605 units, or 72.0 megawatts, in total backlog compared to 426 units, or 29.5 megawatts, as of March 31, 2008. As of March 31, 2009, 421 units, or 53.5

megawatts, valued at \$45.3 million, were current and expected to be shipped within the next twelve months compared to 345 units, or 25.9 megawatts, valued at \$24.6 million as of March 31, 2008. The timing of shipments is subject to change based on several variables (including customer payments and customer delivery schedules), many of which are not in our control and can affect our revenue and backlog.

The following table summarizes our backlog:

	Years Ended March 31,			
	2009		2008	
	Megawatts	Units	Megawatts	Units
Current (Expected delivery within the next twelve months)				
C30	5.3	174	3.2	106
C60 Series	10.8	168	12.1	186
C200	9.8	49	10.6	53
C600	1.8	3	—	—
C800	4.8	6	—	—
C1000	21	21	—	—
Total Current Backlog	53.5	421	25.9	345
Long-term (Expected delivery is greater than twelve months)				
C30	4.7	158	2.2	74
C60 Series	—	—	—	—
C200	3.0	15	1.4	7
C800	0.8	1	—	—
C1000	10	10	—	—
Total Long-term Backlog	18.5	184	3.6	81
Total Backlog	72.0	605	29.5	426

Capstone microturbines are compact, lightweight and environmentally friendly generators of electricity and heat, compared to other competing technologies. They operate on the same principle as a jet engine with the added capability of using a variety of commercially available fuels. For example, our microturbines can operate on low British Thermal Unit ("BTU") gas, which is gas with lower energy content, and can also operate on gas with a high amount of sulfur, known in the industry as sour gas. Examples of these fuel sources include methane from facilities such as wastewater treatment plants, landfills or agrodigesters.

Our microturbines incorporate four major design features:

- advanced combustion technology;
- patented air-bearing technology;
- digital power electronics; and
- remote monitoring.

Our advanced combustion technology allows Capstone microturbines to achieve low emissions capability with a design that is simple to manufacture. These low emission levels not only provide an environmentally friendly product, but also eliminate permitting requirements in several municipalities for continuously operated onsite power generation. The air-bearing system allows the microturbine's single moving assembly to produce power without the need for typical petroleum-based lubrication.

Air-bearings use a high-pressure field of air rather than petroleum lubricants. This improves reliability and reduces maintenance, such as oil changes. The electronic controls manage critical functions and monitor operations of the microturbine. For instance, our electronics control the microturbine's speed, temperature and fuel flow and communicate with external networks and building management systems. The power electronics coordinate with the grid when the units are operated in a grid-connect mode and with the on-board battery when equipped for stand-alone mode. All control functions are performed digitally. Performance is optimized, resulting in lower emissions, higher reliability and high efficiency over a variable power range.

The electrical output of our units can be paralleled in multiple unit configurations through our Advanced Power Server product and a digital communications cable to serve larger installations requiring electrical loads up to ten megawatts.

Our products can operate:

- connected to the electric utility grid as a current source;
- on a stand-alone basis as a voltage source;
- multipacked to support larger loads as a "virtual single" unit; and
- dual mode, where the microturbine operates connected to the electric utility grid or operates independently.

We also offer C60 Series and C200 Integrated CHP systems. These systems combine the standard C60 Series and C200 microturbine unit with a Heat Recovery Module that provides electricity and heats water.

Our family of products is offered in the following configurations:

Fuel Types	C30		C60 Series		C200		C1000 Series	
	Grid Connect	Dual Mode						
Low pressure natural gas	X	X	X	X	X	X	X	X
High pressure natural gas	X	X	X	X	X	X	X	X
Compressed natural gas	X	X	X	X	X	X	X	X
Landfill gas	X		X		X		X	
Digester gas	X		X		X		X	
Gaseous propane	X	X	X	X	X	X	X	X
Diesel	X	X	X	X				
Bio-diesel	X	X	X	X				
Kerosene	X	X	X	X				

We offer various accessories for our products including rotary gas compressors with digital controls, heat recovery modules for CHP applications, dual mode controllers that allow automatic transition between grid connect and stand-alone modes, batteries with digital controls for stand-alone or dual-mode operations, power servers for large multipacked installations, protocol converters for Internet access, packaging options and miscellaneous parts such as frames, exhaust ducting and installation hardware. We also sell microturbine components and subassemblies to OEMs.

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Our electronic controls manage the microturbine using Capstone's proprietary software and advanced algorithms. The controls:

- start the turbogenerator and manage its load;
- coordinate the functioning of the microturbine with the grid;
- manage the speed, fuel flow, and exhaust temperature of the microturbine;
- convert the variable frequency, up to a maximum of 1,600 Hertz, and variable voltage power produced by the generator into a usable output of either 50/60 Hertz AC or DC for HEV applications; and
- provide digital communications to externally maintain and control the equipment.

In addition, our proprietary Capstone Remote Monitoring Software ("CRMS") provides an advantage to end-users by allowing them to remotely operate and manage the microturbine. Unlike the technology of other power sources that require manual monitoring and maintenance, the microturbine allows end-users to remotely and efficiently monitor performance, power generation and time of operation using our CRMS interface software with standard personal computers. This remote capability can provide end-users with power generation flexibility and cost savings. Our Internet-based communication system, the Capstone Service Network ("CSN"), provides continuous remote monitoring and diagnostics to customers who purchase the service. If the CSN detects an out-of-limit condition or alarm, it automatically notifies the responsible ASC for immediate follow-up action.

The C30 microturbines were initially designed to operate connected to an electric utility grid and to use a high pressure, natural gas fuel source. We have expanded our microturbines' functionality to operate with different fuels. The combustor system remains the same for all fuels, except for the fuel injectors, which currently vary between liquid and gaseous fuels. The Capstone microturbines' multi-fuel capability provides significant competitive advantages with respect to some of our selected vertical markets.

Our C60 Series grid-connect and stand-alone microturbine power systems are listed by Underwriters Laboratories ("UL") as meeting the UL 2200 stationary engine generator standards and the UL 1741 utility interconnection requirements. Our products are manufactured by processes that are ISO 9001:2000 and ISO 14001:2004 certified.

In 2002, the California Energy Commission certified our 30-kilowatt and 60-kilowatt microturbine power systems as the first products to comply with the requirements of its "Rule 21" grid interconnection standard. This standard streamlines the process for connecting distributed generation systems to the grid in California. The benefits of achieving this standard include avoiding both costly external equipment procurement requirements and extensive site-by-site and utility-by-utility analysis. Our protective relay functionality has also been recognized by the State of New York which has pre-cleared our microturbines for connection to New York's electric utility grid.

Our 60-kilowatt microturbine power system was the first combustion power generation product to be certified by the CARB as meeting its stringent distributed generation emissions standards that went into effect in 2003. Our C60 Series microturbine now meets the even more stringent CARB 2007 standard for natural gas, as well as the 2008 CARB standard for landfill and digester gas fuels.

We are the first microturbine manufacturer to achieve UL Class I, Division 2 certification for operation in hazardous-area oil and gas applications. These specially packed systems are applied in oil and gas production areas with potentially explosive environments.

In June 2009, we successfully completed scheduled testing that confirmed that our C200 and C1000 Series grid-connect and stand-alone microturbine power systems comply with UL 2200 and UL 1741.

## Applications

Worldwide, stationary power generation applications vary from huge central stationary generating facilities, above 1,000 megawatts, down to back-up uses below ten kilowatts. Historically, power generation in most developed countries, such as the United States, has been part of a regulated system. A number of developments related primarily to the deregulation of the industry, as well as significant technology advances, have broadened the range of power supply choices available to customers. With the introduction of the C200 and C1000 Series, our microturbines may be used in a variety of applications generally requiring less than five megawatts. Within the distributed generation markets served, we focus on vertical markets that we have identified as having the greatest near-term potential. In the markets we are focusing on (CHP, CCHP, resource recovery and secure power), we have identified specific targeted vertical market segments.

### *Cogeneration—CHP/CCHP*

Cogeneration maximizes the use of energy produced by the microturbines, reduces emissions compared with traditional power generation and enhances the economic advantage for customers. Cogeneration uses both the heat and electric energy produced in the power generation process. Using the heat and electricity created from a single combustion process increases the efficiency of the system from approximately 30% to 70%, or more. The increased operating efficiency reduces overall green house gas emissions compared with traditional independent sources of utility electricity and local thermal generation and, through displacement of other separate systems, can reduce variable production costs. Our microturbines' emissions of commonly found air pollutants ("criteria pollutants") such as oxides of Nitrogen ("NOx") and volatile organic compounds ("VOCs") are lower than those from the on-site boilers that our CHP system displaces—meaning that local emissions of these pollutants are actually reduced when a Capstone CHP system is installed. This high CHP efficiency also means more efficient use of expensive fuels and can reduce net utility costs for end users. The most prominent uses of heat energy include space heating and air conditioning, heating and cooling water, as well as drying and other applications. For example, we have used the heat generated by the microturbines to supply hot water solutions for hotels, schools, and swimming pools. When our microturbine exhaust drives an absorption chiller, the chiller produces chilled water for air conditioning and other uses. These systems have also been implemented to supply solutions in grocery stores, office and government buildings and manufacturing facilities.

There are markets for CHP and CCHP applications worldwide. A study that was done for the US Department of Energy ("DOE") calculated the total potential CHP market in the United States to be over 35.5 gigawatts through 2020. Many governments have encouraged more efficient use of the power generation process to reduce pollution, lower dependence on fossil fuels and control the cost of locally produced goods. To access these markets, we have entered into agreements with distributors, which have engineered CHP packages that utilize the hot exhaust air of the microturbine for heating water and also use the hot exhaust to run an absorption chiller for air conditioning. Further, we have our own integrated CHP product for the C60 Series and C200 products.

### *Resource Recovery/Renewable Fuels*

On a worldwide basis, there are thousands of locations where the production of fossil fuels and other extraction and production processes creates fuel byproducts, which traditionally have been released or burned into the atmosphere. Our microturbine products can use methane gases from landfills and wastewater treatment facilities and can burn these waste gases with minimal emissions, thereby, in some cases, avoiding the imposition of penalties incurred for pollution, while simultaneously producing electricity for use at the site or in the surrounding community. Our microturbine products have demonstrated effectiveness in this application and outperform conventional combustion engines in a number of situations, including when the gas contains a high amount of sulfur. We have sold systems

that were installed in the resource recovery market to be used at oil and gas exploration and production sites both onshore and offshore in addition to landfills and wastewater treatment facilities. These gases are considered renewable resources.

#### *Secure Power*

Because of the potentially catastrophic consequences of even momentary system failure, certain power users, such as high technology and information systems companies, require particularly high levels of reliability in their power service. Capstone's secure power offerings are the world's only microturbine-powered Uninterruptible Power Source ("UPS") solutions that can offer clean, IT-grade power produced from microturbines, the utility or a combination of both. We offer two microturbine-powered UPS solutions that support prime and dispatched power options. Capstone UPSource microturbine-powered UPS solution provides prime or emergency power solutions. Capstone's Hybrid UPS microturbine-powered solution provides power when dispatched in high efficiency, standard UPS and emergency power solutions. Both secure power products offer eight 9's of reliability (99.999999%) in common N + 1 configurations. Dual mode units operating in a prime power configuration can support a 150% overload for 10 seconds during transient conditions. Dual mode units operating in grid parallel mode can provide customers a back-up power system with an economic return. These systems offer high onsite energy efficiency when combined with a heat exchanger (CHP) to create hot water or with a chiller (CCHP) for air conditioning at these facilities. This configuration, when combined with the Capstone Dual Mode Controller, can transition from the grid parallel mode to prime power mode in less than 10 seconds. This provides end users with a backup system with a short return on investment.

#### *Hybrid Electric Vehicles*

Our technology is also used in hybrid electric vehicle applications. Our customers have applied our products in hybrid electric vehicles such as buses and trolleys. In these applications the microturbine acts as an onboard battery charger to recharge the battery system as needed. The benefits of these microturbine hybrids include fuel economy gains, quieter operation, reduced emissions and high reliability compared with traditional combustion engines. Internal combustion diesel engine manufacturers have been challenged for the last several years to develop technology improvements that reduce emissions to levels specified by the EPA and CARB 2007 and the upcoming 2010 standards. Many manufacturers are incorporating exhaust treatment that increases upfront equipment costs, life cycle costs and may reduce overall engine efficiency.

#### **Sales, Marketing and Distribution**

We sell our microturbines worldwide. With the introduction of the C200 and C1000 Series products, we anticipate that our microturbines will be used in applications requiring up to five megawatts.

We primarily sell our products through distributors, and in some cases, we sell our products directly. Our parts are sold to distributors, ASCs and end users. Our typical terms of sale include shipment of the products with title, care, custody and control transferring at our dock, payment due anywhere from in advance of shipment to 90 days from shipment, and warranty periods of approximately 15 to 18 months from shipment. We typically do not have customer acceptance provisions in our agreements.

#### *North America*

We have distribution agreements with a number of companies throughout North America for the resale of our products. Many of these distributors serve multiple markets in their select geographic

regions. The primary markets served in this region have been CHP, CCHP, resource recovery, Oil & Gas and hybrid vehicles.

In developing our sales opportunities we have identified the need to address various requirements present in our target localities. These requirements include electric grid interconnection standards, gas utility connection requirements, building and fire safety codes and various inspections and approvals. The costs and schedule ramifications of these various approvals can be significant to the completion of an installation. Our goal is to work with the applicable regulating entities to establish compliant standards for the installation of our microturbines so that the costs and installation timelines are minimized for our customers. We have received pre-approval by the New York State Public Services Commission for installation and interconnection to the electric utilities in New York, and we meet the California interconnection requirements. We believe that we can create market advantages for our products through enhancing the ease of deploying our distributed generation solutions.

In February 2009, we introduced our factory rental program primarily to target the Oil & Gas and telecommunication sectors that frequently deploy temporary power solutions while they build out permanent infrastructure.

#### *Asia*

Our sales and marketing strategy in Asia has been to develop and strengthen distributor relationships throughout Asia.

Our market focus in Asia is CHP, CCHP and Oil & Gas applications. Our historical sales in Southeast Asia have primarily been in the Oil & Gas market. Other areas in Asia and the Pacific Rim offer attractive opportunities as well. South Korea and China are areas where resource recovery applications and CHP and CCHP solutions are expected to experience market growth.

#### *Europe and Russia*

To address the European market, including Russia, we are strengthening our relationships with existing distributors and have increased Capstone local sales and service support. We have an office in Europe for the purpose of working with our distributors there on a daily basis to realize growth opportunities. We have established a spare parts distribution center in Europe to make parts readily available to our distributors. Resource recovery applications have been growing in Europe based on attractive incentives established in several countries. Further, Europe has a history of extensive use of distributed generation technologies.

#### **Revenue**

For geographic and segment revenue information, please see Note 2—Summary of Significant Accounting Policies—Segment Reporting in the "Notes to Consolidated Financial Statements."

#### **Customers**

One customer accounted for 13% of revenue for the year ended March 31, 2009. Sales to Banking Production Centre ("BPC"), our Russian distributor, accounted for 13%, 18% and 16% of our revenue for the years ended March 31, 2009, 2008 and 2007, respectively. Sales to UTC Power Corporation ("UTCP"), an affiliate of United Technologies Corporation ("UTC") and historically one of our largest customers, accounted for 7%, 13% and 12% of our revenue for the years ended March 31, 2009, 2008 and 2007, respectively. As of March 31, 2009, BPC represented 29% and UTCP represented 2% of net accounts receivable, respectively.

## Competition

The market for our products is highly competitive. Our microturbines compete with existing technologies such as reciprocating engines and may also compete with emerging distributed generation technologies, including solar power, wind-powered systems, fuel cells and other microturbines. Many companies who could be our customers today rely on the utility grid for their electrical power. As many of our distributed generation competitors are large, well-established companies, they derive advantages from production economies of scale, worldwide presence and greater resources, which they can devote to product development or promotion.

Generally, power purchased from the electric utility grid is less costly than power produced by distributed generation technologies, such as fuel cells or microturbines. Utilities may also charge fees to interconnect to their power grids. However, we can provide economic benefits to end users in instances where the waste heat from our microturbine has value (CHP and CCHP), where fuel costs are low (resource recovery/renewable fuels), where the costs of connecting to the grid may be high or impractical (such as remote power applications), where reliability and power quality are of critical importance, or in situations where peak shaving could be economically advantageous because of highly variable electricity prices. Because Capstone microturbines can provide a reliable source of power and can operate on multiple fuel sources, we believe they offer a level of flexibility not currently offered by other technologies such as reciprocating engines.

Our reciprocating engine competitors have products and markets that are well developed and technologies that have been proven for some time. A reciprocating engine is also known as an internal combustion engine similar to those used in automotive applications. Reciprocating engines are popular for primary and back-up power applications despite higher levels of emissions, noise and maintenance. These technologies, which typically have a lower up-front cost than microturbines, are currently produced by, among others, Caterpillar Inc., Cummins Inc., Dresser Waukesha, a business unit of Dresser, Inc., GE Energy Jenbacher gas engines, Deutz Corporation and Kohler Power Systems, a division of Kohler Co.

Our microturbines may also compete with other distributed generation technologies, including solar power, wind-powered systems and fuel cells. Solar-powered and wind-powered systems produce no emissions. The main drawbacks to solar-powered and wind-powered systems are their dependence on weather conditions, the utility grid and high capital costs that make these systems uneconomical without government subsidies. Although the market for fuel cells is still developing, a number of companies are focused on markets similar to ours, including FuelCell Energy Inc., UTC Power Inc., Plug Power Inc. and Ballard Power Systems Inc. Fuel cells have lower levels of NO<sub>x</sub> and other criteria pollutant emissions than our microturbines. Fuel cells, like wind-powered systems and solar power systems have received higher levels of incentives for the same applications as microturbines. We believe absent these high government-supported incentives, microturbines provide a better value to end users in most applications. However, over the medium-to-long term, fuel cell technologies that compete more directly with our products may be introduced.

We also compete with several companies who have microturbine products, some of which have significantly greater resources and brand recognition than us, including Ingersoll-Rand Company Limited, Calnetix Inc., Turbec S.p.A. and Toyota Turbine and Systems Inc.

Overall, we compete with end users' other options for electrical power and heat generation on the basis of our microturbines' ability to:

- provide power when a utility grid is not available or goes out of service,
- reduce total cost of purchasing electricity and fuel,
- improve electric power availability and provide high power quality,

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- operate on multiple fuel types,
- reduce emissions—both criteria pollutants and greenhouse gasses,
- simplify operation, and
- control maintenance costs and associated disposal of hazardous materials.

### **Governmental and Regulatory Impact**

Our markets can be positively or negatively impacted by the effects of governmental and regulatory matters. We are affected not only by energy policy, laws, regulations and incentives of governments in the markets into which we sell, but also by rules, regulations and costs imposed by utilities. Utility companies or governmental entities could place barriers on the installation of our product or the interconnection of the product with the electric grid. Further, they may charge additional fees to customers who install on-site power generation; thereby reducing the electricity they take from the utility, or for having the capacity to use power from the grid for back-up or standby purposes. These types of restrictions, fees or charges could hamper the ability to install or effectively use our product or increase the cost to our potential customers for using our systems. This could make our systems less desirable, thereby adversely affecting our revenue and profitability potential. In addition, utility rate reductions can make our products less competitive which would have a material adverse effect on our operations. These costs, incentives and rules are not always the same as those faced by technologies with which we compete. However, rules, regulations, laws and incentives could also provide an advantage to our distributed generation solutions as compared with competing technologies if we are able to achieve required compliance in a lower cost, more efficient manner. Additionally, reduced emissions and higher fuel efficiency could help our customers combat the effects of global warming. Accordingly, we may benefit from increased government regulations that impose tighter emission and fuel efficiency standards.

In February 2009, the President of the United States signed into law the American Recovery and Reinvestment Act of 2009 and while it is difficult to predict with any certainty, we are encouraged by discussions of a U.S. government economic stimulus plan and believe that certain of our customers could benefit from any eventual stimulus spending. The United States stimulus plan includes The American Clean Energy and Security Act of 2009 (ACES) which is expected to raise the CHP tax credit from 10% to 30%, providing an estimated \$100 million for "shovel ready" CHP projects and is pending approval of the United States Senate. However, at this time, we believe that any significant stimulus impact on our customers and their capital equipment purchase plans would not be evident until at least the second half of calendar 2009.

Government funding can impact the rate of development of new technologies. While we continue to receive development funding, committed amounts remaining are relatively low. See "Research and Development." Competing new technologies generally receive larger incentives and development funding than do microturbines.

### **Sourcing and Manufacturing**

Our microturbines are designed to achieve high volume, low-cost production objectives. Our manufacturing designs include the use of conventional technology, which has been proven in high volume automotive and turbocharger production for many years. The microturbines are designed for simple assembly and testing and to facilitate automated production techniques using less-skilled labor.

Our strategy of outsourcing the manufacturing and assembly of our nonproprietary product components allows for more attractive pricing, quick ramp-up and the use of just-in-time inventory management techniques. While the current variability in our demand volumes and resulting imprecise demand forecasting affect our ability to leverage these capabilities, we believe that we can realize

economies of scale related to our product manufacturing costs as unit volume increases. We assemble and test units as well as manufacture air-bearings and certain combustion system components at our facility in Chatsworth, California. Additionally, we manufacture recuperator cores at our facility in Van Nuys, California. We have primary and secondary sources for other critical components and have evaluated our core competencies and identified additional outsourcing opportunities which we are now actively pursuing. We monitor parts subject to a single or a limited source supply to minimize factory down time due to unavailability of such parts, which could impact our ability to meet manufacturing schedules.

We believe our manufacturing facilities located in Chatsworth and Van Nuys, California have a combined production capacity of approximately 2,000 units per year, depending on product mix. Excluding working capital requirements, we believe we can expand our combined production capacity to approximately 4,000 units per year, depending on product mix, with approximately \$10 to \$15 million of capital expenditures. We have not committed to this expansion nor identified a source for its funding, if available.

Solar Turbines Incorporated, a wholly owned subsidiary of Caterpillar Inc., had been our sole supplier of recuperator cores prior to 2001. In 2000, we exercised an option to license Solar's technology, which allows us to manufacture cores ourselves. In June 2001, we started to manufacture recuperator cores. Recuperator cores using the Solar technology, which we make and sell, are subject to a per-unit royalty fee. As of March 31, 2009, cumulative royalties of \$0.2 million have been paid under the terms of the licensing agreement with Solar.

### **Research and Development ("R&D")**

For fiscal years ended March 31, 2009, 2008 and 2007, R&D expense was \$8.1 million, \$8.9 million, and \$9.4 million and was 19%, 28% and 45% of total revenue, respectively. R&D expenses are reported net of benefits from cost-sharing programs, such as the DOE funding and the Development and License Agreement ("Development Agreement") with UTCP. Benefits from cost-sharing programs were \$8.1 million, \$3.0 million, and \$1.7 million for the years ended March 31, 2009, 2008 and 2007 respectively. Our R&D activities enabled us to become one of the first companies to develop a commercially available microturbine that operates in parallel with the grid. We were the first company to successfully demonstrate a commercially available microturbine that operates on a stand-alone basis.

The CARB established extremely high industry standards for distributed generation by requiring emissions levels comparable to the Best Available Control Technology for large state-of-the-art central utility power plants. In March 2009, Capstone's 30-kilowatt microturbines became even "greener" with the successful demonstration of our ultra low emissions product complying with EPA and CARB 2010 emissions requirements which reduced previous requirements for NOx by 86%, carbon monoxide (CO) by 98%, and volatile organic compounds (VOCs) by 98%. Test results showed that the microturbine removed concentrations of unburned hydrocarbons (HC) in the ambient air. The ultra low emissions performance was attained without sacrificing Capstone's signature low maintenance costs by combining ultra low emission lean premix combustion technology with a catalyst that requires no scheduled maintenance for the life of the system. This is in contrast to exhaust cleanup systems used by traditional reciprocating engine driven generation equipment that use chemicals such as ammonia or urea and need frequent adjustments to maintain proper function and air quality. Certification to this standard allows generators to be installed in most of the major air quality management districts in California without regular on-site emissions testing. To date, only microturbines and fuel cells have been certified to this new standard. Installing six 65-kilowatt microturbines operating 24 hours a day reduces NOx emissions approximately five tons per year which equates to the environmental impact of taking 258 cars off the road, based on EPA emissions and efficiency data for the average U.S. power

plant and average passenger vehicle. Capstone enhanced its C60 Series microturbine to meet the CARB 2007 standard with co-funding from the DOE.

Capstone microturbines are the first power generation technology to receive CARB 2008 Waste Gas Emissions certification for operation on landfill and digester gas. Capstone microturbines are capable of burning waste gases with methane contents as low as 30% which can be challenging for competing combustion technologies. We achieve CARB waste gas emissions requirements with our low premix combustion technology inherent to the microturbine which requires no exhaust after treatment. Certification to the new waste fuel emissions standard makes approved technologies such as the Capstone landfill and digester microturbines much easier to locate in California—often avoiding the need for local air permitting. Producing energy using gas from these applications avoids the need to use non-renewable resources such as coal, oil, or natural gas to produce the same amount of energy. A study performed by the EPA Landfill Methane Outreach Program (LMOP) has identified over 570 candidate sites in the United States alone with potential capacity for 1,370 megawatt and approximately 16 million metric tons of carbon equivalent (MMTCE) potential emissions reductions. Methane gas has 23 times the global warming potential of an equal mass of carbon dioxide. These environmental impacts equate to planting nearly 20 million acres of forest, preventing the use of nearly 170 million barrels of oil, or removing 14 million vehicles from our roads, based on EPA emissions and efficiency data for the average U.S. power plant and average passenger vehicle.

Capstone released for sale its C65 Liquid Fuel configuration microturbine system. The high reliability benefits of the Capstone microturbine product make it well suited for remote power and secure power applications which often use liquid fuel. Capstone liquid fuel microturbines are able to burn a variety of fuels including kerosene, high and low sulfur diesel, and biodiesel blends.

Capstone released versions of its C30 and C60 Series microturbine products for operation in high humidity applications. The new package provides resistance to corrosive environmental conditions typical of coastal, jungle and other high humidity installations. Previously released products for offshore manned and unmanned platforms have been well received by our oil and gas customers. The high humidity package is a further offering to many of these same customers for use at land-based oil and gas facilities.

Our more recent significant R&D activity has been the C200 microturbine—a 200-kilowatt, higher electrical efficiency product. Capstone worked with the DOE on its "Advanced MicroTurbine System" program and received funding for some of the early C200 development efforts. C200 beta testing has demonstrated performance to design objectives making the C200 the highest electrical efficiency turbine less than 4.5 megawatts. The C200 includes the same low emissions, certification options, and flexible configuration features incorporated on our existing C30 and C60 Series products. Capstone signed an agreement with UTCP to provide cash and in-kind services to complete development and commercially launch the C200 product in September 2007. Our C200 beta testing was successfully implemented during Fiscal 2005 and the first commercial shipment was on August 28, 2008.

Our C1000 Series product was developed based on Capstone's C200 microturbine product line. This product family can be configured into 1,000 kW, 800 kW and 600 kW solutions in a single ISO container. Benefits of the C1000 Series product include low greenhouse-gas emissions, patented air-bearing microturbine technology, easy to install and commission with a single fuel and electrical connection, minimal scheduled maintenance and downtime, low noise and vibration, and one of the industry's smallest modular footprints. Additional features include Capstone's remote monitoring and diagnostic capabilities and integrated utility synchronization and protection. Our C1000 product beta testing was successfully implemented during Fiscal 2009 and the first commercial shipment was on December 29, 2008.

In June 2009, we successfully completed scheduled testing that confirmed that our C200 and C1000 Series grid-connect and stand-alone microturbine power systems comply with UL 2200 and UL 1741.

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R&D activities have historically also focused on development of related products and applications, including gas compressors that enhance the microturbines' multi-fuel capability and integration with energy storage devices like battery packs for stand-alone applications. Current and future development activities will be in support of our focused target markets.

Capstone has a microturbine concept in the early stages of development, which is targeted at the needs of the Class 8 truck market (trucks or tractor-trailers with a manufacturer's listed gross vehicle weight of 33,000 pounds or more). This Inter Cooled and Recuperated ("ICR") microturbine is targeted to achieve 45% shaft efficiency while meeting 2010 EPA requirements for heavy duty diesel engines. In March 2009, we successfully demonstrated that our ICR microturbine produces emission levels that comply with the EPA and CARB 2010 requirements for heavy duty diesel engines and hybrid electric buses. Sales of heavy duty trucks and busses represent a major market opportunity, and therefore these applications have the potential to become a focused area for development if we can achieve the required performance and price levels.

### **Protecting our Intellectual Property Rights and Patents**

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 this regard, we have obtained 96 U.S. and 30 international patents (in certain cases covering the same technology in multiple jurisdictions). The patents we have obtained will expire between 2014 and 2024.

We believe that a policy of protecting intellectual property is an important component of our strategy of being the leader in microturbine system technology and will provide us with a long-term competitive advantage. In addition, we implement security procedures at our plants and facilities and have confidentiality agreements with our suppliers, distributors, employees and certain visitors to our facilities.

### **Organization and Employees**

We were organized in 1988. On June 22, 2000, we reincorporated as a Delaware corporation.

As of March 31, 2009, we employed 212 employees. No employees are covered by collective bargaining arrangements. We consider relations with our employees to be good.

### **Available Information**

This annual report on Form 10-K ("Annual Report"), as well as our quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act are made available free of charge on the Company's Internet website (<http://www.capstoneturbine.com>) as soon as reasonably practicable after such materials are electronically filed with or furnished to the Securities and Exchange Commission ("SEC").

**Item 1A. Risk Factors.**

*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, our future results of operations, profits and losses, R&D activities, sales expectations, our ability to develop markets for our products, sources for parts, federal, state and local regulations, general business, industry and economic conditions applicable to us, the reliability of our products and their need for maintenance, our ability to be cost-competitive and to outperform competition, customer satisfaction, the value of using our products, our ability to achieve economies of scale, market advantage, return on investment and functionality of our products. These statements are based largely on our current expectations, estimates and forecasts and are subject to a number of risks and uncertainties. Actual results could differ materially from those anticipated by 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 assume no obligation to update any of the forward-looking statements after the filing of this Annual Report to conform such statements to actual results or to changes in our expectations, except as may be required by law.*

*The following are risk factors that could affect our business, financial condition, results of operations, and cash flows. These risk factors should be considered in connection with evaluating the forward-looking statements contained in this Annual Report because these factors could cause the actual results and conditions to differ materially from those projected in forward-looking statements. Before you invest in our publicly traded securities, you should know that making such an investment involves some risks, including the risks described below. Additional risks of which we may not be aware or that we currently believe are immaterial may also impair our business operations or our stock price. If any of the risks actually occur, our business, financial condition, results of operations or cash flow could be negatively affected. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Annual Report, our quarterly reports on Form 10-Q and other documents filed by us from time to time.*

**Our operating history is characterized by net losses. We anticipate further losses and we may never become profitable.**

Since inception, we have incurred annual operating losses. We expect this trend to continue until such time that we can sell a sufficient number of units and achieve a cost structure to become profitable. Our business is such that we have relatively few customers and limited repeat business. As a result, we may not maintain or increase revenue. We may not have adequate cash resources to reach the point of profitability, and we may never become profitable. Even if we do achieve profitability, we may be unable to increase our sales and sustain or increase our profitability in the future.

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

To the extent that the funds we now have on hand are insufficient to fund our future operating requirements, we would need to raise additional funds, through further public or private equity or debt financings depending upon prevailing market conditions. These financings may not be available, or if available, may be on terms that are not favorable to us and could result in dilution to our stockholders and reduction of the trading price of our stock. The state of worldwide capital markets could also impede our ability to raise additional capital on favorable terms or at all. If adequate capital were not

available to us, we likely would be required to significantly curtail our operations or possibly even cease our operations.

On May 3, 2009, we received from Wells Fargo Bank, National Association ("Wells Fargo") a waiver of our noncompliance with two financial covenants as of March 31, 2009 in the credit facility agreements regarding our monthly book net worth and quarterly net income. If we had not received the waiver or if we fail to comply with the financial covenants contained in the credit facility agreements in the future, we would not be able to draw additional funds under the line of credit. In addition, we have pledged our accounts receivables, inventories, equipment, patents or other assets as collateral for our credit facility with Wells Fargo, which would be subject to seizure by our creditors if we were in default under our agreement and unable to repay the indebtedness. We must comply with the financial and other covenants contained in the credit facility agreements that could limit our flexibility in conducting our business and put us at a disadvantage compared to our competitors, and we are required to use our available cash to pay debt service. On June 9, 2009, we amended the credit facility agreements to revise the financial covenants regarding our monthly book net worth and quarterly and annual net income.

**If we are unable to either substantially improve our operating results or obtain additional financing, we may be unable to continue as a going concern.**

Should we be unable to execute our plans to build sales and margins while controlling costs and obtain additional financing, we may be unable to continue as a going concern. In particular, we must generate positive cash flow from operations and net income and otherwise improve our results of operations substantially. Our available cash, including net proceeds of \$11.2 million from our May 2009 registered direct placement, and proceeds from future financings, if any, that we may be able to obtain, may not be sufficient to fund our operating expenses, capital expenditures and other cash requirements. As a result, this would affect our ability to continue as a going concern. These events and circumstances could have a material adverse effect on our ability to raise additional capital and on the market value of our common stock. Moreover, should we experience a cash shortage that requires us to curtail or cease our operations, or should we be unable to continue as a going concern, you could lose all or part of your investments in our securities.

**A sustainable market for microturbines may never develop or may take longer to develop than we anticipate which would adversely affect our results of operations.**

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 allow our business to grow. To succeed, demand for our products must increase significantly in existing markets, and there must be strong demand for products that we introduce in the future. 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, and we may be unable to meet our operational expenses. The development of a sustainable market for our systems may be hindered by many factors, including some that are out of our control. Examples include:

- consumer reluctance to try a new product;
- regulatory requirements;
- the cost competitiveness of our microturbines;
- costs associated with the installation and commissioning of our microturbines;
- maintenance and repair costs associated with our microturbines;
- the future costs and availability of fuels used by our microturbines;

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- economic downturns and reduction in capital spending;
- consumer perceptions of our microturbines' safety and quality;
- the emergence of newer, more competitive technologies and products; and
- decrease in domestic and international incentives.

**Our operating results are dependent, in large part, upon the successful development and commercialization of our C200 product. Failure to produce this product as scheduled and budgeted would materially and adversely affect our business and financial condition.**

We cannot be certain that we will deliver ordered products in a timely manner. Any reliability or quality issues that may arise with the C200 could prevent or delay scheduled deliveries. We may also encounter material unexpected costs in connection with the commercialization of the C200. Any such delays or costs could significantly impact our business, financial condition and operating results.

**We may not be able to effectively manage our growth, expand our production capabilities or improve our operational, financial and management information systems, which would impair our results of operations.**

If we are successful in executing our business plan, we will experience growth in our business that could place a significant strain on our business operations, management and other resources. Our ability to manage our growth will require us to expand our production capabilities, continue to improve our operational, financial and management information systems, and to motivate and effectively manage our employees. We cannot provide assurance that our systems, procedures and controls or financial resources will be adequate, or that our management will keep pace with this growth. We cannot provide assurance that our management will be able to manage this growth effectively.

**The current global financial crisis may have an impact on our business and financial condition, including some effects we may not be able to predict.**

The continued credit crisis could prevent our customers from purchasing our products or delay their purchases, which would adversely affect our business, financial condition and results of operations. In addition, our ability to access the capital markets may be severely restricted or made very expensive at a time when we need, or would like to do so, which could have a material adverse impact on our liquidity and financial resources. Certain industries in which our customers do business and certain geographic areas have been and could continue to be adversely affected by the recession in economic activity.

**Our suppliers may not supply us with a sufficient amount of components or components of adequate quality or they may provide components at significantly increased prices, and, therefore, we may not be able to produce 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 suppliers, or if 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 suppliers that allow them to procure inventories 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. Our inability to meet volume commitments with suppliers could affect the availability or pricing of our parts and components. 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. Financial problems of suppliers on whom we rely could limit our supply of components or increase our costs. Also, we cannot guarantee that any of the parts or components that we purchase will be of adequate quality or that the prices we pay for the parts or components will not increase. Inadequate quality of products from suppliers could interrupt our ability to supply quality products to our customers in a timely manner. Additionally, defects in materials or products supplied by our suppliers that are not identified before our products are placed in service by our customers could result in higher warranty costs and damage to our reputation. We also outsource certain of our components internationally and expect to increase international outsourcing of components. As a result of outsourcing internationally, we may be subject to delays in delivery due to the timing or regulations associated with the import/export process, delays in transportation or regional instability.

**Product quality expectations may not be met causing slower market acceptance or warranty cost exposure.**

In order to achieve our goal of improving the quality and lowering the total costs of ownership of our products, we may require engineering changes. Such improvement initiatives may render existing inventories obsolete or excessive. Despite our continuous quality improvement initiatives, we may not meet customer expectations. Any significant quality issues with our products could have a material adverse effect on our rate of product adoption, results of operations, financial condition and cash flow. Moreover, as we develop new configurations for our microturbines or as our customers place existing configurations in commercial use, our products may perform below expectations. Any significant performance below expectations could adversely affect our operating results, financial condition and cash flow and affect the marketability of our products.

We sell our products with warranties. There can be no assurance that the provision for estimated product warranty will be sufficient to cover our warranty expenses in the future. We cannot ensure that our efforts to reduce our risk through warranty disclaimers will effectively limit our liability. Any significant incurrence of warranty expense in excess of estimates could have a material adverse effect on our operating results, financial condition and cash flow. Further, we have at times undertaken programs to enhance the performance of units previously sold. These enhancements have at times been provided at no cost or below our cost. If we choose to offer such programs again in the future, such actions could result in significant costs.

**We operate in a highly competitive market among competitors who have significantly greater resources than we have and we may not be able to compete effectively.**

Capstone microturbines compete with several technologies, including reciprocating engines, fuel cells and solar power. Competing technologies may receive certain benefits, like governmental subsidies or promotion, or be able to offer consumer rebates or other incentives that we cannot receive or offer to the same extent. This could enhance our competitors' abilities to fund research, penetrate markets or increase sales. We also compete with other manufacturers of microturbines.

Our competitors include several well-known companies with histories of providing power solutions. They have substantially greater resources than we have and have established worldwide presence. 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 they may lobby for governmental regulations and policies to create competitive advantages 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

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.

Overall, 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, including some that are outside of our control, include:

- name recognition, historical performance and market power of our competitors;
- product quality and performance;
- operating efficiency;
- product price;
- availability, price and compatibility of fuel;
- development of new products and features; and
- emissions levels.

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, financial condition and cash flow.

**If we do not effectively implement our sales, marketing and service plans, our sales will not grow and our results of operations will suffer.**

Our sales and marketing efforts may not achieve intended results and therefore may not generate the revenue we anticipate. As a result of our corporate strategies, we have decided to focus our resources on selected vertical markets. We may change our focus to other markets or applications in the future. There can be no assurance that our focus or our near term 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.

We offer direct sales and service in selected markets. We do not have extensive experience in providing direct sales and service and may not be successful in executing this strategy. In addition, we may lose existing distributors or service providers or we may have more difficulty attracting new distributors and service providers as a result of this strategy. Further we may incur new types of obligations, such as extended service obligations, that could result in costs that exceed the related revenue. We may encounter new transaction types through providing direct sales and service and these transactions may require changes to our historic business practices. For example, an arrangement with a third party leasing company may require us to provide a residual value guarantee, which is not consistent with our past operating practice.

Also, as we expand in international markets, customers may have difficulty or be unable to integrate our products into their existing systems or may have difficulty complying with foreign regulatory and commercial requirements. 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 import/export restrictions, fluctuations in currency exchange rates and global economic or political instability. In that regard, BPC, which accounted for approximately 29% of our net accounts receivable as of March 31, 2009 and approximately 13% of our revenue for Fiscal 2009, is a privately owned company located in Russia, and we are, therefore, particularly susceptible to risks associated with doing business in that country.

**We cannot be certain of the future effectiveness of our internal controls over financial reporting or the impact thereof on our operations or the market price of our common stock.**

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include in our Annual Reports on Form 10-K our assessment of the effectiveness of our internal controls over financial reporting. Although we believe that we currently have adequate internal controls procedures in place, we cannot be certain that our internal controls over financial reporting will remain effective or that future material changes to our internal controls will be effective. If we cannot adequately maintain the effectiveness of our internal controls over financial reporting, we might be subject to sanctions or investigation by regulatory authorities, such as the SEC. Any such action could adversely affect our financial results and the market price of our common stock or warrants.

**We may not be able to retain or develop relationships with OEMs or distributors in our targeted markets, in which case our sales would not increase as expected.**

In order to serve certain of our targeted markets, we believe that we must ally ourselves with companies that have particular expertise or better access to those markets. We believe that retaining or developing relationships with strong OEMs (which to date have typically resold our products under their own brands or packaged our products with other products as part of an integrated unit) or distributors in these 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. Because of OEMs' and distributors' relationships in their respective markets, the loss of an OEM or distributor could adversely impact the ability to penetrate our target markets. We offer our OEMs and distributors stated discounts from list price for the products they purchase. In the future, to attract and retain OEMs and distributors we may provide volume price discounts or otherwise incur significant costs that may reduce the potential revenues from these relationships. We may not be able to retain or develop appropriate OEMs and distributors on a timely basis, and we cannot provide assurance that the OEMs and distributors 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 our being unable to enter into other arrangements at a time when the OEM or distributor with whom we form a relationship is not successful in selling our products or has reduced its commitment to market our products. We cannot provide assurance that we will be able to negotiate collaborative relationships on favorable terms or at all. Our inability to have appropriate distribution in our target markets may adversely affect our financial condition, results of operations and cash flow.

**A significant customer may not achieve its forecasted sales growth. Also, we may incur expenses greater than we anticipate related to the sub-contractor service agreement we have with this customer, thereby adversely affecting our revenue levels and cash flow.**

Sales to UTCP, an affiliate of United Technologies Corporation, accounted for approximately 7% and 13% of our revenue for the fiscal years ended March 31, 2009 and 2008, respectively. Our OEM agreement with UTCP permits UTCP to package the Capstone microturbine products with chillers and heat exchange equipment manufactured by UTCP and to sell and service the integrated CCHP units. UTCP's performance as it relates to engineering, installation and provision of after-market service could have a significant impact on our reputation and products. Our near-term sales and cash flow could be adversely affected if UTCP does not achieve its forecasted sales growth. In addition, we entered into a service agreement with UTCP to act as a sub-contractor for UTCP in providing equipment maintenance for Capstone microturbines to certain UTCP customers. If we have to perform more warranty repairs than expected pursuant to this service agreement, our near-term and long-term cash flow and results of operations would suffer.

**Loss of a significant customer could have a material adverse effect on our results of operations.**

BPC and UTCP accounted for approximately 13% and 7% of our revenue, respectively, for the fiscal year ended March 31, 2009; and 29% and 2% of our net accounts receivable, respectively, as of March 31, 2009. Loss of these or any other significant customers could adversely affect our results of operations.

**We may not be able to develop sufficiently trained applications engineering, installation and service support to serve our targeted markets.**

Our ability to identify and develop business relationships with companies who can provide quality, cost-effective applications engineering, installations and service can significantly affect our success. The application engineering and proper installation of our microturbines, as well as proper maintenance and service, are critical to the performance of the units. Additionally, we need to reduce the total installed cost of our microturbines to enhance market opportunities. Our inability to improve the quality of applications, installation and service while reducing associated costs could affect the marketability of our products.

**Changes in our product components may require us to replace parts held at distributors and ASCs.**

We have entered into agreements with some of our distributors and ASCs that require that if we render parts obsolete in inventories they own and hold in support of their obligations to serve fielded microturbines, then we are required to replace the affected stock at no cost to the distributors or ASCs. It is possible that future changes in our product technology could involve costs that have a material adverse effect on our results of operations, cash flow or financial position.

**We operate in a highly regulated business environment, and changes in regulation could impose significant costs on us or make our products less economical, thereby affecting demand for our microturbines.**

Our products are subject to federal, state, local and foreign laws and regulations, governing, among other things, emissions to air and occupational health and safety. Regulatory agencies may impose special requirements for the implementation and operation of our products or that may significantly affect 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. Furthermore, our potential utility customers must comply with numerous laws and regulations. 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. We can provide no assurances that we will be able to obtain these approvals and changes in a timely manner, or at all. Non-compliance with applicable regulations could have a material adverse effect on our operating results.

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 cause rule changes that may reduce or eliminate some of the advantages of such deregulation and restructuring. We cannot determine how any deregulation or restructuring of the electric utility industry may ultimately affect the market for our microturbines. Changes in regulatory standards or policies could reduce the level of investment in the research and development of alternative power sources, including microturbines. Any reduction or termination of

such programs could increase the cost to our potential customers, making our systems less desirable, and thereby adversely affect our revenue and other operating results.

**Utility companies or governmental entities could place barriers to our entry into the marketplace, and we may not be able to effectively sell our products.**

Utility companies or governmental entities could place barriers on the installation of our products or the interconnection of the products with the electric grid. Further, they may charge additional fees to customers who install on-site generation, or for having the capacity to use power from the grid for back-up or standby purposes. These types of restrictions, fees or charges could hamper the ability to install or effectively use our products or increase the cost to our potential customers for using our systems. This could make our systems less desirable, thereby adversely affecting our revenue and other operating results. In addition, utility rate reductions can make our products less competitive which would have a material adverse effect on our operations. The cost of electric power generation bears a close relationship to natural gas and other fuels. However, changes to electric utility tariffs often require lengthy regulatory approval and include a mix of fuel types as well as customer categories. Potential customers may perceive the resulting swings in natural gas and electric pricing as an increased risk of investing in on-site generation.

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

Our operating results depend on our ability to develop and introduce new products, or enhance existing products and to reduce the costs to produce our products. The success of our products is dependent on several factors, including proper product definition, product cost, timely completion and introduction of the products, differentiation of 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 and enhancements 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 or enhanced products to market in a timely manner, successfully lower costs 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.

**Operational restructuring may result in asset impairment or other unanticipated charges.**

As a result of our corporate strategies, we have identified opportunities to outsource to third-party suppliers certain functions which we currently perform. We believe outsourcing can reduce product costs, improve product quality or increase operating efficiency. These actions may not yield the expected results, and outsourcing may result in production delays or lower quality products. Transitioning to outsourcing may cause certain of our affected employees to leave before the outsourcing is complete. This could result in a lack of the experienced in-house talent necessary to successfully implement the outsourcing. Further, depending on the nature of operations outsourced and the structure of agreements we reach with suppliers to perform these functions, we may experience impairment in the value of manufacturing assets related to the outsourced functions or other unanticipated charges, which could have a material adverse effect on our operating results.

**We may not achieve production cost reductions necessary to competitively price our product, which would adversely affect 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 supplier contracts and to increase sales volumes so we can achieve economies of scale. We cannot provide assurance that we will be able to achieve any such production cost reductions. Our failure to achieve such cost reductions could have a material adverse effect on our business and results of operations.

**Commodity market factors impact our costs and availability of materials.**

Our products contain a number of commodity materials, from metals, which includes steel, special high temperature alloys, copper, nickel and molybdenum, to computer components. The availability of these commodities could impact our ability to acquire the materials necessary to meet our requirements. The cost of metals has historically fluctuated. The pricing could impact the costs to manufacture our products. If we are not able to acquire commodity materials at prices and on terms satisfactory to us or at all, our operating results may be materially adversely affected.

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

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, results of operations and cash flow would 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, which would negatively impact our operations. 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 materially from period to period.

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

We may face litigation relating to intellectual property matters, labor matters, product liability, or other matters. We are subject to stockholder lawsuits alleging violations of securities laws in connection with our June 2000 initial public offering and November 2000 secondary offering described under "Legal Proceedings" in this Annual Report. An adverse judgment could negatively impact our financial position and results of operations, the trading 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.

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

Our success depends in significant part upon the continuing service of our executive officers, senior management and sales and technical personnel. The failure of our personnel to execute our strategy or our failure to retain management and personnel could have a material adverse effect on our business. 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 rely on people trained in the execution of the controls. Loss of these people or our inability to replace them with similarly skilled and trained individuals or new processes in a timely manner could adversely impact our internal control mechanisms.

**Our operations are vulnerable to interruption by fire, earthquake and other events beyond our control.**

Our operations are vulnerable to interruption by fire, earthquake and other events beyond our control. Our executive offices and manufacturing facilities are located in southern California. Because the southern California area is located in an earthquake-sensitive area, we are particularly susceptible to the risk of damage to, or total destruction of, our facilities in southern California and the surrounding transportation infrastructure, which could affect our ability to make and transport our products. We do not maintain earthquake insurance coverage for personal property or resulting business interruption. If an earthquake, fire or other natural disaster occurs at or near our facilities, our business, financial condition, operating results and cash flow could be materially adversely affected.

**The market price of our common stock has been and may continue to be highly volatile and you could lose all or part of your investment in our securities.**

An investment in our securities is risky, and stockholders could lose their investment in our securities or suffer significant losses and wide fluctuations in the market value of their investment. The market price of our common stock is highly volatile and is likely to continue to be highly volatile. As a result of, among other things, the factors discussed below, our operating results for a particular quarter are difficult to predict. Given the continued uncertainty surrounding many variables that may affect our business and the industry in which we operate, our ability to foresee results for future periods is limited. This variability could affect our operating results and thereby adversely affect our stock price. Many factors that contribute to this volatility are beyond our control and may cause the market price of our common stock to change, regardless of our operating performance. Factors that could cause fluctuation in our stock price may include, among other things:

- actual or anticipated variations in quarterly operating results;
- market sentiment toward alternative energy stocks in general or toward Capstone;
- changes in financial estimates or recommendations by securities analysts;
- conditions or trends in our industry or the overall economy;
- loss of one or more of our significant customers;
- errors, omissions or failures by third parties in meeting commitments to us;
- changes in the market valuations or earnings of our competitors or other technology companies;
- the trading of options on our common stock;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives;
- announcements of significant market events, such as power outages, regulatory changes or technology changes;
- changes in the estimation of the future size and growth rate of our market;
- future equity financings;
- the failure to produce our products on a timely basis in accordance with customer expectations;
- the inability to obtain necessary components on time and at a reasonable cost;
- litigation or disputes with customers or business partners;
- capital commitments;
- additions or departures of key personnel;

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- sales or purchases of our common stock;
- the trading volume of our common stock;
- developments relating to litigation or governmental investigations; and
- decreases in oil, natural gas and electricity prices.

In addition, the stock market in general, and the Nasdaq Global Market and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies affected. The market prices of securities of technology companies and companies servicing the technology industries have been particularly volatile. These broad market and industry factors may cause a material decline in the market price of our common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class-action litigation has often been instituted against that company. We are currently subject to litigation relating to our initial public offering and a subsequent common stock offering as described under "Legal Proceedings" in this Annual Report. This type of litigation, regardless of whether we prevail on the underlying claim, could result in substantial costs and a diversion of management's attention and resources, which could materially harm our financial condition, results of operations and cash flow.

### **Provisions in our certificate of incorporation, bylaws and our stockholder rights plan, as well as Delaware law, may discourage, delay or prevent a merger or acquisition at a premium price.**

Provisions of our second amended and restated certificate of incorporation, amended and restated bylaws and our stockholder rights plan, as well as provisions of the General Corporation Law of the State of Delaware, could discourage, delay or prevent unsolicited proposals to merge with or acquire us, even though such proposals may be at a premium price or otherwise beneficial to you. These provisions include our board's authorization to issue shares of preferred stock, on terms the board determines in its discretion, without stockholder approval, and the following provisions of Delaware law that restrict many business combinations.

We are subject to the provisions of Section 203 of the General Corporation Law of the State of Delaware, which could prevent us from engaging in a business combination with a 15% or greater stockholder for a period of three years from the date it acquired such status unless appropriate board or stockholder approvals are obtained.

Our board of directors has adopted a stockholder rights plan, pursuant to which one preferred stock purchase right has been issued for each share of our common stock authorized and outstanding. Until the occurrence of certain prescribed events, the rights are not exercisable and are transferable along with, and only with, each share of our common stock and are evidenced by the common stock certificates. One preferred stock purchase right will also be issued with each share of our common stock we issue in the future until the rights plan expires or is terminated or we redeem or exchange the rights for other property in accordance with the terms of the rights plan or at such time, if any, as the rights separate from each share of our common stock and become exercisable. Each share of Series A Junior Participating Preferred Stock will be entitled to receive, when, as and if declared by our board of directors out of funds legally available for the purpose, dividends payable in cash in an amount per share (rounded to the nearest cent) equal to 100 times the aggregate per share amount of all dividends or other distributions, including non-cash dividends (payable in kind), declared on our common stock other than a dividend payable in shares of common stock or a subdivision of the outstanding shares of common stock. The rights plan prohibits the issuance of additional rights after the rights separate from our common stock. The rights plan is intended to protect our stockholders in the event of an unfair or coercive offer to acquire us. However, the existence of the rights plan may discourage, delay or prevent a merger or acquisition of us that is not supported by our board of directors.

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

Our principal corporate offices, administrative, sales and marketing, R&D and support facilities consist of approximately 98,000 square feet of leased office space, warehouse space and assembly and test space located at 21211 Nordhoff Street in Chatsworth, California. Our lease for those premises expires in May 2010. We also lease an approximately 79,000 square foot facility at 16640 Stagg Street in nearby Van Nuys, California as an engineering test and manufacturing facility for our recuperator cores. This lease will expire in November 2010.

We also lease approximately 47,500 square feet of space in Brooklyn, New York pursuant to a lease agreement which expires in October 2010 to accommodate offices, warehousing and manufacturing and light component assembly work. In January 2008, we had reduced the occupancy by 22,392 square feet of space in this office.

We lease approximately 3,083 square feet of space in Elmwood Park, New Jersey pursuant to a lease agreement which expires in August 2010 to accommodate offices and warehousing.

We believe our facilities are adequate for our current needs.

**Item 3. Legal Proceedings.**

In December 2001, a purported stockholder class action lawsuit was filed in the United States District Court for the Southern District of New York (the "District Court") against the Company, two of its then 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. The Plaintiffs allege that the underwriter defendants agreed to allocate stock in our 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. The 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. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998; the complaints have been consolidated into an action captioned In re Initial Public Offering Securities Litigation, No. 21 MC 92. On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all the actions, including the action involving the Company. On July 15, 2002, the Company, along with other non-underwriter defendants in the coordinated cases, moved to dismiss the litigation. On October 9, 2002, the Plaintiffs dismissed, without prejudice, the claims against the named officers and directors in the action against the Company. On February 19, 2003, the District Court issued an order denying the motion to dismiss the claims against the Company under Rule 10b-5. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including the Company. In June 2004 a stipulation of partial settlement and release of claims against the issuer and individual defendants was submitted to the District Court. While the partial settlement was pending approval, the Plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of "focus cases" and on October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. In light of the Second Circuit opinion, liaison counsel for all issuer defendants, including the Company, informed the District Court that the settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On August 14, 2007, the Plaintiffs filed their second consolidated amended complaints against the six focus cases and on

September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. The motion for class certification was withdrawn without prejudice on October 10, 2008. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement "fairness" hearing has been scheduled for September 10, 2009. Following the hearing, if the Court determines that the settlement is fair to the class members, the settlement will be approved and the case against the Company and its individual defendants will be dismissed with prejudice. Because of the inherent uncertainties of litigation and because the settlement approval process is at a preliminary stage, the ultimate outcome of the matter is uncertain, and we believe that the outcome of this litigation will not have a material adverse impact on the consolidated financial position and results of operations.

On October 9, 2007, Vanessa Simmonds, a purported stockholder of the Company, filed suit in the U.S. District Court for the Western District of Washington against The Goldman Sachs Group, Inc., Merrill Lynch & Co., Inc., and Morgan Stanley, the lead underwriters of our initial public offering in June 1999, and our secondary offering of common stock in November 2000, alleging violations of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The complaint sought to recover from the lead underwriters any "short-swing profits" obtained by them in violation of Section 16(b). The suit names the Company as a nominal defendant, contained no claims against the Company, and sought no relief from the Company. Simmonds filed an Amended Complaint on February 27, 2008 (the "Amended Complaint"), naming as defendants Goldman Sachs & Co. and Merrill Lynch Pierce, Fenner & Smith Inc. and again naming Morgan Stanley. The Goldman Sachs Group, Inc. and Merrill Lynch & Co., Inc. were no longer named as defendants. The Amended Complaint asserted substantially similar claims as those set forth in the initial complaint. On July 25, 2008, the Company joined with 29 other issuers to file the Issuer Defendants' Joint Motion to Dismiss. Simmonds filed her opposition to this motion on September 8, 2008, and the Company and the other Issuer Defendants filed a Reply in Support of Their Joint Motion to Dismiss on October 23, 2008. On March 12, 2009, the Court granted the Issuer Defendants' Joint Motion to Dismiss, dismissing the complaint without prejudice on the grounds that Simmonds had failed to make an adequate demand on the Company prior to filing her complaint. In its order, the Court stated that it would not permit Simmonds to amend her demand letters while pursuing her claims in the litigation. Because the Court dismissed the case on the grounds that it lacked subject matter jurisdiction, it did not specifically reach the issue of whether Simmonds' claims were barred by the applicable statute of limitations. However, the Court also granted the Underwriters' Joint Motion to Dismiss with respect to cases involving non-moving issuers, holding that the cases were barred by the applicable statute of limitations because the issuers' shareholders had notice of the potential claims more than five years prior to filing suit. Simmonds filed a Notice of Appeal on April 10, 2009. Simmonds' opening brief in the appeal is due on July 27, 2009, with the Company and the underwriters' responses due on August 25, 2009. Simmonds may file a reply brief on September 8, 2009. We believe that the outcome of this litigation will not have a material adverse impact on the consolidated financial position and results of operations.

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

We did not submit any matters to a vote of our stockholders during the fourth quarter of the year ended March 31, 2009.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

#### *Price Range of Common Stock*

Our common stock is publicly traded on the Nasdaq Global Market under the symbol "CPST". The following table sets forth the low and high sales prices for each period indicated.

	<u>High</u>	<u>Low</u>
<b>Year Ended March 31, 2008:</b>		
First Quarter	\$1.28	\$0.86
Second Quarter	\$1.48	\$0.91
Third Quarter	\$1.83	\$1.02
Fourth Quarter	\$2.28	\$1.20
<b>Year Ended March 31, 2009:</b>		
First Quarter	\$4.42	\$2.14
Second Quarter	\$4.15	\$1.12
Third Quarter	\$1.67	\$0.61
Fourth Quarter	\$1.10	\$0.39

As of June 5, 2009, the last reported sale price of our common stock on the Nasdaq Global Market was \$0.70 per share.

#### *Stockholders*

As of June 5, 2009 there were 929 stockholders of record of our common stock. This does not include the number of persons whose stock is held in nominee or "street name" accounts through brokers.

#### *Dividend Policy*

We currently intend to retain any earnings for use in our business and, therefore, we do not anticipate paying any cash dividends in the foreseeable future. We have never declared or paid any cash dividends on our capital stock. In the future, the decision to pay any cash dividends will depend upon our results of operations, financial condition, cash flow and capital expenditure plans, as well as such other factors as our Board of Directors, in its sole discretion, may consider relevant and approval from Wells Fargo.

**Item 6. Selected Financial Data.**

The selected financial data shown below have been derived from the audited financial statements of Capstone. The historical results are not necessarily indicative of the operating results to be expected in the future. The selected financial data should be read in conjunction with "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes included elsewhere in this Annual Report.

Amounts in thousands, except per share data.

	Year Ended March 31,				
	2009	2008	2007	2006	2005
<b>Statement of Operations:</b>					
Revenue	\$ 43,949	\$ 31,305	\$ 21,018	\$ 24,103	\$ 16,968
Cost of goods sold	49,277	35,105	26,045	34,563	25,545
Gross loss	(5,328)	(3,800)	(5,027)	(10,460)	(8,577)
Operating costs and expenses:					
Research and development	8,125	8,906	9,374	11,019	11,761
Selling, general and administrative	28,628	25,622	24,615	27,741	20,782
Loss from operations	(42,081)	(38,328)	(39,016)	(49,220)	(41,120)
Net loss	\$(41,717)	\$(36,113)	\$(36,728)	\$(47,073)	\$(39,449)
Net loss per share of common stock—basic and diluted	\$ (0.25)	\$ (0.25)	\$ (0.32)	\$ (0.50)	\$ (0.47)

	As of March 31,				
	2009	2008	2007	2006	2005
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$19,519	\$42,605	\$60,322	\$58,051	\$63,593
Working capital	34,741	44,934	72,103	60,099	61,562
Total assets	72,329	74,046	97,003	89,717	95,190
Revolving credit facility	3,654	—	—	—	—
Capital lease/note payable obligations	41	18	46	66	83
Long-term liabilities	288	463	561	626	1,002
Stockholders' equity	\$50,470	\$53,053	\$81,785	\$71,628	\$76,678

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause a difference include, but are not limited to, those discussed under Item 1A (Risk Factors) in this Annual Report. The following section is qualified in its entirety by the more detailed information, including our financial statements and the notes thereto, which appears elsewhere in this Annual Report.*

### **Overview**

Capstone is, and has been, the market leader in microturbines based on the number of microturbines sold. However, the adoption rate for our products has been slower than originally anticipated. We believe that the following key factors contributed to this result: inadequate technology robustness and solution-specific engineering, installation, commissioning and service work; market approach; new technology adoption barriers; and Capstone's R&D-focused culture and constrained capital spending as a result of general economic conditions. The performance of our early-generation microturbines was inconsistent. While some units performed as expected, others did not. These performance inconsistencies have been identified as coming from the product itself and from inappropriate application and inadequate installation and service work. Contributing to these challenges, our historical market approach was to emphasize sales volume primarily rather than sales with higher contribution margins. This historical focus on volume introduced high variability in the configurations sold, types of applications, system installations and customer requirements. In addition, new technologies traditionally encounter adoption barriers. An important means to overcome adoption barriers is to fully meet customers' needs and develop groups of customers who provide good references for potential new customers in their specific markets. Capstone's widespread approach to marketing did not focus on any given market. While these types of challenges are not unusual for new companies, we believe Capstone's historically R&D-focused business structure and culture prohibited us from adequately addressing necessary changes.

Our Chief Executive Officer, Executive Vice President of Sales & Marketing and Senior Vice President of Customer Service have an approximate combined experience of sixty years in distributed generation and co-generation. This team has successfully sold competing products including GE Energy Jenbacher gas engines, and Caterpillar Inc., Deutz Corporation, Waukesha and other microturbines.

We continue to focus on our customers, learning from them what we need to do to improve our delivery of products and services. We continue to implement the necessary changes to transition from an R&D-focused company and culture to a business that is focused on customers and operational excellence. Engineering projects are approved based on market requirements and decisions to move forward on projects are tied to our financial goals. Our focus is on products and solutions that provide near-term opportunities to drive repeatable business rather than discrete projects for niche markets.

In order to increase volume and reduce cost, we are focusing our efforts in vertical markets that we expect to generate repeat business for the Company. To support our opportunities to grow in these target markets, we continue to enhance the reliability of our products' performance through a multi-faceted approach. We developed new processes and enhanced training to assist those who apply, install and use our products, and we improved the products themselves.

An overview of our direction, targets and key initiatives follows:

- 1) *Focus on Vertical Markets*—Within the distributed generation markets that we serve, we focus on vertical markets that we identify as having the greatest near-term potential. In our primary products and applications (CHP and CCHP, resource recovery and secure power), we identify specific targeted vertical market segments. Within each of these markets, we identify what we

believe to be the critical factors to penetrating these markets and have based our plans on those factors.

During Fiscal 2009, we booked orders for 76.6 megawatts and shipped 34.1 megawatts of products, resulting in 72.0 megawatts in backlog at the end of the fiscal year. Our actual product shipments in Fiscal 2009 were: 36% for use in CHP applications, 7% for use in CCHP applications, 40% for use in resource recovery applications and 17% for use in other applications (including secure power).

- 2) *Sales and Distribution Channel*—We seek out distributors and representatives that have business experience and capabilities to support our growth plans in our targeted markets. In North America, we currently have 26 distributors and OEMs. Internationally, outside of North America, we currently have 32 distributors and OEMs. We continue to refine the distribution channels to address our specific targeted markets.
- 3) *Service*—We serve our customers directly and through qualified distributors and ASCs, all of whom will perform their service work using technicians specifically trained by Capstone. In Fiscal 2009, we continued to present alternatives to customers under-served by our distributor and ASC base through Capstone factory direct service. Service revenue in Fiscal 2009 was approximately 7% of total revenue.
- 4) *Product Robustness and Life Cycle Maintenance Costs*—To provide us with the ability to evaluate microturbine performance in the field, we developed a "real-time" remote monitoring and diagnostic feature. This feature allows us to monitor installed units and rapidly collect operating data on a continual basis. We use this information to anticipate and more quickly respond to field performance issues, evaluate component robustness and identify areas for continuous improvement. This feature is important in allowing us to better serve our customers.
- 5) *New Product Development*—Our new product development is targeted specifically to meet the needs of our selected vertical markets. We expect that our existing product platforms, the C30, C60 Series, C200 and C1000 Series microturbines, will be our foundational product lines for the foreseeable future. Our product development efforts are centered on enhancing the features of these base products. Our C200 product beta testing was successfully implemented during Fiscal 2005 and first commercial shipment was on August 28, 2008. Our C1000 Series product was developed based on Capstone's C200 microturbine product line. This product family can be configured into 1,000-kW, 800-kW and 600-kW solutions in a single ISO-sized container. Our C1000 product beta testing was successfully implemented during Fiscal 2009 and the first commercial shipment was on December 29, 2008.
- 6) *Cost and Core Competencies*—We are making progress towards achieving overall cost improvements through design changes, automation, parts commonality across multiple product lines, and by outsourcing areas not consistent with our core competencies. In conjunction with these changes, we launched a strategic supply chain initiative to develop suppliers on a global basis. The Company continues to review avenues for cost reduction by sourcing to the best value supply chain option. We have made progress diversifying our suppliers in the international "marketplace" as well as within the United States. We expect to leverage our costs as product volumes increase.

We believe that effective execution in each of these key areas will be necessary to leverage Capstone's promising technology and early market leadership into achieving positive cash flow with growing market presence and improving financial performance. Based on our recent progress and assuming achievement of targeted contribution margins, our financial model indicates that we will

achieve positive cash flow when we ship approximately 200 units in a quarter, depending on product mix.

### **Critical Accounting Policies**

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosures of contingent liabilities. On an on-going basis, we evaluate our estimates, including but not limited to those related to long-lived assets, including intangible assets and fixed assets, bad debts and sales allowances, inventories, warranty obligations, stock-based compensation, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe that the following critical accounting policies affect our more significant judgments and estimates used in the preparation of the consolidated financial statements.

- In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we evaluate the carrying value of long-lived assets, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Factors that are considered important that could trigger an impairment review include a current-period operating or cash flow loss combined with a history of operating or cash flow losses and a projection or forecast that demonstrates continuing losses or insufficient income associated with the use of a long-lived asset or asset group. Other factors include a significant change in the manner of the use of the asset or a significant negative industry or economic trend. This evaluation is performed based on undiscounted estimated future cash flows compared with the carrying value of the related assets. If the undiscounted estimated future cash flows are less than the carrying value, an impairment loss is recognized, measured by the difference between the carrying value and the estimated fair value of the assets, with such estimated fair values determined using the best information available, generally the discounted estimated future cash flows of the assets using a rate that approximates our weighted-average cost of capital. Quarterly, we assess whether events or changes in circumstances have occurred that potentially indicate the carrying value of long-lived assets may not be recoverable.

The estimation of future cash flows requires significant estimates of factors that include future sales growth, gross margin performance and reductions in operating expenses. If our sales growth, gross margin performance or other estimated operating results are not achieved at or above our forecasted level, or inflation exceeds our forecast and we are unable to recover such costs through price increases, the carrying value of our asset groups may prove to be unrecoverable and we may incur impairment charges in the future. The Company performed an analysis during Fiscal 2009 and determined that the estimated fair value of the long-lived assets exceeded the carrying value of the assets and no write-down was necessary.

- Our inventories are valued at lower of cost or market. We routinely evaluate the composition of our inventories and identify slow-moving, excess, obsolete or otherwise impaired inventories. Inventories identified as impaired are evaluated to determine if write-downs are required. Included in this assessment is a review for obsolescence as a result of engineering changes in our product. Future product enhancement and development may render certain inventories obsolete,

resulting in additional write-downs of inventories. In addition, inventories are classified as current or long-term based on our sales forecast. A change in forecast could impact the classification of inventories.

- We provide for the estimated cost of warranties at the time revenue from sales is recognized. We also accrue the estimated costs to address reliability repairs on products no longer under warranty when, in our judgment, and in accordance with a specific plan developed by us, it is prudent to provide such repairs. We estimate warranty expenses based upon historical and projected product failure rates, estimated costs of parts, labor and shipping to repair or replace a unit and the number of units covered under the warranty period. While we engage in extensive quality programs and processes, our warranty obligation is affected by failure rates and service costs in correcting failures. As we have more units commissioned and longer periods of actual performance, additional data becomes available to assess expected warranty costs. When we have sufficient evidence that product changes are altering the historical failure occurrence rates, the impact of such changes is then taken into account in estimating future warranty liabilities. Changes in estimates are recorded in the period that new information, such as design changes, cost of repair and product enhancements, becomes available. Should actual failure rates or service costs differ from our estimates, revisions to the warranty liability would be required and could be material to our financial condition, results of operations and cash flow.
- Our revenue consists of sales of products, parts, accessories and service, net of discounts and allowances for sales returns. Our distributors purchase products and parts for sale to end users and are also required to provide a variety of additional services, including application engineering, installation, commissioning and post-commissioning service. Our standard terms of sales to distributors and direct end users include transfer of title, care, custody and control at the point of shipment, payment terms ranging from full payment in advance of shipment to payment in 90 days, no right of return or exchange, and no post-shipment performance obligations by us except for warranties provided on the products and parts sold. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, selling price is fixed or determinable and collectibility is reasonably assured. While there are no rights of return privileges on product sales, we have made some limited exceptions to the no-right-of-return policy. We have provided an allowance for future sales returns based on information from the previous three years. We occasionally enter into agreements that contain multiple elements, such as equipment, installation, engineering and/or service. For multiple-element arrangements, we recognize revenue for delivered elements when the delivered item has stand-alone value to the customer, fair values of undelivered elements are known and customer acceptance, if required, has occurred.
- We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We evaluate all accounts aged over 60 days or past payment terms. If the financial condition of our customers deteriorates or if other conditions arise that result in an impairment of their ability or intention to make payments, additional allowances may be required.
- We have a history of unprofitable operations. These losses generated significant federal and state net operating loss ("NOL") carryforwards. SFAS No. 109, "Accounting for Income Taxes" requires that we record a valuation allowance against the net deferred income tax assets associated with these NOLs if it is "more likely than not" that we will not be able to utilize them to offset future income taxes. Because of the uncertainty surrounding the timing of realizing the benefits of our favorable tax attributes in future income tax returns, a valuation allowance has been provided against all of our net deferred income tax assets. We currently provide for income taxes only to the extent that we expect to pay cash taxes, primarily state

taxes. It is possible, however, that we could be profitable in the future at levels which could cause management to determine that it is more likely than not that we will realize all or a portion of the NOL carryforwards. Upon reaching such a conclusion, we would record the estimated net realizable value of the deferred income tax asset at that time. Such adjustment would increase income in the period that the determination was made. On April 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes—an interpretation of SFAS No. 109". FIN 48 prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Only tax positions meeting the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. FIN 48 also provides guidance on accounting for derecognition, interest and penalties, and classification and disclosure of matters related to uncertainty in income taxes. Because of our significant historical losses, we have not been subject to federal or state income taxes and thus any FIN 48 liabilities identified currently reduce deferred tax assets.

- We account for contingencies in accordance with SFAS No. 5, "Accounting for Contingencies." SFAS No. 5 requires that we record an estimated loss from a loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accounting for contingencies, such as legal matters, requires us to use our judgment. Any unfavorable outcome of litigation or other contingencies could have an adverse impact on our financial condition, results of operations and cash flow.
- SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)") requires that we recognize stock-based compensation expense associated with stock options in the statement of operations, rather than disclose it in a pro forma footnote to the consolidated financial statements. Determining the amount of stock-based compensation to be recorded requires us to develop estimates to be used in calculating the grant-date fair value of stock options. We calculate the grant-date fair values using the Black-Scholes valuation model. The use of valuation models requires us to make estimates of the following assumptions:
  - Expected volatility—The estimated stock price volatility was derived based upon the Company's actual historic stock prices over the expected option life, which represents the Company's best estimate of expected volatility.
  - Expected option life—For Fiscal 2008 and 2007, the Company's estimate of an expected option life was calculated in accordance with the Staff Accounting Bulletin No. 107 simplified method for calculating the expected term assumption. In Fiscal 2009, the expected life, or term, of options granted is derived from historical exercise behavior and represents the period of time that stock option awards are expected to be outstanding.
  - Risk-free interest rate—We used the yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected life assumption as the risk-free interest rate.

The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term "forfeitures" is distinct from "cancellations" or "expirations" and represents only the unvested portion of the surrendered option. We review historical forfeiture data and determine the appropriate forfeiture rate based on that data. We re-evaluate this analysis periodically and adjust the forfeiture rate as necessary. Ultimately, we recognize the actual expense over the vesting period only for the shares that vest.

**Results of Operations*****Year Ended March 31, 2009 Compared to Year Ended March 31, 2008***

*Revenue.* Revenue is reported net of sales returns and allowances. Revenue for the year ended March 31, 2009 increased \$12.6 million, or 40%, to \$43.9 million from \$31.3 million for the year ended March 31, 2008.

Revenue from microturbine product shipments increased \$10.7 million, or 49%, to \$32.4 million for 494 units during Fiscal 2009 from \$21.7 million for 434 units during Fiscal 2008. Shipments of microturbine units were 34.1 megawatts during Fiscal 2009 compared to 22.5 megawatts during Fiscal 2008. Revenue from C30 product shipments decreased \$2.4 million, or 38%, to \$4.0 million for 104 units during Fiscal 2009 from \$6.4 million for 165 units during Fiscal 2008. Shipments of C30 product were 3.1 megawatts during Fiscal 2009 compared to 5.0 megawatts during Fiscal 2008. Revenue from C60 Series product shipments increased \$8.5 million, or 56%, to \$23.8 million for 375 units during Fiscal 2009 from \$15.3 million for 269 units during Fiscal 2008. Shipments of C60 Series products were 24.4 megawatts during Fiscal 2009 compared to 17.5 megawatts during Fiscal 2008. Revenue from C200 product shipments was \$1.4 million for 9 units, or 1.8 megawatts, during Fiscal 2009. There were no C200 product shipments in the same period last year. Revenue from C600 product shipments was \$1.0 million for two units, or 1.2 megawatts, during Fiscal 2009. There were no C600 product shipments in the same period last year. Revenue from C800 product shipments was \$1.1 million for two units, or 1.6 megawatts, during Fiscal 2009. There were no C800 product shipments in the same period last year. Revenue from C1000 product shipments was \$1.1 million for two units, or 2.0 megawatts, during Fiscal 2009. There were no C1000 product shipments in the same period last year. Revenue from accessories, parts and service during Fiscal 2009 increased \$1.9 million to \$11.5 million from \$9.6 million during Fiscal 2008.

The overall revenue increase for the year ended March 31, 2009 compared to the previous year included a \$9.0 million increase in revenue from the North American market, a \$4.6 million increase in revenue from the Asian market, a \$1.4 million increase in revenue from the European market, all primarily the result of efforts to improve distribution channels. South American market revenue for the year ended March 31, 2009 was \$2.4 million lower than the previous year because the year ended March 31, 2008 included an unusually large product sale for this historically small revenue market. The timing of shipments is subject to change based on several variables (including customer payments and customer delivery schedules), some of which are not in our control and can affect our quarterly revenue and backlog. Therefore, we evaluate historical revenue in conjunction with backlog to anticipate the growth trend of our revenue.

The following table summarizes our revenue (revenue amounts in millions):

	Years Ended March 31,					
	2009			2008		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
C30	\$ 4.0	3.1	104	\$ 6.4	5.0	165
C60 Series	23.8	24.4	375	15.3	17.5	269
C200	1.4	1.8	9	—	—	—
C600	1.0	1.2	2	—	—	—
C800	1.1	1.6	2	—	—	—
C1000 Series	1.1	2.0	2	—	—	—
Total from Microturbine Products	\$32.4	34.1	494	\$21.7	22.5	434
Accessories, Parts and Service	11.5	—	—	9.6	—	—
Total	\$43.9	34.1	494	\$31.3	22.5	434

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One customer accounted for 13% of revenue for the year ended March 31, 2009. For the year ended March 31, 2008, two customers accounted for 18% and 13% of revenue, respectively. Sales to BPC accounted for 13% and 18% of revenues for the year ended March 31, 2009 and 2008, respectively. Sales to UTC accounted for 7% and 13% of revenue for year ended March 31, 2009 and 2008, respectively.

*Gross Loss.* Cost of goods sold includes direct material costs, production overhead, inventory charges and provision for estimated product warranty expenses. The gross loss was \$5.3 million, or 12% of revenue, for the year ended March 31, 2009 compared to \$3.8 million, or 12% of revenue, for the year ended March 31, 2008. The increase in gross loss reflects increased manufacturing costs of \$2.9 million because of the product launch of the C200 and C1000 Series systems offset by an improvement of \$0.1 million as a result of a higher margin product mix, primarily because of increased sales of C60 Series systems and reduced warranty expense of \$1.3 million. Warranty expense is a combination of a per-unit warranty accrual recorded at the time revenue is recognized and changes, if any, in estimates for warranty programs. Warranty program estimates are recorded in the period that new information, such as design changes, cost of repair and product enhancements, becomes available. Warranty expense for unit shipments increased slightly as a result of higher shipment volumes and the product launch of the C200 and C1000 Series systems offset by a decrease in the estimated cost of repair. In addition, the warranty expense increase was offset by a \$1.3 million reduction in warranty programs because of units subsequently covered by factory protection plans, units decommissioned and our expectation that units will fall outside of the estimated warranty failure period.

We expect to continue to incur gross losses until we are able to achieve higher unit sales volumes to cover our fixed manufacturing costs. We have taken initiatives to further reduce direct material costs and other manufacturing and warranty costs as we work to achieve profitability.

*Research and Development Expenses.* R&D expenses include compensation, engineering department expenses, overhead allocations for administration and facilities and materials costs associated with development. R&D expenses for the year ended March 31, 2009 decreased \$0.8 million, or 9%, to \$8.1 million from \$8.9 million for the year ended March 31, 2008. R&D expenses are reported net of benefits from cost-sharing programs, such as the DOE and the UTCP funding. There were approximately \$8.1 million of such benefits for the year ended March 31, 2009 and \$3.0 million of such benefits for the year ended March 31, 2008. In-kind services performed by UTCP under the cost-sharing program for each of the years ended March 31, 2009 and 2008 were valued at \$0.2 million and recorded as consulting expense. The overall decrease in R&D expenses of \$0.8 million resulted from the increased recognition of \$5.1 million of funding from UTCP for the cost-sharing program. This benefit was offset by increased spending for supplies of \$2.3 million, labor costs of \$1.4 million, consulting fees of \$0.4 million and facilities expense of \$0.2 million. Cost-sharing programs vary from period to period depending on the phases of the programs. We expect to enter into at least one cost sharing program in Fiscal 2010. If we do not enter into the cost sharing programs as expected, we will not incur some of the planned costs and, as a result, would expect our spending in Fiscal 2010 to be lower to that in Fiscal 2009.

*Selling, General and Administrative ("SG&A") Expenses.* SG&A expenses increased \$3.0 million, or 12%, to \$28.6 million for the year ended March 31, 2009 from \$25.6 million for the year ended March 31, 2008. The net increase in SG&A expenses was comprised of an increase of \$1.9 million in labor expense, \$1.6 million related to travel expense, \$0.3 million of marketing expense and \$0.1 million in professional services expense, including accounting, legal and insurance expense, offset by a decrease for a change in estimate of legal accruals of \$0.4 million, supplies of \$0.3 million and consulting expense of \$0.2 million. The increase in labor and travel costs reflects the continued effort to develop worldwide distributors and the launch of the C200 and C1000 Series systems. We expect SG&A costs in Fiscal 2010 to be slightly lower than in Fiscal 2009.

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*Interest Income.* Interest income for the year ended March 31, 2009 decreased \$1.7 million, or 77%, to \$0.5 million from \$2.2 million for the year ended March 31, 2008. The decrease during Fiscal 2009 was attributable to lower average cash balances and interest rates during the year ended March 31, 2009. We expect interest income to decline for the year ending March 31, 2010 as we continue to use cash to support our operations.

*Interest Expense.* Interest expense for the year ended March 31, 2009 increased \$62,000, or 886%, to \$69,000 from \$7,000 for the year ended March 31, 2008. Interest expense related to the Credit Facility accounted for the increase in interest expense in Fiscal 2009. On February 9, 2009, we entered into two Credit and Security Agreements (the "Agreements") with Wells Fargo. The Agreements provide us with a line of credit (the "Credit Facility") of up to \$10 million in the aggregate. As of March 31, 2009, we had total debt of \$3.7 million outstanding under our revolving Credit Facility.

*Income Tax Provision.* At March 31, 2009, we had federal and state net operating loss carryforwards of approximately \$508.6 million and \$341.8 million, respectively, which may be utilized to reduce future taxable income, subject to limitations under Section 382 of the Internal Revenue Code of 1986. We provided a valuation allowance for 100% of our net deferred tax asset of \$210.6 million at March 31, 2009 because the realization of the benefits of these favorable tax attributes in future income tax returns is not deemed more likely than not. Similarly, at March 31, 2008, the net deferred tax asset was fully reserved.

### ***Year Ended March 31, 2008 Compared to Year Ended March 31, 2007***

*Revenue.* Revenue for the year ended March 31, 2008 increased \$10.3 million, or 49%, to \$31.3 million from \$21.0 million for the year ended March 31, 2007. Revenue from microturbine product shipments increased \$6.6 million, or 44%, to \$21.7 million for 434 units during Fiscal 2008 from \$15.1 million for 277 units during Fiscal 2007. Shipments of microturbine units were 22.4 megawatts during Fiscal 2008 compared with 15.6 megawatts during Fiscal 2007. Revenue from C30 product shipments increased \$4.1 million, or 178% to \$6.4 million for 165 units during Fiscal 2008 from \$2.3 million for 56 units during Fiscal 2007. Shipments of C30 product were 5.0 megawatts during Fiscal 2008 compared with 1.7 megawatts during Fiscal 2007. Revenue from C60 Series product shipments increased \$2.5 million, or 20% to \$15.3 million for 269 units during Fiscal 2008 from \$12.8 million for 221 units during Fiscal 2007. Shipments of C60 Series products were 17.5 megawatts during Fiscal 2008 compared with 13.9 megawatts during Fiscal 2007. Revenue from accessories, parts and service during Fiscal 2008 increased \$3.7 million to \$9.6 million from \$5.9 million during Fiscal 2007. Included in the overall revenue increase was a \$1.8 million increase in revenue from the North American market, a \$5.0 million increase in revenue from the European market, a \$1.3 million increase in revenue from the Asian market, and a \$2.2 million increase in revenue from the South American market primarily the result of the benefits of efforts to improve customer relationships.

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The following table summarizes our revenue (revenue amounts in millions):

	Years Ended March 31,					
	2008			2007		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
C30	\$ 6.4	5.0	165	\$ 2.3	1.7	56
C60 Series	15.3	17.5	269	12.8	13.9	221
Total from Microturbine Products	\$21.7	22.5	434	\$15.1	15.6	277
Accessories, Parts, and Service	9.6	—	—	5.9	—	—
Total	\$31.3	22.5	434	\$21.0	15.6	277

Two customers accounted for 18% and 13% of revenue, respectively, for the year ended March 31, 2008. For the year ended March 31, 2007, two customers accounted for 16% and 12% of revenue, respectively. Sales to BPC accounted for 18% and 16% of revenues for the year ended March 31, 2008 and 2007, respectively. Sales to UTC accounted for 13% and 12% of revenue for year ended March 31, 2008 and 2007, respectively.

*Gross Loss.* The gross loss was \$3.8 million, or 12% of revenue, for the year ended March 31, 2008 compared to \$5.0 million, or 24% of revenue, for the year ended March 31, 2007. The decrease in the gross loss and corresponding improvement in the gross loss percentage reflects increased sales of both C30 and C60 Series units along with reduced warranty expense of \$2.9 million, offset by increased manufacturing costs of \$1.6 million and lower absorption of overhead costs into inventory of \$4.3 million. Warranty expense is a combination of a per-unit warranty accrual recorded at the time revenue is recognized and changes in estimates for several reliability enhancement programs. These program estimates are recorded in the period that new information, such as design changes and product enhancements, becomes available. Warranty expense for units shipped decreased \$0.1 million as a result of improvements that have been made through engineering design changes and product robustness. Of the remaining \$2.8 million in reductions to warranty expense, \$2.4 million relates to higher expenses incurred in the prior year for several reliability repair programs. The remaining decrease of \$0.4 million relates to a reduction of \$0.7 million to specific reliability repair programs due to product enhancements and technology changes, offset by an increase of \$0.3 million in actual repair spend.

*Research and Development Expenses.* R&D expenses for the year ended March 31, 2008 decreased \$0.5 million, or 5% to \$8.9 million from \$9.4 million for the year ended March 31, 2007. R&D expenses are reported net of benefits from cost-sharing programs, such as the DOE and the UTC Development Agreement. The net decrease in R&D spending was the result of lower facilities costs of \$0.4 million and an increase in benefits from cost-sharing programs of \$1.3 million. This net decrease was offset by increased spending for developmental hardware and supplies of \$0.1 million, an increase in spending for travel and administrative costs of \$0.1 million and increased spending for labor and consulting services of \$1.0 million, of which \$0.3 million relates to non-cash stock compensation charges. Cost-sharing programs vary from period to period depending on the phases of the programs.

*Selling, General and Administrative Expenses.* SG&A expenses increased \$1.0 million, or 4%, to \$25.6 million for the year ended March 31, 2008 from \$24.6 million for the year ended March 31, 2007. Included in SG&A expenses for the year ended March 31, 2008 was \$2.1 million of non-cash stock compensation, compared to \$2.3 million for the prior year. The net increase in spending was the result of higher travel costs of \$0.9 million due to increased customer site visits and trade show activity, higher facility costs of \$0.4 million and higher supplies of \$0.3 million, offset by lower administrative costs of \$0.4 million and an additional benefit of \$0.1 million from utilities and maintenance and repair costs.

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**Interest Income.** Interest income for the year ended March 31, 2008 decreased \$0.1 million, or 3%, to \$2.2 million from \$2.3 million for the same period last year. The decrease during Fiscal 2008 was attributable to lower average cash balances and interest rates during the year ended March 31, 2008.

**Income Tax Provision.** At March 31, 2008, we had federal and state net operating loss carryforwards of approximately \$470.0 million and \$314.7 million, respectively, which may be utilized to reduce future taxable income, subject to limitations under Section 382 of the Internal Revenue Code of 1986. We provided a valuation allowance for 100% of our net deferred tax asset of \$194.8 million at March 31, 2008 because the realization of the benefits of these favorable tax attributes in future income tax returns is not deemed more likely than not. Similarly, at March 31, 2007, the net deferred tax asset was fully reserved.

### Quarterly Results of Operations

The following table presents unaudited quarterly financial information. This information was prepared in accordance with GAAP, and, in the opinion of management, contains all adjustments necessary for a fair presentation of such quarterly information when read in conjunction with the financial statements included elsewhere herein. Our operating results for any prior quarters may not necessarily indicate the results for any future periods.

Amounts in thousands, except per share data

(Unaudited)	Year Ended March 31, 2009				Year Ended March 31, 2008			
	Fourth Quarter	Third Quarter	Second Quarter(1)	First Quarter(1)	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Revenue	\$ 11,822	\$ 11,482	\$ 13,121	\$ 7,524	\$ 9,254	\$ 9,217	\$ 7,219	\$ 5,615
Cost of goods sold	14,727	12,083	13,656	8,811	9,785	9,257	7,975	8,088
Gross loss	(2,905)	(601)	(535)	(1,287)	(531)	(40)	(756)	(2,473)
Operating costs and expenses:								
R&D	2,076	2,048	2,017	1,984	1,963	1,761	2,433	2,749
SG&A	6,929	7,441	7,512	6,746	7,357	6,462	5,910	5,893
Loss from operations	(11,910)	(10,090)	(10,064)	(10,017)	(9,851)	(8,263)	(9,099)	(11,115)
Net loss	\$(11,954)	\$(10,035)	\$(9,911)	\$(9,817)	\$(9,565)	\$(7,688)	\$(8,453)	\$(10,407)
Net loss per common share—basic and diluted	\$ (0.06)	\$ (0.06)	\$ (0.06)	\$ (0.07)	\$ (0.07)	\$ (0.05)	\$ (0.06)	\$ (0.07)

- (1) Certain reclassifications were made to amounts previously reported as a result of reclassifying certain service costs from SG&A to cost of goods sold.

### Liquidity and Capital Resources

Our cash requirements depend on many factors, including the execution of our plan. We expect to continue to devote substantial capital resources to running our business and creating the strategic changes summarized herein. Based on our current forecasts and assumptions, we believe that our existing cash and cash equivalents, in addition to the proceeds from our May 2009 registered direct offering, are sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next twelve months. Our planned capital expenditures for Fiscal 2010 include approximately \$3.6 million for rental units, and plant and equipment costs related to manufacturing and operations. The majority of the \$3.6 million relates to the rental units, which can be built primarily from inventory on hand. We have invested our cash in institutional funds that invest in high quality short-term money market instruments to provide liquidity for operations and for capital preservation.

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Our cash and cash equivalent balances decreased \$23.1 million and \$17.7 million for the years ended March 31, 2009 and 2008, respectively. The cash was generated from or used in:

*Operating Activities*—During the year ended March 31, 2009 we used \$55.5 million in cash in our operating activities, which primarily consisted of a net loss for the period of approximately \$41.7 million, offset by non-cash adjustments (primarily employee stock compensation, depreciation, warranty and inventory charges) of \$6.3 million and cash used for working capital of approximately \$20.1 million. This compared to operating cash usage of \$21.1 million during the year ended March 31, 2008, which consisted of a net loss for the period of approximately \$36.1 million, offset by non-cash adjustments (primarily depreciation and impairment charges) of \$6.7 million and cash from working capital of approximately \$8.3 million. The increase in working capital cash usage of \$28.4 million is primarily attributable to inventory which has increased by \$20.9 million as a result of the C200 and C1000 Series commercialization and to support an overall increase in sales and backlog. The timing of shipments and the delivery and payment of inventory purchases with long lead times resulted in an increase in cash usage from inventory in Fiscal 2009. Additionally, the change in working capital is attributable to a \$10.5 million decrease in other current liabilities because of the completion of certain UTCP Development Agreement milestones. Additionally, accounts receivable increased \$1.0 million because of higher sales occurring at the end of the period and the timing of collections and sales. Additionally, warranty claims spending has decreased \$1.0 million because of a continued focus on product quality and the timing of claims.

*Investing Activities*—Net cash used in investing activities, primarily resulting from the acquisition of fixed assets, was \$6.7 million and \$0.8 million for the years ended March 31, 2009 and 2008, respectively. Our historical cash usage for investing activities has been relatively low related to capital expenditures. However, in Fiscal 2009 we increased cash usage for investing activities as a result of investments in production equipment and leasehold improvements related to the C200 and C1000 Series products.

*Financing Activities*—During the year ended March 31, 2009, we generated \$39.2 million from financing activities compared to cash generated during the year ended March 31, 2008 of \$4.2 million. The funds generated from financing activities in the year ended March 31, 2009 were primarily the result of a registered offering of our common stock, which was completed effective September 23, 2008. Pursuant to the offering, we issued a total of 21.5 million shares of common stock and warrants to purchase 6.4 million shares of common stock with an initial exercise price of \$1.92 per share, resulting in gross proceeds of approximately \$32.0 million. We incurred approximately \$2.5 million in direct costs in connection with the offering. Additionally, we also generated additional financing from our credit facility with Wells Fargo. The exercise of stock options and warrants and employee stock purchases, net of repurchases of shares for employee taxes on vesting of restricted units, yielded \$6.2 million in cash for the year ended March 31, 2009 compared with \$4.2 million during the year ended March 31, 2008.

On February 9, 2009, we entered into the Agreements with Wells Fargo. The Agreements provide us with a Credit Facility of up to \$10 million in the aggregate. The amount actually available to us may be substantially less and may vary from time to time, depending on, among other factors, the amount of our eligible inventory and accounts receivable. As security for the payment and performance of the Credit Facility, we granted a security interest in favor of Wells Fargo in substantially all of our assets. The Agreements will terminate in accordance with their terms on February 9, 2012, unless terminated sooner. As of March 31, 2009, we had \$3.7 million outstanding under the Credit Facility.

The Agreements include affirmative covenants as well as negative covenants that prohibit a variety of actions without Wells Fargo's consent, including covenants that limit our ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or

purchase all or substantially all of the assets or stock of another entity, (d) pay dividends on, or purchase, acquire, redeem or retire shares of, our capital stock, (e) sell, assign, transfer or otherwise dispose of all or substantially all of our assets, (f) change our accounting method or (g) enter into a different line of business. Furthermore, the Agreements contain financial covenants, including (a) a requirement to maintain a specified minimum book worth, (b) a requirement not to exceed specified levels of losses, (c) a requirement to maintain a specified ratio of minimum cash balances to unreimbursed line of credit advances, and (d) limitations on our capital expenditures. As of March 31, 2009, we determined that we were not in compliance with two financial covenants in the Agreements regarding our monthly book net worth and quarterly and annual net income. If we had not received the waiver or if we fail to comply with the financial covenants contained in the credit facility agreements in the future, we would not be able to draw additional funds under the line of credit. We obtained a waiver from Wells Fargo and on June 9, 2009, we amended the Agreements to revise the financial covenants regarding our monthly book net worth and quarterly and annual net income.

We believe that our existing cash and cash equivalents, in addition to the proceeds from our May 2009 registered direct offering, are sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next twelve months. However, if our anticipated cash needs change, it is possible that we may decide to raise additional capital in the future. We could seek to raise such funds by selling additional securities to the public or to selected investors, or by obtaining debt financing. We cannot be assured that we will be able to obtain additional funds on commercially favorable terms, or at all, especially given the state of worldwide capital markets. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing stockholders would be reduced (on a fully diluted basis in the case of convertible securities). In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock.

Although we believe we have sufficient capital to fund our working capital and capital expenditures for at least the next twelve months, depending on the timing of our future sales and collection of related receivables, managing inventory costs and the timing of inventory purchases and deliveries required to fulfill the current backlog, our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will require us to achieve dramatically increased sales volume which is dependent on many factors, including:

- the market acceptance of our products and services;
- our business, product and capital expenditure plans;
- capital improvements to new and existing facilities;
- our competitors' response to our products and services;
- our relationships with customers, distributors, dealers and project resellers; and
- our customers' ability to afford and/or finance our products.

Additionally, the continued credit crisis could prevent our customers from purchasing our products or delay their purchases, which would adversely affect our business, financial condition and results of operations. In addition, our ability to access the capital markets may be severely restricted or made very expensive at a time when we need, or would like, to do so, which could have a material adverse impact on our liquidity and financial resources. Certain industries in which our customers do business and certain geographic areas may have been and could continue to be adversely affected by the recession in economic activity.

Should we be unable to execute our plans or obtain additional financing, that might be needed if our cash needs change, we may be unable to continue as a going concern. The condensed consolidated

financial statements do not include any adjustments that might result from the outcome of these uncertainties.

### Contractual Obligations and Commercial Commitments

At March 31, 2009, our commitments under notes payable and non-cancelable operating leases were as follows:

	Payment Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
(in Thousands)					
<b>Contractual Obligations:</b>					
Long-term Debt Obligations	\$ 41	\$ 13	\$ 25	\$ 3	\$ —
Operating Lease Obligations	\$2,822	\$2,008	\$814	\$—	\$—
Revolving Credit Facility	\$3,654	\$3,654	\$—	\$—	\$—

As of March 31, 2009, we had firm commitments to purchase inventories of approximately \$27.1 million through Fiscal 2011. Certain inventory delivery dates and related payments are not firmly scheduled; therefore amounts under these firm purchase commitments will be payable concurrent with the receipt of the related inventories.

Agreements we have with some of our distributors and ASCs require that if we render parts obsolete in inventories they own and hold in support of their obligations to serve fielded microturbines, then we are required to replace the affected stock at no cost to the distributors or ASCs. While we have never incurred costs or obligations for these types of replacements, it is possible that future changes in product technology could result and yield costs if significant amounts of inventory are held at ASCs. As of March 31, 2009, no significant inventories were held at ASCs.

### Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements.

### Impact of Recently Issued Accounting Standards

In April 2009, the Financial Accounting Standards Board ("FASB") issued three related FASB Staff Positions ("FSP"): (i) FSP No. 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly", ("FSP 157-4"), (ii) SFAS No. 115-2 and SFAS No. 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments", ("FSP 115-2" and "FSP 124-2"), and (iii) FSP 107-1 and Accounting Principals Board 28-1, "Interim Disclosures about Fair Value of Financial Instruments", ("FSP 107-1" and "APB 28-1"), which will be effective for interim and annual periods ending after June 15, 2009. FSP 157-4 provides guidance on how to determine the fair value of assets and liabilities under SFAS No. 157 in the current economic environment and reemphasizes that the objective of a fair value measurement remains an exit price. If we were to conclude that there has been a significant decrease in the volume and level of activity of the asset or liability in relation to normal market activities, quoted market values may not be representative of fair value and we may conclude that a change in valuation technique or the use of multiple valuation techniques may be appropriate. FSP 115-2 and FSP 124-2 modify the requirements for recognizing other-than-temporarily impaired debt securities and revise the existing impairment model for such securities, by modifying the current intent and ability indicator in determining whether a debt security is other-than-temporarily impaired. FSP 107-1 and APB 28-1 enhance the disclosure of instruments under the scope of SFAS No. 157 for both interim and annual periods. We are currently evaluating the requirements of these standards; however,

these standards are not expected to have a material impact on the consolidated financial position or results of operations.

In June 2008, the FASB issued Emerging Issues Task Force Issue 07-5 "Determining whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock" ("EITF No. 07-5"). This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of SFAS No. 133 "Accounting for Derivatives and Hedging Activities" ("SFAS 133") specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF No. 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and is able to qualify for the SFAS 133 paragraph 11(a) scope exception. We have not determined the impact that adoption of this standard will have on the consolidated financial position or results of operations.

In April 2008, the FASB issued FSP No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). FSP 142-3 removes the requirement of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. The intent of FSP 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations," ("SFAS No. 141(R)") and other U.S. generally accepted accounting principles. FSP 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity considers its own experience in renewing similar arrangements. FSP 142-3 applies to all intangible assets, whether acquired in a business combination or otherwise and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and applied prospectively to intangible assets acquired after the effective date. We are currently evaluating the requirements of this standard; however, this standard is not expected to have a material impact on the consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), which changes accounting principles for business acquisitions. SFAS No. 141(R) requires the recognition of all the assets acquired and liabilities assumed in the transaction based on the acquisition-date fair value. Certain provisions of this standard will, among other things, impact the determination of consideration paid or payable in a business combination and change accounting practices for transaction costs, acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. SFAS No. 141(R) is effective for business combinations and adjustments to all acquisition-related deferred tax asset and liability balances occurring after December 15, 2008. Adoption of this standard has not had an impact on the consolidated financial position or results of operations. Adoption of this statement is, however, expected to have a significant effect on how acquisition transactions, subsequent to March 31, 2009, are reflected in the financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51" ("SFAS No. 160"). This statement establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This standard is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the requirements of this

standard; however, this standard is not expected to have an impact on the consolidated financial position or results of operations.

In January 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value, with the objective of mitigating volatility in reported earnings caused by measuring related assets and liabilities differently (without being required to apply complex hedge accounting provisions), amends SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" and expands disclosures related to the use of fair value measures in financial statements. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We adopted SFAS No. 159 with no impact on the consolidated financial position or results of operations as we did not elect the fair value option.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. While SFAS No. 157 did not impact the Company's valuation methods, it expanded disclosures of assets and liabilities that are recorded at fair value. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We adopted this standard in Fiscal 2009, and the adoption did not impact the consolidated financial position or results of operations. On April 1, 2009, we are required to implement the previously-deferred provisions of SFAS No. 157 for nonfinancial long-lived assets or asset groups measured at fair value for an impairment assessment under FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," as required. We do not believe that the remaining provisions will have an impact on the consolidated financial position or results of operations when they are implemented.

#### **Item 7A. Quantitative and Qualitative Disclosure About Market Risk.**

##### *Foreign Currency*

We currently develop products in the U.S. and market and sell our products predominantly in North America, Europe and Asia. As a result, factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets could affect our financial results. As all of our sales and purchases are currently made in U.S. dollars, we do not utilize foreign exchange contracts to reduce our exposure to foreign currency fluctuations. In the future, as our customers, employees and vendor bases expand, we anticipate entering into more transactions that are denominated in foreign currencies.

##### *Interest*

As of March 31, 2009, we had \$3.7 million outstanding under our Credit Facility. A hypothetical 2% change in interest rates would not have any effect on our interest expense or interest payments because interest on our Credit Facility balance of \$3.7 million as of March 31, 2009 would still be lower than the minimum monthly interest payment of \$31,000 per month payable pursuant to the Credit Facility.

#### **Item 8. Financial Statements and Supplementary Data.**

Our Consolidated Financial Statements and Financial Statement Schedule included in this Report beginning at page F-1 are incorporated in this Item 8 by reference.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

*Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to ensure that the information required to be disclosed in the Company's reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

In connection with the preparation of this Annual Report on Form 10-K for the year ended March 31, 2009, an evaluation was performed under the supervision and with the participation of our management, including the CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on this evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are effective as of March 31, 2009 to ensure that the information required to be disclosed by us in reports we submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

*Management's Annual Report on Internal Control Over Financial Reporting*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organization of the Treadway Commission. Based on our evaluation under the framework in Internal Control—Integrated Framework, our management concluded that the Company maintained effective internal control over financial reporting as of March 31, 2009. Deloitte & Touche LLP, the Company's independent registered public accounting firm, has issued a report on the Company's internal control over financial reporting. The report of Deloitte & Touch LLP follows. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*Changes in Internal Control Over Financial Reporting*

There were no changes in the Company's internal control over financial reporting during the three month period ended March 31, 2009 which have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Capstone Turbine Corporation  
Chatsworth, California

We have audited the internal control over financial reporting of Capstone Turbine Corporation and subsidiary (the "Company") as of March 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2009, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended March 31, 2009 of the Company and our report dated June 15, 2009 expressed an unqualified opinion on those financial statements and financial statement schedule.

**/s/ DELOITTE & TOUCHE LLP**

Los Angeles, California  
June 15, 2009

**Item 9B. Other Information.**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance.**

The information required by this Item 10 is incorporated by reference from Capstone's definitive proxy statement for its 2009 annual meeting of stockholders, scheduled to be held on August 27, 2009.

**Item 11. Executive Compensation.**

The information required by this Item 11 is incorporated by reference from Capstone's definitive proxy statement for its 2009 annual meeting of stockholders, scheduled to be held on August 27, 2009.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholders Matters.**

The information required by this Item 12 is incorporated by reference from Capstone's definitive proxy statement for its 2009 annual meeting of stockholders, scheduled to be held on August 27, 2009.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information required by this Item 13 is incorporated by reference from Capstone's definitive proxy statement for its 2009 annual meeting of stockholders, scheduled to be held on August 27, 2009.

**Item 14. Principal Accounting Fees and Services.**

The information required by this Item 14 is incorporated by reference from Capstone's definitive proxy statement for its 2009 annual meeting of stockholders, scheduled to be held on August 27, 2009.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules.**

*(a) 1. and 2. Financial statements and financial statement schedule*

The financial statements, notes and financial statement schedule are listed in the Index to Consolidated Financial Statements on page F-1 of this Report.

*(a) 3. Index to Exhibits.*

<b>Exhibit Number</b>	<b>Description</b>
1.1	Placement Agency Agreement, dated as of May 4, 2009, between Capstone Turbine Corporation and Lazard Capital Markets LLC(a)
1.2	Placement Agency Agreement, dated as of September 17, 2008, between Capstone Turbine Corporation and Wachovia Capital Markets, LLC(b)
1.3	Placement Agency Agreement with A.G. Edwards & Sons Inc., dated January 18, 2007(c)
3.1	Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation(d)
3.2	Amended and Restated Bylaws of Capstone Turbine Corporation(e)
4.1	Specimen stock certificate(f)
4.2	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock(g)
4.3	Rights Agreement, dated July 7, 2005, between Capstone Turbine Corporation and Mellon Investor Services LLC(g)
4.4	Amendment No. 1 to Rights Agreement, dated July 3, 2008, between Capstone Turbine Corporation and Mellon Investor Services LLC(h)
4.5	Form of Warrant issued to investors in the 2009 registered direct offering(a)
4.6	Form of Warrant issued to investors in the 2008 registered direct offering(b)
4.7	Form of Warrant issued to investors in the 2007 registered direct offering(c)
10.1	Transition Agreement, dated August 2, 2000, by and between Capstone Turbine Corporation and Solar Turbines Incorporated(i)
10.2	Amended and Restated License Agreement, dated August 2, 2000, by and between Solar Turbines Incorporated and Capstone Turbine Corporation(i)
10.3	Lease between Capstone Turbine Corporation and Northpark Industrial—Leahy Division LLC, dated December 1, 1999, for leased premises at 21211 Nordhoff Street, Chatsworth, California(j)
10.4	Lease between Capstone Turbine Corporation and AMB Property, L.P., dated September 25, 2000, for leased premises at 16640 Stagg Street, Van Nuys, California(k)
10.5*	1993 Incentive Stock Option Plan(j)
10.6*	Employee Stock Purchase Plan(d)
10.7*	Capstone Turbine Corporation Amended and Restated 2000 Equity Incentive Plan(l)

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<b>Exhibit Number</b>	<b>Description</b>
10.8*	Amendment to the Capstone Turbine Corporation Amended and Restated 2000 Equity Incentive Plan(m)
10.9*	Form of Stock Option Agreement for Amended and Restated 2000 Equity Incentive Plan(n)
10.10*	Deferred Compensation Plan of Capstone Turbine Corporation(o)
10.11*	Amended and Restated Capstone Turbine Corporation Change of Control Severance Plan(p)
10.12	Lease Agreement dated October 15, 2005 with Addendum, dated September 27, 2006, with CapGen CHP, Inc.(q)
10.13*	Inducement Stock Option Agreement with Darren R. Jamison, dated December 18, 2006(r)
10.14*	Restricted Stock Agreement with Darren R. Jamison, dated December 18, 2006(r)
10.15*	Letter Agreement between Capstone Turbine Corporation and Darren R. Jamison, dated December 1, 2006(r)
10.16*	Amendment to Letter Agreement between Capstone Turbine Corporation and Darren R. Jamison, effective April 8, 2009
10.17*	Amended and Restated Change of Control Severance Agreement between Capstone Turbine Corporation and Darren R. Jamison, effective April 8, 2009
10.18*	Letter Agreement between Capstone Turbine Corporation and James D. Crouse, dated January 31, 2007(s)
10.19*	Inducement Stock Option Agreement with James D. Crouse, dated February 5, 2007(s)
10.20*	Restricted Stock Agreement with James D. Crouse, dated February 5, 2007(s)
10.21	Development and License Agreement between Capstone Turbine Corporation and UTC Power Corporation, dated September 4, 2007(l)
10.22*	Capstone Turbine Corporation Executive Performance Incentive Plan(t)
10.23	Form of Subscription Agreement between Capstone Turbine Corporation and investors in the 2009 registered direct offering(a)
10.24	Form of Subscription Agreement between Capstone Turbine Corporation and investors in the 2008 registered direct offering(b)
10.25	Form of Subscription Agreement between Capstone Turbine Corporation and investors in the 2007 registered direct offering(c)
10.26*	Inducement Stock Option Agreement with Leigh L. Estus, dated November 7, 2005(u)
10.27*	General Release and Separation Agreement with Leigh L. Estus, dated December 1, 2008(v)
10.28*	Consulting Agreement with Leigh L. Estus, dated December 1, 2008(v)
10.29	Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 9, 2009 (Domestic Facility)
10.30	Credit and Security Agreement between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated February 9, 2009 (Ex-Im Subfacility)
10.31	First Amendment to Credit and Security Agreements between Capstone Turbine Corporation and Wells Fargo Bank, NA, dated June 9, 2009

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<b>Exhibit Number</b>	<b>Description</b>
14.1	Code of Business Conduct(w)
14.2	Code of Ethics for Senior Financial Officers and Chief Executive Officer(w)
21	Subsidiary List(s)
23	Consent of Independent Registered Public Accounting Firm
24	Power of Attorney (included on the signature page of this Form 10-K)
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32	Certification of Chief Executive Officer and Chief Financial Officer
(a)	Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on May 4, 2009 (File No. 001-15957).
(b)	Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 18, 2008 (File No. 001-15957).
(c)	Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on January 19, 2007 (File No. 001-15957).
(d)	Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated May 8, 2000 (File No. 333-33024).
(e)	Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, dated February 9, 2006 (File No. 001-15957).
(f)	Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated June 21, 2000 (File No. 333-33024).
(g)	Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 8, 2005 (File No. 001-15957).
(h)	Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 10, 2008 (File No. 001-15957).
(i)	Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on October 16, 2000 (File No. 001-15957).
(j)	Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated March 22, 2000 (File No. 333-33024).
(k)	Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K, dated March 29, 2002 (File No. 001-15957).
(l)	Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, dated November 8, 2007 (File No. 001-15957).
(m)	Incorporated by reference to Appendix B to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 18, 2008 (File No. 001-15957).
(n)	Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, dated November 9, 2005 (File No. 001-15957).
(o)	Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-8, dated July 31, 2001 (File No. 333-66390).

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- (p) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K, dated June 29, 2005 (File No. 001-15957).
- (q) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, dated November 9, 2006 (File No. 001-15957).
- (r) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, dated February 9, 2007 (File No. 001-15957).
- (s) Incorporated by reference to Capstone Turbine Corporation's Annual Report on Form 10-K, dated June 13, 2007 (File No. 001-15957).
- (t) Incorporated by reference to Appendix A to Capstone Turbine Corporation's Definitive Proxy Statement, filed on July 18, 2008 (File No. 001-15957).
- (u) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-8, dated February 1, 2006 (File No. 333-131431).
- (v) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, dated February 9, 2009 (File No. 001-15957).
- (w) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, dated February 17, 2004 (File No. 001-15957).
- \* Management contract or compensatory plan or arrangement

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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Financial statement schedules not included in this Annual Report on Form 10-K have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Capstone Turbine Corporation  
Chatsworth, California

We have audited the accompanying consolidated balance sheets of Capstone Turbine Corporation and subsidiary (the "Company") as of March 31, 2009 and 2008 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended March 31, 2009. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of March 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended March 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

Effective April 1, 2007, the Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109", as discussed in Note 7 to the consolidated financial statements.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of March 31, 2009, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 15, 2009 expressed an unqualified opinion on the Company's internal control over financial reporting.

**/s/ DELOITTE & TOUCHE LLP**

Los Angeles, California  
June 15, 2009

## CAPSTONE TURBINE CORPORATION AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	March 31, 2009	March 31, 2008
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 19,519	\$ 42,605
Accounts receivable, net of allowance for doubtful accounts and sales returns of \$644 in 2009 and \$629 in 2008	10,871	6,768
Inventories	24,379	14,472
Prepaid expenses and other current assets	1,515	1,614
Total current assets	<u>56,284</u>	<u>65,459</u>
Property, plant and equipment, net	9,432	5,536
Non-current portion of inventories	5,883	2,221
Intangible asset, net	411	624
Other assets	319	206
Total	<u>\$ 72,329</u>	<u>\$ 74,046</u>
<b>Liabilities and Stockholders' Equity</b>		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 11,484	\$ 7,964
Accrued salaries and wages	2,062	1,519
Accrued warranty reserve	2,344	4,591
Deferred revenue	1,171	780
Revolving credit facility	3,654	—
Current portion of notes payable	13	13
Other current liabilities	815	5,658
Total current liabilities	<u>21,543</u>	<u>20,525</u>
Long-term portion of notes payable	28	5
Other long-term liabilities	288	463
Commitments and contingencies (Note 10)	—	—
Stockholders' Equity:		
Preferred stock, \$.001 par value; 10,000,000 shares authorized; none issued	—	—
Common stock, \$.001 par value; 415,000,000 shares authorized; 174,888,521 shares issued and 174,070,581 shares outstanding at March 31, 2009; 148,238,852 shares issued and 147,578,311 shares outstanding at March 31, 2008	175	148
Additional paid-in capital	666,357	626,952
Accumulated deficit	(615,100)	(573,383)
Treasury stock, at cost; 817,940 shares at March 31, 2009 and 660,541 shares at March 31, 2008	(962)	(664)
Total stockholders' equity	<u>50,470</u>	<u>53,053</u>
Total	<u>\$ 72,329</u>	<u>\$ 74,046</u>

See accompanying notes to consolidated financial statements.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share amounts)**

	Years Ended March 31,		
	2009	2008	2007
Revenue	\$ 43,949	\$ 31,305	\$ 21,018
Cost of goods sold	49,277	35,105	26,045
Gross loss	(5,328)	(3,800)	(5,027)
Operating expenses:			
Research and development	8,125	8,906	9,374
Selling, general and administrative	28,628	25,622	24,615
Total operating expenses	36,753	34,528	33,989
Loss from operations	(42,081)	(38,328)	(39,016)
Interest income	515	2,224	2,292
Interest expense	(69)	(7)	(2)
Loss before income taxes	(41,635)	(36,111)	(36,726)
Provision for income taxes	82	2	2
Net loss	\$ (41,717)	\$ (36,113)	\$ (36,728)
Net loss per common share—basic and diluted	\$ (0.25)	\$ (0.25)	\$ (0.32)
Weighted average shares used to calculate basic and diluted net loss per common share	164,462	145,425	113,770

See accompanying notes to consolidated financial statements.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(In thousands, except share amounts)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Deferred Stock Compensation	Treasury Stock	Total Stockholders' Equity
	Shares	Amount					
Balance, March 31, 2006	103,521,829	\$ 104	\$572,787	\$ (500,542)	\$ (208)	\$ (513)	\$ 71,628
Restricted stock awards cancellation	(125,000)	—	—	—	—	—	—
Stock-based compensation	—	—	2,428	—	208	—	2,636
Exercise of stock options and employee stock purchases	1,070,291	1	1,685	—	—	—	1,686
Stock awards to Board of Directors	45,877	—	71	—	—	—	71
Issuance of common stock, net of issuance costs	40,000,000	40	42,452	—	—	—	42,492
Net loss	—	—	—	(36,728)	—	—	(36,728)
Balance, March 31, 2007	144,512,997	145	619,423	(537,270)	—	(513)	81,785
Purchase of treasury stock	—	—	—	—	—	(151)	(151)
Vested restricted stock awards	293,545	—	—	—	—	—	—
Stock-based compensation	—	—	3,125	—	—	—	3,125
Exercise of stock options and employee stock purchases	1,847,595	2	2,370	—	—	—	2,372
Stock awards to Board of Directors	60,592	—	53	—	—	—	53
Warrants exercised	1,524,123	1	1,981	—	—	—	1,982
Net loss	—	—	—	(36,113)	—	—	(36,113)
Balance, March 31, 2008	148,238,852	148	626,952	(573,383)	—	(664)	53,053
Purchase of treasury stock	—	—	—	—	—	(298)	(298)
Vested restricted stock awards	691,174	1	(1)	—	—	—	—
Stock-based compensation	—	—	3,320	—	—	—	3,320
Exercise of stock options and employee stock purchases	1,197,582	1	2,411	—	—	—	2,412
Stock awards to Board of Directors	102,886	—	101	—	—	—	101
Warrants exercised	3,172,367	3	4,121	—	—	—	4,124
Issuance of common stock, net of issuance costs	21,485,660	22	29,453	—	—	—	29,475
Net loss	—	—	—	(41,717)	—	—	(41,717)
Balance, March 31, 2009	174,888,521	\$ 175	\$666,357	\$ (615,100)	\$ —	\$ (962)	\$ 50,470

See accompanying notes to consolidated financial statements.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	Year Ended March 31,		
	2009	2008	2007
<b>Cash Flows from Operating Activities:</b>			
Net loss	\$ (41,717)	\$ (36,113)	\$ (36,728)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	2,959	2,215	3,004
Amortization of deferred financing costs	10	—	—
Provision (benefit) for allowance for doubtful accounts and sales returns	15	(160)	488
Inventory write-down	786	1,038	1,372
Provision (benefit) for warranty expenses	(944)	372	3,299
Loss on disposal of equipment	7	22	175
Stock-based compensation	3,421	3,178	2,708
Changes in operating assets and liabilities:			
Accounts receivable	(4,118)	(3,094)	1,867
Inventories	(14,355)	6,557	(10,002)
Prepaid expenses and other assets	144	(56)	(567)
Accounts payable and accrued expenses	3,645	1,793	(2,362)
Accrued salaries and wages	368	(13)	(255)
Accrued warranty reserve	(1,303)	(2,335)	(3,743)
Deferred revenue	391	(157)	305
Other current liabilities	(4,843)	5,658	—
Net cash used in operating activities	(55,534)	(21,095)	(40,439)
<b>Cash Flows from Investing Activities:</b>			
Acquisition of and deposits on equipment and leasehold improvements	(6,754)	(767)	(1,497)
Proceeds from disposal of equipment	20	3	49
Changes in restricted cash	33	(33)	—
Net cash used in investing activities	(6,701)	(797)	(1,448)
<b>Cash Flows from Financing Activities:</b>			
Net proceeds from revolving credit facility	3,654	—	—
Payment of deferred financing costs	(202)	—	—
Repayment of notes payable	(16)	(28)	(20)
Net proceeds from employee stock-based transactions	2,114	2,221	1,686
Net proceeds from issuance of common stock and warrants	29,475	—	42,492
Proceeds from exercise of common stock warrants	4,124	1,982	—
Net cash provided by financing activities	39,149	4,175	44,158
Net (Decrease) Increase in Cash and Cash Equivalents	(23,086)	(17,717)	2,271
Cash and Cash Equivalents, Beginning of Year	42,605	60,322	58,051
Cash and Cash Equivalents, End of Year	\$ 19,519	\$ 42,605	\$ 60,322
<b>Supplemental Disclosures of Cash Flow Information:</b>			
Cash paid during the year for:			
Interest	\$ 29	\$ 7	\$ 2
Income taxes	\$ 2	\$ 2	\$ 2
<b>Supplemental Disclosures of Non-Cash Information:</b>			
During the years ended March 31, 2009, 2008 and 2007, the Company purchased on account \$371, \$496, and \$11 of fixed assets respectively.			
During the year ended March 31, 2009, the Company purchased fixed assets with a note payable of \$40. There were no fixed assets purchased with a note payable during the years ended March 31, 2008 and 2007.			

See accompanying notes to consolidated financial statements.



## CAPSTONE TURBINE CORPORATION AND SUBSIDIARY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Description of the Company and Basis of Presentation

Capstone Turbine Corporation (the "Company") develops, manufactures, markets and services microturbine technology solutions for use in stationary distributed power generation applications, including cogeneration (combined heat and power ("CHP"), integrated combined heat and power ("ICHP"), and combined cooling, heat and power ("CCHP")), resource recovery (including "renewable" fuels) and secure power. In addition, the Company's microturbines can be used as battery charging generators for hybrid electric vehicle applications. 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 revenue to cover its operating costs. To date, the Company has funded its activities primarily through private and public equity offerings. As of March 31, 2009, the Company had \$61.5 million, or 605 units, in backlog, of which \$45.3 million, or 421 units, are expected to be shipped within the next twelve months. However, the timing of shipments is subject to change based on several variables (including customer payments and customer delivery schedules), some of which are beyond the Company's control and can affect the Company's revenue and backlog. The Company believes that existing cash and cash equivalents, in addition to the proceeds from its May 2009 registered direct offering, are sufficient to meet its anticipated cash needs for working capital and capital expenditures for at least the next twelve months (see note 13). However, if anticipated cash needs of the Company change, it is possible that the Company may decide to raise additional capital in the future. The Company could raise such funds by selling additional securities to the public or to selected investors, or by obtaining debt financing. If the Company raises additional funds by issuing additional equity or convertible debt securities, the fully diluted ownership percentages of existing stockholders would be reduced. In addition, any equity or debt securities that it would issue may have rights, preferences or privileges senior to those of the holders of its common stock. Should the Company be unable to execute its plans or obtain additional financing, that might be needed if the Company's cash needs change, the Company may be unable to continue as a going concern. The condensed consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties

The consolidated financial statements include the accounts of the Company and Capstone Turbine International, Inc., its wholly owned subsidiary that was formed in June 2004, after elimination of inter-company transactions.

#### 2. Summary of Significant Accounting Policies

**Cash Equivalents**—The Company considers only those investments that are highly liquid and readily convertible to cash with original maturities of three months or less at date of purchase as cash equivalents.

**Restricted Cash**—As of March 31, 2008, the Company had set aside \$33,000, that was included in other assets to cover warranty related issues in connection with a performance guarantee. This performance guarantee covers a period of 18 months and expired in May 2009. The restricted cash was replaced by a letter of credit for \$36,000 during Fiscal 2009.

**Fair Value of Financial Instruments**—The carrying value of certain financial instruments, including cash equivalents, accounts receivable, accounts payable, accrued expenses, revolving credit facility and notes payable approximate fair market value based on their short-term nature.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

**Accounts Receivable**—The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. The Company also provides an allowance for sales returns. Although the Company sells its products without rights of return, because occasional exceptions have been made, an allowance is provided based on historical return rates.

**Inventories**—The Company values inventories at first in first out ("FIFO") and lower of cost or market. The composition of inventory is routinely evaluated to identify slow-moving, excess, obsolete or otherwise impaired inventories. Inventories identified as impaired are evaluated to determine if write-downs are required. Included in the assessment is a review for obsolescence as a result of engineering changes in the Company's products. All inventories expected to be used in more than one year are classified as long-term.

**Depreciation and Amortization**—Depreciation and amortization are provided for using the straight-line method over the estimated useful lives of the related assets, ranging from two to ten years. Leasehold improvements are amortized over the period of the lease or the estimated useful lives of the assets, whichever is shorter. Intangible assets that have finite useful lives are amortized over their estimated useful lives using the straight-line method.

**Long-Lived Assets**—The Company reviews the recoverability of long-lived assets whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. If the expected future cash flows from the use of such assets (undiscounted and without interest charges) are less than the carrying value, the Company may be required to record a write-down, which is determined based on the difference between the carrying value of the assets and their estimated fair value. The Company performed an analysis during Fiscal 2009 and determined that the estimated fair value of the long-lived assets exceeded the carrying value of the assets and no write-down was necessary.

The estimation of future cash flows requires significant estimates of factors that include future sales growth, gross margin performance and reductions in operating expenses. If our sales growth, gross margin performance or other estimated operating results are not achieved at or above our forecasted level, or inflation exceeds our forecast and we are unable to recover such costs through price increases, the carrying value of our asset groups may prove to be unrecoverable and we may incur impairment charges in the future.

**Deferred Revenue**—Deferred revenue consists of deferred product and service revenue and customer deposits. Deferred revenue will be recognized when earned in accordance with the Company's revenue recognition policy. The Company has the right to retain all or part of customer deposits under certain conditions.

**Revenue**—The Company's revenue consists of sales of products, parts and accessories and service, net of discounts and allowances for sales returns. Capstone's distributors purchase products and parts for sale to end users and are also required to provide a variety of additional services, including application engineering, installation, commissioning and post-commissioning repair and maintenance service. The Company's standard terms of sales to distributors and direct end-users include transfer of title, care, custody and control at the point of shipment, payment terms ranging from full payment in advance of shipment to payment in 90 days, no right of return or exchange, and no post-shipment performance obligations by Capstone except for warranties provided on the products and parts sold. Revenue is generally recognized and earned when all of the following criteria are satisfied:

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

(a) persuasive evidence of a sales arrangement exists; (b) price is fixed or determinable; (c) collectibility is reasonably assured; and (d) delivery has occurred or service has been rendered. Delivery generally occurs when the title and the risks and rewards of ownership have substantially transferred to the customer. While there are no rights of return privileges on product sales, the Company has made some limited exceptions to the no-right-of-return policy. Therefore, the Company has provided for an allowance for future sales returns based on historical information. To date, the Company has not had significant levels of service revenue. Service performed by the Company has consisted primarily of commissioning and time and materials based contracts. The time and materials contracts are usually related to out-of-warranty units. Service revenue derived from time and materials contracts is recognized as performed. The Company has also started providing maintenance service contracts to the customers of its existing install base. The maintenance service contracts are agreements to perform certain agreed-upon service to maintain a product for a specified period of time. Service revenue derived from maintenance service contracts is recognized on a straight-line basis over the contract period. The Company occasionally enters into agreements that contain multiple elements, such as sale of equipment, installation, engineering and/or service. For multiple-element arrangements, the Company recognizes revenue for delivered elements when the delivered item has stand-alone value to the customer, fair values of undelivered elements are known and customer acceptance provisions, if any, have occurred.

**Warranty**—The Company provides for the estimated costs of warranties at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the product sold, geography of sale and the length of extended warranties sold. The Company's product warranties generally start from the delivery date and continue for up to eighteen months. Factors that affect the Company's warranty obligation include product failure rates, anticipated hours of product operations and costs of repair or replacement in correcting product failures. These factors are estimates that may change based on new information that becomes available each period. Similarly, the Company also accrues the estimated costs to address reliability repairs on products no longer in warranty when, in the Company's judgment, and in accordance with a specific plan developed by the Company, it is prudent to provide such repairs. The Company assesses the adequacy of recorded warranty liabilities quarterly and makes adjustments to the liability as necessary. When the Company has sufficient evidence that product changes are altering the historical failure occurrence rates, the impact of such changes is then taken into account in estimating future warranty liabilities.

**Research and Development ("R&D")**—The Company accounts for grant distributions and development funding as offsets to R&D expenses and are recorded as the related costs are incurred. Total offsets to R&D expenses amounted to \$8.1 million, \$3.0 million and \$1.8 million, for the years ended March 31, 2009, 2008 and 2007, respectively.

**Income Taxes**—The Company accounts for income taxes in accordance with the Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes" ("SFAS 109") and FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of SFAS No. 109" ("FIN 48"). FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Deferred income tax assets and liabilities are computed for differences between the consolidated financial statement and income tax basis of assets and liabilities. Such deferred income tax asset and liability computations are based on enacted

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

tax laws and rates applicable to periods in which the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amounts expected to be realized.

**Contingencies**—The Company accounts for contingencies in accordance with SFAS No. 5, "Accounting for Contingencies" ("SFAS No. 5"). SFAS No. 5 requires that the Company record an estimated loss from a loss contingency when information available prior to issuance of its financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

**Risk Concentrations**—Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company places its cash and cash equivalents with high credit quality institutions. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses.

The Company sells microturbines and related parts and service. One customer accounted for 13% of the Company's revenue for the year ended March 31, 2009. Two customers accounted for 18% and 13% of the Company's revenue for the year ended March 31, 2008 totaling approximately 31%. Two customers accounted for 16% and 12% of the Company's revenue for the year ended March 31, 2007, totaling approximately 28%. Additionally, one customer accounted for 29% of net accounts receivable as of March 31, 2009. Two customers accounted for 33% and 11% of net accounts receivable as of March 31, 2008, totaling approximately 44%.

Several components of the Company's products are available from a limited number of suppliers. An interruption in supply could cause a delay in manufacturing and a possible loss of sales, which would affect operating results adversely.

**Estimates and Assumptions**—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates include accounting for doubtful accounts, stock-based compensation, inventory write-downs, valuation of long-lived assets including intangible assets, product warranties, sales allowances, income taxes and other contingencies. Actual results could differ from those estimates.

During Fiscal 2009, the Company began using its sole intangible asset manufacturing license technology in its new line of C200 and C1000 Series products. As a result, the Company changed its accounting estimate and adjusted the amortization period to end in conjunction with the termination of the agreement on August 2, 2017. The effect of the change in the accounting estimate on the loss from operations and net loss for the year ended March 31, 2009 was a decrease from \$42,136,000 to \$42,081,000 and a decrease from \$41,772,000 to \$41,717,000, respectively. The change in accounting estimate did not result in a change to earnings per share for the year ended March 31, 2009.

**Net Loss Per Common Share**—Basic loss per common share is computed using the weighted-average number of common shares outstanding for the period. Diluted loss per share is also computed without consideration to potentially dilutive instruments because the Company incurred losses which would make such instruments antidilutive. Outstanding stock options at March 31, 2009, 2008 and 2007, were

## CAPSTONE TURBINE CORPORATION AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**2. Summary of Significant Accounting Policies (Continued)**

9.2 million, 9.2 million and 10.3 million, respectively. Outstanding restricted stock units at March 31, 2009, 2008 and 2007 was 2.5 million, 2.3 million and 1.1 million, respectively.

**Stock-Based Compensation**—On April 1, 2006, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment," ("SFAS No. 123(R)"), which requires the measurement and recognition of compensation expense for all stock options issued to employees and directors based on estimated fair values. In March 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS No. 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS No. 123(R). Options or stock awards issued to non-employees who are not directors of the Company are recorded at their estimated fair value at the measurement date in accordance with SFAS No. 123(R) and Emerging Issues Task Force ("EITF") Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring or in Conjunction with Selling Goods or Services."

**Restructuring Costs**—The Company accounts for restructuring activity in accordance with SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"). Beginning in December 2008 and continuing into March 2009, the Company eliminated 42 employees, or 17%, of its workforce. As a result of this restructuring activity, \$0.6 million in severance costs were expensed during Fiscal 2009. As of March 31, 2009, the Company had \$0.2 million in remaining severance cost accruals recorded and scheduled for payment during the first quarter of Fiscal 2010.

**Segment Reporting**—The Company is considered to be a single operating segment in conformity with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." The business activities of this operating segment are the development, manufacture and sale of turbine generator sets and their related parts and service. Following is the geographic revenue information based on the customer's primary operating location:

	Year Ended March 31,		
	2009	2008	2007
	(In thousands)		
<b>North America</b>	<b>\$21,309</b>	<b>\$12,349</b>	<b>\$10,552</b>
<i>United States</i>	16,708	10,757	10,222
<i>Mexico</i>	4,496	1,124	46
<i>All others</i>	105	468	284
<b>Europe</b>	<b>\$14,627</b>	<b>\$13,157</b>	<b>\$ 8,171</b>
<i>Russia</i>	5,582	5,610	3,385
<i>All others</i>	9,045	7,547	4,786
<b>Asia</b>	<b>\$ 7,355</b>	<b>\$ 2,768</b>	<b>\$ 1,495</b>
<b>All others</b>	<b>\$ 658</b>	<b>\$ 3,031</b>	<b>\$ 800</b>
Total Revenue	<u>\$43,949</u>	<u>\$31,305</u>	<u>\$21,018</u>

Substantially all of the Company's operating assets are in the United States.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

*New Accounting Pronouncements*—In April 2009, the FASB issued three related FASB Staff Positions ("FSP"): (i) FSP No. 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly", ("FSP 157-4"), (ii) SFAS No. 115-2 and SFAS No. 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments", ("FSP 115-2" and "FSP 124-2"), and (iii) FSP 107-1 and Accounting Principals Board 28-1, "Interim Disclosures about Fair Value of Financial Instruments", ("FSP 107-1" and "APB 28-1") which will be effective for interim and annual periods ending after June 15, 2009. FSP 157-4 provides guidance on how to determine the fair value of assets and liabilities under SFAS No. 157 in the current economic environment and reemphasizes that the objective of a fair value measurement remains an exit price. If the Company were to conclude that there has been a significant decrease in the volume and level of activity of the asset or liability in relation to normal market activities, quoted market values may not be representative of fair value and the Company may conclude that a change in valuation technique or the use of multiple valuation techniques may be appropriate. FSP 115-2 and FSP 124-2 modify the requirements for recognizing other-than-temporarily impaired debt securities and revise the existing impairment model for such securities, by modifying the current intent and ability indicator in determining whether a debt security is other-than-temporarily impaired. FSP 107-1 and APB 28-1 enhance the disclosure of instruments under the scope of SFAS No. 157 for both interim and annual periods. The Company is currently evaluating the requirements of these standards; however, these standards are not expected to have a material impact on the consolidated financial position or results of operations.

In June 2008, the FASB issued Emerging Issues Task Force Issue 07-5 "Determining whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock" ("EITF No. 07-5"). This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of SFAS No. 133 "Accounting for Derivatives and Hedging Activities" ("SFAS 133") specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF No. 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and is able to qualify for the SFAS 133 paragraph 11(a) scope exception. The Company has not determined the impact that adoption of this standard will have on the Company's consolidated financial position or results of operations.

In April 2008, the FASB issued FSP No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). FSP 142-3 removes the requirement of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. The intent of FSP 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations," ("SFAS No. 141(R)") and other U.S. generally accepted accounting principles. FSP 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity considers its own experience in renewing similar arrangements. FSP 142-3 applies to all intangible assets, whether acquired in a business combination or otherwise and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

interim periods within those fiscal years and applied prospectively to intangible assets acquired after the effective date. The Company is currently evaluating the requirements of this standard; however, this standard is not expected to have a material impact on the consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), which changes accounting principles for business acquisitions. SFAS No. 141(R) requires the recognition of all the assets acquired and liabilities assumed in the transaction based on the acquisition-date fair value. Certain provisions of this standard will, among other things, impact the determination of consideration paid or payable in a business combination and change accounting practices for transaction costs, acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. SFAS No. 141(R) is effective for business combinations and adjustments to all acquisition-related deferred tax asset and liability balances occurring after December 15, 2008. Adoption of this standard has not had an impact on the consolidated financial position or results of operations. Adoption of this statement is, however, expected to have a significant effect on how acquisition transactions, subsequent to March 31, 2009, are reflected in the financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51" ("SFAS No. 160"). This statement establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This standard is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the requirements of this standard; however, this standard is not expected to have an impact on the consolidated financial position or results of operations.

In January 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value, with the objective of mitigating volatility in reported earnings caused by measuring related assets and liabilities differently (without being required to apply complex hedge accounting provisions), amends SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" and expands disclosures related to the use of fair value measures in financial statements. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company adopted SFAS No. 159 with no impact on the consolidated financial position or results of operations as the Company did not elect the fair value option.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. While SFAS No. 157 did not impact the Company's valuation methods, it expanded disclosures of assets and liabilities that are recorded at fair value. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS

## CAPSTONE TURBINE CORPORATION AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**2. Summary of Significant Accounting Policies (Continued)**

No. 157 does not require any new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company adopted this standard in Fiscal 2009, and the adoption did not impact our consolidated financial position or results of operations. On April 1, 2009, the Company is required to implement the previously-deferred provisions of SFAS No. 157 for nonfinancial long-lived assets or asset groups measured at fair value for an impairment assessment under FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," as required. The Company does not believe that the remaining provisions will have an impact on the consolidated financial position or results of operations when they are implemented.

**3. Inventories**

Inventories are stated at the lower of standard cost (which approximates actual cost on the first-in, first-out method) or market and consisted of the following as of March 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
	(In thousands)	
Raw materials	\$27,353	\$15,516
Work in process	15	236
Finished goods	2,894	941
Total	<u>30,262</u>	<u>16,693</u>
Less non-current portion	5,883	2,221
Current portion	<u>\$24,379</u>	<u>\$14,472</u>

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

**4. Property, Plant and Equipment**

Property, plant and equipment as of March 31, 2009 and 2008 consisted of the following:

	<u>2009</u>	<u>2008</u>	<u>Estimated Useful Life</u>
	(In thousands)		
Machinery, rental equipment, equipment, automobiles and furniture	\$ 23,472	\$ 18,727	2-10 years
Leasehold improvements	9,597	8,753	10 years
Molds and tooling	4,470	3,805	2-5 years
	<u>37,539</u>	<u>31,285</u>	
Less, accumulated depreciation	<u>(28,107)</u>	<u>(25,749)</u>	
Total property, plant and equipment, net	<u>\$ 9,432</u>	<u>\$ 5,536</u>	

Depreciation expense for property, plant and equipment was \$2.7 million, \$1.9 million and \$2.7 million for the years ended March 31, 2009, 2008 and 2007, respectively.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Intangible Assets**

The Company's sole intangible asset is a manufacturing license. The gross carrying amount is \$3.7 million. The balance of the intangible asset was \$0.4 million and \$0.6 million as of March 31, 2009 and 2008, respectively. The intangible asset was being amortized over an initial estimated useful life of ten years. The Company recorded \$0.3 million of amortization expense for each of the years ended March 31, 2009, 2008 and 2007.

During the three months ended March 31, 2009, the Company determined the useful life of the intangible asset had changed from an original estimate of ten years to a revised estimate of 17 years because of the continued use of certain intellectual property in the production of recuperator cores. This change in the estimated useful life of the intangible asset resulted in a decrease in the annual amortization from \$0.3 million per year to \$49,300 per year in Fiscal 2010 to Fiscal 2017. Prior to the change in the accounting estimate, the intangible asset had a remaining useful life of 19 months and after the change in the accounting estimate the intangible asset's new remaining life is 103 months. The manufacturing license is scheduled to be fully amortized by Fiscal 2017 with corresponding amortization estimated to be \$49,300 for each of the fiscal years 2010 through 2017.

The manufacturing license provides the Company with the ability to manufacture recuperator cores previously purchased from the supplier. The Company is required to pay a per-unit royalty fee over a seventeen-year period for cores manufactured and sold by the Company using the technology. Royalties of \$52,100, \$43,700 and \$28,000 were earned by the supplier for the years ended March 31, 2009, 2008 and 2007, respectively. Earned royalties of \$12,400 were unpaid as of March 31, 2009 and are included in accrued expenses in the accompanying consolidated balance sheet.

**6. Accrued Warranty Reserve**

Changes in the accrued warranty reserve are as follows as of March 31, 2009, 2008 and 2007:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In thousands)		
Balance, beginning of the period	\$ 4,591	\$ 6,554	\$ 6,998
Warranty provision relating to products shipped during the period	353	327	408
Changes for accruals related to preexisting warranties or reliability repair programs	(1,297)	45	2,891
Deductions for warranty claims	(1,303)	(2,335)	(3,743)
Balance, end of the period	<u>\$ 2,344</u>	<u>\$ 4,591</u>	<u>\$ 6,554</u>

**7. Income Taxes**

On April 1, 2007, the Company adopted the provisions of FIN 48 which clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Based on the Company's evaluation, the total amount of unrecognized tax benefits related to research and development credits as of March 31, 2009 and 2008 was \$1.4 million and \$2.5 million, respectively. There were no interest or penalties related to unrecognized tax benefits as of March 31,

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. Income Taxes (Continued)**

2009 or March 31, 2008. The amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate as of March 31, 2009 and March 31, 2008 was \$1.4 million and \$2.5 million, respectively. However, this impact would be offset by an equal increase in the deferred tax valuation allowance as the Company has recorded a full valuation allowance against its deferred tax assets because of uncertainty as to future realization. Prior to the adoption of FIN 48, fully reserved federal and state deferred tax assets related to research and development credits had been recorded in the amount of \$10.9 million and \$7.2 million, respectively. Upon adoption of FIN 48, \$2.2 million of federal and state deferred tax assets related to research and development credits had been derecognized leaving a fully reserved balance as of March 31, 2008 of \$8.7 million and \$6.3 million, respectively. The fully reserved recognized federal and state research and development credit balance as of March 31, 2009 was \$6.1 million and \$6.4 million, respectively. The decrease in the federal and state research and development credit balance during the year ended March 31, 2009 was due to changes in estimates as to the qualification of certain research and development expenses for the credits. A reconciliation of the beginning and ending amount of total gross unrecognized tax benefits is as follows (in thousands):

Balance at March 31, 2007	\$ 2,192
Gross increase related to prior year tax positions	—
Gross increase related to current year tax positions	287
Lapse of statute of limitations	—
Balance at March 31, 2008	\$ 2,479
Gross decrease related to prior year tax positions	(1,177)
Gross increase related to current year tax positions	73
Lapse of statute of limitations	—
Balance at March 31, 2009	\$ 1,375

The Company files income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state, local or non-U.S. income tax examinations by tax authorities for the years before 2004. However, net operating loss carryforwards remain subject to examination to the extent they are carried forward and impact a year that is open to examination by tax authorities. The Company's evaluation was performed for the tax years which remain subject to examination by major tax jurisdictions as of March 31, 2009. When applicable, the Company accounts for interest and penalties generated by tax contingencies as interest and other expense, net in the statements of operations.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**7. Income Taxes (Continued)**

The Company's deferred tax assets and liabilities consisted of the following at March 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
	(In thousands)	
Deferred tax assets:		
Inventories	\$ 2,596	\$ 1,630
Warranty reserve	942	1,845
Deferred revenue	525	140
Net operating loss ("NOL") carryforwards	194,061	179,264
Tax credit carryforwards	12,556	16,508
Depreciation, amortization and impairment loss	2,402	1,788
Other	3,357	3,239
Total deferred tax assets	<u>216,439</u>	<u>204,414</u>
Deferred tax liabilities:		
State taxes	(9,904)	(9,638)
Net deferred tax assets before valuation allowance	<u>206,535</u>	<u>194,776</u>
Valuation allowance	<u>(205,535)</u>	<u>(194,776)</u>
Total deferred income tax assets	<u>\$ —</u>	<u>\$ —</u>

Due to the uncertainty surrounding the timing of realizing the benefits of favorable tax attributes in future income tax returns, the Company has placed a valuation allowance against its deferred income tax assets. The change in valuation allowance for Fiscal 2009, 2008 and 2007 was \$11.8 million, \$11.5 million, and \$13.9 million, respectively.

The Company's NOL and tax credit carryforwards for federal and state income tax purposes at March 31, 2009 were as follows (In thousands):

	<u>Amount</u>	<u>Expiration Period</u>
	(In thousands)	
Federal NOL	\$508,566	2009-2028
State NOL	\$341,757	2009-2013
Federal tax credit carryforwards	\$ 6,115	2009-2028
State tax credit carryforwards	\$ 6,441	Various

The NOLs and federal and state tax credits can be carried forward to offset future taxable income, if any. Utilization of the net operating losses and tax credits are subject to an annual limitation of approximately \$57.6 million due to the ownership change limitations provided by the Internal Revenue Code of 1986 and similar state provisions. The federal tax credit carryforward is a research and development credit, which may be carried forward. The state tax credits consist of a research and development credit of approximately \$6.4 million, which may be carried forward indefinitely.

Tax benefits arising from the disposition of certain shares issued upon exercise of stock options within two years of the date of grant or within one year of the date of exercise by the option holder ("Disqualifying Dispositions") provide the Company with a tax deduction equal to the difference

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. Income Taxes (Continued)**

between the exercise price and the fair market value of the stock on the date of exercise. Approximately \$27.7 million of the Company's federal and state NOL carryforwards as of March 31, 2009 were generated by Disqualifying Dispositions of stock options and exercises of nonqualified stock options. Upon realization, if any, tax benefits of approximately \$10.5 million associated with these stock options would be excluded from the provision for income taxes and credited directly to additional paid-in-capital.

A reconciliation of income tax benefit to the federal statutory rate follows:

	Year Ended March 31,		
	2009	2008	2007
	(In thousands)		
Federal income tax at the statutory rate	\$(14,194)	\$(12,278)	\$(12,488)
State taxes, net of federal effect	(1,705)	(1,475)	(1,500)
Foreign taxes	80	—	—
Tax credit adjustment	4,384	—	—
Valuation allowance	11,759	13,924	13,839
Other	(242)	(169)	151
Income tax expense	<u>\$ 82</u>	<u>\$ 2</u>	<u>\$ 2</u>

**8. Stockholders' Equity****Stock Plans***1993 Incentive Stock Plan and 2000 Equity Incentive Plan*

In 1993, the Board of Directors adopted and the stockholders approved the 1993 Incentive Stock Plan ("1993 Plan"). A total of 7,800,000 shares of common stock were initially reserved for issuance under the 1993 Plan. In June 2000, the Company adopted the 2000 Equity Incentive Plan ("2000 Plan") as a successor plan to the 1993 Plan. A total of 3,300,000 shares of common stock were initially reserved for issuance under the 2000 Plan. The 2000 Plan was amended in May 2002 to add 400,000 shares of common stock to the total available for issuance, amended in January 2004 to update certain administrative provisions, amended in September 2004 to add 2,380,000 shares of common stock to the total available for issuance, amended on January 31, 2005 and March 17, 2005 to coordinate the provisions for change in control with the Company's change in control agreements and programs, and was amended and restated on August 24, 2007 to incorporate prior amendments, update certain administrative provisions and include the requirement of an adjustment in the event of a stock split. The 2000 Plan provides for awards of up to 6,080,000 shares of common stock, plus 7,800,000 shares previously authorized under the 1993 Plan; provided, however, that the maximum aggregate number of shares which may be issued is 13,880,000 shares. The 2000 Plan is administered by the Compensation Committee designated by the Board of Directors. The Compensation Committee's authority includes determining the number of options granted and vesting provisions. As of March 31, 2009, there were 3,587,755 shares available for future grant.

As of March 31, 2009, the Company had outstanding 4,200,000 non-qualified common stock options issued outside of the 2000 Plan. These stock options were originally granted at exercise prices equal to the fair market value of the Company's common stock on the grant date, as inducement grants

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Stockholders' Equity (Continued)**

to new executive officers and employees of the Company. Included in the 4,200,000 options were 2,000,000 options granted to the Company's President and Chief Executive Officer, 850,000 options granted to the Company's Senior Vice President of Sales and Service, 650,000 options granted to the Company's Vice President of Customer Service, 500,000 options granted to the Company's former Vice President of Operations and 200,000 options granted to the Company's Senior Vice President of Human Resources. Additionally, the Company had outstanding 462,500 restricted stock units issued outside of the 2000 Plan. These restricted stock units were issued as inducement grants to new executive officers of the Company. Included in the 462,500 units were 250,000 units granted to the Company's President and Chief Executive Officer, 100,000 units granted to the Company's Executive Vice President of Sales and Marketing, and 112,500 granted to the Company's Vice President of Customer Service. Although the options and units were not granted under the 2000 Plan, they were governed by terms and conditions identical to those under the 2000 Plan. All options granted are subject to the following vesting provisions: one-fourth 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. All outstanding options have a contractual term of ten years. The restricted stock units vest in equal installments over a period of two or four years. For two year vesting, one-half of the value vests one year after the issuance date and the other half vests on the first day of the subsequent year. The four year vesting occurs as follows: one-fourth vests one year after the issuance date and one-fourth vests on the first day of each full year thereafter, so that all shall be vested on the first day of the fourth year after the issuance date.

During each of the years ended March 31, 2009 and 2008, the Company issued 100,000 shares of stock awards to consultants under the 2000 Equity Incentive Plan ("2000 Plan").

In June 2000, the Company adopted the 2000 Employee Stock Purchase Plan (the "Purchase Plan"), which provides for the granting of rights to purchase common stock to regular full and part-time employees or officers of the Company and its subsidiaries. Under the Purchase Plan, shares of common stock will be issued upon exercise of the purchase rights. Under the Purchase Plan, an aggregate of 900,000 shares may be issued pursuant to the exercise of purchase rights. The maximum amount that an employee can contribute during a purchase right period is \$25,000 or 15% of the employee's regular compensation. Under the Purchase Plan, the exercise price of a purchase right is 95% of the fair market value of such shares on the last day of the purchase right period. The fair market value of the stock is its closing price as reported on the Nasdaq Stock Market on the day in question. As of March 31, 2009, there were 62,752 shares available for future grant under the Purchase Plan.

***Valuation and Expense Information under SFAS No. 123(R)***

For the fiscal years ended March 31, 2009, 2008 and 2007, the Company recognized stock-based compensation expense of \$3.4 million, \$3.2 million and \$2.7 million, respectively. The following table

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. Stockholders' Equity (Continued)**

summarizes, by statement of operations line item, stock-based compensation expense for the years ended March 31, 2009, 2008 and 2007 (in thousands):

	Fiscal Year		
	Ended March 31,		
	2009	2008	2007
Cost of goods sold	\$ 519	\$ 428	107
Research and development	631	570	232
Selling, general and administrative	2,203	2,180	2,369
Revenue	68	—	—
Stock-based compensation expense	<u>\$3,421</u>	<u>\$3,178</u>	<u>\$2,708</u>

The Company calculated the estimated fair value of each stock option on the date of grant using the Black-Scholes option-pricing model and the following weighted-average assumptions:

	Fiscal Year		
	Ended March 31,		
	2009	2008	2007
Risk-free interest rates	2.4%	3.8%	4.7%
Expected lives (in years)	4.9	6.3	6.1
Dividend yield	—%	—%	—%
Expected volatility	98.7%	98.3%	101.3%

The Company's computation of expected volatility for the fiscal years ended March 31, 2009, 2008 and 2007 was based on historical volatility. The Company estimated the expected life of each stock option granted in the fiscal year ended March 31, 2008 and 2007 using the simplified method permissible under Staff Accounting Bulletin No. 107 ("SAB 107"), which utilizes the weighted average expected life of each tranche of the stock option, determined based on the sum of each tranche's vesting period plus one-half of the period from the vesting date of each tranche to the stock option's expiration. Beginning in Fiscal 2009, the expected life, or term, of options granted is derived from historical exercise behavior and represents the period of time that stock option awards are expected to be outstanding. The Company has selected a risk-free rate based on the implied yield available on U.S. Treasury Securities with a maturity equivalent to the options' expected term. Included in the calculation is the Company's estimated forfeiture rate. SFAS No. 123(R) requires that equity-based compensation expense be based on awards that are ultimately expected to vest and accordingly, equity-based compensation recognized has been reduced by estimated forfeitures. The Company's estimate of forfeitures is based on historical option forfeiture behavior.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Stockholders' Equity (Continued)**

Information relating to all outstanding stock options, except for rights associated with the Purchase Plan, is as follows:

	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term (in years)</u>	<u>Aggregate Intrinsic Value</u>
Options outstanding at March 31, 2008	9,182,923	\$ 1.89		
Granted	1,530,000	\$ 1.02		
Exercised	(1,142,395)	\$ 2.05		
Forfeited, cancelled or expired	(360,154)	\$ 1.73		
Options outstanding at March 31, 2009	9,210,374	\$ 1.74	7.56	\$ 8,460
Options fully vested at March 31, 2009 and those expected to vest beyond March 31, 2009	8,403,856	\$ 1.79	7.44	\$ 8,460
Options exercisable at March 31, 2009	<u>5,115,968</u>	<u>\$ 2.14</u>	<u>6.79</u>	<u>\$ 8,460</u>

The weighted average per share grant date fair value of options granted during the fiscal years ended March 31, 2009, 2008 and 2007 was \$1.02, \$1.26 and \$1.18, respectively. The total intrinsic value of option exercises during the fiscal years ended March 31, 2009, 2008 and 2007, was approximately \$1.2 million, \$1.8 million and \$1.4 million, respectively. As of March 31, 2009, there was approximately \$2.3 million of total compensation cost related to unvested stock option awards that is expected to be recognized as expense over a weighted average period of 2.48 years.

During the year ended March 31, 2009, the Company issued a total of 102,866 shares of stock to non-employee directors who elected to take payment of all or any part of the directors' fees in stock in lieu of cash. For each term of the Board of Directors (beginning on the date of an annual meeting of stockholders and ending on the date immediately preceding the next annual meeting of stockholders), a non-employee director may elect to receive, in lieu of all or any portion of their annual retainer or committee fee cash payment, a stock award. The shares of stock were valued based on the closing price of the Company's common stock on the date of grant, and the weighted average grant date fair value for these shares was \$0.98.

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. Stockholders' Equity (Continued)**

The following table outlines the restricted stock units activity:

<u>Restricted Stock Units</u>	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested restricted stock units outstanding at March 31, 2008	2,296,638	\$ 1.19
Granted	1,339,997	\$ 1.27
Vested and issued	(691,174)	\$ 1.78
Forfeited	(433,809)	\$ 1.32
Nonvested restricted stock units outstanding at March 31, 2009	2,511,652	\$ 1.05
Restricted stock units expected to vest beyond March 31, 2009	1,873,697	\$ 0.72

The restricted stock units vest in equal installments over a period of two or four years. For restricted stock units with two year vesting, one-half of such units vest one year after the issuance date and the other half vest two years after the issuance date. For restricted stock units with four year vesting, one-fourth vest annually beginning one year after the issuance date. The restricted stock units were valued based on the closing price of the Company's common stock on the date of issuance, and compensation cost is recorded on a straight-line basis over the vesting period. The related compensation expense recognized has been reduced by estimated forfeitures. The Company's estimate of forfeitures is based on historical forfeitures.

The total fair value of restricted stock units vested and issued by the Company during the year ended March 31, 2009, 2008 and 2007 was approximately \$1.2 million, \$0.4 million and \$0.2 million, respectively. The Company recorded expense of approximately \$0.8 million, \$0.6 million and \$0.3 million associated with its restricted stock awards and units for fiscal years ended March 31, 2009, 2008 and 2007, respectively. As of March 31, 2009, there was approximately \$2.1 million of total compensation cost related to unvested restricted stock units that is expected to be recognized as expense over a weighted average period of 2.83 years.

**Stockholder Rights Plan**

The Company has entered into a rights agreement, as amended, with Mellon Investor Services LLC, as rights agent. In connection with the rights agreement, the Company's board of directors authorized and declared a dividend distribution of one preferred stock purchase right for each share of the Company's common stock authorized and outstanding. Each right entitles the registered holder to purchase from the Company a unit consisting of one one-hundredth of a share of Series A Junior Participating Preferred Stock, par value \$0.001 per share, at a purchase price of \$10.00 per unit, subject to adjustment. The description and terms of the rights are set forth in the rights agreement. Initially, the rights will be attached to all common stock certificates representing shares then outstanding, and no separate rights certificates will be distributed. Subject to certain exceptions specified in the rights agreement, the rights will separate from the common stock and will be exercisable upon the earlier of (i) 10 days following a public announcement that a person or group of

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Stockholders' Equity (Continued)**

affiliated or associated persons has acquired, or obtained the right to acquire, beneficial ownership of 20% or more of the outstanding shares of common stock, other than as a result of repurchases of stock by the Company or certain inadvertent actions by institutional or certain other stockholders, or (ii) 10 days (or such later date as the Company's board of directors shall determine) following the commencement of a tender offer or exchange offer (other than certain permitted offers described in the rights agreement) that would result in a person or group beneficially owning 20% or more of the outstanding shares of the Company's common stock. The rights will expire at the close of business on the 30<sup>th</sup> day after the Company's 2011 annual meeting of stockholders unless a continuation of the rights plan is approved by the stockholders of the Company at that meeting. If so approved by the stockholders, the rights expire on July 18, 2015, unless such date is extended or the rights are earlier redeemed or exchanged by the Company. The rights are intended to protect the Company's stockholders in the event of an unfair or coercive offer to acquire the Company. The rights, however, should not affect any prospective offeror willing to make an offer at a fair price and otherwise in the best interests of the Company and its stockholders, as determined by the board of directors. The rights should also not interfere with any merger or other business combination approved by the board of directors.

**Registered Direct Offering and Placement of Common Stock**

Effective September 23, 2008, the Company completed a registered direct placement in which it sold 21.5 million shares of the Company's common stock, par value \$.001 per share, and warrants to purchase 6.4 million shares of common stock with an initial exercise price of \$1.92 per share, at a price of \$14.90 per unit. Each unit consisted of ten shares of common stock and warrants to purchase three shares of common stock. The five-year warrants are immediately exercisable and include anti-dilution provisions, subject to certain limitations. Additionally, the Company has the right, at its option, to accelerate the expiration of the exercise period of the outstanding warrants issued in the offering, in whole or from time to time in part, at any time after the second anniversary of the original issue date of the warrants, subject to certain limitations. The sale resulted in gross proceeds of \$32.0 million and proceeds, net of direct incremental costs, of the offering of \$29.5 million. During the fiscal year ended March 31, 2009, none of the warrants issued in September 2008 were exercised. Of the warrants issued in September 2008, warrants to purchase 6.4 million shares were outstanding as of March 31, 2009. As discussed in Note 13, the number of shares to be received upon exercise and the exercise price of the warrants were adjusted as a result of the May 2009 registered direct offering. Following the offering, the warrants issued in September 2008 and still outstanding represented warrants to purchase 7.1 million shares at an exercise price of \$1.74 per share.

Effective January 24, 2007, the Company completed a registered direct placement in which it sold 40 million shares of the Company's common stock, par value \$.001 per share, and warrants to purchase 20 million shares of common stock with an initial exercise price of \$1.30 per share, at a price of \$1.14 per unit. Each unit consisted of one share of common stock and warrants to purchase 0.5 shares of common stock. The five-year warrants are immediately exercisable and include anti-dilution provisions, subject to certain limitations. During the fiscal years ended March 31, 2009 and 2008, warrants to purchase 3.2 million and 1.5 million shares were exercised resulting in proceeds of \$4.1 million and \$2.0 million, respectively. Of the warrants issued in January 2007 warrants to purchase 15.3 million shares were outstanding as of March 31, 2009. As discussed in Note 13, the number of shares to be received upon exercise and the exercise price of the warrants were adjusted as a result of the May 2009

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Stockholders' Equity (Continued)**

registered direct offering. Following the offering, the warrants issued in January 2007 and still outstanding represented warrants to purchase 16.6 million shares at an exercise price of \$1.20 per share.

**9. Revolving Credit Facility**

On February 9, 2009, the Company entered into two Credit and Security Agreements (the "Agreements") with Wells Fargo. The Agreements provide the Company with a Credit Facility of up to \$10 million in the aggregate. The amount actually available to the Company may be less and may vary from time to time depending on, among other factors, the amount of its eligible inventory and accounts receivable. As security for the payment and performance of the Credit Facility, the Company granted a security interest in favor of Wells Fargo in substantially all of the assets of the Company. Included in the revolving credit facility and reducing the available borrowings is a letter of credit to a vendor for \$36,000. The agreements will terminate in accordance with their terms on February 9, 2012 unless terminated sooner.

The Agreements include affirmative covenants as well as negative covenants that prohibit a variety of actions without Wells Fargo's consent, including covenants that limit our ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another entity, (d) pay dividends on, or purchase, acquire, redeem or retire shares of, our capital stock, (e) sell, assign, transfer or otherwise dispose of all or substantially all of our assets, (f) change our accounting method or (g) enter into a different line of business. Furthermore, the Agreements contain financial covenants, including (a) a requirement to maintain a specified minimum book worth, (b) a requirement not to exceed specified levels of losses, (c) a requirement to maintain a specified ratio of minimum cash balances to unreimbursed line of credit advances, and (d) limitations on our capital expenditures. As of March 31, 2009, the Company determined that it was not in compliance with two financial covenants.

On May 3, 2009, the Company received from Wells Fargo a waiver of our noncompliance with two financial covenants as of March 31, 2009 in the Agreements regarding its monthly book net worth and quarterly and annual net income. If the Company had not received the waiver or failed to comply with the financial covenants contained in the credit facility agreements in the future, the Company would not be able to draw additional funds under the line of credit. In addition, the Company has pledged its accounts receivables, inventories, equipment, patents and other assets as collateral for its credit facility with Wells Fargo, which would be subject to seizure by our creditors if the Company was in default under the Agreements and unable to repay the indebtedness. The Company must comply with the financial and other covenants contained in the Agreements which could limit its flexibility in conducting its business and put it at a disadvantage compared to its competitors, and the Company is required to use its available cash to pay debt service. On June 9, 2009, the Company amended the Agreements to revise the financial covenants regarding monthly book net worth and quarterly and annual net income.

The Company is required to maintain a Wells Fargo collection account for cash receipts on all of its accounts receivable. These amounts are immediately applied to reduce the outstanding amount on the line of credit. The floating rate for line of credit advances is the greater of the Prime Rate plus applicable margin or 5% plus applicable margin, subject to a minimum interest floor. Based on the revolving nature of our borrowings and payments, the Company classifies all outstanding amounts as

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. Revolving Credit Facility (Continued)**

current liabilities. The applicable margin varies based on net income and the minimum interest floor is set at \$31,000 per month. Our borrowing rate at March 31, 2009 was 3.25%.

The Company has incurred \$0.2 million in origination fees. These fees have been capitalized and are being amortized to interest expense through February 2012. The Company is also required to pay an annual unused line fee of one-quarter of one percent of the daily average of the maximum line amount and 1.5% interest with respect to each letter of credit issued by Wells Fargo. These amounts, if any, are also recorded as interest expense by the Company. As of March 31, 2009, the Company had \$3.7 million in borrowings under this facility and total capacity of \$10.0 million. Interest expense related to the revolving credit facility for the year ended March 31, 2009 was \$66,000, which includes \$10,000 in amortization of deferred financing costs.

**10. Commitments and Contingencies****Purchase Commitments**

As of March 31, 2009, the Company had firm commitments to purchase inventories of approximately \$27.1 million through Fiscal 2011. Certain inventory delivery dates and related payments are not firmly scheduled; therefore amounts under these firm purchase commitments will be payable upon the receipt of the related inventories.

**Lease Commitments**

The Company leases offices and manufacturing facilities under various non-cancelable operating leases expiring at various times through the fiscal year ending March 31, 2011. All of the leases require the Company to pay maintenance, insurance and property taxes. The lease agreements for primary office and manufacturing facilities provide for rent escalation over the lease term and renewal options for five year periods. Rent expense is recognized on a straight-line basis over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent which is included in other long-term liabilities in the accompanying consolidated balance sheets. Deferred rent amounted to \$0.3 million and \$0.5 million as of March 31, 2009 and 2008, respectively. Rent expense amounted to approximately \$2.1 million, \$2.3 million and \$2.3 million for the years ended March 31, 2009, 2008 and 2007, respectively.

At March 31, 2009, the Company's minimum commitments under non-cancelable operating leases were as follows:

<u>Year Ending March 31,</u>	<u>Operating Leases (In thousands)</u>
2010	\$ 2,008
2011	814
2012	—
Total minimum lease payments	<u>\$ 2,822</u>

The Company owns automobiles that it has financed with notes payable. The outstanding balances of the notes payable as of March 31, 2009 and 2008 were \$41,000 and \$18,000, respectively. The notes

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**10. Commitments and Contingencies (Continued)**

bear interest at 6.9% with principal and interest paid monthly through June 2013. The related automobiles collateralize the notes payable.

**Other Commitments**

Agreements the Company has with some of its distributors and Authorized Service Companies ("ASCs") require that if the Company renders parts obsolete in inventories they own and hold in support of their obligations to serve fielded microturbines, then the Company is required to replace the affected stock at no cost to the distributors or ASCs. While the Company has never incurred costs or obligations for these types of replacements, it is possible that future changes in the Company's product technology could result and yield costs to the Company if significant amounts of inventory are held at ASCs. As of March 31, 2009, no significant inventories were held at ASCs.

**Legal Matters**

In December 2001, a purported stockholder class action lawsuit was filed in the United States District Court for the Southern District of New York (the "District Court") against the Company, two of its then 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. The 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. The 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. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998; the complaints have been consolidated into an action captioned *In re Initial Public Offering Securities Litigation*, No. 21 MC 92. On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all the actions, including the action involving the Company. On July 15, 2002, the Company, along with other non-underwriter defendants in the coordinated cases, moved to dismiss the litigation. On October 9, 2002, the Plaintiffs dismissed, without prejudice, the claims against the named officers and directors in the action against the Company. On February 19, 2003, the District Court issued an order denying the motion to dismiss the claims against the Company under Rule 10b-5. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including the Company. In June 2004 stipulation of partial settlement and release of claims against the issuer and individual defendants was submitted to the District Court. While the partial settlement was pending approval, the Plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of "focus cases" and on October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. In light of the Second Circuit opinion, liaison counsel for all issuer defendants, including the Company, informed the District Court that the settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On August 14, 2007, the Plaintiffs filed their second consolidated amended complaints against the six focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**10. Commitments and Contingencies (Continued)**

the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. The motion for class certification was withdrawn without prejudice on October 10, 2008. The Court granted the plaintiffs' motion for preliminary approval and preliminarily certified the settlement classes on June 10, 2009. The settlement "fairness" hearing has been scheduled for September 10, 2009. Following the hearing, if the Court determines that the settlement is fair to the class members, the settlement will be approved and the case against the Company and its individual defendants will be dismissed with prejudice. Because of the inherent uncertainties of litigation and because the settlement approval process is at a preliminary stage, the ultimate outcome of the matter is uncertain, and the Company believes that the outcome of this litigation will not have a material adverse impact on its consolidated financial position and results of operations.

On October 9, 2007, Vanessa Simmonds, a purported stockholder of the Company, filed suit in the U.S. District Court for the Western District of Washington against The Goldman Sachs Group, Inc., Merrill Lynch & Co., Inc., and Morgan Stanley, the lead underwriters of our initial public offering in June 1999, and our secondary offering of common stock in November 2000, alleging violations of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The complaint sought to recover from the lead underwriters any "short-swing profits" obtained by them in violation of Section 16(b). The suit names the Company as a nominal defendant, contained no claims against the Company, and sought no relief from the Company. Simmonds filed an Amended Complaint on February 27, 2008 (the "Amended Complaint"), naming as defendants Goldman Sachs & Co. and Merrill Lynch Pierce, Fenner & Smith Inc. and again naming Morgan Stanley. The Goldman Sachs Group, Inc. and Merrill Lynch & Co., Inc. were no longer named as defendants. The Amended Complaint asserted substantially similar claims as those set forth in the initial complaint. On July 25, 2008, the Company joined with 29 other issuers to file the Issuer Defendants' Joint Motion to Dismiss. Simmonds filed her opposition to this motion on September 8, 2008, and the Company and the other Issuer Defendants filed a Reply in Support of Their Joint Motion to Dismiss on October 23, 2008. On March 12, 2009, the Court granted the Issuer Defendants' Joint Motion to Dismiss, dismissing the complaint without prejudice on the grounds that Simmonds had failed to make an adequate demand on the Company prior to filing her complaint. In its order, the Court stated that it would not permit Simmonds to amend her demand letters while pursuing her claims in the litigation. Because the Court dismissed the case on the grounds that it lacked subject matter jurisdiction, it did not specifically reach the issue of whether Simmonds' claims were barred by the applicable statute of limitations. However, the Court also granted the Underwriters' Joint Motion to Dismiss with respect to cases involving non-moving issuers, holding that the cases were barred by the applicable statute of limitations because the issuers' shareholders had notice of the potential claims more than five years prior to filing suit. Simmonds filed a Notice of Appeal on April 10, 2009. Simmonds' opening brief in the appeal is due on July 27, 2009, with the Company and the underwriters' responses due on August 25, 2009. Simmonds may file a reply brief on September 8, 2009. The Company believes that the outcome of this litigation will not have a material adverse impact on its consolidated financial position and results of operations.

From time to time, the Company may become subject to additional legal proceedings, claims and litigation arising in the ordinary course of business. Other than the matters discussed above, the Company is not a party to any other material legal proceedings, nor is the Company aware of any other

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**10. Commitments and Contingencies (Continued)**

pending or threatened litigation that would have a material adverse effect on the Company's business, operating results, cash flows or financial condition should such litigation be resolved unfavorably.

**11. Employee Benefit Plans**

The Company maintains a defined contribution 401(k) profit-sharing plan in which all employees are eligible to participate. Employees may contribute up to Internal Revenue Service annual limits or, if less, 90% of their eligible compensation. Employees are fully vested in their contributions to the plan. The plan also provides for both Company matching and discretionary contributions, which are determined by the Board of Directors. The Company began matching 50 cents on the dollar up to 4% of the employee's contributions in October 2006 (Fiscal 2007). Prior to that date, no Company contributions had been made since the inception of the plan. The Company's match vests 25% a year over four years starting from the employee's hire date. The expense recorded by the Company for the years ended March 31, 2009, 2008 and 2007 was approximately \$0.2 million, \$0.2 million, and \$0.1 million, respectively.

The Company has a deferred compensation plan providing eligible executives with the opportunity to participate in an unfunded, deferred compensation program. Under the program, participants may defer base compensation and bonuses and earn interest on their deferred amounts. The program is not qualified under Section 401 of the Internal Revenue Code. There were no participant deferrals and earnings during the years ended March 31, 2009, 2008 and 2007, respectively.

**12. Other Current Liabilities**

In September 2007, the Company entered into the Development Agreement with UTCP, a division of UTC, a former stockholder of the Company that liquidated their position on January 19, 2007. The Development Agreement engages UTCP to fund and support the Company's continued development and commercialization of the Company's C200. Pursuant to the terms of the Development Agreement, UTCP will contribute \$12.0 million in cash and approximately \$800,000 of in-kind services toward the Company's efforts to develop the C200. In return, the Company will pay to UTCP an ongoing royalty of 10% of the sales price of the C200 sold to customers other than UTCP until the aggregate of UTCP's cash and in-kind services investment has been recovered and, thereafter, the royalty will be reduced to 5% of the sales price. UTCP earned \$0.1 million in royalties for C200 system sales for the year ended March 31, 2009. There were no C200 system sales in the same period last year. No royalties were unpaid as of March 31, 2009. The Company received \$1.5 million upon the signing of the Development Agreement in September 2007. During the year ended March 31, 2008, the company achieved three of the development milestones and received \$2.0 million for the systems requirements review, \$2.5 million for the preliminary design review, and \$2.5 million for the critical design review. During the year ended March 31, 2009, the Company reached three additional development milestones and received \$0.5 million for the physical verification, \$1.5 million for the microturbine completion and \$1.0 million for 90% completion of the qualification results milestone. The Company is scheduled to receive the remaining \$0.5 million at completion of the qualification results milestone. As of March 31, 2009, the Company had received \$11.5 million and offset approximately \$10.7 million of research and development ("R&D") expenses with this funding. The remaining \$0.8 million is recorded in other current liabilities in the accompanying condensed consolidated balance sheet. The Company records the benefits from this Development Agreement as a reduction of R&D expenses. There were approximately \$8.1 million and \$3.0 million of such benefits for the years ended March 31, 2009 and

**CAPSTONE TURBINE CORPORATION AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**12. Other Current Liabilities (Continued)**

2008, respectively, which included \$0.2 million of in-kind services performed by UTCP under the cost-sharing program for each of the years ended March 31, 2009 and 2008, respectively. In-kind services performed by UTCP under the cost-sharing program are recorded as consulting expense within R&D expenses. The reduction of R&D expenses is recognized on a percentage of completion basis, limited by the amount of funding received and/or earned based on milestone deliverables. If the Company fails to complete the development and commercialization of the C200, UTCP will receive a non-exclusive, perpetual, world-wide license to the C200 and the Company would receive royalty payments of 3% per unit of the burdened manufacturing cost for C200s sold by UTCP. In addition, the Company entered into a service agreement with UTCP to act as a sub-contractor for UTCP in providing equipment maintenance for Capstone microturbines to certain UTCP customers.

In October 2002, the Company entered into a strategic alliance with UTC. In March 2005, the Company and UTC replaced the strategic alliance agreement with an original equipment manufacturer ("OEM") agreement (the "OEM Agreement") between the Company and UTCP. The Development Agreement extends the OEM Agreement to ensure that such agreement is in effect during the period of commercialization of the C200 and for an additional six months thereafter. Additionally, as part of the Development Agreement, the Company and UTC resolved previous disputes related to the OEM Agreement. The OEM Agreement involves the integration, marketing, sales and service of CCHP solutions worldwide. Sales to UTCP were approximately \$3.0 million, \$4.1 million, and \$2.4 million for the years ended March 31, 2009, 2008, and 2007, respectively. Related accounts receivable were \$0.2 million and \$0.3 million, as of March 31, 2009 and 2008, respectively.

**13. Subsequent Event**

Effective May 4, 2009, the Company completed a registered direct offering in which it sold 14.4 million shares of the Company's common stock, par value \$.001 per share, and warrants to purchase 10.8 million shares of common stock with an initial exercise price of \$0.95 per share, at a unit price of \$0.865 per unit. Each unit consisted of one share of common stock and a warrant to purchase 0.75 shares of common stock at an exercise price of \$0.95 per share of common stock. The seven-year warrants are immediately exercisable and include standard weighted average anti-dilution provisions, subject to certain limitations. The sale resulted in gross proceeds of approximately \$12.5 million and net proceeds of \$11.2 million after issuance costs. The May 2009 offering triggered certain anti-dilution provisions in the warrants outstanding prior to the offering. As a result, the number of shares to be received upon exercise and the exercise price of each warrant previously outstanding were adjusted. Following the offering, (a) the warrants issued in September 2008 and still outstanding represented warrants to purchase 7.1 million shares at an exercise price of \$1.74 per share and (b) the warrants issued in January 2007 and still outstanding represented warrants to purchase 16.6 million shares at an exercise price of \$1.20 per share.

**CAPSTONE TURBINE CORPORATION**  
**VALUATION AND QUALIFYING ACCOUNTS**  
**FOR THE YEARS ENDED MARCH 31, 2009, 2008 and 2007**

(In thousands)

<u>Allowance for Doubtful Accounts and Sales Returns:</u>	
<b>Balance, March 31, 2006</b>	\$ 858
Additions charged to costs and expenses	648
Deductions	<u>(717)</u>
<b>Balance, March 31, 2007</b>	789
Additions charged to costs and expenses	107
Deductions	<u>(267)</u>
<b>Balance, March 31, 2008</b>	629
Additions charged to costs and expenses	273
Deductions	<u>(258)</u>
<b>Balance, March 31, 2009</b>	<u>\$ 644</u>



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<u>Signature</u>	<u>Title</u>	<u>Date</u>
<hr/> <u>/s/ NOAM LOTAN</u> Noam Lotan	Director	June 15, 2009
<hr/> <u>/s/ GARY J. MAYO</u> Gary J. Mayo	Director	June 15, 2009
<hr/> <u>/s/ GARY D. SIMON</u> Gary D. Simon	Director	June 15, 2009
<hr/> <u>/s/ HOLY A. VAN DEURSEN</u> Holly A. Van Deursen	Director	June 15, 2009
<hr/> <u>/s/ DARRELL J. WILK</u> Darrell J. Wilk	Director	June 15, 2009

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April 13, 2009

Mr. Darren R. Jamison  
21211 Nordhoff Street  
Chatsworth CA 91311

Dear Darren:

As described below, the compensation committee of the Capstone Turbine Corporation Board of Directors has extended the time period during which you can earn the Special Performance Bonus described in the December 1, 2006 letter agreement that was entered into when you commenced your employment by Capstone.

The letter agreement provides for a Special Performance Bonus of \$100,000 to be paid to you upon the achievement of Capstone cash flow positive for any two (2) consecutive quarters during the first two years of your employment. On April 8, 2009, the compensation committee extended the opportunity to earn the Special Performance Bonus for achievement of positive cash flow for any two (2) consecutive quarters through the fiscal year ending March 31, 2010.

Sincerely,

/s/ ELIOT G. PROTSCH

Eliot G. Protsch

Chairman of the Board  
Capstone Turbine Corporation

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**AMENDED AND RESTATED  
CHANGE OF CONTROL SEVERANCE AGREEMENT**

**THIS AMENDED AND RESTATED CHANGE OF CONTROL SEVERANCE AGREEMENT** (the "Agreement") is made and entered into between Capstone Turbine Corporation (the "Company") and **Darren R. Jamison** (the "Executive") to be effective April 8, 2009.

**RECITALS:**

**WHEREAS**, effective December 18, 2006, the Executive became the Company's president and chief executive officer pursuant to the terms of a letter agreement dated December 1, 2006, (the "Letter Agreement") which included certain benefits and payments upon the severance of the Executive following a change in control of the Company;

**WHEREAS**, in connection therewith, the Executive was made eligible for participation in the Capstone Turbine Corporation Change in Control Severance Plan (the "Plan"), which provides a portion of the severance benefits described in the Letter Agreement; and

**WHEREAS**, the parties entered into a Change of Control Severance Agreement (the "Original Agreement") to provide the severance benefits described in the Letter Agreement that are not provided through the Plan; and

**WHEREAS**, the parties desire to amend and restate the Original Agreement as more specifically provided herein.

**NOW, THEREFORE**, the parties do hereby agree to the following terms and conditions regarding severance payable to Executive in the events described herein:

**Section 1. Termination of Employment Without Cause**

In the event that Executive's employment is terminated by the Company for reasons other than Misconduct (as defined herein), the Executive will receive continuation of payments in the amount of his base salary then in effect for a period of one year following termination of employment. Provided, however, that the provisions of this Section 1 will not apply in the event that Executive is entitled to payments provided in Section 2 hereof. "Misconduct" shall mean the commission of any act of fraud, embezzlement, theft or dishonesty by Executive, any unauthorized use or disclosure by Executive of confidential information or trade secrets of the Company (or any parent or subsidiary thereof), or any other intentional misconduct by Executive adversely affecting the business or affairs of the Company (or any parent or subsidiary) in a material manner.

The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Company (or any parent or subsidiary) may consider as grounds for the termination of the employment of the Executive. Except as provided in Section 2, Executive will not be entitled to severance under this Agreement upon a termination of employment for reasons other than Misconduct.

**Section 2. Termination Upon a Change in Control**

In the event that Executive is Involuntarily Terminated within 12 months of a Change of Control or within the Trial Period, Executive shall be entitled to receive from the Company an amount equal to the base salary that would be payable to the Executive for a period of 18 months. The payment shall be made

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in one lump sum on the date of termination of employment. Notwithstanding anything herein to the contrary, the amount payable under this Section 2 shall be reduced by the amount of the cash severance amount payable to Executive under the Plan.

**Section 3. General Terms**

Except as otherwise provided herein, the capitalized terms used in this agreement shall have the meanings ascribed thereto in the Plan. The benefits provided through this Agreement and through the Plan are intended by the parties to be granted in fulfillment of the Company's obligations regarding cash severance payments pursuant to the Letter Agreement; the terms of this Agreement and the Plan completely replace and supersede the terms addressing the subject matter contained in the Letter Agreement.

**Section 4. Term of Agreement**

The provisions of this Agreement shall apply in the event of the termination of the employment of the Executive or a Change in Control that occurs during the period between April 8, 2009 and April 8, 2012.

**Section 5. Commencement of Deferred Compensation Payments**

Notwithstanding anything herein to the contrary, any payments to Executive that would be subject to an additional tax described in section 409A of the Internal Revenue Code shall commence six months following Executive's separation from service or, if sooner, upon the death

of the Executive.

**Section 6. Amendment or Termination**

The Company may amend this Agreement in its sole discretion at any time, provided that any amendment that would diminish the rights of the Executive is subject to Executive's express written consent.

**Section 7. Successors**

This Agreement shall be binding upon and accrue to the benefit of any successors and assigns of the Company.

**Section 8. Construction**

This Agreement shall be construed under and enforced in accordance with the laws of the State of California.

**IN WITNESS WHEREOF**, the Company, acting through the undersigned authorized representative, has executed this instrument and the Executive has set his hand hereto on this the 13th day of April, 2009, but to be effective on the date first written above.

**DARREN R. JAMISON**

**CAPSTONE TURBINE CORPORATION**

/s/ DARREN R. JAMISON

By: /s/ LARRY COLSON

Its: Senior Vice President Human Resources

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**WELLS FARGO BUSINESS CREDIT**  
**Credit and Security Agreement**

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## WELLS FARGO BUSINESS CREDIT

### Credit and Security Agreement

This Credit and Security Agreement (the "Agreement") is dated February 9, 2009, and is entered into between Capstone Turbine Corporation, a Delaware corporation ("Company"), and Wells Fargo Bank, National Association (as more fully defined in Exhibit A, "Wells Fargo"), acting through its Wells Fargo Business Credit operating division.

### RECITALS

Company has asked Wells Fargo to provide it with a \$10,000,000 revolving line of credit (the "Line of Credit") for working capital purposes and to facilitate the issuance of letters of credit. Wells Fargo is agreeable to meeting Company's request, provided that Company agrees to the terms and conditions of this Agreement.

For purposes of this Agreement, capitalized terms not otherwise defined in the Agreement shall have the meaning given them in Exhibit A.

### 1. AMOUNT AND TERMS OF THE LINE OF CREDIT

#### 1.1 Line of Credit; Limitations on Borrowings; Termination Date; Use of Proceeds.

(a) Line of Credit and Limitations on Borrowing. Wells Fargo shall make Advances to Company under the Line of Credit that (i) together with the L/C Amount and the aggregate outstanding amount of Indebtedness and other obligations owing under or in

connection with the Ex-Im Credit Agreement, shall not at any time exceed in the aggregate \$10,000,000 (the "Maximum Line Amount"), and (ii) together with the L/C Amount, exceed in the aggregate, the Borrowing Base limitations described in Section 1.2. Within these limits, Company may periodically borrow, prepay in whole or in part, and reborrow. Wells Fargo has no obligation to make an Advance during a Default Period or at any time Wells Fargo believes that an Advance would result in an Event of Default.

(b) Maturity and Termination Dates. Company may request Advances from the date that the conditions set forth in Section 3 are satisfied until the earlier of: (i) February 9, 2012 (the "Maturity Date"), (ii) the date Company terminates the Line of Credit, or (iii) the date Wells Fargo terminates the Line of Credit following an Event of Default (the earliest of such dates, the "Termination Date")

(c) Use of Line of Credit Proceeds. Company shall use the proceeds of each Advance and each Letter of Credit for ongoing working capital purposes, to cover any book overdraft, and to fund accounts payable more than 60 days past due.

(d) Revolving Note. Company's obligation to repay Line of Credit Advances, regardless of how initiated under Section 1.3, shall be evidenced by a revolving promissory note (as renewed, amended or replaced from time to time, the "Revolving Note").

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## 1.2 Borrowing Base; Mandatory Prepayment.

(a) Borrowing Base. The borrowing base (the "Borrowing Base") is an amount equal to:

(i) 85% or such lesser percentage of Eligible Accounts as Wells Fargo in its sole discretion may deem appropriate; provided that this rate may be reduced at any time by Wells Fargo's in its sole discretion by one percent (1%) for each percentage point by which Dilution on the date of determination is in excess of five percent (5.0%), plus

(ii) the lesser of (i) 25% or such lesser percentage of Eligible Inventory as Wells Fargo in its sole discretion may deem appropriate or (ii) \$1,000,000, plus

(iii) a reserve equal to ten percent (10%) of the aggregate outstanding amount of Indebtedness and other obligations owing under or in connection with the Ex-Im Credit Agreement from time to time, less

(vi) the Borrowing Base Reserve, less

(v) Indebtedness (other than Indebtedness constituting "Advances" under the Ex-Im Credit Agreement) that is not otherwise described in Section 1, including Indebtedness that Wells Fargo in its sole discretion finds on the date of determination to be equal to Wells Fargo's net credit exposure with respect to any swap, derivative, foreign exchange, hedge, deposit, treasury management or similar transaction or arrangement extended to Company by Wells Fargo and any Indebtedness owed by Company to Wells Fargo Merchant Services, L.L.C.

(b) Mandatory Prepayment; Overadvances. If (i) unreimbursed Line of Credit Advances evidenced by the Revolving Note plus the L/C Amount exceed the Borrowing Base, or (ii) the sum of the unreimbursed Line of Credit Advances evidenced by the Revolving Note, the L/C Amount, and the aggregate outstanding amount of Indebtedness and other obligations owing under or in connection with the Ex-Im Credit Agreement exceeds the Maximum Line Amount at any time, then Company shall immediately prepay the Revolving Note in an amount sufficient to eliminate the excess, and if payment in full of the Revolving Note is insufficient to eliminate this excess and the L/C Amount continues to exceed the Borrowing Base, then Company shall deliver cash to Wells Fargo in an amount equal to the remaining excess for deposit to the Special Account, unless in each case, Wells Fargo has delivered to Company an Authenticated Record consenting to the Overadvance prior to its occurrence, in which event the Overadvance shall be temporarily permitted on such terms and conditions as Wells Fargo in its sole discretion may deem appropriate, including the payment of additional fees or interest, or both.

## 1.3 Procedures for Line of Credit Advances.

(a) Advances to Operating Account. Advances shall be credited to Company's demand deposit account maintained with Wells Fargo (the "Operating Account"), unless the parties agree in a Record Authenticated by both of them to disburse to another account.

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(i) Advances upon Company's Request. Line of Credit Advances may be funded upon Company's request. No request will be deemed received until Wells Fargo acknowledges receipt, and Company, if requested by Wells Fargo, confirms the request in an Authenticated Record. Company shall repay all Advances, even if the Person requesting the Advance on behalf of Company lacked authorization.

(A) Floating Rate Advances. If Company wants a Floating Rate Advance, it shall make the request no later than 9:00 a.m. Pasadena, California Time on the Business Day on which it wants the Floating Rate Advance to be funded, which request shall specify the principal Advance amount being requested.

(B) LIBOR Advances. If Company wants a LIBOR Advance, it shall make the request no later

than 9:00 a.m. Pasadena, California Time three (3) Business Days prior to the Business Day on which it wants the LIBOR Advance to be funded, which request shall specify both the principal Advance amount and Interest Period being requested. No more than five (5) separate LIBOR Advance Interest Periods may be outstanding at any time under this Agreement and the Ex-Im Credit Agreement, on a combined basis. Each LIBOR Advance shall be in multiples of \$500,000 and in the minimum amount of at least \$500,000. LIBOR Advances are not available for Advances made through the Loan Manager Service, and shall not be available during Default Periods.

(ii) Advances through Loan Manager. If Wells Fargo has separately agreed that Company may use the Wells Fargo Loan Manager service (“Loan Manager”), Line of Credit Advances will be initiated by Wells Fargo and credited to the Operating Account as Floating Rate Advances as of the end of each Business Day in an amount sufficient to maintain an agreed upon ledger balance in the Operating Account, subject only to Line of Credit availability as provided in Section 1.1(a). If Wells Fargo terminates Company’s access to Loan Manager, Company may continue to request Line of Credit Advances as provided in Section 1.3(a)(i). Wells Fargo shall have no obligation to make an Advance through Loan Manager during a Default Period, or in an amount in excess of Line of Credit availability, and may terminate Loan Manager at any time in its sole discretion.

(b) Protective Advances; Advances to Pay Indebtedness Due. Wells Fargo may initiate a Floating Rate Advance on the Line of Credit in its sole discretion for any reason at any time, without Company’s compliance with any of the conditions of this Agreement, and (i) disburse the proceeds directly to third Persons in order to protect Wells Fargo’s interest in Collateral or to perform any of Company’s obligations under this Agreement, or (ii) apply the proceeds to the amount of any Indebtedness then due and payable to Wells Fargo.

(c) LIBOR Advances.

(i) Funding Line of Credit Advances as LIBOR Advances for Fixed Interest Periods. Subject to the other terms and conditions of this Agreement, Company may request a Line of Credit Advance as a LIBOR Advance for one, three, or six month periods (each period, an “Interest Period”, as more fully defined in Exhibit A).

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(ii) Procedure for Converting Floating Rate Advances to LIBOR Advances. Company may request that all or any part of an outstanding Floating Rate Advance be converted to a LIBOR Advance, provided that no Default Period is in effect, and that Wells Fargo receives the request no later than 9:00 a.m. Pasadena, California Time three (3) Business Days prior to the Business Day on which Company wishes the conversion to become effective. Each request shall (i) specify the principal amount of the Floating Rate Advance to be converted, (ii) the Business Day of conversion, and (iii) the Interest Period desired. The request shall be confirmed in an Authenticated Record if requested by Wells Fargo. Each conversion to a LIBOR Advance shall be in multiples of \$500,000 and in the minimum amount of at least \$500,000.

(iii) Expiring LIBOR Advance Interest Periods. Unless Company requests a new LIBOR Advance, or prepays an outstanding LIBOR Advance at the expiration of an Interest Period, Wells Fargo shall convert each LIBOR Advance to a Floating Rate Advance on the last day of the expiring Interest Period. If no Default Period is in effect, Company may request that all or part of any expiring LIBOR Advance be renewed as a new LIBOR Advance, provided that Wells Fargo receives the request no later than 9:00 a.m. Pasadena, California Time three (3) Business Days prior to the Business Day that constitutes the first day of the new Interest Period. Each request shall specify the principal amount of the expiring LIBOR Advance to be continued and Interest Period desired, and shall be confirmed in an Authenticated Record if requested by Wells Fargo. Each renewal of a LIBOR Advance shall be in multiples of \$500,000 and in the minimum amount of at least \$500,000.

(iv) Quotation of LIBOR Advance Interest Rates. Wells Fargo shall, with respect to any request for a new or renewal LIBOR Advance, or the conversion of a Floating Rate Advance to a LIBOR Advance, provide Company with a LIBOR quote for each Interest Period identified by Company on the Business Day on which the request was made, if the request is received by Wells Fargo no later than 9:00 a.m. Pasadena, California Time three (3) Business Days prior to the Business Day on which Company has requested that the LIBOR Advance be made effective. If Company does not immediately accept a LIBOR quote, the quoted rate shall expire and any subsequent request for a LIBOR quote shall be subject to redetermination by Wells Fargo.

(v) Taxes and Regulatory Costs. Company shall also pay Wells Fargo with respect to any LIBOR Advance all (i) withholdings, interest equalization taxes, stamp taxes or other taxes (except income and franchise taxes) imposed by any domestic or foreign governmental authority that are related to LIBOR, and (ii) future, supplemental, emergency or other changes in the LIBOR Reserve Percentage, the assessment rates imposed by the Federal Deposit Insurance Corporation, or similar costs imposed by any domestic or foreign governmental authority or resulting from compliance by Wells Fargo with any request or directive (whether or not having the force of law) from any central bank or other governmental authority that are related to LIBOR but not otherwise included in the calculation of LIBOR. In determining which of these amounts are attributable to an existing LIBOR Advance, any reasonable allocation made by Wells Fargo among its operations shall be deemed conclusive and binding.

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#### **1.4 Collection of Accounts and Application to Revolving Note.**

(a) The Collection Account. Company has granted a security interest to Wells Fargo in the Collateral, including all Accounts. Except as otherwise agreed by both parties in an Authenticated Record, all Proceeds of Accounts and other Collateral, upon receipt or collection, shall be deposited each Business Day into the Collection Account. Funds so deposited (“Account Funds”) are the property of Wells Fargo, and may only be withdrawn from the Collection Account by Wells Fargo for application in accordance with

Section 1.4(c) or as otherwise provided in the Loan Documents or by applicable law.

(b) Payment of Accounts by Company's Account Debtors. Company shall instruct all account debtors to make payments either directly to the Lockbox for deposit by Wells Fargo directly to the Collection Account, or instruct them to deliver such payments to Wells Fargo by wire transfer, ACH, or other means as Wells Fargo may direct for deposit to the Collection Account or for direct application to the Line of Credit. If Company receives a payment or the Proceeds of Collateral directly, Company will promptly deposit the payment or Proceeds into the Collection Account. Until deposited, it will hold all such payments and Proceeds in trust for Wells Fargo without commingling with other funds or property. All deposits held in the Collection Account shall constitute Proceeds of Collateral and shall not constitute the payment of Indebtedness.

(c) Application of Payments to Revolving Note. Wells Fargo will withdraw Account Funds deposited to the Collection Account and pay down borrowings on the Line of Credit by applying them to the Revolving Note on the first Business Day following the Business Day of deposit to the Collection Account, or, if payments are received by Wells Fargo that are not first deposited to the Collection Account pursuant to any treasury management service provided to Company by Wells Fargo, such payments shall be applied to the Revolving Note as provided in the Master Agreement for Treasury Management Services and the relevant service description.

## 1.5 Interest and Interest Related Matters.

(a) Interest Rates Applicable to Line of Credit. Except as otherwise provided in this Agreement, the unpaid principal amount of each Line of Credit Advance evidenced by the Revolving Note shall accrue interest at an annual interest rate calculated as follows:

The "Floating Rate" for Line of Credit Advances = the greater of (i) the Prime Rate plus the applicable Margin, or (ii) five percent (5.0%), plus the applicable Margin, which interest rate shall change whenever the Prime Rate changes, subject to the minimum interest rate floor;

Or

LIBOR Advance Rate pricing for one, three, or six month fixed rate Interest Periods: the "LIBOR Advance Rate" for Line of Credit Advances = LIBOR applicable to the selected Interest Period plus the applicable Margin;

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Multiple Advances under the Line of Credit may simultaneously accrue interest at both the Floating Rate and at the LIBOR Advance Rate, subject to the limitations of Section 1.3(a)(i)

If Borrower's Net Income for the most recently completed fiscal year is less than \$1.00 for such year, the Margins for the immediately succeeding fiscal year shall be two and one-half percent (2.5%) per annum for Floating Rate Advances, and three and one-half percent (3.5%) per annum for LIBOR Advances. If Borrower's Net Income for the most recently completed fiscal year equals or exceeds \$1.00 for such year, the Margins for the immediately succeeding fiscal year shall be two percent (2.0%) per annum for Floating Rate Advances, and three percent (3.0%) per annum for LIBOR Advances.

Each Margin change shall become effective on the first calendar day of the month following the month of receipt by Wells Fargo of the audited annual financial statements. If Company fails to timely deliver audited annual financial statements as agreed, the Margins shall be at the highest level set forth above and Wells Fargo may notify Company that an Event of Default has occurred and impose the Default Rate.

If amended or restated financial statements would change previously calculated Margins, or if Wells Fargo determines that any financial statements have materially misstated Company's financial condition, then Wells Fargo may, using the most accurate information available to it, recalculate the financial test or tests governing the Margins and retroactively reduce or increase the Margins from the date of receipt of such amended or restated financial statements and charge Company additional interest (such that Wells Fargo receives the interest that it should have received under this Agreement if the Company's financial condition had been properly reported), which may be imposed on them from the beginning of the appropriate month to which the previous change has been made or to the beginning of the month in which any Event of Default has occurred, as Wells Fargo in its sole discretion deems appropriate.

(b) Minimum Interest Charge. Notwithstanding the other terms of Section 1.5 to the contrary, and except as limited by the usury savings provision of Section 1.5(e), Company shall pay Wells Fargo at least \$31,000 of interest each calendar month under this Agreement and the Ex-Im Credit Agreement following the initial Advance (the "Minimum Interest Charge") during the term of this Agreement, and Company shall pay any deficiency between the Minimum Interest Charge and the amount of interest otherwise payable on the first day of each month and on the Termination Date. When calculating this deficiency, the Default Rate set forth in Section 1.5(c), if applicable, shall be disregarded.

(c) Default Interest Rate. Commencing on the day an Event of Default occurs, through and including the date identified by Wells Fargo in a Record as the date that the Event of Default has been cured or waived (each such period a "Default Period"), or during a time period specified in Section 1.8, or at any time following the Termination Date, in Wells Fargo's sole discretion and without waiving any of its other rights or remedies, the principal amount of the Revolving Note shall bear interest at a rate that is three percent (3.0%) above the contractual rate set forth in Section 1.5(a) (the "Default Rate"), or any lesser rate that Wells Fargo may deem appropriate, starting on the first day of the month in which the Default Period

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begins through the last day of that Default Period, or any shorter time period to which Wells Fargo may agree in an Authenticated Record.

(d) Interest Accrual on Payments Applied to Revolving Note. Payments received by Wells Fargo shall be applied to the Revolving Note as provided in Section 1.4(c), but the principal amount paid down shall continue to accrue interest through the end of the first Business Day following the Business Day that the payment was applied to the Revolving Note.

(e) Usury. No interest rate shall be effective which would result in a rate greater than the highest rate permitted by law. Payments in the nature of interest and other charges made under any Loan Documents or any other document or agreement described in or related to this Agreement that are later determined to be in excess of the limits imposed by applicable usury law will be deemed to be a payment of principal, and the Indebtedness shall be reduced by that amount so that such payments will not be deemed usurious.

## 1.6 Fees.

(a) Origination Fee. Company shall pay Wells Fargo a one time origination fee of \$150,000, and payable as follows: (i) \$105,000 upon execution of this Agreement by Borrower, which shall be fully earned and payable upon the execution of this Agreement, and (ii) \$45,000 which shall be due and payable on June , 2009; provided that any remaining unpaid amount of the origination fee shall be due and payable in full upon the occurrence of the earlier of the termination of this Agreement by Borrower or an Event of Default.

(b) Unused Line Fee. Company shall pay Wells Fargo an annual unused line fee of one-quarter of one percent (0.25%) of the daily average of the Maximum Line Amount reduced by outstanding Advances, the L/C Amount, and outstanding "Advances" under the Ex-Im Credit Agreement (the "Unused Amount"), from the date of this Agreement to and including the Termination Date, which unused line fee shall be payable monthly in arrears on the first day of each month and on the Termination Date.

(c) Collateral Exam Fees. Company shall pay Wells Fargo fees in connection with any collateral exams, audits or inspections conducted by or on behalf of Wells Fargo at the current rates established from time to time by Wells Fargo as its collateral exam fees (which fees are currently \$125.00 per hour per collateral examiner), together with all actual out-of-pocket costs and expenses incurred in conducting any collateral examination or inspection.

(d) Collateral Monitoring Fees. Company shall pay Wells Fargo a fee rates established from time to time by Wells Fargo as its Collateral monitoring fees (which fees include an initial fee of \$2,000 and monthly fees which are currently \$600 per month), due and payable monthly in advance on the first day of the month and on the Termination Date.

(e) Line of Credit Termination and/or Reduction Fees. If (i) Wells Fargo terminates the Line of Credit during a Default Period, (ii) Company terminates or reduces the Line of Credit on a date prior to the Maturity Date, (iii) Company terminates or reduces the Line of Credit on the Maturity Date in accordance with Section 1.8(b), or (iv) Company and Wells Fargo agree to reduce the Maximum Line Amount, then Company shall pay Wells Fargo as

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liquidated damages a termination or reduction fee in an amount equal to a percentage of the Maximum Line Amount (or the reduction of the Maximum Line Amount, as the case may be) calculated as follows: (A) three percent (3.0%) if the termination or reduction occurs on or before the first anniversary of the first Line of Credit Advance; (B) two percent (2.0%) if the termination or reduction occurs after the first anniversary of the first Line of Credit Advance, but on or before the second anniversary of the first Line of Credit Advance; and (C) one percent (1.0%) if the termination or reduction occurs after the second anniversary of the first Line of Credit Advance.

(f) Overadvance Fees. Company shall pay a \$500 Overadvance fee for each day that an Overadvance exists which was not agreed to by Wells Fargo in an Authenticated Record prior to its occurrence; provided that Wells Fargo's acceptance of the payment of such fees shall not constitute either consent to the Overadvance or waiver of the resulting Event of Default. Company shall pay additional Overadvance fees and interest in such amounts and on such terms as Wells Fargo in its sole discretion may consider appropriate for any Overadvance to which Wells Fargo has specifically consented in an Authenticated Record prior to its occurrence.

(g) Treasury Management Fees. Company will pay service fees to Wells Fargo for treasury management services provided pursuant to the Master Agreement for Treasury Management Services or any other agreement entered into by the parties, in the amount prescribed in Wells Fargo's current service fee schedule.

(h) Letter of Credit Fees. Company shall pay a fee with respect to each Letter of Credit issued by Wells Fargo of one and one-half percent (1.5%) of the aggregate undrawn amount of the Letter of Credit (the "Aggregate Face Amount") accruing daily from and including the date the Letter of Credit is issued until the date that it either expires or is returned, which shall be payable monthly in arrears on the first day of each month and on the date that the Letter of Credit either expires or is returned; and following an Event of Default, this fee shall increase to four and one-half percent (4.5%) of the Aggregate Face Amount, commencing on the first day of the month in which the Default Period begins and continuing through the last day of such Default Period, or any shorter time period that Wells Fargo in its sole discretion may deem appropriate, without waiving any of its other rights and remedies.

(i) Letter of Credit Administrative Fees. Company shall pay all administrative fees charged by Wells Fargo in connection with the honoring of drafts under any Letter of Credit, and any amendments to or transfers of any Letter of Credit, and any other activity with respect to the Letters of Credit at the current rates published by Wells Fargo for such services rendered on behalf of its customers generally.

(i) Other Fees and Charges. Wells Fargo may impose additional fees and charges during a Default Period for

(i) waiving an Event of Default, or (ii) the administration of Collateral by Wells Fargo. All such fees and charges shall be imposed at Wells Fargo's sole discretion following oral notice to Company on either an hourly, periodic, or flat fee basis, and in lieu of or in addition to imposing interest at the Default Rate, and Company's request for an Advance following such notice shall constitute Company's agreement to pay such fees and charges.

(k) Termination and Prepayment Fees Following Refinance by a Wells Fargo Regional Commercial Banking Group. If after June , 2010, the Line of Credit is refinanced by a Wells Fargo Regional Commercial Banking Office and this Agreement is terminated, such refinancing will not be deemed a termination or prepayment resulting in the payment of termination and/or prepayment fees, or LIBOR Advance breakage fees, provided that Company agrees, at the time of transfer, to the payment of comparable fees in an amount not less than that set forth in this Agreement, in the event that any facilities extended under this Agreement are terminated early or prepaid after the transfer.

(1) LIBOR Advance Breakage Fees. Company may prepay any Revolving Note LIBOR Advance at any time in any amount, whether voluntarily or by acceleration; provided, however, that if the LIBOR Advance is prepaid, Company shall pay Wells Fargo upon demand a LIBOR Advance breakage fee equal to the sum of the discounted monthly differences for each month from the month of prepayment through the month in which such Interest Period matures, calculated as follows for each such month:

(i) Determine the amount of interest which would have accrued each month on the amount prepaid at the interest rate applicable to such amount had it remained outstanding until the last day of the applicable Interest Period.

(ii) Subtract from the amount determined in (i) above the amount of interest which would have accrued for the same month on the amount prepaid for the remaining term of such Interest Period at LIBOR in effect on the date of prepayment for new loans made for such term in a principal amount equal to the amount prepaid.

(iii) If the result obtained in (ii) for any month is greater than zero, discount that difference by LIBOR used in (ii) above.

Company acknowledges that prepayment of the Revolving Note may result in Wells Fargo incurring additional costs, expenses or liabilities, and that it is difficult to ascertain the full extent of such costs, expenses or liabilities. Company agrees to pay the above-described LIBOR Advance breakage fee and agrees that this amount represents a reasonable estimate of the LIBOR Advance breakage costs, expenses and/or liabilities of Wells Fargo.

#### **1.7 Interest Accrual; Principal and Interest Payments; Computation.**

(a) Interest Payments and Interest Accrual. Accrued and unpaid interest under the Revolving Note on Floating Rate Advances shall be due and payable on the first day of each month (each an "Interest Payment Date") and on the Termination Date, and shall be paid in the manner provided in Section 1.4(c). Interest shall accrue from the most recent date to which interest has been paid or, if no interest has been paid, from the date of Advance to the Interest Payment Date. Interest accruing on any LIBOR Advance shall be due and payable on the last day of the applicable Interest Period and on the Termination Date; provided, however, for Interest Periods in excess of one month, interest shall nevertheless be due and payable monthly on the last day of each month, and on the last day of the Interest Period.

(b) Payment of Revolving Note Principal. The principal amount of the Revolving Note shall be paid from time to time as provided in this Agreement, and shall be fully due and payable on the Termination Date.

(c) Payments Due on Non-Business Days. If an Interest Payment Date or the Termination Date falls on a day which is not a Business Day, payment shall be made on the next Business Day, and interest shall continue to accrue during that time period.

(d) Computation of Interest and Fees. Interest accruing on the unpaid principal amount of the Revolving Note and fees payable under this Agreement shall be computed on the basis of the actual number of days elapsed in a year of 360 days.

(e) Liability Records. Wells Fargo shall maintain accounting and bookkeeping records of all Advances and payments under the Line of Credit and all other Indebtedness due to Wells Fargo in such form and content as Wells Fargo in its sole discretion deems appropriate. Wells Fargo's calculation of current Indebtedness shall be presumed correct unless proven otherwise by Company. Upon Wells Fargo's request, Company will admit and certify in a Record the exact principal balance of the Indebtedness that Company then believes to be outstanding. Any billing statement or accounting provided by Wells Fargo shall be conclusive and binding unless Company notifies Wells Fargo in a detailed Record of its intention to dispute the billing statement or accounting within 30 days of receipt.

#### **1.8 Termination, Reduction or Non-Renewal of Line of Credit by Company; Notice.**

(a) Termination or Reduction by Company after Advance Notice. Company may terminate or reduce the Line of Credit at any time prior to the Maturity Date, if it (i) delivers an Authenticated Record notifying Wells Fargo of its intentions at least sixty (60) days prior to the proposed Termination Date, (ii) pays Wells Fargo the termination or reduction fee set forth in Section 1.6(e), and

(iii) pays the Indebtedness in full or down to the reduced Maximum Line Amount. Any reduction in the Maximum Line Amount shall be in multiples of \$500,000, with a minimum reduction of at least \$500,000.

(b) Termination or Reduction by Company without Advance Notice. If Company fails to deliver Wells Fargo timely notice of its intention to terminate the Line of Credit or reduce the Maximum Line Amount as provided in Section 1.8(a), Company may nevertheless terminate the Line of Credit or reduce the Maximum Line Amount and pay the Indebtedness in full or down to the reduced Maximum Line Amount if it (i) pays the termination fee set forth in Section 1.6(e), and (ii) pays additional interest for each day that the notice was short of the required sixty (60) days notice, which interest shall be in an amount that is equal to the greater of (A) interest calculated at the Default Rate based on the Borrower's average borrowings under the Line of Credit for the two (2) months prior to the date that Wells Fargo receives delivery of an Authenticated Record giving it actual notice of Company's intention to terminate or reduce the Line of Credit, or (B) the unused line fee for the three (3) months prior to the date that Wells Fargo receives delivery of an Authenticated Record giving it actual notice of Company's intention to terminate or reduce the Line of Credit, calculated as provided in Section 1.7(b) of this Agreement.

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(c) Non-Renewal by Company; Notice. If Company does not wish Wells Fargo to consider renewal of the Line of Credit on the next Maturity Date, Company shall deliver an Authenticated Record to Wells Fargo at least sixty (60) days prior to the Maturity Date notifying Wells Fargo of its intention not to renew. If Company fails to deliver to Wells Fargo such timely notice, then the Revolving Note shall accrue interest at the Default Rate commencing on the sixtieth (60<sup>th</sup>) day prior to the Maturity Date and continuing through the date that Wells Fargo receives delivery of an Authenticated Record giving it actual notice of Company's intention not to renew.

## 1.9 Letters of Credit.

(a) Issuance of Letters of Credit; Amount. Wells Fargo, subject to the terms and conditions of this Agreement, shall issue, on or after the date that Wells Fargo is obligated to make its first Advance under this Agreement and prior to the Termination Date, one or more irrevocable standby or documentary letters of credit (each, a "Letter of Credit", and collectively, "Letters of Credit") for Company's account. Wells Fargo will not issue any Letter of Credit if the face amount of the Letter of Credit would exceed the lesser of: (i) \$1,000,000 less the L/C Amount, (ii) the Borrowing Base, less an amount equal to aggregate unreimbursed Line of Credit Advances plus the L/C Amount, or (iii) the Maximum Line Amount, less an amount equal to the aggregate unreimbursed Line of Credit Advances, plus the L/C Amount, plus the aggregate unreimbursed "Advances" under the Ex-Im Credit Agreement. Wells Fargo has previously issued Letter of Credit number NZS606899 for Company's account in favor of Sinopec in the amount of \$32,415.00 (the "Existing Letter of Credit"), which is secured by cash in the account number 4121616924 of Borrower. The Existing Letter of Credit shall be deemed issued under this Agreement.

(b) Additional Letter of Credit Documentation. Prior to requesting issuance of a Letter of Credit, Company shall first execute and deliver to Wells Fargo a Standby Letter of Credit Agreement or a Commercial Letter of Credit Agreement, as applicable, an L/C Application, and any other documents that Wells Fargo may request, which shall govern the issuance of the Letter of Credit and Company's obligation to reimburse Wells Fargo for any related Letter of Credit draws (the "Obligation of Reimbursement").

(c) Expiration. No Letter of Credit shall be issued that has an expiry date that is later than one (1) year from the date of issuance, or the Maturity Date in effect on the date of issuance, whichever is earlier.

(d) Obligation of Reimbursement During Default Periods. If Company is unable, due to the existence of a Default Period or for any other reason, to obtain an Advance to pay any Obligation of Reimbursement, Company shall pay Wells Fargo on demand and in immediately available funds, the amount of the Obligation of Reimbursement together with interest, accrued from the date presentment of the underlying draft until reimbursement in full at the Default Rate. Wells Fargo is authorized, alternatively and in its sole discretion, to make an Advance in an amount sufficient to discharge the Obligation of Reimbursement and pay all accrued but unpaid interest and fees with respect to the Obligation of Reimbursement.

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**1.10 Special Account.** If the Line of Credit is terminated for any reason while a Letter of Credit is outstanding, or if after prepayment of the Revolving Note the L/C Amount continues to exceed the Borrowing Base, then Company shall promptly pay Wells Fargo in immediately available funds for deposit to the Special Account, an amount equal, as the case may be, to either (a) the L/C Amount plus any anticipated fees and costs, or (b) the amount by which the L/C Amount exceeds the Borrowing Base. If Company fails to pay these amounts promptly, then Wells Fargo may in its sole discretion make an Advance to pay these amounts and deposit the proceeds to the Special Account. The Special Account shall be an interest bearing account maintained with Wells Fargo or any other financial institution acceptable to Wells Fargo. Wells Fargo may in its sole discretion apply amounts on deposit in the Special Account to the Indebtedness. Company may not withdraw amounts deposited to the Special Account until the Line of Credit has been terminated and all outstanding Letters of Credit have either been returned to Wells Fargo or have expired and the Indebtedness has been fully paid.

## 2. SECURITY INTEREST AND OCCUPANCY OF COMPANY'S PREMISES

**2.1 Grant of Security Interest.** Company hereby pledges, assigns and grants to Wells Fargo, for the benefit of Wells Fargo and as agent for Wells Fargo Merchant Services, L.L.C., a Lien and security interest (collectively referred to as the "Security Interest") in the Collateral, as security for the payment and performance of all Indebtedness. Following request by Wells Fargo, Company shall grant Wells

Fargo, for the benefit of Wells Fargo and as agent for Wells Fargo Merchant Services, L.L.C., a Lien and security interest in all commercial tort claims that it may have against any Person.

**2.2 Notifying Account Debtors and Other Obligors; Collection of Collateral.** Wells Fargo may at any time (whether or not a Default Period then exists) deliver a Record giving an account debtor or other Person obligated to pay an Account, a General Intangible, or other amount due, notice that the Account, General Intangible, or other amount due has been assigned to Wells Fargo for security and must be paid directly to Wells Fargo. Company shall join in giving such notice and shall Authenticate any Record giving such notice upon Wells Fargo's request. After Company or Wells Fargo gives such notice, Wells Fargo may, but need not, in Wells Fargo's or in Company's name, demand, sue for, collect or receive any money or property at any time payable or receivable on account of, or securing, such Account, General Intangible, or other amount due, or grant any extension to, make any compromise or settlement with or otherwise agree to waive, modify, amend or change the obligations (including collateral obligations) of any account debtor or other obligor. Wells Fargo may, in Wells Fargo's name or in Company's name, as Company's agent and attorney-in-fact, notify the United States Postal Service to change the address for delivery of Company's mail to any address designated by Wells Fargo, otherwise intercept Company's mail, and receive, open and dispose of Company's mail, applying all Collateral as permitted under this Agreement and holding all other mail for Company's account or forwarding such mail to Company's last known address.

**2.3 Assignment of Insurance.** As additional security for the Indebtedness, Company hereby assigns to Wells Fargo and to Wells Fargo Merchant Services, L.L.C., all rights of Company under every policy of insurance covering the Collateral and all business records and other documents relating to it, and all monies (including proceeds and refunds) that may be payable under any policy, and Company hereby directs the issuer of each policy to pay all such

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monies directly to Wells Fargo. At any time, whether or not a Default Period then exists, Wells Fargo may (but need not), in Wells Fargo's or Company's name, execute and deliver proofs of claim, receive payment of proceeds and endorse checks and other instruments representing payment of the policy of insurance, and adjust, litigate, compromise or release claims against the issuer of any policy. Any monies received under any insurance policy assigned to Wells Fargo, other than liability insurance policies, or received as payment of any award or compensation for condemnation or taking by eminent domain, shall be paid to Wells Fargo and, as determined by Wells Fargo in its sole discretion, either be applied to prepayment of the Indebtedness or disbursed to Company under staged payment terms reasonably satisfactory to Wells Fargo for application to the cost of repairs, replacements, or restorations which shall be effected with reasonable promptness and shall be of a value at least equal to the value of the items or property destroyed.

**2.4 Company's Premises.**

(a) Wells Fargo's Right to Occupy Company's Premises. Company hereby grants to Wells Fargo the right, at any time during a Default Period and without notice or consent, to take exclusive possession of all locations where Company conducts its business or has any rights of possession, including the locations described on Exhibit B (the "Premises"), until the earlier of (i) payment in full and discharge of all Indebtedness and termination of the Line of Credit, or (ii) final sale or disposition of all items constituting Collateral and delivery of those items to purchasers.

(b) Wells Fargo's Use of Company's Premises. Wells Fargo may use the Premises to store, process, manufacture, sell, use, and liquidate or otherwise dispose of items that are Collateral, and for any other incidental purposes deemed appropriate by Wells Fargo in good faith.

(c) Company's Obligation to Reimburse Wells Fargo. Wells Fargo shall not be obligated to pay the Company rent or other compensation for the possession or use of any Premises, but if Wells Fargo elects to pay rent or other compensation to the owner of any Premises in order to have access to the Premises, then Company shall promptly reimburse Wells Fargo all such amounts, as well as all taxes, fees, charges and other expenses at any time payable by Wells Fargo with respect to the Premises by reason of the execution, delivery, recordation, performance or enforcement of any terms of this Agreement.

**2.5 License.** Without limiting the generality of any other Security Document, Company hereby grants to Wells Fargo a non-exclusive, worldwide and royalty-free license to use or otherwise exploit all Intellectual Property Rights of Company for the purpose of: (a) completing the manufacture of any in-process materials during any Default Period so that such materials become saleable Inventory, all in accordance with the same quality standards previously adopted by Company for its own manufacturing and subject to Company's reasonable exercise of quality control; and (b) selling, leasing or otherwise disposing of any or all Collateral during any Default Period.

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**2.6 Financing Statements.**

(a) Authorization to File. Company authorizes Wells Fargo to file financing statements describing Collateral to perfect Wells Fargo's Security Interest in the Collateral, and Wells Fargo may describe the Collateral as "all personal property" or "all assets" or describe specific items of Collateral including commercial tort claims as Wells Fargo may consider necessary or useful to perfect the Security Interest. All financing statements filed before the date of this Agreement to perfect the Security Interest were authorized by Company and are hereby re-authorized. Following the termination of the Line of Credit and payment of all Indebtedness, Wells Fargo shall, at Company's expense and within the time periods required under applicable law, release or terminate any filings or other agreements that perfect the Security Interest.

(b) **Termination.** Wells Fargo shall, at Company's expense, release or terminate any filings or other agreements that perfect the Security Interest, provided that there are no suits, actions, proceedings or claims pending or threatened against any Indemnitee under this Agreement with respect to any Indemnified Liabilities, upon Wells Fargo's receipt of the following, in form and content satisfactory to Wells Fargo: (i) cash payment in full of all Indebtedness and a completed performance by Company with respect to its other obligations under this Agreement, (ii) evidence that the commitment of Wells Fargo to make Advances under the Line of Credit or under any other facility with Company has been terminated, (iii) a release of all claims against Wells Fargo by Company relating to Wells Fargo's performance and obligations under the Loan Documents, and (iv) an agreement by Company, any Guarantor, and any new lender to Company to indemnify Wells Fargo for any payments received by Wells Fargo that are applied to the Indebtedness as a final payoff that may subsequently be returned or otherwise not paid for any reason.

**2.7 Setoff.** Wells Fargo may at any time, in its sole discretion and without demand or notice to anyone, setoff any liability owed to Company by Wells Fargo against any Indebtedness, whether or not due.

**2.8 Collateral Related Matters.** This Agreement does not contemplate a sale of Accounts or chattel paper, and, as provided by law, Company is entitled to any surplus and shall remain liable for any deficiency. Wells Fargo's duty of care with respect to Collateral in its possession (as imposed by law) will be deemed fulfilled if it exercises reasonable care in physically keeping such Collateral, or in the case of Collateral in the custody or possession of a bailee or other third Person, exercises reasonable care in the selection of the bailee or third Person, and Wells Fargo need not otherwise preserve, protect, insure or care for such Collateral. Wells Fargo shall not be obligated to preserve rights Company may have against prior parties, to liquidate the Collateral at all or in any particular manner or order or apply the Proceeds of the Collateral in any particular order of application. Wells Fargo has no obligation to clean-up or prepare Collateral for sale. Company waives any right it may have to require Wells Fargo to pursue any third Person for any of the Indebtedness.

**2.9 Notices Regarding Disposition of Collateral.** If notice to Company of any intended disposition of Collateral or any other intended action is required by applicable law in a particular situation, such notice will be deemed commercially reasonable if given in the manner specified in Section 7.4 at least ten calendar days before the date of intended disposition or other action.

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### 3. CONDITIONS PRECEDENT

**3.1 Conditions Precedent to Initial Advance and Issuance of Initial Letter of Credit.** Wells Fargo's obligation to make the initial Advance or issue the first Letter of Credit shall be subject to the condition that Wells Fargo shall have received this Agreement and each of the Loan Documents, and any document, agreement, or other item described in or related to this Agreement, and all fees and information described in Exhibit C, executed and in form and content satisfactory to Wells Fargo.

**3.2 Additional Conditions Precedent to All Advances and Letters of Credit.** Wells Fargo's obligation to make any Advance (including the initial Advance) or issue any Letter of Credit shall be subject to the further additional conditions: (a) that the representations and warranties described in Exhibit D are correct on the date of the Advance or the issuance of the Letter of Credit, except to the extent that such representations and warranties relate solely to an earlier date; and (b) that no event has occurred and is continuing, or would result from the requested Advance or issuance of the Letter of Credit that would result in an Event of Default.

### 4. REPRESENTATIONS AND WARRANTIES

To induce Wells Fargo to enter into this Agreement, Company makes the representations and warranties described in Exhibit D. Any request for an Advance will be deemed a representation by Company that all representations and warranties described in Exhibit D are true, correct, and complete as of the time of the request, unless they relate exclusively to an earlier date. Company shall promptly deliver a Record notifying Wells Fargo of any change in circumstance that would affect the accuracy of any representation or warranty, unless the representation and warranty specifically relates to an earlier date.

### 5. COVENANTS

So long as the Indebtedness remains unpaid, or the Line of Credit has not been terminated, Company shall comply with each of the following covenants, unless Wells Fargo shall consent otherwise in an Authenticated Record delivered to Company.

**5.1 Reporting Requirements.** Company shall deliver to Wells Fargo the following information, compiled where applicable using GAAP consistently applied, in form and content acceptable to Wells Fargo:

(a) **Annual Financial Statements.** As soon as available and in any event within ninety (90) days after Company's fiscal year end, Company's audited financial statements prepared by an independent certified public accountant acceptable to Wells Fargo, which shall include Company's balance sheet, income statement, and statement of retained earnings and cash flows prepared, if requested by Wells Fargo, on a consolidated and consolidating basis to include Company's Subsidiaries. The annual financial statements shall be accompanied by a certificate (the "Compliance Certificate") in the form of Exhibit E that is signed by Company's chief financial officer. Each Compliance Certificate that accompanies an annual financial statement shall also be accompanied by (i) copies of all management letters prepared by Company's accountants; and (ii) a report signed by the accountant stating that in making the investigations

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necessary to render the opinion, the accountant obtained no knowledge, except as specifically stated, of any Event of Default under the Agreement, and a detailed statement, including computations, demonstrating whether or not Company is in compliance with the financial covenants of this Agreement.

(b) 10-Q Financial Reports. As soon as available and in any event within forty-five (45) days after the end of each fiscal quarter of Company, Company's 10-Q financial reports filed with the Securities and Exchange Commission. This requirement may be satisfied by Company by posting a link to the filing on the Company's publicly-accessible website.

(c) Monthly Financial Statements. As soon as available and in any event within thirty (30) days after the end of each month, a Company prepared balance sheet, income statement, and statement of retained earnings prepared for that month and for the year-to-date period then ended, prepared, if requested by Wells Fargo, on a consolidated and consolidating basis to include Company's Subsidiaries, and stating in comparative form the figures for the corresponding date and periods in the prior fiscal year, subject to year-end adjustments. The financial statements shall be accompanied by a Compliance Certificate in the form of Exhibit E that is signed by Company's chief financial officer.

(d) Collateral Reports. No later than 20 days after each month end (or more frequently if Wells Fargo shall request it), detailed agings of Company's accounts receivable and accounts payable, an accounts receivable reconciliation report and a calculation of Company's Accounts, including an accounts receivable ineligibility report, Eligible Accounts, Inventory and Eligible Inventory as of the end of that month or shorter time period requested by Wells Fargo.

(e) Projections. No later than sixty (60) days prior to each fiscal year end, Company's projected balance sheet and income statement and statement of retained earnings and cash flows for each month of the next fiscal year, certified as accurate by Company's chief financial officer and accompanied by a statement of assumptions and supporting schedules and information. Wells Fargo acknowledges that such projections are estimates only and not promises of performance.

(f) Supplemental Reports. Weekly, or more frequently if Wells Fargo requests, Wells Fargo's standard form of "daily collateral report", together with receivables schedules, collection reports, credit memos, sales reports, adjustments to accounts receivable and copies of invoices in excess of \$100,000, shipment documents and delivery receipts for goods sold to account debtors in excess of \$100,000.

(g) Customer Lists. On January 1 and July 1 of each calendar year, an updated customer listing (with contact names and addresses).

(h) Litigation. No later than three (3) Business Days after discovery, a Record notifying Wells Fargo of any litigation or other proceeding before any court or governmental agency which seeks a monetary recovery against Company in excess of \$100,000.

(i) Intellectual Property. (i) No later than 30 Business Days after it acquires material Intellectual Property Rights, a Record notifying Wells Fargo of Company's acquisition

of such rights; (ii) except for transfers permitted under Section 5.17, no later than 15 Business Days before it disposes of material Intellectual Property Rights, a Record notifying Wells Fargo of Company's intention to dispose of such rights, along with copies of all proposed documents and agreements concerning the disposal of such rights as requested by Wells Fargo; (iii) promptly upon discovery, a Record notifying Wells Fargo of (A) any Infringement of Company's Intellectual Property Rights by any Person, (B) claims that Company is Infringing another Person's Intellectual Property Rights and (C) any threatened cancellation, termination or material limitation of Company's Intellectual Property Rights; and (iv) promptly upon receipt, copies of all registrations and filings with respect to Company's Intellectual Property Rights.

(j) Defaults. No later than three days after learning of the probable occurrence of any Event of Default, a Record notifying Wells Fargo of the Event of Default and the steps being taken by Company to cure the Event of Default.

(k) Disputes. Promptly upon discovery, a Record notifying Wells Fargo of (i) any disputes or claims by Company's customers exceeding \$20,000 individually or \$75,000 in the aggregate during any fiscal year; (ii) credit memos not previously reported in Section 5.1(f); and (iii) any goods returned to or recovered by Company outside of the ordinary course of business or in the ordinary course of business but with a value in an amount in excess of \$50,000.

(l) Changes in Officers and Directors. Promptly following occurrence, a Record notifying Wells Fargo of any change in the persons constituting Company's Officers and Directors.

(m) Collateral. Promptly upon discovery, a Record notifying Wells Fargo of any loss of or material damage to any Collateral having a fair market value, individually or in the aggregate, of \$50,000 or more, or of any substantial adverse change in (i) any Collateral having a fair market value, individually or in the aggregate, of \$50,000 or more, or (ii) the prospect of such Collateral's payment.

(n) Commercial Tort Claims. Promptly upon discovery, a Record notifying Wells Fargo of any commercial tort claims in excess of \$50,000 individually or \$100,000 in the aggregate brought by Company against any Person, including the name and address of each defendant, a summary of the facts, an estimate of Company's damages, copies of any complaint or demand letter submitted by Company, and such other information as Wells Fargo may reasonably request.

(o) Reports to Owners. Promptly upon distribution, copies of all financial statements, reports and proxy statements which Company shall have sent to its Owners. This requirement may be satisfied by Company by posting a link to the filings attaching such documents on the Company's publicly-accessible website.

(p) Tax Returns of Company. No later than 15 Business Days after they are required to be filed, copies of Company's signed and dated state and federal income tax returns and all related schedules, and copies of any extension requests.

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(q) Violations of Law. No later than three (3) Business Days after discovery of any violation, a Record notifying Wells Fargo of Company's violation of any law, rule or regulation, the non-compliance with which could have a Material Adverse Effect on Company.

(r) Pension Plans. (i) Promptly upon discovery, and in any event within 30 days after Company knows or has reason to know that any Reportable Event with respect to any Pension Plan has occurred, a Record authenticated by Company's chief financial officer notifying Wells Fargo of the Reportable Event in detail and the actions which Company proposes to take to correct the deficiency, together with a copy of any related notice sent to the Pension Benefit Guaranty Corporation; (ii) promptly upon discovery, and in any event within 10 days after Company fails to make a required quarterly Pension Plan contribution under Section 412(m) of the IRC, a Record authenticated by Company's chief financial officer notifying Wells Fargo of the failure in detail and the actions that Company will take to cure the failure, together with a copy of any related notice sent to the Pension Benefit Guaranty Corporation; and (iii) promptly upon discovery, and in any event within 10 days after Company knows or has reason to know that it may be liable or may be reasonably expected to have liability for any withdrawal, partial withdrawal, reorganization or other event under any Multiemployer Plan under Sections 4201 or 4243 of ERISA, a Record authenticated by Company's chief financial officer notifying Wells Fargo of the details of the event and the actions that Company proposes to take in response.

(s) Other Reports. From time to time, with reasonable promptness, all customer lists, receivables schedules, inventory reports, collection reports, deposit records, equipment schedules, invoices to account debtors, shipment documents and delivery receipts for goods sold, and such other materials, reports, records or information as Wells Fargo may request.

**5.2 Financial Covenants.** Company agrees to comply with the financial covenants described below, which shall be calculated using GAAP consistently applied, except as they may be otherwise modified by the following capitalized definitions:

(a) Minimum Book Net Worth. Company shall maintain a Book Net Worth, determined as of the following test dates, in an amount not less than the amount set forth for each such test date (numbers appearing between "< >" are negative):

Test Date	Minimum Book Net Worth
December 31, 2008	\$ 61,000,000
January 31, 2009	\$ 57,000,000
February 28, 2009	\$ 52,700,000
March 31, 2009	\$ 51,000,000
April 30, 2009	\$ 48,150,000
May 31, 2009	\$ 45,300,000
June 30, 2009	\$ 46,500,000
July 31, 2009	\$ 43,900,000
August 31, 2009	\$ 41,300,000
September 30, 2009	\$ 44,450,000
October 31, 2009	\$ 42,100,000
November 30, 2009	\$ 39,850,000
December 31, 2009	\$ 44,600,000
January 31, 2010	\$ 42,250,000
February 28, 2010	\$ 40,000,000
March 31, 2010	\$ 45,150,000

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(b) Minimum Net Income. Company shall achieve Net Income, measured on each of the following test dates described below, for the quarter period ending on each such test date, Net Income of not less than the amount set forth opposite each such test date (numbers appearing between "< >" are negative):

Test Date	Minimum Net Income
December 31, 2008	\$ <10,800,000>
March 31, 2009	\$ <11,000,000>
June 30, 2009	\$ <5,750,000>
September 30, 2009	\$ <3,200,000>
December 31, 2009	\$ <1,000,000>
March 31, 2010	\$ <500,000>

(c) Minimum Cash to Unreimbursed Line of Credit Advances Coverage Ratio. At all times, the sum of the outstanding Advances under the Revolving Note plus the L/C Amount plus the outstanding "Advances" under the Ex-Im Credit Agreement shall not exceed eighty percent (80%) of cash and Cash Equivalents of Company in which Wells Fargo has a perfected first priority security interest. Compliance with the foregoing covenant shall be reported as Wells Fargo shall request from time to time in its sole discretion.

(d) Capital Expenditures. Company shall not incur or contract to incur Capital Expenditures of more than (i) \$7,500,000 in the aggregate during Company's fiscal year ending March 31, 2009, (ii) \$10,000,000 in the aggregate during Company's fiscal year ending March 31, 2010, and (iii) zero for each subsequent year until Company and Wells Fargo agree on limits on Capital Expenditures for subsequent periods based on Company's projections for such periods.

### 5.3 Other Liens and Permitted Liens.

(a) Other Liens; Permitted Liens. Company shall not create, incur or suffer to exist any Lien upon any of its assets, now owned or later acquired, as security for any indebtedness, with the exception of the following (each a "Permitted Lien"; collectively, "Permitted Liens"): (i) In the case of real property, covenants, restrictions, rights, easements and minor irregularities in title which do not materially interfere with Company's business or operations as presently conducted; (ii) Liens in existence on the date of this Agreement that are described in Exhibit F and secure indebtedness for borrowed money permitted under Section 5.4

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(iii) The Security Interest and Liens created by the Security Documents; (iv) Purchase money Liens relating to the acquisition of Equipment not exceeding the lesser of cost or fair market value, not exceeding \$3,000,000 for any one purchase or \$7,000,000 in the aggregate during the fiscal year ending March 31, 2009, and \$10,000,000 in the aggregate during the fiscal year ending March 31, 2010, and so long as no Default Period is then in existence and none would exist because of any such acquisition; (v) liens for taxes not yet due or that are being contested in good faith by appropriate proceedings, provided that adequate reserves with respect thereto are maintained on the books of the Company, in conformity with GAAP; (vi) carriers', warehousemen's, mechanics', materialmen's, repairmen's or other like liens arising in the ordinary course of business that are being contested in good faith by appropriate proceedings; (vii) pledges or deposits in connection with workers' compensation, unemployment insurance and other social security legislation; (viii) deposits to secure the performance of bids, trade contracts (other than for borrowed money), leases, statutory obligations, surety and appeal bonds, performance bonds and other obligations of a like nature incurred in the ordinary course of business; (ix) liens securing Indebtedness of Company incurred to finance capital expenditures otherwise permitted hereunder (and, without limitation, subject to Section 5.2(d) of this Agreement), provided that (a) such liens shall be created concurrently or within 90 Business Days after the acquisition of the property being financed, (b) such liens do not at any time encumber any property other than the property financed by such Indebtedness, and (c) Indebtedness secured by such liens does not cause or result in an Event of Default; (x) any interest or title of a lessor under any lease entered into by the Company or any other Subsidiary in the ordinary course of its business and covering only the assets so leased; and (xi) liens that are junior in priority to Wells Fargo's liens on the Collateral that arise from judgments and attachments in connection with court proceedings provided that the attachment or enforcement of such liens would not result in an Event of Default hereunder and such liens are being contested in good faith by appropriate proceedings, adequate reserves have been set aside and no material Collateral is subject to a material risk of loss or forfeiture and the claims in respect of such liens are fully covered by insurance (subject to ordinary and customary deductibles) and a stay of execution pending appeal or proceeding for review is in effect.

(b) Financing Statements. Company shall not authorize the filing of any financing statement by any Person as Secured Party with respect to any of Company's assets, other than (i) filings by Wells Fargo and (ii) filings in connection with Permitted Liens. Company shall not amend any financing statement filed by Wells Fargo as Secured Party except as permitted by law.

**5.4 Indebtedness.** Company shall not incur, create, assume or permit to exist any indebtedness or liability on account of deposits or letters of credit issued on Company's behalf, or advances or any indebtedness for borrowed money of any kind, whether or not evidenced by an instrument, except: (a) Indebtedness described in this Agreement and the Ex-Im Credit Agreement; (b) indebtedness of Company described in Exhibit F, and extensions and refinancings thereof (so long as the principal amount thereof is not increased, the maturity date is not shortened, the average life is not shortened, no additional mandatory prepayments or sinking fund payments are required and the cash payment portion of the interest due on any such Indebtedness is not increased); (c) indebtedness secured by Permitted Liens; (d) Indebtedness

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constitution guaranties permitted by Section 5.5 hereof; and (e) Indebtedness constituting Subordinated Debt not to exceed \$7,500,000 in the aggregate outstanding at any time.

**5.5 Guaranties.** Company shall not assume, guarantee, endorse or otherwise become directly or contingently liable for the obligations of any Person (collectively, "Guarantee Obligations"), except: (a) the endorsement of negotiable instruments by Company for deposit or collection or similar transactions in the ordinary course of business; (b) guaranties, endorsements and other direct or contingent liabilities in connection with the obligations of other Persons in existence on the date of this Agreement and described in Exhibit F; (c) Guaranties Obligations in respect of performance bonds, surety bonds, appeal bonds or custom bonds required in the ordinary course of business or in connection with the enforcement of rights or claims of Company or in connection with judgments that do not result in an Event of Default; and (d) Guaranties Obligations in the form of endorsements in the ordinary course of business of negotiable instruments for deposit or collection.

**5.6 Investments and Subsidiaries.** Company shall not make or permit to exist any loans or advances to, or make any investment or acquire any interest whatsoever in, any Person or Affiliate, including any partnership or joint venture, nor purchase or hold beneficially any stock or other securities or evidence of indebtedness of any Person or Affiliate, except:

(a) Investments in direct obligations of the United States of America or any of its political subdivisions whose obligations constitute the full faith and credit obligations of the United States of America and have a maturity of one year or less, commercial paper issued by U.S. corporations rated "A-1" or "A-2" by Standard & Poor's Ratings Services or "P-1" or "P-2" by Moody's Investors Service or certificates of deposit or bankers' acceptances having a maturity of one year or less issued by members of the Federal Reserve System having deposits in excess of \$100,000,000 (which certificates of deposit or bankers' acceptances are fully insured by the Federal Deposit Insurance Corporation);

(b) Travel advances or loans to Company's Officers and employees not exceeding at any one time an aggregate of \$25,000;

(c) Prepaid rent not exceeding one month or security deposits; and

(d) Current investments in those Subsidiaries in existence on the date of this Agreement which are identified on Exhibit D.

**5.7 Dividends and Distributions.** Company shall not declare or pay any dividends (other than dividends payable solely in stock of Company) on any class of its stock, or make any payment on account of the purchase, redemption or retirement of any shares of its stock, or other securities or evidence of its indebtedness or make any distribution regarding its stock, either directly or indirectly.

**5.8 Salaries.** [INTENTIONALLY OMITTED].

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**5.9 Books and Records; Collateral Examination; Inspection and Appraisals.**

(a) Books and Records; Inspection. Company shall keep complete and accurate books and records with respect to the Collateral and Company's business and financial condition and any other matters that Wells Fargo may reasonably request, in accordance with GAAP. Company shall permit any employee, attorney, accountant or other agent of Wells Fargo to audit, review, make extracts from and copy any of its books and records at any time during ordinary business hours, and to discuss Company's affairs with any of its Directors, Officers, employees, Owners or agents.

(b) Authorization to Company's Agents to Make Disclosures to Wells Fargo. Company authorizes all accountants and other Persons acting as its agent to disclose and deliver to Wells Fargo's employees, accountants, attorneys and other Persons acting as its agent, at Company's expense, all financial information, books and records, work papers, management reports and other information in their possession regarding Company.

(c) Collateral Exams and Inspections. Company shall permit Wells Fargo's employees, accountants, attorneys or other Persons acting as its agent, to examine and inspect any Collateral or any other property of Company at any time during ordinary business hours.

(d) Collateral Appraisals. Wells Fargo may also obtain, from time to time, at Company's expense, an appraisal of Company's Collateral, by an appraiser acceptable to Wells Fargo in its sole discretion.

**5.10 Account Verification; Payment of Permitted Liens.**

(a) Account Verification. Wells Fargo or its agents may (i) contact account debtors and other obligors at any time to verify Company's Accounts; and (ii) require Company to send requests for verification of Accounts or send notices of assignment of Accounts to account debtors and other obligors.

(b) Covenant to Pay Permitted Liens. Company shall pay when due, subject to applicable cure periods, each account payable due to any Person holding a Permitted Lien (as a result of such payable) on any Collateral.

**5.11 Compliance with Laws.**

(a) General Compliance with Applicable Law; Use of Collateral. Company shall (i) comply, and cause each Subsidiary to comply, with the requirements of applicable laws and regulations, the non-compliance with which would have a Material Adverse Effect on its business or its financial condition and (ii) use and keep the Collateral, and require that others use and keep the Collateral, only for lawful purposes, without violation of any federal, state or local law, statute or ordinance.

(b) Compliance with Federal Regulatory Laws. Company shall (i) prohibit, and cause each Subsidiary to prohibit, any Person that is an Owner or Officer from being listed on the Specially Designated Nationals and Blocked Person List or other similar lists maintained by the Office of Foreign Assets Control ("OFAC"), the Department of the Treasury or included in any Executive Orders, (ii) not permit the proceeds of the Line of Credit or any other financial

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accommodation extended by Wells Fargo to be used in any way that violates any foreign asset control regulations of OFAC or other applicable law, (iii) comply, and cause each Subsidiary to comply, with all applicable Bank Secrecy Act laws and regulations, as amended from time to time, and (iv) otherwise comply with the USA Patriot Act and Wells Fargo's related policies and procedures.

(c) **Compliance with Environmental Laws.** Company shall (i) comply, and cause each Subsidiary to comply, with the requirements of applicable Environmental Laws and obtain and comply with all permits, licenses and similar approvals required by them, and (ii) not generate, use, transport, treat, store or dispose of any Hazardous Substances in such a manner as to create any material liability or obligation under the common law of any jurisdiction or any Environmental Law.

**5.12 Payment of Taxes and Other Claims.** Company shall pay or discharge, when due, and cause each Subsidiary to pay or discharge, when due, (a) all taxes, assessments and governmental charges levied or imposed upon it or upon its income or profits, upon any properties belonging to it (including the Collateral) or upon or against the creation, perfection or continuance of the Security Interest, prior to the date on which penalties attach, (b) all federal, state and local taxes required to be withheld by it, and (c) all lawful claims for labor, materials and supplies which, if unpaid, might by law become a Lien upon any properties of Company, although Company shall not be required to pay any such tax, assessment, charge or claim whose amount, applicability or validity is being contested in good faith by appropriate proceedings and for which proper reserves have been made.

**5.13 Maintenance of Collateral and Properties.**

(a) Company shall keep and maintain the Collateral and all of its other properties necessary or useful in its business in good condition, repair and working order (normal wear and tear excepted) and will from time to time replace or repair any worn, defective or broken parts, although Company may discontinue the operation and maintenance of any properties if Company believes that such discontinuance is desirable to the conduct of its business and not disadvantageous in any material respect to Wells Fargo. Company shall take all commercially reasonable steps necessary to protect and maintain its Intellectual Property Rights.

(b) Company shall defend the Collateral against all Liens, claims and demands of all third Persons claiming any interest in the Collateral, other than Permitted Liens. Company shall keep all Collateral free and clear of all Liens except Permitted Liens. Company shall take all commercially reasonable steps necessary to prosecute any Person Infringing its Intellectual Property Rights and to defend itself against any Person accusing it of Infringing any Person's Intellectual Property Rights.

**5.14 Insurance.** Company shall at all times maintain insurance with insurers acceptable to Wells Fargo, in such amounts and on such terms (including deductibles) as Wells Fargo in its sole discretion may require and including, as applicable and without limitation, business interruption insurance (including force majeure coverage), hazard coverage on an "all risks" basis for all tangible Collateral, and theft and physical damage coverage for Collateral

consisting of motor vehicles. All insurance policies must contain an appropriate lender's interest endorsement or clause, and name Wells Fargo as an additional insured.

**5.15 Preservation of Existence.** Company shall preserve and maintain its existence and all of its rights, privileges and franchises necessary or desirable in the normal conduct of its business and shall conduct its business in an orderly, efficient and regular manner.

**5.16 Delivery of Instruments, etc.** Upon request by Wells Fargo, Company shall promptly deliver to Wells Fargo in pledge all instruments, documents and chattel paper in excess of \$50,000 individually and \$75,000 in the aggregate and constituting Collateral, endorsed or assigned by Company.

**5.17 Sale or Transfer of Assets; Suspension of Business Operations.** Company shall not sell, lease, assign, transfer or otherwise dispose of (a) the stock of any Subsidiary, (b) all or a substantial part of its assets, or (c) any Collateral or any interest in Collateral (whether in one transaction or in a series of transactions) to any other Person other than the sale of Inventory in the ordinary course of business, the disposition of Collateral no longer useful in its business, and other Collateral having a fair market value not in excess of \$100,000 in the aggregate for each fiscal year and shall not liquidate, dissolve or suspend business operations. Company shall not transfer any part of its ownership interest in any Intellectual Property Rights and shall not permit its rights as licensee of Licensed Intellectual Property to lapse, except that Company may transfer such rights or permit them to lapse if it has reasonably determined that such Intellectual Property Rights are no longer useful in its business. If Company transfers any Intellectual Property Rights for value, Company shall pay the Proceeds to Wells Fargo for application to the Indebtedness. Company shall not license any other Person to use any of Company's Intellectual Property Rights, except that Company may grant licenses in the ordinary course of its business in connection with sales of Inventory or the provision of services to its customers.

**5.18 Consolidation and Merger; Asset Acquisitions.** Company shall not consolidate with or merge into any other entity, or permit any other entity to merge into it, or acquire (in a transaction analogous in purpose or effect to a consolidation or merger) all or substantially all of the assets of any other entity.

**5.19 Sale and Leaseback.** Company shall not enter into any arrangement, directly or indirectly, with any other Person pursuant to which Company shall sell or transfer any real or personal property, whether owned now or acquired in the future, and then rent or lease all or part of such property or any other property which Company intends to use for substantially the same purpose or purposes as

the property being sold or transferred.

**5.20 Restrictions on Nature of Business.** Company will not engage in any line of business materially different from that presently engaged in by Company, and will not purchase, lease or otherwise acquire assets not related to its business.

**5.21 Accounting.** Company will not adopt any material change in accounting principles except as required by GAAP, consistently applied. Company will not change its fiscal year.

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**5.22 Discounts, etc.** During a Default Period and after notice from Wells Fargo, (i) Company will not grant any discount, credit or allowance to any customer of Company or accept any return of goods sold, and (ii) Company will not modify, amend, subordinate, cancel or terminate any Account.

**5.23 Pension Plans.** Except as disclosed to Wells Fargo in a Record prior to the date of this Agreement, neither Company nor any ERISA Affiliate will (a) adopt, create, assume or become party to any Pension Plan, (b) become obligated to contribute to any Multiemployer Plan, (c) incur any obligation to provide post-retirement medical or insurance benefits with respect to employees or former employees (other than benefits required by law) or (d) amend any Plan in a manner that would materially increase its funding obligations.

**5.24 Place of Business; Name.** Company will not transfer its chief executive office or principal place of business, or move, relocate, close or sell any business Premises without providing 30 days advance written notice to Wells Fargo. Company will not permit any tangible Collateral or any records relating to the Collateral to be located in any state or area in which, in the event of such location, a financing statement covering such Collateral would be required to be, but has not in fact been, filed in order to perfect the Security Interest. Company will not change its name or jurisdiction of organization.

**5.25 Constituent Documents.** Company will not amend its Constituent Documents in any manner that is materially adverse to Wells Fargo (as determined by Wells Fargo in Wells Fargo's reasonable discretion). No later than 10 days after any change to Company's Constituent Documents, Company shall (i) notify Wells Fargo in writing of such change, and (iii) provide copies of such changes to Wells Fargo.

**5.26 Performance by Wells Fargo.** If Company fails to perform or observe any of its obligations under this Agreement at any time, Wells Fargo may, but need not, perform or observe them on behalf of Company and may, but need not, take any other actions which Wells Fargo may reasonably deem necessary to cure or correct this failure; and Company shall pay Wells Fargo upon demand the amount of all costs and expenses (including reasonable attorneys' fees and legal expense) incurred by Wells Fargo in performing these obligations, together with interest on these amounts at the Default Rate.

**5.27 Wells Fargo Appointed as Company's Attorney in Fact.** To facilitate Wells Fargo's performance or observance of Company's obligations under this Agreement, Company hereby irrevocably appoints Wells Fargo and Wells Fargo's agents, as Company's attorney in fact (which appointment is coupled with an interest) with the right (but not the duty) to create, prepare, complete, execute, deliver, endorse or file on behalf of Company any instruments, documents, assignments, security agreements, financing statements, applications for insurance and any other agreements or any Record required to be obtained, executed, delivered or endorsed by Company in accordance with the terms of this Agreement.

## 6. EVENTS OF DEFAULT AND REMEDIES

**6.1 Events of Default.** An "Event of Default" means any of the following:

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- (a) Company fails to pay any the amount of any Indebtedness on the date that it becomes due and payable;
- (b) Company fails to observe or perform any covenant or agreement of Company set forth in this Agreement, or in any of the Loan Documents, or in any other document or agreement described in or related to this Agreement or to any Indebtedness, or any covenant in Section 5.2 becomes inapplicable due to the lapse of time, and Company and Wells Fargo fail to come to an agreement, acceptable to Wells Fargo in its sole discretion, to amend the covenant to apply to future periods;
- (c) An Overadvance arises as the result of any reduction in the Borrowing Base, or arises in any manner or on terms not otherwise approved of in advance by Wells Fargo in a Record that it has Authenticated;
- (d) An event of default or termination event (however defined) occurs under any swap, derivative, foreign exchange, hedge or any similar transaction or arrangement entered into between Company and Wells Fargo;
- (e) A Change of Control or Material Adverse Effect shall occur;
- (f) Company or any Guarantor becomes insolvent or admits in a Record an inability to pay debts as they mature, or Company or any Guarantor makes an assignment for the benefit of creditors; or Company or any Guarantor applies for or consents to the

appointment of any receiver, trustee, or similar officer for the benefit of Company or any Guarantor, or for any of their properties; or any receiver, trustee or similar officer is appointed without the application or consent of Company or such Guarantor; or any judgment, writ, warrant of attachment or execution or similar process is issued or levied against a substantial part of the property of Company or any Guarantor;

(g) Company or any Guarantor files a petition under any chapter of the United States Bankruptcy Code or under the laws of any other jurisdiction naming Company or such Guarantor as debtor; or any such petition is instituted against Company or any such Guarantor; or Company or any Guarantor institutes (by petition, application, answer, consent or otherwise) any bankruptcy, insolvency, reorganization, debt arrangement, dissolution, liquidation or similar proceeding under the laws of any jurisdiction; or any such proceeding is instituted (by petition, application or otherwise) against Company or any such Guarantor;

(h) Any representation or warranty made by Company in this Agreement or by any Guarantor in any Guaranty, or by Company (or any of its Officers) or any Guarantor in any agreement, certificate, instrument or financial statement or other statement delivered to Wells Fargo in connection with this Agreement or pursuant to such Guaranty is untrue or misleading in any material respect when delivered to Wells Fargo;

(i) A final, non-appealable arbitration award, judgment, or decree or order for the payment of money in an amount in excess of \$50,000 which is not insured or subject to indemnity, is entered against Company which is not immediately stayed or appealed;

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(j) Company is in default with respect to any bond, debenture, note or other evidence of material indebtedness issued by Company that is held by any third Person other than Wells Fargo, or under any instrument under which any such evidence of indebtedness has been issued or by which it is governed, or under any material lease or other contract, and the applicable grace period, if any, has expired, regardless of whether such default has been waived by the holder of such indebtedness;

(k) Company liquidates, dissolves, terminates or suspends its business operations or otherwise fails to operate its business in the ordinary course, or merges with another Person; or sells or attempts to sell all or substantially all of its assets;

(l) Company fails to pay any indebtedness or obligation owed to Wells Fargo which is unrelated to the Line of Credit or this Agreement as it becomes due and payable;

(m) Any Guarantor repudiates or purports to revoke the Guarantor's Guaranty, or fails to perform any obligation under such Guaranty, or any individual Guarantor dies or becomes incapacitated, or any other Guarantor ceases to exist for any reason;

(n) Company engages in any act prohibited by any Subordination Agreement, or makes any payment on Subordinated Indebtedness (as defined in the Subordination Agreement) that the Subordinated Creditor was not contractually entitled to receive;

(o) Any event or circumstance occurs that Wells Fargo in good faith believes may impair the prospect of payment of all or part of the Indebtedness, or Company's ability to perform any of its material obligations under any of the Loan Documents, or any other document or agreement described in or related to this Agreement, or there occurs any material adverse change in the business or financial condition of Company;

(p) (i) Company hires an Officer or appoints a Director who has been convicted of any felony offense under state or federal law, or (ii) any Director, Officer, or Designated Person is indicted for a felony offence under state or federal law if, with respect to this clause (ii), (x) such indictment has not been dismissed within 15 days of the indictment of such Director, Officer, or Designated Person, or (y) such Director, Officer, or Designated Person has not been relieved of his or her duties as a Director, Officer, or Designated Officer, as applicable, within 15 days of such indictment;

(q) Any Reportable Event, which Wells Fargo in good faith believes to constitute sufficient grounds for termination of any Pension Plan or for the appointment of a trustee to administer any Pension Plan, has occurred and is continuing 30 days after Company gives Wells Fargo a Record notifying it of the Reportable Event; or a trustee is appointed by an appropriate court to administer any Pension Plan; or the Pension Benefit Guaranty Corporation institutes proceedings to terminate or appoint a trustee to administer any Pension Plan; or Company or any ERISA Affiliate files for a distress termination of any Pension Plan under Title IV of ERISA; or Company or any ERISA Affiliate fails to make any quarterly Pension Plan contribution required under Section 412(m) of the IRC, which Wells Fargo in good faith believes may, either by itself or in combination with other failures, result in the imposition of a Lien on Company's assets in favor of the Pension Plan; or any withdrawal, partial withdrawal,

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reorganization or other event occurs with respect to a Multiemployer Plan which could reasonably be expected to result in a material liability by Company to the Multiemployer Plan under Title IV of ERISA; or

(r) Any "Event of Default" occurs under any of the Ex-Im Loan Documents.

**6.2 Rights and Remedies.** During any Default Period, Wells Fargo may in its discretion exercise any or all of the following rights and remedies:

(a) Wells Fargo may terminate the Line of Credit and decline to make Advances, and terminate any services extended to Company under the Master Agreement for Treasury Management Services;

(b) Wells Fargo may declare the Indebtedness to be immediately due and payable and accelerate payment of the Revolving Note, and all Indebtedness shall immediately become due and payable, without presentment, notice of dishonor, protest or further notice of any kind, all of which Company hereby expressly waives;

(c) Wells Fargo may, without notice to Company, apply any money owing by Wells Fargo to Company to payment of the Indebtedness;

(d) Wells Fargo may exercise and enforce any rights and remedies available upon default to a secured party under the UCC, including the right to take possession of Collateral, proceeding with or without judicial process (without a prior hearing or notice of hearing, which Company hereby expressly waives) and sell, lease or otherwise dispose of Collateral for cash or on credit (with or without giving warranties as to condition, fitness, merchantability or title to Collateral, and in the event of a credit sale, Indebtedness shall be reduced only to the extent that payments are actually received), and Company will upon Wells Fargo's demand assemble the Collateral and make it available to Wells Fargo at any place designated by Wells Fargo which is reasonably convenient to both parties;

(e) Wells Fargo may exercise and enforce its rights and remedies under any of the Loan Documents and any other document or agreement described in or related to this Agreement;

(f) Company will pay Wells Fargo upon demand in immediately available funds an amount equal to the Aggregate Face Amount plus any anticipated costs and fees for deposit to the Special Account pursuant to Section 1.10;

(g) Wells Fargo may for any reason apply for the appointment of a receiver of the Collateral, to which appointment Company hereby consents; and

(h) Wells Fargo may exercise any other rights and remedies available to it by law or agreement.

**6.3 Immediate Default and Acceleration.** Following the occurrence of an Event of Default described in Section 6.1(f) or (g), the Line of Credit shall immediately terminate and all

of Company's Indebtedness shall immediately become due and payable without presentment, demand, protest or notice of any kind.

## 7. MISCELLANEOUS

**7.1 No Waiver; Cumulative Remedies.** No delay or any single or partial exercise by Wells Fargo of any right, power or remedy under the Loan Documents, or under any other document or agreement described in or related to this Agreement, shall constitute a waiver of any other right, power or remedy under the Loan Documents or granted by Company to Wells Fargo under other agreements or documents that are unrelated to the Loan Documents. No notice to or demand on Company in any circumstance shall entitle Company to any additional notice or demand in any other circumstances. The remedies provided in the Loan Documents or in any other document or agreement described in or related to this Agreement are cumulative and not exclusive of any remedies provided by law. Wells Fargo may comply with applicable law in connection with a disposition of Collateral, and such compliance will not be considered to adversely affect the commercial reasonableness of any sale of the Collateral.

**7.2 Amendment; Consents and Waivers; Authentication.** No amendment or modification of any Loan Documents, or any other document or agreement described in or related to this Agreement, or consent to or waiver of any Event of Default, or consent to or waiver of the application of any covenant or representation set forth in any of the Loan Documents, or any other document or agreement described in or related to this Agreement, or any release of Wells Fargo's Security Interest in any Collateral, shall be effective unless it has been agreed to by Wells Fargo and memorialized in a Record that: (a) specifically states that it is intended to amend or modify specific Loan Documents, or any other document or agreement described in or related to this Agreement, or waive any Event of Default or the application of any covenant or representation of any terms of specific Loan Documents, or any other document or agreement described in or related to this Agreement, or is intended to release Wells Fargo's Security Interest in specific Collateral; and (b) is Authenticated by the signature of an authorized employee of both parties, or by an authorized employee of Wells Fargo with respect to a consent or waiver. The terms of an amendment, consent or waiver memorialized in any Record shall be effective only to the extent, and in the specific instance, and for the limited purpose to which Wells Fargo has agreed.

**7.3 Execution in Counterparts; Delivery of Counterparts.** This Agreement and all other Loan Documents, or any other document or agreement described in or related to this Agreement, and any amendment or modification to them may be Authenticated by the parties in any number of counterparts, each of which, once authenticated and delivered in accordance with the terms of this Section 7.3, will be deemed an original, and all such counterparts, taken together, shall constitute one and the same instrument. Delivery by fax or by encrypted e-mail or e-mail file attachment of any counterpart to any Loan Document Authenticated by an authorized signature will be deemed the equivalent of the delivery of the original Authenticated instrument. Company shall send the original Authenticated counterpart to Wells Fargo by first class U.S. mail or by overnight courier, but Company's failure to deliver a Record in this form shall not affect the validity, enforceability, and binding effect of this Agreement or the other Loan Documents, or any other document or agreement described in or related to this Agreement.

**7.4 Notices, Requests, and Communications; Confidentiality.** Except as otherwise expressly provided in this Agreement:

(a) Delivery of Notices, Requests and Communications. Any notice, request, demand, or other communication by either party that is required under the Loan Documents, or any other document or agreement described in or related to this Agreement, to be in the form of a Record (but excluding any Record containing information Company must report to Wells Fargo under Section 5.1) may be delivered (i) in person, (ii) by first class U.S. mail, (iii) by overnight courier of national reputation, or (iv) by fax, or the Record may be sent as an Electronic Record and delivered (v) by an encrypted e-mail, or (vi) through Wells Fargo's Commercial Electronic Office® ("CEO") portal or other secure electronic channel to which the parties have agreed.

(b) Addresses for Delivery. Delivery of any Record under this Section 7.4 shall be made to the appropriate address set forth on the last page of this Agreement (which either party may modify by a Record sent to the other party), or through Wells Fargo's CEO portal or other secure electronic channel to which the parties have agreed.

(c) Date of Receipt. Each Record sent pursuant to the terms of this Section 7.4 will be deemed to have been received on (i) the date of delivery if delivered in person, (ii) the date deposited in the mail if sent by mail, (iii) the date delivered to the courier if sent by overnight courier, (iv) the date of transmission if sent by fax, or (v) the date of transmission, if sent as an Electronic Record by electronic mail or through Wells Fargo's CEO portal or similar secure electronic channel to which the parties have agreed; except that any request for an Advance or any other notice, request, demand or other communication from Company required under Section 1, and any request for an accounting under Section 9-210 of the UCC, will not be deemed to have been received until actual receipt by Wells Fargo on a Business Day by an authorized employee of Wells Fargo.

(d) Confidentiality of Unencrypted E-mail. Company acknowledges that if it sends or receives an Electronic Record to or from Wells Fargo without encryption by e-mail or as an e-mail file attachment, there is a risk that the Electronic Record may be received by unauthorized Persons, and that by so doing it will be deemed to have accepted this risk and the consequences of any such unauthorized disclosure.

**7.5 Company Information Reporting; Confidentiality.** Except as otherwise expressly provided in this Agreement:

(a) Delivery of Company Information Records. Any information that Company is required to deliver under Section 5.1 in the form of a Record may be delivered to Wells Fargo (i) in person, or by (ii) first class U.S. mail, (iii) overnight courier of national reputation, or (iv) fax, or the Record may be sent as an Electronic Record (v) by encrypted e-mail, or (vi) through the file upload service of Wells Fargo's CEO portal or other secure electronic channel to which the parties have agreed.

(b) Addresses for Delivery. Delivery of any Record to Wells Fargo under this Section 7.5 shall be made to the appropriate address set forth on the last page of this Agreement

(which Wells Fargo may modify by a Record sent to Company), or through Wells Fargo's CEO portal or other secure electronic channel to which the parties have agreed.

(c) Date of Receipt. Each Record sent pursuant to this Section will be deemed to have been received on (i) the date of delivery to an authorized employee of Wells Fargo, if delivered in person, or by U.S. mail, overnight courier, fax, or e-mail; or (ii) the date of transmission, if sent as an Electronic Record through Wells Fargo's CEO portal or similar secure electronic channel to which the parties have agreed.

(d) Authentication of Company Information Records. Company shall Authenticate any Record delivered (i) in person, or by U.S. mail, overnight courier, or fax, by the signature of the Officer or employee of Company who prepared the Record; (ii) as an Electronic Record sent via encrypted e-mail, by the signature of the Officer or employee of Company who prepared the Record by any file format signature that is acceptable to Wells Fargo, or by a separate certification signed and sent by fax; or (iii) as an Electronic Record via the file upload service of Wells Fargo's CEO portal or similar secure electronic channel to which the parties have agreed, through such credentialing process as Wells Fargo and Company may agree to under the CEO agreement.

(e) Certification of Company Information Records. Any Record (including any Electronic Record) Authenticated and delivered to Wells Fargo under this Section 7.5 will be deemed to have been certified as materially true, correct, and complete by Company and each Officer or employee of Company who prepared and Authenticated the Record on behalf of Company, and may be legally relied upon by Wells Fargo without regard to method of delivery or transmission.

(f) Confidentiality of Company Information Records Sent by Unencrypted E-mail. Company acknowledges that if it sends an Electronic Record to Wells Fargo without encryption by e-mail or as an e-mail file attachment, there is a risk that the Electronic Record may be received by unauthorized Persons, and that by so doing it will be deemed to have accepted this risk and the consequences of any such unauthorized disclosure. Company acknowledges that it may deliver Electronic Records containing Company information to Wells Fargo by e-mail pursuant to any encryption tool acceptable to Wells Fargo and Company, or through Wells Fargo's CEO portal file upload service without risk of unauthorized disclosure.

**7.6 Further Documents.** Company will from time to time execute, deliver, endorse and authorize the filing of any instruments, documents, conveyances, assignments, security agreements, financing statements, control agreements and other agreements that Wells Fargo may reasonably request in order to secure, protect, perfect or enforce the Security Interest or Wells Fargo's rights under the Loan Documents, or any other document or agreement described in or related to this Agreement (but any failure to request or assure that Company executes, delivers, endorses or authorizes the filing of any such item shall not affect or impair the validity, sufficiency or enforceability of the Loan Documents, or any other document or agreement described in or related to this Agreement, and the Security Interest, regardless of whether any such item was or was not executed, delivered or endorsed in a similar context or on a prior occasion).

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**7.7 Costs and Expenses.** Company shall pay on demand all costs and expenses, including reasonable attorneys' fees, incurred by Wells Fargo in connection with the Indebtedness, this Agreement, the Loan Documents, or any other document or agreement described in or related to this Agreement, and the transactions contemplated by this Agreement, including all such costs, expenses and fees incurred in connection with the negotiation, preparation, execution, delivery, amendment, administration, performance, collection and enforcement of the Indebtedness and all such documents and agreements and the creation, perfection, protection, satisfaction, foreclosure or enforcement of the Security Interest.

**7.8 Indemnity.** In addition to its obligation to pay Wells Fargo's expenses under the terms of this Agreement, Company shall indemnify, defend and hold harmless Wells Fargo, its parent Wells Fargo & Company, and any of its affiliates and successors, and all of their present and future Officers, Directors, employees, attorneys and agents (each an "Indemnitee") from and against any of the following (collectively, "Indemnified Liabilities"):

(a) Any and all transfer taxes, documentary taxes, assessments or charges made by any governmental authority by reason of the execution and delivery of the Loan Documents, or any other document or agreement described in or related to this Agreement or the making of the Advances;

(b) Any claims, loss or damage to which any Indemnitee may be subjected if any representation or warranty contained in Exhibit D proves to be incorrect in any respect or as a result of any violation of the covenants contained in Section 5.11; and

(c) Any and all other liabilities, losses, damages, penalties, judgments, suits, claims, costs and expenses of any kind or nature whatsoever (including the reasonable fees and disbursements of counsel) in connection with this Agreement and any other investigative, administrative or judicial proceedings, whether or not such Indemnitee shall be designated a party to such proceedings, which may be imposed on, incurred by or asserted against any such Indemnitee, in any manner related to or arising out of or in connection with the making of the Advances and the Loan Documents, or any other document or agreement described in or related to this Agreement, or the use or intended use of the proceeds of the Advances, with the exception of any Indemnified Liability caused by the gross negligence or willful misconduct of an Indemnitee.

If any investigative, judicial or administrative proceeding described in this Section is brought against any Indemnitee, upon the Indemnitee's request, Company, or counsel designated by Company and satisfactory to the Indemnitee, will resist and defend the action, suit or proceeding to the extent and in the manner directed by the Indemnitee, at Company's sole cost and expense. Each Indemnitee will use its best efforts to cooperate in the defense of any such action, suit or proceeding. If this agreement to indemnify is held to be unenforceable because it violates any law or public policy, Company shall nevertheless make the maximum contribution to the payment and satisfaction of each of the Indemnified Liabilities to the extent permissible under applicable law. Company's obligations under this Section shall survive the termination of this Agreement and the discharge of Company's other obligations under this Agreement.

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**7.9 Retention of Company's Records.** Wells Fargo shall have no obligation to maintain Electronic Records or retain any documents, schedules, invoices, agings, or other Records delivered to Wells Fargo by Company in connection with the Loan Documents, or any other document or agreement described in or related to this Agreement for more than 30 days after receipt by Wells Fargo. If there is a special need to retain specific Records, Company must notify Wells Fargo of its need to retain or return such Records with particularity, which notice must be delivered to Wells Fargo in accordance with the terms of this Agreement at the time of the initial delivery of the Record to Wells Fargo.

**7.10 Binding Effect; Assignment; Complete Agreement.** The Loan Documents, or any other document or agreement described in or related to this Agreement, shall be binding upon and inure to the benefit of Company and Wells Fargo and their respective successors and assigns, except that Company shall not have the right to assign its rights under this Agreement or any interest in this Agreement without Wells Fargo's prior consent, which must be confirmed in a Record Authenticated by Wells Fargo. To the extent permitted by law, Company waives and will not assert against any assignee any claims, defenses or set-offs which Company could assert against Wells Fargo. This Agreement shall also bind all Persons who become a party to this Agreement as a borrower. This Agreement, together with the Loan Documents, or any other document or agreement described in or related to this Agreement, comprises the complete and integrated agreement of the parties on the subject matter of this Agreement and supersedes all prior agreements, whether oral or evidenced in a Record. To the extent that any provision of this Agreement contradicts other provisions of the Loan Documents other than this Agreement, or any other document or agreement described in or related to this Agreement, this Agreement shall control.

**7.11 Sharing of Information.** Wells Fargo may share any Confidential Information that it may have regarding Company and its Affiliates with its accountants, lawyers, and other advisors, and with each business unit and line of business within Wells Fargo and each direct and indirect subsidiary of Wells Fargo & Company; provided that Wells Fargo shall advise such accountants, lawyers, other advisors,

business units, line of business, and subsidiaries of the confidential nature of such Confidential Information and that all such Confidential Information is subject to the terms of this Agreement (including this Section 7.11).

**7.12 Severability of Provisions.** Any provision of this Agreement which is prohibited or unenforceable shall be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining terms of this Agreement.

**7.13 Headings.** Section and subsection headings in this Agreement are included for convenience of reference only and shall not constitute a part of this Agreement for any other purpose.

**7.14 Governing Law; Jurisdiction; Venue.** The Loan Documents (other than real estate related documents, if any) shall be governed by and construed in accordance with the substantive laws (other than conflict laws) of the State of California. The parties to this Agreement (a) consent to the personal jurisdiction of the state and federal courts located in the State of California in connection with any controversy related to this Agreement; (b) waive any argument that venue in any such forum is not convenient; (c) agree that any litigation initiated by

Wells Fargo or Company in connection with this Agreement or the other Loan Documents may be venued in either the state or federal courts located in the City of Los Angeles, County of Los Angeles, State of California; and (d) agree that a final judgment in any such suit, action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law.

## 8. ARBITRATION

**8.1 Arbitration.** Wells Fargo and Company agree, upon demand by either party, to submit to binding arbitration all claims, disputes and controversies between or among them (and their respective employees, officers, directors, attorneys, and other agents), whether in tort, contract or otherwise, in any way arising out of or relating to (a) any credit subject hereto, or any of the Loan Documents, and their negotiation, execution, collateralization, administration, repayment, modification, extension, substitution, formation, inducement, enforcement, default or termination; or (b) requests for additional credit.

**8.2 Governing Rules.** Any arbitration proceeding will (a) proceed in a location in Los Angeles, California selected by the American Arbitration Association (“AAA”); (b) be governed by the Federal Arbitration Act (Title 9 of the United States Code), notwithstanding any conflicting choice of law provision in any of the documents between the parties; and (c) be conducted by the AAA, or such other administrator as the parties shall mutually agree upon, in accordance with the AAA’s commercial dispute resolution procedures, unless the claim or counterclaim is at least \$1,000,000.00 exclusive of claimed interest, arbitration fees and costs in which case the arbitration shall be conducted in accordance with the AAA’s optional procedures for large, complex commercial disputes (the commercial dispute resolution procedures or the optional procedures for large, complex commercial disputes to be referred to herein, as applicable, as the “Rules”). If there is any inconsistency between the terms hereof and the Rules, the terms and procedures set forth herein shall control. Any party who fails or refuses to submit to arbitration following a demand by any other party shall bear all costs and expenses incurred by such other party in compelling arbitration of any dispute. Nothing contained herein shall be deemed to be a waiver by any party that is a bank of the protections afforded to it under 12 U.S.C. §91 or any similar applicable state law.

**8.3 No Waiver of Provisional Remedies, Self-Help and Foreclosure.** The arbitration requirement does not limit the right of any party to (a) foreclose against real or personal property collateral; (b) exercise self-help remedies relating to collateral or proceeds of collateral such as setoff or repossession; or (c) obtain provisional or ancillary remedies such as replevin, injunctive relief, attachment or the appointment of a receiver, before during or after the pendency of any arbitration proceeding. This exclusion does not constitute a waiver of the right or obligation of any party to submit any dispute to arbitration or reference hereunder, including those arising from the exercise of the actions detailed in paragraphs (a), (b) and (c) of this Section 8.3.

**8.4 Arbitrator Qualifications and Powers.** Any arbitration proceeding in which the amount in controversy is \$5,000,000.00 or less will be decided by a single arbitrator selected according to the Rules, and who shall not render an award of greater than \$5,000,000.00. Any dispute in which the amount in controversy exceeds \$5,000,000.00 shall be decided by majority

vote of a panel of three arbitrators; provided however, that all three arbitrators must actively participate in all hearings and deliberations. The arbitrator will be a neutral attorney licensed in the State of California or a neutral retired judge of the state or federal judiciary of California, in either case with a minimum of ten years experience in the substantive law applicable to the subject matter of the dispute to be arbitrated. The arbitrator will determine whether or not an issue is arbitratable and will give effect to the statutes of limitation in determining any claim. In any arbitration proceeding the arbitrator will decide (by documents only or with a hearing at the arbitrator’s discretion) any pre-hearing motions which are similar to motions to dismiss for failure to state a claim or motions for summary adjudication. The arbitrator shall resolve all disputes in accordance with the substantive law of California and may grant any remedy or relief that a court of such state could order or grant within the scope hereof and such ancillary relief as is necessary to make effective any award. The arbitrator shall also have the power to award recovery of all costs and fees, to impose sanctions and to take such other action as the arbitrator deems necessary to the same extent a judge could pursuant to the Federal Rules of Civil Procedure, the California Rules of Civil Procedure or other applicable law. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction. The institution and maintenance of an action for judicial relief or pursuit of a provisional or ancillary remedy shall not constitute a waiver of the right of any party, including the plaintiff, to submit the controversy or claim to arbitration if any other party contests such action for judicial relief.

**8.5 Discovery.** In any arbitration proceeding, discovery will be permitted in accordance with the Rules. All discovery shall be expressly limited to matters directly relevant to the dispute being arbitrated and must be completed no later than 20 days before the hearing date. Any requests for an extension of the discovery periods, or any discovery disputes, will be subject to final determination by the arbitrator upon a showing that the request for discovery is essential for the party's presentation and that no alternative means for obtaining information is available.

**8.6 Class Proceedings and Consolidations.** No party hereto shall be entitled to join or consolidate disputes by or against others in any arbitration, except parties who have executed any Loan Document, or to include in any arbitration any dispute as a representative or member of a class, or to act in any arbitration in the interest of the general public or in a private attorney general capacity.

**8.7 Payment of Arbitration Costs and Fees.** The arbitrator shall award all costs and expenses of the arbitration proceeding.

**8.8 Miscellaneous.** To the maximum extent practicable, the AAA, the arbitrators and the parties shall take all action required to conclude any arbitration proceeding within 180 days of the filing of the dispute with the AAA. No arbitrator or other party to an arbitration proceeding may disclose the existence, content or results thereof, except for disclosures of information by a party required in the ordinary course of its business or by applicable law or regulation. If more than one agreement for arbitration by or between the parties potentially applies to a dispute, the arbitration provision most directly related to the Loan Documents or the subject matter of the dispute shall control. This arbitration provision shall survive termination, amendment or expiration of any of the Loan Documents or any relationship between the parties.

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[signatures on the following page]

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COMPANY AND WELLS FARGO have executed this Agreement through their authorized officers as of the date set forth above.

**WELLS FARGO BANK,  
NATIONAL ASSOCIATION**

**CAPSTONE TURBINE CORPORATION**

By: /s/ John Curry  
Name: John Curry  
Its: Vice President

By: /s/ Darren Jamison  
Name: Darren Jamison  
Its: CEO

**Wells Fargo Bank, National Association**  
245 S. Los Robles Avenue, Suite 700  
Pasadena, CA 91101  
Fax: 626.844.9063  
Attention: Capstone Turbine Account Officer  
email: curry.john@wellsfargo.com

**Capstone Turbine Corporation**  
21211 Nordhoff Street  
Chatsworth, California 91311  
Fax: 818.734.5380  
Attention:  
e-mail:  
Federal Employer Identification No.  
  
Organizational Identification No.

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**Exhibit A to Credit and Security Agreement**

**DEFINITIONS**

"AAA" is defined in Section 8.2

"Account Funds" is defined in Section 1.4(a).

"Accounts" shall have the meaning given it under the UCC.

"Advance" and "Advances" means an advance or advances under the Line of Credit.

"Affiliate" or "Affiliates" means Capstone Turbine International, Inc. and any other Person controlled by, controlling or under

common control with Company, including any Subsidiary of Company. For purposes of this definition, “control,” when used with respect to any specified Person, means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise.

“Aggregate Face Amount” means the aggregate amount that may then be drawn under each outstanding Letter of Credit, assuming compliance with all conditions for drawing.

“Agreement” means this Credit and Security Agreement.

“Authenticated” means (a) to have signed; or (b) to have executed or to have otherwise adopted a symbol, or have encrypted or similarly processed a Record in whole or in part, with the present intent of the authenticating Person to identify the Person and adopt or accept a Record.

“Book Net Worth” means the aggregate of the common and preferred shareholder’s equity in Company, determined in accordance with GAAP, and calculated without regard to (a) any change in the valuation of goodwill made in accordance with FASB Accounting Standard 142, and (b) any non-cash effects of accounting for stock based compensation in accordance with FASB pronouncement SFAS 123(r).

“Borrowing Base” is defined in Section 1.2(a).

“Borrowing Base Reserve” means, as of any date of determination, an amount or a percent of a specified category or item that Wells Fargo establishes in its sole discretion from time to time to reduce availability under the Borrowing Base (a) to reflect events, conditions, contingencies or risks which affect the assets, business or prospects of Company, or the Collateral or its value, or the enforceability, perfection or priority of Wells Fargo’s Security Interest in the Collateral, as the term “Collateral” is defined in this Agreement, or (b) to reflect Wells Fargo’s judgment that any collateral report or financial information relating to Company and furnished to Wells Fargo may be incomplete, inaccurate or misleading in any material respect.

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“Business Day” means a day on which the Federal Reserve Bank of New York is open for business and, if such day relates to a LIBOR Advance, a day on which dealings are carried on in the London interbank eurodollar market.

“Capital Expenditures” means for a period, any expenditure of money during such period for the lease, purchase or other acquisition of any capital asset, or for the lease of any other asset whether payable currently or in the future.

“Cash Equivalents” means (i) marketable direct obligations issued or unconditionally guaranteed by the United States government and backed by the full faith and credit of the United States government; (ii) domestic and eurodollar certificates of deposit and time deposits, bankers’ acceptances and floating rate certificates of deposit issued by any commercial bank organized under the laws of the United States, any state thereof, the District of Columbia, any foreign bank, or its branches or agencies, the long-term indebtedness of which institution at the time of acquisition is rated A- (or better) by S&P or A3 (or better) by Moody’s, and which certificates of deposit and time deposits are fully protected against currency fluctuations for any such deposits with a term of more than ninety (90) days; (iii) shares of money market, mutual or similar funds having assets in excess of \$100,000,000 and the investments of which are limited to (a) investment grade securities (i.e., securities rated at least Baa by Moody’s or at least BBB by S&P) and (b) commercial paper of United States and foreign banks and bank holding companies and their subsidiaries and United States and foreign finance, commercial industrial or utility companies which, at the time of acquisition, are rated A-1 (or better) by S&P or P-1 (or better) by Moody’s (all such institutions being, “Qualified Institutions”); and (iv) commercial paper of Qualified Institutions; provided that the maturities of such Cash Equivalents shall not exceed three hundred sixty-five (365) days from the date of acquisition thereof.

“CEO” is defined in Section 7.4(a).

“Change of Control” means the occurrence of any of the following events:

(a) Any Person or “group” (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934) who does not have an ownership interest in Company on the date of the initial Advance is or becomes the “beneficial owner” (as defined in Rules 13d-3 and 13d-5 under the Securities Exchange Act of 1934, except that any such Person, entity or group will be deemed to have “beneficial ownership” of all securities that such Person, entity or group has the right to acquire, whether such right is exercisable immediately or only after the passage of time), directly or indirectly, of more than twenty percent (20%) of the voting power of all classes of ownership of Company;

(b) During any consecutive two-year period, individuals who at the beginning of such period constituted the board of Directors of Company (together with any new Directors whose election to such board of Directors, or whose nomination for election by the Owners of Company, was approved by a vote of two thirds of the Directors then still in office who were either Directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of the board of Directors of Company then in office.

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“Collateral” means all of Company’s Accounts, chattel paper and electronic chattel paper, deposit accounts, documents, Equipment,

General Intangibles, goods, instruments, Inventory, Investment Property, letter-of-credit rights, letters of credit, all sums on deposit in any Collection Account, and any items in any Lockbox; together with (a) all substitutions and replacements for and products of such property; (b) in the case of all goods, all accessions; (c) all accessories, attachments, parts, Equipment and repairs now or subsequently attached or affixed to or used in connection with any goods; (d) all warehouse receipts, bills of lading and other documents of title that cover such goods now or in the future; (e) all collateral subject to the Lien of any of the Security Documents; (f) any money, or other assets of Company that come into the possession, custody, or control of Wells Fargo now or in the future; (g) Proceeds of any of the above Collateral; (h) books and records of Company, including all mail or e-mail addressed to Company; and (i) all of the above Collateral, whether now owned or existing or acquired now or in the future or in which Company has rights now or in the future.

“Collateral Pledge Agreement” means each Collateral Pledge Agreement entered into between Company and Wells Fargo.

“Collection Account” means “Collection Account” as defined in the Master Agreement for Treasury Management Services and related Lockbox and Collection Account Service Description or Collection Account Service Description, whichever is applicable.

“Compliance Certificate” is defined in Section 5.1(a) and is in the form of Exhibit E.

“Commercial Letter of Credit Agreement” means an agreement governing the issuance of documentary letters of credit entered into between Company as applicant and Wells Fargo as issuer.

“Company” is defined in the Recitals.

“Constituent Documents” means with respect to any Person, as applicable, that Person’s certificate of incorporation, articles of incorporation, by-laws, certificate of formation, articles of organization, limited liability company agreement, management agreement, operating agreement, shareholder agreement, partnership agreement or similar document or agreement governing such Person’s existence, organization or management or concerning disposition of ownership interests of such Person or voting rights among such Person’s owners.

“Debt” means of a Person as of a given date, all items of indebtedness or liability which in accordance with GAAP would be included in determining total liabilities as shown on the liabilities side of a balance sheet for such Person and shall also include the aggregate payments required to be made by such Person at any time under any lease that is considered a capitalized lease under GAAP.

“Default Period” is defined in Section 1.5(c).

“Default Rate” is defined in Section 1.5(c).

“Designated Person” means any of Darren R. Jamison or Edward I. Reich.

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“Dilution” means, as of any date of determination, a percentage, based upon the prior six (6) months, which is the result of dividing (a) actual bad debt write-downs, discounts, advertising allowances, credits, and any other items with respect to the Accounts determined to be dilutive by Wells Fargo in its sole discretion during this period, by (b) Company’s net sales during such period (excluding extraordinary items) plus the amount of clause (a).

“Director” means a director if Company is a corporation, or a governor or manager if Company is a limited liability company.

“Electronic Record” means a Record that is created, generated, sent, communicated, received, or stored by electronic means, but does not include any Record that is sent, communicated, or received by fax.

“Eligible Accounts” means all unpaid Accounts of Company arising from the sale or lease of goods or the performance of services, net of any credits, but excluding any Accounts having any of the following characteristics:

(c) That portion of Accounts unpaid 90 days or more after the invoice date; provided that, in the case of Banking Production Centre, Accounts owed by Banking Production Centre that are not paid within one hundred fifty (150) days from the invoice date shall not be Eligible Accounts;

(d) That portion of Accounts related to goods or services with respect to which Company has received notice of a claim or dispute, which are subject to a claim of offset or a contra account, or which reflect a reasonable reserve for warranty claims or returns unless Wells Fargo has received a satisfactory non-offset letter;

(e) That portion of Accounts not yet earned by the final delivery of goods or that portion of Accounts not yet earned by the final rendition of services by Company to the account debtor, including with respect to both goods and services, progress billings, and that portion of Accounts for which an invoice has not been sent to the applicable account debtor;

(f) Accounts constituting (i) Proceeds of copyrightable material unless such copyrightable material shall have been registered with the United States Copyright Office, or (ii) Proceeds of patentable inventions unless such patentable inventions have been registered with the United States Patent and Trademark Office;

(g) Accounts owed by any unit of government, whether foreign or domestic (except that there shall be included in Eligible Accounts that portion of Accounts owed by such units of government for which Company has provided evidence satisfactory to Wells Fargo that (i) Wells Fargo’s Security Interest constitutes a perfected first priority Lien in such Accounts, and (ii) such Accounts may

be enforced by Wells Fargo directly against such unit of government under all applicable laws);

- (h) Accounts denominated in any currency other than United States Dollars;
- (i) Accounts owed by an account debtor located outside the United States;

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- (j) Accounts owed by an account debtor who is insolvent or is the subject of bankruptcy proceedings or who has gone out of business;
- (k) Accounts owed by an Owner, Subsidiary, Affiliate, Officer or employee of Company;
- (l) Accounts not subject to the Security Interest or which are subject to any Lien in favor of any Person other than Wells Fargo;
- (m) That portion of Accounts that has been restructured, extended, amended or modified;
- (n) That portion of Accounts that constitutes advertising, finance charges, service charges or sales or excise taxes;
- (o) Accounts owed by an account debtor, regardless of whether otherwise eligible, to the extent that the aggregate balance of such Accounts exceeds 15% of the aggregate amount of all Accounts;
- (p) Accounts owed by an account debtor, regardless of whether otherwise eligible, if 25% or more of the total amount of Accounts due from such debtor is ineligible under clauses (a), (b), or (k) above;
- (q) Accounts arising from the sale of warranty or service contracts, maintenance service, warranty service or replacement parts;
- (r) Any Accounts deemed to be "Eligible Accounts" under the Ex-Im Credit Agreement; and
- (s) Accounts, or portions of Accounts, otherwise deemed ineligible by Wells Fargo in its sole discretion.

"Eligible Inventory" means all Inventory of Company, valued at the lower of cost or market in accordance with GAAP; but excluding Inventory having any of the following characteristics:

- (t) Inventory that is: in-transit; located at any warehouse, job site or other premises not approved by Wells Fargo in an Authenticated Record delivered to Company; not subject to a perfected first priority Lien in Wells Fargo's favor; covered by any negotiable or non-negotiable warehouse receipt, bill of lading or other document of title; on consignment from any consignor; or on consignment to any consignee or subject to any bailment unless the consignee or bailee has executed an agreement with Wells Fargo;
- (u) Supplies, packaging, maintenance parts or sample Inventory, or customer supplied parts or Inventory;
- (v) Work-in-process Inventory;

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- (w) Finished goods Inventory;
- (x) Inventory that is damaged, defective, obsolete, slow moving or not currently saleable in the normal course of Company's operations, or the amount of such Inventory that has been reduced by shrinkage;
- (y) Inventory that Company has returned, has attempted to return, is in the process of returning or intends to return to the vendor of the Inventory;
- (z) Inventory that is perishable or live;
- (aa) Inventory manufactured by Company pursuant to a license unless the applicable licensor has agreed in a Record that has been Authenticated by licensor to permit Wells Fargo to exercise its rights and remedies against such Inventory;
- (bb) Inventory that is subject to a Lien in favor of any Person other than Wells Fargo;
- (cc) Inventory stored at locations holding less than 10% of the aggregate value of Company's Inventory;
- (dd) Inventory that is deemed to be "Eligible Inventory" under the Ex-Im Credit Agreement; and
- (ee) Inventory otherwise deemed ineligible by Wells Fargo in its sole discretion.

"Environmental Law" means any federal, state, local or other governmental statute, regulation, law or ordinance dealing with the

protection of human health and the environment.

“Equipment” shall have the meaning given it under the Uniform Commercial Code in effect in the state whose laws govern this Agreement.

“ERISA” means the Employee Retirement Income Security Act of 1974, as amended from time to time.

“ERISA Affiliate” means any trade or business (whether or not incorporated) that is a member of a group which includes Company and which is treated as a single employer under Section 414 of the IRC.

“Event of Default” is defined in Section 6.1.

“Existing Letter of Credit” is defined in Section 1.9 (a).

“Ex-Im Credit Agreement” means that certain Credit and Security Agreement (Ex-Im Subfacility), between the Company and Wells Fargo of even date with this Agreement.

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“Ex-Im Loan Documents” means the Ex-Im Credit Agreement and all other documents, agreements, instruments, and certificates now or hereafter executed or provided in connection with the Ex-Im Credit Agreement.

“Floating Rate” is defined in Section 1.5 (a).

“Floating Rate Advance” means an Advance bearing interest at the Floating Rate.

“GAAP” means generally accepted accounting principles, applied on a basis consistent with the accounting practices applied in the financial statements described on Exhibit D.

“General Intangibles” shall have the meaning given it under the UCC.

“Guarantor” means Capstone Turbine International, Inc., and any other Person now or in the future guaranteeing any Indebtedness through the issuance of a Guaranty.

“Guaranty” means an unconditional continuing guaranty executed by a Guarantor in favor of Wells Fargo (if more than one, the “Guaranties”).

“Hazardous Substances” means pollutants, contaminants, hazardous substances, hazardous wastes, petroleum and fractions thereof, and all other chemicals, wastes, substances and materials listed in, regulated by or identified in any Environmental Law.

“Indebtedness” is used in its most comprehensive sense and means any debts, obligations and liabilities of Company to Wells Fargo, whether incurred in the past, present or future, whether voluntary or involuntary, and however arising, and whether due or not due, absolute or contingent, liquidated or unliquidated, determined or undetermined, and including without limitation all obligations arising under any swap, derivative, foreign exchange, hedge, deposit, treasury management or similar transaction or arrangement however described or defined that Company may enter into at any time with Wells Fargo or with Wells Fargo Merchant Services, L.L.C., whether or not Company may be liable individually or jointly with others, or whether recovery upon such Indebtedness may subsequently become unenforceable.

“Indemnified Liabilities” is defined in Section 7.8.

“Indemnitee” is defined in Section 7.8.

“Infringement” or “Infringing” when used with respect to Intellectual Property Rights means any infringement or other violation of Intellectual Property Rights.

“Intellectual Property Rights” means all actual or prospective rights arising in connection with any intellectual property or other proprietary rights, including all rights arising in connection with copyrights, patents, service marks, trade dress, trade secrets, trademarks, trade names or mask works.

“Interest Payment Date” is defined in Section 1.7 (a).

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“Interest Period” means the period that commences on (and includes) the Business Day on which either a LIBOR Advance is made or continued or on which a Floating Rate Advance is converted to a LIBOR Advance, and ending on (but excluding) the Business Day numerically corresponding to that date that falls the number of months afterward as selected by Company pursuant to Section 1.3 (c), during which period the outstanding principal amount of the LIBOR Advance shall bear interest at the LIBOR Advance Rate; provided, however, that:

(ff) If an Interest Period would otherwise end on a day which is not a Business Day, then it shall end on the next Business Day, unless that day is the first Business Day of a month, in which case the Interest Period shall end on the last Business Day of the preceding month;

(gg) No Interest Period applicable to an Advance may end later than the Maturity Date; and

(hh) In no event shall Company select Interest Periods with respect to LIBOR Advances which would result in the payment of a LIBOR Advance breakage fee under this Agreement in order to make required principal payments.

“Inventory” shall have the meaning given it under the UCC.

“Investment Property” shall have the meaning given it under the UCC.

“L/C Amount” means the sum of (a) the Aggregate Face Amount of any outstanding Letters of Credit, plus (b) the amount of each Obligation of Reimbursement that either remains unreimbursed or has not been paid through an Advance on the Line of Credit.

“L/C Application” means an application for the issuance of standby or documentary Letters of Credit pursuant to the terms of a Standby Letter of Credit Agreement or Commercial Letter of Credit Agreement, in form acceptable to Wells Fargo.

“Letter of Credit” and “Letters of Credit” are each defined in Section 1.9 (a).

“LIBOR” means the rate per annum (rounded upward, if necessary, to the nearest whole 1/8<sup>th</sup> of one percent (1%)) determined pursuant to the following formula:

$$\text{LIBOR} = \frac{\text{Base LIBOR}}{100\% - \text{LIBOR Reserve Percentage}}$$

(a) “Base LIBOR” means the rate per annum for United States dollar deposits quoted by Wells Fargo as the Inter-Bank Market Offered Rate, with the understanding that such rate is quoted by Wells Fargo for the purpose of calculating effective rates of interest for loans making reference to it, on the first day of an Interest Period for delivery of funds on that date for a period of time approximately equal to the number of days in that Interest Period and in an amount approximately equal to the principal amount to which that Interest Period applies. Company understands and agrees that Wells Fargo may base its quotation of the Inter-Bank

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Market Offered Rate upon such offers or other market indicators of the Inter-Bank Market as Wells Fargo in its discretion deems appropriate including the rate offered for U.S. dollar deposits on the London Inter-Bank Market.

(b) “LIBOR Reserve Percentage” means the reserve percentage prescribed by the Board of Governors of the Federal Reserve System (or any successor) for “Eurocurrency Liabilities” (as defined in Regulation D of the Federal Reserve Board, as amended), adjusted by Wells Fargo for expected changes in such reserve percentage during the applicable Interest Period.

“LIBOR Advance” means an Advance bearing interest at the LIBOR Advance Rate.

“LIBOR Advance Rate” is defined in Section 1.5 (a).

“Licensed Intellectual Property” is defined in Exhibit D.

“Lien” means any security interest, mortgage, deed of trust, pledge, lien, charge, encumbrance, title retention agreement or analogous instrument or device, including the interest of each lessor under any capitalized lease and the interest of any bondsman under any payment or performance bond, in, of or on any assets or properties of a Person, whether now owned or subsequently acquired and whether arising by agreement or operation of law.

“Line of Credit” is defined in the Recitals.

“Loan Documents” means this Agreement, the Revolving Note, the Master Agreement for Treasury Management Services, each Guaranty, each Subordination Agreement, each Standby Letter of Credit Agreement, each Commercial Letter of Credit Agreement, any L/C Applications, and the Security Documents, together with every other agreement, note, document, contract or instrument to which Company now or in the future may be a party and which may be required by Wells Fargo in connection with, or as a condition to, the execution of this Agreement. Any documents or other agreements entered into between Company and Wells Fargo that relate to any swap, derivative, foreign exchange, hedge, or similar product or transaction, or which are entered into with an operating division of Wells Fargo other than Wells Fargo Business Credit, shall not be included in this definition.

“Loan Manager” means the treasury management service defined in the Master Agreement for Treasury Management Services and related Loan Manager Service Description.

“Lockbox” means “Lockbox” as defined in the Master Agreement for Treasury Management Services and related Lockbox and Collection Account Service Description.

“Margin” means a rate per annum, expressed as a percentage, as more fully described in Section 1.5 (a).

“Master Agreement for Treasury Management Services” means the Master Agreement for Treasury Management Services, the related Acceptance of Services, and the Service Description governing each treasury management service used by Company.

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“Material Adverse Effect” means any of the following:

(ii) A material adverse effect on the business, operations, results of operations, assets, liabilities or financial condition of Company;

(jj) A material adverse effect on the ability of Company to perform its obligations under the Loan Documents, or any other document or agreement related to this Agreement;

(kk) A material adverse effect on the ability of Wells Fargo to enforce the Indebtedness or to realize the intended benefits of the Security Documents, including a material adverse effect on the validity or enforceability of any Loan Document or of any rights against any Guarantor, or on the status, existence, perfection, priority (subject to Permitted Liens) or enforceability of any Lien securing payment or performance of the Indebtedness; or

(ll) Any claim against Company or threat of litigation which if determined adversely to Company would cause Company to be liable to pay an amount exceeding \$500,000 or would result in the occurrence of an event described in clauses (a), (b) and (c) above.

“Maturity Date” is defined in Section 1.1 (b).

“Maximum Line Amount” is defined in Section 1.1 (a).

“Minimum Interest Charge” is defined in Section 1.5 (b).

“Multiemployer Plan” means a multiemployer plan (as defined in Section 4001(a)(3) of ERISA) to which Company or any ERISA Affiliate contributes or is obligated to contribute.

“Net Income” means fiscal year-to-date after-tax net income from continuing operations, including extraordinary losses but excluding extraordinary gains, all as determined in accordance with GAAP.

“Obligation of Reimbursement” is defined in Section 1.9 (b).

“OFAC” is defined in Section 5.11 (b).

“Officer” means with respect to Company, an officer if Company is a corporation, a manager if Company is a limited liability company, or a partner if Company is a partnership.

“Operating Account” is defined in Section 1.3 (a), and maintained in accordance with the terms of Wells Fargo’s Commercial Account Agreement in effect for demand deposit accounts.

“Overadvance” means the amount, if any, by which the unpaid principal amount of the Revolving Note, plus the L/C Amount, is in excess of the then-existing Borrowing Base.

“Owned Intellectual Property” is defined in Exhibit D.

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“Owner” means with respect to Company, each Person having legal or beneficial title to an ownership interest in Company or a right to acquire such an interest.

“Patent and Trademark Security Agreement” means each Patent and Trademark Security Agreement entered into between Company and Wells Fargo.

“Pension Plan” means a pension plan (as defined in Section 3(2) of ERISA) maintained for employees of Company or any ERISA Affiliate and covered by Title IV of ERISA.

“Permitted Lien” and “Permitted Liens” are defined in Section 5.3 (a).

“Person” means any individual, corporation, partnership, joint venture, limited liability company, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision of a governmental entity.

“Plan” means an employee benefit plan (as defined in Section 3(3) of ERISA) maintained for employees of Company or any ERISA Affiliate.

“Premises” is defined in Section 2.4 (a).

“Prime Rate” means at any time the rate of interest most recently announced by Wells Fargo at its principal office as its Prime Rate, with the understanding that the Prime Rate is one of Wells Fargo’s base rates, and serves as the basis upon which effective rates of interest are calculated for those loans making reference to it, and is evidenced by its recording in such internal publication or publications as Wells Fargo may designate. Each change in the rate of interest shall become effective on the date each Prime Rate change is announced by Wells Fargo.

“Proceeds” shall have the meaning given it under the UCC.

“Record” means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form, and includes all information that is required to be reported by Company to Wells Fargo pursuant to Section 5.1.

“Reportable Event” means a reportable event (as defined in Section 4043 of ERISA), other than an event for which the 30-day notice requirement under ERISA has been waived in regulations issued by the Pension Benefit Guaranty Corporation.

“Revolving Note” is defined in Section 1.1 (d).

“Security Documents” means this Agreement, the Collateral Pledge Agreement, the Patent and Trademark Security Agreement(s), and any other document delivered to Wells Fargo from time to time to secure the Indebtedness.

“Security Interest” is defined in Section 2.1.

“Special Account” means a specified cash collateral account maintained with Wells Fargo or another financial institution acceptable to Wells Fargo in connection with each undrawn Letter of Credit issued by Wells Fargo, as more fully described in Section 1.10.

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“Standby Letter of Credit Agreement” means an agreement governing the issuance of standby letters of credit by Wells Fargo entered into between Company as applicant and Wells Fargo as issuer.

“Subordinated Creditor(s)” means any Person now or in the future subordinating indebtedness of Company held by that Person to the payment of the Indebtedness.

“Subordinated Debt” means any Debt, contingent equity, earnout or other obligations of Company that is unsecured and has subordination terms, covenants, pricing and other terms which have been approved in an Authenticated Record from Wells Fargo and with respect to which the holder thereof has executed and delivered to Wells Fargo a Subordination Agreement.

“Subordination Agreement” means any agreement between Wells Fargo and the holder(s) of Subordinated Debt pursuant to which such Subordinated Debt is subordinated in right of payment, liens, security and remedies to all of the Indebtedness and all of Wells Fargo’s rights, liens and remedies, in form and substance satisfactory to Wells Fargo (if more than one, the “Subordination Agreements”).

“Subsidiary” means any Person of which more than 50% of the outstanding ownership interests having general voting power under ordinary circumstances to elect a majority of the board of directors or the equivalent of such Person, irrespective of whether or not at the time ownership interests of any other class or classes shall have or might have voting power by reason of the happening of any contingency, is at the time directly or indirectly owned by Company, by Company and one or more other Subsidiaries, or by one or more other Subsidiaries.

“Termination Date” is defined in Section 1.1 (b).

“UCC” means the Uniform Commercial Code in effect in the state designated in this Agreement as the state whose laws shall govern this Agreement, or in any other state whose laws are held to govern this Agreement or any portion of this Agreement.

“Unused Amount” is defined in Section 1.6 (b).

“Wells Fargo” means Wells Fargo Bank, National Association in its broadest and most comprehensive sense as a legal entity, and is not limited in its meaning to the Wells Fargo Business Credit operating division, or to any other operating division of Wells Fargo.

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## **Exhibit B to Credit and Security Agreement**

### **PREMISES**

The Premises referred to in the Credit and Security Agreement have an address of:

21211 Nordhoff Street, Chatsworth, CA 91311

## **Exhibit C to Credit and Security Agreement**

### **Conditions Precedent**

Wells Fargo's obligation to make an initial Advance shall be subject to the condition that Wells Fargo shall have received the following, executed and in form and content satisfactory to Wells Fargo. The following descriptions are limited descriptions for reference purposes only and should not be construed as limiting in any way the subject matter that Wells Fargo requires each document to address.

#### **A. Loan Documents to be Executed by Company:**

- (1) The Revolving Note.
- (2) The Credit and Security Agreement.
- (3) The Master Agreement for Treasury Management Services, the Acceptance of Services, and the related Service Description for each deposit or treasury management related product or service that Company will subscribe to, including without limitation the Loan Manager Service Description and the Lockbox and Collection Account Service Description.
- (4) The Collateral Pledge Agreement, pursuant to which Company grants Wells Fargo a security interest in the shares of stock more fully described in the Collateral Pledge Agreement, together with the stock certificates and stock powers, as security for the full and prompt payment of Company's Indebtedness.
- (5) The Patent and Trademark Security Agreement.
- (6) The Ex-Im Loan Documents.
- (7) A Standby Letter of Credit Agreement and the Commercial Letter of Credit Agreement, and a separate L/C Application for each Letter of Credit that Company has requested that Wells Fargo issue.

#### **B. Loan Documents to be Executed by Third Parties:**

- (1) The Guaranty by Corporation of Capstone Turbine International, Inc., pursuant to which that Person unconditionally guarantees the full and prompt payment of Company's Indebtedness.
- (2) The Security Agreement of Capstone Turbine International, Inc., pursuant to which that Person grants Wells Fargo a security interest in the personal property more fully described in the Security Agreement, as security for the full and prompt payment of Company's Indebtedness.

- (3) Certificates of Insurance required under this Agreement, with all hazard insurance containing a lender's interest endorsement in Wells Fargo's favor and with all liability insurance naming Wells Fargo as additional insured.
- (4) Any Ex-Im Loan Documents requiring the execution by a third party (including, but not limited to, the Export-Import Bank of the United States).

#### **C. Documents Related to the Premises**

- (1) Any leases pursuant to which Company is leasing the Premises from a lessor.

#### **D. Federal Tax, State Tax, Judgment, UCC and Intellectual Property Lien Searches**

- (1) Current searches of Company in appropriate filing offices showing that (i) no Liens have been filed and remain in effect against Company and Collateral except Permitted Liens or Liens held by Persons who have agreed in an Authenticated Record that upon receipt of proceeds of the initial Advances, they will satisfy, release or terminate such Liens in a manner satisfactory to Wells Fargo, and (ii) Wells Fargo has filed all UCC financing statements necessary to perfect the Security Interest, to the extent the Security Interest is capable of being perfected by filing.
- (2) Current searches of Third Persons in appropriate filing offices with respect to any of the Collateral that is in the possession of a Person other than Company that is held for resale, showing that (i) UCC financing statements sufficient to protect

Company's and Wells Fargo's interests in such Collateral have been filed, and (ii) no other secured party has filed a financing statement against such Person and covering property similar to Company's, other than Company, or if there exists any such secured party, evidence that each such party has received notice from Company and Wells Fargo sufficient to protect Company's and Wells Fargo's interests in Company's goods from any claim by such secured party.

**E. Constituent Documents:**

- (1) The Certificate of Authority of Company, which shall include as part of the Certificate or as exhibits to the Certificate, (i) the Resolution of Company's Directors and, if required, Owners, authorizing the execution, delivery and performance of those Loan Documents and other documents or agreements described in or related to this Agreement to which Company is a party, (ii) an Incumbency Certificate containing the signatures of Company's Officers or agents authorized to execute and deliver those instruments, agreements and certificates referenced in (i) above, as well as Advance requests, on Company's behalf, (iii) Company's Constituent Documents, (iv) a current Certificate of Good Standing or Certificate of Status issued by the secretary of state or other appropriate authority for Company's state of organization, certifying that Company is in good standing and in compliance with all applicable organizational requirements of the state of organization, and (v) a Secretary's Certificate of

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Company's secretary or assistant secretary certifying that the Certificate of Authority of Company is true, correct and complete.

- (2) The Certificate of Authority of Corporate Guarantor, which shall include as part of the Certificate or as exhibits to the Certificate, (i) the Resolution of Guarantor's Directors and, if required, Owners, authorizing the execution, delivery and performance of the Guaranty of Corporation, (ii) an Incumbency Certificate containing the signatures of Guarantor's Officers or agents authorized to execute and deliver the Guaranty by Corporation on Guarantor's behalf, (iii) Guarantor's Constituent Documents, (iv) a current Certificate of Good Standing or Certificate of Status issued by the secretary of state or other appropriate authority for Guarantor's state of organization, certifying that Guarantor is in good standing and in compliance with all applicable organizational requirements of the state of organization, and (v) a Secretary's Certificate of Guarantor's secretary or assistant secretary certifying that the Certificate of Authority of Corporate Guarantor and all attached exhibits are true, correct and complete.
- (3) Evidence that Company is licensed or qualified to transact business in all jurisdictions where the character of the property owned or leased or the nature of the business transacted by it makes such licensing or qualification necessary.
- (4) An Officer's Certificate of an appropriate Officer of Company confirming, in his or her capacity as an Officer, the representations and warranties set forth in this Agreement.
- (5) A Customer Identification Information Form and such other forms and verification as Wells Fargo may need to comply with the U.S.A. Patriot Act.

**F. Miscellaneous Matters or Documents:**

- (1) Final approval of the Ex-Im Credit Agreement by the Export-Import Bank of the United States.
- (2) Payment of fees and reimbursable costs and expenses due under this Agreement through the date of initial Advance or issuance of a Letter of Credit, including all legal expenses incurred through the date of the closing of this Agreement.
- (3) Evidence that after making the initial Advance and issuing the initial Letter of Credit, establishing all reserves under the Borrowing Base (including a reserve equal to 10% of the outstanding balance (or initial projected balance) under the Ex-Im Credit Agreement), paying all trade payables older than sixty (60) days from invoice date, and paying all book overdrafts and closing costs and fees (including any fees deemed paid), the combined availability under the Line of Credit under this Agreement and the "Line of Credit" under the Ex-Im Credit Agreement is not less than \$750,000.

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- (4) Any documents or other agreements entered into by Company and Wells Fargo that relate to any swap, derivative, foreign exchange, hedge, deposit, treasury management or similar product or transaction extended to Company by Wells Fargo not already provided pursuant to the requirements of (A) through (E) above.
- (5) Such other documents as Wells Fargo in its sole discretion may require.

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## REPRESENTATIONS AND WARRANTIES

Company represents and warrants to Wells Fargo as follows:

- (a) Existence and Power; Name; Chief Executive Office; Inventory and Equipment Locations; Federal Employer Identification Number and Organizational Identification Number. Company is a corporation, organized, validly existing and in good standing under the laws of the State of Delaware and is licensed or qualified to transact business in all jurisdictions where the character of the property owned or leased or the nature of the business transacted by it makes such licensing or qualification necessary, except where failure to do so could not reasonably be expected to have a Material Adverse Effect. Company has all requisite power and authority to conduct its business, to own its properties and to execute and deliver, and to perform all of its obligations under, those Loan Documents and any other documents or agreements that it has entered into with Wells Fargo related to this Agreement. During the last five (5) years of its existence, Company has done business solely under the names set forth below in addition to its correct legal name. Company's chief executive office and principal place of business is located at the address set forth below, and all of Company's records relating to its business or the Collateral are kept at that location. All Inventory and Equipment is located at that location or at one of the other locations set forth below. Company's name, Federal Employer Identification Number and Organization Identification Number are correctly set forth at the end of the Agreement next to Company's signature.

### **Trade Names**

Capstone  
Capstone Microturbine

### **Chief Executive Office / Principal Place of Business**

21211 Nordhoff Street, Chatsworth, California 91311

### **Other Inventory and Equipment Locations**

Aard Stamping, 42075 Avenida Alvarado, Temecula, CA 92590  
Accurate Electronics, 20700 Lassen Street, Chatsworth, CA 91311  
Alliance Metal Products, 20620 Superior Street, Unit #4, Chatsworth, CA 91311  
Allied Fastners, 814 Calle Plano, Camarillo, CA 93010

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AMANET, 16525 Sherman Way#C-11, Van Nuys, CA 91406  
American Aikoku Alpha, Inc., 520 Lake Cook Rd, Ste. 180, Deerfield, IL 60015  
Asigma, 2930 San Luis Rey Road, Oceanside CA 92054  
Auer Precision Co., 1050 W. Birchwood, Mesa, AZ 85210  
Axiomtek, 18138 Rowland, City of Industry, CA 91748  
Bebco Industries, 4725 Lawndale, Lamarque, TX 77568  
Cliffdale Mfg. Company, 20409 Prairie Street, Chatsworth, CA 91311  
Delafield, 152 Flower Avenue, Duarte, CA 91010  
Dry Coolers, 3232 Adventure Ln., Oxford, MI 48371  
Electro Controls, Inc., 1625 Ferguson Ct., Sidney, OH 45365  
Elgiloy Specialty Metals, 1565 Fleetwood Drive, Elgin, IL 68123  
EM Corporation, 1 John Downey Drive, New Britain, CT 06051  
Enercon Engineering, Inc., No. 1 Altofrer Lane, East Peoria, IL 61611  
Erico, Inc., 34600 Solon Road, Solon, OH 44139  
Frost Magnatics, Inc., 49643 Hartwell Road, Oakhurst, CA 93644  
Fuses Unlimited, 9248 Eton Avenue, Chatsworth, CA 91311  
Ovison Manufacturing, 750 W. Southern Ave., Tempe, AZ 85282  
Extrude Hone, 8800 Somerset Blvd., Paramount, CA 90723  
J&F Machine, Inc., 10563 Progress Way, Cypress, CA 90630  
Karel Manufacturing, 280 Campillo Ave, Suite G, Calexico, CA 92231  
Mc Donald Packaging, 2601 Garnsey Street, Santa Ana, CA 92707-3338  
Pacific Transformer, 5399 E. Hunter Avenue, Anaheim, CA 92807  
Parker Energy Systems, 95 Edgewood Avenue, New Britain, CT 06051

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Polymax, 1224 W 130th St., Gardena, CA 90247  
Precision Resources, 13916 Cordary Avenue, Hawthorne, CA 90250  
RND Enterprises, 42122 8th Street East, Lancaster, CA 93535  
Robinson FIN Machines, 13670 Highway 68 South, Kenton, OH 43326  
Schneider's Mfg. Co, Inc., 11122 Pernrose Street, Sun Valley, CA 91352

Semikron, 11 Executive Drive, Hudson, NH 03051  
 Sermatech Int'l, 7615 Fairview, Houston, TX 77041  
 Sermatech Int'l Tech, 24 Landry Street, Biddeford, ME 04005  
 T.H.T Machining, Inc., 3617 West Cambridge Suite 1B, Phoenix, AZ 85009  
 Arbo Box, Inc., 12468 Putnam Street, Whittier, CA 90602  
 Trend Technologies LLC, 4626 Eucalyptus Ave., Chino, CA 91710  
 Triumph Components – Arizonia, 6733 Westhills Road, Chandler AZ 85226  
 Turbocam, 5 Faraday Drive, Dover NH 03820  
 CKE/Verdesis, 1000 Lucernce Road, Lucernemines, PA 15754  
 Victron, 6600 Stevenson Blvd., Fremont, CA 94538  
 Weldmac, 1533 North Johnson, El Cajon, CA 92020  
 Windings, Inc., 208 North Valley Street, P.O. Box 566, New Ulm, MN 56073-0566  
 F Building, 2-26-5 Nishihara, Shibuya-ku, Tokyo, JAPAN  
 1 Room 1105, No.317, Xian Xia Road, Far East Int'l Plaza, Changning District Shanghai, China 200051  
 Via Fatebenefratelli 15, Milano, Italy 20121  
 Suite 4, Floor 6, City Gate East, Toll House Hill, Nottingham, England NG 1 5SF  
 Campos Eliseos 154-101, 11580 Polanco, Mexico

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- (b) Organization. The Organizational Chart below shows the ownership structure of all Subsidiaries of Company.

<u>Holder</u>	<u>Type of Rights/Stock</u>	<u>No. of Shares (after exercise of all rights to acquire shares)</u>	<u>% Interest (on a fully diluted basis)</u>
Capstone Turbine Corporation	Common	1000	100 %

- (c) Authorization of Borrowing; No Conflict as to Law or Agreements. The execution, delivery and performance by Company of the Loan Documents and any other documents or agreements described in or related to this Agreement, and all borrowing under the Line of Credit have been authorized and do not (i) require the consent or approval of Company's Owners; (ii) require the authorization, consent or approval by, or registration, declaration or filing with (except for the filing of any financing statements or similar documents), or notice to, any governmental agency or instrumentality, whether domestic or foreign, or any other Person, except to the extent obtained, accomplished or given prior to the date of this Agreement; (iii) violate any provision of any law, rule or regulation (including Regulation X of the Board of Governors of the Federal Reserve System) or of any order, writ, injunction or decree presently in effect having applicability to Company or of Company's Constituent Documents; (iv) result in a breach of or constitute a default or event of default under any indenture or loan or credit agreement or any other material agreement, lease or instrument to which Company is a party or by which it or its properties may be bound or affected; or (v) result in, or require, the creation or imposition of any Lien (other than the Security Interest) upon or with respect to any of the properties now owned or subsequently acquired by Company.
- (d) Legal Agreements. This Agreement, the other Loan Documents, and any other document or agreement described in or related to this Agreement, will constitute the legal, valid and binding obligations of Company, enforceable against Company in accordance with their respective terms.
- (e) Subsidiaries. Except as disclosed below, Company has no Subsidiaries.

**Subsidiaries**

Capstone Turbine International, Inc., a Delaware corporation

- (f) Financial Condition; No Adverse Change. Company has furnished to Wells Fargo its audited financial statements for its fiscal year ended March 31, 2008, and unaudited financial statements for the fiscal-year-to-date period ended September 30, 2008, and those statements fairly present Company's financial condition as of those dates and the results of Company's operations and cash

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flows for the periods then ended and were prepared in accordance with GAAP. Since the date of the most recent financial statements, there has been no Material Adverse Effect.

- (g) Litigation. Except as disclosed below, there are no actions, suits or proceedings pending or, to Company's knowledge, threatened against or affecting Company or any of its Affiliates or the properties of Company or any of its Affiliates before any court or governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, which, if determined adversely to Company or any of its Affiliates, would have a Material Adverse Effect on the financial condition, properties or operations of Company or any of its Affiliates.

## Litigation

In December 2001, a purported stockholder class action lawsuit was filed in the United States District Court for the Southern District of New York (the "District Court") against the Company, two of its then 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. The 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. The 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.

- (h) Intellectual Property Rights.
- (i) Owned Intellectual Property. Set forth below is a complete list of all patents, applications for patents, trademarks, applications to register trademarks, service marks, applications to register service marks, mask works, trade dress and copyrights for which Company is the owner of record (the "Owned Intellectual Property"). Except as set forth below, (A) Company owns the Owned Intellectual Property free and clear of all restrictions (including covenants not to sue any Person), court orders, injunctions, decrees, writs or Liens, whether by agreement memorialized in a Record Authenticated by Company or otherwise, (B) no Person other than Company owns or has been granted any right in the Owned Intellectual Property, (C) all Owned Intellectual Property is valid, subsisting and enforceable, and (D) Company has taken all commercially reasonable action necessary to maintain and protect the Owned Intellectual Property.

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- (i) Agreements with Employees and Contractors. Company has entered into a legally enforceable agreement with each Person that is an employee or subcontractor obligating that Person to assign to Company, without additional compensation, any Intellectual Property Rights created, discovered or invented by that Person in the course of that Person's employment or engagement with Company (except to the extent prohibited by law), and further obligating that Person to cooperate with Company, without additional compensation, to secure and enforce the Intellectual Property Rights on behalf of Company, unless the job description of the Person is such that it is not reasonably foreseeable that the employee or subcontractor will create, discover, or invent Intellectual Property Rights.
- (ii) Intellectual Property Rights Licensed from Others. Set forth below is a complete list of all agreements under which Company has licensed Intellectual Property Rights from another Person ("Licensed Intellectual Property") other than readily available, non-negotiated licenses of computer software and other intellectual property used solely for performing accounting, word processing and similar administrative tasks ("Off-the-shelf Software") and a summary of any ongoing payments Company is obligated to make with respect thereto. Except as set forth below or in any other Record, copies of which have been given to Wells Fargo, Company's licenses to use the Licensed Intellectual Property are free and clear of all restrictions, Liens, court orders, injunctions, decrees, or writs, whether by agreed to in a Record Authenticated by Company or otherwise. Except as disclosed below, Company is not contractually obligated to make royalty payments of a material nature, or pay fees to any owner of, licensor of, or other claimant to, any Licensed Intellectual Property Rights (excluding Off-the-shelf Software").
- (iii) Other Intellectual Property Needed for Business. Except for Off-the-shelf Software and as disclosed below, the Owned Intellectual Property and the Licensed Intellectual Property constitute all Intellectual Property Rights used or necessary to conduct Company's business as it is presently conducted or as Company reasonably foresees conducting it.
- (iv) Infringement. Except as disclosed below, Company has no knowledge of, and has not received notice either orally or in a Record alleging, any Infringement of another Person's Intellectual Property Rights (including any claim set forth in a Record that Company must license or refrain from using the Intellectual Property Rights of any Person) nor, to Company's knowledge, is there any threatened claim or any reasonable basis for any such claim.

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## PATENTS AND PATENT APPLICATIONS

### I. Capstone Issued U. S. Patents

No	Issue No.	Description	App. Ser. No.	Filing Date	Issue Date
1.	D433,997	Turbogenerator	29/111,104	9/20/99	11/21/00
2.	5,427,455	Compliant Foil Hydrodynamic Fluid Film Radial Bearing	229,205	4/18/94	6/27/95
3.	5,497,615	Gas Turbine Generator Set	180,881	3/21/94	3/12/96
4.	5,529,398	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	08/363,540	12/23/94	6/25/96
5.	5,685,156	Catalytic Combustion System	650,625	5/20/96	11/11/97
6.	5,697,848	Compound Shaft with Flexible Disk Coupling	440,541	5/12/95	12/16/97

7.	5,752,380	Liquid Fuel Pressurization and Control System	730,941	10/16/96	5/19/98
8.	5,791,868	Thrust Load Compensating System for a Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	663,732	6/14/96	8/11/98
9.	5,819,524	Gaseous Fuel Compression and Control S&M	730,945	10/16/96	10/13/98
10.	5,827,040	Hydrostatic Augmentation of a Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	662,250	6/14/96	10/27/98
11.	5,850,732	Low Emissions Combustion System for a Gas Turbine Engine	855,210	5/13/97	12/22/98
12.	5,850,733	Gaseous Fuel Compression and Control S&M	85,817	5/27/98	12/22/98
13.	5,873,235	Liquid Fuel Pressurization and Control Method	990,467	12/15/97	2/23/99
14.	5,894,720	Low Emissions Combination System For A Gas Turbine Engine Employing Flame Stabilization Within The Injector Tube	09/168,299	10/7/98	4/20/99
15.	5,899,673	Helical Flow Compressor/Turbine Permanent Magnet Motor/Generator	08/730,946	10/16/96	5/4/99
16.	5,903,116	Turbogenerator/Motor Controller	08/924,966	9/8/97	5/11/99
17.	5,915,841 See Re39190	Compliant Foil Fluid Film Radial Bearing	09/002,690	1/5/98	6/29/99
18.	5,918,985 See Re38373	Compliant Foil Fluid Thrust Film Bearing With a Tilting Pad Underspring	08/933,695	9/19/97	7/6/99
19.	5,964,663	Double Diaphragm Compound Shaft	08/934,430	9/19/97	10/12/99
20.	5,966,926	Liquid Fuel Injector Purge System	08/864,279	5/28/97	10/19/99
21.	6,016,658	Low Emissions Combustion System	09/182,966	10/8/98	1/25/00
22.	6,020,713	Turbogenerator/Motor Pulse Width Modulated Controller	09/002,890	1/5/98	2/1/00
23.	6,023,135	Turbogenerator/Motor Control System	09/080,892	5/18/98	2/8/00
24.	6,031,294	Turbogenerator/Motor Controller With Ancillary Energy Storage/Discharge	09/003,078	1/5/98	2/29/00
25.	6,037,687	Double Diaphragm Compound Shaft	09/224,208	12/30/98	3/14/00

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No	Issue No.	Description	App. Ser. No.	Filing Date	Issue Date
26.	6,049,195	Split Generator Winding Inverter	09/356,065	7/19/99	4/11/00
27.	6,062,016	Gas Turbine Engine Fixed Speed Light-Off	08/837,600	4/21/97	5/16/00
28.	6,065,281	Liquid Fuel Injector and Injector System	09/357,523	7/19/99	5/23/00
29.	6,070,404	Gaseous Fuel Compression and Control Method	09/086,615	5/27/98	7/6/00
30.	6,082,112	Liquid Fuel Injector	09/357,519	7/19/99	7/4/00
31.	6,093,975	Turbogenerator/Motor Control	09/181,388	10/27/98	7/25/00
32.	6,094,799	Method of Making Double Diaphragm Compound Shaft	09/224,206	12/30/98	8/1/00
33.	6,155,780	Ceramic Radial Flow Turbine Heat Shield	09/374,916	8/13/99	12/5/00
34.	6,158,892	Fluid Film Thrust Bearing Having Integral Compliant Foils	09/383,067	8/25/99	12/12/00
35.	6,169,334	Command and Control S&M for Multiple Turbogenerators	09/181,389	10/27/98	1/2/01
36.	6,178,751	Liquid Fuel Injector System	09/356,479	7/19/99	1/30/01
37.	6,190,048	Compliant Foil Fluid Film Radial Bearing	09/195,354	11/18/98	2/20/01
38.	6,192,668	M&A for Compressing Gaseous Fuel In a Turbine Engine	09/420,494	10/19/99	2/27/01
39.	6,194,794	Integrated Reciprocating Engine Generator Set and Turbogenerator System and Method	09/359,815	7/23/99	2/27/01
40.	6,213,234	Vehicle Powered by a Fuel Cell/Gas	09/202,968	—	4/10/01
41.	6,239,520	Permanent Magnet Rotor Cooling S&M	09/558,406	4/24/00	5/29/01
42.	6,265,786	Turbogenerator Power Control System	09/181,213	10/27/98	7/24/01
43.	6,274,945	Combustion Control Method and System	09/459,719	12/13/99	8/14/01
44.	6,281,596	Automatic Turbogenerator Restarting M&S	09/444,487	11/19/99	8/28/01
45.	6,281,601	Turbogenerator Power Control S&M	09/360,043	7/23/99	8/28/01
46.	6,325,142	Turbogenerator Power Control System	09/316,896	5/22/99	12/4/01
47.	6,361,271	Crossing Spiral Compressor/Pump	09/444,014	11/19/99	3/26/02
48.	6,381,944	M&A for Compressing Gaseous Fuel in a Turbine Engine	09/772,537	1/29/01	5/7/02
49.	6,405,522	S&M for Modular Control of a Multi-Fuel Low Emissions Turbogenerator	09/453,825	12/1/99	6/18/02
50.	6,410,992	S&M for Dual Mode Control of a Turbogenerator/Motor	09/644,527	8/23/00	6/25/02
51.	6,425,732	Shrouded Rotary Compressor	09/643,625	8/22/00	7/30/02
52.	6,437,468	Permanent Magnet Rotor Cooling System and Method	09/829,778	4/10/01	8/20/02

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No	Issue No.	Description	App. Ser. No.	Filing Date	Issue Date
53.	6,438,937	S&M for Modular Control of a Multi-Fuel Low Emissions Turbogenerator	09/972,672	10/5/01	8/27/02
54.	6,453,658	Multi-Stage Multi-Plane Combustion System for a Gas Turbine Engine	09/512,986	2/24/00	9/24/02
55.	6,468,051	Helical Flow Compressor/Turbine Permanent Magnet Motor/ Generator	09/800,900	3/7/01	10/22/02
56.	6,487,096	Power Controller	09/207,817	12/8/98	11/26/02
57.	6,489,692	Method and Apparatus for Controlling Rotation of A Magnetic Rotor	09/459,426	12/13/99	12/3/02
58.	6,495,929	Turbogenerator Power Control System	09/829,035	4/9/01	12/17/02
59.	6,522,030	Multiple Power Generator Connection Method and System	09/624,315	7/24/00	2/18/03
60.	6,539,720	Generated System Bottoming Cycle	09/985,789	11/6/01	4/1/03
61.	6,552,440	Automatic Turbogenerator Restarting Method & System	09/900,246	7/6/01	4/22/03
62.	6,612,112	Transient Turbine Exhaust Temperature Control For A Turbogenerator	10/012,770	11/5/01	9/2/03
63.	6,629,064	Apparatus and Method for Distortion Compensation	09/265,729	3/9/99	9/30/03
64.	6,634,176	Turbine Exhaust Vortex Disrupter	09/977,445	10/15/01	10/21/03
65.	6,639,328	Microturbine/Capacitor Power Distribution System	10/033,826	12/19/01	10/28/03
66.	6,657,332	Turbogenerator Cooling System	09/984,501	10/30/01	12/2/03
67.	6,657,348	Rotor Shield For Magnetic Rotary Machine	09/985,439	11/2/01	12/2/03
68.	6,664,653	Command and Control System and Method for Controlling Operational Sequencing of Multiple Turbogenerators Using a Selected Control Mode	09/689,577	10/12/00	12/16/03
69.	6,664,654	System and Method for Dual Mode Control of a Turbogenerator/Motor	10/158,095	5/29/02	12/16/03
70.	6,675,583	Combustion Method	09/969,491	11/2/01	1/13/04
71.	6,683,389	Hybrid Electric Vehicle DC Power Generation System	09/938,101	8/23/01	1/27/04
72.	6,684,642	Gas Turbine Engine Having a Multi-Stage Multi-Plane Combustion System	10/171,684	6/17/02	2/3/04
73.	6,702,463	Compliant Foil Thrust Bearing	09/714,349	11/15/00	3/9/04
74.	6,709,243	Rotary Machine With Reduced Axial Thrust Loads	09/696,316	10/25/00	3/23/04
75.	6,713,892	Automatic Turbogenerator Restarting Method and System	09/900,635	7/6/01	3/30/04
76.	6,720,685	Turbogenerator Cooling System (Div Of 09/984,501)	10/339,247	1/9/03	4/13/04

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No	Issue No.	Description	App. Ser. No.	Filing Date	Issue Date
77.	6,732,531	Combustion System for a Gas Turbine Engine With Variable Airflow Pressure Actuated Premix Injector	10/101,032	3/18/02	5/11/04
78.	6,747,372	Distributed Control Method for Multiple Connected Generators	10/007,219	11/2/01	6/8/04
79.	6,748,742	Power Offsetting Compressor System	10/008,047	11/7/01	6/15/04
80.	6,751,941	Foil Bearing Rotary Flow Compressor With Control Valve	10/080,179	2/19/02	6/22/04
81.	6,784,565	Turbogenerator With Electrical Brake	10/077,121	2/15/02	8/31/04
82.	6,787,933	Power Generation System Having Transient Ride-Through/Load-Leveling Capabilities	10/043,694	1/10/2002	9/7/2004
83.	6,804,946	Combustion System With Shutdown Fuel Purge	10/720,145	11/25/03	10/19/04
84.	6,812,586	Distributed Power System	10/066,349	1/30/02	11/2/04
85.	6,812,587	Continuous Power Supply With Back-Up Generation	10/300,936	11/21/02	11/2/04
86.	6,815,932	Detection of Islanded Behavior and Anti-Islanding Protection of a Generator in Grid-Connected Mode	09/975,148	10/12/01	11/9/04
87.	6,864,595	Detection of Islanded Behavior and Anti-Islanding Protection of a Generator in Grid-Connected Mode	10/812,979	3/31/04	3/8/05
88.	6,870,279	Method And System For Control Of Turbogenerator Power And Temperature	10/037,916	1/2/02	3/22/05
89.	6,951,110	Annular Recuperator Design	09/966,514	9/27/01	10/4/05
90.	6,958,550	Method and System For Control of Turbogenerator Power and Temperature	10/887,297	7/9/04	10/25/05
91.	6,960,840	Integrated Turbine Power Generation System With Catalytic Reactor	10/706,070	11/13/03	11/1/05
92.	7,065,873	Recuperator Assembly and Procedures	10/917,118	8/12/04	6/27/06
93.	7,092,262	Pre-charge Circuit and Method	10/813,550	3/31/04	8/15/06
94.	7,112,036	Rotor and Bearing System For A Turbomachine	10/862,136	6/4/04	9/26/06
95.	7,147,050	Recuperator Construction For a Gas Turbine Engine	10/917,107	8/12/04	12/12/06
96.	7,415,764	Recuperator Assembly And Procedures	11/336,718	1/20/06	8/26/08
97.	RE38,373	Compliant Foil Fluid Thrust Film Bearing With a Tilting	09/900,775	7/6/01	12/30/03

98.	RE39,190	Pad Underspring (Reissue of 5,918,985) Compliant Foil Fluid Film Radial Bearing (Reissue of 5,915,841.)	09/895,568	—	7/18/06
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## II. CAPSTONE PENDING U.S. PATENT APPLICATIONS

Description	App. Ser. No.	Filing Date
Turbogenerator/Motor Controller (Reissue)	09/853,852	5/11/01
Emergency Elevator System Interface Package	11/517,957	9/8/06
Compliant Foil Fluid Film Radial Bearing Or Seal	11/740,798	4/26/2007

## III. CAPSTONE ISSUED FOREIGN PATENTS

Issue No.	Description	Country	App. Ser. No.
0746680	Gas Turbine Engine Generator Set	Europe	95909213.1
69527283.7 in DE	(U.S. 5,497,615)		
0 799 388	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	Europe	95937420.8
69519684.7 in DE	(U.S. 5,529,398)		
0 756 672	Compliant Foil Hydrodynamic Fluid Radial Bearing	Europe	95914005.4
69522683.5 in DE	(U.S. 5,427,455)		
1001180	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing (divisional)	Europe	00200446.3
69532538.8 in DE	(U.S. 5,529,398)		
3725548	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	Japan	0520429/96
	(U.S. 5,529,398)		
0903466	Double Diaphragm Compound Shaft	Europe	98307606.8
69824801.5 in DE	(U.S. 5,964,663)		
0878665	Low Emissions Combustion System For a Gas Turbine Engine (U.S. 5,850,732)	Europe	98303693.0
122912	Low Emissions Combustion System For A Gas Turbine Engine (U.S. 5,850,732)	Israel	122912
112275	Gas Turbine Engine Generator Set (U.S. 5,497,615)	Israel	112275
117546	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing (U.S. 5,529,398)	Israel	117546
113289	Compliant Foil Hydrodynamic Fluid Radial Bearing (U.S. 5,427,455)	Israel	113289
118216	Compound Shaft (U.S. 5,697,848)	Israel	118216

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Issue No.	Description	Country	App. Ser. No.
121531	Gaseous Fuel Compression And Control System (U.S. 5,819,524)	Israel	121531
124664	Compliant Foil Fluid Film Thrust Bearing (U.S. 5,918,985)	Israel	124664
125679	Double Diaphragm Compound Shaft (U.S. 5,964,663)	Israel	125679
127021	Compliant Foil Film Radial Bearing (U.S. 5,915,841)	Israel	127021
125905	Turbogenerator/motor Controller With ancillary Energy Storage/Discharge (B2) (U.S. 6,031,294)	Israel	125905
137542	Turbogenerator/motor Controller (B1) (U.S. 5,903,116)	Israel	137542
121532	Helical Flow Compression Turbine With Permanent Magnet Motor/Generator (U.S. 5,899,673)	Israel	121532
3598437	Compliant Foil Hydrodynamic Fluid Film Radial Bearing (U.S. 5,427,455)	Japan	7-526958
1075724	Power Controller (B3) (U.S. 6,487,096)	Europe	98962993.6
0903510 GB and Fr.; 69830961.8-08 Germ.	Compliant Foil Fluid Film Thrust Bearing with Tilting Pad Underspring (U.S. 5,918,985)	Europe	98307596.1
0927831 GB and Fr.; 69832579.6-08 Germ.	Compliant Foil Fluid Film Radial Bearing (U.S. 5,915,841)	Europe	98310805.1
0901218 GB and Fr.; 69832860.4-08 Germ.	Turbogenerator/Motor Controller (B1) (U.S. 5,903,116)	Europe	98307247.1

1130322 GB and FR; 60125441.4 Germany 1337761 in GB, FR and IT; 60125583.6 in Germany 2,242,947	Multi-Stage Multi-Plane Combustion System for a Gas Turbine Engine (U.S. 6,453,658) Compliant Foil Thrust Bearing (U.S. 6,702,463) Double Diaphragm Compound Shaft (U.S. 5,964,663)	Europe Europe Canada	01301676.1 01996693.6 2,242,947
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Issue No.	Description	Country	App. Ser. No.
2,254,034	Compliant Foil Fluid Film Radial Bearing (U.S. 5,915,841)	Canada	2,254,034
0963035 Germany 69936424.8	Turbogenerator/Motor Control System (U.S. 6,023,135)	Europe	99303642.5
2,238,356	Compliant Foil Fluid Film Thrust Bearing with Tilting Pad Underspring (U.S. 5,918,985)	Canada	2,238,356

#### IV. CAPSTONE PENDING FOREIGN PATENT APPLICATIONS

Description	Country	App. Ser. No.	Filing Date
Command and Control System and Method For Multiple Turbogenerators (U.S. 6,169,334)	Canada	2,279,047	7/29/99
Helical Flow Compressor/Turbine Permanent Magnet Motor/Generator (U.S. 6,468,051)	Japan	2000-117024	4/19/99
Turbogenerator/Motor Controller (B1) (U.S. 5,903,116)	Canada	2,246,769	9/8/98
Compliant Foil Fluid Film Thrust Bearing With a Tilting Pad Underspring (U.S. 5,918,985)	Japan	10-250675	9/4/98
Compliant Foil Fluid Film Radial Bearing (U.S. 5,915,841)	Japan	10-347079	12/7/98
Multi-Stage Multi-Plane Combustion System For a Gas Turbine Engine (U.S. 6,453,658)	Japan	2001-45027	2/21/01
Multiple Power Generator Connection Method and System (U.S. 6,522,030)	Europe	01923202.4	4/6/01
Power Controller (B3) (Div. of #131) (U.S. 6,487,096)	Europe	05025283.2	11/18/05
Compliant Foil Fluid Film Radial Bearing Or Seal	PCT	PCT/US08/57716	3/20/2008

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#### TRADEMARK APPLICATIONS AND REGISTRATIONS BY COUNTRY

Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
CAPSTONE	Australia	—	755,739	Registered	February 23, 2018
	Australia	—	755,737	Registered	February 23, 2018
CAPSTONE	Brazil	824/638,859	824/638,859	Registered	November 20, 2017
CAPSTONE	Bulgaria	41,473	37,397	Registered	July 28, 2008(1)
CAPSTONE	Bulgaria	42,775	34,967	Registered	July 28, 2008
	Bulgaria	42,776	34,968	Registered	July 28, 2008
CAPSTONE	Canada	870,563	TMA 563,894	Registered	June 21, 2017
	Canada	870,564	TMA 504,764	Registered	November 30, 2013
CAPSTONE	China (PRC)	9,800,017,341	1,291,874	Registered	July 06, 2009
CAPSTONE	China (PRC)	9,800,017,342	1,284,494	Registered	June 13, 2009
CAPSTONE	China (PRC)	9,800,017,343	1,299,981	Registered	July 27, 2009
CAPSTONE	China (PRC)	9,800,017,344	1,301,274	Registered	August 06, 2009

	China (PRC)	9,800,017,340	1,284,495	Registered	June 13, 2009
CAPSTONE	CTM	637,082	637,082	Registered	September 23, 2017

(1) **Bulgaria** — Renewals have been issued for these registrations.

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
CAPSTONE	CTM	745,109	745,109	Registered	February 13, 2018
	CTM	524,306	524,306	Registered	April 29, 2017
CAPSTONE	Czech Republic	128,183	212,315	Registered	December 05, 2017
CAPSTONE	Czech Republic	128,352	218,818	Registered	December 11, 2017
CAPSTONE	Czech Republic	128,353	218,819	Registered	December 11, 2017
CAPSTONE	Czech Republic	130,446	228,042	Registered	February 25, 2018
	Czech Republic	130,447	228,043	Registered	February 25, 2018
CAPSTONE	Estonia	9,800,433	29,393	Registered	September 03, 2009
CAPSTONE	Estonia	EE9,702,761	28,852	Registered	May 26, 2009
CAPSTONE	Estonia	EE9,702,762	28,853	Registered	May 26, 2009
	Estonia	9,800,434	29,394	Registered	September 03, 2009
CAPSTONE	Hungary	M9,704,089	157,005	Registered	November 06, 2017
CAPSTONE	Hungary	M9,800,530	155,108	Registered	February 16, 2018
	Hungary	M9,800,529	155,107	Registered	February 16, 2018
CAPSTONE	India	769,311	769,311	Registered	September 23, 2017
	India	769,314	769,314	Registered	September 23, 2017
CAPSTONE	Indonesia	D00.2002.142 59.14414	543,704	Registered	July 04, 2012
CAPSTONE	Israel	115,027	115,027	Registered	September 23, 2018

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
CAPSTONE	Israel	115,028	115,028	Registered	September 23, 2018
CAPSTONE	Israel	115,029	115,029	Registered	September 23, 2018
CAPSTONE	Israel	117,832	117,832	Registered	February 15, 2019
	Israel	112,062	112,062	Registered	April 30, 2018
	Israel	112,063	112,063	Registered	April 30, 2018
CAPSTONE	Japan	05-077077	3,179,900	Registered	July 31, 2016
CAPSTONE	Japan	10-017382	4,414,046	Registered	September 01, 2010
CAPSTONE	Japan	9-174425	4,413,826	Registered	September 01, 2010
CAPSTONE (in Katakana)	Japan	62-4732	2,221,178	Registered	April 23, 2010

	Japan	9-112736	4,378,971	Registered	April 21, 2010
CAPSTONE	Malaysia	98/02655	9,802,655	Registered	September 16, 2017
CAPSTONE	Malaysia	98/02658	9,802,658	Registered	March 04, 2018
CAPSTONE	Malaysia	98/02659	9,802,659	Registered	September 04, 2017
CAPSTONE	Malaysia	98/02660	9,802,660	Registered	March 04, 2018
	Malaysia	98/02656	9,802,656	Registered	March 04, 2018

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
	Malaysia	98/02657	9,802,657	Registered	March 04, 2018
CAPSTONE	Mexico	324,506	576,585	Registered	March 04, 2008(2)
CAPSTONE	Mexico	324,507	579,612	Registered	March 04, 2008
CAPSTONE	Mexico	324,508	577,332	Registered	March 04, 2008
CAPSTONE	Mexico	324,509	582,024	Registered	March 04, 2008
	Mexico	324,510	578,232	Registered	March 04, 2008
	Mexico	324,512	582,025	Registered	March 04, 2008
CAPSTONE	New Zealand	289,011	289,011	Registered	February 26, 2015
CAPSTONE	New Zealand	289,012	289,012	Registered	February 26, 2015
CAPSTONE	New Zealand	289,013	289,013	Registered	September 04, 2014
CAPSTONE	New Zealand	289,014	289,014	Registered	September 16, 2014
CAPSTONE	New Zealand	311,548	311,548	Registered	June 24, 2016
	New Zealand	289,015	289,015	Registered	February 26, 2015
	New Zealand	289,016	289,016	Registered	February 26, 2015
CAPSTONE	Nigeria	84672/04	RTM 66760	Registered	February 04, 2011
CAPSTONE	Nigeria	84673/04	RTM 66750	Registered	February 04, 2011

(2) **Mexico** — Renewal petitions and change of legal address have been filed with the Mexican Intellectual Property Office.

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
	Nigeria	84670/04	RTM 66752	Registered	February 04, 2011
	Nigeria	84671/04	RTM 66761	Registered	February 04, 2011
CAPSTONE	Poland	Z-180,350	125,456	Registered	November 20, 2017
CAPSTONE	Poland	Z-184,099	128,663	Registered	March 02, 2018
	Poland	Z-183,816	130,098	Registered	February 24, 2018
CAPSTONE	Republic of Korea	97/52389	430,990	Registered	November 25, 2008(3)
CAPSTONE	Republic of Korea	97/52390	438,925	Registered	January 22, 2009

CAPSTONE	Republic of Korea	98/1917	54,995	Registered	May 17, 2009
CAPSTONE	Republic of Korea	98/9567	59,573	Registered	February 15, 2010
	Republic of Korea	97/45930	427,401	Registered	October 28, 2008
	Republic of Korea	97/45931	430,962	Registered	November 25, 2008
CAPSTONE	Romania	47,388	34,319	Registered	December 09, 2017
CAPSTONE	Romania	50,051	35,291	Registered	March 16, 2018

(3) **Republic of Korea** — Renewal applications have been filed for the two pertinent registrations in the Republic of Korea. Delay has been caused due to Korea's change of classification of goods into a separate international class number. Waller Lansden Dortch & Davis is awaiting renewal certificates and next renewal deadlines from local counsel.

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
	Romania	50,052	35,292	Registered	March 16, 2018
CAPSTONE	Russian Federation	97,718,654	174,403	Registered	December 05, 2017
CAPSTONE	Russian Federation	97,718,655	173,434	Registered	December 05, 2017
CAPSTONE	Russian Federation	97,718,656	173,435	Registered	December 05, 2017
CAPSTONE	Russian Federation	98,702,564	176,654	Registered	February 18, 2018
	Russian Federation	98,702,573	176,655	Registered	February 18, 2018
CAPSTONE	Slovak Republic	0499-98	191,841	Registered	February 27, 2018
CAPSTONE	Slovak Republic	3643-97	189,134	Registered	December 11, 2017
CAPSTONE	Slovak Republic	3655-97	188,650	Registered	December 11, 2017
CAPSTONE	Slovak Republic	3656-97	188,651	Registered	December 11, 2017
	Slovak Republic	0500-98	191,068	Registered	February 27, 2018
CAPSTONE	Slovenia	Z-9771850	9,771,850	Registered	December 11, 2017
CAPSTONE	Slovenia	Z-9870250	9,870,250	Registered	February 26, 2018
	Slovenia	Z-9870249	9,870,249	Registered	February 26, 2018
CAPSTONE	South Africa	98/02522	98/02522	Registered	February 20, 2018
CAPSTONE	South Africa	98/02523	98/02523	Registered	February 20, 2018
CAPSTONE	South Africa	98/02524	98/02524	Registered	February 20, 2018
CAPSTONE	South Africa	98/02525	98/02525	Registered	February 20, 2018

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
	South Africa	2004/03561	2004/03561	Registered	March 08, 2014
	South Africa	98/02526	98/02526	Registered	February 20, 2018
	South Africa	98/02527	98/02527	Registered	February 20, 2018
CAPSTONE	Switzerland	04728/2002	502,265	Registered	May 27, 2012
CAPSTONE	Ukraine	98/020713	20,994	Registered	February 23, 2018

	Ukraine	98/020714	20,655	Registered	February 23, 2018
CAPSTONE	USA	74/732,798	2,058,307	Registered	April 29, 2017
CAPSTONE	USA	75/306,958	2,248,687	Registered	June 01, 2009
CAPSTONE	USA	75/351,980	2,201,317	Registered	November 03, 2018
CAPSTONE	USA	75/357,665	2,487,869	Registered	September 11, 2011
	USA	78/166,520	2,993,044	Registered	September 06, 2015
	USA	78/975,666	2,940,243	Registered	April 12, 2015
CAPSTONE MICROTURBINE	USA	78/166,522	2,956,871	Registered	May 31, 2015
	USA	78/970,583	—	Pending	—
	USA	75/191,384	2,144,240	Registered	March 17, 2018

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
SAFE RETURN SYSTEM	USA	78/947,172	—	Pending	—
SRS	USA	78/947,412	—	Pending	—

#### INTELLECTUAL PROPERTY RIGHTS LICENSED FROM THIRD PARTIES

1. Licensing Agreement, dated as of April 14, 2008, between the Company and United Technologies Corporation, Pratt & Whitney, which grants the Company a non-exclusive, non-transferable license, without the right to sub-license, to use the patents and/or technical information related to material and material properties listed on Exhibit A attached thereto and the related Technical Support (as defined therein) for the design of the C200, as agreed upon in that certain Development and License Agreement, dated as of September 7, 2007, between the parties thereto. All fees for such license have been paid in full in advance.

2. Amended and Restated License Agreement, dated as of August 2, 2000 (“Solar License Agreement”), between the Company and Solar Turbines Incorporated (“Solar”), which grants the Company a non-exclusive, non-transferable license, without the right to sub-license to use the Solar Intellectual Property (as defined therein) as set forth therein. The Company pays to Solar a royalty for each Licensed Product (as defined in the Solar License Agreement) manufactured by the Company in accordance with the Solar License Agreement pursuant to the following schedule:

-	0-100kW:	\$	100.00
-	101kW-200kW:	\$	200.00
-	201kW-300kW:	\$	300.00
-	301kW-400kW:	\$	400.00
-	401kW-500kW:	\$	500.00

- i **Bulgaria** — Renewals have been issued for these registrations.
- ii **Mexico** — Renewal petitions and change of legal address have been filed with the Mexican Intellectual Property Office.
- iii **Republic of Korea** — Renewal applications have been filed for the two pertinent registrations in the Republic of Korea. Delay has been caused due to Korea’s change of classification of goods into a separate international class number. Waller Lansden Dortch & Davis is awaiting renewal certificates and next renewal deadlines from local counsel.

- (j) **Taxes.** Company and its Affiliates have paid or caused to be paid to the proper authorities when due all federal, state and local taxes required to be withheld by

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each of them except for those taxes being contested in good faith by appropriate proceedings and for which appropriate reserves have been maintained under GAAP. Company and its Affiliates have filed all federal, state and local tax returns which to the knowledge of the Officers of Company or any Affiliate, as the case may be, are required to be filed, and Company and its Affiliates have paid or caused to be paid to the respective taxing authorities all taxes as shown on these returns or on any assessment received by any of them to the extent such taxes have become due except for those taxes being contested in good faith by appropriate proceedings and for which appropriate reserves have been maintained under GAAP.

- (k) Titles and Liens. Company has good and absolute title to all Collateral free and clear of all Liens other than Permitted Liens. No financing statement naming Company as debtor is on file in any office except to perfect only Permitted Liens.
- (l) No Defaults. Company is in compliance with all provisions of all agreements, instruments, decrees and orders to which it is a party or by which it or its property is bound or affected, the breach or default of which could have a Material Adverse Effect.
- (m) Submissions to Wells Fargo. All financial and other information provided to Wells Fargo by or on behalf of Company in connection with Company's request for the credit facilities contemplated hereby is (i) true and correct in all material respects, (ii) does not omit any material fact that would cause such information to be misleading, and (iii) as to projections, valuations or proforma financial statements, present a good faith opinion as to such projections, valuations and proforma condition and results.
- (n) Financing Statements. Company has previously authorized the filing of financing statements sufficient when filed to perfect the Security Interest and other Liens created by the Security Documents. When such financing statements are filed, Wells Fargo will have a valid and perfected security interest in all Collateral capable of being perfected by the filing of financing statements. None of the Collateral is or will become a fixture on real estate, unless a sufficient fixture filing has been filed with respect to such Collateral.
- (o) Rights to Payment. Each right to payment and each instrument, document, chattel paper and other agreement constituting or evidencing Collateral is (or, in the case of all future Collateral, will be when arising or issued) the valid, genuine and legally enforceable obligation, subject to no defense, setoff or counterclaim of the account debtor or other obligor named in that instrument.
- (p) Employee Benefit Plans.
  - (i) Maintenance and Contributions to Plans. Except as disclosed below, neither Company nor any ERISA Affiliate (A) maintains or has maintained any Pension Plan, (B) contributes or has contributed to any

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Multiemployer Plan, or (C) provides or has provided post-retirement medical or insurance benefits to employees or former employees (other than benefits required under Section 601 of ERISA, Section 4980B of the IRC, or applicable state law).

- (ii) Knowledge of Plan Noncompliance with Applicable Law. Except as disclosed below, neither Company nor any ERISA Affiliate has (A) knowledge that Company or the ERISA Affiliate is not in full compliance with the requirements of ERISA, the IRC, or applicable state law with respect to any Plan, (B) knowledge that a Reportable Event occurred or continues to exist in connection with any Pension Plan, or (C) sponsored a Plan that it intends to maintain as qualified under the IRC that is not so qualified, and no fact or circumstance exists which may have a material adverse effect on such Plan's tax-qualified status.
- (iii) Funding Deficiencies and Other Liabilities. Neither Company nor any ERISA Affiliate has liability for any (A) accumulated funding deficiency (as defined in Section 302 of ERISA and Section 412 of the IRC) under any Plan, whether or not waived, (B) withdrawal, partial withdrawal, reorganization or other event under any Multiemployer Plan under Section 4201 or 4243 of ERISA, or (C) event or circumstance which could result in financial obligation to the Pension Benefit Guaranty Corporation, the Internal Revenue Service, the Department of Labor or any participant in connection with any Plan (other than routine claims for benefits under the Plan).

#### **Employee Benefit Plans**

**None.**

- (q) Environmental Matters.
  - (i) Hazardous Substances on Premises. Except as disclosed below, there are not present in, on or under the Premises any Hazardous Substances in such form or quantity as to create any material liability or obligation for either Company or Wells Fargo under the common law of any jurisdiction or under any Environmental Law, and no Hazardous Substances have ever been stored, buried, spilled, leaked, discharged, emitted or released in, on or under the Premises in such a way as to create a liability which would have a Material Adverse Effect.
  - (ii) Disposal of Hazardous Substances. Except as disclosed below, Company has not disposed of Hazardous Substances in such a manner as to create any liability under any Environmental Law which would have a Material Adverse Effect.

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- (iii) Claims and Proceedings with Respect to Environmental Law Compliance. Except as disclosed below, there have not existed in the past, nor are there any threatened or impending requests, claims, notices, investigations, demands, administrative proceedings, hearings or litigation relating in any way to the Premises or Company, alleging material liability under, violation of, or noncompliance with any Environmental Law or any license, permit or other authorization issued pursuant thereto.
- (iv) Compliance with Environmental Law; Permits and Authorizations. Except as disclosed below, Company (A) conducts its business at all times in compliance with applicable Environmental Law where the failure to be so in compliance could reasonably be expected to have a Material Adverse Effect, (B) possesses valid licenses, permits and other authorizations required under applicable Environmental Law for the lawful and efficient operation of its business, none of which are scheduled to expire, or withdrawal, or material limitation within the next 12 months, and (C) has not been denied insurance on grounds related to potential environmental liability.
- (v) Status of Premises. Except as disclosed below, the Premises are not and never have been listed on the National Priorities List, the Comprehensive Environmental Response, Compensation and Liability Information System or any similar federal, state or local list, schedule, log, inventory or database.
- (vi) Environmental Audits, Reports, Permits and Licenses. Company has delivered to Wells Fargo all environmental assessments, audits, reports, permits, licenses and other documents describing or relating in any way to the Premises or Company's businesses.

**Environmental Matters**

**Environmental Reports**

Review of Site Conditions, dated February 11, 2005 for 16640 Stagg Street, Van Nuys, California, by TRC

Environmental Site Assessment Report, dated February 27, 2006 for 16640 Stagg Street, Van Nuys, California, by TRC

Indoor Air Quality Investigation, dated April 17, 2006 for 16640 Stagg Street, Van Nuys, California, by Environmics Southwest, LLC

Personal Breathing Zone Sampling, dated July 25, 2006 for 16640 Stagg Street, Van Nuys, California, by Environmics Southwest, LLC

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**Exhibit E to Credit and Security Agreement**

**COMPLIANCE CERTIFICATE**

To: Wells Fargo Bank, National Association  
 Date: [ , 200 ]  
 Subject: Financial Statements

In accordance with our Credit and Security Agreement dated February 9, 2009 (as amended from time to time, the "Credit Agreement"), attached are the financial statements of Capstone Turbine Corporation (the "Company") dated [ , 200 ] (the "Reporting Date") and the year-to-date period then ended (the "Current Financials"). All terms used in this certificate have the meanings given in the Credit Agreement.

**A. Preparation and Accuracy of Financial Statements.** I certify that the Current Financials have been prepared in accordance with GAAP, subject to year-end audit adjustments, and fairly present Company's financial condition as of the Reporting Date.

**B.** Name of Company; Merger and Consolidation. I certify that:

(Check one)

Company has not, since the date of the Credit Agreement, changed its name or jurisdiction of organization, nor has it consolidated or merged with another Person.

Company has, since the date of the Credit Agreement, either changed its name or jurisdiction of organization, or both, or has consolidated or merged with another Person, which change, consolidation or merger:  was consented to in advance by Wells Fargo in an Authenticated Record, and/or  is more fully described in the statement of facts attached to this Certificate.

**C. Events of Default.** I certify that:

(Check one)

I have no knowledge of the occurrence of an Event of Default under the Credit Agreement, except as previously reported to Wells Fargo in a Record.

I have knowledge of an Event of Default under the Credit Agreement not previously reported to Wells Fargo in a Record, as more fully described in the statement of facts attached to this Certificate, and further, I acknowledge that Wells Fargo may under the terms of the Credit Agreement impose the Default Rate at any time during the resulting Default Period.

**D. Litigation Matters.** I certify that:

(Check one)

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I have no knowledge of any material adverse change to the litigation exposure of Company or any of its Affiliates or of any Guarantor.

I have knowledge of material adverse changes to the litigation exposure of Company or any of its Affiliates or of any Guarantor not previously disclosed in Exhibit D, as more fully described in the statement of facts attached to this Certificate.

**E. Financial Covenants.** I further certify that:

(Check and complete each of the following)

1. **Minimum Book Net Worth.** Pursuant to Section 5.2 (a) of the Credit Agreement, as of the Reporting Date, Company's Book Net Worth was \$[ ], which  satisfies  does not satisfy the requirement that such amount be not less than the applicable amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

Test Date	Minimum Book Net Worth
December 31, 2008	\$ 61,000,000
January 31, 2009	\$ 57,000,000
February 28, 2009	\$ 52,700,000
March 31, 2009	\$ 51,000,000
April 30, 2009	\$ 48,150,000
May 31, 2009	\$ 45,300,000
June 30, 2009	\$ 46,500,000
July 31, 2009	\$ 43,900,000
August 31, 2009	\$ 41,300,000
September 30, 2009	\$ 44,450,000
October 31, 2009	\$ 42,100,000
November 30, 2009	\$ 39,850,000
December 31, 2009	\$ 44,600,000
January 31, 2010	\$ 42,250,000
February 28, 2010	\$ 40,000,000
March 31, 2010	\$ 45,150,000

2. **Minimum Net Income.** Pursuant to Section 5.2 (b) of the Credit Agreement, as of the Reporting Date, Company's Net Income was [\$ ], which  satisfies  does not satisfy the requirement that Net Income be not less than the amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

Test Date	Minimum Net Income
December 31, 2008	\$ <10,800,000 >
March 31, 2009	\$ <11,000,000 >
June 30, 2009	\$ <5,750,000 >

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Test Date	Minimum Net Income
September 30, 2009	\$ <3,200,000 >
December 31, 2009	\$ <1,000,000 >
March 31, 2010	\$ <500,000 >

3. **Minimum Cash to Unreimbursed Line of Credit Advances Coverage Ratio.** Pursuant to Section 5.2(c) of the Credit Agreement, as of the Reporting Date, at all times, Company has  has not  been in compliance with the requirement that the percentage of the unreimbursed Line of Credit Advances under the Revolving Note plus the L/C Amount plus outstanding "Advances" under the Ex-Im Credit Agreement to the amount of cash plus Cash Equivalents of Company in which Wells Fargo has a perfected first priority security interest be not greater than 80%.

4. **Capital Expenditures.** Pursuant to Section 5.2 (d) of the Credit Agreement, for the year-to-date period ending on the Reporting Date, Companies have expended or contracted to expend during the fiscal year ended \_\_\_\_\_, 200\_\_\_\_, for Capital Expenditures, \$ \_\_\_\_\_ in the aggregate, which  satisfies  does not satisfy the requirement that such expenditures not exceed \$7,500,000 in the aggregate during the fiscal year ended March 31, 2009, \$10,000,000 in the aggregate during the fiscal year ended March 31, 2010, and zero for each subsequent fiscal year.

Attached are statements of all relevant facts and computations in reasonable detail sufficient to evidence Company's compliance with the financial covenants referred to above, which computations were made in accordance with GAAP.

Capstone Turbine Corporation

By: \_\_\_\_\_  
Its: Chief Financial Officer

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**Exhibit F to Credit and Security Agreement**

**PERMITTED LIENS**

<u>Creditor</u>	<u>Collateral</u>	<u>Jurisdiction</u>	<u>Filing Date</u>	<u>Filing No.</u>
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10826789
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10826805
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10826953
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10826979
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10827001
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10827035
Crown Credit Company	Daewoo Lift Truck, G25P-186, SN: DZ- 00140	Delaware	7/28/03	31940421

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<u>Creditor</u>	<u>Collateral</u>	<u>Jurisdiction</u>	<u>Filing Date</u>	<u>Filing No.</u>
General Electric Capital Corporation	Various equipment	Delaware	1/11/06	60109413

**INDEBTEDNESS**

**None.**

**GUARANTIES**

**None.**

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**Credit and Security Agreement  
(Ex-Im Subfacility)**

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### **Credit and Security Agreement (Ex-Im Subfacility)**

This Credit and Security Agreement (Ex-Im Subfacility) (the "Agreement") is dated February 9, 2009, and is entered into between Capstone Turbine Corporation, a Delaware corporation ("Company"), and Wells Fargo Bank, National Association (as more fully defined in Exhibit A, "Wells Fargo"), acting through its Wells Fargo Business Credit operating division.

#### **RECITALS**

Company has asked Wells Fargo to provide it with a \$7,000,000 revolving line of credit (the "Line of Credit") for working capital purposes, with such Line of Credit constituting a subfacility within the Domestic Facility Agreement (defined below). Wells Fargo is agreeable to meeting Company's request, provided that Company agrees to the terms and conditions of this Agreement.

For purposes of this Agreement, capitalized terms not otherwise defined in the Agreement shall have the meaning given them in Exhibit A.

#### **1. AMOUNT AND TERMS OF THE LINE OF CREDIT**

##### **1.1 Line of Credit; Limitations on Borrowings; Termination Date; Use of Proceeds.**

(a) Line of Credit and Limitations on Borrowing. Wells Fargo shall make Advances to Company under the Line of Credit that do not exceed in the aggregate the lesser of (i) \$7,000,000 (the "Maximum Line Amount"), and (ii) the Borrowing Base limitations described in Section 1.2. Within these limits, Company may periodically borrow, prepay in whole or in part, and reborrow. Wells Fargo has no obligation to make an Advance during a Default Period or at any time Wells Fargo believes that an Advance would result in an Event of Default. The Line of Credit provided for in this Agreement is subject to the limitations set forth in the Domestic Facility Agreement and is deemed to be a subfacility within the "Line of Credit" provided for in the Domestic Facility Agreement as set forth therein.

(b) Maturity and Termination Dates. Company may request Advances from the date that the conditions set forth in Section 3 are satisfied until the earlier of: (i) February 9, 2012 (the "Maturity Date"), (ii) the date Company terminates the Line of Credit, (iii) the date Wells Fargo terminates the Line of Credit following an Event of Default, or (iv) the date the Domestic Facility Agreement is terminated (the earliest of such dates, the "Termination Date")

(c) Use of Line of Credit Proceeds. Company shall use the proceeds of each Advance to provide working capital to fulfill written export orders or contracts from customers outside the United States to purchase goods or services from Company.

(d) Revolving Notes. Company's obligation to repay Line of Credit Advances, regardless of how initiated under Section 1.3, shall be evidenced by one or more revolving promissory notes (as renewed, amended or replaced from time to time, the "Revolving Notes").

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## 1.2 Borrowing Base; Mandatory Prepayment.

(a) Borrowing Base. The borrowing base (the "Borrowing Base") is an amount equal to:

(i) 85% or such lesser percentage of Eligible Accounts as Wells Fargo in its sole discretion may deem appropriate; provided that this rate may be reduced at any time by Wells Fargo's in its sole discretion by one percent (1%) for each percentage point by which Dilution on the date of determination is in excess of five percent (5.0%), plus

(ii) the lesser of (i) 50% or such lesser percentage of Eligible Inventory as Wells Fargo in its sole discretion may deem appropriate or (ii) \$2,000,000, less

(iii) the Borrowing Base Reserve, less

(iv) Indebtedness that Company owes Wells Fargo that has not been advanced on the Revolving Notes (other than Indebtedness constituting "Advances" under the Domestic Facility Agreement), less

(v) Indebtedness that is not otherwise described in Section 1, including Indebtedness that Wells Fargo in its sole discretion finds on the date of determination to be equal to Wells Fargo's net credit exposure with respect to any swap, derivative, foreign exchange, hedge, deposit, treasury management or similar transaction or arrangement extended to Company by Wells Fargo and any Indebtedness owed by Company to Wells Fargo Merchant Services, L.L.C.

(b) Mandatory Prepayment; Overadvances. If unreimbursed Line of Credit Advances evidenced by the Revolving Notes exceed the lesser of the Borrowing Base, or the Maximum Line Amount at any time, then Company shall immediately prepay the Revolving Notes in an amount sufficient to eliminate the excess, unless Wells Fargo has delivered to Company an Authenticated Record consenting to the Overadvance prior to its occurrence, in which event the Overadvance shall be temporarily permitted on such terms and conditions as Wells Fargo in its sole discretion may deem appropriate, including the payment of additional fees or interest, or both.

## 1.3 Procedures for Line of Credit Advances.

(a) Advances to Operating Account. Advances shall be credited to Company's demand deposit account maintained with Wells Fargo (the "Operating Account"), unless the parties agree in a Record Authenticated by both of them to disburse to another account.

(i) Advances upon Company's Request. Line of Credit Advances may be funded upon Company's request. No request will be deemed received until Wells Fargo acknowledges receipt, and Company, if requested by Wells Fargo, confirms the request in an Authenticated Record. Company shall repay all Advances, even if the Person requesting the Advance on behalf of Company lacked authorization.

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(A) Floating Rate Advances. If Company wants a Floating Rate Advance, it shall make the request no later than 9:00 a.m. Pasadena, California Time on the Business Day on which it wants the Floating Rate Advance to be funded, which request shall specify the principal Advance amount being requested.

(B) LIBOR Advances. If Company wants a LIBOR Advance, it shall make the request no later than 9:00 a.m. Pasadena, California Time three (3) Business Days prior to the Business Day on which it wants the LIBOR Advance to be funded, which request shall specify both the principal Advance amount and Interest Period being requested. No more than five (5) separate LIBOR Advance Interest Periods may be outstanding at any time under this Agreement and the Ex-Im Credit Agreement, on a combined basis. Each LIBOR Advance shall be in multiples of \$500,000 and in the minimum amount of at least \$500,000. LIBOR Advances are not available for Advances made through the Loan Manager Service, and shall not be available during Default Periods.

(ii) Advances through Loan Manager. If Wells Fargo has separately agreed that Company may use the Wells Fargo Loan Manager service ("Loan Manager"), Line of Credit Advances will be initiated by Wells Fargo and credited to the Operating Account as Floating Rate Advances as of the end of each Business Day in an amount sufficient to maintain an agreed upon ledger balance in the Operating Account, subject only to Line of Credit availability as provided in Section 1.1(a). If Wells Fargo terminates Company's access to Loan Manager, Company may continue to request Line of Credit Advances as provided in Section 1.3(a)(i). Wells Fargo shall have no obligation to make an Advance through Loan Manager during a Default Period, or in an amount in excess of Line of

Credit availability, and may terminate Loan Manager at any time in its sole discretion.

(b) Protective Advances; Advances to Pay Indebtedness Due. Wells Fargo may initiate a Floating Rate Advance on the Line of Credit in its sole discretion for any reason at any time, without Company's compliance with any of the conditions of this Agreement, and (i) disburse the proceeds directly to third Persons in order to protect Wells Fargo's interest in Collateral or to perform any of Company's obligations under this Agreement, or (ii) apply the proceeds to the amount of any Indebtedness then due and payable to Wells Fargo.

(c) LIBOR Advances.

(i) Funding Line of Credit Advances as LIBOR Advances for Fixed Interest Periods. Subject to the other terms and conditions of this Agreement, Company may request a Line of Credit Advance as a LIBOR Advance for one, three, or six month periods (each period, an "Interest Period", as more fully defined in Exhibit A).

(ii) Procedure for Converting Floating Rate Advances to LIBOR Advances. Company may request that all or any part of an outstanding Floating Rate Advance be converted to a LIBOR Advance, provided that no Default Period is in effect, and that Wells Fargo receives the request no later than 9:00 a.m. Pasadena, California Time three (3) Business Days prior to the Business Day on which Company wishes the conversion to become effective. Each request shall (i) specify the principal amount of the Floating Rate Advance to be converted, (ii) the Business Day of conversion, and (iii) the Interest Period desired. The request shall be

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confirmed in an Authenticated Record if requested by Wells Fargo. Each conversion to a LIBOR Advance shall be in multiples of \$500,000 and in the minimum amount of at least \$500,000.

(iii) Expiring LIBOR Advance Interest Periods. Unless Company requests a new LIBOR Advance, or prepays an outstanding LIBOR Advance at the expiration of an Interest Period, Wells Fargo shall convert each LIBOR Advance to a Floating Rate Advance on the last day of the expiring Interest Period. If no Default Period is in effect, Company may request that all or part of any expiring LIBOR Advance be renewed as a new LIBOR Advance, provided that Wells Fargo receives the request no later than 9:00 a.m. Pasadena, California Time three (3) Business Days prior to the Business Day that constitutes the first day of the new Interest Period. Each request shall specify the principal amount of the expiring LIBOR Advance to be continued and Interest Period desired, and shall be confirmed in an Authenticated Record if requested by Wells Fargo. Each renewal of a LIBOR Advance shall be in multiples of \$500,000 and in the minimum amount of at least \$500,000.

(iv) Quotation of LIBOR Advance Interest Rates. Wells Fargo shall, with respect to any request for a new or renewal LIBOR Advance, or the conversion of a Floating Rate Advance to a LIBOR Advance, provide Company with a LIBOR quote for each Interest Period identified by Company on the Business Day on which the request was made, if the request is received by Wells Fargo no later than 9:00 a.m. Pasadena, California Time three (3) Business Days prior to the Business Day on which Company has requested that the LIBOR Advance be made effective. If Company does not immediately accept a LIBOR quote, the quoted rate shall expire and any subsequent request for a LIBOR quote shall be subject to redetermination by Wells Fargo.

(v) Taxes and Regulatory Costs. Company shall also pay Wells Fargo with respect to any LIBOR Advance all (i) withholdings, interest equalization taxes, stamp taxes or other taxes (except income and franchise taxes) imposed by any domestic or foreign governmental authority that are related to LIBOR, and (ii) future, supplemental, emergency or other changes in the LIBOR Reserve Percentage, the assessment rates imposed by the Federal Deposit Insurance Corporation, or similar costs imposed by any domestic or foreign governmental authority or resulting from compliance by Wells Fargo with any request or directive (whether or not having the force of law) from any central bank or other governmental authority that are related to LIBOR but not otherwise included in the calculation of LIBOR. In determining which of these amounts are attributable to an existing LIBOR Advance, any reasonable allocation made by Wells Fargo among its operations shall be deemed conclusive and binding.

#### **1.4 Collection of Accounts and Application to Revolving Notes.**

(a) The Collection Account. Company has granted a security interest to Wells Fargo in the Collateral, including all Accounts. Except as otherwise agreed by both parties in an Authenticated Record, all Proceeds of Accounts and other Collateral, upon receipt or collection, shall be deposited each Business Day into the Collection Account. Funds so deposited ("Account Funds") are the property of Wells Fargo, and may only be withdrawn from the Collection

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Account by Wells Fargo for application in accordance with Section 1.4(c) or as otherwise provided in the Loan Documents or by applicable law.

(b) Payment of Accounts by Company's Account Debtors. Company shall instruct all account debtors to make payments either directly to the Lockbox for deposit by Wells Fargo directly to the Collection Account, or instruct them to deliver such payments to Wells Fargo by wire transfer, ACH, or other means as Wells Fargo may direct for deposit to the Collection Account or for direct application to the Line of Credit. If Company receives a payment or the Proceeds of Collateral directly, Company will promptly deposit the payment or Proceeds into the Collection Account. Until deposited, it will hold all such payments and Proceeds in trust for Wells Fargo without commingling with other funds or property. All deposits held in the Collection Account shall constitute Proceeds of Collateral and

shall not constitute the payment of Indebtedness.

(c) Application of Payments to Revolving Notes. Wells Fargo will withdraw Account Funds deposited to the Collection Account and pay down borrowings on the Line of Credit by applying them to the Revolving Notes on a pro rata basis on the first Business Day following the Business Day of deposit to the Collection Account, or, if payments are received by Wells Fargo that are not first deposited to the Collection Account pursuant to any treasury management service provided to Company by Wells Fargo, such payments shall be applied to the Revolving Notes as provided in the Master Agreement for Treasury Management Services and the relevant service description.

## 1.5 Interest and Interest Related Matters.

(a) Interest Rates Applicable to Line of Credit. Except as otherwise provided in this Agreement, the unpaid principal amount of each Line of Credit Advance evidenced by the Revolving Notes shall accrue interest at an annual interest rate calculated as follows:

The "Floating Rate" for Line of Credit Advances = the greater of (i) the Prime Rate plus the applicable Margin, or (ii) five percent (5.0%), plus the applicable Margin, which interest rate shall change whenever the Prime Rate changes, subject to the minimum interest rate floor;

Or

LIBOR Advance Rate pricing for one, three, or six month fixed rate Interest Periods; the "LIBOR Advance Rate" for Line of Credit Advances = LIBOR applicable to the selected Interest Period plus the applicable Margin;

Multiple Advances under the Line of Credit may simultaneously accrue interest at both the Floating Rate and at the LIBOR Advance Rate, subject to the limitations of Section 1.3(a)(i)

If Borrower's Net Income for the most recently completed fiscal year is less than \$1.00 for such year, the Margins for the immediately succeeding fiscal year shall be two and one-half percent (2.5%) per annum for Floating Rate Advances, and three and one-half percent (3.5%) per annum

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for LIBOR Advances. If Borrower's Net Income for the most recently completed fiscal year equals or exceeds \$1.00 for such year, the Margins for the immediately succeeding fiscal year shall be two percent (2.0%) per annum for Floating Rate Advances, and three percent (3.0%) per annum for LIBOR Advances.

Each Margin change shall become effective on the first calendar day of the month following the month of receipt by Wells Fargo of the audited annual financial statements. If Company fails to timely deliver audited annual financial statements as agreed, the Margins shall be at the highest level set forth above and Wells Fargo may notify Company that an Event of Default has occurred and impose the Default Rate.

If amended or restated financial statements would change previously calculated Margins, or if Wells Fargo determines that any financial statements have materially misstated Company's financial condition, then Wells Fargo may, using the most accurate information available to it, recalculate the financial test or tests governing the Margins and retroactively reduce or increase the Margins from the date of receipt of such amended or restated financial statements and charge Company additional interest (such that Wells Fargo receives the interest that it should have received under this Agreement if the Company's financial condition had been properly reported), which may be imposed on them from the beginning of the appropriate month to which the previous change has been made or to the beginning of the month in which any Event of Default has occurred, as Wells Fargo in its sole discretion deems appropriate.

(b) Minimum Interest Charge. [Intentionally Omitted].

(c) Default Interest Rate. Commencing on the day an Event of Default occurs, through and including the date identified by Wells Fargo in a Record as the date that the Event of Default has been cured or waived (each such period a "Default Period"), or during a time period specified in Section 1.8, or at any time following the Termination Date, in Wells Fargo's sole discretion and without waiving any of its other rights or remedies, the principal amount of the Revolving Notes shall bear interest at a rate that is three percent (3.0%) above the contractual rate set forth in Section 1.5(a) (the "Default Rate"), or any lesser rate that Wells Fargo may deem appropriate, starting on the first day of the month in which the Default Period begins through the last day of that Default Period, or any shorter time period to which Wells Fargo may agree in an Authenticated Record.

(d) Interest Accrual on Payments Applied to Revolving Notes. Payments received by Wells Fargo shall be applied to the Revolving Notes as provided in Section 1.4(c), but the principal amount paid down shall continue to accrue interest through the end of the first Business Day following the Business Day that the payment was applied to the Revolving Notes.

(e) Usury. No interest rate shall be effective which would result in a rate greater than the highest rate permitted by law. Payments in the nature of interest and other charges made under any Loan Documents or any other document or agreement described in or related to this Agreement that are later determined to be in excess of the limits imposed by applicable usury law will be deemed to be a payment of principal, and the Indebtedness shall be reduced by that amount so that such payments will not be deemed usurious.

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## 1.6 Fees.

- (a) Origination Fee. [Intentionally Omitted].
- (b) Unused Line Fee. [Intentionally Omitted].
- (c) Facility Fees. On each anniversary date of this Agreement of this Agreement, Company shall pay Wells Fargo a facility fee equal to 1.5% of the Maximum Line Amount, which fee when paid shall be deemed fully earned and non-refundable as of each such anniversary date under all circumstances.
- (d) Collateral Exam Fees. Company shall pay Wells Fargo fees in connection with any collateral exams, audits or inspections conducted by or on behalf of Wells Fargo at the current rates established from time to time by Wells Fargo as its collateral exam fees (which fees are currently \$125.00 per hour per collateral examiner), together with all actual out-of-pocket costs and expenses incurred in conducting any collateral examination or inspection.
- (e) Collateral Monitoring Fees. Company shall pay Wells Fargo a fee rates established from time to time by Wells Fargo as its Collateral monitoring fees (which fees include an initial fee of \$2,000 and monthly fees which are currently \$600 per month), due and payable monthly in advance on the first day of the month and on the Termination Date.
- (f) Line of Credit Termination and/or Reduction Fees. [Intentionally Omitted].
- (g) Overadvance Fees. Company shall pay a \$500 Overadvance fee for each day that an Overadvance exists which was not agreed to by Wells Fargo in an Authenticated Record prior to its occurrence; provided that Wells Fargo's acceptance of the payment of such fees shall not constitute either consent to the Overadvance or waiver of the resulting Event of Default. Company shall pay additional Overadvance fees and interest in such amounts and on such terms as Wells Fargo in its sole discretion may consider appropriate for any Overadvance to which Wells Fargo has specifically consented in an Authenticated Record prior to its occurrence.
- (h) Treasury Management Fees. Company will pay service fees to Wells Fargo for treasury management services provided pursuant to the Master Agreement for Treasury Management Services or any other agreement entered into by the parties, in the amount prescribed in Wells Fargo's current service fee schedule.
- (i) Other Fees and Charges. Wells Fargo may impose additional fees and charges during a Default Period for (i) waiving an Event of Default, or (ii) the administration of Collateral by Wells Fargo. All such fees and charges shall be imposed at Wells Fargo's sole discretion following oral notice to Company on either an hourly, periodic, or flat fee basis, and in lieu of or in addition to imposing interest at the Default Rate, and Company's request for an Advance following such notice shall constitute Company's agreement to pay such fees and charges.
- (j) LIBOR Advance Breakage Fees. Company may prepay any LIBOR Advance at any time in any amount, whether voluntarily or by acceleration; provided, however,

that if the LIBOR Advance is prepaid, Company shall pay Wells Fargo upon demand a LIBOR Advance breakage fee equal to the sum of the discounted monthly differences for each month from the month of prepayment through the month in which such Interest Period matures, calculated as follows for each such month:

- (i) Determine the amount of interest which would have accrued each month on the amount prepaid at the interest rate applicable to such amount had it remained outstanding until the last day of the applicable Interest Period.
- (ii) Subtract from the amount determined in (i) above the amount of interest which would have accrued for the same month on the amount prepaid for the remaining term of such Interest Period at LIBOR in effect on the date of prepayment for new loans made for such term in a principal amount equal to the amount prepaid.
- (iii) If the result obtained in (ii) for any month is greater than zero, discount that difference by LIBOR used in (ii) above.

Company acknowledges that prepayment of the Revolving Notes may result in Wells Fargo incurring additional costs, expenses or liabilities, and that it is difficult to ascertain the full extent of such costs, expenses or liabilities. Company agrees to pay the above-described LIBOR Advance breakage fee and agrees that this amount represents a reasonable estimate of the LIBOR Advance breakage costs, expenses and/or liabilities of Wells Fargo.

## 1.7 Interest Accrual; Principal and Interest Payments; Computation.

- (a) Interest Payments and Interest Accrual. Accrued and unpaid interest under the Revolving Notes on Floating Rate Advances shall be due and payable on the first day of each month (each an "Interest Payment Date") and on the Termination Date, and shall be paid in the manner provided in Section 1.4(c). Interest shall accrue from the most recent date to which interest has been paid or, if no interest has been paid, from the date of Advance to the Interest Payment Date. Interest accruing on any LIBOR Advance shall be due and payable on the last day of the applicable Interest Period and on the Termination Date; provided, however, for Interest Periods in excess of one month, interest shall nevertheless be due and payable monthly on the last day of each month, and on the last day of the Interest Period.

(b) Payment of Revolving Notes Principal. The principal amount of the Revolving Notes shall be paid from time to time as provided in this Agreement, and shall be fully due and payable on the Termination Date.

(c) Payments Due on Non-Business Days. If an Interest Payment Date or the Termination Date falls on a day which is not a Business Day, payment shall be made on the next Business Day, and interest shall continue to accrue during that time period.

(d) Computation of Interest and Fees. Interest accruing on the unpaid principal amount of the Revolving Notes and fees payable under this Agreement shall be computed on the basis of the actual number of days elapsed in a year of 360 days.

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(e) Liability Records. Wells Fargo shall maintain accounting and bookkeeping records of all Advances and payments under the Line of Credit and all other Indebtedness due to Wells Fargo in such form and content as Wells Fargo in its sole discretion deems appropriate. Wells Fargo's calculation of current Indebtedness shall be presumed correct unless proven otherwise by Company. Upon Wells Fargo's request, Company will admit and certify in a Record the exact principal balance of the Indebtedness that Company then believes to be outstanding. Any billing statement or accounting provided by Wells Fargo shall be conclusive and binding unless Company notifies Wells Fargo in a detailed Record of its intention to dispute the billing statement or accounting within 30 days of receipt.

(f) Pro Rata Application. All payments or other sums received by Wells Fargo and applied to the Revolving Notes shall be applied on a pro rata basis.

### **1.8 Termination, Reduction or Non-Renewal of Line of Credit by Company; Notice.**

(a) Termination or Reduction by Company after Advance Notice. Company may terminate or reduce the Line of Credit at any time prior to the Maturity Date, if it (i) delivers an Authenticated Record notifying Wells Fargo of its intentions at least sixty (60) days prior to the proposed Termination Date, (ii) pays Wells Fargo the termination or reduction fee set forth in Section 1.6(f), and (iii) pays the Indebtedness in full or down to the reduced Maximum Line Amount. Any reduction in the Maximum Line Amount shall be in multiples of \$500,000, with a minimum reduction of at least \$500,000.

(b) Termination or Reduction by Company without Advance Notice. If Company fails to deliver Wells Fargo timely notice of its intention to terminate the Line of Credit or reduce the Maximum Line Amount as provided in Section 1.8(a), Company may nevertheless terminate the Line of Credit or reduce the Maximum Line Amount and pay the Indebtedness in full or down to the reduced Maximum Line Amount if it pays additional interest for each day that the notice was short of the required sixty (60) days notice, which interest shall be in an amount that is equal to the interest calculated at the Default Rate based on the Borrower's average borrowings under the Line of Credit for the two months prior to the date that Wells Fargo receives delivery of an Authenticated Record giving it actual notice of Company's intention to terminate or reduce the Line of Credit.

(c) Non-Renewal by Company; Notice. If Company does not wish Wells Fargo to consider renewal of the Line of Credit on the next Maturity Date, Company shall deliver an Authenticated Record to Wells Fargo at least sixty (60) days prior to the Maturity Date notifying Wells Fargo of its intention not to renew. If Company fails to deliver to Wells Fargo such timely notice, then the Revolving Note shall accrue interest at the Default Rate commencing on the sixtieth (60<sup>th</sup>) day prior to the Maturity Date and continuing through the date that Wells Fargo receives delivery of an Authenticated Record giving it actual notice of Company's intention not to renew.

**1.9 Facility Subject to Ex-Im Bank Rules.** Company acknowledges that Wells Fargo is willing to make the Ex-Im Subfacility available to Company because the Ex-Im Bank is willing to guaranty payment of a significant portion of the Indebtedness pursuant to the Master

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Guarantee Agreement (as defined in the Borrower Agreement). Accordingly, in the event of any inconsistency between this Agreement and the Master Guarantee Agreement or the Borrower Agreement, the provision that is the more stringent on Company shall control with respect to Advances under this Agreement and procedures related thereto. This Agreement is supplemental to the Borrower Agreement.

## **2. SECURITY INTEREST AND OCCUPANCY OF COMPANY'S PREMISES**

**2.1 Grant of Security Interest.** Company hereby pledges, assigns and grants to Wells Fargo, for the benefit of Wells Fargo and as agent for Wells Fargo Merchant Services, L.L.C., a Lien and security interest (collectively referred to as the "Security Interest") in the Collateral, as security for the payment and performance of all Indebtedness. Following request by Wells Fargo, Company shall grant Wells Fargo, for the benefit of Wells Fargo and as agent for Wells Fargo Merchant Services, L.L.C., a Lien and security interest in all commercial tort claims that it may have against any Person.

**2.2 Notifying Account Debtors and Other Obligors; Collection of Collateral.** Wells Fargo may at any time (whether or not a Default Period then exists) deliver a Record giving an account debtor or other Person obligated to pay an Account, a General Intangible, or other amount due, notice that the Account, General Intangible, or other amount due has been assigned to Wells Fargo for security and must be paid directly to Wells Fargo. Company shall join in giving such notice and shall Authenticate any Record giving such

notice upon Wells Fargo's request. After Company or Wells Fargo gives such notice, Wells Fargo may, but need not, in Wells Fargo's or in Company's name, demand, sue for, collect or receive any money or property at any time payable or receivable on account of, or securing, such Account, General Intangible, or other amount due, or grant any extension to, make any compromise or settlement with or otherwise agree to waive, modify, amend or change the obligations (including collateral obligations) of any account debtor or other obligor. Wells Fargo may, in Wells Fargo's name or in Company's name, as Company's agent and attorney-in-fact, notify the United States Postal Service to change the address for delivery of Company's mail to any address designated by Wells Fargo, otherwise intercept Company's mail, and receive, open and dispose of Company's mail, applying all Collateral as permitted under this Agreement and holding all other mail for Company's account or forwarding such mail to Company's last known address.

**2.3 Assignment of Insurance.** As additional security for the Indebtedness, Company hereby assigns to Wells Fargo and to Wells Fargo Merchant Services, L.L.C., all rights of Company under every policy of insurance covering the Collateral and all business records and other documents relating to it, and all monies (including proceeds and refunds) that may be payable under any policy, and Company hereby directs the issuer of each policy to pay all such monies directly to Wells Fargo. At any time, whether or not a Default Period then exists, Wells Fargo may (but need not), in Wells Fargo's or Company's name, execute and deliver proofs of claim, receive payment of proceeds and endorse checks and other instruments representing payment of the policy of insurance, and adjust, litigate, compromise or release claims against the issuer of any policy. Any monies received under any insurance policy assigned to Wells Fargo, other than liability insurance policies, or received as payment of any award or compensation for condemnation or taking by eminent domain, shall be paid to Wells Fargo and, as determined by Wells Fargo in its sole discretion, either be applied to prepayment of the Indebtedness or

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disbursed to Company under staged payment terms reasonably satisfactory to Wells Fargo for application to the cost of repairs, replacements, or restorations which shall be effected with reasonable promptness and shall be of a value at least equal to the value of the items or property destroyed.

#### **2.4 Company's Premises.**

(a) Wells Fargo's Right to Occupy Company's Premises. Company hereby grants to Wells Fargo the right, at any time during a Default Period and without notice or consent, to take exclusive possession of all locations where Company conducts its business or has any rights of possession, including the locations described on Exhibit B (the "Premises"), until the earlier of (i) payment in full and discharge of all Indebtedness and termination of the Line of Credit, or (ii) final sale or disposition of all items constituting Collateral and delivery of those items to purchasers.

(b) Wells Fargo's Use of Company's Premises. Wells Fargo may use the Premises to store, process, manufacture, sell, use, and liquidate or otherwise dispose of items that are Collateral, and for any other incidental purposes deemed appropriate by Wells Fargo in good faith.

(c) Company's Obligation to Reimburse Wells Fargo. Wells Fargo shall not be obligated to pay the Company rent or other compensation for the possession or use of any Premises, but if Wells Fargo elects to pay rent or other compensation to the owner of any Premises in order to have access to the Premises, then Company shall promptly reimburse Wells Fargo all such amounts, as well as all taxes, fees, charges and other expenses at any time payable by Wells Fargo with respect to the Premises by reason of the execution, delivery, recordation, performance or enforcement of any terms of this Agreement.

**2.5 License.** Without limiting the generality of any other Security Document, Company hereby grants to Wells Fargo a non-exclusive, worldwide and royalty-free license to use or otherwise exploit all Intellectual Property Rights of Company for the purpose of: (a) completing the manufacture of any in-process materials during any Default Period so that such materials become saleable Inventory, all in accordance with the same quality standards previously adopted by Company for its own manufacturing and subject to Company's reasonable exercise of quality control; and (b) selling, leasing or otherwise disposing of any or all Collateral during any Default Period.

#### **2.6 Financing Statements.**

(a) Authorization to File. Company authorizes Wells Fargo to file financing statements describing Collateral to perfect Wells Fargo's Security Interest in the Collateral, and Wells Fargo may describe the Collateral as "all personal property" or "all assets" or describe specific items of Collateral including commercial tort claims as Wells Fargo may consider necessary or useful to perfect the Security Interest. All financing statements filed before the date of this Agreement to perfect the Security Interest were authorized by Company and are hereby re-authorized. Following the termination of the Line of Credit and payment of all Indebtedness,

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Wells Fargo shall, at Company's expense and within the time periods required under applicable law, release or terminate any filings or other agreements that perfect the Security Interest.

(b) Termination. Wells Fargo shall, at Company's expense, release or terminate any filings or other agreements that perfect the Security Interest, provided that there are no suits, actions, proceedings or claims pending or threatened against any Indemnitee under this Agreement with respect to any Indemnified Liabilities, upon Wells Fargo's receipt of the following, in form and content satisfactory to Wells Fargo: (i) cash payment in full of all Indebtedness and a completed performance by Company with respect to its other obligations under this Agreement, (ii) evidence that the commitment of Wells Fargo to make Advances under the Line of Credit or under any

other facility with Company has been terminated, (iii) a release of all claims against Wells Fargo by Company relating to Wells Fargo's performance and obligations under the Loan Documents, and (iv) an agreement by Company, any Guarantor, and any new lender to Company to indemnify Wells Fargo for any payments received by Wells Fargo that are applied to the Indebtedness as a final payoff that may subsequently be returned or otherwise not paid for any reason.

**2.7 Setoff.** Wells Fargo may at any time, in its sole discretion and without demand or notice to anyone, setoff any liability owed to Company by Wells Fargo against any Indebtedness, whether or not due.

**2.8 Collateral Related Matters.** This Agreement does not contemplate a sale of Accounts or chattel paper, and, as provided by law, Company is entitled to any surplus and shall remain liable for any deficiency. Wells Fargo's duty of care with respect to Collateral in its possession (as imposed by law) will be deemed fulfilled if it exercises reasonable care in physically keeping such Collateral, or in the case of Collateral in the custody or possession of a bailee or other third Person, exercises reasonable care in the selection of the bailee or third Person, and Wells Fargo need not otherwise preserve, protect, insure or care for such Collateral. Wells Fargo shall not be obligated to preserve rights Company may have against prior parties, to liquidate the Collateral at all or in any particular manner or order or apply the Proceeds of the Collateral in any particular order of application. Wells Fargo has no obligation to clean-up or prepare Collateral for sale. Company waives any right it may have to require Wells Fargo to pursue any third Person for any of the Indebtedness.

**2.9 Notices Regarding Disposition of Collateral.** If notice to Company of any intended disposition of Collateral or any other intended action is required by applicable law in a particular situation, such notice will be deemed commercially reasonable if given in the manner specified in Section 7.4 at least ten calendar days before the date of intended disposition or other action.

### 3. CONDITIONS PRECEDENT

**3.1 Conditions Precedent to Initial Advance.** Wells Fargo's obligation to make the initial Advance shall be subject to the condition that Wells Fargo shall have received this Agreement and each of the Loan Documents, and any document, agreement, or other item described in or related to this Agreement, and all fees and information described in Exhibit C, executed and in form and content satisfactory to Wells Fargo.

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**3.2 Additional Conditions Precedent to All Advances.** Wells Fargo's obligation to make any Advance (including the initial Advance) shall be subject to the further additional conditions: (a) that the representations and warranties described in Exhibit D are correct on the date of the Advance, except to the extent that such representations and warranties relate solely to an earlier date; and (b) that no event has occurred and is continuing, or would result from the requested Advance that would result in an Event of Default.

### 4. REPRESENTATIONS AND WARRANTIES

To induce Wells Fargo to enter into this Agreement, Company makes the representations and warranties described in Exhibit D. Any request for an Advance will be deemed a representation by Company that all representations and warranties described in Exhibit D are true, correct, and complete as of the time of the request, unless they relate exclusively to an earlier date. Company shall promptly deliver a Record notifying Wells Fargo of any change in circumstance that would affect the accuracy of any representation or warranty, unless the representation and warranty specifically relates to an earlier date.

### 5. COVENANTS

So long as the Indebtedness remains unpaid, or the Line of Credit has not been terminated, Company shall comply with each of the following covenants, unless Wells Fargo shall consent otherwise in an Authenticated Record delivered to Company.

**5.1 Reporting Requirements.** Company shall deliver to Wells Fargo the following information, compiled where applicable using GAAP consistently applied, in form and content acceptable to Wells Fargo:

(a) Annual Financial Statements. As soon as available and in any event within ninety (90) days after Company's fiscal year end, Company's audited financial statements prepared by an independent certified public accountant acceptable to Wells Fargo, which shall include Company's balance sheet, income statement, and statement of retained earnings and cash flows prepared, if requested by Wells Fargo, on a consolidated and consolidating basis to include Company's Subsidiaries. The annual financial statements shall be accompanied by a certificate (the "Compliance Certificate") in the form of Exhibit E that is signed by Company's chief financial officer. Each Compliance Certificate that accompanies an annual financial statement shall also be accompanied by (i) copies of all management letters prepared by Company's accountants; and (ii) a report signed by the accountant stating that in making the investigations necessary to render the opinion, the accountant obtained no knowledge, except as specifically stated, of any Event of Default under the Agreement, and a detailed statement, including computations, demonstrating whether or not Company is in compliance with the financial covenants of this Agreement.

(b) 10-Q Financial Reports. As soon as available and in any event within forty-five (45) days after the end of each fiscal quarter of Company, Company's 10-Q financial reports filed with the Securities and Exchange Commission. This requirement may be satisfied by Company by posting a link to the filing on the Company's publicly-accessible website.

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(c) Monthly Financial Statements. As soon as available and in any event within thirty (30) days after the end of each month, a Company prepared balance sheet, income statement, and statement of retained earnings prepared for that month and for the year-to-date period then ended, prepared, if requested by Wells Fargo, on a consolidated and consolidating basis to include Company's Subsidiaries, and stating in comparative form the figures for the corresponding date and periods in the prior fiscal year, subject to year-end adjustments. The financial statements shall be accompanied by a Compliance Certificate in the form of Exhibit E that is signed by Company's chief financial officer.

(d) Collateral Reports. No later than 20 days after each month end (or more frequently if Wells Fargo shall request it), (i) detailed agings of Company's accounts receivable and accounts payable, an accounts receivable reconciliation report and a calculation of Company's Accounts, including an accounts receivable ineligibility report, Eligible Accounts, Inventory and Eligible Inventory as of the end of that month or shorter time period requested by Wells Fargo, and (ii) Company shall deliver to Wells Fargo a current Borrowing Base Certificate for Ex-Im Bank Guaranteed Line, the form of which is attached hereto as Exhibit G.

(e) Projections. No later than sixty (60) days prior to each fiscal year end, Company's projected balance sheet and income statement and statement of retained earnings and cash flows for each month of the next fiscal year, certified as accurate by Company's chief financial officer and accompanied by a statement of assumptions and supporting schedules and information. Wells Fargo acknowledges that such projections are estimates only and not promises of performance.

(f) Supplemental Reports. Weekly, or more frequently if Wells Fargo requests, Wells Fargo's standard form of "daily collateral report", together with receivables schedules, collection reports, credit memos, sales reports, adjustments to accounts receivable and copies of invoices in excess of \$100,000, shipment documents and delivery receipts for goods sold to account debtors in excess of \$100,000.

(g) Customer Lists. On January 1 and July 1 of each calendar year, an updated customer listing (with contact names and addresses).

(h) Litigation. No later than three (3) Business Days after discovery, a Record notifying Wells Fargo of any litigation or other proceeding before any court or governmental agency which seeks a monetary recovery against Company in excess of \$100,000.

(i) Intellectual Property. (i) No later than 30 Business Days after it acquires material Intellectual Property Rights, a Record notifying Wells Fargo of Company's acquisition of such rights; (ii) except for transfers permitted under Section 5.17, no later than 15 Business Days before it disposes of material Intellectual Property Rights, a Record notifying Wells Fargo of Company's intention to dispose of such rights, along with copies of all proposed documents and agreements concerning the disposal of such rights as requested by Wells Fargo; (iii) promptly upon discovery, a Record notifying Wells Fargo of (A) any Infringement of Company's Intellectual Property Rights by any Person, (B) claims that Company is Infringing another Person's Intellectual Property Rights and (C) any threatened cancellation, termination or

material limitation of Company's Intellectual Property Rights; and (iv) promptly upon receipt, copies of all registrations and filings with respect to Company's Intellectual Property Rights.

(j) Defaults. No later than three days after learning of the probable occurrence of any Event of Default, a Record notifying Wells Fargo of the Event of Default and the steps being taken by Company to cure the Event of Default.

(k) Disputes. Promptly upon discovery, a Record notifying Wells Fargo of (i) any disputes or claims by Company's customers exceeding \$20,000 individually or \$75,000 in the aggregate during any fiscal year; (ii) credit memos not previously reported in Section 5.1(f); and (iii) any goods returned to or recovered by Company outside of the ordinary course of business or in the ordinary course of business but with a value in an amount in excess of \$50,000.

(l) Changes in Officers and Directors. Promptly following occurrence, a Record notifying Wells Fargo of any change in the persons constituting Company's Officers and Directors.

(m) Collateral. Promptly upon discovery, a Record notifying Wells Fargo of any loss of or material damage to any Collateral having a fair market value, individually or in the aggregate, of \$50,000 or more, or of any substantial adverse change in (i) any Collateral having a fair market value, individually or in the aggregate, of \$50,000 or more, or (ii) the prospect of such Collateral's payment.

(n) Commercial Tort Claims. Promptly upon discovery, a Record notifying Wells Fargo of any commercial tort claims in excess of \$50,000 individually or \$100,000 in the aggregate brought by Company against any Person, including the name and address of each defendant, a summary of the facts, an estimate of Company's damages, copies of any complaint or demand letter submitted by Company, and such other information as Wells Fargo may reasonably request.

(o) Reports to Owners. Promptly upon distribution, copies of all financial statements, reports and proxy statements which Company shall have sent to its Owners. This requirement may be satisfied by Company by posting a link to the filings attaching such documents on the Company's publicly-accessible website.

(p) Tax Returns of Company. No later than 15 Business Days after they are required to be filed, copies of Company's signed and dated state and federal income tax returns and all related schedules, and copies of any extension requests.

(q) Violations of Law. No later than three (3) Business Days after discovery of any violation, a Record notifying Wells Fargo of Company's violation of any law, rule or regulation, the non-compliance with which could have a Material Adverse Effect on Company.

(r) Pension Plans. (i) Promptly upon discovery, and in any event within 30 days after Company knows or has reason to know that any Reportable Event with respect to any Pension Plan has occurred, a Record authenticated by Company's chief financial officer notifying Wells Fargo of the Reportable Event in detail and the actions which Company proposes

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to take to correct the deficiency, together with a copy of any related notice sent to the Pension Benefit Guaranty Corporation; (ii) promptly upon discovery, and in any event within 10 days after Company fails to make a required quarterly Pension Plan contribution under Section 412(m) of the IRC, a Record authenticated by Company's chief financial officer notifying Wells Fargo of the failure in detail and the actions that Company will take to cure the failure, together with a copy of any related notice sent to the Pension Benefit Guaranty Corporation; and (iii) promptly upon discovery, and in any event within 10 days after Company knows or has reason to know that it may be liable or may be reasonably expected to have liability for any withdrawal, partial withdrawal, reorganization or other event under any Multiemployer Plan under Sections 4201 or 4243 of ERISA, a Record authenticated by Company's chief financial officer notifying Wells Fargo of the details of the event and the actions that Company proposes to take in response.

(s) Other Reports. From time to time, with reasonable promptness, all customer lists, receivables schedules, inventory reports, collection reports, deposit records, equipment schedules, invoices to account debtors, shipment documents and delivery receipts for goods sold, and such other materials, reports, records or information as Wells Fargo may request.

**5.2 Financial Covenants.** Company agrees to comply with the financial covenants described below, which shall be calculated using GAAP consistently applied, except as they may be otherwise modified by the following capitalized definitions:

(a) Minimum Book Net Worth. Company shall maintain a Book Net Worth, determined as of the following test dates, in an amount not less than the amount set forth for each such test date (numbers appearing between "< >" are negative):

Test Date	Minimum Book Net Worth
December 31, 2008	\$ 61,000,000
January 31, 2009	\$ 57,000,000
February 28, 2009	\$ 52,700,000
March 31, 2009	\$ 51,000,000
April 30, 2009	\$ 48,150,000
May 31, 2009	\$ 45,300,000
June 30, 2009	\$ 46,000,000
July 31, 2009	\$ 43,900,000
August 31, 2009	\$ 41,300,000
September 30, 2009	\$ 44,450,000
October 31, 2009	\$ 42,100,000
November 30, 2009	\$ 39,850,000
December 31, 2009	\$ 44,600,000
January 31, 2010	\$ 42,250,000
February 28, 2010	\$ 40,000,000
March 31, 2010	\$ 45,150,000

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(b) Minimum Net Income. Company shall achieve Net Income, measured on each of the following test dates described below, for the quarter period ending on each such test date, Net Income of not less than the amount set forth opposite each such test date (numbers appearing between "< >" are negative):

Test Date	Minimum Net Income
December 31, 2008	\$ <10,800,000>
March 31, 2009	\$ <11,000,000>
June 30, 2009	\$ <5,750,000>
September 30, 2009	\$ <3,200,000>
December 31, 2009	\$ <1,000,000>
March 31, 2010	\$ <500,000>

(c) Minimum Cash to Unreimbursed Line of Credit Advances Coverage Ratio. At all times, the sum of the outstanding "Advances" plus the "L/C Amount" under the Domestic Facility Agreement plus the outstanding "Advances" under the Revolving Notes shall not exceed eighty percent (80%) of cash and Cash Equivalents of Company in which Wells Fargo has a perfected first priority security interest. Compliance with the foregoing covenant shall be reported as Wells Fargo shall request from time to time in its sole discretion.

(d) Capital Expenditures. Company shall not incur or contract to incur Capital Expenditures of more than

(i) \$7,500,000 in the aggregate during Company's fiscal year ending March 31, 2009, (ii) \$10,000,000 in the aggregate during Company's fiscal year ending March 31, 2010, and (iii) zero for each subsequent year until Company and Wells Fargo agree on limits on Capital Expenditures for subsequent periods based on Company's projections for such periods.

### 5.3 Other Liens and Permitted Liens.

(a) Other Liens; Permitted Liens. Company shall not create, incur or suffer to exist any Lien upon any of its assets, now owned or later acquired, as security for any indebtedness, with the exception of the following (each a "Permitted Lien"; collectively, "Permitted Liens"): (i) In the case of real property, covenants, restrictions, rights, easements and minor irregularities in title which do not materially interfere with Company's business or operations as presently conducted; (ii) Liens in existence on the date of this Agreement that are described in Exhibit F and secure indebtedness for borrowed money permitted under Section 5.3(b) (iii) The Security Interest and Liens created by the Security Documents; (iv) Purchase money Liens relating to the acquisition of Equipment not exceeding the lesser of cost or fair market value, not exceeding \$3,000,000 for any one purchase or \$7,000,000 in the aggregate during the fiscal year ending March 31, 2009, and \$10,000,000 in the aggregate during the fiscal year ending March 31, 2010, and so long as no Default Period is then in existence and none would exist because of any such acquisition; (v) liens for taxes not yet due or that are being contested in good faith by appropriate proceedings, provided that adequate reserves with respect thereto are maintained on the books of the Company, in conformity with GAAP; (vi) carriers', warehousemen's, mechanics', materialmen's, repairmen's or other like liens arising in the ordinary course of business that are being contested in good faith by appropriate proceedings;

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(vii) pledges or deposits in connection with workers' compensation, unemployment insurance and other social security legislation; (viii) deposits to secure the performance of bids, trade contracts (other than for borrowed money), leases, statutory obligations, surety and appeal bonds, performance bonds and other obligations of a like nature incurred in the ordinary course of business; (ix) liens securing Indebtedness of Company incurred to finance capital expenditures otherwise permitted hereunder (and, without limitation, subject to Section 5.2(d) of this Agreement), provided that (a) such liens shall be created concurrently or within 90 Business Days after the acquisition of the property being financed, (b) such liens do not at any time encumber any property other than the property financed by such Indebtedness, and (c) Indebtedness secured by such liens does not cause or result in an Event of Default; (x) any interest or title of a lessor under any lease entered into by the Company or any other Subsidiary in the ordinary course of its business and covering only the assets so leased; and (xi) liens that are junior in priority to Wells Fargo's liens on the Collateral that arise from judgments and attachments in connection with court proceedings provided that the attachment or enforcement of such liens would not result in an Event of Default hereunder and such liens are being contested in good faith by appropriate proceedings, adequate reserves have been set aside and no material Collateral is subject to a material risk of loss or forfeiture and the claims in respect of such liens are fully covered by insurance (subject to ordinary and customary deductibles) and a stay of execution pending appeal or proceeding for review is in effect.

(b) Financing Statements. Company shall not authorize the filing of any financing statement by any Person as Secured Party with respect to any of Company's assets, other than (i) filings by Wells Fargo and (ii) filings in connection with Permitted Liens. Company shall not amend any financing statement filed by Wells Fargo as Secured Party except as permitted by law.

**5.4 Indebtedness.** Company shall not incur, create, assume or permit to exist any indebtedness or liability on account of deposits or letters of credit issued on Company's behalf, or advances or any indebtedness for borrowed money of any kind, whether or not evidenced by an instrument, except: (a) Indebtedness described in this Agreement and the Ex-Im Credit Agreement; (b) indebtedness of Company described in Exhibit F, and extensions and refinancings thereof (so long as the principal amount thereof is not increased, the maturity date is not shortened, the average life is not shortened, no additional mandatory prepayments or sinking fund payments are required and the cash payment portion of the interest due on any such Indebtedness is not increased); (c) indebtedness secured by Permitted Liens; (d) Indebtedness constitution guaranties permitted by Section 5.5 hereof; and (e) Indebtedness constituting Subordinated Debt not to exceed \$7,500,000 in the aggregate outstanding at any time.

**5.5 Guaranties.** Company shall not assume, guarantee, endorse or otherwise become directly or contingently liable for the obligations of any Person (collectively, "Guarantee Obligations"), except: (a) the endorsement of negotiable instruments by Company for deposit or collection or similar transactions in the ordinary course of business; (b) guaranties, endorsements and other direct or contingent liabilities in connection with the obligations of other Persons in existence on the date of this Agreement and described in Exhibit E; (c) Guarantee Obligations in respect of performance bonds, surety bonds, appeal bonds or custom bonds required in the ordinary course of business or in connection with the enforcement of rights or claims of Company or in connection with judgments that do not result in an Event of Default; and

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(d) Guarantee Obligations in the form of endorsements in the ordinary course of business of negotiable instruments for deposit or collection.

**5.6 Investments and Subsidiaries.** Company shall not make or permit to exist any loans or advances to, or make any investment or acquire any interest whatsoever in, any Person or Affiliate, including any partnership or joint venture, nor purchase or hold beneficially any stock or other securities or evidence of indebtedness of any Person or Affiliate, except:

(a) Investments in direct obligations of the United States of America or any of its political subdivisions whose obligations constitute the full faith and credit obligations of the United States of America and have a maturity of one year or less, commercial paper issued by U.S. corporations rated "A-1" or "A-2" by Standard & Poor's Ratings Services or "P-1" or "P-2" by Moody's Investors

Service or certificates of deposit or bankers' acceptances having a maturity of one year or less issued by members of the Federal Reserve System having deposits in excess of \$100,000,000 (which certificates of deposit or bankers' acceptances are fully insured by the Federal Deposit Insurance Corporation);

(b) Travel advances or loans to Company's Officers and employees not exceeding at any one time an aggregate of \$25,000;

(c) Prepaid rent not exceeding one month or security deposits; and

(d) Current investments in those Subsidiaries in existence on the date of this Agreement which are identified on Exhibit D.

**5.7 Dividends and Distributions.** Company shall not declare or pay any dividends (other than dividends payable solely in stock of Company) on any class of its stock, or make any payment on account of the purchase, redemption or retirement of any shares of its stock, or other securities or evidence of its indebtedness or make any distribution regarding its stock, either directly or indirectly.

**5.8 Salaries.** [INTENTIONALLY OMITTED].

**5.9 Books and Records; Collateral Examination; Inspection and Appraisals.**

(a) Books and Records; Inspection. Company shall keep complete and accurate books and records with respect to the Collateral and Company's business and financial condition and any other matters that Wells Fargo may reasonably request, in accordance with GAAP. Company shall permit any employee, attorney, accountant or other agent of Wells Fargo to audit, review, make extracts from and copy any of its books and records at any time during ordinary business hours, and to discuss Company's affairs with any of its Directors, Officers, employees, Owners or agents.

(b) Authorization to Company's Agents to Make Disclosures to Wells Fargo. Company authorizes all accountants and other Persons acting as its agent to disclose and deliver to Wells Fargo's employees, accountants, attorneys and other Persons acting as its agent, at Company's expense, all financial information, books and records, work papers, management reports and other information in their possession regarding Company.

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(c) Collateral Exams and Inspections. Company shall permit Wells Fargo's employees, accountants, attorneys or other Persons acting as its agent, to examine and inspect any Collateral or any other property of Company at any time during ordinary business hours.

(d) Collateral Appraisals. Wells Fargo may also obtain, from time to time, at Company's expense, an appraisal of Company's Collateral, by an appraiser acceptable to Wells Fargo in its sole discretion.

**5.10 Account Verification; Payment of Permitted Liens.**

(a) Account Verification. Wells Fargo or its agents may (i) contact account debtors and other obligors at any time to verify Company's Accounts; and (ii) require Company to send requests for verification of Accounts or send notices of assignment of Accounts to account debtors and other obligors.

(b) Covenant to Pay Permitted Liens. Company shall pay when due, subject to applicable cure periods, each account payable due to any Person holding a Permitted Lien (as a result of such payable) on any Collateral.

**5.11 Compliance with Laws.**

(a) General Compliance with Applicable Law; Use of Collateral. Company shall (i) comply, and cause each Subsidiary to comply, with the requirements of applicable laws and regulations, the non-compliance with which would have a Material Adverse Effect on its business or its financial condition and (ii) use and keep the Collateral, and require that others use and keep the Collateral, only for lawful purposes, without violation of any federal, state or local law, statute or ordinance.

(b) Compliance with Federal Regulatory Laws. Company shall (i) prohibit, and cause each Subsidiary to prohibit, any Person that is an Owner or Officer from being listed on the Specially Designated Nationals and Blocked Person List or other similar lists maintained by the Office of Foreign Assets Control ("OFAC"), the Department of the Treasury or included in any Executive Orders, (ii) not permit the proceeds of the Line of Credit or any other financial accommodation extended by Wells Fargo to be used in any way that violates any foreign asset control regulations of OFAC or other applicable law, (iii) comply, and cause each Subsidiary to comply, with all applicable Bank Secrecy Act laws and regulations, as amended from time to time, and (iv) otherwise comply with the USA Patriot Act and Wells Fargo's related policies and procedures.

(c) Compliance with Environmental Laws. Company shall (i) comply, and cause each Subsidiary to comply, with the requirements of applicable Environmental Laws and obtain and comply with all permits, licenses and similar approvals required by them, and (ii) not generate, use, transport, treat, store or dispose of any Hazardous Substances in such a manner as to create any material liability or obligation under the common law of any jurisdiction or any Environmental Law.

**5.12 Payment of Taxes and Other Claims.** Company shall pay or discharge, when due, and cause each Subsidiary to pay or discharge, when due, (a) all taxes, assessments and

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governmental charges levied or imposed upon it or upon its income or profits, upon any properties belonging to it (including the Collateral) or upon or against the creation, perfection or continuance of the Security Interest, prior to the date on which penalties attach, (b) all federal, state and local taxes required to be withheld by it, and (c) all lawful claims for labor, materials and supplies which, if unpaid, might by law become a Lien upon any properties of Company, although Company shall not be required to pay any such tax, assessment, charge or claim whose amount, applicability or validity is being contested in good faith by appropriate proceedings and for which proper reserves have been made.

**5.13 Maintenance of Collateral and Properties.**

(a) Company shall keep and maintain the Collateral and all of its other properties necessary or useful in its business in good condition, repair and working order (normal wear and tear excepted) and will from time to time replace or repair any worn, defective or broken parts, although Company may discontinue the operation and maintenance of any properties if Company believes that such discontinuance is desirable to the conduct of its business and not disadvantageous in any material respect to Wells Fargo. Company shall take all commercially reasonable steps necessary to protect and maintain its Intellectual Property Rights.

(b) Company shall defend the Collateral against all Liens, claims and demands of all third Persons claiming any interest in the Collateral, other than Permitted Liens. Company shall keep all Collateral free and clear of all Liens except Permitted Liens. Company shall take all commercially reasonable steps necessary to prosecute any Person Infringing its Intellectual Property Rights and to defend itself against any Person accusing it of Infringing any Person's Intellectual Property Rights.

**5.14 Insurance.** Company shall at all times maintain insurance with insurers acceptable to Wells Fargo, in such amounts and on such terms (including deductibles) as Wells Fargo in its sole discretion may require and including, as applicable and without limitation, business interruption insurance (including force majeure coverage), hazard coverage on an "all risks" basis for all tangible Collateral, and theft and physical damage coverage for Collateral consisting of motor vehicles. All insurance policies must contain an appropriate lender's interest endorsement or clause, and name Wells Fargo as an additional insured.

**5.15 Preservation of Existence.** Company shall preserve and maintain its existence and all of its rights, privileges and franchises necessary or desirable in the normal conduct of its business and shall conduct its business in an orderly, efficient and regular manner.

**5.16 Delivery of Instruments, etc.** Upon request by Wells Fargo, Company shall promptly deliver to Wells Fargo in pledge all instruments, documents and chattel paper in excess of \$50,000 individually and \$75,000 in the aggregate and constituting Collateral, endorsed or assigned by Company.

**5.17 Sale or Transfer of Assets; Suspension of Business Operations.** Company shall not sell, lease, assign, transfer or otherwise dispose of (a) the stock of any Subsidiary, (b) all or a substantial part of its assets, or (c) any Collateral or any interest in Collateral (whether in one transaction or in a series of transactions) to any other Person other than the sale of

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Inventory in the ordinary course of business, the disposition of Collateral no longer useful in its business, and other Collateral having a fair market value not in excess of \$100,000 in the aggregate for each fiscal year and shall not liquidate, dissolve or suspend business operations. Company shall not transfer any part of its ownership interest in any Intellectual Property Rights and shall not permit its rights as licensee of Licensed Intellectual Property to lapse, except that Company may transfer such rights or permit them to lapse if it has reasonably determined that such Intellectual Property Rights are no longer useful in its business. If Company transfers any Intellectual Property Rights for value, Company shall pay the Proceeds to Wells Fargo for application to the Indebtedness. Company shall not license any other Person to use any of Company's Intellectual Property Rights, except that Company may grant licenses in the ordinary course of its business in connection with sales of Inventory or the provision of services to its customers.

**5.18 Consolidation and Merger; Asset Acquisitions.** Company shall not consolidate with or merge into any other entity, or permit any other entity to merge into it, or acquire (in a transaction analogous in purpose or effect to a consolidation or merger) all or substantially all of the assets of any other entity.

**5.19 Sale and Leaseback.** Company shall not enter into any arrangement, directly or indirectly, with any other Person pursuant to which Company shall sell or transfer any real or personal property, whether owned now or acquired in the future, and then rent or lease all or part of such property or any other property which Company intends to use for substantially the same purpose or purposes as the property being sold or transferred.

**5.20 Restrictions on Nature of Business.** Company will not engage in any line of business materially different from that presently engaged in by Company, and will not purchase, lease or otherwise acquire assets not related to its business.

**5.21 Accounting.** Company will not adopt any material change in accounting principles except as required by GAAP, consistently applied. Company will not change its fiscal year.

**5.22 Discounts, etc.** During a Default Period and after notice from Wells Fargo, (i) Company will not grant any discount, credit or allowance to any customer of Company or accept any return of goods sold, and (ii) Company will not modify, amend, subordinate, cancel or terminate any Account.

**5.23 Pension Plans.** Except as disclosed to Wells Fargo in a Record prior to the date of this Agreement, neither Company nor any ERISA Affiliate will (a) adopt, create, assume or become party to any Pension Plan, (b) become obligated to contribute to any Multiemployer Plan, (c) incur any obligation to provide post-retirement medical or insurance benefits with respect to employees or former employees (other than benefits required by law) or (d) amend any Plan in a manner that would materially increase its funding obligations.

**5.24 Place of Business; Name.** Company will not transfer its chief executive office or principal place of business, or move, relocate, close or sell any business Premises without providing 30 days advance written notice to Wells Fargo. Company will not permit any tangible

Collateral or any records relating to the Collateral to be located in any state or area in which, in the event of such location, a financing statement covering such Collateral would be required to be, but has not in fact been, filed in order to perfect the Security Interest. Company will not change its name or jurisdiction of organization.

**5.25 Constituent Documents.** Company will not amend its Constituent Documents in any manner that is materially adverse to Wells Fargo (as determined by Wells Fargo in Wells Fargo's reasonable discretion). No later than 10 days after any change to Company's Constituent Documents, Company shall (i) notify Wells Fargo in writing of such change, and (ii) provide copies of such changes to Wells Fargo.

**5.26 Performance by Wells Fargo.** If Company fails to perform or observe any of its obligations under this Agreement at any time, Wells Fargo may, but need not, perform or observe them on behalf of Company and may, but need not, take any other actions which Wells Fargo may reasonably deem necessary to cure or correct this failure; and Company shall pay Wells Fargo upon demand the amount of all costs and expenses (including reasonable attorneys' fees and legal expense) incurred by Wells Fargo in performing these obligations, together with interest on these amounts at the Default Rate.

**5.27 Wells Fargo Appointed as Company's Attorney in Fact.** To facilitate Wells Fargo's performance or observance of Company's obligations under this Agreement, Company hereby irrevocably appoints Wells Fargo and Wells Fargo's agents, as Company's attorney in fact (which appointment is coupled with an interest) with the right (but not the duty) to create, prepare, complete, execute, deliver, endorse or file on behalf of Company any instruments, documents, assignments, security agreements, financing statements, applications for insurance and any other agreements or any Record required to be obtained, executed, delivered or endorsed by Company in accordance with the terms of this Agreement.

## 6. EVENTS OF DEFAULT AND REMEDIES

**6.1 Events of Default.** An "Event of Default" means any of the following:

- (a) Company fails to pay any the amount of any Indebtedness on the date that it becomes due and payable;
- (b) Company fails to observe or perform any covenant or agreement of Company set forth in this Agreement, or in any of the Loan Documents, or in any other document or agreement described in or related to this Agreement or to any Indebtedness, or any covenant in Section 5.2 becomes inapplicable due to the lapse of time, and Company and Wells Fargo fail to come to an agreement, acceptable to Wells Fargo in its sole discretion, to amend the covenant to apply to future periods;
- (c) An Overadvance arises as the result of any reduction in the Borrowing Base, or arises in any manner or on terms not otherwise approved of in advance by Wells Fargo in a Record that it has Authenticated;

(d) An event of default or termination event (however defined) occurs under any swap, derivative, foreign exchange, hedge or any similar transaction or arrangement entered into between Company and Wells Fargo;

(e) A Change of Control or Material Adverse Effect shall occur;

(f) Company or any Guarantor becomes insolvent or admits in a Record an inability to pay debts as they mature, or Company or any Guarantor makes an assignment for the benefit of creditors; or Company or any Guarantor applies for or consents to the appointment of any receiver, trustee, or similar officer for the benefit of Company or any Guarantor, or for any of their properties; or any receiver, trustee or similar officer is appointed without the application or consent of Company or such Guarantor; or any judgment, writ, warrant of attachment or execution or similar process is issued or levied against a substantial part of the property of Company or any

Guarantor;

(g) Company or any Guarantor files a petition under any chapter of the United States Bankruptcy Code or under the laws of any other jurisdiction naming Company or such Guarantor as debtor; or any such petition is instituted against Company or any such Guarantor; or Company or any Guarantor institutes (by petition, application, answer, consent or otherwise) any bankruptcy, insolvency, reorganization, debt arrangement, dissolution, liquidation or similar proceeding under the laws of any jurisdiction; or any such proceeding is instituted (by petition, application or otherwise) against Company or any such Guarantor;

(h) Any representation or warranty made by Company in this Agreement or by any Guarantor in any Guaranty, or by Company (or any of its Officers) or any Guarantor in any agreement, certificate, instrument or financial statement or other statement delivered to Wells Fargo in connection with this Agreement or pursuant to such Guaranty is untrue or misleading in any material respect when delivered to Wells Fargo;

(i) A final, non-appealable arbitration award, judgment, or decree or order for the payment of money in an amount in excess of \$50,000 which is not insured or subject to indemnity, is entered against Company which is not immediately stayed or appealed;

(j) Company is in default with respect to any bond, debenture, note or other evidence of material indebtedness issued by Company that is held by any third Person other than Wells Fargo, or under any instrument under which any such evidence of indebtedness has been issued or by which it is governed, or under any material lease or other contract, and the applicable grace period, if any, has expired, regardless of whether such default has been waived by the holder of such indebtedness;

(k) Company liquidates, dissolves, terminates or suspends its business operations or otherwise fails to operate its business in the ordinary course, or merges with another Person; or sells or attempts to sell all or substantially all of its assets;

(l) Company fails to pay any indebtedness or obligation owed to Wells Fargo which is unrelated to the Line of Credit or this Agreement as it becomes due and payable;

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(m) Any Guarantor repudiates or purports to revoke the Guarantor's Guaranty, or fails to perform any obligation under such Guaranty, or any individual Guarantor dies or becomes incapacitated, or any other Guarantor ceases to exist for any reason;

(n) Company engages in any act prohibited by any Subordination Agreement, or makes any payment on Subordinated Indebtedness (as defined in the Subordination Agreement) that the Subordinated Creditor was not contractually entitled to receive;

(o) Any event or circumstance occurs that Wells Fargo in good faith believes may impair the prospect of payment of all or part of the Indebtedness, or Company's ability to perform any of its material obligations under any of the Loan Documents, or any other document or agreement described in or related to this Agreement, or there occurs any material adverse change in the business or financial condition of Company;

(p) (i) Company hires an Officer or appoints a Director who has been convicted of any felony offense under state or federal law, or (ii) any Director, Officer, or Designated Person is indicted for a felony offence under state or federal law if, with respect to this clause (ii), (x) such indictment has not been dismissed within 15 days of the indictment of such Director, Officer, or Designated Person, or (y) such Director, Officer, or Designated Person has not been relieved of his or her duties as a Director, Officer, or Designated Officer, as applicable, within 15 days of such indictment;

(q) Any Reportable Event, which Wells Fargo in good faith believes to constitute sufficient grounds for termination of any Pension Plan or for the appointment of a trustee to administer any Pension Plan, has occurred and is continuing 30 days after Company gives Wells Fargo a Record notifying it of the Reportable Event; or a trustee is appointed by an appropriate court to administer any Pension Plan; or the Pension Benefit Guaranty Corporation institutes proceedings to terminate or appoint a trustee to administer any Pension Plan; or Company or any ERISA Affiliate files for a distress termination of any Pension Plan under Title IV of ERISA; or Company or any ERISA Affiliate fails to make any quarterly Pension Plan contribution required under Section 412 (m) of the IRC, which Wells Fargo in good faith believes may, either by itself or in combination with other failures, result in the imposition of a Lien on Company's assets in favor of the Pension Plan; or any withdrawal, partial withdrawal, reorganization or other event occurs with respect to a Multiemployer Plan which could reasonably be expected to result in a material liability by Company to the Multiemployer Plan under Title IV of ERISA; or

(r) Any "Event of Default" occurs under any of the Domestic Loan Documents.

**6.2 Rights and Remedies.** During any Default Period, Wells Fargo may in its discretion exercise any or all of the following rights and remedies:

(a) Wells Fargo may terminate the Line of Credit and decline to make Advances, and terminate any services extended to Company under the Master Agreement for Treasury Management Services;

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(b) Wells Fargo may declare the Indebtedness to be immediately due and payable and accelerate payment of the Revolving Notes, and all Indebtedness shall immediately become due and payable, without presentment, notice of dishonor, protest or further

notice of any kind, all of which Company hereby expressly waives;

(c) Wells Fargo may, without notice to Company, apply any money owing by Wells Fargo to Company to payment of the Indebtedness;

(d) Wells Fargo may exercise and enforce any rights and remedies available upon default to a secured party under the UCC, including the right to take possession of Collateral, proceeding with or without judicial process (without a prior hearing or notice of hearing, which Company hereby expressly waives) and sell, lease or otherwise dispose of Collateral for cash or on credit (with or without giving warranties as to condition, fitness, merchantability or title to Collateral, and in the event of a credit sale, Indebtedness shall be reduced only to the extent that payments are actually received), and Company will upon Wells Fargo's demand assemble the Collateral and make it available to Wells Fargo at any place designated by Wells Fargo which is reasonably convenient to both parties;

(e) Wells Fargo may exercise and enforce its rights and remedies under any of the Loan Documents and any other document or agreement described in or related to this Agreement;

(f) Wells Fargo may for any reason apply for the appointment of a receiver of the Collateral, to which appointment Company hereby consents; and

(g) Wells Fargo may exercise any other rights and remedies available to it by law or agreement.

**6.3 Immediate Default and Acceleration.** Following the occurrence of an Event of Default described in Section 6.1(f) or (g), the Line of Credit shall immediately terminate and all of Company's Indebtedness shall immediately become due and payable without presentment, demand, protest or notice of any kind.

## 7. MISCELLANEOUS

**7.1 No Waiver; Cumulative Remedies.** No delay or any single or partial exercise by Wells Fargo of any right, power or remedy under the Loan Documents, or under any other document or agreement described in or related to this Agreement, shall constitute a waiver of any other right, power or remedy under the Loan Documents or granted by Company to Wells Fargo under other agreements or documents that are unrelated to the Loan Documents. No notice to or demand on Company in any circumstance shall entitle Company to any additional notice or demand in any other circumstances. The remedies provided in the Loan Documents or in any other document or agreement described in or related to this Agreement are cumulative and not exclusive of any remedies provided by law. Wells Fargo may comply with applicable law in connection with a disposition of Collateral, and such compliance will not be considered to adversely affect the commercial reasonableness of any sale of the Collateral.

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**7.2 Amendment; Consents and Waivers; Authentication.** No amendment or modification of any Loan Documents, or any other document or agreement described in or related to this Agreement, or consent to or waiver of any Event of Default, or consent to or waiver of the application of any covenant or representation set forth in any of the Loan Documents, or any other document or agreement described in or related to this Agreement, or any release of Wells Fargo's Security Interest in any Collateral, shall be effective unless it has been agreed to by Wells Fargo and memorialized in a Record that: (a) specifically states that it is intended to amend or modify specific Loan Documents, or any other document or agreement described in or related to this Agreement, or waive any Event of Default or the application of any covenant or representation of any terms of specific Loan Documents, or any other document or agreement described in or related to this Agreement, or is intended to release Wells Fargo's Security Interest in specific Collateral; and (b) is Authenticated by the signature of an authorized employee of both parties, or by an authorized employee of Wells Fargo with respect to a consent or waiver. The terms of an amendment, consent or waiver memorialized in any Record shall be effective only to the extent, and in the specific instance, and for the limited purpose to which Wells Fargo has agreed.

**7.3 Execution in Counterparts; Delivery of Counterparts.** This Agreement and all other Loan Documents, or any other document or agreement described in or related to this Agreement, and any amendment or modification to them may be Authenticated by the parties in any number of counterparts, each of which, once authenticated and delivered in accordance with the terms of this Section 7.3, will be deemed an original, and all such counterparts, taken together, shall constitute one and the same instrument. Delivery by fax or by encrypted e-mail or e-mail file attachment of any counterpart to any Loan Document Authenticated by an authorized signature will be deemed the equivalent of the delivery of the original Authenticated instrument. Company shall send the original Authenticated counterpart to Wells Fargo by first class U.S. mail or by overnight courier, but Company's failure to deliver a Record in this form shall not affect the validity, enforceability, and binding effect of this Agreement or the other Loan Documents, or any other document or agreement described in or related to this Agreement.

**7.4 Notices, Requests, and Communications; Confidentiality.** Except as otherwise expressly provided in this Agreement:

(a) Delivery of Notices, Requests and Communications. Any notice, request, demand, or other communication by either party that is required under the Loan Documents, or any other document or agreement described in or related to this Agreement, to be in the form of a Record (but excluding any Record containing information Company must report to Wells Fargo under Section 5.1) may be delivered (i) in person, (ii) by first class U.S. mail, (iii) by overnight courier of national reputation, or (iv) by fax, or the Record may be sent as an Electronic Record and delivered (v) by an encrypted e-mail, or (vi) through Wells Fargo's Commercial Electronic Office® ("CEO") portal or other secure electronic channel to which the parties have agreed.

(b) Addresses for Delivery. Delivery of any Record under this Section 7.4 shall be made to the appropriate address

set forth on the last page of this Agreement (which either party may modify by a Record sent to the other party), or through Wells Fargo's CEO portal or other secure electronic channel to which the parties have agreed.

(c) Date of Receipt. Each Record sent pursuant to the terms of this Section 7.4 will be deemed to have been received on (i) the date of delivery if delivered in person, (ii) the date deposited in the mail if sent by mail, (iii) the date delivered to the courier if sent by overnight courier, (iv) the date of transmission if sent by fax, or (v) the date of transmission, if sent as an Electronic Record by electronic mail or through Wells Fargo's CEO portal or similar secure electronic channel to which the parties have agreed; except that any request for an Advance or any other notice, request, demand or other communication from Company required under Section 1, and any request for an accounting under Section 9-210 of the UCC, will not be deemed to have been received until actual receipt by Wells Fargo on a Business Day by an authorized employee of Wells Fargo.

(d) Confidentiality of Unencrypted E-mail. Company acknowledges that if it sends or receives an Electronic Record to or from Wells Fargo without encryption by e-mail or as an e-mail file attachment, there is a risk that the Electronic Record may be received by unauthorized Persons, and that by so doing it will be deemed to have accepted this risk and the consequences of any such unauthorized disclosure.

**7.5 Company Information Reporting; Confidentiality.** Except as otherwise expressly provided in this Agreement:

(a) Delivery of Company Information Records. Any information that Company is required to deliver under Section 5.1 in the form of a Record may be delivered to Wells Fargo (i) in person, or by (ii) first class U.S. mail, (iii) overnight courier of national reputation, or (iv) fax, or the Record may be sent as an Electronic Record (v) by encrypted e-mail, or (vi) through the file upload service of Wells Fargo's CEO portal or other secure electronic channel to which the parties have agreed.

(b) Addresses for Delivery. Delivery of any Record to Wells Fargo under this Section 7.5 shall be made to the appropriate address set forth on the last page of this Agreement (which Wells Fargo may modify by a Record sent to Company), or through Wells Fargo's CEO portal or other secure electronic channel to which the parties have agreed.

(c) Date of Receipt. Each Record sent pursuant to this Section will be deemed to have been received on (i) the date of delivery to an authorized employee of Wells Fargo, if delivered in person, or by U.S. mail, overnight courier, fax, or e-mail; or (ii) the date of transmission, if sent as an Electronic Record through Wells Fargo's CEO portal or similar secure electronic channel to which the parties have agreed.

(d) Authentication of Company Information Records. Company shall Authenticate any Record delivered (i) in person, or by U.S. mail, overnight courier, or fax, by the signature of the Officer or employee of Company who prepared the Record; (ii) as an Electronic Record sent via encrypted e-mail, by the signature of the Officer or employee of Company who prepared the Record by any file format signature that is acceptable to Wells Fargo, or by a separate certification signed and sent by fax; or (iii) as an Electronic Record via the file upload service of Wells Fargo's CEO portal or similar secure electronic channel to which the parties have agreed, through such credentialing process as Wells Fargo and Company may agree to under the CEO agreement.

(e) Certification of Company Information Records. Any Record (including any Electronic Record) Authenticated and delivered to Wells Fargo under this Section 7.5 will be deemed to have been certified as materially true, correct, and complete by Company and each Officer or employee of Company who prepared and Authenticated the Record on behalf of Company, and may be legally relied upon by Wells Fargo without regard to method of delivery or transmission.

(f) Confidentiality of Company Information Records Sent by Unencrypted E-mail. Company acknowledges that if it sends an Electronic Record to Wells Fargo without encryption by e-mail or as an e-mail file attachment, there is a risk that the Electronic Record may be received by unauthorized Persons, and that by so doing it will be deemed to have accepted this risk and the consequences of any such unauthorized disclosure. Company acknowledges that it may deliver Electronic Records containing Company information to Wells Fargo by e-mail pursuant to any encryption tool acceptable to Wells Fargo and Company, or through Wells Fargo's CEO portal file upload service without risk of unauthorized disclosure.

**7.6 Further Documents.** Company will from time to time execute, deliver, endorse and authorize the filing of any instruments, documents, conveyances, assignments, security agreements, financing statements, control agreements and other agreements that Wells Fargo may reasonably request in order to secure, protect, perfect or enforce the Security Interest or Wells Fargo's rights under the Loan Documents, or any other document or agreement described in or related to this Agreement (but any failure to request or assure that Company executes, delivers, endorses or authorizes the filing of any such item shall not affect or impair the validity, sufficiency or enforceability of the Loan Documents, or any other document or agreement described in or related to this Agreement, and the Security Interest, regardless of whether any such item was or was not executed, delivered or endorsed in a similar context or on a prior occasion).

**7.7 Costs and Expenses.** Company shall pay on demand all costs and expenses, including reasonable attorneys' fees, incurred by Wells Fargo in connection with the Indebtedness, this Agreement, the Loan Documents, or any other document or agreement described in or related to this Agreement, and the transactions contemplated by this Agreement, including all such costs, expenses and fees incurred in connection with the negotiation, preparation, execution, delivery, amendment, administration, performance, collection and

enforcement of the Indebtedness and all such documents and agreements and the creation, perfection, protection, satisfaction, foreclosure or enforcement of the Security Interest.

**7.8 Indemnity.** In addition to its obligation to pay Wells Fargo's expenses under the terms of this Agreement, Company shall indemnify, defend and hold harmless Wells Fargo, its parent Wells Fargo & Company, and any of its affiliates and successors, and all of their present and future Officers, Directors, employees, attorneys and agents (each an "Indemnitee") from and against any of the following (collectively, "Indemnified Liabilities"):

(a) Any and all transfer taxes, documentary taxes, assessments or charges made by any governmental authority by reason of the execution and delivery of the Loan Documents, or any other document or agreement described in or related to this Agreement or the making of the Advances;

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(b) Any claims, loss or damage to which any Indemnitee may be subjected if any representation or warranty contained in Exhibit D proves to be incorrect in any respect or as a result of any violation of the covenants contained in Section 5.11; and

(c) Any and all other liabilities, losses, damages, penalties, judgments, suits, claims, costs and expenses of any kind or nature whatsoever (including the reasonable fees and disbursements of counsel) in connection with this Agreement and any other investigative, administrative or judicial proceedings, whether or not such Indemnitee shall be designated a party to such proceedings, which may be imposed on, incurred by or asserted against any such Indemnitee, in any manner related to or arising out of or in connection with the making of the Advances and the Loan Documents, or any other document or agreement described in or related to this Agreement, or the use or intended use of the proceeds of the Advances, with the exception of any Indemnified Liability caused by the gross negligence or willful misconduct of an Indemnitee.

If any investigative, judicial or administrative proceeding described in this Section is brought against any Indemnitee, upon the Indemnitee's request, Company, or counsel designated by Company and satisfactory to the Indemnitee, will resist and defend the action, suit or proceeding to the extent and in the manner directed by the Indemnitee, at Company's sole cost and expense. Each Indemnitee will use its best efforts to cooperate in the defense of any such action, suit or proceeding. If this agreement to indemnify is held to be unenforceable because it violates any law or public policy, Company shall nevertheless make the maximum contribution to the payment and satisfaction of each of the Indemnified Liabilities to the extent permissible under applicable law. Company's obligations under this Section shall survive the termination of this Agreement and the discharge of Company's other obligations under this Agreement.

**7.9 Retention of Company's Records.** Wells Fargo shall have no obligation to maintain Electronic Records or retain any documents, schedules, invoices, agings, or other Records delivered to Wells Fargo by Company in connection with the Loan Documents, or any other document or agreement described in or related to this Agreement for more than 30 days after receipt by Wells Fargo. If there is a special need to retain specific Records, Company must notify Wells Fargo of its need to retain or return such Records with particularity, which notice must be delivered to Wells Fargo in accordance with the terms of this Agreement at the time of the initial delivery of the Record to Wells Fargo.

**7.10 Binding Effect; Assignment; Complete Agreement.** The Loan Documents, or any other document or agreement described in or related to this Agreement, shall be binding upon and inure to the benefit of Company and Wells Fargo and their respective successors and assigns, except that Company shall not have the right to assign its rights under this Agreement or any interest in this Agreement without Wells Fargo's prior consent, which must be confirmed in a Record Authenticated by Wells Fargo. To the extent permitted by law, Company waives and will not assert against any assignee any claims, defenses or set-offs which Company could assert against Wells Fargo. This Agreement shall also bind all Persons who become a party to this Agreement as a borrower. This Agreement, together with the Loan Documents, or any other document or agreement described in or related to this Agreement, comprises the complete and integrated agreement of the parties on the subject matter of this Agreement and supersedes all prior agreements, whether oral or evidenced in a Record. To the extent that any provision of this

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Agreement contradicts other provisions of the Loan Documents other than this Agreement, or any other document or agreement described in or related to this Agreement, this Agreement shall control.

**7.11 Sharing of Information.** Wells Fargo may share any Confidential Information that it may have regarding Company and its Affiliates with its accountants, lawyers, and other advisors, with Ex-Im Bank, and with each business unit and line of business within Wells Fargo and each direct and indirect subsidiary of Wells Fargo & Company; provided that Wells Fargo shall advise such accountants, lawyers, other advisors, business units, line of business, and subsidiaries of the confidential nature of such Confidential Information and that all such Confidential Information is subject to the terms of this Agreement (including this Section 7.11).

**7.12 Severability of Provisions.** Any provision of this Agreement which is prohibited or unenforceable shall be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining terms of this Agreement.

**7.13 Headings.** Section and subsection headings in this Agreement are included for convenience of reference only and shall not constitute a part of this Agreement for any other purpose.

**7.14 Governing Law; Jurisdiction; Venue.** The Loan Documents (other than real estate related documents, if any) shall be governed by and construed in accordance with the substantive laws (other than conflict laws) of the State of California. The parties to this Agreement (a) consent to the personal jurisdiction of the state and federal courts located in the State of California in connection with any controversy related to this Agreement; (b) waive any argument that venue in any such forum is not convenient; (c) agree that any litigation initiated by Wells Fargo or Company in connection with this Agreement or the other Loan Documents may be venued in either the state or federal courts located in the City of Los Angeles, County of Los Angeles, State of California; and (d) agree that a final judgment in any such suit, action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law.

**7.15 Incorporation of Borrower Agreement by Reference.** This Agreement shall constitute the "Loan Agreement" under the Borrower Agreement, and the Line of Credit shall constitute the "Loan Facility" under the Borrower Agreement. The terms of the Borrower Agreement are hereby incorporated herein by this reference. In the event that any provision of this Agreement conflicts with or is inconsistent with any provision of the Borrower Agreement, the provision that is more burdensome or restrictive as to Company shall control.

[signatures on the following page]

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COMPANY AND WELLS FARGO have executed this Agreement through their authorized officers as of the date set forth above.

**WELLS FARGO BANK,  
NATIONAL ASSOCIATION**

**CAPSTONE TURBINE CORPORATION**

By: /s/ John Curry  
Name: John Curry  
Its: Vice President

By: /s/ Darren Jamison  
Name: Darren Jamison  
Its: CEO

**Wells Fargo Bank, National Association**  
245 S. Los Robles Avenue, Suite 700  
Pasadena, CA 91101  
Fax: 626.844.9063  
Attention: Capstone Turbine Account Officer  
email: curry.john@wellsfargo.com

**Capstone Turbine Corporation**  
21211 Nordhoff Street  
Chatsworth, California 91311  
Fax: 818.734.5380  
Attention:  
e-mail:  
Federal Employer Identification No.  
  
Organizational Identification No.

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**Exhibit A to Credit and Security Agreement (Ex-Im Subfacility)**

**DEFINITIONS**

"Account Funds" is defined in Section 1.4(a).

"Accounts" shall have the meaning given it under the UCC.

"Advance" and "Advances" means an advance or advances under the Line of Credit.

"Affiliate" or "Affiliates" means Capstone Turbine International, Inc. and any other Person controlled by, controlling or under common control with Company, including any Subsidiary of Company. For purposes of this definition, "control," when used with respect to any specified Person, means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise.

"Agreement" means this Credit and Security Agreement.

"Authenticated" means (a) to have signed; or (b) to have executed or to have otherwise adopted a symbol, or have encrypted or similarly processed a Record in whole or in part, with the present intent of the authenticating Person to identify the Person and adopt or accept a Record.

"Book Net Worth" means the aggregate of the common and preferred shareholder's equity in Company, determined in accordance with GAAP, and calculated without regard to (a) any change in the valuation of goodwill made in accordance with FASB Accounting Standard 142, and (b) any non-cash effects of accounting for stock based compensation in accordance with FASB pronouncement SFAS

“Borrower Agreement” means the Borrower Agreement, dated on or about the date hereof, made by Company in favor of Ex-Im Bank and Wells Fargo, as the same may hereafter be amended, modified, supplemented or restated from time to time.

“Borrowing Base” is defined in Section 1.2(a).

“Borrowing Base Reserve” means, as of any date of determination, an amount or a percent of a specified category or item that Wells Fargo establishes in its sole discretion from time to time to reduce availability under the Borrowing Base (a) to reflect events, conditions, contingencies or risks which affect the assets, business or prospects of Company, or the Collateral or its value, or the enforceability, perfection or priority of Wells Fargo’s Security Interest in the Collateral, as the term “Collateral” is defined in this Agreement, or (b) to reflect Wells Fargo’s judgment that any collateral report or financial information relating to Company and furnished to Wells Fargo may be incomplete, inaccurate or misleading in any material respect.

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“Business Day” means a day on which the Federal Reserve Bank of New York is open for business and, if such day relates to a LIBOR Advance, a day on which dealings are carried on in the London interbank eurodollar market.

“Buyer” shall have the meaning provided for such term in the Borrower Agreement.

“Capital Expenditures” means for a period, any expenditure of money during such period for the lease, purchase or other acquisition of any capital asset, or for the lease of any other asset whether payable currently or in the future.

“Cash Equivalents” means (i) marketable direct obligations issued or unconditionally guaranteed by the United States government and backed by the full faith and credit of the United States government; (ii) domestic and eurodollar certificates of deposit and time deposits, bankers’ acceptances and floating rate certificates of deposit issued by any commercial bank organized under the laws of the United States, any state thereof, the District of Columbia, any foreign bank, or its branches or agencies, the long-term indebtedness of which institution at the time of acquisition is rated A- (or better) by S&P or A3 (or better) by Moody’s, and which certificates of deposit and time deposits are fully protected against currency fluctuations for any such deposits with a term of more than ninety (90) days; (iii) shares of money market, mutual or similar funds having assets in excess of \$100,000,000 and the investments of which are limited to (a) investment grade securities (i.e., securities rated at least Baa by Moody’s or at least BBB by S&P) and (b) commercial paper of United States and foreign banks and bank holding companies and their subsidiaries and United States and foreign finance, commercial industrial or utility companies which, at the time of acquisition, are rated A-1 (or better) by S&P or P-1 (or better) by Moody’s (all such institutions being, “Qualified Institutions”); and (iv) commercial paper of Qualified Institutions; provided that the maturities of such Cash Equivalents shall not exceed three hundred sixty-five (365) days from the date of acquisition thereof.

“CEO” is defined in Section 7.4(a).

“Change of Control” means the occurrence of any of the following events:

(a) Any Person or “group” (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934) who does not have an ownership interest in Company on the date of the initial Advance is or becomes the “beneficial owner” (as defined in Rules 13d-3 and 13d-5 under the Securities Exchange Act of 1934, except that any such Person, entity or group will be deemed to have “beneficial ownership” of all securities that such Person, entity or group has the right to acquire, whether such right is exercisable immediately or only after the passage of time), directly or indirectly, of more than twenty percent (20%) of the voting power of all classes of ownership of Company;

(b) During any consecutive two-year period, individuals who at the beginning of such period constituted the board of Directors of Company (together with any new Directors whose election to such board of Directors, or whose nomination for election by the Owners of Company, was approved by a vote of two thirds of the Directors then still in office who were either Directors at the beginning of such period or whose election or nomination for election was

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previously so approved) cease for any reason to constitute a majority of the board of Directors of Company then in office.

“Collateral” means all of Company’s Accounts, chattel paper and electronic chattel paper, deposit accounts, documents, Equipment, General Intangibles, goods, instruments, Inventory, Investment Property, letter-of-credit rights, letters of credit, all sums on deposit in any Collection Account, and any items in any Lockbox; together with (a) all substitutions and replacements for and products of such property; (b) in the case of all goods, all accessions; (c) all accessories, attachments, parts, Equipment and repairs now or subsequently attached or affixed to or used in connection with any goods; (d) all warehouse receipts, bills of lading and other documents of title that cover such goods now or in the future; (e) all collateral subject to the Lien of any of the Security Documents; (f) any money, or other assets of Company that come into the possession, custody, or control of Wells Fargo now or in the future; (g) Proceeds of any of the above Collateral; (h) books and records of Company, including all mail or e-mail addressed to Company; and (i) all of the above Collateral, whether now owned or existing or acquired now or in the future or in which Company has rights now or in the future.

“Collateral Pledge Agreement” means each Collateral Pledge Agreement entered into between Company and Wells Fargo.

“Collection Account” means “Collection Account” as defined in the Master Agreement for Treasury Management Services and related Lockbox and Collection Account Service Description or Collection Account Service Description, whichever is applicable..

“Compliance Certificate” is defined in Section 5.1(a) and is in the form of Exhibit E.

“Company” is defined in the Recitals.

“Constituent Documents” means with respect to any Person, as applicable, that Person’s certificate of incorporation, articles of incorporation, by-laws, certificate of formation, articles of organization, limited liability company agreement, management agreement, operating agreement, shareholder agreement, partnership agreement or similar document or agreement governing such Person’s existence, organization or management or concerning disposition of ownership interests of such Person or voting rights among such Person’s owners.

“Country Limitation Schedule” shall have the meaning provided for such term in the Borrower Agreement.

“Debt” means of a Person as of a given date, all items of indebtedness or liability which in accordance with GAAP would be included in determining total liabilities as shown on the liabilities side of a balance sheet for such Person and shall also include the aggregate payments required to be made by such Person at any time under any lease that is considered a capitalized lease under GAAP.

“Default Period” is defined in Section 1.5(c).

“Default Rate” is defined in Section 1.5(c).

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“Designated Person” means any of Darren R. Jamison or Edward I. Reich.

“Dilution” means, as of any date of determination, a percentage, based upon the prior six (6) months, which is the result of dividing (a) actual bad debt write-downs, discounts, advertising allowances, credits, and any other items with respect to the Accounts determined to be dilutive by Wells Fargo in its sole discretion during this period, by (b) Company’s net sales during such period (excluding extraordinary items) plus the amount of clause (a).

“Director” means a director if Company is a corporation, or a governor or manager if Company is a limited liability company.

“Dollars” or “\$” shall mean the lawful currency of the United States.

“Domestic Facility Agreement” means the Credit and Security Agreement, dated as of February 9, 2009, between Company and Wells Fargo.

“Domestic Loan Documents” means the “Loan Documents” as defined in the Domestic Facility Agreement.

“Electronic Record” means a Record that is created, generated, sent, communicated, received, or stored by electronic means, but does not include any Record that is sent, communicated, or received by fax.

“Eligible Accounts” means all unpaid Accounts of Company owing by account debtors located outside of the United States of America arising from the sale or lease of goods or the performance of services, net of any credits, but excluding any Accounts having any of the following characteristics:

- (a) that does not arise from the sale of Items in the ordinary course of business;
- (b) that is not subject to a valid, perfected first priority Lien in favor of Wells Fargo;
- (c) as to which any covenant, representation or warranty contained in the Loan Documents with respect to such Account has been breached;
- (d) that is not owned by a Company or that is subject to any right, claim or interest of another Person other than the Lien in favor of Wells Fargo;
- (e) with respect to which an invoice has not been sent;
- (f) that arises from the sale of defense articles or defense services;
- (g) that is due and payable from a Buyer located in a country with which Ex-Im Bank is prohibited from doing business as designated in the Country Limitation Schedule;
- (h) that does not comply with the requirements of the Country Limitation Schedule;
- (i) that is not paid within ninety (90) days from the invoice date; provided that, in the case of [Banking Production Centre], Accounts owed by [Banking Production Centre] that are

not paid within one hundred fifty (150) days from the invoice date shall not be Eligible Accounts;

(j) that arises from a sale of goods to or performance of services for an employee of Company, a stockholder of Company, a subsidiary of Company, a Person with a controlling interest in Company or a Person which shares common controlling ownership with Company;

(k) that is backed by a letter of credit unless the Items covered by the subject letter of credit have been shipped;

(l) that Wells Fargo or Ex-Im Bank, in its reasonable judgment, deems uncollectible for any reason;

(m) that is due and payable in a currency other than Dollars, except as may be approved in writing by Ex-Im Bank;

(n) that is due and payable from a military Buyer, except as may be approved in writing by Ex-Im Bank;

(o) that does not comply with the terms of sale set forth in Section 7 of the Loan Authorization Notice;

(p) that is due and payable from a Buyer who (A) applies for, suffers, or consents to the appointment of, or the taking of possession by, a receiver, custodian, trustee or liquidator of itself or of all or a substantial part of its property or calls a meeting of its creditors, (B) admits in writing its inability, or is generally unable, to pay its debts as they become due or ceases operations of its present business, (C) makes a general assignment for the benefit of creditors, (D) commences a voluntary case under any state or federal bankruptcy laws (as now or hereafter in effect), (E) is adjudicated as bankrupt or insolvent, (F) files a petition seeking to take advantage of any other law providing for the relief of debtors, (G) acquiesces to, or fails to have dismissed, any petition which is filed against it in any involuntary case under such bankruptcy laws, or (H) takes any action for the purpose of effecting any of the foregoing;

(q) that arises from a bill-and-hold, guaranteed sale, sale-and-return, sale on approval, consignment or any other repurchase or return basis or is evidenced by chattel paper;

(r) for which the Items giving rise to such Account have not been shipped and delivered and accepted by the Buyer or the services giving rise to such Account have not been performed by Company and accepted by the Buyer or the Account otherwise does not represent a final sale;

(s) that portion of the Account that is subject to any offset, deduction, defense, dispute, or counterclaim or where the Buyer is also a creditor or supplier of Company or that portion of the Account that is contingent in any respect or for any reason unless Wells Fargo has received a satisfactory non-offset letter;

(t) for which Company has made any agreement with the Buyer for any deduction therefrom, except for discounts or allowances made in the ordinary course of business for prompt

payment, all of which discounts or allowances are reflected in the calculation of the face value of each respective invoice related thereto;

(u) for which any of the Items giving rise to such Account have been returned, rejected or repossessed;

(v) to the extent it includes any finance charges, service charges, taxes, discounts, credits, allowances and Retainages;

(w) that arises from the sale of Items containing less than fifty one percent (51%) U.S. Content;

(x) that arises from the sale of Items containing any Foreign Content not incorporated into such Items in the United States;

(y) that arises from the sale of any Items to be used in the construction, alteration, operation or maintenance of nuclear power, enrichment, reprocessing, research or heavy water production facilities;

(z) that does not meet the requirements set forth in the definition of "Eligible-Related Accounts Receivable" in the Borrower Agreement;

(aa) that is not subject to a duly perfected security interest in Wells Fargo's favor or which are subject to any Lien in favor of any Person other than Wells Fargo;

(bb) that has been restructured, extended, amended or modified;

(cc) that is owing by an account debtor, regardless of whether otherwise eligible, to the extent that the balance of such Accounts exceeds fifteen (15%) of the aggregate amount of all Eligible Accounts;

(dd) that is owed by an account debtor, regardless of whether otherwise eligible, if twenty-five percent (25%) or more of the total amount due under Accounts from such debtor is ineligible under clauses (i), (s), or (bb) above;

- (ee) that is included as an “Eligible Account” under the Domestic Facility Agreement;
- (ff) Accounts arising from the sale of warranty or service contracts, maintenance service, warranty service or replacement parts;
- (gg) that portion of Accounts constituting (i) Proceeds of copyrightable material unless such copyrightable material shall have been registered with the United States Copyright Office, or (ii) Proceeds of patentable inventions unless such patentable inventions have been registered with the United States Patent and Trademark Office; and
- (hh) that are otherwise deemed ineligible for any reason by Wells Fargo or Ex-Im Bank in their sole discretion.

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For sake of clarity, any Accounts that are deemed to be “Eligible Accounts” under the Domestic Facility Agreement shall not be Eligible Accounts under this Agreement, and any Eligible Accounts under this Agreement shall not be deemed to be “Eligible Accounts” under the Domestic Facility Agreement.

“Eligible Inventory” means all export-related Inventory of Company, valued at the lower of cost or market in accordance with GAAP; but excluding Inventory having any of the following characteristics:

- (a) Inventory that is: in-transit; located at any warehouse, job site or other premises not approved by Wells Fargo in an Authenticated Record delivered to Company; not subject to a perfected first priority Lien in Wells Fargo’s favor; covered by any negotiable or non-negotiable warehouse receipt, bill of lading or other document of title; on consignment from any consignor; or on consignment to any consignee or subject to any bailment unless the consignee or bailee has executed an agreement with Wells Fargo;
- (b) Supplies, packaging, maintenance parts or sample Inventory, or customer supplied parts or Inventory;
- (c) Work-in-process Inventory;
- (d) Finished goods Inventory;
- (e) Inventory that is damaged, defective, obsolete, slow moving or not currently saleable in the normal course of Company’s operations, or the amount of such Inventory that has been reduced by shrinkage;
- (f) Inventory that Company has returned, has attempted to return, is in the process of returning or intends to return to the vendor of the Inventory;
- (g) Inventory that is perishable or live;
- (h) Inventory manufactured by Company pursuant to a license unless the applicable licensor has agreed in a Record that has been Authenticated by licensor to permit Wells Fargo to exercise its rights and remedies against such Inventory;
- (i) Inventory that is subject to a Lien in favor of any Person other than Wells Fargo;
- (j) Inventory stored at locations holding less than 10% of the aggregate value of Company’s Inventory;
- (k) Inventory that is deemed to be “Eligible Inventory” under the Domestic Facility Agreement;
- (l) Inventory containing less than fifty-one percent (51%) U.S. Content;

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- (m) Inventory containing any Foreign Content not incorporated into such Inventory in the United States;
- (n) Inventory that was previously exported;
- (o) Inventory that consists of proprietary software;
- (p) Inventory consisting of defense articles or goods; and
- (q) Inventory otherwise deemed ineligible by Wells Fargo or Ex-Im Bank in their sole discretion.

For sake of clarity, any Inventory that is deemed to be “Eligible Inventory” under the Domestic Facility Agreement shall not be Eligible Inventory under this Agreement, and any Eligible Inventory under this Agreement shall not be deemed to be “Eligible Inventory” under the Domestic Facility Agreement.

“Environmental Law” means any federal, state, local or other governmental statute, regulation, law or ordinance dealing with the protection of human health and the environment.

“Equipment” shall have the meaning given it under the Uniform Commercial Code in effect in the state whose laws govern this Agreement.

“ERISA” means the Employee Retirement Income Security Act of 1974, as amended from time to time.

“ERISA Affiliate” means any trade or business (whether or not incorporated) that is a member of a group which includes Company and which is treated as a single employer under Section 414 of the IRC.

“Event of Default” is defined in Section 6.1.

“Ex-Im Bank” means the Export-Import Bank of the United States, and its successors and assigns.

“Ex-Im Bank Guaranty” means that certain Master Guarantee Agreement between Wells Fargo and the Export-Import Bank of the United States, as the same may hereafter be amended, modified, supplemented or restated from time to time.

“Export Order” means a written export order or contract for the purchase by the Buyer from the Company of any of the Items.

“Floating Rate” is defined in Section 1.5(a).

“Floating Rate Advance” means an Advance bearing interest at the Floating Rate.

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“Foreign Content” means, with respect to any Item, all of the labor, materials and services which are not of United States origin or manufacture, or which are not incorporated into such Item in the United States.

“GAAP” means generally accepted accounting principles, applied on a basis consistent with the accounting practices applied in the financial statements described on Exhibit D.

“General Intangibles” shall have the meaning given it under the UCC.

“Guarantor” means Capstone Turbine International, Inc., and any other Person now or in the future guaranteeing any Indebtedness through the issuance of a Guaranty.

“Guaranty” means an unconditional continuing guaranty executed by a Guarantor in favor of Wells Fargo (if more than one, the “Guaranties”).

“Hazardous Substances” means pollutants, contaminants, hazardous substances, hazardous wastes, petroleum and fractions thereof, and all other chemicals, wastes, substances and materials listed in, regulated by or identified in any Environmental Law.

“Indebtedness” is used in its most comprehensive sense and means any debts, obligations and liabilities of Company to Wells Fargo, whether incurred in the past, present or future, whether voluntary or involuntary, and however arising, and whether due or not due, absolute or contingent, liquidated or unliquidated, determined or undetermined, and including without limitation all obligations arising under any swap, derivative, foreign exchange, hedge, deposit, treasury management or similar transaction or arrangement however described or defined that Company may enter into at any time with Wells Fargo or with Wells Fargo Merchant Services, L.L.C., whether or not Company may be liable individually or jointly with others, or whether recovery upon such Indebtedness may subsequently become unenforceable.

“Indemnified Liabilities” is defined in Section 7.8.

“Indemnitee” is defined in Section 7.8.

“Infringement” or “Infringing” when used with respect to Intellectual Property Rights means any infringement or other violation of Intellectual Property Rights.

“Intellectual Property Rights” means all actual or prospective rights arising in connection with any intellectual property or other proprietary rights, including all rights arising in connection with copyrights, patents, service marks, trade dress, trade secrets, trademarks, trade names or mask works.

“Interest Payment Date” is defined in Section 1.7(a).

“Interest Period” means the period that commences on (and includes) the Business Day on which either a LIBOR Advance is made or continued or on which a Floating Rate Advance is converted to a LIBOR Advance, and ending on (but excluding) the Business Day numerically corresponding to that date that falls the number of months afterward as selected by Company

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pursuant to Section 1.3(c), during which period the outstanding principal amount of the LIBOR Advance shall bear interest at the LIBOR

Advance Rate; provided, however, that:

(a) If an Interest Period would otherwise end on a day which is not a Business Day, then it shall end on the next Business Day, unless that day is the first Business Day of a month, in which case the Interest Period shall end on the last Business Day of the preceding month;

(b) No Interest Period applicable to an Advance may end later than the Maturity Date; and

(c) In no event shall Company select Interest Periods with respect to LIBOR Advances which would result in the payment of a LIBOR Advance breakage fee under this Agreement in order to make required principal payments.

“Inventory” shall have the meaning given it under the UCC.

“Investment Property” shall have the meaning given it under the UCC.

“Items” means the finished goods or services which are intended for export from the United States, as specified in Section 4(A) of the Loan Authorization Notice.

“Joint Application” means the Joint Application for Working Capital Guarantee made by Company and Wells Fargo to Ex-Im Bank in connection with this Agreement.

“LIBOR” means the rate per annum (rounded upward, if necessary, to the nearest whole 1/8<sup>th</sup> of one percent (1%)) determined pursuant to the following formula:

$$\text{LIBOR} = \frac{\text{Base LIBOR}}{100\% - \text{LIBOR Reserve Percentage}}$$

(a) “Base LIBOR” means the rate per annum for United States dollar deposits quoted by Wells Fargo as the Inter-Bank Market Offered Rate, with the understanding that such rate is quoted by Wells Fargo for the purpose of calculating effective rates of interest for loans making reference to it, on the first day of an Interest Period for delivery of funds on that date for a period of time approximately equal to the number of days in that Interest Period and in an amount approximately equal to the principal amount to which that Interest Period applies. Company understands and agrees that Wells Fargo may base its quotation of the Inter-Bank Market Offered Rate upon such offers or other market indicators of the Inter-Bank Market as Wells Fargo in its discretion deems appropriate including the rate offered for U.S. dollar deposits on the London Inter-Bank Market.

(b) “LIBOR Reserve Percentage” means the reserve percentage prescribed by the Board of Governors of the Federal Reserve System (or any successor) for “Eurocurrency Liabilities” (as defined in Regulation D of the Federal Reserve Board, as amended), adjusted by Wells Fargo for expected changes in such reserve percentage during the applicable Interest Period.

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“LIBOR Advance” means an Advance bearing interest at the LIBOR Advance Rate.

“LIBOR Advance Rate” is defined in Section 1.5(a).

“Licensed Intellectual Property” is defined in Exhibit D.

“Lien” means any security interest, mortgage, deed of trust, pledge, lien, charge, encumbrance, title retention agreement or analogous instrument or device, including the interest of each lessor under any capitalized lease and the interest of any bondsman under any payment or performance bond, in, of or on any assets or properties of a Person, whether now owned or subsequently acquired and whether arising by agreement or operation of law.

“Line of Credit” is defined in the Recitals.

“Loan Authorization Notice” means the Loan Authorization Notice executed and delivered in connection with this Agreement.

“Loan Documents” means this Agreement, the Revolving Notes, the Domestic Facility Agreement, the Ex-Im Bank Guaranty, the Borrower Agreement, the Joint Application, the Loan Authorization Notice, the Master Agreement for Treasury Management Services, each Guaranty, each Subordination Agreement, each Patent and Trademark Security Agreement, and the Security Documents, together with every other agreement, note, document, contract or instrument to which Company now or in the future may be a party and which may be required by Wells Fargo in connection with, or as a condition to, the execution of this Agreement. Any documents or other agreements entered into between Company and Wells Fargo that relate to any swap, derivative, foreign exchange, hedge, or similar product or transaction, or which are entered into with an operating division of Wells Fargo other than Wells Fargo Business Credit, shall not be included in this definition.

“Loan Manager” means the treasury management service defined in the Master Agreement for Treasury Management Services and related Loan Manager Service Description.

“Lockbox” means “Lockbox” as defined in the Master Agreement for Treasury Management Services and related Lockbox and Collection Account Service Description.

“Margin” means a rate per annum, expressed as a percentage, as more fully described in Section 1.5(a).

“Master Agreement for Treasury Management Services” means the Master Agreement for Treasury Management Services, the related Acceptance of Services, and the Service Description governing each treasury management service used by Company.

“Material Adverse Effect” means any of the following:

(r) A material adverse effect on the business, operations, results of operations, assets, liabilities or financial condition of Company;

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(s) A material adverse effect on the ability of Company to perform its obligations under the Loan Documents, or any other document or agreement related to this Agreement;

(t) A material adverse effect on the ability of Wells Fargo to enforce the Indebtedness or to realize the intended benefits of the Security Documents, including a material adverse effect on the validity or enforceability of any Loan Document or of any rights against any Guarantor, or on the status, existence, perfection, priority (subject to Permitted Liens) or enforceability of any Lien securing payment or performance of the Indebtedness; or

(u) Any claim against Company or threat of litigation which if determined adversely to Company would cause Company to be liable to pay an amount exceeding \$500,000 or would result in the occurrence of an event described in clauses (a), (b) and (c) above.

“Maturity Date” is defined in Section 1.1(b).

“Maximum Line Amount” is defined in Section 1.1(a).

“Multiemployer Plan” means a multiemployer plan (as defined in Section 4001(a)(3) of ERISA) to which Company or any ERISA Affiliate contributes or is obligated to contribute.

“Net Income” means fiscal year-to-date after-tax net income from continuing operations, including extraordinary losses but excluding extraordinary gains, all as determined in accordance with GAAP.

“OFAC” is defined in Section 5.11(b).

“Officer” means with respect to Company, an officer if Company is a corporation, a manager if Company is a limited liability company, or a partner if Company is a partnership.

“Operating Account” is defined in Section 1.3(a), and maintained in accordance with the terms of Wells Fargo’s Commercial Account Agreement in effect for demand deposit accounts.

“Overadvance” means the amount, if any, by which the unpaid principal amount of the Revolving Note is in excess of the then-existing Borrowing Base.

“Owned Intellectual Property” is defined in Exhibit D.

“Owner” means with respect to Company, each Person having legal or beneficial title to an ownership interest in Company or a right to acquire such an interest.

“Patent and Trademark Security Agreement” means each Patent and Trademark Security Agreement entered into between Company and Wells Fargo.

“Pension Plan” means a pension plan (as defined in Section 3(2) of ERISA) maintained for employees of Company or any ERISA Affiliate and covered by Title IV of ERISA.

“Permitted Lien” and “Permitted Liens” are defined in Section 5.3(a).

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“Person” means any individual, corporation, partnership, joint venture, limited liability company, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision of a governmental entity.

“Plan” means an employee benefit plan (as defined in Section 3(3) of ERISA) maintained for employees of Company or any ERISA Affiliate.

“Premises” is defined in Section 2.4(a).

“Prime Rate” means at any time the rate of interest most recently announced by Wells Fargo at its principal office as its Prime Rate, with the understanding that the Prime Rate is one of Wells Fargo’s base rates, and serves as the basis upon which effective rates of interest are calculated for those loans making reference to it, and is evidenced by its recording in such internal publication or publications as Wells Fargo may designate. Each change in the rate of interest shall become effective on the date each Prime Rate change is announced by Wells Fargo.

“Proceeds” shall have the meaning given it under the UCC.

“Record” means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form, and includes all information that is required to be reported by Company to Wells Fargo pursuant to Section 5.1.

“Reportable Event” means a reportable event (as defined in Section 4043 of ERISA), other than an event for which the 30-day notice requirement under ERISA has been waived in regulations issued by the Pension Benefit Guaranty Corporation.

“Retainage” shall mean that portion of the purchase price of an Export Order that a Buyer is not obligated to pay until the end of a specified period of time following the satisfactory performance under such Export Order.

“Revolving Notes” is defined in Section 1.1(d).

“Security Documents” means this Agreement, the Collateral Pledge Agreement, the Patent and Trademark Security Agreement(s), the Domestic Facility Agreement, the Borrower Agreement, and any other document delivered to Wells Fargo from time to time to secure the Indebtedness.

“Security Interest” is defined in Section 2.1.

“Subordinated Creditor(s)” means any Person now or in the future subordinating indebtedness of Company held by that Person to the payment of the Indebtedness.

“Subordinated Debt” means any Debt, contingent equity, earnout or other obligations of Company that is unsecured and has subordination terms, covenants, pricing and other terms which have been approved in an Authenticated Record from Wells Fargo and with respect to which the holder thereof has executed and delivered to Wells Fargo a Subordination Agreement.

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“Subordination Agreement” means any agreement between Wells Fargo and the holder(s) of Subordinated Debt pursuant to which such Subordinated Debt is subordinated in right of payment, liens, security and remedies to all of the Indebtedness and all of Wells Fargo’s rights, liens and remedies, in form and substance satisfactory to Wells Fargo (if more than one, the “Subordination Agreements”).

“Subsidiary” means any Person of which more than 50% of the outstanding ownership interests having general voting power under ordinary circumstances to elect a majority of the board of directors or the equivalent of such Person, irrespective of whether or not at the time ownership interests of any other class or classes shall have or might have voting power by reason of the happening of any contingency, is at the time directly or indirectly owned by Company, by Company and one or more other Subsidiaries, or by one or more other Subsidiaries.

“Termination Date” is defined in Section 1.1(b).

“UCC” means the Uniform Commercial Code in effect in the state designated in this Agreement as the state whose laws shall govern this Agreement, or in any other state whose laws are held to govern this Agreement or any portion of this Agreement.

“Unused Amount” is defined in Section 1.6(b).

“U.S. Content” means, with respect to any Item, all of the labor, materials and services which are of United States origin or manufacture, and which are incorporated into such Item in the United States.

“Wells Fargo” means Wells Fargo Bank, National Association in its broadest and most comprehensive sense as a legal entity, and is not limited in its meaning to the Wells Fargo Business Credit operating division, or to any other operating division of Wells Fargo.

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## **Exhibit B to Credit and Security Agreement (Ex-Im Subfacility)**

### **PREMISES**

The Premises referred to in the Credit and Security Agreement have an address of:

21211 Nordhoff Street, Chatsworth, CA 91311  
16640 Stagg Street, Van Nuys, CA 91406

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**Exhibit C to Credit and Security Agreement (Ex-Im Subfacility)**

**Conditions Precedent**

Wells Fargo's obligation to make an initial Advance shall be subject to the condition that Wells Fargo shall have received the following, executed and in form and content satisfactory to Wells Fargo. The following descriptions are limited descriptions for reference purposes only and should not be construed as limiting in any way the subject matter that Wells Fargo requires each document to address.

**A. Loan Documents to be Executed by Company:**

- (1) The Revolving Notes.
- (2) The Credit and Security Agreement.
- (3) The Master Agreement for Treasury Management Services, the Acceptance of Services, and the related Service Description for each deposit or treasury management related product or service that Company will subscribe to, including without limitation the Loan Manager Service Description and the Lockbox and Collection Account Service Description.
- (4) The Collateral Pledge Agreement, pursuant to which Company grants Wells Fargo a security interest in the shares of stock more fully described in the Collateral Pledge Agreement, together with the stock certificates and stock powers, as security for the full and prompt payment of Company's Indebtedness..
- (5) The Patent and Trademark Security Agreement.
- (6) The Domestic Facility Agreement and all related documents, agreements, and instruments.
- (7) The Borrower Agreement and other related documents, instruments and certificates required by Ex-Im Bank.

**B. Loan Documents to be Executed by Third Parties:**

- (1) Certificates of Insurance required under this Agreement, with all hazard insurance containing a lender's interest endorsement in Wells Fargo's favor and with all liability insurance naming Wells Fargo as additional insured.
- (2) Any documents, agreements or instruments requiring the execution by a third party (including, but not limited to, the Export-Import Bank of the United States).

**C. Documents Related to the Premises**

- (1) Any leases pursuant to which Company is leasing the Premises from a lessor.

**D. Federal Tax, State Tax, Judgment, UCC and Intellectual Property Lien Searches**

- (1) Current searches of Company in appropriate filing offices showing that (i) no Liens have been filed and remain in effect against Company and Collateral except Permitted Liens or Liens held by Persons who have agreed in an Authenticated Record that upon receipt of proceeds of the initial Advances, they will satisfy, release or terminate such Liens in a manner satisfactory to Wells Fargo, and (ii) Wells Fargo has filed all UCC financing statements necessary to perfect the Security Interest, to the extent the Security Interest is capable of being perfected by filing.
- (2) Current searches of Third Persons in appropriate filing offices with respect to any of the Collateral that is in the possession of a Person other than Company that is held for resale, showing that (i) UCC financing statements sufficient to protect Company's and Wells Fargo's interests in such Collateral have been filed, and (ii) no other secured party has filed a financing statement against such Person and covering property similar to Company's, other than Company, or if there exists any such secured party, evidence that each such party has received notice from Company and Wells Fargo sufficient to protect Company's and Wells Fargo's interests in Company's goods from any claim by such secured party.

**E. Constituent Documents:**

- (1) The Certificate of Authority of Company, which shall include as part of the Certificate or as exhibits to the Certificate, (i) the Resolution of Company's Directors and, if required, Owners, authorizing the execution, delivery and performance of those Loan Documents and other documents or agreements described in or related to this Agreement to which Company is a party, (ii) an Incumbency Certificate containing the signatures of Company's Officers or agents authorized to execute and

deliver those instruments, agreements and certificates referenced in (i) above, as well as Advance requests, on Company's behalf, (iii) Company's Constituent Documents, (iv) a current Certificate of Good Standing or Certificate of Status issued by the secretary of state or other appropriate authority for Company's state of organization, certifying that Company is in good standing and in compliance with all applicable organizational requirements of the state of organization, and (v) a Secretary's Certificate of Company's secretary or assistant secretary certifying that the Certificate of Authority of Company is true, correct and complete.

- (2) The Certificate of Authority of Corporate Guarantor, which shall include as part of the Certificate or as exhibits to the Certificate, (i) the Resolution of Guarantor's Directors and, if required, Owners, authorizing the execution, delivery and performance of the Guaranty of Corporation, (ii) an Incumbency Certificate containing the signatures of Guarantor's Officers or agents authorized to execute and deliver the Guaranty by Corporation on Guarantor's behalf, (iii) Guarantor's Constituent Documents, (iv) a current Certificate of Good Standing or Certificate of Status issued by the secretary of state or other appropriate authority for

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Guarantor's state of organization, certifying that Guarantor is in good standing and in compliance with all applicable organizational requirements of the state of organization, and (v) a Secretary's Certificate of Guarantor's secretary or assistant secretary certifying that the Certificate of Authority of Corporate Guarantor and all attached exhibits are true, correct and complete.

- (3) Evidence that Company is licensed or qualified to transact business in all jurisdictions where the character of the property owned or leased or the nature of the business transacted by it makes such licensing or qualification necessary.
- (4) An Officer's Certificate of an appropriate Officer of Company confirming, in his or her capacity as an Officer, the representations and warranties set forth in this Agreement.
- (5) A Customer Identification Information Form and such other forms and verification as Wells Fargo may need to comply with the U.S.A. Patriot Act.

**F. Miscellaneous Matters or Documents:**

- (1) Final approval of the Agreement by Ex-Im Bank.
- (2) Payment of fees and reimbursable costs and expenses due under this Agreement through the date of initial Advance, including all legal expenses incurred through the date of the closing of this Agreement.
- (3) Evidence that after making the initial Advance, establishing all reserves under the Borrowing Base, paying all trade payables older than sixty (60) days from invoice date, and paying all book overdrafts and closing costs and fees (including any fees deemed paid), the combined availability under the Line of Credit under this Agreement and the "Line of Credit" under the Domestic Facility Agreement is not less than \$750,000.
- (4) Any documents or other agreements entered into by Company and Wells Fargo that relate to any swap, derivative, foreign exchange, hedge, deposit, treasury management or similar product or transaction extended to Company by Wells Fargo not already provided pursuant to the requirements of (A) through (E) above.
- (5) Such other documents as Wells Fargo in its sole discretion may require.

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**Exhibit D to Credit and Security Agreement (Ex-Im Subfacility)**

**REPRESENTATIONS AND WARRANTIES**

Company represents and warrants to Wells Fargo as follows:

- (a) Existence and Power; Name; Chief Executive Office; Inventory and Equipment Locations; Federal Employer Identification Number and Organizational Identification Number. Company is a corporation, organized, validly existing and in good standing under the laws of the State of Delaware and is licensed or qualified to transact business in all jurisdictions where the character of the property owned or leased or the nature of the business transacted by it makes such licensing or qualification necessary, except where failure to do so could not reasonably be expected to have a Material Adverse Effect. Company has all requisite power and authority to conduct its business, to own its properties and to execute and deliver, and to perform all of its obligations under, those Loan Documents and any other documents or agreements that it has entered into with Wells Fargo related to this Agreement. During the last five (5) years of its existence, Company has done business solely under the names set forth below in addition to its correct legal name. Company's chief executive office and principal place of business is located at the address set forth below, and all of Company's records relating to its business or the Collateral are kept at that location. All Inventory and Equipment is located at that location or at one of the other locations set forth below. Company's name, Federal Employer Identification Number and Organization Identification Number are

correctly set forth at the end of the Agreement next to Company's signature.

**Trade Names**

Capstone  
Capstone Microturbine

**Chief Executive Office / Principal Place of Business**

21211 Nordhoff Street, Chatsworth, California 91311

**Other Inventory and Equipment Locations**

Aard Stamping, 42075 Avenida Alvarado, Temecula, CA 92590  
Accurate Electronics, 20700 Lassen Street, Chatsworth, CA 91311  
Alliance Metal Products, 20620 Superior Street, Unit #4, Chatsworth, CA 91311

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AMANET, 16525 Sherman Way#C-11, Van Nuys, CA 91406  
American Aikoku Alpha, Inc., 520 Lake Cook Rd, Ste. 180, Deerfield, IL 60015  
Asigma, 2930 San Luis Rey Road, Oceanside CA 92054  
Auer Precision Co., 1050 W. Birchwood, Mesa, AZ 85210  
Axiomtek, 18138 Rowland, City of Industry, CA 91748  
Bebco Industries, 4725 Lawndale, Lamarque, TX 77568  
Cliffdale Mfg. Company, 20409 Prairie Street, Chatsworth, CA 91311  
Delafield, 152 Flower Avenue, Duarte, CA 91010  
Dry Coolers, 3232 Adventure Ln., Oxford, MI 48371  
Electro Controls, Inc., 1625 Ferguson Ct., Sidney, OH 45365  
Elgiloy Specialty Metals, 1565 Fleetwood Drive, Elgin, IL 68123  
EM Corporation, 1 John Downey Drive, New Britain, CT 06051  
Enercon Engineering, Inc., No. 1 Altofrer Lane, East Peoria, IL 61611  
Erico, Inc., 34600 Solon Road, Solon, OH 44139  
Frost Magnatics, Inc., 49643 Hartwell Road, Oakhurst, CA 93644  
Fuses Unlimited, 9248 Eton Avenue, Chatsworth, CA 91311  
Ovison Manufacturing, 750 W. Southern Ave., Tempe, AZ 85282  
Extrude Hone, 8800 Somerset Blvd., Paramount, CA 90723  
J&F Machine, Inc., 10563 Progress Way, Cypress, CA 90630  
Karel Manufacturing, 280 Campillo Ave, Suite G, Calexico, CA 92231  
Mc Donald Packaging, 2601 Garnsey Street, Santa Ana, CA 92707-3338  
Pacific Transformer, 5399 E. Hunter Avenue, Anaheim, CA 92807  
Parker Energy Systems, 95 Edgewood Avenue, New Britain, CT 06051

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Polymax, 1224 W 130th St., Gardena, CA 90247

Precision Resources, 13916 Cordary Avenue, Hawthorne, CA 90250

RND Enterprises, 42122 8th Street East, Lancaster, CA 93535

Robinson FIN Machines, 13670 Highway 68 South, Kenton, OH 43326

Schneider's Mfg. Co, Inc., 11122 Pernrose Street, Sun Valley, CA 91352

Semikron, 11 Executive Drive, Hudson, NH 03051

Sermatech Int'l, 7615 Fairview, Houston, TX 77041

Sermatech Int'l Tech, 24 Landry Street, Biddeford, ME 04005

T.H.T Machining, Inc., 3617 West Cambridge Suite 1B, Phoenix, AZ 85009

Arbo Box, Inc., 12468 Putnam Street, Whittier, CA 90602

Trend Technologies LLC, 4626 Eucalyptus Ave., Chino, CA 91710

Triumph Components — Arizonia, 6733 Westhills Road, Chandler AZ 85226

Turbocam, 5 Faraday Drive, Dover NH 03820

CKE/Verdesis, 1000 Lucernce Road, Lucernemines, PA 15754

Victron, 6600 Stevenson Blvd., Fremont, CA 94538

Weldmac, 1533 North Johnson, El Cajon, CA 92020

Windings, Inc., 208 North Valley Street, P.O. Box 566, New Ulm, MN 56073-0566

F Building, 2-26-5 Nishihara, Shibuya-ku, Tokyo, JAPAN

1Room 1105, No.317, Xian Xia Road, Far East Int'l Plaza, Changning District Shanghai, China 200051

Via Fatebenefratelli 15, Milano, Italy 20121

Suite 4, Floor 6, City Gate East, Toll House Hill, Nottingham, England NG1 5SF

Campos Eliseos 154-101, 11580 Polanco, Mexico

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(b) Organization. The Organizational Chart below shows the ownership structure of all Subsidiaries of Company.

<u>Holder</u>	<u>Type of Rights/Stock</u>	<u>No. of Shares (after exercise of all rights to acquire shares)</u>	<u>% Interest (on a fully diluted basis)</u>
Capstone Turbine Corporation	Common	1000	100%

(c) Authorization of Borrowing; No Conflict as to Law or Agreements. The execution, delivery and performance by Company of the Loan Documents and any other documents or agreements described in or related to this Agreement, and all borrowing under the Line of Credit have been authorized and do not (i) require the consent or approval of Company's Owners; (ii) require the authorization, consent or approval by, or registration, declaration or filing with (except for the filing of any financing statements or similar documents), or notice to, any governmental agency or instrumentality, whether domestic or foreign, or any other Person, except to the extent obtained, accomplished or given prior to the date of this Agreement; (iii) violate any provision of any law, rule or regulation (including Regulation X of the Board of Governors of the Federal Reserve System) or of any order, writ, injunction or decree presently in effect having applicability to Company or of Company's Constituent Documents; (iv) result in a breach of or constitute a default or event of default under any indenture or loan or credit agreement or any other material agreement, lease or instrument to which Company is a party or by which it or its properties may be bound or affected; or (v) result in, or require, the creation or imposition of any Lien (other than the Security Interest) upon or with respect to any of the properties now owned or subsequently acquired by Company.

(d) Legal Agreements. This Agreement, the other Loan Documents, and any other document or agreement described in or

related to this Agreement, will constitute the legal, valid and binding obligations of Company, enforceable against Company in accordance with their respective terms.

- (e) Subsidiaries. Except as disclosed below, Company has no Subsidiaries.

#### **Subsidiaries**

Capstone Turbine International, Inc., a Delaware corporation

- (f) Financial Condition; No Adverse Change. Company has furnished to Wells Fargo its audited financial statements for its fiscal year ended March 31, 2008, and unaudited financial statements for the fiscal-year-to-date period ended September 30, 2008, and those statements fairly present Company's financial

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condition as of those dates and the results of Company's operations and cash flows for the periods then ended and were prepared in accordance with GAAP. Since the date of the most recent financial statements, there has been no Material Adverse Effect.

- (g) Litigation. Except as disclosed below, there are no actions, suits or proceedings pending or, to Company's knowledge, threatened against or affecting Company or any of its Affiliates or the properties of Company or any of its Affiliates before any court or governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, which, if determined adversely to Company or any of its Affiliates, would have a Material Adverse Effect on the financial condition, properties or operations of Company or any of its Affiliates.

#### **Litigation**

In December 2001, a purported stockholder class action lawsuit was filed in the United States District Court for the Southern District of New York (the "District Court") against the Company, two of its then 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. The 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. The 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.

- (h) Intellectual Property Rights.
- (i) Owned Intellectual Property. Set forth below is a complete list of all patents, applications for patents, trademarks, applications to register trademarks, service marks, applications to register service marks, mask works, trade dress and copyrights for which Company is the owner of record (the "Owned Intellectual Property"). Except as set forth below, (A) Company owns the Owned Intellectual Property free and clear of all restrictions (including covenants not to sue any Person), court orders, injunctions, decrees, writs or Liens, whether by agreement memorialized in a Record Authenticated by Company or otherwise, (B) no Person other than Company owns or has been granted any right in the Owned Intellectual Property, (C) all Owned Intellectual Property is valid, subsisting and enforceable, and (D) Company has taken all commercially reasonable action necessary to maintain and protect the Owned Intellectual Property.

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- (i) Agreements with Employees and Contractors. Company has entered into a legally enforceable agreement with each Person that is an employee or subcontractor obligating that Person to assign to Company, without additional compensation, any Intellectual Property Rights created, discovered or invented by that Person in the course of that Person's employment or engagement with Company (except to the extent prohibited by law), and further obligating that Person to cooperate with Company, without additional compensation, to secure and enforce the Intellectual Property Rights on behalf of Company, unless the job description of the Person is such that it is not reasonably foreseeable that the employee or subcontractor will create, discover, or invent Intellectual Property Rights.
- (ii) Intellectual Property Rights Licensed from Others. Set forth below is a complete list of all agreements under which Company has licensed Intellectual Property Rights from another Person ("Licensed Intellectual Property") other than readily available, non-negotiated licenses of computer software and other intellectual property used solely for performing accounting, word processing and similar administrative tasks ("Off-the-shelf Software") and a summary of any ongoing payments Company is obligated to make with respect thereto. Except as set forth below or in any other Record, copies of which have been given to Wells Fargo, Company's licenses to use the Licensed Intellectual Property are free and clear of all restrictions, Liens, court orders, injunctions, decrees, or writs, whether by agreed to in a Record Authenticated by Company or otherwise. Except as disclosed below, Company is not contractually obligated to make royalty payments of a material nature, or pay fees to any owner of, licensor of, or other claimant to, any Licensed Intellectual Property Rights (excluding

Off-the-shelf Software”).

- (iii) Other Intellectual Property Needed for Business. Except for Off-the-shelf Software and as disclosed below, the Owned Intellectual Property and the Licensed Intellectual Property constitute all Intellectual Property Rights used or necessary to conduct Company’s business as it is presently conducted or as Company reasonably foresees conducting it.
- (iv) Infringement. Except as disclosed below, Company has no knowledge of, and has not received notice either orally or in a Record alleging, any Infringement of another Person’s Intellectual Property Rights (including any claim set forth in a Record that Company must license or refrain from using the Intellectual Property Rights of any Person) nor, to Company’s knowledge, is there any threatened claim or any reasonable basis for any such claim.

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### **PATENTS AND PATENT APPLICATIONS**

#### **1. Capstone Issued U.S. Patents**

<b>No</b>	<b>Issue No.</b>	<b>Description</b>	<b>App. Ser. No.</b>	<b>Filing Date</b>	<b>Issue Date</b>
1.	D433,997	Turbogenerator	29/111,104	9/20/99	11/21/00
2.	5,427,455	Compliant Foil Hydrodynamic Fluid Film Radial Bearing	229,205	4/18/94	6/27/95
3.	5,497,615	Gas Turbine Generator Set	180,881	3/21/94	3/12/96
4.	5,529,398	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	08/363,540	12/23/94	6/25/96
5.	5,685,156	Catalytic Combustion System	650,625	5/20/96	11/11/97
6.	5,697,848	Compound Shaft with Flexible Disk Coupling	440,541	5/12/95	12/16/97
7.	5,752,380	Liquid Fuel Pressurization and Control System	730,941	10/16/96	5/19/98
8.	5,791,868	Thrust Load Compensating System for a Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	663,732	6/14/96	8/11/98
9.	5,819,524	Gaseous Fuel Compression and Control S&M	730,945	10/16/96	10/13/98
10.	5,827,040	Hydrostatic Augmentation of a Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	662,250	6/14/96	10/27/98
11.	5,850,732	Low Emissions Combustion System for a Gas Turbine Engine	855,210	5/13/97	12/22/98
12.	5,850,733	Gaseous Fuel Compression and Control S&M	85,817	5/27/98	12/22/98
13.	5,873,235	Liquid Fuel Pressurization and Control Method	990,467	12/15/97	2/23/99
14.	5,894,720	Low Emissions Combination System For A Gas Turbine Engine Employing Flame Stabilization Within The Injector Tube	09/168,299	10/7/98	4/20/99
15.	5,899,673	Helical Flow Compressor/Turbine Permanent Magnet Motor/Generator	08/730,946	10/16/96	5/4/99
16.	5,903,116	Turbogenerator/Motor Controller	08/924,966	9/8/97	5/11/99
17.	5,915,841 See Re39190	Compliant Foil Fluid Film Radial Bearing	09/002,690	1/5/98	6/29/99
18.	5,918,985 See Re38373	Compliant Foil Fluid Thrust Film Bearing With a Tilting Pad Underspring	08/933,695	9/19/97	7/6/99
19.	5,964,663	Double Diaphragm Compound Shaft	08/934,430	9/19/97	10/12/99
20.	5,966,926	Liquid Fuel Injector Purge System	08/864,279	5/28/97	10/19/99
21.	6,016,658	Low Emissions Combustion System	09/182,966	10/8/98	1/25/00
22.	6,020,713	Turbogenerator/Motor Pulse Width Modulated Controller	09/002,890	1/5/98	2/1/00
23.	6,023,135	Turbogenerator/Motor Control System	09/080,892	5/18/98	2/8/00
24.	6,031,294	Turbogenerator/Motor Controller With Ancillary Energy Storage/Discharge	09/003,078	1/5/98	2/29/00
25.	6,037,687	Double Diaphragm Compound Shaft	09/224,208	12/30/98	3/14/00
26.	6,049,195	Split Generator Winding Inverter	09/356,065	7/19/99	4/11/00

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<b>No</b>	<b>Issue No.</b>	<b>Description</b>	<b>App. Ser. No.</b>	<b>Filing Date</b>	<b>Issue Date</b>
27.	6,062,016	Gas Turbine Engine Fixed Speed Light-Off	08/837,600	4/21/97	5/16/00
28.	6,065,281	Liquid Fuel Injector and Injector System	09/357,523	7/19/99	5/23/00
29.	6,070,404	Gaseous Fuel Compression and Control Method	09/086,615	5/27/98	7/6/00
30.	6,082,112	Liquid Fuel Injector	09/357,519	7/19/99	7/4/00
31.	6,093,975	Turbogenerator/Motor Control	09/181,388	10/27/98	7/25/00
32.	6,094,799	Method of Making Double Diaphragm Compound Shaft	09/224,206	12/30/98	8/1/00
33.	6,155,780	Ceramic Radial Flow Turbine Heat Shield	09/374,916	8/13/99	12/5/00
34.	6,158,892	Fluid Film Thrust Bearing Having Integral	09/383,067	8/25/99	12/12/00

No	Issue No.	Description	App. Ser. No.	Filing Date	Issue Date
		Compliant Foils			
35.	6,169,334	Command and Control S&M for Multiple Turbogenerators	09/181,389	10/27/98	1/2/01
36.	6,178,751	Liquid Fuel Injector System	09/356,479	7/19/99	1/30/01
37.	6,190,048	Compliant Foil Fluid Film Radial Bearing	09/195,354	11/18/98	2/20/01
38.	6,192,668	M&A for Compressing Gaseous Fuel In a Turbine Engine	09/420,494	10/19/99	2/27/01
39.	6,194,794	Integrated Reciprocating Engine Generator Set and Turbogenerator System and Method	09/359,815	7/23/99	2/27/01
40.	6,213,234	Vehicle Powered by a Fuel Cell/Gas	09/202,968	—	4/10/01
41.	6,239,520	Permanent Magnet Rotor Cooling S&M	09/558,406	4/24/00	5/29/01
42.	6,265,786	Turbogenerator Power Control System	09/181,213	10/27/98	7/24/01
43.	6,274,945	Combustion Control Method and System	09/459,719	12/13/99	8/14/01
44.	6,281,596	Automatic Turbogenerator Restarting M&S	09/444,487	11/19/99	8/28/01
45.	6,281,601	Turbogenerator Power Control S&M	09/360,043	7/23/99	8/28/01
46.	6,325,142	Turbogenerator Power Control System	09/316,896	5/22/99	12/4/01
47.	6,361,271	Crossing Spiral Compressor/Pump	09/444,014	11/19/99	3/26/02
48.	6,381,944	M&A for Compressing Gaseous Fuel in a Turbine Engine	09/772,537	1/29/01	5/7/02
49.	6,405,522	S&M for Modular Control of a Multi-Fuel Low Emissions Turbogenerator	09/453,825	12/1/99	6/18/02
50.	6,410,992	S&M for Dual Mode Control of a Turbogenerator/Motor	09/644,527	8/23/00	6/25/02
51.	6,425,732	Shrouded Rotary Compressor	09/643,625	8/22/00	7/30/02
52.	6,437,468	Permanent Magnet Rotor Cooling System and Method	09/829,778	4/10/01	8/20/02
53.	6,438,937	S&M for Modular Control of a Multi-Fuel Low Emissions	09/972,672	10/5/01	8/27/02

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No	Issue No.	Description	App. Ser. No.	Filing Date	Issue Date
		Turbogenerator			
54.	6,453,658	Multi-Stage Multi-Plane Combustion System for a Gas Turbine Engine	09/512,986	2/24/00	9/24/02
55.	6,468,051	Helical Flow Compressor/Turbine Permanent Magnet Motor/ Generator	09/800,900	3/7/01	10/22/02
56.	6,487,096	Power Controller	09/207,817	12/8/98	11/26/02
57.	6,489,692	Method and Apparatus for Controlling Rotation of A Magnetic Rotor	09/459,426	12/13/99	12/3/02
58.	6,495,929	Turbogenerator Power Control System	09/829,035	4/9/01	12/17/02
59.	6,522,030	Multiple Power Generator Connection Method and System	09/624,315	7/24/00	2/18/03
60.	6,539,720	Generated System Bottoming Cycle	09/985,789	11/6/01	4/1/03
61.	6,552,440	Automatic Turbogenerator Restarting Method & System	09/900,246	7/6/01	4/22/03
62.	6,612,112	Transient Turbine Exhaust Temperature Control For A Turbogenerator	10/012,770	11/5/01	9/2/03
63.	6,629,064	Apparatus and Method for Distortion Compensation	09/265,729	3/9/99	9/30/03
64.	6,634,176	Turbine Exhaust Vortex Disrupter	09/977,445	10/15/01	10/21/03
65.	6,639,328	Microturbine/Capacitor Power Distribution System	10/033,826	12/19/01	10/28/03
66.	6,657,332	Turbogenerator Cooling System	09/984,501	10/30/01	12/2/03
67.	6,657,348	Rotor Shield For Magnetic Rotary Machine	09/985,439	11/2/01	12/2/03
68.	6,664,653	Command and Control System and Method for Controlling Operational Sequencing of Multiple Turbogenerators Using a Selected Control Mode	09/689,577	10/12/00	12/16/03
69.	6,664,654	System and Method for Dual Mode Control of a Turbogenerator/Motor	10/158,095	5/29/02	12/16/03
70.	6,675,583	Combustion Method	09/969,491	11/2/01	1/13/04
71.	6,683,389	Hybrid Electric Vehicle DC Power Generation System	09/938,101	8/23/01	1/27/04
72.	6,684,642	Gas Turbine Engine Having a Multi-Stage Multi-Plane Combustion System	10/171,684	6/17/02	2/3/04
73.	6,702,463	Compliant Foil Thrust Bearing	09/714,349	11/15/00	3/9/04
74.	6,709,243	Rotary Machine With Reduced Axial Thrust Loads	09/696,316	10/25/00	3/23/04
75.	6,713,892	Automatic Turbogenerator Restarting Method and System	09/900,635	7/6/01	3/30/04
76.	6,720,685	Turbogenerator Cooling System (Div Of 09/984,501)	10/339,247	1/9/03	4/13/04

77.	6,732,531	Combustion System for a Gas Turbine Engine With Variable	10/101,032	3/18/02	5/11/04
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No	Issue No.	Description	App. Ser. No.	Filing Date	Issue Date
		Airflow Pressure Actuated Premix Injector			
78.	6,747,372	Distributed Control Method for Multiple Connected Generators	10/007,219	11/2/01	6/8/04
79.	6,748,742	Power Offsetting Compressor System	10/008,047	11/7/01	6/15/04
80.	6,751,941	Foil Bearing Rotary Flow Compressor With Control Valve	10/080,179	2/19/02	6/22/04
81.	6,784,565	Turbogenerator With Electrical Brake	10/077,121	2/15/02	8/31/04
82.	6,787,933	Power Generation System Having Transient Ride-Through/Load-Leveling Capabilities	10/043,694	1/10/2002	9/7/2004
83.	6,804,946	Combustion System With Shutdown Fuel Purge	10/720,145	11/25/03	10/19/04
84.	6,812,586	Distributed Power System	10/066,349	1/30/02	11/2/04
85.	6,812,587	Continuous Power Supply With Back-Up Generation	10/300,936	11/21/02	11/2/04
86.	6,815,932	Detection of Islanded Behavior and Anti-Islanding Protection of a Generator in Grid-Connected Mode	09/975,148	10/12/01	11/9/04
87.	6,864,595	Detection of Islanded Behavior and Anti-Islanding Protection of a Generator in Grid-Connected Mode	10/812,979	3/31/04	3/8/05
88.	6,870,279	Method And System For Control Of Turbogenerator Power And Temperature	10/037,916	1/2/02	3/22/05
89.	6,951,110	Annular Recuperator Design	09/966,514	9/27/01	10/4/05
90.	6,958,550	Method and System For Control of Turbogenerator Power and Temperature	10/887,297	7/9/04	10/25/05
91.	6,960,840	Integrated Turbine Power Generation System With Catalytic Reactor	10/706,070	11/13/03	11/1/05
92.	7,065,873	Recuperator Assembly and Procedures	10/917,118	8/12/04	6/27/06
93.	7,092,262	Pre-charge Circuit and Method	10/813,550	3/31/04	8/15/06
94.	7,112,036	Rotor and Bearing System For A Turbomachine	10/862,136	6/4/04	9/26/06
95.	7,147,050	Recuperator Construction For a Gas Turbine Engine	10/917,107	8/12/04	12/12/06
96.	7,415,764	Recuperator Assembly And Procedures	11/336,718	1/20/06	8/26/08
97.	RE38,373	Compliant Foil Fluid Thrust Film Bearing With a Tilting Pad Underspring (Reissue of 5,918,985)	09/900,775	7/6/01	12/30/03
98.	RE39,190	Compliant Foil Fluid Film Radial Bearing (Reissue of 5,915,841.)	09/895,568	—	7/18/06

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## II. CAPSTONE PENDING U.S. PATENT APPLICATIONS

Description	App. Ser. No.	Filing Date
Turbogenerator/Motor Controller (Reissue)	09/853,852	5/11/01
Emergency Elevator System Interface Package	11/517,957	9/8/06
Compliant Foil Fluid Film Radial Bearing Or Seal	11/740,798	4/26/2007

## III. CAPSTONE ISSUED FOREIGN PATENTS

Issue No.	Description	Country	App. Ser. No.
0746680	Gas Turbine Engine Generator Set	Europe	95909213.1
69527283.7 in DE	(U.S. 5,497,615)		
0 799 388	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	Europe	95937420.8
69519684.7 in DE	(U.S. 5,529,398)		
0 756 672	Compliant Foil Hydrodynamic Fluid Radial Bearing	Europe	95914005.4
69522683.5 in DE	(U.S. 5,427,455)		
1001180	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing (divisional)	Europe	00200446.3
69532538.8 in DE	(U.S. 5,529,398)		
3725548	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing	Japan	0520429/96
	(U.S. 5,529,398)		
0903466	Double Diaphragm Compound Shaft	Europe	98307606.8
69824801.5 in DE	(U.S. 5,964,663)		
0878665	Low Emissions Combustion System For a Gas Turbine Engine	Europe	98303693.0

	(U.S. 5,850,732)		
122912	Low Emissions Combustion System For A Gas Turbine Engine (U.S. 5,850,732)	Israel	122912
112275	Gas Turbine Engine Generator Set (U.S. 5,497,615)	Israel	112275
117546	Compliant Foil Hydrodynamic Fluid Film Thrust Bearing (U.S. 5,529,398)	Israel	117546
113289	Compliant Foil Hydrodynamic Fluid Radial Bearing (U.S. 5,427,455)	Israel	113289
118216	Compound Shaft (U.S. 5,697,848)	Israel	118216
121531	Gaseous Fuel Compression And Control System	Israel	121531

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Issue No.	Description	Country	App. Ser. No.
	(U.S. 5,819,524)		
124664	Compliant Foil Fluid Film Thrust Bearing (U.S. 5,918,985)	Israel	124664
125679	Double Diaphragm Compound Shaft (U.S. 5,964,663)	Israel	125679
127021	Compliant Foil Film Radial Bearing (U.S. 5,915,841)	Israel	127021
125905	Turbogenerator/motor Controller With ancillary Energy Storage/Discharge (B2) (U.S. 6,031,294)	Israel	125905
137542	Turbogenerator/motor Controller (B1) (U.S. 5,903,116)	Israel	137542
121532	Helical Flow Compression Turbine With Permanent Magnet Motor/Generator (U.S. 5,899,673)	Israel	121532
3598437	Compliant Foil Hydrodynamic Fluid Film Radial Bearing (U.S. 5,427,455)	Japan	7-526958
1075724	Power Controller (B3) (U.S. 6,487,096)	Europe	98962993.6
0903510 GB and Fr.; 69830961.8-08 Germ.	Compliant Foil Fluid Film Thrust Bearing with Tilting Pad Underspring (U.S. 5,918,985)	Europe	98307596.1
0927831 GB and Fr.; 69832579.6-08 Germ.	Compliant Foil Fluid Film Radial Bearing (U.S. 5,915,841)	Europe	98310805.1
0901218 GB and Fr.; 69832860.4-08 Germ.	Turbogenerator/Motor Controller (B1) (U.S. 5,903,116)	Europe	98307247.1
1130322 GB and FR; 60125441.4 Germany	Multi-Stage Multi-Plane Combustion System for a Gas Turbine Engine (U.S. 6,453,658)	Europe	01301676.1
1337761 in GB, FR and IT; 60125583.6 in Germany	Compliant Foil Thrust Bearing (U.S. 6,702,463)	Europe	01996693.6
2,242,947	Double Diaphragm Compound Shaft (U.S. 5,964,663)	Canada	2,242,947
2,254,034	Compliant Foil Fluid Film Radial Bearing	Canada	2,254,034

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Issue No.	Description	Country	App. Ser. No.
	(U.S. 5,915,841)		
0963035 Germany 69936424.8	Turbogenerator/Motor Control System (U.S. 6,023,135)	Europe	99303642.5
2,238,356	Compliant Foil Fluid Film Thrust Bearing with Tilting Pad Underspring (U.S. 5,918,985)	Canada	2,238,356

#### IV. CAPSTONE PENDING FOREIGN PATENT APPLICATIONS

Description	Country	App. Ser. No.	Filing Date
Command and Control System and Method For Multiple Turbogenerators (U.S. 6,169,334)	Canada	2,279,047	7/29/99
Helical Flow Compressor/Turbine Permanent Magnet Motor/Generator	Japan	2000-117024	4/19/99

(U.S. 6,468,051)				
Turbogenerator/Motor Controller (B1)	Canada		2,246,769	9/8/98
(U.S. 5,903,116)				
Compliant Foil Fluid Film Thrust Bearing With a Tilting Pad Underspring	Japan		10-250675	9/4/98
(U.S. 5,918,985)				
Compliant Foil Fluid Film Radial Bearing	Japan		10-347079	12/7/98
(U.S. 5,915,841)				
Multi-Stage Multi-Plane Combustion System For a Gas Turbine Engine	Japan		2001-45027	2/21/01
(U.S. 6,453,658)				
Multiple Power Generator Connection Method and System	Europe		01923202.4	4/6/01
(U.S. 6,522,030)				
Power Controller (B3) (Div. of #131)	Europe		05025283.2	11/18/05
(U.S. 6,487,096)				
Compliant Foil Fluid Film Radial Bearing Or Seal	PCT		PCT/US08/57716	3/20/2008

#### TRADEMARK APPLICATIONS AND REGISTRATIONS BY COUNTRY

Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
CAPSTONE	Australia	—	755,739	Registered	February 23, 2018

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
	Australia	—	755,737	Registered	February 23, 2018
CAPSTONE	Brazil	824/638,859	824/638,859	Registered	November 20, 2017
CAPSTONE	Bulgaria	41,473	37,397	Registered	July 28, 2008(1)
CAPSTONE	Bulgaria	42,775	34,967	Registered	July 28, 2008
	Bulgaria	42,776	34,968	Registered	July 28, 2008
CAPSTONE	Canada	870,563	TMA 563,894	Registered	June 21, 2017
	Canada	870,564	TMA 504,764	Registered	November 30, 2013
CAPSTONE	China (PRC)	9,800,017,341	1,291,874	Registered	July 06, 2009
CAPSTONE	China (PRC)	9,800,017,342	1,284,494	Registered	June 13, 2009
CAPSTONE	China (PRC)	9,800,017,343	1,299,981	Registered	July 27, 2009
CAPSTONE	China (PRC)	9,800,017,344	1,301,274	Registered	August 06, 2009
	China (PRC)	9,800,017,340	1,284,495	Registered	June 13, 2009
CAPSTONE	CTM	637,082	637,082	Registered	September 23, 2017
CAPSTONE	CTM	745,109	745,109	Registered	February 13, 2018

(1) Bulgaria — Renewals have been issued for these registrations.

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
	CTM	524,306	524,306	Registered	April 29, 2017
CAPSTONE	Czech Republic	128,183	212,315	Registered	December 05, 2017
CAPSTONE	Czech Republic	128,352	218,818	Registered	December 11, 2017
CAPSTONE	Czech Republic	128,353	218,819	Registered	December 11, 2017
CAPSTONE	Czech Republic	130,446	228,042	Registered	February 25, 2018

	Czech Republic	130,447	228,043	Registered	February 25, 2018
CAPSTONE	Estonia	9,800,433	29,393	Registered	September 03, 2009
CAPSTONE	Estonia	EE9,702,761	28,852	Registered	May 26, 2009
CAPSTONE	Estonia	EE9,702,762	28,853	Registered	May 26, 2009
	Estonia	9,800,434	29,394	Registered	September 03, 2009
CAPSTONE	Hungary	M9,704,089	157,005	Registered	November 06, 2017
CAPSTONE	Hungary	M9,800,530	155,108	Registered	February 16, 2018
	Hungary	M9,800,529	155,107	Registered	February 16, 2018
CAPSTONE	India	769,311	769,311	Registered	September 23, 2017
	India	769,314	769,314	Registered	September 23, 2017
CAPSTONE	Indonesia	D00.2002.142 59.14414	543,704	Registered	July 04, 2012
CAPSTONE	Israel	115,027	115,027	Registered	September 23, 2018
CAPSTONE	Israel	115,028	115,028	Registered	September 23, 2018

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
CAPSTONE	Israel	115,029	115,029	Registered	September 23, 2018
CAPSTONE	Israel	117,832	117,832	Registered	February 15, 2019
	Israel	112,062	112,062	Registered	April 30, 2018
	Israel	112,063	112,063	Registered	April 30, 2018
CAPSTONE	Japan	05-077077	3,179,900	Registered	July 31, 2016
CAPSTONE	Japan	10-017382	4,414,046	Registered	September 01, 2010
CAPSTONE	Japan	9-174425	4,413,826	Registered	September 01, 2010
CAPSTONE (in Katakana)	Japan	62-4732	2,221,178	Registered	April 23, 2010
	Japan	9-112736	4,378,971	Registered	April 21, 2010
CAPSTONE	Malaysia	98/02655	9,802,655	Registered	September 16, 2017
CAPSTONE	Malaysia	98/02658	9,802,658	Registered	March 04, 2018
CAPSTONE	Malaysia	98/02659	9,802,659	Registered	September 04, 2017
CAPSTONE	Malaysia	98/02660	9,802,660	Registered	March 04, 2018
	Malaysia	98/02656	9,802,656	Registered	March 04, 2018

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
	Malaysia	98/02657	9,802,657	Registered	March 04, 2018
CAPSTONE	Mexico	324,506	576,585	Registered	March 04, 2008(2)
CAPSTONE	Mexico	324,507	579,612	Registered	March 04, 2008
CAPSTONE	Mexico	324,508	577,332	Registered	March 04, 2008
CAPSTONE	Mexico	324,509	582,024	Registered	March 04, 2008

	Mexico	324,510	578,232	Registered	March 04, 2008
	Mexico	324,512	582,025	Registered	March 04, 2008
CAPSTONE	New Zealand	289,011	289,011	Registered	February 26, 2015
CAPSTONE	New Zealand	289,012	289,012	Registered	February 26, 2015
CAPSTONE	New Zealand	289,013	289,013	Registered	September 04, 2014
CAPSTONE	New Zealand	289,014	289,014	Registered	September 16, 2014
CAPSTONE	New Zealand	311,548	311,548	Registered	June 24, 2016
	New Zealand	289,015	289,015	Registered	February 26, 2015
	New Zealand	289,016	289,016	Registered	February 26, 2015
CAPSTONE	Nigeria	84672/04	RTM 66760	Registered	February 04, 2011
CAPSTONE	Nigeria	84673/04	RTM 66750	Registered	February 04, 2011

(2) **Mexico** — Renewal petitions and change of legal address have been filed with the Mexican Intellectual Property Office.

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
	Nigeria	84670/04	RTM 66752	Registered	February 04, 2011
	Nigeria	84671/04	RTM 66761	Registered	February 04, 2011
CAPSTONE	Poland	Z-180,350	125,456	Registered	November 20, 2017
CAPSTONE	Poland	Z-184,099	128,663	Registered	March 02, 2018
	Poland	Z-183,816	130,098	Registered	February 24, 2018
CAPSTONE	Republic of Korea	97/52389	430,990	Registered	November 25, 2008(3)
CAPSTONE	Republic of Korea	97/52390	438,925	Registered	January 22, 2009
CAPSTONE	Republic of Korea	98/1917	54,995	Registered	May 17, 2009
CAPSTONE	Republic of Korea	98/9567	59,573	Registered	February 15, 2010
	Republic of Korea	97/45930	427,401	Registered	October 28, 2008
	Republic of Korea	97/45931	430,962	Registered	November 25, 2008
CAPSTONE	Romania	47,388	34,319	Registered	December 09, 2017
CAPSTONE	Romania	50,051	35,291	Registered	March 16, 2018

(3) **Republic of Korea** — Renewal applications have been filed for the two pertinent registrations in the Republic of Korea. Delay has been caused due to Korea's change of classification of goods into a separate international class number. Waller Lansden Dortch & Davis is awaiting renewal certificates and next renewal deadlines from local counsel.

<b>Trademark</b>	<b>Jurisdiction</b>	<b>Application Number</b>	<b>Reg. Number</b>	<b>Status</b>	<b>Renewal Deadline</b>
	Romania	50,052	35,292	Registered	March 16, 2018
CAPSTONE	Russian Federation	97,718,654	174,403	Registered	December 05, 2017
CAPSTONE	Russian Federation	97,718,655	173,434	Registered	December 05, 2017
CAPSTONE	Russian Federation	97,718,656	173,435	Registered	December 05, 2017
CAPSTONE	Russian Federation	98,702,564	176,654	Registered	February 18, 2018
	Russian Federation	98,702,573	176,655	Registered	February 18, 2018
CAPSTONE	Slovak Republic	0499-98	191,841	Registered	February 27, 2018
CAPSTONE	Slovak Republic	3643-97	189,134	Registered	December 11, 2017
CAPSTONE	Slovak Republic	3655-97	188,650	Registered	December 11, 2017
CAPSTONE	Slovak Republic	3656-97	188,651	Registered	December 11, 2017
	Slovak Republic	0500-98	191,068	Registered	February 27, 2018
CAPSTONE	Slovenia	Z-9771850	9,771,850	Registered	December 11, 2017
CAPSTONE	Slovenia	Z-9870250	9,870,250	Registered	February 26, 2018
	Slovenia	Z-9870249	9,870,249	Registered	February 26, 2018
CAPSTONE	South Africa	98/02522	98/02522	Registered	February 20, 2018
CAPSTONE	South Africa	98/02523	98/02523	Registered	February 20, 2018
CAPSTONE	South Africa	98/02524	98/02524	Registered	February 20, 2018
CAPSTONE	South Africa	98/02525	98/02525	Registered	February 20, 2018

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<b>Trademark</b>	<b>Jurisdiction</b>	<b>Application Number</b>	<b>Reg. Number</b>	<b>Status</b>	<b>Renewal Deadline</b>
	South Africa	2004/03561	2004/03561	Registered	March 08, 2014
	South Africa	98/02526	98/02526	Registered	February 20, 2018
	South Africa	98/02527	98/02527	Registered	February 20, 2018
CAPSTONE	Switzerland	04728/2002	502,265	Registered	May 27, 2012
CAPSTONE	Ukraine	98/020713	20,994	Registered	February 23, 2018
	Ukraine	98/020714	20,655	Registered	February 23, 2018
CAPSTONE	USA	74/732,798	2,058,307	Registered	April 29, 2017
CAPSTONE	USA	75/306,958	2,248,687	Registered	June 01, 2009
CAPSTONE	USA	75/351,980	2,201,317	Registered	November 03, 2018
CAPSTONE	USA	75/357,665	2,487,869	Registered	September 11, 2011
	USA	78/166,520	2,993,044	Registered	September 06, 2015
	USA	78/975,666	2,940,243	Registered	April 12, 2015
CAPSTONE	USA	78/166,520	2,956,871	Registered	May 21, 2015

MICROTURBINE	USA	78/100,322	2,950,871	Registered	May 31, 2015
	USA	78/970,583	—	Pending	—
	USA	75/191,384	2,144,240	Registered	March 17, 2018

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Trademark	Jurisdiction	Application Number	Reg. Number	Status	Renewal Deadline
SAFE RETURN SYSTEM	USA	78/947,172	—	Pending	—
SRS	USA	78/947,412	—	Pending	—

#### INTELLECTUAL PROPERTY RIGHTS LICENSED FROM THIRD PARTIES

1. Licensing Agreement, dated as of April 14, 2008, between the Company and United Technologies Corporation, Pratt & Whitney, which grants the Company a non-exclusive, non-transferable license, without the right to sub-license, to use the patents and/or technical information related to material and material properties listed on Exhibit A attached thereto and the related Technical Support (as defined therein) for the design of the C200, as agreed upon in that certain Development and License Agreement, dated as of September 7, 2007, between the parties thereto. All fees for such license have been paid in full in advance.

2. Amended and Restated License Agreement, dated as of August 2, 2000 (“Solar License Agreement”), between the Company and Solar Turbines Incorporated (“Solar”), which grants the Company a non-exclusive, non-transferable license, without the right to sub-license to use the Solar Intellectual Property (as defined therein) as set forth therein. The Company pays to Solar a royalty for each Licensed Product (as defined in the Solar License Agreement) manufactured by the Company in accordance with the Solar License Agreement pursuant to the following schedule:

-	0-100kW:	\$	100.00
-	101kW-200kW:	\$	200.00
-	201kW-300kW:	\$	300.00
-	301kW-400kW:	\$	400.00
-	401kW-500kW:	\$	500.00

- i **Bulgaria** — Renewals have been issued for these registrations.
- ii **Mexico** — Renewal petitions and change of legal address have been filed with the Mexican Intellectual Property Office.
- iii **Republic of Korea** — Renewal applications have been filed for the two pertinent registrations in the Republic of Korea. Delay has been caused due to Korea’s change of classification of goods into a separate international class number. Waller Lansden Dortch & Davis is awaiting renewal certificates and next renewal deadlines from local counsel.

- (j) **Taxes.** Company and its Affiliates have paid or caused to be paid to the proper authorities when due all federal, state and local taxes required to be withheld by each of them except for those taxes being contested in good faith by appropriate

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proceedings and for which appropriate reserves have been maintained under GAAP. Company and its Affiliates have filed all federal, state and local tax returns which to the knowledge of the Officers of Company or any Affiliate, as the case may be, are required to be filed, and Company and its Affiliates have paid or caused to be paid to the respective taxing authorities all taxes as shown on these returns or on any assessment received by any of them to the extent such taxes have become due except for those taxes being contested in good faith by appropriate proceedings and for which appropriate reserves have been maintained under GAAP.

- (k) **Titles and Liens.** Company has good and absolute title to all Collateral free and clear of all Liens other than Permitted Liens. No financing statement naming Company as debtor is on file in any office except to perfect only Permitted Liens.
- (l) **No Defaults.** Company is in compliance with all provisions of all agreements, instruments, decrees and orders to which it is a party or by which it or its property is bound or affected, the breach or default of which could have a Material Adverse Effect.
- (m) **Submissions to Wells Fargo.** All financial and other information provided to Wells Fargo by or on behalf of Company in connection with Company’s request for the credit facilities contemplated hereby is (i) true and correct in all material respects, (ii) does not omit any material fact that would cause such information to be misleading, and (iii) as to projections, valuations or proforma financial statements, present a good faith opinion as to such projections, valuations and proforma condition and results.
- (n) **Financing Statements.** Company has previously authorized the filing of financing statements sufficient when filed to perfect the Security Interest and other Liens created by the Security Documents. When such financing statements are filed, Wells

Fargo will have a valid and perfected security interest in all Collateral capable of being perfected by the filing of financing statements. None of the Collateral is or will become a fixture on real estate, unless a sufficient fixture filing has been filed with respect to such Collateral.

- (o) Rights to Payment. Each right to payment and each instrument, document, chattel paper and other agreement constituting or evidencing Collateral is (or, in the case of all future Collateral, will be when arising or issued) the valid, genuine and legally enforceable obligation, subject to no defense, setoff or counterclaim of the account debtor or other obligor named in that instrument.
- (p) Employee Benefit Plans.
  - (i) Maintenance and Contributions to Plans. Except as disclosed below, neither Company nor any ERISA Affiliate (A) maintains or has maintained any Pension Plan, (B) contributes or has contributed to any Multiemployer Plan, or (C) provides or has provided post-retirement

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medical or insurance benefits to employees or former employees (other than benefits required under Section 601 of ERISA, Section 4980B of the IRC, or applicable state law).

- (ii) Knowledge of Plan Noncompliance with Applicable Law. Except as disclosed below, neither Company nor any ERISA Affiliate has (A) knowledge that Company or the ERISA Affiliate is not in full compliance with the requirements of ERISA, the IRC, or applicable state law with respect to any Plan, (B) knowledge that a Reportable Event occurred or continues to exist in connection with any Pension Plan, or (C) sponsored a Plan that it intends to maintain as qualified under the IRC that is not so qualified, and no fact or circumstance exists which may have a material adverse effect on such Plan's tax-qualified status.
- (iii) Funding Deficiencies and Other Liabilities. Neither Company nor any ERISA Affiliate has liability for any (A) accumulated funding deficiency (as defined in Section 302 of ERISA and Section 412 of the IRC) under any Plan, whether or not waived, (B) withdrawal, partial withdrawal, reorganization or other event under any Multiemployer Plan under Section 4201 or 4243 of ERISA, or (C) event or circumstance which could result in financial obligation to the Pension Benefit Guaranty Corporation, the Internal Revenue Service, the Department of Labor or any participant in connection with any Plan (other than routine claims for benefits under the Plan).

#### **Employee Benefit Plans**

**None.**

- (q) Environmental Matters.
  - (i) Hazardous Substances on Premises. Except as disclosed below, there are not present in, on or under the Premises any Hazardous Substances in such form or quantity as to create any material liability or obligation for either Company or Wells Fargo under the common law of any jurisdiction or under any Environmental Law, and no Hazardous Substances have ever been stored, buried, spilled, leaked, discharged, emitted or released in, on or under the Premises in such a way as to create a liability which would have a Material Adverse Effect.
  - (ii) Disposal of Hazardous Substances. Except as disclosed below, Company has not disposed of Hazardous Substances in such a manner as to create any liability under any Environmental Law which would have a Material Adverse Effect.

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- (iii) Claims and Proceedings with Respect to Environmental Law Compliance. Except as disclosed below, there have not existed in the past, nor are there any threatened or impending requests, claims, notices, investigations, demands, administrative proceedings, hearings or litigation relating in any way to the Premises or Company, alleging material liability under, violation of, or noncompliance with any Environmental Law or any license, permit or other authorization issued pursuant thereto.
- (iv) Compliance with Environmental Law; Permits and Authorizations. Except as disclosed below, Company (A) conducts its business at all times in compliance with applicable Environmental Law where the failure to be so in compliance could reasonably be expected to have a Material Adverse Effect, (B) possesses valid licenses, permits and other authorizations required under applicable Environmental Law for the lawful and efficient operation of its business, none of which are scheduled to expire, or withdrawal, or material limitation within the next 12 months, and (C) has not been denied insurance on grounds related to potential environmental liability.
- (v) Status of Premises. Except as disclosed below, the Premises are not and never have been listed on the National Priorities List, the Comprehensive Environmental Response, Compensation and Liability Information System or any similar federal, state or local list, schedule, log, inventory or database.

- (vi) Environmental Audits, Reports, Permits and Licenses. Company has delivered to Wells Fargo all environmental assessments, audits, reports, permits, licenses and other documents describing or relating in any way to the Premises or Company's businesses.

**Environmental Matters**

**Environmental Reports**

Review of Site Conditions, dated February 11, 2005 for 16640 Stagg Street, Van Nuys, California, by TRC

Environmental Site Assessment Report, dated February 27, 2006 for 16640 Stagg Street, Van Nuys, California, by TRC

Indoor Air Quality Investigation, dated April 17, 2006 for 16640 Stagg Street, Van Nuys, California, by Environmics Southwest, LLC

Personal Breathing Zone Sampling, dated July 25, 2006 for 16640 Stagg Street, Van Nuys, California, by Environmics Southwest, LLC

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**Exhibit E to Credit and Security Agreement (Ex-Im Subfacility)**

**COMPLIANCE CERTIFICATE**

To: Wells Fargo Bank, National Association  
Date: [ ], 200 [ ]  
Subject: Financial Statements

In accordance with our Credit and Security Agreement (Ex-Im Subfacility) dated February 9, 2009 (as amended from time to time, the "Credit Agreement"), attached are the financial statements of Capstone Turbine Corporation (the "Company") dated [ ], 200 [ ] (the "Reporting Date") and the year-to-date period then ended (the "Current Financials"). All terms used in this certificate have the meanings given in the Credit Agreement.

**A. Preparation and Accuracy of Financial Statements.** I certify that the Current Financials have been prepared in accordance with GAAP, subject to year-end audit adjustments, and fairly present Company's financial condition as of the Reporting Date.

**B. Name of Company; Merger and Consolidation.** I certify that:

(Check one)

- Company has not, since the date of the Credit Agreement, changed its name or jurisdiction of organization, nor has it consolidated or merged with another Person.
- Company has, since the date of the Credit Agreement, either changed its name or jurisdiction of organization, or both, or has consolidated or merged with another Person, which change, consolidation or merger:  was consented to in advance by Wells Fargo in an Authenticated Record, and/or  is more fully described in the statement of facts attached to this Certificate.

**C. Events of Default.** I certify that:

(Check one)

- I have no knowledge of the occurrence of an Event of Default under the Credit Agreement, except as previously reported to Wells Fargo in a Record.
- I have knowledge of an Event of Default under the Credit Agreement not previously reported to Wells Fargo in a Record, as more fully described in the statement of facts attached to this Certificate, and further, I acknowledge that Wells Fargo may under the terms of the Credit Agreement impose the Default Rate at any time during the resulting Default Period.

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**D. Litigation Matters.** I certify that:

(Check one)

- I have no knowledge of any material adverse change to the litigation exposure of Company or any of its Affiliates or of any Guarantor.
- I have knowledge of material adverse changes to the litigation exposure of Company or any of its Affiliates or of any Guarantor not previously disclosed in Exhibit D, as more fully described in the statement of facts attached to this Certificate.

**E. Financial Covenants.** I further certify that:

(Check and complete each of the following)

1. **Minimum Book Net Worth.** Pursuant to Section 5.2(a) of the Credit Agreement, as of the Reporting Date, Company's Book Net Worth was \$[ ], which  satisfies  does not satisfy the requirement that such amount be not less than the applicable amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

<u>Test Date</u>	<u>Minimum Book Net Worth</u>
December 31, 2008	\$ 61,000,000
January 31, 2009	\$ 57,000,000
February 28, 2009	\$ 52,700,000
March 31, 2009	\$ 51,000,000
April 30, 2009	\$ 48,150,000
May 31, 2009	\$ 45,300,000
June 30, 2009	\$ 46,500,000
July 31, 2009	\$ 43,900,000
August 31, 2009	\$ 41,300,000
September 30, 2009	\$ 44,450,000
October 31, 2009	\$ 42,100,000
November 30, 2009	\$ 39,850,000
December 31, 2009	\$ 44,600,000
January 31, 2010	\$ 42,250,000
February 28, 2010	\$ 40,000,000
March 31, 2010	\$ 45,150,000

2. **Minimum Net Income.** Pursuant to Section 5.2(b) of the Credit Agreement, as of the Reporting Date, Company's Net Income was [\$ ], which  satisfies  does not satisfy the requirement that Net Income be not less than the amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

<u>Test Date</u>	<u>Minimum Net Income</u>
December 31, 2008	\$ <10,800,000 >

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<u>Test Date</u>	<u>Minimum Net Income</u>
March 31, 2009	\$ <11,000,000 >
June 30, 2009	\$ <5,750,000 >
September 30, 2009	\$ <3,200,000 >
December 31, 2009	\$ <1,000,000 >
March 31, 2010	\$ <500,000 >

3. **Minimum Cash to Unreimbursed Line of Credit Advances Coverage Ratio.** Pursuant to Section 5.2(c) of the Credit Agreement, as of the Reporting Date, at all times, Company has  has not  been in compliance with the requirement that the percentage of the unreimbursed "Advances" plus the "L/C Amount" under the Domestic Facility Agreement plus outstanding Advances under the Revolving Notes to the amount of cash plus Cash Equivalents of Company in which Wells Fargo has a perfected first priority security interest be not greater than 80%.

4. **Capital Expenditures.** Pursuant to Section 5.2(d) of the Credit Agreement, for the year-to-date period ending on the Reporting Date, Companies have expended or contracted to expend during the fiscal year ended , 200 , for Capital Expenditures, \$ in the aggregate, which  satisfies  does not satisfy the requirement that such expenditures not exceed \$7,500,000 in the aggregate during the fiscal year ended March 31, 2009, \$10,000,000 in the aggregate during the fiscal year ended March 31, 2010, and zero for each subsequent fiscal year.

Attached are statements of all relevant facts and computations in reasonable detail sufficient to evidence Company's compliance with the financial covenants referred to above, which computations were made in accordance with GAAP.

**Capstone Turbine Corporation**

By: \_\_\_\_\_  
Its: Chief Financial Officer

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**Exhibit F to Credit and Security Agreement (Ex-Im Subfacility)**

**PERMITTED LIENS**

<u>Creditor</u>	<u>Collateral</u>	<u>Jurisdiction</u>	<u>Filing Date</u>	<u>Filing No.</u>
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10826789
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10826805
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10826953
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10826979
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10827001
GE Business Credit Corporation	Various equipment	Delaware	Original Filing Date: 8/13/01 Continuation Filing Date: 2/15/06	10827035
Crown Credit Company	Daewoo Lift Truck, G25P-186, SN: DZ-00140	Delaware	7/28/03	31940421

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<u>Creditor</u>	<u>Collateral</u>	<u>Jurisdiction</u>	<u>Filing Date</u>	<u>Filing No.</u>
General Electric Capital Corporation	Various equipment	Delaware	1/11/06	60109413

**INDEBTEDNESS**

**None.**

**GUARANTIES**

**None.**

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**Exhibit G to Credit and Security Agreement (Ex-Im Subfacility)**

**Borrowing Base Certificate for Ex-Im Guaranteed Line**

(See attached form)

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**BORROWING BASE CERTIFICATE (“BBC”) FOR EXPORT LINE  
Exhibit B to Ex-Im Working Capital Guarantee Credit Agreement**

To: John Curry, VP, Wells Fargo Business Credit  
Tel: 626-685-9918 Fax: 626-844-9063 curry.john@wellsfargo.com  
To: Edmund Catolico, VP, Wells Fargo HSBC Trade Bank  
Tel: 415-396-6166 Fax: 415-975-6558 edmund.catolico@wellsfargo.com

As of Date (“Reporting Date”): \_\_\_\_\_

**Borrower: Capstone Turbine Corporation**

In accordance with the Ex-Im Working Capital Guarantee Credit Agreement dated as of December XX, 2008 (the “Credit Agreement”) and subsequent Amendment, set forth below is the calculation of the Borrowing Base and Availability as of the date shown above (the “Reporting Date”). All terms used in this certificate have the meanings given to them in the Credit Agreement. Unless otherwise indicated, all amounts are as of the Reporting Date.

Per Section 2.04 of the Ex-Im Borrower Agreement, the Borrowing Base Certificate must be supported by Export Orders from Borrower's Buyers. This can be submitted monthly in summary form per tab 2 below or by submitting written export orders.

At the end of each calendar quarter, Borrower is to submit with this Borrowing Base Certificate copies of invoices and corresponding export orders that represent at least 10% of the total number of invoices and export orders and at least 10% of the dollar amount of total export-related A/R. These copies should be faxed or e-mailed in PDF format to Edmund Catolico at 415.975.6558 or edmund.catolico@wellsfargo.com.

Amount

**A. Eligible Export-Related Accounts Receivable**

A. Beginning Gross Export A/R from prior month

- a. Add Export Sales: enter positive figure
- b. Less Export Payments received: enter positive figure
- c. Less Credit memos or other adjustments: enter positive figure

Total of Control Balance = A + a - b - c

G/L Balance

A/R Aging Balance

1. Export A/R Beginning Balance (Use lower of Control, G/L or A/R Aging balance).

2. Ineligible Export-Related Accounts Receivable

- aa. That is due and payable more than ninety (90) days from the earlier of the invoice or shipment date (i.e. selling terms)
- ab. For Accounts owed by Banking Production Center ("BPC") with selling terms of 90 day or less, that is not paid within one hundred twenty (120) calendar days from invoice date;
- ac. Accounts owed by an account debtor, regardless of whether otherwise eligible, to the extent that the balance of such Accounts exceeds fifteen percent (15%) of the aggregate amount of all Eligible Export-Related and Domestic Accounts;
- ad. Accounts owned by an account debtor, regardless of whether otherwise eligible, if 25% or more of the total amount due under Accounts from such debtor is ineligible under clauses (aa), (ab) or (ac) above (cross aging);
- b. That portion of Accounts that is subject to any offset, deduction, defense, dispute, or counterclaim or the Buyer is also a creditor or supplier of the Borrower or the Account Receivable is contingent in any respect or for any reason;
- c. That portion of Accounts that have not been shipped to the Buyer or when the Items are services, such services have not been performed or when the Export Order specifies a timing for invoicing the Items other than shipment or performance and the Items have not been invoiced in accordance with such terms of the Export Order, or the Accounts Receivable otherwise do not represent a final sale;
- d. That portion of Accounts for which an invoice has not been sent to the applicable account debtor
- e. That portion of Accounts that is disputed or subject to a claim of offset or a contra account or credit memos for amounts previously billed and collected;
- f. Any Account that is due and payable from a Buyer who (A) applies for, suffers, or consents to the appointment of, or the taking of possession by, a receiver, custodian, trustee or liquidator of itself or of all or a substantial part of its property or calls a meeting of its creditors, (B) admits in writing its inability, or is generally unable, to pay its debts as they become due or ceases operations of its present business, (C) makes a general assignment for the benefit of creditors, (D) commences a voluntary case under any state or federal bankruptcy laws (as now or hereafter in effect), (E) is adjudicated as bankrupt or insolvent, (F) files a petition seeking to take advantage of any other law providing for the relief of debtors, (G) acquiesces to, or fails to have dismissed, any petition which is filed against it in any involuntary case under such bankruptcy laws, or (H) takes any action for the purpose of effecting any of the foregoing;
- g. Any Account owed by an Owner, Subsidiary, Affiliate, Officer or employee of the Borrower
- h. Any Account not subject to a valid, perfected first priority security interest in the Lender's favor

- i. That portion of Accounts that has been restructured, extended, amended or modified
  - j. That portion of Accounts that constitutes advertising, finance charges, service charges or sales or excise taxes
- 
- k. Accounts that are due and payable from a Buyer located in a country with which Ex-Im Bank is prohibited from doing business as designated in the Country Limitation Schedule which can be viewed on the website at [exim.gov](http://exim.gov) under "Apply". Those countries with an "X" for financing under one year are ineligible.
  - l. Accounts that do not comply with the requirements of the Country Limitation Schedule ("CLS"). Some countries which are open for short-term Ex-Im support have restrictions outlined in the footnotes which may make these receivables ineligible.
  - m. Accounts that arise from the sale of Items containing less than fifty percent (50%) US Content;
  - n. Accounts that the Lender or Ex-Im Bank deems uncollectible or unacceptable for any reason
  - o. Accounts denominated in any currency other than United States dollars, unless otherwise approved in writing by Ex-Im Bank
  - p. Accounts with respect to which the Borrower has not instructed the Account debtor to pay the Account to the Borrower's Account
  - q. Accounts owed by debtors located in countries not acceptable to the Lender or Ex-Im Bank in their sole discretion
  - r. Accounts which are not otherwise "Eligible Export-Related Accounts Receivable", as such term is defined in the Borrower Agreement
  - s. Any Account that does not arise from the sale of Items in the ordinary course of the Borrower's business
  - t. Any Account as to which any covenant, representation or warranty contained in the Loan Documents with respect to such Account Receivable has been breached;
  - u. Any Account that is not owned by the Borrower or is subject to any right, claim or interest of another Person other than the Liens in favor of the Lender;
  - v. Any Account that arises from the sale of defense articles or defense services;
  - w. Any Account that is backed by a letter of credit unless the Items covered by the subject letter of credit have been shipped or if a service milestone, the service has been performed in accordance with the terms of the letter of credit;
  - x. Any Account that is due and payable from a military Buyer, except as may be approved in writing by Ex-Im Bank
  - y. Any Account that does not comply with the terms of sale set forth in Section 7 of the Loan Authorization Agreement
  - z. Any Account that arises from a bill and hold, guaranteed sale, sale and return, sale on approval, consignment or any other repurchase or return basis or is evidenced by chattel paper
  - za. Any Account for which the Borrower has made any agreement with the Buyer for any deduction therefrom, except for discounts or allowances made in the ordinary course of business for prompt payment, all of which discounts or allowances are reflected in the calculation of the face value of each respective invoice related thereto
  - zb. Any Account for which any of the Items giving rise to such Account Receivable have been returned, rejected or repossessed;
  - zc. Any Account arising from retainage, i.e. where the retention payment is subject to further performance.
  - zd. Accounts otherwise deemed unacceptable to the Lender and Ex-Im Bank in their sole discretion (under 20k invoices and down payments)

ze. Total ineligible (sum of 2.a through 2.ze)

3. Total Eligible Export-Related Accounts Receivable (line 1 less line 2.ze)

Amount

**B. Eligible Total Inventory**

4. Total raw materials at the lower of cost or market value as determined in accordance with GAAP.

4.a Total Work-In-Process inventory at the lower of cost or market value as determined in accordance with GAAP.

4.b. Total Finished Goods inventory at the lower of cost or market value as determined in accordance with GAAP.

4.c. Total eligible inventory, or total raw materials

5. Ineligible Inventory

(i) that is not subject to a valid, perfected first priority Lien in favor of the Lender or is subject to a security interest in favor of any Person other than the Lender;

(ii) that is located at an address that has not been approved by the Lender in writing;

(iii) that is placed by the Borrower on consignment or held by the Borrower on consignment from another Person;

(iv) that is in-transit, covered by any negotiable or non-negotiable warehouse receipt, bill of lading or other document of title; in the possession of a processor or bailee, or located on premises leased or subleased to the Borrower, or on premises subject to a mortgage in favor of a Person other than the Lender, unless such processor or bailee or mortgagee or the lessor or sublessor of such premises, as the case may be, has executed and delivered all documentation which the Lender shall require to evidence the subordination or other limitation or extinguishment of such Person's rights with respect to such Inventory and the Lender's right to gain access thereto;

(v) that is produced in violation of the Fair Labor Standards Act or subject to the "hot goods" provisions contained in 29 U.S.C. § 215 or any successor statute or section;

(vi) as to which any covenant, representation or warranty with respect to such Inventory contained in the Loan Documents has been breached;

(vii) that is not located in the United States;

(viii) that is sample or demonstration Inventory; that is packaging, labels, or office supplies

(ix) that consists of proprietary software (i.e. software designed solely for the Borrower's internal use and not intended for resale);

(x) that is damaged, slow moving, obsolete, returned, defective, recalled or unfit for further processing or not currently saleable in the normal course of the Borrower's operations;

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(xi) that the Borrower has returned, has attempted to return, is in the process of returning or intends to return to the vendor thereof;

(xii) Inventory otherwise deemed ineligible by the Lender in its discretion.

(xiii) Total inventory ineligible

5.a Total Eligible Inventory (line 5 minus line 5.xiii)

5.b Export Sales Percentage calculated on a rolling twelve month basis, updated quarterly and calculated on the tab below. Note: export sales do not include sales to "foreign" companies located in the U.S.

5.c Export Sales Percentage times Total Eligible Inventory derives Export-Related Inventory before deducting specific ineligible relating to export inventory. (5.a times 5.b)

5.d. Ineligible Export-Related Inventory

(i). that has been previously exported from the United States

(ii). that is not supported by an Export Order

(iii). that is to be incorporated into Items destined for shipment to a country as to which Ex-Im Bank is **prohibited** from doing business as designated in the Country Limitation Schedule or that the Borrower has knowledge will be re-exported by a foreign Buyer to a country in which Ex-Im Bank is prohibited from doing business

(iv) that is to be incorporated into Items destined for shipment to a Buyer located in a country in which Ex-Im Bank coverage is not available for commercial reasons as designated in the Country Limitation Schedule, unless and only to the extent that such Items are to be sold to such country on terms of a letter of credit confirmed by a bank acceptable to Ex-Im Bank

(v) that is to be incorporated into Items whose sale would result in an Account which would not be an Eligible Export-Related Account

(vi) that contains less than fifty percent (50%) of U.S. Content

(vii) that constitutes nuclear articles or defense articles/services or is destined to be sold to a military buyer

(viii) Total ineligibles (sum of 5.d.i through 5.d.vii)

6. Total Eligible Export-Related Inventory (line 5.c less line 5.d.vii)

Amount

**D. Borrowing Base (“BB”)**

7. Export Collateral Base: The sum of:

(a) 85% of Eligible Export Accounts Receivable from line 3.

(b) 50% of Eligible Export-Related Inventory from line 6

(c) The lesser of 7.b or \$2,000,000 is the inventory figure in the BB

8. Total Export Collateral Base (lines 7.a plus 7.c)

Amount

**E. Availability**

9. Final Export Collateral Base

10. Outstanding Principal Balance

11. Availability: line 9 less line 10

12. Maximum Line Amount

13. Maximum Line Amount less sum of Advances

14. The lesser of lines 11 and 13 is Export Availability. A negative figure indicates that additional collateral be supplied or outstanding Advances be reduced.

The Borrower represents and warrants that this Borrowing Base Certificate and related schedules are a true and correct statement regarding the status of the matters set forth herein. The Borrower further represents and warrants that no Default or Event of Default has occurred and is continuing. The Borrower acknowledges that any Ex-Im Advances made to the Borrower under the Credit Agreement will be based upon the Lender’s reliance on the information contained herein.

Capstone Turbine Corporation

Signed by:

Date Signed & Submitted:

Title of Signer:

Note: Ex-Im Bank prohibits or restricts its support of short-term transactions for various countries shown in its Country Limitation Schedule (“CLS”). The most current CLS can be viewed on Ex-Im Bank’s website at [www.exim.gov](http://www.exim.gov) under Apply.

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## FIRST AMENDMENT TO CREDIT AND SECURITY AGREEMENTS

THIS FIRST AMENDMENT TO CREDIT AND SECURITY AGREEMENTS (the "Amendment"), dated June 9, 2009, is entered into by and between CAPSTONE TURBINE CORPORATION, a Delaware corporation ("Company"), and WELLS FARGO BANK, NATIONAL ASSOCIATION ("Wells Fargo"), acting through its Wells Fargo Business Credit operating division.

## RECITALS

A. Company and Wells Fargo are parties to (i) a Credit and Security Agreement dated February 9, 2009 (as amended from time to time, the "Domestic Credit Agreement"), and (ii) a Credit and Security Agreement (Ex-Im Subfacility), dated February 9, 2009 (as amended from time to time, the "Ex-Im Credit Agreement"; and together with the Domestic Credit Agreement, the "Credit Agreements"). Capitalized terms used in these recitals have the meanings given to them in the Credit Agreements unless otherwise specified.

B. Company has requested that certain amendments be made to the Credit Agreements, which Wells Fargo is willing to make pursuant to the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements herein contained, it is agreed as follows:

1. Section 5.2(a) of the Credit Agreements. Section 5.2(a) of the Credit Agreements is hereby deleted in its entirety and replaced with the following:

“(a) Minimum Book Net Worth. Company shall maintain a Book Net Worth, determined as of the following test dates, in an amount not less than the amount set forth for each such test date (numbers appearing between “< >” are negative):

Test Date	Minimum Book Net Worth
April 30, 2009	\$ 45,791,000
May 31, 2009	\$ 53,826,000
June 30, 2009	\$ 53,336,000
July 31, 2009	\$ 50,504,000
August 31, 2009	\$ 47,727,000
September 30, 2009	\$ 48,709,000
October 31, 2009	\$ 46,045,000
November 30, 2009	\$ 43,460,000
December 31, 2009	\$ 46,259,000
January 31, 2010	\$ 43,763,000
February 28, 2010	\$ 41,149,000
March 31, 2010	\$ 45,294,000

2. Section 5.2(b) of the Credit Agreements. Section 5.2(b) of the Credit Agreements is hereby deleted in its entirety and replaced with the following:

“(a) Minimum Net Income. Company shall achieve Net Income, measured on each of the following test dates described below, for the quarter period ending on each such test date, Net Income of not less than the amount set forth opposite each such test date (numbers appearing between “< >” are negative):

Test Date	Minimum Net Income
June 30, 2009	\$ <9,226,000 >
September 30, 2009	\$ <7,003,000 >
December 31, 2009	\$ <4,826,000 >
March 31, 2010	\$ <3,341,000 >

3. Section 5.2(e) of the Credit Agreements. The following paragraph is added as a new Section 5.2(e) to the Credit Agreements:

“(e) Maximum Annual Loss. During the fiscal year ending March 31, 2010, Company shall not suffer an Annual Loss in excess of \$20,000,000.

4. Exhibit A to the Credit Agreements. The following defined term is hereby added to Exhibit A to the Credit Agreements in the appropriate alphabetical order:

““Annual Loss” means, as of each fiscal year end, the after-tax net loss from continuing operations during such fiscal year, including extraordinary losses but excluding extraordinary gains, as determined in accordance with GAAP.”

5. Exhibit E to the Domestic Credit Agreement. Exhibit E to the Domestic Credit Agreement is hereby deleted and replaced with Exhibit E-1 attached to this Amendment.

6. Exhibit E to the Ex-Im Credit Agreement. Exhibit E to the Ex-Im Credit Agreement is hereby deleted and replaced with Exhibit E-2 attached to this Amendment.

7. No Other Changes. Except as explicitly amended by this Amendment, all of the terms and conditions of the Credit Agreements shall remain in full force and effect and shall apply to any advance or letter of credit thereunder.

8. Accommodation Fee. Company shall pay Wells Fargo as of the date hereof a fully earned, non-refundable fee in the amount of \$20,000 in consideration of Wells Fargo's execution and delivery of this Amendment (the "Accommodation Fee").

9. Conditions Precedent. This Amendment shall be effective when Wells Fargo shall have received an executed original of this Amendment, together with each of the following, each in substance and form acceptable to Wells Fargo in its sole discretion:

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9.1 A Certificate of the Secretary of Company certifying as to (i) the resolutions of the board of directors of Company approving the execution and delivery of this Amendment, (ii) the fact that the certificate of incorporation and bylaws of Company, which were certified and delivered to Wells Fargo pursuant to the Certificate of Authority of Company's secretary or assistant secretary dated February 9, 2009, continue in full force and effect and have not been amended or otherwise modified except as set forth in the Certificate to be delivered, and (iii) the fact that the officers and agents of Company who have been certified to Wells Fargo, pursuant to the Certificate of Authority of Company's secretary or assistant secretary dated February 9, 2009, as being authorized to sign and to act on behalf of Company continue to be so authorized;

9.2 Consent and approval of this Amendment by the Export Import Bank of the United States, if required by Wells Fargo;

9.3 The Acknowledgement and Agreement of Guarantor set forth at the end of this Amendment, duly executed by Guarantor;

9.4 Payment of the Accommodation Fee described in Section 8 of this Amendment; and

9.5 Such other matters as Wells Fargo may require.

10. Representations and Warranties. Company hereby represents and warrants to Wells Fargo as follows:

10.1 Company has all requisite power and authority to execute this Amendment and any other agreements or instruments required hereunder and to perform all of its obligations hereunder, and this Amendment and all such other agreements and instruments have been duly executed and delivered by Company and constitute the legal, valid and binding obligation of Company, enforceable in accordance with their terms.

10.2 The execution, delivery and performance by Company of this Amendment and any other agreements or instruments required hereunder have been duly authorized by all necessary corporate action and do not (i) require any authorization, consent or approval by any governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, (ii) violate any provision of any law, rule or regulation or of any order, writ, injunction or decree presently in effect, having applicability to Company, or the certificate of incorporation or bylaws of Company, or (iii) result in a breach of or constitute a default under any indenture or loan or credit agreement or any other agreement, lease or instrument to which Company is a party or by which it or its properties may be bound or affected.

10.3 All of the representations and warranties contained in Section 4 of, and Exhibit D to, the Credit Agreements are true and correct on and as of the date hereof as though made on and as of such date, except to the extent that such representations and warranties relate solely to an earlier date.

11. References. All references in the Credit Agreements to "this Agreement" shall be deemed to refer to the relevant Credit Agreement as amended hereby; and any and all references in the Security Documents to the Credit Agreements shall be deemed to refer to the relevant Credit Agreement as amended hereby.

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12. No Waiver. The execution of this Amendment and the acceptance of all other agreements and instruments related hereto shall not be deemed to be a waiver of any Default or Event of Default under the Credit Agreements or a waiver of any breach, default or event of default under any Security Document or other document held by Wells Fargo, whether or not known to Wells Fargo and whether or not existing on the date of this Amendment.

13. Release. Company and the Guarantor signing the Acknowledgment and Agreement of Guarantors set forth below hereby absolutely and unconditionally release and forever discharge Wells Fargo, and any and all participants, parent corporations, subsidiary corporations, affiliated corporations, insurers, indemnitors, successors and assigns thereof, together with all of the present and former directors, officers, agents, attorneys, and employees of any of the foregoing, from any and all claims, demands or causes of action of any kind, nature or description, whether arising in law or equity or upon contract or tort or under any state or federal law or otherwise, which Company or Guarantor has had, now has or has made claim to have against any such person for or by reason of any act, omission, matter, cause or thing whatsoever arising from the beginning of time to and including the date of this Amendment, whether such claims, demands and causes of action are matured or unmatured or known or unknown. It is the intention of the Company in executing this release that the same shall be effective as a bar to each and every claim, demand and cause of action specified and in furtherance of this intention the Company waives and relinquishes all rights and benefits under Section 1542 of the Civil Code of the State of California, which provides:

“A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MIGHT HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR.”

14. Costs and Expenses. Company hereby reaffirms its agreement under the Credit Agreements to pay or reimburse Wells Fargo on demand for all costs and expenses incurred by Wells Fargo in connection with the Loan Documents, including without limitation all fees and disbursements of legal counsel. Without limiting the generality of the foregoing, Company specifically agrees to pay all fees and disbursements of counsel to Wells Fargo for the services performed by such counsel in connection with the preparation of this Amendment and the documents and instruments incidental hereto. Company hereby agrees that Wells Fargo may, at any time or from time to time in its sole discretion and without further authorization by Company, make a loan to Company under the Credit Agreements, or apply the proceeds of any loan, for the purpose of paying any such fees, disbursements, costs and expenses and the fee set forth in Section 8 of this Amendment.

15. Miscellaneous. This Amendment and the Acknowledgment and Agreement of Guarantor may be executed in any number of counterparts, each of which when so executed and delivered shall be deemed an original and all of which counterparts, taken together, shall constitute one and the same instrument. Transmission by facsimile or “pdf” file of an executed counterpart of this Amendment shall be deemed to constitute due and sufficient delivery of such counterpart. Any party hereto may request an original counterpart of any party delivering such electronic counterpart. This Amendment and the rights and obligations of the parties hereto shall be construed in accordance with, and governed by, the laws of the State of California. In the event of any conflict between this Amendment and the Credit Agreements, the terms of this Amendment shall govern. The Export-Import Bank of the United States shall be an express intended beneficiary of this Amendment.

[Signatures on next page]

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed as of the date first above written.

**WELLS FARGO BANK,  
NATIONAL ASSOCIATION**

By: /s/ JOHN CURRY  
Print Name: John Curry  
Title: Vice President

**CAPSTONE TURBINE CORPORATION**

By: /s/ EDWARD REICH  
Print Name: Edward Reich  
Title: Executive Vice President and CFO

S-1

**ACKNOWLEDGMENT AND AGREEMENT OF GUARANTOR**

The undersigned, a guarantor of the indebtedness of Capstone Turbine Corporation (“Company”) to Wells Fargo Bank, National Association (as more fully defined in the Amendment, “Wells Fargo”), acting through its Wells Fargo Business Credit operating division, pursuant to the separate Guaranty dated February 9, 2009 (“Guaranty”), hereby (i) acknowledges receipt of the foregoing Amendment; (ii) consents to the terms (including without limitation the release set forth in Section 13 of the Amendment) and execution thereof; (iii) reaffirms all obligations to Wells Fargo pursuant to the terms of the Guaranty; and (iv) acknowledges that Wells Fargo may amend, restate, extend, renew or otherwise modify the Credit Agreements and any indebtedness or agreement of the Company, or enter into any agreement or extend additional or other credit accommodations, without notifying or obtaining the consent of the undersigned and without impairing the liability of the undersigned under the Guaranty for all of the Company’s present and future indebtedness to Wells Fargo.

**CAPSTONE TURBINE INTERNATIONAL, INC.**

By: \_\_\_\_\_  
Print Name: \_\_\_\_\_  
Title: \_\_\_\_\_

Exhibit E-1

Exhibit E to Credit and Security Agreement

**COMPLIANCE CERTIFICATE**

To: Wells Fargo Bank, National Association  
Date: [ , 200 ]  
Subject: Financial Statements

In accordance with our Credit and Security Agreement dated February 9, 2009 (as amended from time to time, the "Credit Agreement"), attached are the financial statements of Capstone Turbine Corporation (the "Company") dated [ , 200 ] (the "Reporting Date") and the year-to-date period then ended (the "Current Financials"). All terms used in this certificate have the meanings given in the Credit Agreement.

**A. Preparation and Accuracy of Financial Statements.** I certify that the Current Financials have been prepared in accordance with GAAP, subject to year-end audit adjustments, and fairly present Company's financial condition as of the Reporting Date.

**B. Name of Company; Merger and Consolidation.** I certify that:

(Check one)

- Company has not, since the date of the Credit Agreement, changed its name or jurisdiction of organization, nor has it consolidated or merged with another Person.
- Company has, since the date of the Credit Agreement, either changed its name or jurisdiction of organization, or both, or has consolidated or merged with another Person, which change, consolidation or merger:  was consented to in advance by Wells Fargo in an Authenticated Record, and/or  is more fully described in the statement of facts attached to this Certificate.

**C. Events of Default.** I certify that:

(Check one)

- I have no knowledge of the occurrence of an Event of Default under the Credit Agreement, except as previously reported to Wells Fargo in a Record.
- I have knowledge of an Event of Default under the Credit Agreement not previously reported to Wells Fargo in a Record, as more fully described in the statement of facts attached to this Certificate, and further, I acknowledge that Wells Fargo may under the terms of the Credit Agreement impose the Default Rate at any time during the resulting Default Period.

E-1-1

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**D. Litigation Matters.** I certify that:

(Check one)

- I have no knowledge of any material adverse change to the litigation exposure of Company or any of its Affiliates or of any Guarantor.
- I have knowledge of material adverse changes to the litigation exposure of Company or any of its Affiliates or of any Guarantor not previously disclosed in Exhibit D, as more fully described in the statement of facts attached to this Certificate.

**E. Financial Covenants.** I further certify that:

(Check and complete each of the following)

1. **Minimum Book Net Worth.** Pursuant to Section 5.2(a) of the Credit Agreement, as of the Reporting Date, Company's Book Net Worth was \$[ ], which  satisfies  does not satisfy the requirement that such amount be not less than the applicable amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

Test Date	Minimum Book Net Worth
April 30, 2009	\$ 45,791,000
May 31, 2009	\$ 53,826,000
June 30, 2009	\$ 53,336,000
July 31, 2009	\$ 50,504,000
August 31, 2009	\$ 47,727,000
September 30, 2009	\$ 48,709,000

October 31, 2009	\$	46,045,000
November 30, 2009	\$	43,460,000
December 31, 2009	\$	46,259,000
January 31, 2010	\$	43,763,000
February 28, 2010	\$	41,149,000
March 31, 2010	\$	45,294,000

2. **Minimum Net Income.** Pursuant to Section 5.2(b) of the Credit Agreement, as of the Reporting Date, Company's Net Income was [\$ ], which  satisfies  does not satisfy the requirement that Net Income be not less than the amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

Test Date		Minimum Net Income
June 30, 2009	\$	<9,226,000 >
September 30, 2009	\$	<7,003,000 >
December 31, 2009	\$	<4,826,000 >
March 31, 2010	\$	<3,341,000 >

E-1-2

3. **Minimum Cash to Unreimbursed Line of Credit Advances Coverage Ratio.** Pursuant to Section 5.2(c) of the Credit Agreement, as of the Reporting Date, at all times, Company has  has not  been in compliance with the requirement that the percentage of the unreimbursed Line of Credit Advances under the Revolving Note plus the L/C Amount plus outstanding "Advances" under the Ex-Im Credit Agreement to the amount of cash plus Cash Equivalents of Company in which Wells Fargo has a perfected first priority security interest be not greater than 80%.

4. **Capital Expenditures.** Pursuant to Section 5.2(d) of the Credit Agreement, for the year-to-date period ending on the Reporting Date, Company has expended or contracted to expend during the fiscal year ended [ ], 200 [ ], for Capital Expenditures, \$ [ ] in the aggregate, which  satisfies  does not satisfy the requirement that such expenditures not exceed \$7,500,000 in the aggregate during the fiscal year ended March 31, 2009, \$10,000,000 in the aggregate during the fiscal year ended March 31, 2010, and zero for each subsequent fiscal year.

5. **Maximum Annual Loss.** Pursuant to Section 5.2(e) of the Credit Agreement, during the fiscal year ending March 31, 2010, Company has suffered an Annual Loss of \$ [ ], which  satisfies  does not satisfy the requirement that Company not suffer an Annual Loss in excess of \$20,000,000.

Attached are statements of all relevant facts and computations in reasonable detail sufficient to evidence Company's compliance with the financial covenants referred to above, which computations were made in accordance with GAAP.

Capstone Turbine Corporation

By: \_\_\_\_\_  
Its: Chief Financial Officer

E-1-3

## Exhibit E-2

### Exhibit E to Credit and Security Agreement (Ex-Im Subfacility)

#### COMPLIANCE CERTIFICATE

To: Wells Fargo Bank, National Association  
Date: [ ], 200 [ ]  
Subject: Financial Statements

In accordance with our Credit and Security Agreement (Ex-Im Subfacility) dated February 9, 2009 (as amended from time to time, the "Credit Agreement"), attached are the financial statements of Capstone Turbine Corporation (the "Company") dated [ ], 200 [ ] (the "Reporting Date") and the year-to-date period then ended (the "Current Financials"). All terms used in this certificate have the meanings given in the Credit Agreement.

**F. Preparation and Accuracy of Financial Statements.** I certify that the Current Financials have been prepared in accordance with GAAP, subject to year-end audit adjustments, and fairly present Company's financial condition as of the Reporting Date.

**G. Name of Company; Merger and Consolidation.** I certify that:

(Check one)

- Company has not, since the date of the Credit Agreement, changed its name or jurisdiction of organization, nor has it consolidated or merged with another Person.
- Company has, since the date of the Credit Agreement, either changed its name or jurisdiction of organization, or both, or has consolidated or merged with another Person, which change, consolidation or merger:  was consented to in advance by Wells Fargo in an Authenticated Record, and/or  is more fully described in the statement of facts attached to this Certificate.

**H. Events of Default.** I certify that:

(Check one)

- I have no knowledge of the occurrence of an Event of Default under the Credit Agreement, except as previously reported to Wells Fargo in a Record.
- I have knowledge of an Event of Default under the Credit Agreement not previously reported to Wells Fargo in a Record, as more fully described in the statement of facts attached to this Certificate, and further, I acknowledge that Wells Fargo may under the terms of the Credit Agreement impose the Default Rate at any time during the resulting Default Period.

E-2-1

**I. Litigation Matters.** I certify that:

(Check one)

- I have no knowledge of any material adverse change to the litigation exposure of Company or any of its Affiliates or of any Guarantor.
- I have knowledge of material adverse changes to the litigation exposure of Company or any of its Affiliates or of any Guarantor not previously disclosed in Exhibit D, as more fully described in the statement of facts attached to this Certificate.

**J. Financial Covenants.** I further certify that:

(Check and complete each of the following)

1. **Minimum Book Net Worth.** Pursuant to Section 5.2(a) of the Credit Agreement, as of the Reporting Date, Company's Book Net Worth was \$[ ], which  satisfies  does not satisfy the requirement that such amount be not less than the applicable amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

Test Date	Minimum Book Net Worth
April 30, 2009	\$ 45,791,000
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November 30, 2009	\$ 43,460,000
December 31, 2009	\$ 46,259,000
January 31, 2010	\$ 43,763,000
February 28, 2010	\$ 41,149,000
March 31, 2010	\$ 45,294,000

2. **Minimum Net Income.** Pursuant to Section 5.2(b) of the Credit Agreement, as of the Reporting Date, Company's Net Income was [\$ ], which  satisfies  does not satisfy the requirement that Net Income be not less than the amount set forth in the table below (numbers appearing between "< >" are negative) on the Reporting Date:

Test Date	Minimum Net Income
June 30, 2009	\$ <9,226,000 >
September 30, 2009	\$ <7,003,000 >
December 31, 2009	\$ <4,826,000 >
March 31, 2010	\$ <3,341,000 >

E-2-2

3. **Minimum Cash to Unreimbursed Line of Credit Advances Coverage Ratio.** Pursuant to Section 5.2(c) of the Credit Agreement, as of the Reporting Date, at all times, Company has  has not  been in compliance with the requirement that the

percentage of the unreimbursed "Advances" plus the L/C Amount under the Domestic Facility Agreement plus outstanding "Advances" under the Domestic Facility Agreement to the amount of cash plus Cash Equivalents of Company in which Wells Fargo has a perfected first priority security interest be not greater than 80%.

4. **Capital Expenditures.** Pursuant to Section 5.2(d) of the Credit Agreement, for the year-to-date period ending on the Reporting Date, Company has expended or contracted to expend during the fiscal year ended \_\_\_\_\_, 200\_\_\_\_, for Capital Expenditures, \$ \_\_\_\_\_ in the aggregate, which  satisfies  does not satisfy the requirement that such expenditures not exceed \$7,500,000 in the aggregate during the fiscal year ended March 31, 2009, \$10,000,000 in the aggregate during the fiscal year ended March 31, 2010, and zero for each subsequent fiscal year.

5. **Maximum Annual Loss.** Pursuant to Section 5.2(e) of the Credit Agreement, during the fiscal year ending March 31, 2010, Company has suffered an Annual Loss of \$ \_\_\_\_\_, which  satisfies  does not satisfy the requirement that Company not suffer an Annual Loss in excess of \$20,000,000.

Attached are statements of all relevant facts and computations in reasonable detail sufficient to evidence Company's compliance with the financial covenants referred to above, which computations were made in accordance with GAAP.

Capstone Turbine Corporation

By: \_\_\_\_\_  
Its: Chief Financial Officer

E-2-3

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**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement Nos. 333-131431, 333-40838, 333-40846, 333-40868, 333-66390, 333-101201, 333-102039, 333-107628 and 333-110847 on Form S-8 and Registration Statement Nos. 333-128164, 333-102036, 333-153551 and 333-156459 on Form S-3 of our reports dated June 15, 2009 relating to the consolidated financial statements and financial statement schedule of Capstone Turbine Corporation (which report expresses an unqualified opinion and includes an explanatory paragraph regarding Capstone Turbine Corporation's adoption of Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109) and the effectiveness of the internal control over financial reporting, of Capstone Turbine Corporation appearing in this Annual Report on Form 10-K of Capstone Turbine Corporation for the year ended March 31, 2009.

/s/ DELOITTE & TOUCHE LLP

Los Angeles, California  
June 15, 2009

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