TELECOM ARGENTINA STET FRANCE TELECOM SA
Form 6-K
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14. Commitments and Contingencies (Continued)

Licenses

The Company licenses, on a non-exclusive basis, certain DMFC technology from Los Alamos National Laboratory ("LANL"). Under this agreement, the Company is required to pay future minimum annual license fees of $250 thousand yearly through 2019. Once products are being sold, royalties will be based on 2% of the first $50 million of net sales, 1% on net sales in excess of $50 million but less than $100 million and .5% on net sales in excess of $100 million. License payments made in any year can be applied against royalties due and total annual fees in any year shall not exceed $1 million.

Employment Agreements

The Company has employment agreements with certain employees that provide severance payments and accelerated vesting of certain options upon termination of employment under certain circumstances, as defined in

the applicable agreements. As of June 30, 2005, the Company's potential minimum obligation to these employees was approximately $.924 million.

Investment Company Act

The Company's securities available for sale constitute investment securities under the Investment Company Act of 1940 (the "Investment Company Act"). In general, a company may be deemed to be an investment company if it owns investment securities with a value exceeding 40% of its total assets, subject to certain exclusions and exemptions.

Investment companies are subject to registration under, and compliance with, the Investment Company Act unless a particular exemption or safe harbor provision applies. If the Company were to be deemed an investment company, the Company would become subject to the requirements of the Investment Company Act. As a consequence, the Company would be prohibited from engaging in certain businesses or issuing certain securities, certain of the Company's contracts might be voidable, and the Company might be subject to civil and criminal penalties for noncompliance.

Until 2001, the Company qualified for a safe harbor exemption under the Investment Company Act based upon the level of its ownership of shares of Plug Power and its influence over Plug Power's management or policies. However, since the Company began selling shares of Plug Power, this safe harbor exemption is no longer available.

On December 3, 2001, the Company made an application to the SEC requesting that they either declare that the Company is not an investment company because it is primarily engaged in another business or exempt it from the provisions of the Investment Company Act. The Company amended this application on October 20, 2003. On July 18, 2005, the Company requested that the application be withdrawn following discussions and other communications with the SEC staff in which the staff expressed the view that the application was no longer necessary. Since the value of the

Company's interests in Plug Power has decreased in relation to its total assets, the Company believes that it is not an investment company subject to the regulations of the Investment Company Act.

If the Company was deemed to be an investment company and could not find another safe harbor or exemption and failed to register as an investment company, the SEC could require the Company to sell its interest in Plug Power, until the value of these securities is further reduced in relation to the Company's total assets. This could result in sales of the Company's securities in quantities of shares at depressed prices and the Company may never realize anticipated benefits from, or may incur losses on, these sales. Further, the Company may be unable to sell some securities due to contractual or legal restrictions or the inability to locate a suitable buyer. Moreover, the Company may incur tax liabilities when selling assets.

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14. Commitments and Contingencies (Continued)

Contract Losses

During 2004, MTI Micro entered into a fixed price-cost type completion contract with the U.S. Army. The contract which totals $250 thousand permits monthly cost progress payments and calls for the delivery of five DMFC power system units. These prototypes require substantial engineering to meet the performance requirements of the customer. At the end of 2004, MTI Micro forecasted that the contract would be completed during 2005 and accrued $540 thousand for the then anticipated cost needed to be incurred to complete the project. The expected overrun is currently estimated at $828 thousand and the accrued anticipated cost to complete the project is $169 thousand as of June 30, 2005 and was $540 thousand as of December 31, 2004. Although MTI Micro believes that it will complete this contract to the satisfaction of the customer, it is possible that MTI Micro will not be successful. Through monthly reports, MTI Micro updates the customer on accomplishments, technical issues, financial status, forecast to complete and anticipated solutions.

Additionally, other contracts had forecasted costs in excess of contract values as of December 31, 2004. As of the end of 2004, MTI Micro accrued $17 thousand for the anticipated cost overruns for the projects and as of June 30, 2005 no amounts are accrued for the anticipated costs to complete the projects.

15. Issuance of Stock by Subsidiary

MTI Micro was formed on March 26, 2001. As of June 30, 2005, the Company owns approximately 89% of MTI Micro's outstanding common stock.

The increase in the Company's paid-in-capital related to the Company's investment in MTI Micro totaling $93 thousand for the period ended June 30, 2005, represents the changes in the Company's equity investment in MTI Micro, which resulted from third-party stock transactions in MTI Micro.

This Item 2 contains forward-looking statements that involve risks and uncertainties, which may cause the Company's actual results, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. See "Statement Concerning Forward-Looking Statements" on pages 36 and 37.

Overview

The Company is primarily engaged in the development and commercialization of Mobion™ cord-free advanced portable power systems, through its subsidiary MTI MicroFuel Cells Inc. ("MTI Micro"), and in the design, manufacture, and sale of high-performance test and measurement instruments and systems through its subsidiary MTI Instruments, Inc. ("MTI Instruments"). MTI also co-founded and retains a minority interest in Plug Power Inc. ("Plug Power") (Nasdaq: PLUG), a designer and developer of on-site energy systems based on proton exchange membrane fuel cells.

MTI Micro designs and develops Mobion™ fuel cell systems for portable power applications. A micro fuel cell is a portable power source that converts chemical energy into useable electrical energy. MTI Micro is developing a micro fuel cell that uses methanol, a common alcohol, as its fuel. The Company believes direct methanol fuel cell ("DMFC") systems could potentially have an energy density of five to ten times that of Li-Ion batteries. The Company believes that, when commercialized, DMFC systems should be able to power a wireless electronic device for longer periods of time than Li-Ion batteries without recharging/refueling. In addition, Mobion™ fuel cell systems may be instantly refueled eliminating the need for a power outlet or a lengthy recharge.

MTI Micro's fuel cell technology platform can be customized to provide portable power for a number of applications depending on the power level, required run time and size requirements. In December 2004, MTI Micro shipped its first low volume production of Mobion™ fuel cell systems for use in hand held Radio Frequency Identification tag readers. Although this product shipment was an important milestone, the Company and MTI Micro recognize that significant technical, engineering, manufacturing, cost and marketing challenges remain before Mobion™ fuel cells can become commercially viable or available.

MTI Instruments has three product groups: aviation, general gaging and semiconductor. These product groups provide: electronic, computerized general gaging instruments for position, displacement and vibration applications; and semiconductor products for wafer characterization of semi-insulating and semi-conducting wafers and vibration analysis systems for aircraft engines. MTI Instruments' strategy is to continue to enhance and expand its product offerings with the goal of increasing market share and profitability. MTI Instruments' largest customers include the U.S. Air Force and industry leaders in the computer, electronic, semiconductor, automotive, aerospace, aircraft and bioengineering fields.

MTI Instruments' engine balancing and vibration analysis system primarily serves the aviation industry, both in the commercial and military sectors. These systems perform a number of vibration analysis and engine balancing functions typically for large turbofan engines on the flight-line and in test cells. In addition, MTI Instruments' engine balancing and vibration analysis system has recently been used for the first time in an industrial turbo machinery application.

MTI Instruments' general gaging product line employs three sensing technologies - capacitance, fiber optics and laser triangulation - to measure displacement, position, thickness, vibration and other dimensional measurement applications. The advantages of each technology are generally related to the requirements of specific applications, which typically transcend the capabilities of conventional measuring techniques. End-users cover a broad range of industrial markets, as well as research labs, universities and the government agencies.

MTI Instruments' semiconductor tools compete in the wafer metrology segment of the semiconductor equipment market. Product models include manual units, semi-automated units and fully automated systems that measure thickness, total thickness variation, bow, warp, site and global flatness. These metrology and inspection tools cover a broad range of applications both on the front-end and back-end of the manufacturing process. End-users of these tools include both wafer manufacturers (foundries) and device (chip) manufacturers.

From inception through June 30, 2005, the Company has incurred net losses of $75.471 million and expects to incur losses as it continues micro fuel cell product development and commercialization programs. The Company expects that losses will fluctuate from year to year and that such fluctuations may be substantial as a result of, among other factors, gains on sales of securities available for sale and the operating results of MTI Instruments and MTI Micro.

Critical Accounting Policies and Significant Judgments and Estimates

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. Note 1 to the Company's 2004 annual consolidated financial statements includes a summary of the Company's most significant accounting policies. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of assets and liabilities. On an on-going basis, the Company evaluates its estimates and judgments, including those related to revenue recognition, inventories, securities available for sale, income taxes and derivatives. Management bases its estimates on historical experience and on various other factors that are believed 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. Our critical accounting estimates were discussed with our Audit Committee.

Discussion and Analysis of Results of Operations

Results of Operations for the Three and Six Months Ended June 30, 2005 Compared to the Three and Six Months Ended June 30, 2004

The following is management's discussion and analysis of certain significant factors, which have affected the Company's results of operations for the three and six months ended June 30, 2005 compared to the three and six months ended June 30, 2004.

Product Revenue.

Product revenue for the three months ended June 30, 2005 increased in comparison to the same period in 2004 by $.054 million, or 4.4%, to $1.285 million. This increase is the result of increases in sales to general gaging customers of $.140 million and aviation customers of $.080 million offset by a decrease in sales to semiconductor customers of $.166 million. The increase in general instrument sales is primarily due to a $.171 million increase in capacitance product sales. The decrease in semiconductor sales reflects the shipment of one manual gage, one semi automated unit and two OEM machines during the second quarter of 2005 as compared to five manual gages, two semi-automated units and one AutoScan unit for the same period in 2004. The increase in sales to aviation customers includes a $.146 million increase in commercial aviation sales offset by $.111 million decrease related to the new buys Air Force contract which concluded in 2004.

Product revenue for the six months ended June 30, 2005 decreased in comparison to the same period in 2004 by $.122 million, or 4.3%, to $2.688 million. This decrease is the result of decreases in sales to semiconductor customers of $.308 million and aviation customers of $.055 million offset by increases in sales to general gaging customers of $.241 million. The decrease in semiconductor sales reflects the shipment of two manual gages, one semi automated unit and two OEM machines during the first half of 2005 as compared to ten manual gages and two semi-automated units and an AutoScan unit for the same period in 2004. The decrease in sales to aviation customers includes a $.292 million decrease related to the expiration of the new buy Air Force contract on September 30, 2004 coupled with the timing of shipments under the Retrofit Air Force contract due to fewer portable balancing systems, change amplifiers and accessory kits being sent by the U.S. Air Force for upgrade in 2005 than in 2004. This reduction in upgrade business was partially offset by the shipment of five new accessory kits under a priority contract from the U.S. Air Force for $.059 million and commercial unit sales of $.172 million. The increase in general instrument sales is primarily due to a $.261 million increase in capacitance product sales.

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Information regarding government contracts included in product revenue is as follows:

(Dollars in thousands, except contract values)

Contract	Expiration	Revenues Six months Ended June 30, 2005	Revenues Six months Ended June 30, 2004	Revenues Contract to Date June 30, 2005	Total Contract Orders Received to Date June 30, 2005
$8.8 million Retrofit and Maintenance of PBS 4100's	06/20/2008	$ 778	$ 958	$ 4,436	$ 4,524
$3.1 million PBS Units and Accessory Kits	09/30/2004	$ -	$ 111	$ 2,469	$ 2,469

Funded Research and Development Revenue.

Funded research and development revenue for the three months ended June 30, 2005 increased in comparison to the same period in 2004 by $.189 million to $.380 million, a 99% increase. The increase in revenue is the result of increases of $.219 million from the Department of Energy ("DOE") contract, $.124 million from the New York State Energy Research and Development Authority ("NYSERDA") contract and $.004 million from the Marines partially offset by a decrease from the National Institute of Standards and Technology ("NIST") contract's completion in 2004 when it contributed $.013 million in revenue and the Army Research Laboratories contract's completion in 2004 when it contributed $.145 million.

Funded research and development revenue for the six months ended June 30, 2005 increased in comparison to the same period in 2004 by $.125 million to $.704 million, a 21.6% increase. The increase is the result of increases of $.370 million from the DOE contract, $.236 million from the NYSERDA contract, $.029 million from the Marines and $.036 million from the Cabot Superior Micro Powders ("CSMP") NIST subcontract partially offset by decreases from the NIST contract's completion in 2004 when it contributed $.401 million and the Army Research Laboratories contract's completion in 2004 when it contributed $.145 million.

Information regarding government contracts included in funded research and development revenue is as follows:

(Dollars in thousands, except contract values)

Contract	Expiration	Revenues Six months Ended June 30, 2005	Revenues Six months Ended June 30, 2004	Revenues Contract to Date June 30, 2005
$3.0 million DOE	07/31/07	$ 370	$ -	$ 549
$1.250 million NYSERDA(1)	06/30/06	$ 236	$ -	$ 1,041
$249.8 thousand Army(4)	09/30/05	$ -	$ -	$ -
$69.9 thousand Marine	06/30/05	$ 29	$ -	$ 29
$210 thousand NIST (2)	06/30/05	$ 69	$ 33	$ 179
$250 thousand Harris(4)	03/31/05	$ -	$ -	$ -
$200 thousand ARL	12/31/04	$ -	$ 145	$ 200
$4.6 million NIST (3)	09/30/04	$ -	$ 401	$ 3,342

(1)

Total contract value is $1.250 million consisting of four Phases: Phase I for $500 thousand was from 3/12/02 thru 9/30/03; Phase II for $200 thousand was from 10/28/03 with a completion date of 10/31/04; Phase III for $348 thousand commenced 8/23/04 and expires on 8/31/05; and Phase IV for $202 thousand which commenced on 12/14/04 and expires on 6/30/06. Phases I and II have been completed.

(2)

This contract is a subcontract with CSMP under NIST and includes the original contract for $200 thousand and a contract amendment for $10 thousand.

(3)

This contract was a joint venture with DuPont. DuPont's share of the contract revenue was $1.3 million.

(4)

Revenue under these contracts has been deferred subject to customer acceptance.

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Cost of Product Revenue.

Cost of product revenue in the Test and Measurement Instrumentation segment for the three months ended June 30, 2005 decreased in comparison to the same period in 2004 by $.106 million, or 17%, to $.517 million despite an actual increase in three-month sales. Gross profit as a percentage of product revenue increased to 59.77% for the three months ended June 30, 2005 from 49.39% in the prior year. These improvements in gross profit are primarily attributable to increased commercial aviation product sales. Additionally, the gross margin in 2004 was negatively impacted by the first AutoScan unit sale at a discounted price.

Cost of product revenue in the Test and Measurement Instrumentation segment for the six months ended June 30, 2005 decreased in comparison to the same period in 2004 by $.151 million, or 11.9%, to $1.119 million. This decrease coincides with the lower sales volume for the first six months of 2005, which during 2005 included lower semiconductor and aviation sales and increases in general gaging sales. Gross profit as a percentage of product revenue, however, increased to 58.4% for the six months ended June 30, 2005 from 54.8% in the prior year. The gross profit percentage increase is primarily attributable to a two-point rise in aviation product margins stemming from the growth in commercial customer product sales. Furthermore, the margin in 2004 was negatively impacted by the first AutoScan unit sale at a discounted price.

Funded Research and Product Development Expenses.

Funded research and product development expenses in the New Energy segment increased by $.516 million, or 95.4%, to $1.057 million for the three months ended June 30, 2005 in comparison to the same period in 2004. The increased costs were attributable to a change in contracts under development. In 2005 MTI Micro is working on contracts for DOE, NYSERDA, the U.S. Marines, the U.S. Army and CSMP while in 2004 MTI Micro was working on the NIST contract.

Funded research and product development expenses in the New Energy segment increased by $.417 million, or 24.6%, to $2.112 million for the six months ended June 30, 2005 in comparison to the same period in 2004. The increased costs were attributable to a change in contracts under development. In 2005 MTI Micro is working on contracts for DOE, NYSERDA, the U.S. Marines, the U.S. Army and CSMP while in 2004 they were working on the NIST contract.

Unfunded Research and Product Development Expense.

Unfunded research and product development expenses decreased by $.609 million, or 24.7%, to $1.856 million for the three months ended June 30, 2005 in comparison to the same period in 2004. This decrease reflects a $.588 million decrease in the New Energy segment reflecting increased development associated with funded contracts underway with an associated decrease to internal development costs directed at commercializing micro fuel cells. Internal development costs include costs for the development of our micro fuel cell system and development costs in connection with Gillette and potential commercial products. Unfunded research and product development costs include the cost of micro fuel cell products warranty activity related to the shipments of its initial fuel cell units at low volume production. This increase also includes a $.021 million decrease in product development expenses in the Test and Measurement Instrumentation segment. Product development includes costs for improvements for the Microtrak II product and a high temperature capacitance gauge to serve the brake rotor market.

Unfunded research and product development expenses decreased by $.518 million, or 13%, to $3.461 million for the six months ended June 30, 2005 in comparison to the same period in 2004. This decrease reflects a $.499 million decrease in the New Energy segment reflecting increased development associated with funded contracts underway with an associated decrease to internal development costs directed at commercializing micro fuel cells. Internal development costs include costs for the development of our micro fuel cell system and development costs in connection with Gillette and potential commercial products. Unfunded research and product development costs include the cost of micro fuel cell products warranty activity related to the shipments of its initial fuel cell units at low volume production. This increase also includes a $.019 million decrease in product development expenses in the Test and Measurement Instrumentation segment. Product development includes costs for improvements for the Microtrak II product and a high temperature capacitance gauge to serve the brake rotor market.

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Selling, General and Administrative Expenses.

Selling, general and administrative expenses increased by $.451 million, or 21.9%, to $2.508 million for the three months ended June 30, 2005 in comparison to the same period in 2004. This change is primarily the result of the following changes: increased salaries and employee benefits of $.749 million related to an increase in the number of employees working in micro fuel cell engineering management, government and military relations and strategic planning and business development efforts, an expanded sales organization at MTI Instruments, an increase in corporate support employees related to Sarbanes-Oxley compliance, the addition of the role of President of Government Systems in September 2004 and the accrual of severance costs relating to the non-renewal of the President of Government System's employment contract as of June 30, 2005; increased depreciation expense of $.092 million due to an increase in capital expenditures; a decrease of $.256 million in consulting and other professional fees including an increase of $.133 million of costs related to Sarbanes-Oxley compliance, an increase of $.100 million of costs related to consultants for government relations, financial consulting and information technology offset by decreases of $.300 million in advisory fees and $.148 million in legal fees related to the 2004 private placement amendment; and a $.134 million decrease in other expenses, net.

Selling, general and administrative expenses increased by $2.178 million, or 64.7%, to $5.542 million for the six months ended June 30, 2005 in comparison to the same period in 2004. This change is primarily the result of the following changes: an increase of $.100 million in licensing fees related to the LANL license; an increase of $.221 million in consulting and other professional fees including approximately $.444 million of costs related to Sarbanes-Oxley compliance and the SEC review of the Company's filings, $.183 million of costs related to consultants for government relations, financial consulting and information technology partially offset by decreases of $.300 million in advisory fees and $.148 million in legal fees related to the 2004 private placement amendment; increased salaries and employee benefits of $1.498 million related to an increase in the number of employees working in micro fuel cell engineering management, government and military relations and strategic planning and business development efforts, an expanded sales organization at MTI Instruments, an increase in corporate support employees related to Sarbanes-Oxley compliance, the addition of the role of President of Government Systems in September 2004 and the accrual of severance costs relating to the non-renewal of the President of Government System's employment contract as of June 30, 2005; increased depreciation expense of $.206 million due to an increase in capital expenditures; and a $.153 million increase in other expenses, net.

Operating Loss.

Operating loss for the three months ended June 30, 2005 in comparison to the same period last year increased by $.009 million to $4.273 million, a 0.2% increase.

Operating loss for the six months ended June 30, 2005 in comparison to the same period last year increased by $1.923 million to $8.842 million, a 27.8% increase. This increase in operating loss results primarily from increases in selling, general and administration expense partially offset by increases in funded research and development revenue in the New Energy segment and increases in gross profits from product revenues in the Test and Measurement Instrumentation segment.

Other Income, Net.

Other income increased by $.077 million, or 240.6%, to $.109 million for three months ended June 30, 2005 in comparison to the same period in 2004. This change is primarily the result of increased interest income.

Other income increased by $.190 million, or 1,000%, to $.209 million for the six months ended June 30, 2005 in comparison to the same period in 2004. This change is primarily the result of increased interest income.

Revenue from sales of micro fuel cell products was $0 million for both the three and six months ended June 30, 2005 and June 30, 2004. We defer recognition of initial micro fuel cell product-related revenue at the time of delivery and recognize this revenue as other income as the continued warranty obligations expire. The costs associated with the product and warranty obligations are expensed as they are incurred.

Our initial sales of low volume production Mobion™ products in December 2004 were a customer-specific arrangement that included fuel cell systems and continued warranty support. While contract terms require payment upon delivery of the fuel cell system and are not contingent on the achievement of specific milestones or other substantive performance, the continuing obligation to warranty results in the Company deferring recognition

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of product-related revenue and recognizing product-related revenue as other income when the warranty obligations expire. The warranty on the product is for a period of fifteen months.

During the fourth quarter of 2004, we received a purchase order for 50 Systems and delivered 25 Systems during December 2004. The product-related revenue associated with these 25 Systems is subject to warranty obligations and has been deferred. For each of the three and six months ended June 30, 2005 and 2004, we had no System sales.

Gain on Sale of Securities Available for Sale, Net.

Results for the three and six months ended June 30, 2005 included a $9.635 million gain on sale of securities available for sale, compared to gains of $0 and $3.129 million , respectively, for the same periods in 2004. On June 24, 2005, Fletcher notified the Company of its election to exercise in full its right to purchase from the Company certain shares of common stock of Plug Power. As a result of this election, Fletcher purchased 1,799,791 shares of Plug Power common stock from the Company at a price of $0.7226 per share, with proceeds to the Company of $1.301 million. This transaction closed on June 28, 2005 and, in connection with this exercise, the Company recognized a loss on the derivative immediately prior to exercise of $7.173 million and a gain on the sale of Plug Power common shares of $9.635 million.

(***Loss) gain on Derivatives.*** The Company recorded a loss of $7.173 million and a gain of $1.492 million on derivative accounting for the three months ended June 30, 2005 and 2004, respectively. These results relate to the embedded derivative for the purchase of Plug Power common stock, which is part of the 2004 private placement transaction and the January 2004 expiration of the SatCon warrants. The embedded derivative, prior to its exercise, was valued on a quarterly basis using the Black-Scholes Option Pricing model and upon its exercise on June 24, 2005 was valued using the intrinsic value method.

The Company recorded a loss of $10.407 million and a gain of $.211 million on derivative accounting for the six months ended June 30, 2005 and 2004, respectively. These results relate to the embedded derivative for the purchase of Plug Power common stock, which is part of the 2004 private placement transaction and the January 2004 expiration of the SatCon warrants. Changes in derivative fair value for the embedded derivative is calculated using the

Black-Scholes Option Pricing Model or upon exercise using the intrinsic value method.

Income Tax (Expense) Benefit

The income tax expense rate for the three months ended June 30, 2005 was 86.49% and the income tax benefit rate for the three months ended June 30, 2004 was 38.87%. The tax rates are primarily due to losses generated by operations, changes in the valuation allowance and the projected annual effective tax rate adjustments. It is anticipated that a full valuation allowance will be required by the end of 2005 and the provision for the three months ended June 30, 2005 has been adjusted to reflect the projected annual effective tax rate including the anticipated impact of a full valuation allowance.

The income tax expense rate for the six months ended June 30, 2005 was 2.80% and for the six months ended June 30, 2004 the income tax benefit rate was 38.79%. The tax rates are primarily due to losses generated by operations, changes in the valuation allowance and the projected annual effective tax rate adjustments. It is anticipated that a full valuation allowance will be required by the end of 2005 and the provision for the six months ended June 30, 2005 has been adjusted to reflect the projected annual effective tax rate including the anticipated impact of a full valuation allowance.

The valuation allowance at June 30, 2005 was $5.972 and at December 31, 2004 was $1.836 million. The Company determined that it was more likely than not that the ultimate recognition of certain deferred tax assets would not be realized.

Further, as a result of ownership changes in 1996, the availability of $.561 million of net operating loss carry-forwards to offset future taxable income will be limited pursuant to the Internal Revenue Code.

Liquidity and Capital Resources

The Company has incurred significant losses as it continues to fund MTI Micro's DMFC product development and commercialization programs. The Company expects that losses will fluctuate from year to year and that such fluctuations may be substantial as a result of, among other factors, gains on sales of securities available for sale, the operating results of MTI Instruments and MTI Micro, the availability of equity financing including the

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additional investment rights issued in connection with the 2004 private placement and the ability to attract government funding resources to offset research and development costs. As of June 30, 2005, the Company had an accumulated deficit of $75.471 million. During the six months ended June 30, 2005, the Company's results of operations resulted in a net loss of $8.847 million and used cash in operating activities totaling $7.678 million. This cash use in 2005 was funded primarily by cash and cash equivalents on hand as of December 31, 2004 of $22.545 million. The Company expects to continue to incur losses as it seeks to develop and commercialize Mobion™ fuel cell systems and it expects to continue funding its operations from current cash and cash equivalents, the sales of securities available for sale, proceeds, if any, from the exercise of additional investment rights issued in connection with the 2004 private placement or other equity financings and government program funding. The Company expects to spend approximately $12.5 million on research and development of Mobion™ fuel cells and $1.2 million in research and development on MTI Instruments' products in 2005.

There can be no assurance that the Company will not require additional financing during 2005 or that any additional financing will be available to the Company on terms acceptable to the Company, if at all. Cash used in operations is expected to total approximately $17 million for 2005. Further, cash used for capital expenditures is expected to total approximately $1 million in 2005 and will consist of purchases for furniture, computer equipment, software and manufacturing and laboratory equipment. The Company believes it will have adequate resources to fund operations and capital expenditures through the first quarter of 2007 based on current cash and cash equivalents, current cash flow and revenue projections and the potential sale of securities available for sale at current market values. Proceeds from the sale of securities available for sale are subject to fluctuations in the market value of Plug Power. The Company may also seek to provide additional resources through an equity offering. Additional government revenues and Fletcher's potential exercise of additional investment rights totaling up to an additional $20 million could also provide additional resources. The Company anticipates that it will have to raise additional equity capital to fund its long-term business plan, regardless of whether Fletcher exercises any or all of its additional investment rights.

Future sales of Plug Power securities will generate taxable income or loss, which is different from book income or loss, due to the tax bases in these assets being significantly different from their book bases. Book and tax bases as of June 30, 2005 are as follows:

Security	Shares Held	Average Book Cost Basis	Average Tax Basis
Plug Power	3,793,436	$1.78	$0.96

As of June 30, 2005, the Company owned 3,793,436 shares of Plug Power common stock. In connection with the 2004 private placement the Company had placed 2,700,000 of its Plug Power shares in escrow. On June 24, 2005, Fletcher notified the Company of its election to exercise in full its right to purchase from the Company certain shares of common stock of Plug Power. As a result of this election, Fletcher purchased 1,799,791 shares of Plug Power common stock from the Company at a price of $0.7226 per share, with proceeds to the Company of $1.301 million. This transaction closed on June 28, 2005 and, in connection with this exercise, the Company recognized a loss on the derivative immediately prior to exercise of $7.173 million and a gain on the sale of Plug Power common shares of $9.635 million. Additionally, the remaining 900,209 shares of Plug Power common stock were released from escrow on June 30, 2005.

Plug Power stock is currently traded on the Nasdaq National Market and is therefore subject to stock market conditions. When acquired, these securities were unregistered. Plug Power securities are considered "restricted securities" as defined in Rule 144 and may not be sold in the future without registration under the Securities Act, unless in compliance with an available exemption there from.

Working capital was $33.058 million at June 30, 2005, a $1.754 million decrease from $34.812 million at December 31, 2004. This decrease is primarily the result of the use of cash in operations offset by increases in the market value of securities available for sale and number of shares due to the release from escrow of previously restricted securities.

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At June 30, 2005, the Company's order backlog was $.392 million, compared to $.480 million at December 31, 2004.

Inventory and accounts receivable (from product revenues) turnover ratios and their changes for the six months ended June 30 are as follows:

	2005	2004	Change
Inventory	1.80	1.70	.10

Accounts receivable (from product revenues)	4.11	4.63	(.52)

The change in the inventory turnover ratio is the result of lower inventories in 2005 compared to 2004. The decrease in the accounts receivable turnover ratio is primarily the result of lower sales in 2005 to the U.S. Air Force which pays its obligations more quickly than typical commercial accounts.

Cash flow used by operating activities was $7.678 million for the six months ended June 30, 2005 compared with $5.611 million in 2004. This cash use increase of $2.067 million reflects increases in cash expenditures to fund New Energy segment operations' growth, partially offset by balance sheet changes, which reflect the timing of cash payments and receipts.

Capital expenditures were $.452 million during the first six months of 2005, a decrease of $.379 million from the prior year. Capital expenditures in 2005 included computer equipment, demonstration equipment, software, and manufacturing and laboratory equipment. There were $.021 million in outstanding commitments for capital expenditures as of June 30, 2005. The Company expects to finance these expenditures with current cash and cash equivalents, the sale of securities available for sale, equity financing and other sources, as appropriate and to the extent available.

Pursuant to additional investment rights, Fletcher has the right, but not the obligation, to purchase, in a single purchase or multiple purchases, up to an additional $20 million of our common stock at any time prior to December 31, 2006 at a price per share equal to $6.023 (as adjusted from $6.34), which date and price may be extended and adjusted, respectively, in certain circumstances.

The Company may sell shares of Plug Power common stock in connection with its previously announced strategy to raise additional capital through the sale of Plug Power stock in order to fund its micro fuel cell operations. Taxes on the net gains are expected to be offset by the Company's operating losses. As of June 30, 2005, the Company has estimated its remaining net operating loss carry forwards to be approximately $34.109 million.

New Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, *Inventory Costs-an amendment of ARB No. 43, Chapter 4* ("FAS 151"), which is the result of its efforts to converge U.S. accounting standards for inventories with International Accounting Standards. SFAS No. 151 requires idle facility expenses, freight, handling costs and wasted material (spoilage) costs to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is in the process of evaluating the impact of this standard on its consolidated financial statements.

In December 2004, SFAS No. 123 (revised 2004), *Share-Based Payment,* (SFAS No. 123R) was issued. In March 2005 the SEC issued Staff Accounting Bulletin No. 107 (SAB 107). SAB 107 expresses views of the SEC staff regarding the interaction between SFAS 123R and certain SEC rules. SFAS 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS 123R requires public entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models adjusted for the unique characteristics of those instruments. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. In April 2005, the SEC delayed the implementation of

SFAS 123R for public companies until the first annual period beginning after June 15, 2005. SFAS 123R is required to be adopted by the Company as of January 1, 2006.

The Company currently utilizes a closed form option-pricing model to measure the fair value of stock-based compensation for employees. SFAS 123R permits the use of this model or other models such as a lattice model. The Company has not yet determined which model it will use to measure the fair value of share-based grants to employees upon the adoption of SFAS 123R. The effect of expensing stock options in accordance with the original SFAS 123 is presented above under Note 2, Significant Accounting Policies. SFAS 123R also requires that the benefits associated with the tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This presentation may reduce net operating cash flows and increase net financing cash flows in periods after the effective date. The amount of this excess tax deduction benefit was $39 thousand and $128 thousand in the six months ended June 30, 2005 and 2004, respectively. The unvested value of share awards to be amortized into the operating statement is approximately $4.791 million as of June 30, 2005.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Non-monetary Assets, an amendment of APB Opinion No. 29.* SFAS No. 153 addresses the measurement of exchanges of non-monetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 is effective for non-monetary asset exchanges beginning in our second quarter of fiscal 2006. The Company is in the process of evaluating the impact of this standard on its consolidated financial statements.

In May 2005, SFAS No. 154, *Accounting Changes and Error Corrections - replacement of APB Opinion No. 20 and FASB Statement No. 3,* (SFAS No. 154) was issued. SFAS No. 154 changes the accounting for and reporting of a change in accounting principle by requiring retrospective application to prior periods' financial statements of changes in accounting principle unless impracticable. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005. The Company does not expect the adoption of SFAS No. 154 to have a material impact on its results of operations, financial position or cash flows.

Additional Information Concerning Risks

In connection with the 2004 private placement, we may have to (1) sell shares of our common stock at prices which result in substantial dilution to our shareholders, and (2) issue additional shares of our common stock to Fletcher at prices that may be substantially below market value at the time of issuance without any payment required by Fletcher, which would cause our shareholders to suffer additional dilution.

After giving effect to the 1,261,829 shares of common stock we issued to Fletcher on December 22, 2004 (as well as all shares issued or to be potentially issued to Fletcher in connection with our failure to satisfy the registration requirement as discussed in Note 7, Shareholders' Equity), the 2004 private placement provided Fletcher additional investment rights to purchase up to an additional $20 million of our common stock at a price equal to $6.34 per share (subject to adjustment). This price has been reduced to $6.023 per share due to our failure to satisfy the registration requirement, and may be further reduced due to, among other things, continuing failure to satisfy such registration requirement. Any exercise of the additional investment rights could result in sales of our common stock at prices that are below the market price for our common stock at the time the investment right is exercised and could result in substantial dilution to our shareholders.

Our agreement with Fletcher also provides that Fletcher will receive additional shares of our common stock with respect to shares it already owns, and the exercise price and term relating to unexercised additional investment rights will be adjusted to the benefit of Fletcher, each upon the occurrence of certain events or circumstances, some of which are beyond our control, including:

- issuances of our equity securities at a price below $7.048 per share (which is the price Fletcher paid in connection with its initial $10 million investment) or issuances of our equity securities at a price below $6.34 per share (which was the original exercise price relating to the additional investment rights);

- our failure to satisfy certain requirements relating to registering the resale of shares issued or issuable to Fletcher pursuant to the securities laws;

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- a change in control of our Company; and

- a restatement of our financial results.

In any event, 8,330,411 shares is the maximum number of shares of our common stock we may be required to issue to Fletcher, which amount includes the 1,418,842 shares issued on January 29, 2004, the 1,261,829 shares issued on December 22, 2004 and the 66,413 registration penalty shares issued on April 20, 2005.

In connection with the 2004 private placement, we will be responsible for having the resale of shares purchased by Fletcher registered with the SEC within defined time periods and subject to penalties if the shares are not registered with the SEC within those defined time periods.

Pursuant to our agreement with Fletcher, we are obligated, within ten business days after the closing of the purchase of any additional shares by Fletcher pursuant to rights issued in connection with the 2004 Private

Placement, to file a registration statement with the SEC covering the resale of all such shares. We are also obligated to cause each of those registration statements to be declared effective not more than sixty (60) days after the closing of the purchase of such shares, or if the registration statement is reviewed by the SEC, not more than ninety (90) days after the closing of the purchase of such shares. If we fail to file the registration statements or become effective as set forth above, we must issue to Fletcher a number of additional shares to reflect the number of shares it would have acquired if its purchase price was based on the actual exercise price reduced by five percent for each month in which we fail to satisfy our obligations and adjust the exercise price for the additional investment rights to such lower price. In addition, such failure may result in an extension of the investment term for each day we fail to satisfy our registration obligations. The Company initially filed a Registration Statement on January 6, 2005 which was within ten business days after the closing of the purchase of additional shares by Fletcher on December 22, 2004. The 90-day deadline for this Registration Statement to be declared effective was March 22, 2005. Since the Registration Statement was declared effective on April 21, 2005, we failed to meet the March 22, 2005 deadline and therefore were required to issue 66,413 additional shares of common stock to Fletcher without any payment required on its part.

Statement Concerning Forward-Looking Statements

This Quarterly Report on Form 10-Q and the documents we have filed with the Securities and Exchange Commission that are incorporated by reference into this Form 10-Q contain and incorporate forward-looking

statements that involve risks and uncertainties within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Any statements contained, or incorporated by reference, in this Form 10-Q that are not statements of historical fact may be forward-looking statements. When we use the words "anticipates," "plans," "expects," "believes," "should," "could," "may,"

"will" and similar expressions, we are identifying forward-looking statements. Forward-looking statements involve risks and uncertainties, which may cause our actual results, performance or achievements to be materially different from those expressed or implied by forward-looking statements. These factors include, among others:

- Our need to raise additional financing;
- risks related to developing Mobion^{TM} direct methanol micro fuel cells and whether we will ever successfully develop commercially viable Mobion^{TM} fuel cell systems;
- the potential for early termination of our agreement with Gillette and its Duracell division;
- our inability, or Gillette's inability, to develop Mobion^{TM} fuel cell systems or fuel refills on our planned schedule;

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- market acceptance of Mobion^{TM} fuel cell systems;
- risks related to our first Mobion^{TM} fuel cell product delivered in December 2004, including reliability, run time, customer acceptance and safety;
- our dependence on OEMs integrating Mobion^{TM} fuel cell systems into their devices;
- the need for current regulations to change to permit methanol to be carried onto airplanes for Mobion^{TM} fuel cell systems to achieve mass market commercialization;
- Fletcher's decision whether to exercise its additional investment rights and the price at which Fletcher purchases shares;
- Risks related to the flammable nature of methanol as a fuel source;
- our history of losses;
- intense competition in the DMFC and instrumentation businesses;
- the risk we may become an inadvertent investment company;
- our dependence on the success of Plug Power Inc.;
- risks related to protection and infringement of intellectual property;
- the historical volatility of our stock price;
- general market conditions; and
- other factors referred to under the caption "Risk Factors" which are set forth in our Annual Report on Forms 10-K and 10-K/A.

Readers should not rely on our forward-looking statements. These and other risks are set forth in greater detail in the "Risk Factors" section of our Annual Report on Forms 10-K and 10-K/A, which are incorporated herein by reference and under the caption "*Additional Information Concerning Risks"* in this quarterly report on Form 10-Q. Except as may be required by applicable law, we do not undertake or intend to update any forward-looking statements after the date of our Annual Report on Forms 10-K and 10-K/A, which are incorporated herein by reference.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We develop products in the United States and sell them worldwide. As a result, our financial results could be affected by factors such as changes in foreign exchange rates or weak economic conditions in foreign markets. Since our sales are currently priced in U.S. dollars and are translated to local currency amounts, a strengthening of

the dollar could make our products less competitive in foreign markets. Interest income is sensitive to changes in the general level of U.S. interest rates, particularly since our investments are in cash equivalents. Based on the nature and current levels of our cash equivalents, however, we have concluded that there is no material market risk exposure.

As a result of holding securities available for sale, the Company is exposed to fluctuations in market value. The Company recognizes changes in market value through the balance sheet, however if an other than temporary

market decline were to occur, it could have a material impact on the Company's operating results.

The Company's issued derivatives consist of warrants and rights to purchase shares of the Company's common stock and Plug Power common stock owned by the Company. The fair value of the embedded derivative for the right to purchase Plug Power common stock is recorded in the financial statement line titled "Derivative liability." This derivative, prior to its exercise, was valued on a quarterly basis using the Black-Scholes Option Pricing

model and upon its exercise on June 24, 2005 was valued using the intrinsic value method. The Company recognizes changes in fair value through the operating statement line titled "(Loss) gain on derivatives." The Company does not use derivative financial instruments for speculative or trading purposes.

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Item 4. Controls and Procedures

The certifications of the Company's Chief Executive Officer and Chief Financial Officer attached as Exhibits 31.1 and 31.2 to this Quarterly Report on Form 10-Q include, in paragraph 4 of such certifications, information concerning the Company's disclosure controls and procedures and internal control over financial reporting. Such

certifications should be read in conjunction with the information contained in this Item 4 for a more complete understanding of the matters covered by such certifications.

(a) Evaluation of Disclosure Controls and Procedures

The Company's management, under the supervision of and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this report. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information

required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded , processed, summarized , reported and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure in accordance with Exchange Act Rule 13a-15(e). Based on that evaluation, the Company's management, including the Chief Executive Officer and the Vice President and Chief Financial Officer, concluded that the Company's quarterly disclosure controls and procedures were not effective as of the end of the period covered by this report because there was a material weakness identified in the first quarter and, as a result, additional procedures were established during the second quarter by the Company to address the material weakness. The Company intends to observe the operating effectiveness of these additional internal controls for at least two quarters prior to concluding that disclosure controls are effective.

This conclusion was based on a material weakness that was identified in our Form 10-Q, filed with the Securities and Exchange Commission (SEC) on May 10, 2005 still being present at June 30, 2005. This material weakness was a result of not maintaining effective control over the calculation of the quarterly tax provision in accordance with generally accepted accounting principles. In light of this material weakness, the Company performed additional post closing procedures to ensure its consolidated financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, management believes that the financial statements presented in Item 1 of this 10-Q fairly present, in all material respects, the Company's financial position, results of operations and cash flows for the periods presented.

(b) Changes in Internal Control Over Financial Reporting

In response to the material weakness identified above, we strengthened our internal controls over the preparation and review of our income tax accounting procedures through improvements to our organizational structure that provide for a separate individual preparing the tax accrual and the chief financial officer reviewing the tax accrual. Additionally, we implemented a checklist of items that is considered during the preparation and review of the income tax provision in order to identify unusual or complex transactions that should be evaluated for the appropriate tax and accounting requirements.

There have been no other significant changes in the Company's internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during the Company's fiscal quarter ended June 30, 2005 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

At any point in time, the Company and its subsidiaries may be involved in various lawsuits or other legal proceedings. Such lawsuits could arise from the sale of products or services or from other matters relating to its regular business activities, compliance with various governmental regulations and requirements, or other transactions or circumstances. The Company does not believe there are any such proceedings presently pending which could have a material adverse effect on the Company's financial condition.

Ling Electronics, Inc.

On March 5, 2005, the Company entered into a settlement agreement for the outstanding claim brought against it by Donald R. Gililland, Sharon Gililland, Vernon Dunham and Jean Dunham, related to a facility lease. The claim was settled for $240 thousand to be paid by SatCon and $35 thousand to be paid by the Company. This settlement released the Company from any future obligations. The Company had accrued costs to settle this claim and the settlement of this claim was accounted for in the results of operations for the year ended December 31, 2004. The settlement was paid in March 2005.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

Recent Sales of Unregistered Securities

On December 22, 2004, Fletcher exercised its right to purchase an additional 1,261,829 shares of the Company's common stock. On January 6, 2005, the Company filed a resale registration statement on Form S-3 for the 1,261,829 shares of the Company's common stock issued to Fletcher. This resale registration statement was converted to Form S-1 and on April 20, 2005, we issued 66,413 shares of our common stock to Fletcher. Our agreement with Fletcher requires that we issue such shares without any payment required on the part of Fletcher due to our failure to have the January 6, 2005 registration statement declared effective by March 22, 2005 with respect to the 1,261,829 shares of our common stock sold to Fletcher. The registration statement was amended to include the 66,413 additional shares and was declared effective by the SEC on April 21, 2005, covering the resale of all 1,328,242 shares issued to Fletcher in December 2004 and April 2005. Each of these Fletcher private placements was exempt from registration under the Securities Act pursuant to Section 4(2) thereof since each was a sale not involving a public offering. The purchaser in such transactions represented to us that it was an accredited investor, acquiring the securities for investment and not distribution. No underwriters were involved in the foregoing transactions.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

At the Company's Annual Meeting of Shareholders ("Annual Meeting") held on June 28, 2005, a total of 27,574,689 shares (approximately 89.89%) of the issued and outstanding shares of the Company's common stock of

30,676,626 were represented by proxy or in person at the meeting. The final report from the Inspectors of Election showed that the Company's shareholders approved the following:

1. To elect the following directors for the terms of office noted:

- Election of Directors	Term	Number of Votes For	% Cast	Against/ Withheld	Broker Non-Votes
Thomas J. Marusak	3 Yr.	27,004,775	97.93	569,914	-
E. Dennis O'Connor	3 Yr.	26,662,277	96.69	912,412	-

The other directors, whose terms of office as directors continued after the Annual Meeting, are: Dale W. Church, Edward A. Dohring, Steven N. Fischer, William P. Phelan, Dr. Walter L. Robb and Dr. Beno Sternlicht.

- The approval of the Amendment to the Restated Certificate of Corporation, as amended, to reduce the par value of the Company's common stock from $1.00 to $.01 per share was approved by a majority of the shareholders.

Number of Votes For	Against/ Withheld	Abstentions	Broker Non-Votes
26,337,088	923,801	313,800	-

Item 5. Other Information

Not applicable.

Item 6. Exhibits

Exhibit No.	Description
4.1	Certificate of Additional Investment Rights issued to Fletcher International, Ltd.
31.1	Rule 13a-14(a)/15d-14(a) Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of Steven N. Fischer
31.2	Rule 13a-14(a)/15d-14(a) Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of Cynthia A. Scheuer
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Steven N. Fischer
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Cynthia A. Scheuer

SIGNATURES

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

Mechanical Technology Incorporated

8/09/2005	/s/Steven N. Fischer
(Date)	Steven N. Fischer

Chief Executive Officer

8/09/2005	/s/Cynthia A. Scheuer
(Date)	Cynthia A. Scheuer
	Vice President and Chief Financial Officer