

CAPSTONE TURBINE CORP

Form 424B5

September 18, 2008

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Filed Pursuant to Rule 424(b)(5)  
 Registration Statement  
 Nos. 333-128164  
 and  
 333-153551

**PROSPECTUS SUPPLEMENT**

(To Prospectus dated September 14, 2005)

**21,485,660 Shares**  
**Warrants to Purchase 6,445,698 Shares**  
**CAPSTONE TURBINE CORPORATION**  
**Common Stock**

We are offering up to 21,485,660 shares of our common stock and warrants to purchase up to 6,445,698 shares of our common stock. Purchasers will receive a warrant to purchase three shares of common stock at an exercise price of \$1.92 per share for every ten shares of common stock they purchase in this offering. Investors will be required to purchase ten shares of common stock and a warrant to purchase three shares of common stock as a unit, but no actual units will be issued or certificated. Instead, the shares of common stock and the warrants are immediately separable and will be issued separately.

Our common stock is listed on the Nasdaq Global Market under the symbol CPST. On September 17, 2008, the last reported sale price of our common stock on the Nasdaq Global Market was \$1.75 per share.

We have retained Wachovia Capital Markets, LLC as our placement agent to use its reasonable efforts to solicit offers to purchase our securities in this offering. See Plan of Distribution in this prospectus supplement for more information regarding these arrangements.

**Investing in our securities involves a high degree of risk. See Risk Factors beginning on page S-5 of this prospectus supplement.**

	<b>Per Unit</b>	<b>Total</b>
Public offering price	\$ 14.90	\$ 32,013,633.40
Placement agent's fees	\$ 0.7152	\$ 1,536,654.40
Proceeds, before expenses, to Capstone Turbine Corporation	\$ 14.1848	\$ 30,476,979.00

Each unit reflected in the foregoing table will consist of ten shares of common stock and a warrant to purchase three shares of common stock. In addition to the placement agent's fees reflected in the foregoing table, we have agreed to pay a financial advisory fee of 1.2% of the gross proceeds of this offering (excluding any proceeds from the exercise of the warrants) to a financial advisor as described under Plan of Distribution in this prospectus supplement.

The placement agent is not purchasing or selling any securities pursuant to this prospectus supplement or the accompanying prospectus, nor are we requiring any minimum purchase or sale of any specific number or amount of securities. Because there is no minimum offering amount required as a condition to the closing of this offering, the actual public offering amount, placement agent's fees and proceeds to us are not currently determinable and may be substantially less than the maximum amounts set forth above. We expect that delivery of the securities being offered pursuant to this prospectus supplement and the accompanying prospectus will be made on or about September 23, 2008. Investors purchasing securities in this offering will be required to pay the purchase price directly to us, and we will hold the amounts paid by investors in a separate interest-bearing or money market account until the date on which the securities are delivered to the investors. If for any reason the closing does not occur or the placement agency agreement referred to under Plan of Distribution is terminated, we will return to each investor the purchase price

received from such investor, together with a pro rata portion of any interest or dividends earned on the funds in such account for each day while the purchase price received from such investor was in such account.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

**Wachovia Securities**

The date of this prospectus supplement is September 17, 2008.

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**Prospectus**

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**You should rely only on the information contained or incorporated by reference in this prospectus supplement, the accompanying prospectus and any free writing prospectuses we may provide to you in connection with this offering. We have not authorized any other person to provide you with any information that is different. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. The information contained in this prospectus supplement, the accompanying prospectus, the documents incorporated by reference herein and any free writing prospectuses we may provide to you in connection with this offering is accurate only as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.**

**No action has been taken or will be taken by us or the placement agent that would permit a public offering of our common stock or warrants or the possession or distribution of this prospectus supplement or the**

**accompanying prospectus in any jurisdiction where action for that purpose is required, other than in the United States.**

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**ABOUT THIS PROSPECTUS SUPPLEMENT**

This prospectus supplement and the accompanying prospectus are part of a registration statement that we filed with the Securities and Exchange Commission, or SEC, utilizing a shelf registration process. We are providing information to you about this offering in two separate documents that are combined together. The first document is this prospectus supplement, which provides you with some specific details regarding this offering, including the public offering price, the amount of common stock and warrants to purchase common stock being offered and some of the risks of investing in our securities. The second document is the accompanying prospectus, which provides you with more general information, some of which may not apply to this offering and some of which may have been supplemented or superseded by information in this prospectus supplement or documents incorporated or deemed to be incorporated by reference in this prospectus supplement that we filed with the SEC subsequent to the date of the prospectus. You should read both this prospectus supplement and the accompanying prospectus together with the additional information described under the heading **Where You Can Find More Information**.

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**PROSPECTUS SUPPLEMENT SUMMARY**

*This summary highlights some of the information appearing elsewhere in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference herein and does not contain all of the information that may be important to you. For a more complete understanding of our business and the securities we are offering, you should read this prospectus supplement, the accompanying prospectus and the documents incorporated by reference herein in their entirety, including the risk factors and the financial statements and related notes and the form of warrant attached as Annex A hereto. Unless otherwise expressly stated or the context otherwise requires, references in this prospectus supplement to Capstone, we, us, or our or similar references refer to Capstone Turbine Corporation and its subsidiary, and references to our fiscal years refer to our fiscal years ending March 31.*

**Capstone Turbine Corporation**

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 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.

We believe we were the first company to offer a commercially available power source using microturbine technology. 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. Our 60 and 65-kilowatt ( C60 Series ) microturbine can produce enough heat to provide hot water to a typical 100-room hotel while also providing about one-third of its electrical requirements, based on our estimates. Our 200-kilowatt ( C200 ) microturbine is well suited for larger hotels, office buildings and wastewater treatment plants. By packaging the C200 microturbine power modules into an International Standards Organization (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. We currently estimate that we will begin commercial shipments of our C1000 microturbine in January, 2009. Our microturbines combine patented air-bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and low emission electricity and heat production systems.

**Recent Developments**

On August 26, 2008, we announced that we had received two orders totaling over \$1.3 million for our innovative UPSource product, which is designed to provide an uninterruptible source of electrical power for data center applications. The systems will be delivered to customers in Arlington, Virginia and Houston, Texas.

We shipped the first C200 production unit on August 28, 2008. Originally scheduled for shipment in late September, we were able to deliver this first unit earlier than planned. The first production unit was shipped to Integrated Building Technologies S.R.L., our distributor in Italy. The system will be installed in a wastewater treatment facility in Biella, Italy, and will operate on methane gas generated from the digesters at the facility.

We are in negotiations with potential lenders to obtain a three-year line of credit. We currently anticipate that borrowings under the line of credit would be limited to the lesser of (1) \$10 million and (2) specified percentages of our accounts receivable and inventory. We also anticipate that the line of credit would be secured by all or substantially all of our assets, including accounts receivable, inventory, equipment and patents, licenses and other intellectual property, would require that we comply with certain financial and other covenants and would permit the lender to demand immediate repayment of all borrowings and seize the collateral upon the occurrence of certain events of default, and that our ability to draw on the line of credit would be subject to customary terms and conditions contained in a definitive agreement for the line of credit. There can be no assurance that a line of credit will be obtained. Moreover, if we obtain a line of credit, the terms of the definitive agreement may differ from those described above.





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Capstone was incorporated in California in 1988. On June 22, 2000, we reincorporated as a Delaware corporation. Our principal executive offices are located at 21211 Nordhoff Street, Chatsworth, California 91311. Our telephone number is (818) 734-5300. Our Internet address is *www.capstoneturbine.com*. Information contained on our website is not part of this prospectus supplement or the accompanying prospectus or any document incorporated or deemed to be incorporated by reference herein.

In this prospectus supplement, the accompanying prospectus and documents incorporated herein by reference, we refer to information, forward-looking statements and statistics regarding the distributed power generation industry, our potential markets and our market position or leadership, our position relative to our competitors, the costs, benefits and relative environmental impact and efficiencies of our products and competing technologies, markets for energy and energy costs, supply and demand, environmental matters, including climate change, green building and greenhouse gases, the co-generation market, the electrical efficiency of our products compared to other distributed power generation products and similar matters. Unless otherwise indicated, this information has been derived from reports and other data publicly available from governmental entities, market research firms, trade groups, other companies and non-governmental organizations. We have not independently verified this information and cannot give assurance as to its accuracy or completeness.

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**The Offering**

Issuer	Capstone Turbine Corporation
Common stock offered by us	Up to 21,485,660 shares. Investors will be required to purchase the securities offered by this prospectus supplement as units consisting of ten shares of common stock and a warrant to purchase three shares of common stock. However, no units will actually be issued or certificated and the shares of common stock and warrants are immediately separable and will be issued separately.
Warrants to purchase common stock offered by us	Warrants to purchase up to 6,445,698 shares of common stock. Each warrant will initially entitle the holder to purchase three shares of our common stock at an exercise price of \$1.92 per share. For important information concerning the terms and provisions of the warrants, see <i>Description of Warrants</i> in this prospectus supplement and the form of warrant attached hereto as Annex A. This prospectus supplement also relates to the shares of common stock issuable upon exercise of the warrants.
Common stock to be outstanding after the offering	Up to 173,604,186 shares
Use of proceeds	We intend to use the net proceeds from this offering for product development, corporate growth and for other general corporate purposes. See <i>Use of Proceeds</i> .
Nasdaq Global Market symbol of our common stock	CPST. The warrants will not be listed on any securities exchange or quotation system.
Risk Factors	Investing in our securities involves a high degree of risk. You should consider carefully each of the risks described in this prospectus supplement under the caption <i>Risk Factors</i> and the other information contained and incorporated by reference in this prospectus supplement and the accompanying prospectus before deciding to purchase our securities.

Except as otherwise indicated herein, the information above and elsewhere in this prospectus supplement regarding outstanding shares of our common stock is based on 152,118,526 shares of common stock outstanding as of September 12, 2008, and excludes the following shares of common stock:

8,061,797 shares of common stock issuable upon the exercise of stock options outstanding as of September 12, 2008, with a weighted-average exercise price of \$1.88 per share;

7,875,268 additional shares of common stock reserved for future issuance under our stock incentive plans and our employee stock purchase plans as of September 12, 2008;

15,303,510 shares of common stock issuable upon the exercise of warrants outstanding as of September 12, 2008, with an exercise price of \$1.30 per share (subject to adjustment); and

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6,445,698 shares of common stock issuable upon the exercise of the warrants issued hereunder (assuming that all of the securities offered hereby are sold).

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**RISK FACTORS**

*Investing in our securities involves a high degree of risk. You should consider carefully each of the following risks and all other information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus before deciding to purchase our securities. Additional risks of which we may not be aware or that we currently believe are immaterial may also adversely affect our business. If any of these risks actually occurs, our business, financial condition and operating results could be adversely affected. As a result, the trading price of our common stock and the market value of the warrants offered hereby could decline, perhaps significantly, and you could lose all or part of your investment. In assessing these risks, you should refer to the other information included in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference herein.*

**Risks Related to Our Business and Industry**

**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 net 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.**

We have never generated positive cash flow from operations and are therefore wholly dependent upon external sources of financing to sustain our business. Moreover, we currently do not have any credit facilities or other committed sources of financing. At June 30, 2008, we had \$42.7 million, or 567 units, in backlog. We have significantly exceeded our planned backlog as of June 30, 2008. We will require substantial additional cash to produce the microturbines that were included in our backlog at June 30, 2008 as well as products needed to fill orders we receive after that date, particularly because some of the components and materials used in the manufacturing process have long lead times and therefore must be purchased far in advance of our shipment of the related products to customers. We are conducting this offering to raise a portion of the funds necessary to satisfy the resultant increase in our cash needs and expenditures. However, we expect that the funds raised from this offering and the funds that we now have on hand will not be sufficient to fund our future cash requirements, and we expect that we will 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 market value of our common stock and the warrants offered hereby. If we obtain debt financing, such as the proposed line of credit described under Prospectus Supplement Summary Recent Developments, we may be required to pledge accounts receivables, inventories, equipment, patents or other assets as collateral, which would be subject to seizure by our creditors if we were to default under the debt agreements, we could be required to comply with financial and other covenants that could limit our flexibility in conducting our business and put us at a disadvantage compared to our competitors, and we would be required to use our available cash to pay debt service. If adequate capital is not available to us, we would likely be required to significantly curtail or possibly even cease our operations.

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

As stated in our Quarterly Report on Form 10?Q for the quarter ended June 30, 2008, should we be unable to execute our plans to build sales and margins while controlling costs and obtain additional financing after this offering, 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. The proceeds from the

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offering, together with our other available cash and any proceeds from other 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, our auditors could qualify their report on our audited financial statements by expressing doubt as to 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 and the warrants offered hereby. 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. The foregoing risks will be heightened to the extent that the actual amount of securities we sell in this offering is substantially below the maximum amount of securities we are offering as set forth on the cover page of the prospectus supplement.

**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;

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.**

The first commercial C200 product was shipped on August 28, 2008 and additional units are scheduled to be shipped in late September 2008. 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.

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**Table of Contents****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 advantage vis-à-vis our products. We believe that



developing and maintaining a competitive advantage will require continued investment by us in product development and quality, as well as attention to product performance, our product prices, our conformance to industry standards, manufacturing capability and sales and marketing. In addition, current and potential competitors have established or may in the future establish collaborative relationships among 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.

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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 net revenue we anticipate. As a result of our corporate strategies, we have decided to focus our resources on selected vertical markets, such as cogeneration (CHP, ICHP and CCHP), resource recovery and secure power. 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 have begun offering 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 Energy Systems ( BPC ), which accounted for approximately 46% of our net accounts receivable as of June 30, 2008 and approximately 32% of our revenue for the three months ended June 30, 2008, is a privately owned company located in Russia, and we are, therefore, particularly susceptible to risks associated with doing business in that country.

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**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 or warrants.**

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. In the third quarter of fiscal year 2008, a material weakness was detected which related to a deficiency in the design of controls surrounding our analysis of offsets to research and development expense. This deficiency in controls resulted in our recording adjustments to increase research and development expense by a material amount in the quarter ended December 31, 2007. During the fiscal quarter ended March 31, 2008, we enhanced the design of the control relating to the monthly review procedure of the analysis. 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 Securities and Exchange Commission. Any such action could adversely affect our financial results and the market price of our common stock or warrants.

**Approval of the New York City Department of Buildings Materials Equipment Acceptance ( MEA ) application for listing our product on the MEA Index may not result in an increase in sales.**

Our sales efforts may not achieve our intended targets with regards to the New York City market and, therefore, may not generate the net revenue we anticipate. As a result of our corporate strategies, we decided to focus resources on the New York City market to support the sales that may result from the approval of the New York City Department of Buildings MEA application for listing our product on the MEA Index. Though we received our MEA approval from the New York City Department of Buildings MEA Division and the New York Fire Department on May 24, 2006, certain applications of our products will require further approval and there can be no assurance that our focus on, or our near-term plans for, the New York City market will be successful.

**Approval of Capstone-branded products for listing on the General Service Administration ( GSA ) Schedule does not ensure that we will supply products to the federal government and may not result in an increase in sales.**

We have publicly announced that our products have been approved by the GSA. This approval was obtained by one of our distributors. The GSA approval provides the opportunity for federal end-user customers to negotiate and acquire products and services from commercial suppliers. There is no assurance that we will achieve our intended targets with regards to the sale of our products to the federal government, and, therefore, we may not generate the net revenue we anticipate.

**We may not be able to retain or develop relationships with original equipment manufacturers ( 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.

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**A significant customer may not achieve its forecasted sales growth or we may fail to complete the development and commercialization of the C200, in which case the significant customer would receive a non-exclusive, perpetual, world-wide license to the C200 or we may incur additional expense related to service contracts we acquired from this customer, thereby adversely affecting our revenue levels and cash flow.**

Sales to UTC Power Corporation ( UTCP ), an affiliate of United Technologies Corporation, accounted for approximately 3%, 13% and 12% of our net revenue for the quarter ended June 30, 2008 and the fiscal years ended March 31, 2008 and 2007, 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 September 2007, we entered into the Development and License Agreement with UTCP (the Development Agreement ). The Development Agreement engages UTCP to fund and support our continued development and commercialization of our 200 kilowatt microturbine product, the 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 our efforts to develop the C200. In return, we 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. As of June 30, 2008, we have received approximately \$9.0 million of payments from UTCP under the Development Agreement. If we fail to complete the development and commercialization of the C200, UTCP will receive a non-exclusive, perpetual, world-wide license to the C200 and we would receive royalty payments of 3% per unit of the burdened manufacturing cost for C200s sold by UTCP. Our sales and cash flow could be adversely affected if we fail to complete the development and commercialization of the C200. 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 32% and 3% of our revenue, respectively, for the three months ended June 30, 2008; 46% and 5% of our net accounts receivable, respectively, as of June 30, 2008; 18% and 13% of our revenue, respectively, for the fiscal year ended March 31, 2008; and 33% and 4% of our net accounts receivable, respectively, as of March 31, 2008. 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 application 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 authorized service companies ( 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.

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**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 is ultimately tied to the cost of natural gas. 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.

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**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 delay 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 our Quarterly Report on Form 10-Q for the quarter ended June 30, 2008. An adverse judgment could negatively impact our financial position and results of operations, the trading price of our common stock and the warrants offered hereby 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.

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**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.

**Risks Related to Our Common Stock and Warrants and the Offering**

**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. The market value of the warrants offered hereby will depend primarily on the market price of our common stock and is therefore also likely to be highly volatile and to be affected by many of the same factors that affect the market price of our common stock. 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 and the market value of the warrants offered hereby. Many factors that contribute to this volatility are beyond our control and may cause the market price of our common stock and the warrants offered hereby to change, regardless of our operating performance. Factors that could cause fluctuation in our stock price and the market value of the warrants offered hereby 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;

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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;

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 and the warrants offered hereby, 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 our Quarterly Report on Form 10-Q for the quarter ended June 30, 2008. 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.

**There is no minimum offering amount required as a condition to the closing of this offering and the actual amount of net proceeds we receive may be lower than we anticipate, which may have a material adverse effect on our business.**

There is no minimum offering amount required as a condition to the closing of this offering. Accordingly, the actual amount of securities we sell may be less, perhaps substantially less, than the maximum amount set forth on the cover page of this prospectus supplement. Likewise, the actual amount of net proceeds we receive may be substantially less than the amount set forth in this prospectus supplement under the caption "Use of Proceeds," which is based upon an assumption that we sell the maximum amount of securities offered hereby. Any substantial shortfall in the amount of securities we sell in this offering compared to the maximum amount offered hereby could have a material adverse effect on our results of operations and liquidity and may increase the liquidity and going concern risks discussed above.

**Investors in this offering will experience immediate and substantial dilution.**

The public offering price of the securities to be offered pursuant to this prospectus supplement is substantially higher than the net tangible book value per share of our common stock. Therefore, if you purchase shares of our common stock and warrants in this offering, you will incur immediate and substantial dilution in the net tangible book value per share of common stock from the price per unit that you pay for the securities. Moreover, as described under "Prospectus Supplement Summary - The Offering," we have a substantial number of stock options and warrants to purchase common stock outstanding and reserved for issuance under our equity incentive plans. If the holders of outstanding options and warrants exercise those options and warrants at prices below the public offering price, you will incur further dilution. See "Dilution."

**Sales of substantial amounts of our common stock or the perception that such sales may occur could cause the market price of our common stock and the warrants offered hereby to drop significantly, even if our business is performing well.**

The market price of our common stock and the warrants offered hereby could decline as a result of sales by, or the perceived possibility of sales by, our existing stockholders of shares of our common stock in the market after this offering. These sales might also make it more difficult for us to sell equity securities at a time and price that we deem appropriate.

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**We may choose to call our outstanding warrants at a time that is disadvantageous to our warrant holders and holders whose warrants are cancelled as the result of a call will not be entitled to receive any payment from us in connection with that cancellation.**

We have the right, at our option, to call the outstanding warrants issued in this 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, on the terms and subject to the conditions described in this prospectus supplement under "Description of Warrants - Warrant Call Option" and in the form of warrant attached hereto as Annex A. To exercise this call right, we must deliver notice to holders of warrants indicating, among other things, the date by which warrants subject to such call notice must be exercised to avoid cancellation. If the conditions to such call are satisfied, any warrants that are subject to such call notice and that have not been exercised by 5:00 p.m., New York City time, on the date specified in such notice will be cancelled automatically and holders whose warrants are cancelled will not be entitled to receive any redemption payment or other payment from us in connection with that cancellation. A call of the warrants could force the warrant holders: (i) to exercise the warrants and pay the exercise price at a time when it may be disadvantageous for the holders to do so; or (ii) to sell the warrants at the then current market price when they might otherwise wish to hold the warrants. If you hold warrants through one or more intermediaries, it is unlikely that you will receive notice directly from us that the warrants are being called. If you fail to receive notice of a call from a third party through which you hold warrants and your warrants are cancelled, you will not have recourse to us.

**We will have broad discretion in how we use the proceeds of this offering, and we may not use these proceeds effectively, which could adversely affect our results of operations and cause our common stock price and the market price of the warrants offered hereby to decline.**

We will have considerable discretion in the application of the net proceeds of this offering. Our management has broad discretion over how these proceeds are used and could spend the proceeds in ways with which you may not agree. We may not invest the proceeds of this offering effectively or in a manner that yields a favorable or any return and, consequently, this could result in further financial losses that could have a material and adverse effect on our business, cause the market price of our common stock and warrants to decline or delay the development of our product candidates.

**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 (including the shares offered hereby and the shares issued on exercise of the warrants offered hereby) 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



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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.

For additional information about some of these matters, see Description of Common Stock Anti-Takeover Considerations and Special Provisions of Delaware Law, our Amended and Restated Certificate of Incorporation and our Amended and Restated Bylaws in the accompanying prospectus.

**The warrants are a new issue of securities with no established trading market.**

The warrants are a new issue of securities with no established trading market. The warrants will not be listed on any securities exchange or quotation system. There can be no assurance that a trading market for the warrants will develop or as to the liquidity of any trading market for the warrants that may develop. The absence of a trading market or liquidity for the warrants may adversely affect their value.

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**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This prospectus supplement and the accompanying prospectus (including the information incorporated by reference) contains forward-looking statements within the meaning of 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 ). Forward-looking statements include statements concerning, among other things, our future results of operations, sales expectations, estimates of the number of microturbine units we will be required to ship per quarter to achieve positive cash flow, research and development activities, our ability to develop markets for our products, our ability to produce products on a timely basis in a high quality manner, sources for and costs of component 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, customer satisfaction, the value of using our products, our ability to achieve economies of scale, our ability to penetrate markets and our ability to continue as a going concern. When used in this prospectus supplement, the words estimates, expects, anticipates, projects, plans, intends, believes, should, could, may and variations of such words or similar expressions are intended to identify forward-looking statements. All forward-looking statements, including, without limitation, our examination of historical operation trends, are based upon our current expectations and various assumptions.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this prospectus supplement and the accompanying prospectus and the documents incorporated by reference herein, including those risks described above. We caution you that these factors, as well as the risk factors included and incorporated by reference in this prospectus supplement, may not be exhaustive. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. We operate in a continually changing business environment, and new risk factors emerge from time to time. We cannot accurately predict such future risk factors, nor can we assess the impact, if any, of such possible future risk factors on our businesses or the extent to which any factor or combination of factors may cause actual results to differ materially from those expressed or implied by any forward-looking statements. You are advised to review any further disclosures we make on related subjects in reports we file with the SEC. All forward-looking statements are based on expectations, assumptions and other facts and circumstances as of the respective dates of the documents in which those forward-looking statements appear and are expressly qualified in their entirety by the cautionary statements included in this prospectus supplement and the accompanying prospectus and the documents incorporated by reference herein. We undertake no obligation to publicly update or revise forward-looking statements, which may be made to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

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**USE OF PROCEEDS**

We estimate that the net proceeds we will receive from this offering will be approximately \$29.5 million, after deducting the placement agent's and financial advisor's fees and estimated offering expenses payable by us and assuming that we sell the maximum number of shares of common stock and warrants offered hereby as set forth on the cover page of this prospectus supplement. Each 200,000 unit decrease in the number of units we sell in this offering (each unit consisting of ten shares of common stock and a warrant to purchase three shares of common stock) from the maximum number of units offered hereby (which is 2,148,566 units) would decrease the net proceeds to us from this offering by approximately \$2.8 million.

We intend to use the net proceeds from the securities sold by us in the offering to fund product development, corporate growth and for other general corporate purposes. Pending application of the net proceeds, the net proceeds of this offering will be deposited in interest bearing accounts or invested in certificates of deposit, United States government obligations or other short-term debt instruments selected at our discretion.

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If you invest in our common stock and warrants, you will experience dilution to the extent of the difference between the public offering price and the net tangible book value per share of our common stock immediately after this offering. Our net tangible book value as of June 30, 2008 was approximately \$48,540,000, or \$0.32 per share of common stock. Net tangible book value per share represents our total tangible assets as of June 30, 2008 (which excludes goodwill and other intangible assets), less our total liabilities, as of June 30, 2008 divided by the aggregate number of shares of our common stock outstanding as of June 30, 2008.

After giving effect to the assumed sale of the maximum number of shares of common stock and warrants offered hereby as set forth on the cover page of this prospectus supplement, and after deducting placement agent and financial advisor fees and other estimated offering expenses payable by us, our pro forma net tangible book value as of June 30, 2008 would be approximately \$78,032,815, or \$0.45 per share. This represents an immediate increase in pro forma net tangible book value of \$0.13 per share to existing stockholders and an immediate dilution of \$1.04 per share to new investors. The following table illustrates this per share dilution:

Public offering price per unit		\$ 1.49
Net tangible book value per share as of June 30, 2008 (unaudited)	\$ 0.32	
Increase in net tangible book value per share attributable to new investors	0.13	
Pro forma net tangible book value per share after the offering		0.45
Dilution per share to new investors in the offering		\$ 1.04

Each 200,000 unit decrease in the number of units we sell in this offering (each unit consisting of ten shares of common stock and a warrant to purchase three shares of common stock) from the maximum number of units offered hereby (which is 2,148,566 units) as reflected on the cover page of this prospectus supplement would decrease the pro forma net tangible book value per share after this offering by \$0.011 and the dilution per share to new investors in this offering by \$0.011, after deducting the placement agent and financial advisor fees and other estimated offering expenses payable by us.

The per share data appearing above is based on 151,026,519 shares of our common stock outstanding as of June 30, 2008, and excludes:

8,107,783 shares of common stock issuable upon the exercise of stock options outstanding as of June 30, 2008, with a weighted-average exercise price of \$1.87 per share;

2,966,904 additional shares of common stock reserved for future issuance under our stock incentive plans and our employee stock purchase plans as of June 30, 2008;