

Ocean Power Technologies, Inc.

Form 10-Q

December 10, 2008

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q**

(Mark One)

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

For the Quarterly Period Ended October 31, 2008

Or

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

For the Transition Period From _____ to _____

Commission file number: 001-33417

OCEAN POWER TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

*(State or Other Jurisdiction of
Incorporation or Organization)*

22-2535818

*(I.R.S. Employer
Identification No.)*

1590 Reed Road, Pennington, NJ 08534

(Address of Principal Executive Offices, Including Zip Code)

(609) 730-0400

(Registrant's Telephone Number, Including Area Code)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

As of November 28, 2008, the number of outstanding shares of common stock of the registrant was 10,210,354.

OCEAN POWER TECHNOLOGIES, INC.
INDEX TO FORM 10-Q
FOR THE THREE AND SIX MONTHS ENDED OCTOBER 31, 2008

	Page Number
<u>PART I FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited):</u>	
<u>Consolidated Balance Sheets as of April 30, 2008 and October 31, 2008</u>	3
<u>Consolidated Statements of Operations for the Three and Six Months Ended October 31, 2007 and 2008</u>	4
<u>Consolidated Statements of Cash Flows for the Three and Six Months Ended October 31, 2007 and 2008</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	22
<u>Item 4. Controls and Procedures</u>	23
<u>PART II OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	23
<u>Item 1A. Risk Factors</u>	23
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
<u>Item 3. Defaults Upon Senior Securities</u>	23
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	24
<u>Item 5. Other Information</u>	24
<u>Item 6. Exhibits</u>	24
<u>EX-10.1: FINANCIAL ASSISTANCE AWARD AGREEMENT</u>	
<u>EX-10.2: MODIFICATION OF FINANCIAL ASSISTANCE AWARD AGREEMENT</u>	
<u>EX-10.3: AGREEMENT</u>	
<u>EX-31.1: CERTIFICATION</u>	
<u>EX-31.1: CERTIFICATION</u>	
<u>EX-32.1: CERTIFICATION</u>	
<u>EX-32.2: CERTIFICATION</u>	
EX-10.1: Financial Assistance Award agreement between Ocean Power Technologies, Inc. and US Department of Energy dated September 23, 2008	
EX-10.2: Modification of Financial Assistance Award agreement between Ocean Power Technologies, Inc. and US Department of Energy dated October 16, 2008	
EX-10.3: Agreement between Ocean Power Technologies, Inc. and the Office of Naval Research of the US Navy dated October 31, 2008	
EX-31.1: CERTIFICATION	
EX-31.2: CERTIFICATION	
EX-32.1: CERTIFICATION	
EX-32.2: CERTIFICATION	

PowerBuoy® is a registered trademark of Ocean Power Technologies, Inc. and the Ocean Power Technologies logo is a trademark of Ocean Power Technologies, Inc. All other trademarks appearing in this report are the property of their respective holders.

Special Note Regarding Forward-Looking Statements

We have made statements in this Quarterly Report on Form 10-Q that are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements convey our current expectations or forecasts of future events. Forward-looking statements include statements regarding our future financial position, business strategy, budgets, projected costs, plans and objectives of management for future operations. The words may, continue, estimate, intend, plan, will, believe, project, expect, anticipate, and other similar expressions may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking.

Any or all of our forward-looking statements in this report may turn out to be inaccurate. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. They may be affected by inaccurate assumptions we might make or unknown risks and uncertainties, including the risks, uncertainties and assumptions described in Item 1A, Risk Factors, of our Annual Report on Form 10-K for the year ended April 30, 2008 and elsewhere in this report. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report may not occur as contemplated and actual results could differ materially from those anticipated or implied by the forward-looking statements.

You should not unduly rely on these forward-looking statements, which speak only as of the date of this filing. Unless required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect new information or future events.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****Ocean Power Technologies, Inc. and Subsidiaries
Consolidated Balance Sheets**

	April 30, 2008	October 31, 2008 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 88,836,304	11,390,768
Short-term investments		45,934,653
Accounts receivable	1,728,637	988,285
Unbilled receivables	577,452	951,321
Other current assets	1,375,249	1,343,664
Total current assets	92,517,642	60,608,691
Property and equipment, net	628,454	808,307
Patents, net	717,288	785,274
Restricted cash	1,123,848	939,960
Long-term investments	12,233,437	32,285,422
Other noncurrent assets	330,296	1,237,328
Total assets	\$ 107,550,965	96,664,982

LIABILITIES AND STOCKHOLDERS EQUITY

Current liabilities:		
Accounts payable	\$ 1,457,575	1,231,338
Accrued expenses	4,490,008	3,616,379
Unearned revenues	699,752	375,888
Total current liabilities	6,647,335	5,223,605
Long-term debt	188,784	126,491
Deferred rent	16,237	18,943
Deferred credits	600,000	600,000
Total liabilities	7,452,356	5,969,039

Commitments and contingencies (note 11)

Stockholders' equity:

Preferred stock, \$0.001 par value; authorized 5,000,000 shares, none issued or outstanding

Edgar Filing: Ocean Power Technologies, Inc. - Form 10-Q

Common stock, \$0.001 par value; authorized 105,000,000 shares, issued and outstanding 10,210,354 shares	10,210	10,210
Additional paid-in capital	153,057,265	153,896,651
Accumulated deficit	(52,927,641)	(62,936,507)
Accumulated other comprehensive loss	(41,225)	(274,411)
Total stockholders' equity	100,098,609	90,695,943
Total liabilities and stockholders' equity	\$ 107,550,965	96,664,982

See accompanying notes to consolidated financial statements (unaudited).

3

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Consolidated Statements of Operations
(Unaudited)

	Three Months Ended October		Six Months Ended October	
	31,		31,	
	2007	2008	2007	2008
Revenues	\$ 1,686,212	667,124	2,241,916	2,453,752
Cost of revenues	1,923,196	1,369,578	2,728,188	3,317,724
Gross loss	(236,984)	(702,454)	(486,272)	(863,972)
Operating expenses:				
Product development costs	1,942,713	2,330,073	3,758,447	4,033,022
Selling, general and administrative costs	1,371,160	2,393,738	3,367,762	4,945,554
Total operating expenses	3,313,873	4,723,811	7,126,209	8,978,576
Operating loss	(3,550,857)	(5,426,265)	(7,612,481)	(9,842,548)
Interest income	1,343,877	514,446	2,788,163	1,062,038
Foreign exchange gain (loss)	336,164	(1,203,882)	515,658	(1,228,355)
Net loss	\$ (1,870,816)	(6,115,701)	(4,308,660)	(10,008,865)
Basic and diluted net loss per share	\$ (0.18)	(0.60)	(0.42)	(0.98)
Weighted average shares used to compute basic and diluted net loss per share	10,192,854	10,210,354	10,191,104	10,210,354

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended October 31,	
	2007	2008
Cash flows from operating activities:		
Net loss	\$ (4,308,660)	(10,008,865)
Adjustments to reconcile net loss to net cash used in operating activities:		
Foreign exchange (gain) loss	(515,658)	1,228,355
Depreciation and amortization	121,135	144,233
Loss on disposal of equipment		256,378
Treasury note premium amortization		128,093
Compensation expense related to stock option grants and restricted stock	1,154,516	879,371
Deferred rent	2,706	2,706
Changes in operating assets and liabilities:		
Accounts receivable	298,673	538,254
Unbilled receivables	(810,042)	(561,703)
Other current assets	(673,999)	(98,392)
Other noncurrent assets		(779,718)
Accounts payable	(285,200)	(56,328)
Accrued expenses	(1,295,886)	(784,535)
Unearned revenues	601,082	(323,864)
Net cash used in operating activities	(5,711,333)	(9,436,015)
Cash flows from investing activities:		
Purchases of short-term investments	(8,968,170)	(52,845,078)
Maturities of short-term investments	17,358,316	6,910,425
Purchases of long-term investments		(20,180,078)
Purchases of equipment	(98,271)	(611,324)
Payments of patent costs	(36,376)	(97,188)
Investments in joint ventures and other noncurrent assets	(16,739)	
Net cash provided by (used in) investing activities	8,238,760	(66,823,243)
Cash flows from financing activities:		
Common stock issuance costs	(870,116)	
Proceeds from exercise of stock options	53,296	
Repayment of long-term debt		(42,801)
Net cash used in financing activities	(816,820)	(42,801)

Edgar Filing: Ocean Power Technologies, Inc. - Form 10-Q

Effect of exchange rate changes on cash and cash equivalents	464,992	(1,143,477)
Net increase (decrease) in cash and cash equivalents	2,175,599	(77,445,536)
Cash and cash equivalents, beginning of period	107,505,473	88,836,304
Cash and cash equivalents, end of period	\$ 109,681,072	11,390,768

Supplemental disclosure of noncash investing and financing activities:

Capitalized purchases of equipment financed through accounts payable and accrued expenses, at period end	\$ 15,181	36,906
Capitalized patent costs financed through accounts payable, at period end	18,172	25,587
Capitalized investment in joint ventures financed through accrued expenses, at period end		173,703

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

(1) Background and Basis of Presentation

Ocean Power Technologies, Inc. (the Company) was incorporated on April 19, 1984 in New Jersey, commenced active operations in 1994 and re-incorporated in Delaware in April 2007. The Company develops and is commercializing proprietary systems that generate electricity by harnessing the renewable energy of ocean waves. The Company markets and sells its products in the United States and internationally.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The interim operating results are not necessarily indicative of the results for a full year or for any other interim period. Further information on potential factors that could affect the Company's financial results can be found in the Company's Annual Report on Form 10-K for the year ended April 30, 2008 filed with the Securities and Exchange Commission (SEC) and elsewhere in this Form 10-Q.

(2) Summary of Significant Accounting Policies

(a) Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

In addition, the Company evaluates its relationships with other entities to identify whether they are variable interest entities as defined by Financial Accounting Standards Board (FASB) Interpretation No. 46R, *Consolidation of Variable Interest Entities* (FIN 46R), and to assess whether it is the primary beneficiary of such entities. If the determination is made that the Company is the primary beneficiary, then that entity is included in the consolidated financial statements in accordance with FIN 46R.

(b) Use of Estimates

The preparation of consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include the recoverability of the carrying amount of property and equipment and patents; valuation allowances for receivables and deferred income tax assets; and percentage of completion of customer contracts for purposes of revenue recognition. Actual results could differ from those estimates.

(c) Revenue Recognition

The Company recognizes revenue on government and commercial contracts under the percentage-of-completion method. The percentage of completion is determined by relating the costs incurred to date to the estimated total costs. The cumulative effects resulting from revisions of estimated total contract costs and revenues are recorded in the period in which the facts requiring revision become known. Upon anticipating a loss on a contract, the Company recognizes the full amount of the anticipated loss in the current period. The Company recorded additional provisions related to anticipated losses on contracts of \$221,000 and \$452,000 during the three and six months ended October 31, 2008, respectively. Reserves related to loss contracts in the amounts of approximately \$2,070,000 and \$1,210,000 are included in accrued expenses in the accompanying consolidated balance sheets as of April 30, 2008 and October 31, 2008, respectively.

Unbilled receivables represent expenditures on contracts, plus applicable profit margin, not yet billed. Unbilled receivables are normally billed and collected within one year. Billings made on contracts are recorded as a reduction of unbilled receivables, and to the extent that such billings exceed costs incurred plus applicable profit margin, they are recorded as unearned revenues.

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

(d) Cash Equivalents

Cash equivalents consist of investments in short-term financial instruments with maturities of three months or less from the date of purchase. Cash and cash equivalents include \$15,617,000 and \$3,066,000 of certificates of deposit with an initial term of less than three months at April 30, 2008 and October 31, 2008, respectively; \$1,251,000 and \$1,115,000 invested in a money market fund as of April 30, 2008 and October 31, 2008, respectively; and \$70,881,000 and \$4,500,000 invested in Treasury bills as of April 30, 2008 and October 31, 2008, respectively.

(e) Restricted Cash and Credit Facility

As of October 31, 2008, the Company had \$939,960 in cash restricted under the terms of a security agreement with Barclays Bank. Under this agreement, the cash is on deposit at Barclays Bank and serves as security for letters of credit which are expected to be issued by Barclays Bank on behalf of Ocean Power Technologies Ltd., the Company's UK subsidiary, under a \$800,000 credit facility established by Barclays Bank for such subsidiary. The credit facility is for the issuance of letters of credit and bank guarantees, and carries a fee of 1% per annum of the amount of any such obligations issued by Barclays Bank. The credit facility does not have an expiration date, and is cancelable at the discretion of the bank.

(f) Investment Securities

Short-term investments consist primarily of certificates of deposits and Treasury bills with fixed maturity dates of more than 90 days but less than one year from the date of purchase. Short-term investments included \$6,219,000 of certificates of deposit and \$39,716,000 of Treasury bills at October 31, 2008. Long-term investments consist of Treasury notes with fixed maturity dates of more than one year from the date of purchase. Long-term investments included \$12,233,000 and \$32,285,000 of Treasury notes as of April 30, 2008 and October 31, 2008, respectively.

The Company classifies all of its short-term and long-term investment securities as being held-to-maturity. Held-to-maturity securities are those securities in which the Company has the ability and intent to hold the security until maturity. Held-to-maturity securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. A decline in the market value of any held-to-maturity security below cost that is deemed to be other-than-temporary results in an impairment to reduce the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, the Company considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield. Such amortization and accretion is included in the Interest income line item in the consolidated statements of operations. Interest income is recognized when earned.

(g) Property and Equipment

Property and equipment is stated at cost, less accumulated depreciation and amortization. Depreciation and amortization is calculated using the straight-line method over the estimated useful lives (three to seven years) of the assets. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful life of the asset or the remaining lease term. Expenses for maintenance and repairs are charged to operations as incurred. Depreciation expense was \$49,717 and \$63,889 for the three months ended October 31, 2007 and 2008, respectively, and \$108,677 and \$124,491 for the six months ended October 31, 2007 and 2008, respectively.

(h) Foreign Exchange Gains and Losses

The Company has invested in certain certificates of deposit and has maintained cash accounts that are denominated in British pound sterling, Euros and Australian dollars. Such certificates of deposit and cash accounts had a balance of approximately \$9,646,000 and \$4,469,000 as of April 30, 2008 and October 31, 2008, respectively. Such positions may result in realized and unrealized foreign exchange gains or losses from exchange rate fluctuations, which are included in foreign exchange gain (loss) in the accompanying consolidated statements of operations.

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

(i) Patents

External costs related to the filing of patents, including legal and filing fees, are capitalized. Amortization is calculated using the straight-line method over the life of the patents (17 years). Expenses for the development of technology are charged to operations as incurred. Amortization expense was \$7,509 and \$10,818 for the three months ended October 31, 2007 and 2008, respectively, and \$12,458 and \$19,693 for the six months ended October 31, 2007 and 2008, respectively. Amortization expense for the next five fiscal years related to amounts capitalized for patents as of October 31, 2008 is estimated to be approximately \$50,000 per year.

(j) Long-Lived Assets

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets, such as property and equipment and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated future cash flows, then an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheet. The Company reviewed its long-lived assets for indicators of impairment in accordance with SFAS No. 144 and determined that no impairment review of its long-lived assets was necessary for the six months ended October 31, 2008.

(k) Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and cash equivalents, bank certificates of deposit and trade receivables. The Company invests its excess cash in highly liquid investments (principally short-term bank deposits, money market funds, commercial paper and Treasury bills) and does not believe that it is exposed to any significant risks related to such investments.

The table below shows the percentage of the Company's revenues derived from customers whose revenues accounted for at least 10% of the Company's consolidated revenues in any of the periods indicated:

Customer	Three Months Ended		Six Months Ended	
	October 31,		October 31,	
	2007	2008	2007	2008
US Navy	67%	65%	61%	47%
Iberdrola and Total	27%	14%	27%	40%
Scottish Executive	6%	10%	12%	9%
US Department of Energy		11%		3%

The loss of, or a significant reduction in revenues from, any of these customers could significantly impact the Company's financial position or results of operations. The Company does not require collateral from its customers.

(l) Net Loss per Common Share

Basic and diluted net loss per share for all periods presented is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Due to the Company's net losses, potentially dilutive securities, consisting of outstanding stock options, were excluded from the diluted loss per share calculation due to their anti-dilutive effect.

In computing diluted net loss per share, options to purchase 1,531,404 shares of common stock for the three and six months ended October 31, 2007 and 1,653,938 shares of common stock for the three and six months ended October 31, 2008 were excluded from the computations.

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

(m) Stock-Based Compensation

On May 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R), which requires that the costs resulting from all share-based payment transactions be recognized in the consolidated financial statements at their fair values. The Company adopted SFAS No. 123R using the modified prospective application method under which the provisions of SFAS No. 123R apply to new awards and to awards modified, repurchased, or canceled after the adoption date. Additionally, compensation cost for the portion of the awards for which the requisite service had not been rendered that were outstanding as of May 1, 2006 will be recognized in the consolidated statements of operations over the remaining service period after such date based on the award's original estimated fair value. The aggregate share-based compensation expense, related to stock options, recorded in the consolidated statements of operations under SFAS No. 123R was approximately \$402,000 and \$379,000 for the three months ended October 31, 2007 and 2008, respectively and \$1,155,000 and \$839,000 for the six months ended October 31, 2007 and 2008, respectively.

Valuation Assumptions for Options Granted During the Six Months Ended October 31, 2008

The fair value of each stock option granted during the six months ended October 31, 2008 was estimated at the date of grant using the Black-Scholes option pricing model, assuming no dividends and using the weighted average valuation assumptions noted in the following table. The risk-free rate is based on the US Treasury yield curve in effect at the time of grant. The expected life (estimated period of time outstanding) of the stock options granted was estimated using the simplified method as permitted by the SEC's Staff Accounting Bulletin No. 107, *Share-Based Payment*. Expected volatility was based on historical volatility for a peer group of companies for a period equal to the stock option's expected life, calculated on a daily basis.

Valuation Assumptions:	2007	2008
Risk-free interest rate	5.0%	3.7%
Expected dividend yield	0.0%	0.0%
Expected life	6.0 years	6.2 years
Expected volatility	77.8%	79.4%

The above assumptions were used to determine the weighted average per share fair value of \$11.41 and \$6.73 for stock options granted during the six months ended October 31, 2007 and 2008, respectively.

During the six months ended October 31, 2008, 4,992 shares of common stock were awarded to non-employee directors pursuant to annual retainer arrangements. The aggregate share-based compensation expense recorded in the consolidated statement of operations for the six months ended October 31, 2008 related to the shares was approximately \$40,000, which represents the fair value on the date of grant. The shares were not issued as of October 31, 2008, and accordingly the liability was included in accrued expenses.

(n) Accounting for Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and operating loss and tax credit carryforwards are expected to be recovered, settled or utilized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of operations in the period that includes the enactment date.

(o) Accumulated Other Comprehensive Loss

The functional currency for the Company's foreign operations is the applicable local currency. The translation from the applicable foreign currencies to US dollars is performed for balance sheet accounts using the exchange rates in effect at the balance sheet date and for revenue and expense accounts using an average exchange rate during the period. The unrealized gains or losses resulting from such translation are included in accumulated other

comprehensive loss within stockholders' equity.

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

(p) Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which establishes a framework for reporting fair value and expands disclosures about fair value measurements. SFAS No. 157 as issued is effective for fiscal years beginning after November 15, 2007. On February 12, 2008, FASB Staff Position (FSP) FAS 157-2, *Effective Date of FASB Statement No. 157*, was issued, which delays the effective date to fiscal years beginning after November 15, 2008 for certain nonfinancial assets and liabilities. The Company adopted SFAS No. 157 on May 1, 2008, except for the items covered by FSP FAS 157-2. The adoption of SFAS No. 157 did not have any impact on the Company's consolidated financial statements.

SFAS No. 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1: Observable inputs, such as quoted prices in active markets for identical assets or liabilities;

Level 2: Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

In February 2008, the FASB issued FSP FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*. FSP FAS 157-1 amends SFAS No. 157 to exclude certain leasing transactions accounted for under previously existing accounting guidance. This exclusion, however, does not apply to assets acquired and liabilities assumed in a business combination, regardless of whether those assets and liabilities are related to leases. The adoption of FSP FAS 157-1 did not have any impact on the Company's consolidated financial statements.

In October 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. FSP FAS 157-3 clarifies the application of SFAS No. 157 when the market for a financial asset is not active. FSP FAS 157-3 was effective upon issuance, including reporting for prior periods for which financial statements have not been issued. The adoption of FSP FAS 157-3 for reporting as of October 31, 2008 did not have any impact on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 allows companies to elect to measure certain assets and liabilities at fair value and is effective for fiscal years beginning after November 15, 2007. The adoption of SFAS No. 159 on May 1, 2008 did not have any impact on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141R), which establishes the principles and requirements for how an acquirer recognizes the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquirer at the acquisition date, measured at their fair values as of that date, with limited exceptions. This statement applies to business combinations for which the acquisition date is after the beginning of the first annual reporting period beginning after December 15, 2008. Earlier adoption is not permitted. The Company will adopt SFAS No. 141R upon its effective date as appropriate for any future business combinations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be recorded as a component of equity in the consolidated financial statements. This statement also requires that consolidated net income shall be adjusted to include the net income attributed to the noncontrolling interest. Disclosure on the face of the statement of operations of the amounts

of consolidated net income attributable to the parent and to the noncontrolling interest is required. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. Earlier adoption is not permitted. The Company is currently evaluating the impact of SFAS No. 160.

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, which enhances the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) the location and amounts of derivative instruments in an entity's financial statements, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. The guidance in SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company is currently evaluating the impact of SFAS No. 161.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets*. FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP FAS 142-3 also adds certain disclosures to those already prescribed in SFAS No. 142. FSP FAS 142-3 is effective as of the beginning of the first fiscal year beginning after December 15, 2008, and early adoption is prohibited. The guidance for determining useful lives must be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements must be applied prospectively to all intangible assets recognized as of the effective date. The Company is currently evaluating the impact of FSP FAS 142-3.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This statement is effective November 15, 2008. The Company does not expect the adoption of SFAS No. 162 to have any impact on its consolidated financial statements.

In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*. FSP FAS 133-1 and FIN 45-4 amends SFAS No. 133 to require disclosures by entities that assume credit risk through the sale of credit derivatives including credit derivatives embedded in a hybrid instrument. The intent of these enhanced disclosures is to enable users of financial statements to assess the potential effect on its financial position, financial performance, and cash flows from these credit derivatives. This FSP also amends FASB Interpretation No. 45, *Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, to require an additional disclosure about the current status of the payment/performance risk of a guarantee. FSP FAS 133-1 and FIN 45-4 is effective for financial statements issued for fiscal years and interim periods ending after November 15, 2008, with early application encouraged. FSP FAS 133-1 and FIN 45-4 encourages, but does not require, comparative disclosures. The Company expects to adopt FSP FAS 133-1 and FIN 45-4 on January 31, 2009 and does not expect a material impact on its consolidated financial statements.

(3) Accrued Expenses

Included in accrued expenses at April 30, 2008 and October 31, 2008 were contract loss reserves of approximately \$2,070,000 and \$1,210,000, respectively, and accrued employee incentive payments of approximately \$572,000 and \$155,000, respectively. Accrued expenses at April 30, 2008 and October 31, 2008 also included legal and accounting fees of approximately \$556,000 and \$327,000, respectively, and accrued employee vacation of \$143,000 and \$167,000, respectively.

(4) Related-Party Transactions

In August 1999, the Company entered into a consulting agreement with an individual for marketing services, which currently provides for a rate of \$800 per day of services provided. The individual became a member of the board of directors in June 2006. Under this consulting agreement, the Company expensed approximately \$15,000 and \$21,000

during the three months ended October 31, 2007 and 2008, respectively, and \$31,000 during each of the six-month periods ended October 31, 2007 and 2008.

Also see note 7 for an additional related-party transaction.

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

(5) Debt

During the year ended April 30, 2000, the Company received an award of \$250,000 from the State of New Jersey Commission on Science and Technology for the development of a wave power system that was deployed off the coast of New Jersey. The award contract was assigned to the New Jersey Economic Development Authority in fiscal 2008. Under the terms of this award, the Company must repay the amount funded, without interest, by July 15, 2012. The amounts to be repaid each year are determined as a percentage of revenues (as defined in the loan agreement) the Company receives that year from its customer contracts that meet criteria specified in the loan agreement, with any remaining amount due on July 15, 2012. Based upon the terms of the award, the Company has repaid approximately \$61,000 and was required to repay an additional amount of approximately \$63,000 as of October 31, 2008. The total amount of approximately \$124,000 has reduced the Company's long-term debt balance. The current payment required is included in accrued expenses in the accompanying consolidated balance sheet as of October 31, 2008.

(6) Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, on May 1, 2007. During the six months ended October 31, 2008, the Company had no changes in uncertain tax positions. At October 31, 2008, the Company did not have any unrecognized tax benefits as a result of uncertain tax positions. The Company has net operating loss carryforwards that originated in years dating back to the tax year ended April 30, 1994. The tax years April 30, 1994 through April 30, 2008 remain open to examination by the major taxing jurisdictions to which the Company is subject.

(7) Deferred Credits

During the year ended April 30, 2001, in connection with the sale of common stock to an investor, the Company received \$600,000 from the investor in exchange for an option to purchase up to 500,000 metric tons of carbon emissions credits generated by the Company during the years 2008 through 2012, at a 30% discount from the then-prevailing market rate. This amount has been recorded as a deferred credit in the accompanying consolidated balance sheets as of April 30, 2008 and October 31, 2008. If, by December 31, 2012, the Company does not become entitled under applicable laws to the full amount of emission credits covered by the option, the Company is obligated to return the option fee of \$600,000, less the aggregate discount on any emission credits sold to the investor prior to such date. If the Company receives emission credits under applicable laws and fails to sell to the investor the credits up to the full amount of emission credits covered by the option, the investor is entitled to liquidated damages equal to 30% of the aggregate market value of the shortfall in emission credits (subject to a limit on the market price of emission credits). The Company has not received or sold any emission credits as of October 31, 2008.

(8) Common Stock

On April 30, 2007, the Company completed an initial public offering in the United States on The NASDAQ Global Market by issuing 5,000,000 shares of its common stock for a purchase price of \$20.00 per share, resulting in net proceeds to the Company of approximately \$89,900,000.

(9) Preferred Stock

In September 2003, the Company's stockholders authorized 5,000,000 shares of undesignated preferred stock with a par value of \$0.001 per share. At April 30, 2008 and October 31, 2008, no shares of preferred stock had been issued.

(10) Stock Options

Prior to August 2001, the Company maintained qualified and nonqualified stock option plans. The Company had reserved 467,640 shares of common stock for issuance under these plans. There are no options available for future grant under these plans as of October 31, 2008.

In August 2001, the Company approved the 2001 Stock Plan, which provides for the grant of incentive stock options and nonqualified stock options. A total of 1,000,000 shares were authorized for issuance under the 2001 Stock Plan. As of October 31, 2008, the Company had issued or reserved 643,302 shares for issuance under the 2001 Stock Plan. After the effectiveness of the 2006 Stock Incentive Plan, no further options or other awards have been or will be granted under the 2001 Stock Plan.

Table of Contents

Ocean Power Technologies, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
(Unaudited)

On April 24, 2007, the Company's 2006 Stock Incentive Plan became effective. A total of 803,215 shares are authorized for issuance under the 2006 Stock Incentive Plan. As of October 31, 2008, the Company had issued options for 542,996 shares of common stock and had reserved an additional 260,219 shares of common stock available for future issuance under the 2006 Stock Incentive Plan. The Company's employees, officers, directors, consultants and advisors are eligible to receive awards under the 2006 Stock Incentive Plan; however, incentive stock options may only be granted to employees. The maximum number of shares of common stock with respect to which awards may be granted to any participant under the 2006 Stock Incentive Plan is 200,000 per calendar year. Members of the board of directors who are not full-time employees receive, as part of their annual compensation, a choice of either (a) an option to purchase 2,000 shares of common stock that is fully vested at the time of grant, or (b) shares of common stock worth \$10,000, which vests 50% at the time of grant and 50% one year later. Vesting provisions of stock options are determined by the board of directors. The contractual term of these stock options is up to ten years. The 2006 Stock Incentive Plan is administered by the Company's board of directors who may delegate authority to one or more committees or subcommittees of the board of directors or to the Company's officers. If the board of directors delegates authority to an officer, the officer has the power to make awards to all of the Company's employees, except to executive officers. The board of directors will fix the terms of the awards to be granted by such officer. No award may be granted under the 2006 Stock Incentive Plan after December 7, 2016, but the vesting and effectiveness of awards granted before that date may extend beyond that date.

Transactions under these option plans during the six months ended October 31, 2008 are as follows:

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In Years)
Outstanding April 30, 2008	1,445,302	\$ 14.61	
Forfeited	(29,625)	13.69	
Expired	(20,710)	16.76	
Exercised			
Granted	258,971	9.43	
Outstanding October 31, 2008	1,653,938	13.79	5.5
Exercisable October 31, 2008	1,126,771	14.50	4.0
The total intrinsic value of outs			