ENVIRONMENTAL POWER CORP
Form 424B4
November 16, 2005
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Filed pursuant to Rule 424(b)(4)

Registration No. 333-128863

PROSPECTUS

Energy that is Beyond Renewable

2,000,000 shares of common stock

We are offering 2,000,000 shares of our common stock. Our common stock is listed for trading on the American Stock Exchange under the symbol EPG. The last reported sale price of our common stock on the American Stock Exchange on November 15, 2005 was $7.49 per share.

Investing in our common stock involves certain risks. See Risk Factors commencing on page 7 of this prospectus.

	Per Share	Total
Public Offering Price	$ 7.00	$ 14,000,000
Underwriting Discounts and Commissions	$ 0.49	$ 980,000
Proceeds to us, before expenses	$ 6.51	$ 13,020,000

The underwriter has a 30-day option to purchase up to an additional 300,000 shares of common stock from us to cover over-allotments.

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

The underwriters expect to deliver the shares to purchasers on November 21, 2005.

MDB CAPITAL GROUP LLC

November 15, 2005.

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Our website is located at *www.environmentalpower.com*. We have not incorporated by reference into this prospectus the information on our website and you should not consider it to be a part of this document. Our website address is included as an inactive textual reference only.

You should rely only on the information contained or incorporated by reference to this prospectus. We have not authorized anyone to provide you with information different from that contained or incorporated by reference to this prospectus. Under no circumstances should the delivery to you of this prospectus or any sale made pursuant to this prospectus create any implication that the information contained in this prospectus is correct as of any time after the date of this prospectus.

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PROSPECTUS SUMMARY

The following summary highlights the key information contained elsewhere or incorporated by reference in this prospectus. It does not contain all the information that may be important to you. You should read this entire prospectus carefully, especially the discussion of Risk Factors and our selected consolidated financial statements and related notes, before deciding to invest in shares of our common stock. In this prospectus, when we use phrases such as we, our and us, we are referring to Environmental Power Corporation and its subsidiaries as a whole, except where it is clear from the context that any of these terms refers only to Environmental Power Corporation. Unless otherwise indicated, the information in this prospectus assumes that the underwriter does not exercise its over-allotment option. Unless otherwise noted, all share amounts, share price information and the exercise prices of outstanding options and warrants set forth in this prospectus have been adjusted to give effect to a 1-for-7 reverse split of our common stock that occurred on November 30, 2004.

Environmental Power Corporation

We are a developer, owner and operator of renewable energy production facilities. Our goal is to produce energy that is Beyond Renewable, which we define as energy that not only uses waste materials instead of precious resources, but energy that is also clean, reliable and cost-effective. We believe that there are several factors that are positively impacting our business and will enhance the profitability of our projects:

- Constraints on supplies of fossil fuels, increasing worldwide demand for energy and the resulting increase of energy prices;
- Advances in technology that have enabled renewable energy technologies to generate power economically;
- Increasing governmental regulation and incentives that favor renewable energy technologies; and
- Increasing governmental regulation and pressure on waste producers to manage their waste streams to minimize the harmful effects on the environment.

Today, we have two operating subsidiaries, Microgy, Inc., which constructs and will own and operate facilities that utilize animal and food industry wastes to produce biogas, and Buzzard Power Corporation, which owns a leasehold interest in an approximately 83 megawatt waste coal electrical generation facility, referred to as Scrubgrass.

Our principal operating subsidiary, Microgy, Inc., referred to as Microgy, holds an exclusive license in North America for the development and deployment of a proprietary anaerobic digestion technology for the extraction of methane gas from animal wastes. Microgy develops, sells and will own and operate renewable gas facilities based on its anaerobic digestion technology, with the ability to capitalize on the value of the biogas produced by these facilities in a number of ways, including the direct sale of biogas or pipeline-grade methane, the use of gas to generate electricity or the use of gas to generate thermal energy for use in a variety of industrial and agricultural processes.

Microgy s goal is to apply its technology to the development of projects that can generate profitable quantities of marketable, renewable gas from the great volume of animal and food wastes produced at or near large animal feeding operations, or AFOs, which consist primarily of cattle, dairy and swine farms. We license our anaerobic digestion technology from Danish Biogas Technology A/S, referred to as DBT, which has been a leader in the development of this technology, having constructed 28 anaerobic digester facilities in Europe over the past 15 years. We believe that the increasingly stringent environmental regulations concerning the handling of animal waste will significantly increase the demand for anaerobic digesters similar to Microgy s on AFO sites.

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Microgy has executed agreements with affiliates of several farms pursuant to its relationship with Dairyland Power Cooperative, referred to as Dairyland, one of the largest power generation and transmission cooperatives in the Midwest. These dairy farms have agreed to purchase a Microgy digester system to process animal waste produced by their dairy farm operations in Wisconsin and Minnesota, and to supply biogas to Dairyland for use in the generation of electricity using equipment sold to it by Microgy. To date, Microgy has completed construction on two of these projects, and is nearing the completion of construction on a third. In addition, Microgy has begun construction, along with its partner, South-Tex Treaters, Inc., on the Huckabay Ridge project, a multi-digester biogas production and gas conditioning facility located in Erath County, Texas that is intended to produce and deliver for sale pipeline-grade methane directly into the local natural gas pipeline. Furthermore, Microgy is seeking required permits for its Gallo-Columbard project, a multi-digester facility that will produce biogas for sale to Joseph Gallo Farms as a substitute for propane that is currently used by Joseph Gallo Farms in its cheese producing operations. In addition, we continue to explore additional project development opportunities, and have signed memoranda of understanding or development agreements with several parties to develop projects based on Microgy s proprietary anaerobic digestion technology. Each of these agreements is non-binding, and the actual completion of any projects under these agreements may not occur.

We believe that Microgy s anaerobic digestion facilities provide AFOs with a potentially profitable means of mitigating an existing waste management problem that significantly affects both water and air quality. In addition to providing an animal waste disposal solution to farmers, Microgy s anaerobic digester facilities also provide a renewable source of methane-rich biogas that can be used in a number of ways, including: the direct sale of biogas produced, either as is or refined to pipeline-grade methane; the generation of electricity; or the production of thermal energy for use in a variety of industrial or agricultural processes. We believe that the increased interest in renewable energy sources, or green energy, as well as a desire to mitigate the economic effects of fluctuating commodity energy prices, will continue to drive demand for the multiple uses of the biogas produced by Microgy s facilities.

Our objective is to become a leader in the production and marketing of renewable energy that meets our Beyond Renewable criteria. Today, through Microgy, we are focused on the development and marketing of biogas and biogas resources. Key elements of our strategy include:

- Developing larger-scale multi-digester facilities, to capitalize on attractive economies of scale under a project ownership model, thereby developing and growing the biogas reserves under our management;
- Capitalizing on the increasingly attractive gas market dynamics by providing off-take customers with stable, long-term supplies of renewable gas that are not subject to price fluctuation;
- Aggressively marketing our anaerobic digester facilities, which are a cost-effective tool to assist AFOs in complying with new and more stringent environmental regulations;
- Leveraging the value of our proven anaerobic digester technology, which we believe is superior to competing technologies; and
- Pursuing the advantages of our business model, in which we create and manage profitable renewable energy opportunities while alleviating the environmental pressures facing AFOs.

Our other operating subsidiary, Buzzard Power Corporation, referred to as Buzzard, is the owner of a leasehold interest, which extends through 2016, in an approximately 83 megawatt electrical generating facility, referred to as Scrubgrass. This facility generates electricity from coal mining wastes and has yielded over $50,000,000 in annual revenues to us over each of the last several years. On September 4, 2003, we entered into a financial arrangement with an affiliate of ArcLight Energy Partners Fund I, L.P., referred to as ArcLight, pursuant to which we borrowed $3,700,000, which is repaid from Scrubgrass cash flow. While Buzzard has historically provided us with a reliable source of revenue, we have monetized much of Buzzard s future net cash flows through the transaction with ArcLight. We are currently focusing most of our corporate resources on advancing Microgy s business.

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Risk Factors

Investing in our common stock involves risks. You should carefully consider all of the information in this prospectus. In particular, you should consider carefully the factors discussed under Risk Factors, beginning on page 7, before deciding to invest in our common stock.

Corporate Information

We are a Delaware corporation, incorporated in May 2003, as the successor holding company to our subsidiary, EPC Corporation, which was originally incorporated in Delaware in 1982. EPC Corporation became a publicly traded company in 1986. Our common stock is currently listed on the American Stock Exchange under the symbol EPG. Our principal executive offices are located at One Cate Street, 4th Floor, Portsmouth, New Hampshire 03801 and our telephone number is (603) 431-1780.

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THE OFFERING

Common stock offered by us	2,000,000 shares (2,300,000 shares if the over-allotment option granted to the underwriter is exercised in full).
Common stock to be outstanding after this offering	9,418,632 shares (9,718,632 shares if the over-allotment option granted to the underwriter is exercised in full).
Use of proceeds	Working capital and general corporate purposes, including capital investment in multi-digester projects to be owned and operated by Microgy.
American Stock Exchange Trading Symbol	EPG.

The number of shares of our common stock to be outstanding after this offering is based on the number of shares outstanding as of September 30, 2005 and excludes (a) options to purchase 2,554,585 shares of common stock outstanding as of September 30, 2005, (b) 723,284 additional shares of common stock available for future issuance under our stock option plans and (c) outstanding warrants to purchase 759,976 shares of common stock.

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SUMMARY FINANCIAL DATA

The following table sets forth summary financial data for our business for the fiscal years ended December 31, 2002, 2003 and 2004, the nine months ended September 30, 2005 and the three months ended September 30, 2005. The financial data for the nine months and three months ended September 30, 2005 have not been audited. You should read this information together with the financial statements and the related notes appearing at the end of this prospectus, as well as the information in the section of this prospectus entitled Management s Discussion and Analysis of Financial Condition and Results of Operations.

	Year Ended 12/31/2002	Year Ended 12/31/2003	Year Ended 12/31/2004	Nine Months Ended 9/30/2005	Three Months Ended 9/30/2005
			(in thousands)		
Results of Operations Data:					
Revenues	$ 54,984	$ 53,365	$ 59,790	$ 45,896	$ 15,872
Costs and expenses					
Operating expenses	$ 24,140	$ 25,124	$ 28,625	$ 20,682	$ 8,186
Lease expenses	25,291	22,382	22,066	16,113	4,807
Cost of goods sold			3,736	5,126	1,656
General and administrative expenses	5,605	5,644	6,211	6,984	2,112
Non-cash compensation	50	713	2,320	1,897	2,259
Depreciation and amortization	545	495	472	360	121
Total costs and expenses	$ 55,631	$ 54,358	$ 63,430	$ 51,162	$ 19,141
Operating income (loss)	$ (647)	$ (993)	$ (3,640)	$ (5,266)	$ (3,269)
Other income and expense					
Interest income	$ 48	$ 31	$ 45	$ 176	$ 78
Interest expense	(142)	(352)	(755)	(378)	(115)
Sale of NOx emission credits	2,428			231	77
Amortization of deferred gain	308	308	308	53	25
Other income		2			
Total income (expense)	$ 2,643	$ (11)	$ (402)	$ 82	$ 65
Income (loss) before income taxes	$ 1,995	$ (1,004)	$ (4,042)	$ (5,184)	$ (3,204)
Income tax expense (benefit)	857	(26)	(84)	147	49
Net income (loss)	$ 1,138	$ (978)	$ (3,958)	$ (5,331)	$ (3,253)
Share Data: (1)					
Basic earnings (loss) per common share	$ 0.38	$ (0.29)	$ (0.86)	$ (0.76)	$ (0.44)
Diluted earnings (loss) per common share	$ 0.38	$ (0.29)	$ (0.86)	$ (0.76)	$ (0.44)
Weighted average number of common shares outstanding on a diluted basis (000s)	2,973	3,376	4,583	7,066	7,418
Balance Sheet Data:					
Total assets	$ 92,958	$ 103,154	$ 108,948	$ 115,553	$ 115,553
Working capital	(585)	3,876	5,907	11,938	11,938
Deferred gain	4,164	3,855	3,547	3,315	3,315
Long-term obligations	71,244	79,814	80,410	80,264	80,264
Shareholders equity	6,186	6,620	10,218	19,337	19,337

(1) The share data has been restated to reflect the 1-for-7 reverse stock split that was effective on November 30, 2004.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995, referred to as the PSLRA, provides a safe harbor for forward-looking statements. Certain statements contained in this prospectus and the documents incorporated by reference herein, such as statements concerning planned manure-to-energy systems, our sales pipeline, our backlog, our projected sales and financial performance, statements containing the words may, assumes, forecasts, positions, predicts, strategy, will, expects, estimates, anticipates, believes, projects, intends, plans, continue and variations thereof, and other statements contained in this prospectus and the documents incorporated by reference herein regarding matters that are not historical facts are forward-looking statements as such term is defined in the PSLRA. Because such statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to:

- uncertainties involving development-stage companies,
- uncertainties regarding project financing,
- the lack of binding commitments and the need to negotiate and execute definitive agreements for the construction and financing of projects,
- the lack of binding commitments for the purchase of gas produced by certain projects,
- the lack of binding commitments for supplies of substrate,
- financing and cash flow requirements and uncertainties,
- difficulties involved in developing and executing a business plan,
- difficulties and uncertainties regarding acquisitions, including risks relating to managing and integrating acquired businesses,
- technological uncertainties, including those relating to competing products and technologies,
- unpredictable developments, including plant outages and repair requirements,
- commodity price volatility, particularly with respect to the price of natural gas,
- the difficulty of estimating construction, development, repair, maintenance and operating costs and timeframes,
- the uncertainties involved in estimating insurance and implied warranty recoveries, if any,

- the inability to predict the course or outcome of any negotiations with parties involved with our projects,
- uncertainties relating to general economic and industry conditions, and the amount and rate of growth in expenses,
- uncertainties relating to government and regulatory policies, the legal environment, intellectual property issues, the competitive environment in which Environmental Power Corporation and its subsidiaries operate,

and other factors, including those described in this prospectus under the heading Risk Factors, as well as other filings with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date that they are made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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RISK FACTORS

An investment in our common stock is speculative and involves a high degree of risk. You should purchase the common stock only if you are sophisticated in financial matters and business investments. You should carefully consider the following factors before purchasing our common stock.

Risks Relating to Microgy

Microgy has very little operating history from which to evaluate its business and products.

Our subsidiary, Microgy, Inc., referred to as Microgy, was formed in 1999 and is still in the development stage. Microgy intends to develop facilities that use environmentally friendly anaerobic digestion and other technologies to produce biogas from animal and organic wastes. Because a large part of our future business is expected to involve Microgy s anaerobic digester projects and Microgy is an unproven enterprise with very little operating history, we are unable to determine whether our investment in Microgy will prove to be profitable. If our investment in Microgy is not profitable, your investment in our common stock will be adversely affected.

Microgy has experienced losses to date and we anticipate it will continue to experience losses into 2006.

We expect our Microgy subsidiary to continue to incur losses, reduce our earnings or, as the case may be, add to our earnings deficit as we seek to further develop its business. These ongoing losses will adversely affect our financial condition into 2006, which could have a material adverse effect on the value of your investment in our common stock.

Microgy has little experience in project development, and the marketplace for Microgy s anaerobic digester technology is complex, still developing and subject to change; therefore, we cannot predict how all projects will be developed, what Microgy s costs will be or, consequently, whether Microgy or any project undertaken by Microgy will be profitable.

Microgy has very limited experience in project development, including project assessment, construction and operation. In addition, Microgy markets its anaerobic digester technology in a complicated and changing environment. Due to the many possible applications for Microgy s technology, and the many possible ways in which projects deploying Microgy s technology might be structured, Microgy may decide to develop and own facilities, sell and operate facilities or some combination of the foregoing, either alone or in conjunction with others. We expect to make these determinations on a case-by-case basis. As a result of Microgy s inexperience and the dynamic nature of its market, we are unable to project with certainty Microgy s organizational, structural, staffing or other overhead costs, the construction or operating costs associated with any project, or whether any facility, or Microgy as a whole, will generate a profit. If Microgy fails to generate a profit, your investment in our common stock will be materially adversely affected.

If we are unable to obtain needed financing for Microgy s anaerobic digester projects, the value of our Microgy investment may be reduced significantly.

We are seeking and will require corporate, project or group financing to fund the cost of any development we may decide to pursue for our anaerobic digester projects. This financing may be difficult or impossible for us to obtain. If we are unable to obtain such financing, the value of our Microgy investment may be reduced significantly, and we may be required to substantially curtail our business or completely cease construction or operation of any anaerobic digester projects. This financing will depend on prospective lenders or investors review of our financial capabilities as well as specific projects and other factors, including assessment of our ability to successfully construct and manage each project. If we are unable to obtain the required financing, your investment in our common stock will be materially adversely affected.

The market for anaerobic digester technology is crowded, and our market share may not be sufficient to be profitable.

There are many companies that offer anaerobic digester systems. We believe that at least 60 companies offer complete systems or components to these systems in the U.S. market. Competition from these companies

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may constrain our market share to a degree that will not allow us to be profitable. Although we are unaware of any competitors pursuing a business strategy similar to Microgy s, a number of competitors have more mature businesses and have successfully installed anaerobic digester systems. Competition from any of these sources could harm our business.

We are a small company and the entrance of large companies into the alternative fuels and renewable energy business will likely harm our business.

Competition in the traditional energy business from electric utilities and other energy companies is well established, with many substantial entities having multi-billion dollar, multi-national operations. Competition in the alternative fuels and renewable energy business is expanding with the growth of the industry and the advent of many new technologies. Larger companies, due to their better capitalization, will be better positioned to develop new technologies and to install existing or more advanced renewable energy generators, which could harm our market share and business.

As Microgy focuses a significant portion of its development efforts on projects devoted to the sale of gas as a commodity, we will be increasingly exposed to volatility in the commodity price of natural gas, which could have a material adverse impact on our profitability.

As Microgy begins to focus a significant portion of its development efforts on multi-digester projects for the production of gas for sale as a commodity, we will become increasingly exposed to market risk with respect to the commodity pricing applicable to our gas production. Realized commodity prices received for such production are expected to be primarily driven by spot prices applicable to natural gas. Historically, natural gas prices have been volatile, and we expect such volatility to continue. Fluctuations in the commodity price of natural gas may have a materially adverse impact on the profitability of some of our projects, particularly where we do not have a long-term contract for the sale of the project s output at a fixed or predictable price. At such time as Microgy s projects begin to produce commercial quantities of gas for sale as a commodity, we intend to explore various strategies, including hedging transactions and long-term sale agreements, in order to mitigate the associated commodity price risk. However, we cannot assure you that any such risk management strategies will be successful. As a result, many of Microgy s projects may become unprofitable, which would have a negative impact on your investment in our common stock.

Our projects involve long development cycles that result in high costs and uncertainty.

The negotiation of the large number of agreements necessary to sell, develop, install, operate and manage any of our facilities, as well as to market the energy and other co-products and to provide necessary related resources and services, involves a long development cycle and decision-making process. Delays in the parties decision-making process are outside of our control and may have a negative impact on our development costs, cost of sales, receipt of revenue and sales projections. We expect that, in some cases, it may take a year or more to obtain decisions and to negotiate and close these complex agreements. Such delays could harm our operating results and financial condition.

Because the market for renewable energy and waste management is unproven, it is possible that we may expend large sums of money to bring our offerings to market and the revenue that we derive may be insufficient to fund our operations.

Our business approach to the renewable energy and waste management industry may not produce results as anticipated, be profitable or be readily accepted by the marketplace. We cannot estimate whether demand for facilities based on our technology, or the gas produced by such facilities, will materialize at anticipated prices, or whether satisfactory profit margins will be achieved. If such pricing levels are not achieved or sustained, or if our technologies and business approach to our markets do not achieve or sustain broad acceptance, our business, operating results and financial condition will be materially and negatively impacted.

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If we are unable to obtain sufficient waste resources for our Microgy renewable energy technologies, Microgy will not likely operate profitably.

The performance of our renewable energy technologies is dependent on the availability of animal and other organic waste resources to produce raw energy and meet performance standards in the generation of power or biogas. In many cases, we do not have binding agreements for the supply of some or all of these resources. Lack of these waste resources or adverse changes in the nature, quality or cost of such waste resources would seriously affect our ability to develop and finance projects and to operate efficiently and generate income. As a result, our revenue and financial condition would be materially and negatively affected. We cannot assure you that waste resources will be available in the future for free or at a price that makes them affordable for our waste-to-energy technologies.

Because we have not filed patents to protect Microgy s intellectual property, we might not be able to prevent others from employing competing products. Conversely, others who have filed for patent or other protection might be able to prevent us from employing our products.

Neither we nor, we believe, our licensor have filed any patent applications on the intellectual property Microgy plans to use. Should we or our licensor decide to file patent applications, we cannot assure you that any patent applications relating to our existing or future products or technologies will result in patents being issued, that any issued patents will afford adequate protection to us, or that such patents will not be challenged, invalidated, infringed or circumvented. Furthermore, we cannot assure you that others have not developed, or will not develop, similar products or technologies that will compete with our products without infringing upon, or which do not infringe upon, our intellectual property rights or those of our licensor.

Third parties, including potential competitors, may already have filed patent applications relating to the subject matter of our current or future products. In the event that any such patents are issued to such parties, such patents may preclude our licensors from obtaining patent protection for their technologies, products or processes. In addition, such patents may hinder or prevent us from commercializing our products and could require us to enter into licenses with such parties. We cannot assure you that any required licenses would be available to us on acceptable terms, or at all.

We rely heavily on confidentiality agreements and licensing agreements to maintain the proprietary nature of our base of technologies relating to currently licensed technologies. To compete effectively, we may have to defend the rights to our intellectual property from time to time. Such defense costs may be significant. As a result, we may lack the financial resources to adequately defend our intellectual property.

If our relationship with the licensor of our technology were terminated for any reason or such licensor ceased doing business, our Microgy subsidiary would be negatively impacted.

Microgy licenses its anaerobic digester technology from Danish Biogas Technology, A.S., referred to as DBT, a Danish company. The license agreement grants to Microgy a perpetual, exclusive license to develop projects based on this technology in North America. Pursuant to the license agreement, Microgy is required to pay one-time licensing fee per project and engineering and design fees to DBT in connection with the development of projects. Microgy relies upon DBT for technical advice and engineering assistance. Therefore, if DBT were to cease doing business, Microgy s business may be negatively impacted.

The large number of tasks that need to be accomplished for the development of projects based on our anaerobic digester technology increases the possibility that such projects will incur costly delays.

In our development of projects based on our anaerobic digester technology for ourselves or on behalf of our customers, we are required to enter into or obtain some or all of the following:

Site agreements;

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Supply contracts;

Design/build or other construction-related agreements;

Off-take agreements for gas produced;

Power sales contracts;

Various co-product sales agreements;

Waste disposal agreements;

Licenses;

Environmental and other permits;

Local government approvals; and

Financing commitments required for the successful completion of projects under consideration.

Our failure to accomplish any of these objectives could materially increase the cost or prevent the successful completion of development projects and incur the loss of any investment made. These events could adversely affect our business and results of operations.

Because all of the cash flow we receive from Buzzard is currently dedicated to the repayment of our loan with Arclight, we are entirely dependent upon the capital we raise to fund the continuing development of Microgy.

We do not expect to receive cash from the operations of Buzzard, because such cash, if any, will be used to repay interest and principal on our loan from an affiliate of Arclight. As a result, if we are not able to raise additional capital, including by means of this offering, to fund Microgy s operations and our corporate expenses until Microgy s operations begin to generate positive cash flow, we will not be able to continue to fund Microgy s operations at their current levels, and our business will be materially and adversely affected.

The composition of effluents from our anaerobic digester facilities is not certain and may expose us to liability.

In some cases, we may be responsible for handling the wastes that will be produced by some of our anaerobic digester facilities. We do not have experience in handling or disposing of such wastes. Handling and disposing of such wastes could result in unpredictable regulatory compliance costs, related liabilities and unwanted materials in waste effluents and co-products, all of which could harm our financial condition.

Risks Relating to Buzzard

We currently rely on the Scrubgrass plant for almost all of our operating revenues, and the cash distributions resulting from the Scrubgrass operations have been dedicated to the repayment of the Arclight loan.

We own a 22-year leasehold interest that commenced in 1994 in our Scrubgrass plant, a waste coal-fired electric generating facility in Pennsylvania. Because almost all of our operating revenue currently results from the Scrubgrass plant, we are dependent on its successful and continued operations. Increased working capital requirements of the Scrubgrass plant, significant unscheduled shutdowns or large increases in interest rates at Scrubgrass would reduce our cash flow. In addition, we will not receive any distributions from Buzzard until our loan from Arclight is repaid. Thereafter, we will receive the next $1,400,000 of distributions, after which we will share distributions equally with Arclight through December 31, 2012. As a result, unless we are able to raise additional capital or generate operating income from other sources, we would have to substantially curtail our operations.

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If we default on our obligations under our loan agreement with Arclight, we will lose ownership of our subsidiary, EPC Corporation, and, thereby, the leasehold interest in the Scrubgrass facility.

Our loan from Arclight is secured by a pledge of all of the outstanding stock of our subsidiary, EPC Corporation, which in turns holds our interest in Buzzard Power Corporation as its sole asset, the entity that maintains the Scrubgrass facility. If we were to default on our obligations under our agreement with Arclight, Arclight would have the right to foreclose on this pledge and take ownership of EPC Corporation. As a result, we would lose our interest in the Scrubgrass facility, which is currently our most significant operating asset and revenue source.

The events of default under our agreements with Arclight are narrowly defined. The most significant default is related to non-payment. We are only required to make payments when there is a distribution from Scrubgrass. Nevertheless, if we do not make any payments in a 24-month period, a default under our agreements with Arclight would be triggered.

We do not control the management of the Scrubgrass plant, our primary revenue-generating asset.

We have a management services agreement with Cogentrix, formerly PG&E National Energy Group, to manage the Scrubgrass plant and a 15-year operation and maintenance agreement with PG&E Operating Services to operate the facility. These agreements contain provisions that limit our participation in the management and operation of the Scrubgrass plant. Because we do not exercise control over the operation or management of the Scrubgrass plant, decisions may be made, notwithstanding our opposition, which may have an adverse effect on our business.

Our current power generation revenue is derived from only one customer, the loss of which would severely harm our financial condition and the value of your investment.

Our Scrubgrass plant power generation revenue is earned under a long-term power purchase agreement for all output with one customer, Pennsylvania Electric Company, or Penelec, a subsidiary of FirstEnergy Corporation. This concentration of our revenue with this customer will continue for the foreseeable future. If this customer goes out of business or defaults on its payments to us, our financial condition will be adversely affected. Furthermore, the Scrubgrass plant operates as a qualifying facility, or QF, under the Public Utility Regulatory Policy Act of 1975, or PURPA. The loss of QF status could trigger defaults in the project s PSA. Therefore, Buzzard would most likely have to sell power at prevailing market rates that are much lower than the rate outlined in the PSA.

A large increase in interest rates may adversely affect our operating results.

Our Buzzard and EPC Corporation subsidiaries are leveraged with variable rate and fixed rate debt obligations. Additionally, Buzzard has lease expenses that are based on the principal, interest and fees of the debt obligations of the lessor of our Scrubgrass facility, most of which carries variable rate interest. The table appearing under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Long-Term Liabilities and Commitments Scrubgrass Debt Obligations appearing elsewhere in this prospectus, shows that over 90% of our debt obligations and lease obligations have variable interest rates. Therefore, significant increases in market interest rates will adversely affect our operating results since we are required to pay the Scrubgrass lessor s debt obligations as a base lease expense. For example, a one percent increase in the London Interbank Offering Rate, referred to as LIBOR, and our quoted bond rates would result in a $1,319,840 increase in our lease expense.

Poor quality fuel and other materials may expose us to environmental liability and reduce our operating results.

For our Scrubgrass facility, we obtain waste coal primarily from coal mining companies on a long-term basis because waste coal is plentiful and generally creates environmental hazards, such as acid drainage, when not disposed of properly. The waste coal is burned in the Scrubgrass facility using a circulating fluidized bed

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combustion system. During the circulating fluidized bed combustion process, the waste coal is treated with other substances such as limestone. Depending on the quality of the waste coal and the limestone, the facility operator may need to add additional waste coal or other substances to create the appropriate balance of substances in order to produce the best fuel or sorbent consistency for power generation and compliance with air quality standards. Therefore, the cost of generating power is directly impacted by the quality of the waste coal, which supplies the Scrubgrass power generation facility. Certain conditions, such as poor weather, can create situations where the facility operator has less control over the quality of the waste coal. Poor fuel quality may impact our future operating results.

If we violate performance guarantees granted to Penelec, we will be required to provide them with an incentive payment.

Our agreement for the sale of power to Penelec contains a provision that requires our Scrubgrass facility to provide Penelec with a minimum output of 85% of capacity based on a rolling 3-year average. If we do not comply with this performance guarantee, we will be required to compensate Penelec with an incentive payment. The payment of an incentive payment would have an adverse effect on our financial condition.

Risks Relating to Both Microgy and Buzzard

Our products and services may be subject to numerous governmental regulations.

We expect to provide services that may be subject to various government regulations, including regulations covering air and water quality, solid waste disposal and related pollution issues. These regulations are mandated by the United States Environmental Protection Agency, or EPA, and various state and local governments and are usually implemented through a permitting process, with ongoing compliance requirements thereafter. In addition, our activities will fall under a number of health and safety regulations and laws and regulations relating to farms and zoning. Compliance with these regulations and permitting requirements could delay the development of projects and could be costly and harm our financial condition.

Furthermore, there are from time to time various legislative proposals that would amend or comprehensively restructure PURPA and the electric utility industry. Most recently, these proposals resulted in the enactment of the Energy Policy Act of 2005, which eliminates the PURPA obligation of electric utilities to enter into new contracts with qualifying facilities, or QFs. While the Energy Policy Act does not affect existing contracts, if PURPA is amended again or repealed in the future, the statutory requirement that electric utilities purchase electricity at full-avoided cost from QFs could be repealed or modified. While we expect that existing contracts would continue be honored, the repeal or modification of these statutory purchase requirements under PURPA in the future could, among other things, increase pressure from electric utilities to renegotiate existing contracts. Should there be changes in statutory purchase requirements under PURPA, and should these changes result in amendments to our current power purchase agreement with Penelec for our Scrubgrass facility that reduce the contract rates, our results of operations and financial position could be negatively impacted.

Our power producing activities could be subject to costly regulations and tariffs.

Our Scrubgrass facility produces power for sale to the local electrical grid, as will many of our planned bio-energy projects. The sale of this power may come under the regulations of various state public utility commissions and the Federal Energy Regulatory Commission or FERC, although such sales are currently exempt. These commissions set the price tariffs under which energy can be sold or purchased, they regulate the sale of some generation assets and they set the design standards for the interconnection of power producing equipment with the electrical power grid. Many of our power projects where electricity is sold to the grid may come under regulation by these commissions. These regulations may impede or delay the process of approving and implementing our projects and our ability to sell these assets. Substantial delays may materially affect our financial condition.

Government regulations can be burdensome and may result in delays and expense. In addition, modifications to regulations could adversely affect our ability to sell power or to implement our chosen strategy

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for the sale of power. Subsequent changes in the applicable regulations could also affect our ability to sell or install new facilities or develop and install facilities in an efficient manner or at all. Failure to comply with applicable regulatory requirements can result in, among other things, operating restrictions and fines that could harm our financial condition.

Risks Relating to Our Common Stock and This Offering

We have numerous outstanding options and warrants which may adversely affect the price of our common stock.

As of September 30, 2005, we had outstanding options, both vested and unvested, and warrants to acquire up to approximately 3,314,561 shares of our common stock at prices ranging from $1.40 to $21.56 per share. For the term of such options and warrants, the holders thereof will have an opportunity to profit from a rise in the market price of our common stock without assuming the risk of ownership. This may have an adverse effect on the price of our common stock and on the terms upon which we could obtain additional capital. It should be expected that the holders of such options and warrants would exercise them at a time when we would be able to obtain equity capital on terms more favorable then those provided by the options and warrants.

The issuance of preferred stock may adversely affect the price of our common stock, which could cause a reduction in the value of your investment.

We are authorized to issue up to 2,000,000 shares of preferred stock. The preferred stock may be issued in series from time to time with such designations, rights, preferences and limitations as our board of directors may determine by resolution without shareholder approval. No shares of preferred stock are currently outstanding. However, we may issue preferred stock that would enjoy dividend and liquidation preferences over our common stock, thereby diminishing the value of our common stock.

The sale of a substantial number of shares could cause the market price of our common stock to decline.

Our sale, or the resale by our stockholders, of shares of our common stock after this offering could cause the market price of our common stock to decline.

A significant portion of our outstanding shares of common stock had been restricted from immediate resale, but are now available for sale in the market pursuant to Rule 144 under the Securities Act of 1933. As of September 30, 2005, we had approximately 2,134,067 shares of restricted common stock outstanding, all of which shares are eligible for resale in accordance with Rule 144.

Furthermore, we currently have on file with the Securities and Exchange Commission an effective registration statement that permits the resale by certain of our shareholders of up to 1,677,688 shares of our restricted common stock, of which 1,017,712 shares are currently issued and outstanding and 659,976 shares are subject to outstanding warrants that are currently exercisable at a price of $7.14 per share. We also currently have on file with the Securities and Exchange Commission an effective registration statement that permits the resale of up to 100,000 shares of our common stock subject to warrants exercisable at a price of $6.33 per share by the holders of such warrants.

As of September 30, 2005, we had outstanding options to acquire up to approximately 2,554,585 shares of our common stock at prices ranging from $1.40 to $21.56 per share. The shares of common stock issuable upon exercise of these options will be freely transferable without restriction, except to the extent that they are held by our affiliates. Any shares held by our affiliates may only be sold in compliance with the volume limitations of Rule 144. These volume limitations restrict the number of shares that may be sold by an affiliate in any three-month period to the greater of 1% of the number of shares then outstanding, which equals approximately 74,000 shares as of September 30, 2005, or the average weekly trading volume of our common stock during the four calendar weeks preceding the filing of a notice on Form 144 with respect to the sale.

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Our management and directors will continue to exercise significant control over our management and affairs.

As of September 30, 2005, management and directors, including Joseph E. Cresci, Donald A. Livingston, Kamlesh R. Tejwani, Robert I. Weisberg, Jessie J. Knight, Jr., John R. Cooper, August Schumacher, Jr., Lon Hatamiya, Steven Kessner, John F. O Neill and Randall Hull beneficially owned approximately 24.8% of our outstanding common stock. While there are no voting agreements among them, such persons, as a group, may be able to control the outcome of matters submitted for stockholder action, including the election of members to our board of directors and the approval of significant change in control transactions. This may have the effect of delaying or preventing a change in control of our company and, therefore, your opportunity to sell your shares in such a transaction.

The lack of a developed trading market may make it difficult for you to sell your common stock.

Prior to December 27, 2004, our common stock was traded on the OTC Bulletin Board. While our common stock is now listed for trading on the American Stock Exchange, trading activity in our common stock has fluctuated and has at times been limited. We cannot guarantee that a consistently active trading market will develop in the future. As a result, a holder of our common stock may find it difficult to dispose of our common stock.

The market price for our common stock may be volatile.

The market price for our common stock could be subject to significant fluctuations in response to variations in quarterly operating results, announcements of technological innovations or new projects and products by us or our competitors, or our failure to achieve operating results consistent with any securities analysts projections of our performance. The stock market has experienced extreme price and volume fluctuations and volatility that have particularly affected the market price of many emerging growth and development stage companies. Such fluctuations and volatility have often been unrelated or disproportionate to the operating performance of such companies.

We will require and are actively seeking significant additional financing, which may result in our issuing a significant number of shares of our common stock or preferred stock, which in turn may dilute your investment.

We require and are seeking corporate and project financing to fund our ongoing operations and growth plans as well as and the cost of any development we may decide to pursue for our anaerobic digester projects. Any such financing could be in the form of debt or equity instruments or a combination of debt and equity instruments. To the extent any such financing involves equity, we may issue a significant number of shares of our common stock or preferred stock, which will dilute your investment in our common stock, and we may issue such shares at prices that may be lower than the price you paid for our common stock. In addition, if we issue shares of our preferred stock, such preferred stock will have rights and preferences that are superior to those of the shares of common stock offered hereby.

Purchasers in this offering will suffer immediate and substantial dilution.

If you purchase common stock in this offering, the value of your shares based upon our actual book value will immediately be less than the offering price you paid. This reduction in the value of your equity is known as dilution. Based upon the pro forma net tangible book value of our common stock at September 30, 2005 and the public offering price of $7.00 per share, your shares will be worth $4.29 less per share than the price you paid in this offering. If outstanding options and the warrants are exercised, additional dilution is likely to occur. As of September 30, 2005, options and warrants to purchase 3,314,561 shares of common stock at a weighted average exercise price of $6.20 per share were outstanding. In addition, if we raise additional funding by issuing more equity securities, the newly issued shares will further dilute your percentage ownership of our shares and may also reduce the value of your equity.

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USE OF PROCEEDS

The net proceeds from this offering, after deducting underwriting discounts and commissions and the estimated offering expenses payable by us, will be approximately $12,570,000 (approximately $14,523,000 if the over-allotment option granted to the underwriter is exercised in full).

We intend to use the net proceeds from this offering primarily for working capital and for general corporate purposes, including capital investment in multi-digester projects to be owned, in whole or in part, and operated by Microgy.

The amounts actually spent by us for any specific purpose may vary significantly and will depend on a number of factors, including the progress of our commercialization and development efforts. Accordingly, our management has broad discretion to allocate the net proceeds. Pending the uses described above, we intend to invest the net proceeds of this offering in short-term, interest-bearing, investment-grade securities.

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PRICE RANGE OF COMMON STOCK

Our common stock trades on the American Stock Exchange under the symbol EPG. As of September 30, 2005 there were approximately 335 record holders and approximately 1,560 beneficial holders of our common stock.

The following table shows the quarterly high and low bid prices during 2003 and 2004 as reported by the OTC Bulletin Board, where our stock traded prior to its listing on the American Stock Exchange on December 27, 2004, and after giving effect to a 1-for-7 reverse split of our common stock on November 30, 2004.

	High	Low
Fiscal Year Ended December 31, 2003		
First Quarter	$ 2.10	$ 1.33
Second Quarter	$ 1.96	$ 1.19
Third Quarter	$ 8.05	$ 1.26
Fourth Quarter	$ 7.56	$ 5.60
Fiscal Year Ended December 31, 2004		
First Quarter	$ 10.78	$ 6.16
Second Quarter	$ 8.19	$ 5.95
Third Quarter	$ 7.84	$ 6.44
Fourth Quarter (through December 24, 2004)	$ 8.15	$ 5.60

These over-the-counter quotations reflect inter-dealer prices without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

The following table shows the quarterly high and low sales prices during the remainder of the fourth quarter of 2004, and the first three quarters of 2005 as reported on the American Stock Exchange.

	High	Low
Fiscal Year Ended December 31, 2004		
Fourth Quarter (from December 27, 2004 through December 31, 2004)	$ 7.05	$ 6.85
Fiscal Year Ended December 31, 2005		
First Quarter	$ 7.09	$ 4.60
Second Quarter	$ 5.80	$ 4.20
Third Quarter	$ 7.99	$ 5.48

DIVIDEND POLICY

Our board of directors has not declared any dividends on our common stock since the last quarter of 2000. Due to our acquisition of Microgy in 2001 and the anticipated continued expansion of our business, our board of directors has determined that available cash flows should be used for operating and investing activities for the foreseeable future.

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CAPITALIZATION

The following table sets forth our capitalization as of September 30, 2005:

on an actual basis; and

on an as adjusted basis to reflect the issuance and sale of 2,000,000 shares of our common stock in this offering at an offering price of $7.00 per share, after deducting the underwriting discounts and commissions and the estimated offering expenses payable by us.

This table excludes 3,314,561 shares of our common stock reserved as of September 30, 2005 for issuance upon exercise of outstanding options and warrants. You should read this table together with our financial statements and accompanying notes and with Management s Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this prospectus.

CAPITALIZATION	ACTUAL	AS ADJUSTED
	$ Amount	$ Amount
DEBT		
Working capital loan	$ 616,000	$ 616,000
Secured promissory notes payable and other borrowings	2,715,842	2,715,842
Total Debt	$ 3,331,842	$ 3,331,842
EQUITY		
Preferred stock (1)	$	$
Preferred stock of subsidiary (2)	100	100
Common stock (3)	75,070	95,070
Additional paid-in capital	27,689,989	40,239,989
Accumulated deficit	(10,666,350)	(10,666,350)
Accumulated other comprehensive loss	(204,858)	(204,858)
Treasury stock (4)	(385,402)	(385,402)
Deferred compensation	3,466,185	3,466,185
Notes receivable from board members	(638,219)	(638,219)
Total Equity	$ 19,336,515	$ 31,906,515

(1) $.01 par value; 2,000,000 shares authorized, no shares issued.
(2) Preferred stock of subsidiary, no par value, 10 shares authorized; 10 shares issued as of September 30, 2005.
(3) $.01 par value; 21,400,000 shares authorized; 7,507,062 issued and 7,418,632 outstanding as of September 30, 2005.
(4) 88,430 shares at cost, as of September 30, 2005.

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DILUTION

Our net tangible book value as of September 30, 2005 was approximately $12,978,827, or $1.75 per share. Net tangible book value per share represents our total tangible assets less our total liabilities, divided by the aggregate number of shares of our common stock outstanding. After giving effect to the sale of the 2,000,000 shares of our common stock in this offering, after deducting the estimated underwriting discounts and commissions and the estimated offering expenses payable by us, our net tangible book value at September 30, 2005 would have been approximately $25,548,827 or $2.71 per share. This represents an immediate increase in net tangible book value per share of $0.96 to existing stockholders and an immediate dilution of $4.29 per share to new investors. Dilution per share represents the difference between the amount per share paid by the new investors in this offering and the net tangible book value per share at September 30, 2005, giving effect to this offering. The following table illustrates this per share dilution to new investors.

Public offering price per share	$ 7.00
Net tangible book value per share as of September 30, 2005	$ 1.75
Increase in net tangible book value per share attributable to new investors	$ 0.96
Net tangible book value per share after this offering	$ 2.71
Dilution per share to new investors	$ 4.29

As of September 30, 2005, there were options and warrants outstanding to purchase an aggregate of 3,314,561 shares of our common stock at a weighted average exercise price of $6.20 per share. These calculations assume no exercise of such stock options and warrants. To the extent all of these options and warrants were exercised, the dilution to new investors would be greater.

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SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data presented below for the fiscal years ended December 31, 2000, 2001, 2002 and 2003 have been derived from our consolidated financial statements that have been audited by Deloitte & Touche LLP, an independent registered public accounting firm. The selected consolidated financial data presented below for the fiscal year ended December 31, 2004 have been derived from our consolidated financial statements that have been audited by Vitale, Caturano & Company, Ltd., an independent registered public accounting firm. The selected consolidated financial data for the nine months ended September 30, 2004 and 2005 have been derived from our unaudited consolidated financial statements. In the opinion of our management, such unaudited consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of our operating results and financial position for such periods and as of such date. Our operating results for the nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2005. The financial data presented below should be read in conjunction with the other financial information appearing elsewhere in this prospectus.

SELECTED FINANCIAL DATA	Year Ended 12/31/2000	Year Ended 12/31/2001	Year Ended 12/31/2002	Year Ended 12/31/2003	Year Ended 12/31/2004	Nine Months Ended 9/30/2004	Nine Months Ended 9/30/2005
				(in thousands)			
Results of Operations Data: (1)							
Revenues	$ 54,303	$ 53,518	$ 54,984	$ 53,365	$ 59,790	$ 42,713	$ 45,896
Costs and expenses							
Operating expenses	$ 22,291	$ 23,681	$ 24,140	$ 25,124	$ 28,625	$ 22,528	$ 20,682
Lease expenses	26,416	24,706	25,291	22,382	22,066	14,373	16,113
Cost of goods sold					3,736	1,670	5,126
General and administrative expenses	3,603	3,859	5,605	5,644	6,211	4,367	6,984
Non-cash compensation		114	50	713	2,320	1,988	1,897
Depreciation and amortization	415	441	545	495	472	357	360
Total	$ 52,725	$ 52,801	$ 55,631	$ 54,358	$ 63,430	$ 45,283	$ 51,162
Operating income (loss)	$ 1,578	$ 717	$ (647)	$ (993)	$ (3,640)	$ (2,569)	$ (5,266)
Other income and expense							
Interest income	$ 737	$ 78	$ 48	$ 31	$ 45	$ 30	$ 176
Interest expense	(320)	(185)	(142)	(352)	(755)	(568)	(378)
Sale of NOx emission credits	1,156		2,428				
Amortization of deferred gain	308	308	308	308	308	231	231
Other income		2,135		2			53
Total	$ 1,881	$ 2,336	$ 2,643	$ (11)	$ (402)	$ (306)	$ 82
Income (loss) before income taxes	$ 3,459	$ 3,053	$ 1,995	$ (1,004)	$ (4,042)	$ (2,876)	$ (5,184)
Income tax expense (benefit)	1,632	1,374	857	(26)	(84)	(538)	147
Net income (loss)	$ 1,827	$ 1,679	$ 1,138	$ (978)	$ (3,958)	$ (2,338)	$ (5,331)
Share Data: (2)							
Basic earnings (loss) per common share	$ 1.12	$ 0.83	$ 0.38	$ (0.29)	$ (0.86)	$ (0.54)	$ (0.76)
Diluted earnings (loss) per common share	$ 1.12	$ 0.79	$ 0.38	$ (0.29)	$ (0.86)	$ (0.54)	$ (0.76)
Weighted average number of common shares outstanding on a diluted basis (000s)	1,630	2,107	2,973	3,376	4,583	4,367	7,066
Balance Sheet Data:							
Total assets	$ 69,284	$ 85,566	$ 92,958	$ 103,154	$ 108,948	$ 108,056	$ 115,553

Working capital	(1,176)	(1,499)	(585)	3,876	5,907	8,300	11,938
Deferred gain	4,780	4,472	4,164	3,855	3,547	3,624	3,315
Long-term obligations	58,304	65,216	71,244	79,814	80,410	80,967	80,264
Shareholders equity (deficit)	(3,970)	4,383	6,186	6,620	10,218	11,382	19,337

(1) The Results of Operations Data for 2001 includes Microgy from July 23, 2001 to December 31, 2001.

(2) The share data has been restated to reflect the 1-for-7 reverse stock split that was effective on November 30, 2004.

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MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Our mission is to be a leading company in resource management and energy production technologies that serve multiple socially responsible markets. Since inception, we have been an independent developer and owner of non-commodity, renewable and alternative energy facilities that produce biofuels or electricity by utilizing fuel derived from our agricultural waste management processes or alternative fuel sources such as waste coal. Such fuel sources generally are not subject to the pricing and market fluctuations of commodity fuels and, in some instances, are considered renewable energy fuels. We have developed seven hydroelectric plants, two municipal waste projects, and three waste coal-fired generating facilities. We sold or transferred all of these projects either in development or after completion. We currently have two principal business units, Buzzard Power Corporation and Microgy, Inc., which are described below.

Buzzard Power Corporation

Buzzard Power Corporation, referred to as Buzzard, is a subsidiary of our wholly owned subsidiary, EPC Corporation. Buzzard leases its generating facility from Scrubgrass Generating Company, L.P. The Scrubgrass plant, referred to as Scrubgrass, located on a 600-acre site in Venango County, Pennsylvania, is an approximate 83 megawatt waste coal-fired electric generating station.

Microgy, Inc.

Microgy, Inc., referred to as Microgy, holds an exclusive license in North America for the development and deployment of a proprietary technology for the extraction of methane gas from animal wastes and other organic wastes. This biogas can be used to generate electricity or it can be used in other applications. Microgy s facilities are expected to provide certain farms, known as animal feeding operations, or AFOs, with a potentially profitable means of mitigating an existing waste management problem that affects both water and air quality. Federal and state agencies either have or may be in the process of passing regulations that require AFOs to implement changes to their current waste management practices.

While Microgy is seeking to help farmers meet their waste management needs, we are also seeking to put the biogas produced to use in the generation of electricity or other valuable applications, such as the production of thermal energy to power animal feed production facilities. Many states have either passed or may be in the process of promulgating legislation requiring utilities to obtain a certain percentage of their power from renewable sources. This trend, along with increases in the costs of conventional energy, positions Microgy as a potentially profitable solution to farmers waste management problems, while at the same time providing a new renewable energy source for utilities. We believe that Microgy represents a substantial portion of our future potential growth and, as such, we currently are investing most of our available resources, including both our financial and human capital, to take advantage of Microgy s potential.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenues and expenses during the reporting period, and the disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. Management believes the following critical accounting policies, among others discussed in Note B to our consolidated annual financial statements appearing in this prospectus beginning on page F-11, involve more significant judgments and estimates used in the preparation of our consolidated financial statements.

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Sale and Lease-Back Accounting

Our 1990 sale of Scrubgrass Power Corporation, the original developer of the Scrubgrass facility, was not treated as a sale for financial accounting purposes. This was originally due to the existence of an option that enabled us to reacquire Buzzard, then a wholly owned subsidiary of Scrubgrass Power Corporation and owner of the right to lease the Scrubgrass facility, for a substantial portion of its commercial operation. We exercised our option and reacquired Buzzard in 1991 so that we would have the right to lease the Scrubgrass facility. The then-proposed lease provided Buzzard with a fair market value purchase option to acquire the Scrubgrass facility at the end of the lease. This option meant that we had retained substantial risks or rewards of ownership of Scrubgrass. Therefore, we were not permitted to recognize the sale until 1993, when we agreed to a modification to the proposed form of lease and relinquished the fair market value purchase option. Accordingly, we removed from our consolidated financial statements the gross assets and liabilities of the Scrubgrass facility and reported a gain of $6,785,035 arising from the sale of Scrubgrass. However, due to our anticipated involvement with the lease, we were required to defer our gain over the 22-year minimum lease term, which commenced on June 30, 1994. In connection with the operating lease, we incurred aggregate costs of $3,279,060 to reacquire Buzzard, the lessee of Scrubgrass, and capitalized these costs as the value of our lease rights. The value of our lease rights is also being amortized over the 22-year minimum lease term, which commenced on June 30, 1994.

Lease Expense Recognition

We have a long-term lease agreement for Scrubgrass, which commenced on June 30, 1994, and continues for a 22-year minimum lease term. Under the terms of the lease, Buzzard, as lessee, is required to pay the lessor a specified base rent, which consists of all of the lessor s debt service, scheduled equity repayment, base return on equity and related expenses. Buzzard is also required to pay the lessor an additional rent of 50% of the net cash flows Buzzard receives from the operation of Scrubgrass. The lessor s specified base rent increases over time and is based on a schedule which follows the expected receipt of revenues. In accordance with accounting principles generally accepted in the United States of America, we are required to aggregate the estimated lease payments over the life of the lease and recognize them on a straight-line basis over the 22-year lease term. As such, during the earlier years of the lease agreement, a portion of our lease expenses will be paid in cash and a portion will be recorded to a liability.

As of September 30, 2005, we have a deferred lease expense of $77,547,791 recorded on our consolidated balance sheet. This liability represents accumulated lease expenses recorded on a straight-line basis in previous years that have not been paid to the lessor. In the later years of the lease, we expect that our cash payments to the lessor will exceed the lease expenses recorded on a straight-line basis and the accrued lease expense will be decreased and reach zero by the end of the lease term. This straight-line accounting treatment of certain lease expenses under the Scrubgrass lease resulted in the recognition of non-cash lease expense of $30,477 and $535,413 for the nine months ended September 30, 2005 and 2004, respectively, and $2,141,641, $5,121,732, and $6,543,998 for the years ended December 31, 2004, 2003, and 2002, respectively. Additional rents are not part of this straight-line basis and are recorded as incurred. Our subsidiary, EPC Corporation, which owns 100% of Buzzard s common stock, is not liable for future lease rental payments. Buzzard s stock is pledged as security, and Buzzard is only liable for future lease rental payments to the extent Buzzard receives cash receipts from future power generation revenues.

As of September 30, 2005, without regard to straight-line lease accounting, we estimate the future minimum lease payments over the remaining base term of the Scrubgrass lease are as follows:

2005	2006	2007	2008	2009	Thereafter	Total
$5,428,750	26,058,000	28,910,000	29,390,000	32,459,000	187,391,000	$309,636,750

Our lease expense components, which are discussed in the following paragraphs, consist of

specified base rent payments calculated on a straight-line basis; and

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additional rent.

As noted above, Buzzard, as lessee, is required to pay the lessor a specified base rent, which consists of all of the lessor s debt service, scheduled equity repayment, base return on equity and related expenses. The lessor s debt service largely consists of debt obligations with variable interest rates. Therefore, in order to calculate future minimum lease payments, we estimate an average interest rate which will be payable in the future for each variable rate debt obligation. Since actual interest rates will differ from these estimates, our actual lease expense reported in future periods will differ from these estimates, and the differences may be material.

In order to calculate the straight-line lease expense, we take the total of the estimated future minimum lease payments over the lease term and divide this total by the lease term to get an annual lease expense. The annual lease expense is then compared to the total amount projected to be paid to the lessor in each period, and the difference is reported as a deferred lease expense in our consolidated financial statements. Any differences between actual lease billings and projected lease billings, which principally result from variances between actual interest rates and projected interest rates, are reported as a lease expense in the current period.

We are also required to pay the lessor an additional rent, in addition to the specified base rent, which additional rent represents 50% of the net cash flows Buzzard receives from the operation of Scrubgrass. We estimate and accrue additional rent in the accounting period when earned. However, because additional rent is based on cash flows and not earnings, we are required to determine when the cash flows were generated from operations, which is inherently subjective. Lease expenses may also cause large fluctuations between accounting periods in our reported earnings since the specified base rent and additional rent are not directly related to our earnings. Additional rent is not part of the straight-line lease expense calculation.

Revenue Recognition

We record power generation revenues when electricity is transmitted to the utility under the terms of the underlying power sales agreement. However, under the terms of our long-term power sales agreement, or PSA, with Penelec, the same annual generation of electricity is expected to result in significant increases in revenues over the life of the PSA. For various reasons, including the requirement that all the power generated by the Scrubgrass facility be sold to one customer, we account for power generation revenues under the lease accounting rules as if the power sales agreement were a sublease to this customer. In accordance with accounting principles generally accepted in the United States of America, we are therefore required to aggregate the expected revenue to be received over the life of the power sales agreement and recognize it on a straight-line basis over the 22-year lease term. As such, during the early years of the power sales agreement with Penelec, a portion of our power generation revenues will be received in cash and a portion will be recorded to an asset. However, because we cannot predict whether revenues would be collected over the entire life of the power sales agreement, and, absent revenues, whether Buzzard would be able to perform under the lease, the recognition of revenue on a straight-line basis has been limited to the recognition of lease expense on a straight-line basis. As a result, net income is not affected by straight-line lease and revenue accounting.

As of September 30, 2005, we have accrued power generation revenue of $77,547,791 recorded on our consolidated balance sheet, which is equal in amount to the deferred lease expense. This asset represents accumulated revenue recorded on a straight-line basis in previous years that has not been collected from Penelec. This straight-line accounting treatment of power generation revenue under the PSA with Penelec resulted in non-cash revenues of $30,477 and $535,413 for the nine months ended September 30, 2005 and 2004, respectively, and $2,141,641, $5,121,732, and $6,543,998 for the years ended December 31, 2004, 2003, and 2002, respectively. In the later years of the PSA, we expect that our cash receipts from Penelec will exceed the revenues recorded on a straight-line basis and the accrued power generation revenue will be decreased and reach zero by the end of the lease term. Future cash collections from power generation revenue may vary from the projections used to aggregate the expected revenue to be received over the life of the power sales agreement, which we recognize on a straight-line basis over the 22-year lease term.

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We are recognizing revenues associated with the construction of the first three of the five farm projects that we signed under the Dairyland agreement using the percentage of completion method. However, due to our relative inexperience with the construction of projects of this kind, we are currently limiting our revenue recognition to an amount equal to our cost of construction, thereby not recognizing any gross profit until the project sale process is complete. Once we have a proven track record of successfully completing projects of this kind, we intend to move to the standard percentage of completion method of revenue recognition and recognize a prorated share of gross profit in each period that we record revenue.

Method of Accounting for Contracts

Revenues and profits from our contracts, which appear as product sales on our income statement, are generally recognized by applying percentages of completion for the period to the total estimated profits for the respective contracts. Percentage of completion is determined by relating the actual cost of the work performed to date to the current estimated total cost of the respective contracts. However, on our initial contracts, due to our relative inexperience, profit is not recognized until the contract is completed. When the estimate on a contract indicates a loss, our policy is to record the entire loss during the accounting period in which it is estimated. In the ordinary course of business, at a minimum on a quarterly basis, we prepare updated estimates of the total forecasted revenue, cost and profit or loss for each contract. The cumulative effect of revisions in estimates of the total forecasted revenue and costs, including unapproved change orders and claims during the course of the work, is reflected in the accounting period in which the facts that caused the revision become known. The financial impact of these revisions to any one contract is a function of both the amount of the revision and the percentage of completion of the contract. An amount equal to the costs incurred is included in the total estimated revenue when realization is probable. Profit from unapproved change orders and claims is recorded in the period such amounts are resolved.

In accordance with normal practice in the construction industry, we include in current assets and current liabilities amounts related to construction contracts realizable and payable over a period in excess of one year. Deferred contract revenue represents the excess of billings to date over the amount of contract costs and profits (or contract revenue) recognized to date on the percentage of completion accounting method on certain contracts. Unbilled work represents the excess of contract costs and profits (or contract revenue) recognized to date on the percentage of completion accounting method over billings to date on the remaining contracts. Unbilled work results when the appropriate contract revenue amount has been recognized in accordance with the percentage of completion accounting method, but a portion of the revenue recorded cannot be billed currently due to the billing terms defined in the contract, and/or costs, recorded at estimated realizable value, related to unapproved change orders or claims are incurred. Unbilled work related to our contracts at September 30, 2005, December 31, 2004 and 2003, consisted of the following:

Accounting for Contracts	**September 30, 2005**	**December 31, 2004**	**December 31, 2003**
Billings in excess of revenues (liability)	$ 829,083	$ 737,082	$
Unbilled work (asset)	$	$ 624,683	$

Notes Receivable

In June 2005, we completed construction of the digesters at Five Star Dairy and Wild Rose Dairy and completed a substantial portion of the digester at Norswiss Dairy. Each digester will begin operations over the next several months. The sales price for each digester is $1,037,000. The Company will be paid from the cash flow from the sale of gas generated under the applicable Biogas Supply Agreement with Dairyland Cooperative, which extends through 11 years after the sale for the facility to which it relates. The Company will be paid up to a maximum of $3,111,000 plus interest at 5% per annum, which is evidenced by three notes of $1,037,000 each. Accordingly, we have valued these notes based on our current estimate of the future cash flow stream from the sale of gas, which we estimate will be $2,361,000. On a go-forward basis, we will continue to evaluate the estimated operating cash flows from these digesters that support the ability to realize these notes and make further adjustments, if required.

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Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves us estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as our deferred gain and lease rights, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the consolidated statement of operations.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our deferred tax assets. As of September 30, 2005, we had recorded a deferred income tax asset of $3,912,986 and a valuation allowance of $3,912,986 against our gross deferred income tax assets; due to uncertainties related to our ability to utilize some of our net operating loss carry forwards before they expire. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods we may need to establish an additional valuation allowance which could materially impact our financial position and results of operations.

Intangible Assets

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 142, Goodwill and Other Intangible Assets. The most significant changes made by SFAS No. 142 are:

- goodwill and indefinite-lived intangible assets will be tested for impairment at least annually;
- goodwill and indefinite-lived intangible assets will no longer be amortized to income; and
- the amortization period of intangible assets with finite lives will no longer be limited to forty years.

The provisions of SFAS 142 were applied to the goodwill and intangible assets of $4,912,866 acquired in the Microgy acquisition. We did not have goodwill or intangible assets recorded on our balance sheet prior to the Microgy acquisition. We adopted SFAS 142 on January 1, 2002 and completed the transitional impairment testing in June 2002 and required annual testing at December 31, 2002, 2003, and 2004. We assessed the implied fair value of the reporting unit by using a discounted cash flow analysis. Given consideration of these factors, we concluded that the fair value of the reporting unit exceeded the carrying amount of its net assets and, thus, goodwill was not impaired as of January 1, 2002, December 31, 2002, December 31, 2003, and December 31, 2004.

Results of Operations

Nine-month period ended September 30, 2005 compared to nine-month period ended September 30, 2004

For the nine months ended September 30, 2005, we incurred a net loss of $5.3 million, or loss per common share of $0.76, compared to net loss of $2.3 million, or loss per common share of $0.54, for the nine months ended September 30, 2004. The increase in net loss was primarily attributable to an increase in costs and expenses of $5.9 million, as described in more detail below, which was partially offset by increases in revenues of $3.2 million.

Revenues increased by $3.2 million, or 7%, to $45.9 million for the nine months ended September 30, 2005, as compared to $42.7 million for the same period in 2004. Buzzard operated at 99% of capacity for this period, compared to 90% of capacity for the same period in 2004. Billed power generation revenues at Buzzard increased $2.8 million to $42.2 million in the nine months ended September 30, 2005 as a result of the improved

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capacity, as compared to $39.4 million for the nine months ended September 30, 2004. This increase in billed power generation revenues was partially offset by a decrease in accrued power generation revenues of $1.5 million, as discussed in more detail below. In addition, Microgy recognized $3.6 million of revenues relating to its first three projects, based upon the percentage of completion method, during the nine months ended September 30, 2005, compared to $1.7 million of revenues in the same period in 2004.

Costs and expenses increased by $5.9 million, or 13%, to $51.2 million for the nine months ended September 30, 2005, as compared to $45.3 million for the same period in 2004. Contributing to this increase was an increase in lease expenses at Buzzard of $1.7 million as a result of higher interest rates and scheduled principal payments. Furthermore, Microgy incurred cost of good sold of $5.1 million for the nine months ended September 30, 2005, compared to $1.7 million for the same period in 2004. In addition, general and administrative costs increased by $2.6 million for the nine months ended September 30, 2005 as a result of additional staff expansion, as well as accruals for additional pension obligations, severance pay, and operating expense reserves. These increases were partially offset by a $1.8 million decrease in Buzzard s operating expenses.

We have two primary business segments, Buzzard and Microgy. The results of operations for these business segments, and All Other Segments, which is comprised of parent company expenses and non-current business segments, are discussed below.

Buzzard

Buzzard provided pre-tax income of $2.4 million for the nine months ended September 30, 2005, compared to $1.6 million for the same period in 2004. This improvement is due to the change in the schedule of the planned major maintenance outage at Buzzard. Historically, the major maintenance outage occurred in the second quarter of the year, whereas this year the outage will occur in the fourth quarter.

Revenues at Buzzard, which are comprised of power generation revenues, increased by $1.3 million to $42.3 million for the nine months ended September 30, 2005, as compared to $41 million for the same period in 2004. Buzzard operated at 99% of capacity for this period, compared to 90% of capacity for the same period in 2004. This increase in billed power generation revenues as a result of improved capacity was partially offset by a 2% decrease in billed power rates and by a decrease in accrued power generation revenues of $1.5 million. The accrued power generation revenues result from the FASB 13 accounting treatment of the Scrubgrass lease. In accordance with generally accepted accounting principles in the United States, we are required to treat our power sales agreement with Penelec as a lease, aggregate the minimum lease payments expected to be received over its life, and recognize it on a straight-line basis over the 22-year lease term. However, we have limited the recognition of accrued power revenues to the recognition of the deemed minimum payments of the facility lease so that we do not recognize any profits early related to executory costs or payment for goods and services other than solely for the right to use the facility. This minimum lease payment component is higher in the early years, decreases in the subsequent years, and reverses itself in the later years of the power purchase agreement. This adjustment has no effect on pre-tax income because it is completely offset by an accrued lease expense.

Total operating expenses at Buzzard for the nine months ended September 30, 2005 decreased by $1.8 million to $20.7 million, as compared to $22.5 million for the same period in 2004. This decrease was primarily a result of decreases in maintenance costs of $2.9 million that are related to the change in the planned major maintenance outage schedule from the second quarter to the fourth quarter, as discussed above.

Lease expenses at Buzzard for the nine months ended September 30, 2005 increased by $1.7 million to $16.1 million, as compared to $14.4 million for the same period in 2004. This increase resulted from increases of $3.3 million in interest payments for the nine months ended September 30, 2005 as compared to the same period last year. These increases were partially offset by decreases in deferred lease expenses of $1.5 million for the nine months ended September 30, 2005, as compared to the same period in 2004.

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Microgy

Pre-tax losses at Microgy increased to $4.5 million for the nine months ended September 30, 2005, as compared to $1.7 million for the nine months ended September 30, 2004. This increase resulted from increases in operating expenses associated with the construction of Microgy s first three projects, as well as increased development efforts in California and the southwestern United States.

Microgy recognized revenues of $3.6 million for the nine months ended September 30, 2005, compared to $1.7 for the same period in 2004. We are recognizing revenues associated with the construction of the first three of the projects on which we have commenced construction under our relationship with Dairyland using the percentage of completion method. When the estimate on a contract indicates a loss, our policy is to record the entire loss during the accounting period in which it is estimated. As of September 30, 2005, we had billings in excess of revenues, or deferred contract revenues, of $829,000. These revenues are expected to be recognized during the remainder of the year as we complete the construction of these first three projects.

Microgy s cost of goods sold increased to $5.1 million for the nine months ended September 30, 2005, as compared to $1.7 million for the same period in 2004. These first three projects represent the initial steps in our strategy to commercialize our licensed technology. As such, we have expected and incurred substantial start-up, engineering, and construction costs that we do not expect to have to incur in future projects. The increase in project expenses includes a $750,000 bad debt allowance, which is described in more detail in Note J to the financial statements included in this report. The two completed digesters have been producing gas, and we expect them to meet our initial gas production expectations.

Given the nature of the emerging markets in which we operate, we felt it prudent to expedite the deployment of our initial projects in order to validate our technology and showcase the capabilities of our facilities. We believe that by pursuing this strategy we have successfully accomplished our intended goals. We have begun operations on two facilities, are completing construction on our third, and have demonstrated gas production in excess of target levels. By launching these projects we have demonstrated that the leading European technology at the core of our facilities works in the United States, and have moved next-generation anaerobic digestion power projects in the United States from the conceptual to the operational phase. In addition, we believe that the launch of our first project has generated substantial interest in our technology and our company, laying the groundwork for future growth and increased shareholder value.

The commercial terms of the initial projects are not indicative of the commercial terms for future projects. The reserve on these notes would not be required were gas sold at current market prices. However, in order to expedite the deployment of these initial projects and capture the benefits described above, we chose to accept certain commercial terms and incur certain expenses that we do not expect to incur on future projects. For example, for each of these initial projects, Dairyland Power Cooperative is to purchase, for a thirty-year period, the biogas generated by the digester at a below-market price of $3.00 per MMBTU. In addition, initial operating costs of these first facilities are higher than we expect for future projects. As we build additional projects, further implement operational infrastructure and gain operating experience, we expect these costs to decline.

General and administrative expenses for Microgy increased by $1.2 million to $2.8 million for the nine months ended September 30, 2005, as compared to $1.6 million for the same period in 2004. This increase is primarily due to increases in payroll expenses of $937,000 during the 2005 period, due to the additional staff needed for the growth of Microgy, and $304,000 in professional fees, in each case as compared to the same period in 2004.

All Other Segments

All other segments are comprised of corporate expenses and non-current business segments. We did not have any revenues in these segments for the nine months ended September 30, 2005. We had pre-tax loss in this segment of $3.1 million for the nine months ended September 30, 2005, compared to a pre-tax loss of $2.8 million for the same period in 2004. The increase in loss is primarily due to increases in general and administrative costs of $738,000.

The accounting for performance-based options resulted in expenses of $1.9 million and $2.0 million for the nine months ended September 30, 2005 and 2004, respectively. Please see Note C to the quarterly financial statements included in this prospectus for more information.

We had other income in this segment of $71,000 for the nine months ended September 30, 2005, compared to expenses of $289,000 for the same period in 2004. The increase is primarily due to increases in interest income of $131,000 and a decrease in interest expenses of $200,000 for 2005, due to the fact that we have continued to make repayments on the principal balance of the ArcLight loan, as described in Note G to the quarterly financial statements included in this prospectus.

Three-month period ended September 30, 2005 compared to three-month period ended September 30, 2004

For the three months ended September 30, 2005, we had a net loss of $3.3 million, compared to net income of $2.4 million for the three months ended September 30, 2004. The decrease was primarily due to an increase in costs and expenses of $4.5 million and a decrease in revenues of $900,000, as described in more detail below.

Revenues decreased by $900,000 to $15.9 million for the three months ended September 30, 2005, as compared to $16.8 million from the same period in 2004. This decrease was attributable to a decrease of $588,000 in revenues from Buzzard and a decrease of $312,000 in revenues from Microgy.

Costs and expenses increased to $19.1 million for the three months ended September 30, 2005 from $14.6 million for the same period in 2004. The increase was primarily attributable to a $2.8 million increase in non-cash compensation expense, a $1.1 million increase in operating expense at Buzzard and a $622,000 increase in general and administrative expenses.

We have two primary business segments, Buzzard and Microgy. The results of operations for these business segments, and All Other Segments, which is comprised of parent company expenses and non-current business segments, are discussed below.

Buzzard

Buzzard provided pre-tax income of $619,000 for the three months ended September 30, 2005, compared to pre-tax income of $2.7 million for the three months ended September 30, 2004. This decrease is due to increased operating expenses and decreased revenues resulting from the factors discussed below.

Revenues at Buzzard, which consist of power generation revenues, decreased by $588,000 to $14.5 million for the three months ended September 30, 2005, as compared to $15.1 million for the same period in 2004. Buzzard operated at 101% of capacity for this period, compared to 99% of capacity for the same period in 2004. However, billed power generation revenues decreased by $83,000, primarily due to a 2% decrease in billed power rates. Accrued power generation revenues decreased by $505,000. The accrued power generation revenues result from the FASB 13 accounting treatment of the Scrubgrass lease. In accordance with generally accepted accounting principles in the United States, we are required to treat our power sales agreement with Penelec as a lease, aggregate the minimum lease payments expected to be received over its life, and recognize it on a straight- line basis over the 22-year lease term. However, we have limited the recognition of accrued power revenues to the recognition of the deemed minimum payments of the facility lease so that we do not recognize any profits early related to executory costs or payment for goods and services other than solely for the right to use the facility. This minimum lease payment component is higher in the early years, decreases in the subsequent years, and reverses itself in the later years of the power purchase agreement. This adjustment has no effect on pre-tax income because it is completely offset by an accrued lease expense.

Total operating expenses at Buzzard for the three months ended September 30, 2005 increased by $1.1 million to $8.2 million, as compared to $7.1 million for the same period in 2004. This increase was primarily a result of increases in maintenance costs of $739,000, in limestone and chemical costs of $197,000, and in other operating costs of $146,000.

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Lease expenses at Buzzard were relatively flat at $4.8 million for the three months ended September 30, 2005 and 2004. Increases in principal and interest payments of $550,000 were partially offset by decreases in deferred lease expenses of $505,000 for the three months ended September 30, 2005, as compared to the same period in 2004.

Microgy

Pre-tax losses at Microgy increased to $980,000 the three months ended September 30, 2005, from $726,000 the three months ended September 30, 2004. This increased loss resulted from increases in operating expenses associated with the construction of Microgy s first three projects, as well as increased development efforts in California and the southwestern United States.

Microgy recognized revenues of $1.4 million for the three months ended September 30, 2005, compared to $1.7 million for the same period in 2004. We are recognizing revenues associated with the construction of the first three of the projects on which we have commenced construction under our relationship with Dairyland using the percentage of completion method. When the estimate on a contract indicates a loss, our policy is to record the entire loss during the accounting period in which it is estimated. As of September 30, 2005, we had billings in excess of revenues, or deferred contract revenues, of $829,000. These revenues are expected to be recognized during the remainder of the year as we complete the construction of these first three projects.

Cost of goods sold at Microgy increased to $1.7 million for the three months ended September 30, 2005, as compared $1.7 million for the same period in 2004. These expenses represent the construction costs related to the first three Dairyland projects. These first three projects represent the initial steps in our strategy to commercialize our licensed technology. As such, we have expected and incurred substantial start-up, engineering, and construction costs that we do not expect to have to incur in future projects. The two completed digesters have been producing gas, and we expect them to meet our initial production expectations.

Given the nature of the emerging markets in which we operate, we felt it prudent to expedite the deployment of our initial projects in order to validate our technology and showcase the capabilities of our facilities. We believe that by pursuing this strategy we have successfully accomplished our intended goals. We have begun operations on two facilities, are completing construction on our third, and have demonstrated gas production in excess of target levels. By launching these projects we have demonstrated that the leading European technology at the core of our facilities works in the United States, and have moved next-generation anaerobic digestion power projects in the United States from the conceptual to the operational phase. In addition, we believe that the launch of our first project has generated substantial interest in our technology and our company, laying the groundwork for future growth and generation of shareholder value.

The commercial terms of the initial projects are not indicative of the commercial terms for future projects. The reserve on these notes would not be required were gas sold at current market prices. However, in order to expedite the deployment of these initial projects and capture the benefits described above, we chose to accept certain commercial terms and incur certain expenses that we do not expect to incur on future projects. For example, for each of these initial projects, Dairyland Power Cooperative is to purchase, for a thirty-year period, the biogas generated by the digester at a below-market price of $3.00 per MMBTU. In addition, initial operating costs of these first facilities are higher than we expect for future projects. As we build additional projects, further implement operational infrastructure and gain operating experience, we expect these costs to decline.

General and administrative expenses for Microgy stayed relatively flat at $629,000 for the three months ended September 30, 2005, as compared to $678,000 for the three months ended September 30, 2004.

All Other Segments

All other segments are comprised of corporate expenses and non-current business segments. We did not have any revenues in these segments for the three months ended September 30, 2005. We had a pre-tax loss in

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this segment of $2.8 million for the three months ended September 30, 2005, compared to pre-tax income of $77,000 for the three months ended September 30, 2004. This decrease is attributable primarily to the variable accounting of performance-based options, as discussed below.

The accounting for performance-based options resulted in a non-cash expense of $2.3 million for the three months ended September 30, 2005, as the closing price of our common stock increased to $7.95 on September 30, 2005 from $5.60 on June 30, 2005. Please see Note C to the quarterly financial statements included in this prospectus for more information.

General and administrative expenses increased to $621,000 for the three months ended September 30, 2005, as compared to $283,000 for the same period in 2004. This increase is primarily attributable to a decrease in the corporate allocation of overhead to its Microgy subsidiary as we have changed internal staffing structures.

We had other income in this segment of $46,000 for three months ended September 30, 2005, compared to other expenses of $85,000 for the same period in 2004. The increase is primarily due to increases in interest income of $69,000 and decreases in interest expense of $62,000 for the three months ended September 30, 2005 compared to the same period in 2004, as described in Note G to the quarterly financial statements included in this prospectus.

Comparison of the Years ended December 31, 2004 and 2003

For the year ended December 31, 2004, we had a net loss of $3,958,181, or a loss of $0.86 per common share, compared to a net loss of $978,159, or a loss of $0.29 per common share, for the year ended December 31, 2003. The decrease in net income was primarily attributable to a $2,631,695 pre-tax loss in Microgy and a $3,203,275 pre-tax loss in All Other Segments (as defined below), compared to pre-tax losses in 2003 for Microgy and All Other Segments of $1,718,108 and $1,140,409, respectively. These losses were due to increased operating expenses at Microgy and at the home office that are tied to the construction of the first three Microgy plants. Buzzard provided pre-tax income of $1,792,744 for the year ended December 31, 2004, compared to pre-tax income $1,854,433 for the year ended December 31, 2003. This decrease was due primarily to increased operating and maintenance expenses. The decrease in earnings per common share was partially offset by the increase in the weighted average common shares outstanding due to the issuance of additional shares of common stock in connection with our private placement concluded in the second quarter of this year, referred to as the 2004 Private Placement.

Revenues increased by $6,425,774, or 12%, to $59,790,389 for the year ended December 31, 2004, as compared to $53,364,615 for the year ended December 31, 2003. The increase is primarily attributable to increases in revenues at both Buzzard and Microgy. At Buzzard, operating capacity increased due to the absence of any unexpected outages as had occurred in 2003. In addition, Microgy recognized its first product sales revenues relating to its first three projects, based upon the percentage completion method.

Costs and expenses increased by $9,072,088, or 17%, to $63,430,215 for the year ended December 31, 2004, as compared to $54,358,127 for the year ended December 31, 2003. This increase was attributable in part to an increase in non-cash compensation expense to $2,320,164 for the year ended December 31, 2004 from $713,111 for year ended December 31, 2003. These expenses related to non-employee stock and option grants and employee options that are subject to variable accounting treatment. Additionally, a 14% increase in operating expenses at Buzzard for the year ended December 31, 2004 contributed significantly to the overall increase in costs and expenses for the year.

In 2004, other expenses increased to $402,400 from $10,572 in 2003. This increase was primarily attributable to an increase in interest expense to $755,336 in 2004 from $351,755 in 2003. Almost all of this interest expense related to the Arclight loan, described below in the section titled *Long Term Liabilities & Commitments*.

For the year ended December 31, 2004, we reported a tax benefit of $84,045, as compared to a tax benefit of $25,925 for the year ended December 31, 2003. This change results from a federal tax benefit $358,435 and state tax obligations of $274,390.

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We have two primary business segments, Buzzard Power Corporation and Microgy, Inc. The results of operations for these business segments, and All Other Segments, which is comprised of parent company expenses and non-current business segments are discussed below.

Buzzard

Buzzard provided pre-tax income of $1,792,744 for the year ended December 31, 2004, compared to pre-tax income of $1,854,433 for the year ended December 31, 2003. This modest decrease was caused primarily by increases in maintenance expenses including an additional $1.2 million for steam generators, offset largely by increased revenue.

For the year ended December 31, 2004, power generation revenues increased to $56,053,962, from $53,364,615 for the year ended December 31, 2003. This increase was principally due to a 5% increase in billable rates to Penelec, the purchaser of power from this facility, and an increase in operating capacity to 91.99% for the year ended December 31, 2004 from 86.6% for the year ended December 31, 2003, when we suffered an unexpected outage caused by an electrical storm.

Accrued power generation revenues decreased by $2,980,091 to $2,141,641 for the year ended December 31, 2004, as compared to $5,121,732 for the year ended December 31, 2003. This decrease resulted from the effects of FASB 13 on the accounting treatment of the Scrubgrass lease. In accordance with generally accepted accounting principles in the United States, we are required to treat the power sales agreement with Penelec as a lease, aggregate the minimum lease payments expected to be received over its life, and recognize it on a straight-line basis over the 22-year lease term. However, we have limited the recognition of accrued power revenues to the recognition of the deemed minimum payments of the facility lease so that we do not recognize any profits early related to executory costs or payment for goods and services other than solely for the right to use the facility. This minimum lease payment component is higher in the early years, decreases in the subsequent years, and reverses itself in the later years of the power sales agreement. This adjustment has no effect on pre-tax income because it is completely offset by an accrued lease expense.

Total operating expenses for 2004 increased 14% to $28,625,487, from $25,123,425 for 2003. The increase is primarily attributed to a 20% increase in fuel expenses to $11,091,138 for the year ended December 31, 2004, from $9,239,169 for the year ended December 31, 2003. The increase in fuel expenses resulted principally from increased operating capacity and increases in transportation costs. Operating fees also contributed to the increase in total operating expenses. These fees increased by $801,219 primarily due to operating bonuses that are tied to plant performance. In 2003, the unexpected outage caused the operator to miss reaching several bonus targets.

Lease expenses for 2004 decreased by $316,467 to $22,065,685 for the year ended December 31, 2004, as compared to $22,382,152 for the year ended December 31, 2003. A $3,634,714 increase in scheduled equity rent payments in 2004 was completely offset by decreases in accrued lease expenses of $2,980,091, senior debt principal repayments of $171,715 and additional rent payments of $777,000.

Microgy

Pre-tax losses at Microgy increased to $2,631,695 for the year ended December 31, 2004, compared to a pre-tax loss of $1,718,108 for year ended December 31, 2003. This increase resulted from increases in operating expenses associated with beginning construction on three projects in 2004 and increased development efforts. Additionally, labor expenses increased due to the growth of this subsidiary.

Microgy recognized its first revenues of $3,736,427 in 2004. We are recognizing revenues associated with the construction of the first three of the projects on which we have commenced construction under our agreement with Dairyland using the percentage of completion method. However, due to the uncertainty of the projects, we are currently limiting our percentage complete revenue recognition to an amount equal to our cost of construction, thereby not recognizing any gross profit until the project sale process is complete. Once we have a

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proven track record of successfully completing projects of this kind, we will move to the standard percentage of completion revenue recognition and recognize a prorated share of gross profit each period we record revenue. We began billing Dairyland for construction costs on these farms in August 2004.

Cost of goods sold increased to $3,736,427 in 2004 from $0 in 2003. These expenses represent the construction costs related to the first three Dairyland projects.

Operating expenses for Microgy for the year ended December 31, 2004 increased to $2,436,519 from $1,524,643 for year ended December 31, 2003. This increase is primarily due to increases in payroll expenses of $477,483, due to the additional staff needed for the growth of Microgy, and increases of $463,933 from the allocation of corporate overhead to this subsidiary.

All Other Segments

All other segments are comprised of corporate expenses and non-current business segments. For the year ended December 31, 2004, we had a pre-tax loss of $3,203,275 compared to a pre-tax loss of $1,140,409 for the same period in 2003. This loss is attributable to general and administrative expenses at our parent company, as discussed below. We do not have any revenues in these segments.

General and administrative expenses for the year ended December 31, 2004 increased to $2,821,359 from $1,149,027 for the year ended December 31, 2003. This increase was primarily attributable to increases in non-cash stock compensation. These expenses are related to stock and options granted to non-employees for services rendered and to the variable accounting of performance-based stock options for key executives.

We had total other expenses of $381,915 for the year ended December 31, 2004, compared to other income of $25,543 for the same period in 2003. The decrease in other income is primarily due to increased interest expenses related to the Arclight loan, described below in the section titled *Long Term Liabilities & Commitments*.

Comparison of the Years ended December 31, 2003 and 2002

For 2003, we had a net loss of $978,159, compared to net income of $1,138,383 in 2002. The decrease in net income was primarily due to the absence of sales for nitrogen oxide emission credits, or NOx credits. In 2002, we recorded $2,428,000 of such sales. These differences were partially offset by decreases in additional lease expenses and higher operating revenues at Scrubgrass prior to the transformer failure, as discussed below.

We had a basic and diluted loss per common share of $0.29 in 2003, compared to basic and diluted earnings per common share of $0.38 in 2002. The weighted average common shares outstanding increased in 2003 due to the issuance of additional shares as stock compensation, totaling 115,494 shares, the exercise of 10,000 options and the issuance of 567,857 shares in a private placement in the summer of 2003.

Power generation revenues were $53,364,615 in 2003, as compared to $54,983,934 in 2002, a decrease of approximately 3%. In August 2003, we experienced an unexpected shut down of the Scrubgrass plant. This shut down, caused by a blown transformer during a severe electrical storm, reduced revenues by approximately $2,000,000. However, a 5% increase in power rates in 2003 and improved production capacity before and after the outage helped mitigate these losses. A key performance metric at the Scrubgrass plant is its capacity factor. This metric is defined as the number of kilowatt hours of generation divided by the maximum kilowatt hours of generation possible. We operated at an 86.6% capacity factor in 2003, as compared to 91.3% capacity factor in 2002, with the lower capacity factor in 2003 due to the unexpected shutdown.

This decrease in overall power generation revenues was also attributable to a decrease in the component of power generation revenues recorded as a result of the straight-line accounting treatment of revenues under the PSA which amounted to $5,121,732 in 2003, as compared to $6,543,998 in 2002.

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Operating expenses increased to $25,123,425 for 2003 from $24,139,819 for 2002, and most of the increased operating expenses pertained to Scrubgrass. The increase in operating expenses was primarily due to:

- higher repair and maintenance costs due to the August outage of $814,950;
- higher fuel expense from cost escalations in certain fuel supply agreements of $322,509;
- increased NOx reduction expenses of $153,731; and
- higher labor and labor-related costs of $51,202.

These increases were partially offset by decreases in operating bonuses, repairing rather than replacing a Buzzard plant component, and improvements in fuel quality that reduced ash costs.

Lease expenses decreased to $22,382,152 for 2003 from $25,291,293 for 2002. The decrease was primarily due to a decrease of $2,408,824 in additional rent paid to the lessor, which amounts to 50% of the net available cash flows from Scrubgrass, and to a decrease in interest expense. The average rate on the lessor s outstanding bonds dropped to 1.04% in 2003 from 1.49% in 2002 resulting in a decrease of $963,819 in interest and fees. These decreases in lease expenses were partially offset by an increase in scheduled principal payments for the Scrubgrass debt of $2,702,253 which were billed to us under the terms of the lease and a decrease in lease expenses recorded as a result of the straight-line accounting treatment of lease expenses under the Scrubgrass lease, which amounted to $5,121,732 in 2003 and $6,543,998 in 2002.

General and administrative expenses, excluding non-cash compensation, increased to $5,644,084 for 2003 from $5,605,500 for 2002. The increase was primarily due to increases in our labor expenses of $828,363, as a result of hiring relating to the development of Microgy.

Interest expense increased to $351,755 for 2003 from $141,526 for 2002. The increase was due primarily to the $216,160 of interest related to the Arclight loan of $3,700,000 that is secured by the future cash flows from the Scrubgrass plant.

We earned net proceeds of $2,428,200 from the sale of NOx credits in 2002. Our NOx credits are discussed further under the heading Liquidity and Capital Resources appearing below. No such sales occurred in 2003.

For 2003, we had an income tax benefit of $25,925 compared to income tax expense of $857,274 for 2002. The decrease was primarily due to a decrease in income before taxes in 2003, offset by a $418,717 increase in the valuation allowance for deferred tax assets.

Buzzard

For the year ended December 31, 2003, Buzzard had pre-tax income of $1,854,433, compared to $2,046,172 for the year ended December 31, 2002. The decrease in pre-tax income was primarily attributable to an unplanned outage caused by a blown transformer during a severe electrical storm. This outage resulted in fewer online days in 2003 as compared to 2002, leading to a decrease in power generating revenues.

Power generation revenues were $53,364,615 in 2003, as compared to $54,983,934 in 2002, a decrease of approximately 3%. In August 2003, we experienced an unexpected shutdown of the Scrubgrass plant. This shutdown, caused by the blown transformer, reduced revenues by approximately $2,000,000. However, a 5% increase in power rates in 2003 and improved production capacity before and after the outage helped mitigate these losses. The Scrubgrass plant operated at an 86.6% capacity factor in 2003, as compared to a 91.3% capacity factor in 2002, with the lower capacity factor in 2003 attributable to the unexpected shutdown.

This decrease in overall power generation revenues was also attributable to a decrease in the component of power generation revenues recorded as a result of the straight-line accounting treatment of revenues under the power sales agreement, which amounted to $5,121,732 in 2003 and $6,543,998 in 2002. In accordance with

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accounting principles generally accepted in the United States, we are required to treat the PSA as a lease, aggregate the expected revenue to be received over its life and recognize it on a straight-line basis over the 22-year lease term. We include this component of the power generation revenues to straight-line the revenue. However, we have limited the recognition of accrued power revenues to the recognition of accrued lease expenses so that we do not recognize any profits early. This component is higher in the early years, decreases in the subsequent years, and reverses itself in the later years of the power purchase agreement.

Operating expenses increased to $25,123,425 for 2003 from $24,139,819 for 2002. The increase in operating expenses was primarily due to:

- higher repair and maintenance costs due to the August outage of $814,950;
- higher fuel expense from cost escalations in certain fuel supply agreements of $322,509;
- increased NOx reduction expenses of $153,731; and
- higher labor and labor-related costs of $51,202.

These increases were partially offset by decreases in operating bonuses, repairing rather than replacing a Buzzard plant component and improvements in fuel quality that reduced ash disposal costs.

Lease expenses decreased to $22,382,152 for 2003 from $25,291,293 for 2002. The decrease was primarily due to a decrease of $2,408,824 in additional rent paid to the lessor, which amounts to 50% of the net available cash flows from Scrubgrass, and to a decrease in interest expense. The average rate on the lessor s outstanding bonds dropped to 1.04% in 2003 from 1.49% in 2002, resulting in a decrease of $963,819 in interest and fees. These decreases in lease expenses were partially offset by an increase in scheduled principal payments for the Scrubgrass debt of $2,702,253 which were billed to us under the terms of the lease and a decrease in lease expenses recorded as a result of the straight-line accounting treatment of lease expenses under the Scrubgrass lease, which amounted to $5,121,732 in 2003 and $6,543,998 in 2002.

Microgy

For the year ended December 31, 2003, Microgy had a pre-tax loss of $1,718,108, compared to a pre-tax loss of $2,586,146 for the year ended December 31, 2002. The decrease in pre-tax loss was primarily attributable to a decrease in operating expenses. We expect our pre-tax loss to continue decreasing as we continue to sell systems based on our proprietary technology.

Microgy had no revenues in 2003 or 2002.

Total expenses for the year ended December 31, 2003 decreased 36% to $1,524,643, compared to total expenses of $2,392,377 for the year ended December 31, 2002. Contributing to the decrease in total expenses was a decrease of 11% in payroll.

For the year ended December 31, 2003, project expenses increased 294% to $147,614 from $37,465 for the year ended December 31, 2002. The increase is primarily attributable to an increase in site plan and other project expenses of $143,867 for the year ended December 31, 2003, compared to no expense for these categories for the year ended December 31, 2002.

All Other Segments

For the year ended December 31, 2003, all other segments had a pre-tax loss of $1,140,409, compared to pre-tax income of $2,535,631 for the year ended December 31, 2002. The decrease in pre-tax income was primarily attributable to an increase in corporate salaries and travel-related expenses, as well as interest expenses related to the Arclight loan. There were no revenues for All Other Segments in 2003 or 2002.

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Quarterly Results of Operations

The following table sets forth items from our statements of operations for the eleven quarters ended September 30, 2005, as well as that data expressed as a percentage of our total revenues. This data has been derived from unaudited financial statements that, in the opinion of management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the information. This information should be read in conjunction with the consolidated financial statements and the notes thereto and other financial information appearing elsewhere in this prospectus. We believe that period-to-period comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indication of future performance.

	3/31/2003	6/30/2003	9/30/2003	12/31/2003	3/31/2004	6/30/2004	9/30/2004	12/31/2004	3/31/2005	6/30/2005	9/30/2005
						(in thousands)					
REVENUES											
Power Generation Revenues	$ 14,535	$ 12,554	$ 11,923	$ 14,352	$ 14,338	$ 11,603	$ 15,102	$ 15,011	$ 13,915	$ 13,907	$ 14,514
Product Sales							1,670	2,066	1,256	945	1,359
Total	**$ 14,535**	**$ 12,554**	**$ 11,923**	**$ 14,352**	**$ 14,338**	**$ 11,603**	**$ 16,772**	**$ 17,077**	**$ 15,171**	**$ 14,852**	**$ 15,872**
COSTS AND EXPENSES											
Operating expenses	$ 5,589	$ 8,059	$ 6,020	$ 5,455	$ 6,281	$ 9,204	$ 7,043	$ 6,098	$ 6,232	$ 6,264	$ 8,186
Lease expenses	5,040	4,643	4,756	7,943	4,797	4,817	4,760	7,692	5,570	5,737	4,807
COGS							1,670	2,066	1,546	1,924	1,656
General and administrative	1,445	1,288	1,705	1,206	1,323	1,554	1,491	1,843	1,849	3,023	2,112
Non-cash compensation expense (income)			515	198	232	2,206	(451)	333	(588)	226	2,259
Depreciation and amortization	124	124	124	123	124	121	111	116	117	122	121
Total	**$ 12,198**	**$ 14,114**	**$ 13,120**	**$ 14,925**	**$ 12,756**	**$ 17,902**	**$ 14,624**	**$ 18,148**	**$ 14,726**	**$ 17,296**	**$ 19,141**
OPERATING INCOME	**$ 2,337**	**$ (1,560)**	**$ (1,197)**	**$ (573)**	**$ 1,582**	**$ (6,299)**	**$ 2,148**	**$ (1,071)**	**$ 445**	**$ (2,443)**	**$ (3,269)**
OTHER INCOME (EXPENSE):											
Interest income	$ 6	$ 5	$ 14	$ 6	$ 6	$ 10	$ 14	$ 14	$ 26	$ 72	$ 78
Interest expense	(25)	(22)	(89)	(216)	(208)	(179)	(181)	(187)	(138)	(125)	(115)
Amortization of deferred gain	77	77	77	77	77	77	77	77	77	77	77
Other income (expense)		4	(6)	4						28	25
Total	**$ 58**	**$ 64**	**$ (4)**	**$ (129)**	**$ (125)**	**$ (92)**	**$ (90)**	**$ (96)**	**$ (35)**	**$ 52**	**$ 65**
INCOME (LOSS) BEFORE INCOME TAXES	$ 2,395	$ (1,496)	$ (1,201)	$ (702)	$ 1,458	$ (6,391)	$ 2,058	$ (1,167)	$ 411	$ (2,391)	$ (3,204)
INCOME TAX EXPENSE (BENEFIT)	$ 1,246	$ (694)	$ (453)	$ (125)	$ 29	$ (261)	$ (305)	$ 453	$ 4	$ 93	$ 49
NET INCOME (LOSS)	**$ 1,149**	**$ (802)**	**$ (748)**	**$ (577)**	**$ 1,429**	**$ (6,130)**	**$ 2,363**	**$ (1,620)**	**$ 406**	**$ (2,484)**	**$ (3,253)**
WEIGHTED AVG SHARES OUTSTANDING:											
Basic	3,116	3,113	3,482	3,482	3,822	4,409	4,871	4,963	6,350	7,418	7,418
Diluted	3,118	3,113	3,482	3,482	4,277	4,409	5,288	4,963	6,684	7,418	7,418
EARNINGS (LOSS) PER COMMON SHARE											
Basic	$ 0.37	$ (0.26)	$ (0.21)	$ (0.17)	$ 0.37	$ (1.39)	$ 0.48	$ (0.33)	$ 0.06	$ (0.34)	$ (0.44)
Diluted	$ 0.37	$ (0.26)	$ (0.21)	$ (0.17)	$ 0.33	$ (1.39)	$ 0.44	$ (0.33)	$ 0.06	$ (0.34)	$ (0.44)

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	3/31/2003	6/30/2003	9/30/2003	12/31/2003	3/31/2004	6/30/2004	9/30/2004	12/31/2004	3/31/2005	6/30/2005	9/30/2005
REVENUES											
Power Generation Revenues	100%	100%	100%	100%	100%	100%	90%	88%	92%	94%	91%
Product Sales	0%	0%	0%	0%	0%	0%	10%	12%	8%	6%	9%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
COSTS AND EXPENSES											
Operating expenses	38%	64%	50%	38%	44%	79%	42%	36%	41%	42%	52%
Lease expenses	35%	37%	40%	55%	33%	42%	28%				