UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from to

Commission File Number: 001-15957

Capstone Turbine Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**95-4180883** (I.R.S. Employer Identification No.)
21211 Nordhoff Street, Chatsworth, California (Address of principal executive offices)	**91311** (Zip Code)

818-734-5300

(Registrant s telephone number, including area code)

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

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

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

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

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

The number of shares outstanding of the registrant s common stock as of October 31, 2010 was 246,666,165.

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CAPSTONE TURBINE CORPORATION

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PART I FINANCIAL INFORMATION

Item 1. *Financial Statements*

CAPSTONE TURBINE CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)
(Unaudited)

	September 30, 2010	March 31, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 20,270	$ 47,270
Accounts receivable, net of allowance for doubtful accounts of $255 at September 30, 2010 and $121 at March 31, 2010	24,690	18,464
Inventories	18,496	19,645
Prepaid expenses and other current assets	2,725	1,335
Total current assets	66,181	86,714
Property, plant and equipment, net	6,998	8,247
Non-current portion of inventories	3,380	3,588
Intangible assets, net	4,099	4,643
Restricted cash	5,000	
Other assets	530	254
Total	$ 86,188	$ 103,446
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable and accrued expenses	$ 14,456	$ 15,338
Accrued salaries and wages	1,438	1,741
Accrued warranty reserve	860	1,036
Deferred revenue	1,522	923
Revolving credit facility	7,437	7,571
Current portion of notes payable and capital lease obligations	124	161
Warrant liability	10,622	26,803
Other current liabilities		3,026
Total current liabilities	36,459	56,599
Long-term portion of notes payable and capital lease obligations	82	141
Other long-term liabilities	303	274
Commitments and contingencies (Note 14)		
Stockholders Equity:		
Preferred stock, $.001 par value; 10,000,000 shares authorized; none issued		
Common stock, $.001 par value; 415,000,000 shares authorized; 246,434,409 shares issued and 245,537,009 shares outstanding at September 30, 2010; 243,015,511 shares issued and 242,119,402 shares outstanding at March 31, 2010	246	243
Additional paid-in capital	725,850	721,408

Accumulated deficit		(675,711)		(674,178)
Treasury stock, at cost; 897,400 shares at September 30, 2010 and 896,109 shares at March 31, 2010		(1,041)		(1,041)
Total stockholders equity		49,344		46,432
Total	$	86,188	$	103,446

See accompanying notes to condensed consolidated financial statements.

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CAPSTONE TURBINE CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Six Months Ended September 30, 2010	Six Months Ended September 30, 2009
Revenue	$ 18,922	$ 15,522	$ 34,974	$ 29,247
Cost of goods sold	18,803	18,520	35,367	35,082
Gross margin (loss)	119	(2,998)	(393)	(5,835)
Operating expenses:				
Research and development	2,040	2,271	3,562	3,032
Selling, general and administrative	6,611	6,840	13,047	13,063
Total operating expenses	8,651	9,111	16,609	16,095
Loss from operations	(8,532)	(12,109)	(17,002)	(21,930)
Other income			4	
Interest income	2		2	8
Interest expense	(196)	(143)	(506)	(275)
Change in fair value of warrant liability	6,937	(19,558)	16,181	(24,755)
Loss before income taxes	(1,789)	(31,810)	(1,321)	(46,952)
Provision for income taxes	136	71	212	188
Net loss	$ (1,925)	$ (31,881)	$ (1,533)	$ (47,140)
Net loss per common share basic and diluted	$ (0.01)	$ (0.17)	$ (0.01)	$ (0.25)
Weighted average shares used to calculate basic and diluted net loss per common share	245,510	191,170	243,890	187,480

See accompanying notes to condensed consolidated financial statements.

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CAPSTONE TURBINE CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended September 30, 2010	2009
Cash Flows from Operating Activities:		
Net loss	$ (1,533)	$ (47,140)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,960	1,702
Amortization of deferred financing costs	97	40
Interest expense on second funding liability	80	
Provision for allowance for doubtful accounts		168
Inventory (recovery) write-down	(52)	617
Provision for warranty expenses	961	461
Loss on disposal of equipment	20	
Stock-based compensation	1,333	1,867
Change in fair value of warrant liability	(16,181)	24,755
Changes in operating assets and liabilities:		
Accounts receivable	(6,226)	(4,256)
Inventories	1,774	4,142
Prepaid expenses and other assets	(1,763)	(374)
Accounts payable and accrued expenses	(818)	2,982
Accrued salaries and wages and long term liabilities	(274)	(623)
Accrued warranty reserve	(1,137)	(1,129)
Deferred revenue	599	723
Other current liabilities		(815)
Net cash used in operating activities	(21,160)	(16,880)
Cash Flows from Investing Activities:		
Acquisition of and deposits on equipment and leasehold improvements	(616)	(1,085)
Increase in restricted cash	(5,000)	
Net cash used in investing activities	(5,616)	(1,085)
Cash Flows from Financing Activities:		
Net (repayment) proceeds from revolving credit facility	(134)	4,286
Payment of deferred financing costs		(56)
Repayment of notes payable and capital lease obligations	(96)	(10)
Net proceeds from employee stock-based transactions	6	113
Net proceeds from issuance of common stock and warrants		11,611
Proceeds from exercise of common stock warrants		6,503
Net cash (used in) provided by financing activities	(224)	22,447
Net (decrease) increase in Cash and Cash Equivalents	(27,000)	4,482
Cash and Cash Equivalents, Beginning of Period	47,270	19,519
Cash and Cash Equivalents, End of Period	$ 20,270	$ 24,001
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 339	$ 221
Income taxes	$	$ 2

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Supplemental Disclosures of Non-Cash Information:

Included in accounts payable at September 30, 2010 and 2009, is $27 and $131 of fixed asset purchases, respectively.

During the six months ended September 30, 2010, the Company issued 3,131,313 shares of common stock to Calnetix Power Solutions, Inc. to satisfy the amount due of $3.1 million in connection with the acquisition of the Calnetix microturbine generator line. See Note 16 Acquisition, for a description of tangible and intangible assets acquired and other details of the acquisition.

During the six months ended September 30, 2009, the Company incurred $224 of capital expenditures that were funded by capital lease borrowings.

See accompanying notes to condensed consolidated financial statements.

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CAPSTONE TURBINE CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Business and Organization

Capstone Turbine Corporation (the Company) develops, manufactures, markets and services microturbine technology solutions for use in stationary distributed power generation applications, including cogeneration (combined heat and power (CHP), integrated combined heat and power (ICHP), and combined cooling, heat and power (CCHP)), resource recovery and secure power. In addition, the Company s microturbines can be used as battery charging generators for hybrid electric vehicle applications. The Company was organized in 1988 and has been commercially producing its microturbine generators since 1998.

The Company has incurred significant operating losses since its inception. Management anticipates incurring additional losses until the Company can produce sufficient revenue to cover its operating costs. To date, the Company has funded its activities primarily through private and public equity offerings.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles or GAAP) for interim financial information and pursuant to the instructions to Form 10-Q and Regulation S-X promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). They do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The condensed consolidated balance sheet at March 31, 2010 was derived from audited financial statements included in the Company s Annual Report on Form 10-K for the year ended March 31, 2010. In the opinion of management, the interim condensed consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial condition, results of operations and cash flows for such periods. Results of operations for any interim period are not necessarily indicative of results for any other interim period or for the full year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended March 31, 2010. This Quarterly Report on Form 10-Q (the Form 10-Q) refers to the Company s fiscal years ending March 31 as its Fiscal year.

The condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. At September 30, 2010, the Company had $83.5 million, or 667 units, in backlog, all of which was current and expected to be shipped within the next twelve months. However, the timing of shipments is subject to change based on several variables (including customer payments and customer delivery schedules), some of which are beyond the Company s control and can affect the Company s quarterly revenue and backlog. Although the Company has made progress on direct material cost reduction efforts, the Company was behind schedule in reducing costs at the end of the second quarter of Fiscal 2011. In addition, the Company s working capital requirements are higher than planned primarily because of slower collection of accounts receivable and lower than anticipated inventory turns. Further, the Company has not been able to fully achieve its planned number of product shipments partly as a result of a shortage in certain key supplies. If the Company is unable to improve its performance in the areas discussed above and successfully obtain a release of all or a portion of its restricted cash from Wells Fargo as further described under Liquidity and Capital Resources in this Form 10-Q, the Company may need to raise additional funds in the near term. The Company could seek to raise such funds by selling additional securities to the public or to selected investors, or by obtaining debt financing. There is no assurance that the Company will be able to obtain additional funds on commercially favorable terms, or at all. If the Company raises additional funds by issuing additional equity or convertible debt securities, the fully diluted ownership percentages of existing stockholders would be reduced. In addition, any equity or debt securities that it would issue may have rights, preferences or privileges senior to those of the holders of its common stock. Should the Company be unable to execute its plans or obtain additional financing, that might be needed if the Company s cash needs change, the Company may be unable to continue as a going concern. The unaudited condensed consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

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

The Company has conducted a subsequent events review through the date the financial statements were issued, and has concluded that there were no subsequent events requiring adjustments or additional disclosures to the Company s financial statements at September 30, 2010.

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3. Recently Issued Accounting Standards

In April 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-17, Revenue Recognition Milestone Method (ASU 2010-17). ASU 2010-17 provides guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. A vendor can recognize consideration that is contingent upon achievement of a milestone in its entirety as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive. The following criteria must be met for a milestone to be considered substantive. The consideration earned by achieving the milestone should be: (1) commensurate with either the level of effort required to achieve the milestone or the enhancement of the value of the item delivered as a result of a specific outcome resulting from the vendor s performance to achieve the milestone; (2) related solely to past performance and (3) reasonable relative to all deliverables and payment terms in the arrangement. No split of an individual milestone is allowed and there can be more than one milestone in an arrangement. Accordingly, an arrangement may contain both substantive and non-substantive milestones. ASU 2010-17 is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. The Company adopted this updated guidance with no impact on its consolidated financial position or results of operations.

In September 2009, the FASB issued updated guidance of Accounting Standards Codification (ASC) 605, Revenue Recognition, for establishing the criteria for separating consideration in multiple element arrangements. The updated guidance is effective for fiscal years beginning on or after June 15, 2010 and requires companies allocating the overall consideration to each deliverable to use an estimated selling price of individual deliverables in the arrangement in the absence of vendor specific evidence or other third party evidence of the selling price for the deliverables. The updated guidance also provides additional factors that should be considered when determining whether software in a tangible product is essential to its functionality. The Company adopted this updated guidance with no impact on its consolidated financial position or results of operations.

4. Customer Concentrations and Accounts Receivable

Sales to Aquatec-Maxcon Pty Ltd. (Aquatec), the Company s Australian distributor, Pumps and Service Company (Pumps and Service), one of the Company s domestic distributors, and Banking Production Centre (BPC), one of the Company s Russian distributors, accounted for 14%, 13% and 11% of revenue for the three months ended September 30, 2010, respectively. Sales to BPC, Aquatec, and Fluxo Soluções Intergradas Ltda, the Company s Brazilian distributor, accounted for 20%, 14% and 12% of revenue for the three months ended September 30, 2009, respectively.

BPC and Pumps and Service accounted for 21% and 10% of revenue, respectively, for the six months ended September 30, 2010. For the six months ended September 30, 2009, BPC and Aquatec accounted for 23% and 16% of revenue, respectively.

Additionally, BPC and Greenvironment plc, the Company s Finland distributor, accounted for 19% and 12% of net accounts receivable, respectively, as of September 30, 2010. BPC and Greenvironment plc accounted for 20% and 16% of net accounts receivable, respectively, as of March 31, 2010.

5. Inventories

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

	September 30, 2010	March 31, 2010
	(In thousands)	
Raw materials	$ 20,329	$ 19,772
Work in process	469	583
Finished goods	1,078	2,878
Total	21,876	23,233
Less non-current portion	3,380	3,588
Current portion	$ 18,496	$ 19,645

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

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6. Property, Plant and Equipment

Property, plant and equipment consisted of the following:

	September 30, 2010	March 31, 2010
	(In thousands)	
Machinery, rental equipment, equipment, automobiles and furniture	$ 22,257	$ 22,543
Leasehold improvements	9,652	9,654
Molds and tooling	4,965	4,930
	36,874	37,127
Less accumulated depreciation and amortization	(29,876)	(28,880)
Total property, plant and equipment, net	$ 6,998	$ 8,247

During the three months ended September 30, 2010, the Company sold ten of its microturbine rental units for approximately $430,000. The net book value of the rental equipment related to this sale was approximately $365,000. The Company recognized this sale as revenue and the cost of the units as cost of goods sold.

7. Intangible Assets

Intangible assets consisted of the following (in thousands):

		At					
		September 30, 2010			March 31, 2010		
	Weighted Average Amortization period	Gross carrying amount	Accumulated amortization	Net	Gross carrying amount	Accumulated amortization	Net
Manufacturing license	17 years	$ 3,700	$ (3,363)	$ 337	$ 3,700	$ (3,338)	$ 362
Technology	10 years	2,240	(149)	2,091	2,240	(37)	2,203
Parts and service customer relationships	5 years	1,080	(123)	957	1,080	(26)	1,054
TA100 customer relationships	2 years	617	(206)	411	617	(51)	566
Backlog	1.2 years	490	(216)	274	490	(91)	399
Trade name	1.2 years	69	(40)	29	69	(10)	59
Total		$ 8,196	$ (4,097)	$ 4,099	$ 8,196	$ (3,553)	$ 4,643

The Company recorded amortization expense of $0.2 million and $0.5 million for the three and six months ended September 30, 2010, respectively. The Company recorded amortization expense of $12,300 and $24,600 for the three and six months ended September 30, 2009, respectively.

The manufacturing license provides the Company with the ability to manufacture recuperator cores previously purchased from the supplier. The Company is required to pay a per-unit royalty fee over a seventeen-year period for cores manufactured and sold by the Company using the technology. Royalties of approximately $18,200 and $14,800 were earned by the supplier for the three months ended September 30, 2010 and 2009, respectively. Royalties of approximately $28,400 and $26,200 were earned by the supplier for the six months ended September 30, 2010 and 2009, respectively. Earned royalties of approximately $18,200 and $44,600 were unpaid as of September 30, 2010 and March 31, 2010, respectively, and are included in accrued expenses in the accompanying balance sheets.

On February 1, 2010, the Company acquired the 100 kW (TA100) microturbine product line from Calnetix Power Solutions, Inc. (CPS) to expand the Company s microturbine product line and to gain relationships with distributors to supply the Company s products. See Note 16 Acquisition, for discussion of the TA100 acquired from CPS. The acquired intangible assets include technology, parts and service customer relationships, TA100 customer relationships, backlog and trade name. These intangible assets have estimated useful lives between one and ten years. The fair value assigned to identifiable intangible assets acquired has been determined primarily by using the income approach. Purchased identifiable intangible assets, except for backlog, are amortized on a straight-line basis over their respective useful lives and classified as a component of cost of goods sold or selling, general and administrative expenses based on the function of the underlying asset. Backlog is amortized on a per unit basis as the backlog units are sold and presented as a component of cost of goods sold.

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8. Stock-Based Compensation

As of September 30, 2010, the Company had outstanding 3,700,000 non-qualified common stock options issued outside of the Amended and Restated 2000 Equity Incentive Plan (the 2000 Plan). These stock options were granted prior to Fiscal 2008 with exercise prices equal to the fair market value of the Company s common stock on the grant date as inducement grants to new officers and employees of the Company. Included in the 3,700,000 options were 2,000,000 options granted to the Company s President and Chief Executive Officer, 850,000 options granted to the Company s Executive Vice President of Sales and Marketing, 650,000 options granted to the Company s Senior Vice President of Customer Service and 200,000 options granted to the Company s Senior Vice President of Human Resources. Additionally, the Company had outstanding 212,500 restricted stock units issued outside of the 2000 Plan. These restricted stock units were issued prior to Fiscal 2008 as inducement grants to new officers of the Company. Included in the 212,500 units were 125,000 units granted to the Company s President and Chief Executive Officer, 50,000 units granted to the Company s Executive Vice President of Sales and Marketing and 37,500 granted to the Company s Senior Vice President of Customer Service. Although the options and restricted stock units were not granted under the 2000 Plan, they are governed by terms and conditions identical to those under the 2000 Plan. All options are subject to the following vesting provisions: one-fourth vests one year after the issuance date and 1/48th vests on the first day of each full month thereafter, so that all shall be vested on the first day of the 48th month after the issuance date. All outstanding options have a contractual term of ten years. The restricted stock units vest in equal installments over a period of two or four years. For restricted stock units with two year vesting, one-half of the units vests one year after the issuance date and the other half vests two years after the issuance date. For restricted stock units with four year vesting, one-fourth vests annually beginning one year after the issuance date.

Valuation and Expense Information

For the three months ended September 30, 2010 and 2009, the Company recognized stock-based compensation expense of $0.7 million and $0.9 million, respectively. For the six months ended September 30, 2010 and 2009, the Company recognized stock-based compensation expense of $1.3 million and $1.9 million, respectively. The following table summarizes, by statement of operations line item, stock-based compensation expense (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Cost of goods sold	$ 68	$ 62	$ 169	$ 211
Research and development	32	158	63	316
Selling, general and administrative	571	677	1,101	1,340
Stock-based compensation expense	$ 671	$ 897	$ 1,333	$ 1,867

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Risk-free interest rates	1.4%	3.5%	3.1%	2.9%

Expected lives (in years)	5.0