MECHANICAL TECHNOLOGY INC
Form 10-Q
November 08, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ____ TO ______

Mechanical Technology Incorporated

(Exact name of registrant as specified in its charter)

New York	**0-6890**	**14-1462255**
(State or Other Jurisdiction of Incorporation)	**(Commission File Number)**	**(IRS Employer Identification No.)**

431 New Karner Road, Albany, New York 12205

(Address of registrant s principal executive office)

(518) 533-2200

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer 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 of common stock, par value of $0.01 per share, outstanding as of November 2, 2007 was 38,179,888.

MECHANICAL TECHNOLOGY INCORPORATED AND SUBSIDIARIES

INDEX

2

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MECHANICAL TECHNOLOGY INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

As of September 30, 2007 and December 31, 2006 (Unaudited)

(Dollars in thousands)

	Sept. 30, 2007	December 31, 2006
Assets:		
Current Assets:		
Cash and cash equivalents	$ 4,704	$ 14,545
Securities available for sale	6,789	10,075
Accounts receivable	1,870	1,613
Inventories, net	1,367	1,216
Prepaid expenses and other current assets	893	442
Total Current Assets	15,623	27,891
Property, plant and equipment, net	2,296	2,926
Deferred income taxes	1,853	2,994
Total Assets	$ 19,772	$ 33,811
Liabilities and Shareholders Equity:		
Current Liabilities:		
Accounts payable	$ 266	$ 651
Accrued liabilities	2,121	2,470
Deferred revenue		866
Income taxes payable	8	90
Deferred income taxes	1,853	2,994
Total Current Liabilities	4,248	7,071
Long-Term Liabilities:		
Uncertain tax position liability	204	
Derivative liability	1,574	3,664
Total Liabilities	6,026	10,735
Commitments and contingencies		
Minority interests	96	205
Shareholders Equity:		
Common stock, par value $0.01 per share, authorized 75,000,000; 46,220,624 issued in 2007 and 46,084,678 issued in 2006	462	461
Paid-in-capital	131,455	130,565
Accumulated deficit	(103,615)	(95,385)
Accumulated Other Comprehensive Income:		
Unrealized (loss) gain on securities available for sale, net of tax	(898)	984
Common stock in treasury, at cost, 8,040,736 shares in 2007 and 2006	(13,754)	(13,754)
Total Shareholders Equity	13,650	22,871
Total Liabilities and Shareholders Equity	$ 19,772	$ 33,811

The accompanying notes are an integral part of the condensed consolidated financial statements.

MECHANICAL TECHNOLOGY INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(Dollars in thousands, except per share data)

	Three months ended		Nine months ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Product revenue	$ 2,196	$ 1,693	$ 6,172	$ 4,906
Funded research and development revenue	357	173	1,325	311
Total revenue	2,553	1,866	7,497	5,217
Operating costs and expenses:				
Cost of product revenue	848	650	2,402	1,915
Research and product development expenses:				
Funded research and product development	691	323	1,419	663
Unfunded research and product development	1,986	3,234	7,752	8,706
Total research and product development expenses	2,677	3,557	9,171	9,369
Selling, general and administrative expenses	1,716	1,859	6,612	7,695
Operating loss	(2,688)	(4,200)	(10,688)	(13,762)
Gain on derivatives	363		2,089	
Gain on sale of securities available for sale	417		417	3,810
Other (expense) income, net	(1)	85	231	223
Loss before income taxes and minority interests	(1,909)	(4,115)	(7,951)	(9,729)
Income tax (expense) benefit	(688)	69	(715)	(1,544)
Minority interests in losses of consolidated subsidiary	116	368	542	942
Net loss	$ (2,481)	$ (3,678)	$ (8,124)	$ (10,331)
Loss per Share (Basic and Diluted):				
Loss per share	$ (0.07)	$ (0.12)	$ (0.21)	$ (0.33)

The accompanying notes are an integral part of the condensed consolidated financial statements.

MECHANICAL TECHNOLOGY INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

AND COMPREHENSIVE LOSS (Unaudited)

(Dollars in thousands)

	Nine months ended Sept. 30, 2007	Sept. 30, 2006
Common Stock		
Balance, beginning	$ 461	$ 390
Issuance of shares options		6
Issuance of shares restricted stock	1	1
Balance, ending	$ 462	$ 397
Paid-In Capital		
Balance, beginning	$ 130,565	$ 122,095
Issuance of shares options	59	1,155
MTI MicroFuel Cell investment	(433)	(936)
Share-based compensation	1,264	2,229
Elimination of unearned compensation due to change in accounting principle		(80)
Balance, ending	$ 131,455	$ 124,463
Accumulated Deficit		
Balance, beginning	$ (95,385)	$ (81,718)
Cumulative effect of adoption of FIN 48	(106)	
Net loss	(8,124)	(10,331)
Balance, ending	$ (103,615)	$ (92,049)
Accumulated Other Comprehensive Income (Loss):		
Unrealized Gain (Loss) on Securities Available for Sale, Net of Taxes		
Balance, beginning	$ 984	$ 5,983
Less reclassification adjustment for gains included in net income (net of taxes of $693 in 2007 and $1,566 in 2006)	(152)	(1,464)
Change in unrealized gain on securities available for sale (net of taxes of $0 in 2007 and $0 in 2006)	(1,730)	(2,957)
Balance, ending	$ (898)	$ 1,562
Restricted Stock Grants Unearned Compensation		
Balance, beginning	$	$ (80)
Elimination of unearned compensation due to change in accounting principle		80
Balance, ending	$	$
Treasury Stock		
Balance, beginning	$ (13,754)	$ (13,754)
Balance, ending	$ (13,754)	$ (13,754)
Total Shareholders Equity		
Balance, ending	$ 13,650	$ 20,619
Total Comprehensive (Loss) Income:		
Net loss	$ (8,124)	$ (10,331)
Other comprehensive (loss):		

Less reclassification adjustment for gains included in net income, net of taxes	(152)	(1,464)
Change in unrealized gain on securities available for sale, net of taxes	(1,730)	(2,957)
Total comprehensive loss	$ (10,006)	$ (14,752)

The accompanying notes are an integral part of the condensed consolidated financial statements.

5

MECHANICAL TECHNOLOGY INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(Dollars in thousands)

	Nine months ended Sept. 30, 2007	Nine months ended Sept. 30, 2006
Operating Activities		
Net loss	$ (8,124)	$ (10,331)
Adjustments to reconcile net loss to net cash used by operations:		
Gain on derivatives	(2,089)	
Minority interests in losses of consolidated subsidiary	(542)	(942)
Depreciation and amortization	860	837
Gain on sale of securities available for sale	(417)	(3,810)
Allowance for bad debts		(1)
Loss on disposal of fixed assets	39	34
Deferred income taxes	693	1,543
Stock based compensation	1,264	2,229
Changes in operating assets and liabilities:		
Accounts receivable	(257)	(110)
Other receivables related parties		3
Inventories	(151)	(155)
Prepaid expenses and other current assets	(451)	(218)
Accounts payable	(386)	68
Income taxes payable	16	23
Accrued liabilities related parties		(2)
Deferred revenue	(866)	702
Accrued liabilities	(349)	128
Net cash used by operating activities	(10,760)	(10,002)
Investing Activities		
Purchases of property, plant and equipment	(281)	(867)
Proceeds from sale of property plant equipment	12	2
Proceeds from sale of securities available for sale	1,128	5,415
Net cash (used) provided by investing activities	859	4,550
Financing Activities		
Proceeds from stock option exercises	60	1,161
Net cash provided by financing activities	60	1,161
Decrease in cash and cash equivalents	(9,841)	(4,291)
Cash and cash equivalents - beginning of period	14,545	11,230
Cash and cash equivalents - end of period	$ 4,704	$ 6,939

The accompanying notes are an integral part of the condensed consolidated financial statements.

MECHANICAL TECHNOLOGY INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

In the opinion of management of Mechanical Technology Incorporated (the Company), the accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) and contain all adjustments, consisting of normal, recurring adjustments, necessary for a fair statement of results for such periods. The results of operations for the interim periods presented are not necessarily indicative of results for the full year.

Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted. These unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

The information presented in the accompanying condensed consolidated balance sheet as of December 31, 2006 has been derived from the Company s audited consolidated financial statements but does not include all disclosures required by U.S. GAAP. All other information has been derived from the Company s unaudited condensed consolidated financial statements for the periods as of and ended September 30, 2007 and 2006.

Liquidity

The Company has incurred significant losses as it continues to fund its subsidiary MTI MicroFuel Cells Inc. (MTI Micro) in MTI Micro s Direct Methanol Fuel Cell (DMFC) product development and commercialization programs. The Company expects that losses will continue and may be substantial as a result of, among other factors, sales of securities available for sale, the operating results of its subsidiaries MTI Instruments, Inc. (MTI Instruments) and MTI Micro, and the availability, or lack thereof, of equity financing and the ability to attract government funding resources to fund research and development costs. The Company anticipates that it will continue incurring losses as it seeks to develop and commercialize its DMFC systems. It expects to continue funding its operations from current cash and cash equivalents, the sale of securities available for sale, government research program funding and the proceeds, if any, from potential equity offerings by the Company.

At September 30, 2007, the Company had cash, cash equivalents and securities available for sale in the amount of $11,493 thousand and working capital of $11,375 thousand. The failure to raise the funds necessary to finance our future cash requirements could adversely affect the Company s ability to pursue its strategy and could negatively affect the Company s operations in future periods.

2. Significant Accounting Policies

Changes in significant accounting policies since December 31, 2006 are as follows:

The Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, (FIN 48) on January 1, 2007, the first day of its 2007 fiscal year. FIN 48 is an interpretation of Statement of Financial Accounting Standard (SFAS) No. 109, *Accounting for Income Taxes*, which seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position that an entity takes or expects to take in a tax return. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under FIN 48, an entity may only recognize or continue to recognize tax positions that meet a more likely than not threshold. The Company recorded the cumulative effect of applying FIN 48 of $106 thousand as an adjustment to our opening balance of retained earnings as of January 1, 2007. See Footnote No. 6, Income Taxes, for additional information.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140* (SFAS No. 155), to permit fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation in accordance with the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after June 15, 2006. The adoption of this Statement on January 1, 2007 did not impact the Company s Consolidated Financial Statements.

MECHANICAL TECHNOLOGY INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

3. Accounts Receivable and Allowance for Doubtful Accounts

Receivable balances consist of the following at:

(Dollars in thousands)	Sept. 30, 2007	Dec. 31, 2006
U.S. and State Government:		
Amount billed	$ 687	$ 194
Amount billable		9
Total U.S. and State Government	687	203
Commercial	1,183	1,410
Sub Total	1,183	1,613
Allowance for doubtful accounts		
Total	$ 1,870	$ 1,613

For the three months ended September 30, 2007 and 2006, a single commercial customer represented 30.7% and 25.5%, respectively, of the Company s instrumentation segment product revenue. As of September 30, 2007 and December 31, 2006, this commercial customer represented 29.0% and 48.8%, respectively, of the Company s instrumentation segment accounts receivable.

4. Inventories

Inventories, net consist of the following at:

(Dollars in thousands)	Sept. 30, 2007	Dec. 31, 2006
Finished goods	$ 357	$ 279
Work-in-process	352	238
Raw materials, net	658	699
	$ 1,367	$ 1,216

5. Securities Available for Sale

Securities available for sale are classified as current assets and accumulated net unrealized gains (losses) are charged to other comprehensive income (loss).

The principal components of the Company s securities available for sale consist of the following at:

Security	Book Basis	Unrealized Gain	Recorded Fair Value	Quoted Market Price Per NASDAQ	Ownership	Shares

(Dollars in thousands, except market price and share data)

September 30, 2007						
Plug Power	$ 3,891	$ 2,898	$ 6,789	$ 3.10	2.50	% 2,189,936
December 31, 2006						
Plug Power	$ 4,602	$ 5,473	$ 10,075	$ 3.89	2.99	% 2,589,936

8

MECHANICAL TECHNOLOGY INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The book basis roll forward of Plug Power securities is as follows:

Plug Power Current

(Dollars in thousands)	**Sept. 30, 2007**	**Dec. 31, 2006**
Securities available for sale, beginning of period	$4,602	$6,562
Sale of shares	(711)	(1,960)
Securities book basis	3,891	4,602
Unrealized gain on securities available for sale	2,898	5,473
Securities available for sale, end of period	$6,789	$10,075

Accumulated unrealized gains related to Plug Power securities available for sale are as follows:

(Dollars in thousands)	**Sept. 30, 2007**	**Dec. 31, 2006**
Accumulated unrealized gains	$2,898	$5,473
Accumulated deferred tax expense on unrealized gains	(3,796)	(4,489)
Accumulated net unrealized gains	$(898)	$984

6. Income Taxes

The Company adopted the provisions of FIN 48 on January 1, 2007, the first day of its 2007 fiscal year. As a result of the implementation of FIN 48, the Company recorded a $106 thousand increase in the net liability for uncertain tax positions, which was recorded as an adjustment to our opening balance of retained earnings on January 1, 2007. Additionally, the same tax position that triggered the Company s FIN 48 adoption charge caused the Company to reclassify $80 thousand from current income taxes payable to non-current liabilities for uncertain tax positions. The total amount of unrecognized tax benefits as of January 1, 2007 and September 30, 2007, was approximately $1.8 million. In future periods, if these unrecognized benefits become supportable, the Company may not recognize a change in its effective rate as long as it remains in a full valuation allowance position. As of September 30, 2007, there have been no material changes to the liability for uncertain tax positions from the date of the Company s adoption. Included in the balance of unrecognized tax benefits at January 1, 2007 is $239 thousand related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months. This amount represents unrecognized tax benefits comprising potential recognition for tax purposes of losses in a partnership in which the Company held a minority stake.

In accordance with our accounting policy, we recognize interest and penalties related to uncertain tax positions as a component of tax expense. This policy did not change as a result of the adoption of FIN 48. As of January 1, 2007, accrued interest included in Uncertain Tax Position Liability totaled $34 thousand. During the nine month period ended September 30, 2007, the Company recognized $11 thousand in potential interest expense on uncertain tax positions, and our Condensed Consolidated Balance Sheet as of that date includes total interest of $45 thousand associated with these positions.

The Company files income tax returns, including returns for our subsidiaries, with federal and state jurisdictions. The Company is no longer subject to IRS examination for its federal returns for any periods prior to 2003, although carryforward attributes that were generated prior to 2004 may still be adjusted upon examination by the IRS if they either have been or will be used in a future period. The Company has an ongoing tax examination by New York State for the years 2002 through 2004. We do not believe that the net outcome of this examination will have a material impact on our financial statements.

MECHANICAL TECHNOLOGY INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Company s effective income tax (expense) benefit rate from operations differed from the Federal statutory rate as follows:

	Three months ended		Nine months ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Federal statutory tax rate	34.00 %	34.00 %	34.00 %	34.00 %
State taxes, net of federal tax effect	(2.08)	7.10	3.84	2.33
Change in valuation allowance	(48.66)	(36.99)	(50.76)	(38.49)
Disproportionate tax effect of reclassification adjustment for gains included in net loss	(28.06)		(6.74)	(12.44)
Permanent tax difference on derivative valuation	7.61		10.51	
Other, net	1.15	(2.45)	0.16	(1.27)
Tax rate	(36.04)%	1.66 %	(8.99)%	(15.87)%

Income tax (expense) benefit consists of the following:

(Dollars in thousands)	Three months ended		Nine months ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Operations before minority interest				
Federal	$	$	$	$
State	5	69	(22)	(1)
Deferred	(693)		(693)	(1,543)
Total	$ (688)	$ 69	$ (715)	$ (1,544)
Income tax benefit (expense) allocated directly to shareholders equity:				
Change in unrealized (gain) loss on securities available for sale:				
Tax effect of reclassification adjustment for gains included in net income (loss)	$ 693	$	$ 693	$ 1,566

The valuation allowance at September 30, 2007 and December 31, 2006 was $21,948 thousand and $18,815 thousand, respectively and represents a full valuation allowance. The valuation allowance reflects the estimate that it is more likely than not that the net deferred tax assets in excess of deferred tax liabilities may not be realized.

7. Shareholders Equity

Changes in common shares issued and treasury stock outstanding are as follows:

	Nine Months Ended Sept. 30, 2007	Year Ended Dec. 31, 2006
Common Shares		
Balance, beginning	46,084,678	38,965,937
Issuance of shares for stock option exercises	85,946	719,791

Issuance of shares for restricted and unrestricted stock grants	55,000	76,080
Forfeiture of restricted stock grant	(5,000)	
Issuance of shares for anti-dilution penalty		267,314
Issuance of shares for capital raise		6,055,556
Balance, ending	46,220,624	46,084,678

Treasury Stock

Balance, beginning	8,040,736	8,040,736
Balance, ending	8,040,736	8,040,736

MECHANICAL TECHNOLOGY INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Warrants Issued

On December 20, 2006, the Company issued warrants to investors to purchase 3,027,778 shares of the Company s common stock at an exercise price of $2.27 per share. The estimated fair value of this warrant at the date issued was $1.27 per share, using a Black-Scholes Option Pricing Model and assumptions similar to those used for valuing the Company s share-based compensation. The fair value of the derivative is recorded in the Derivative liability line on its financial statements, and is valued quarterly using the Black-Scholes Option Pricing Model, using the following assumptions:

	Sept. 30, 2007		**Dec. 31, 2006**	
Expected life of options	1,542	days	1,815	days
Risk free interest rate	4.23	%	4.70	%
Expected volatility of stock	76.08	%	80.34	%
Expected dividend yield	None		None	

The Company recognizes changes in fair value through the operating statement line titled Gain on derivatives. These valuations will continue until expiration or exercise of the warrants. The warrants became exercisable on June 20, 2007 and expire on December 19, 2011.

Reservation of Shares

The Company has reserved common shares for future issuance as of September 30, 2007 as follows:

Stock options outstanding	6,402,193
Stock options available for issuance	1,052,776
Warrants outstanding	3,027,778
Number of common shares reserved	10,482,747

8. Loss per Share

The following table sets forth the reconciliation of the numerators and denominators of the basic and diluted per share computations:

(Dollars in thousands, except shares)	**Three months ended**		**Nine months ended**	
Numerator	**Sept. 30, 2007**	**Sept. 30, 2006**	**Sept. 30, 2007**	**Sept. 30, 2006**
Net loss	$(2,481)	$(3,678)	$(8,124)	$(10,331)
Denominator-Basic EPS:				
Common shares outstanding, beginning of period	38,125,963	31,526,435	38,043,942	30,925,201
Weighted average common shares issued during period	34,054	61,669	49,951	404,250

Weighted average restricted shares forfeited during period	(3,424)		(1,154)	
Less: Non-vested restricted stock	(6,576)	(5,000)	(5,769)	(2,491)
Denominator for basic earnings per common share Weighted average common shares	38,150,017	31,583,104	38,086,970	31,326,960
Denominator-Diluted EPS:				
Common shares outstanding, beginning of period	38,125,963	31,526,435	38,043,942	30,925,201
Weighted average common shares issued during period	34,054	61,669	49,951	404,250
Weighted average restricted shares forfeited during period	(3,424)		(1,154)	
Less: Non-vested restricted stock due to anti-dilutive effect (net loss)	(6,576)	(5,000)	(5,769)	(2,491)
Denominator for basic earnings per common share Weighted average common shares	38, 150,017	31,583,104	38,086,970	31,326,960

MECHANICAL TECHNOLOGY INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Not included in the computation of earnings per share-assuming dilution for the three and nine months ended September 30, 2007 were options to purchase 6,402,193 shares of the Company s common stock, warrants to purchase 3,027,778 shares of the Company s stock, 5,000 unvested restricted shares of the Company s common stock, and options to purchase 25,668 shares of MTI Micro s common stock. These potentially dilutive items were excluded because the Company incurred losses for these periods, and their inclusion would be anti-dilutive.

Not included in the computation of earnings per share-assuming dilution for the three and nine months ended September 30, 2006 were options to purchase 5,571,628 shares of the Company s common stock, additional investment rights to purchase approximately 3,320,604 shares of the Company s common stock, 5,000 unvested restricted shares of the Company s common stock, and options to purchase 36,668 shares of MTI Micro s common stock. These potentially dilutive items were excluded because the Company incurred losses for these periods, and their inclusion would be anti-dilutive. The additional investment rights expired on December 31, 2006.

9. Stock-based Compensation

Under our equity incentive compensation plans, the Company has issued time-vesting and performance-based stock options and time-vesting and performance-based restricted stock awards. Awards are typically settled using newly issued shares. The maximum contractual term of stock options granted under the Company s equity incentive plans ranges from 7 to 10 years, depending upon the plan. During the nine month period ended September 30, 2007, the Company granted approximately 1,534,000 stock options with a weighted average fair value per share of $0.80. The total number of outstanding non-vested restricted stock awards was 5,000 at both September 30, 2007 and December 31, 2006.

Total share-based compensation expense related to all of the Company s share-based awards, recognized for the three and nine months ended September 30, 2007 and 2006 was comprised as follows:

(Dollars in thousands)	**Three months ended**		**Nine months ended**	
	Sept. 30, 2007	**Sept. 30, 2006**	**Sept. 30, 2007**	**Sept. 30, 2006**
Unfunded research and product development	$ 85	$ 246	$ 166	$ 599
Selling, general and administrative	222	300	1,098	1,630
Share-based compensation expense before taxes	307	546	1,264	2,229
Related income tax benefits [A]				
Share-based compensation expense, net of taxes	$ 307	$ 546	$ 1,264	$ 2,229

[A] Income tax effect is zero due to the Company maintaining a full valuation allowance.

Unrecognized compensation costs related to non-vested awards as of September 30, 2007 is $1,828 thousand for stock options and $5 thousand for restricted stock, and is expected to be recognized on a weighted average vesting period of approximately 1.32 years.

The fair value of stock option awards is estimated on the date of grant using a Black-Scholes Pricing Model with the following weighted average assumptions:

	Three months ended				Nine months ended			
	Sept. 30, 2007		**Sept. 30, 2006**		**Sept. 30, 2007**		**Sept. 30, 2006**	
Expected life of options	4.65	years	4.31	years	3.46	years	4.47	years
Risk free interest rate range	4.26-4.26	%	4.73-5.29	%	4.26-5.04	%	4.73-5.29	%
Expected volatility of stock	72.78	%	77.03	%	72.57	%	76.68	%
Expected dividend yield	None		None		None		None	

The fair value of restricted stock awards is determined using the intrinsic value of the award on the date of grant.

MECHANICAL TECHNOLOGY INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

10. Cash Flows Supplemental Information

(Dollars in thousands)	**Nine Months ended Sept. 30, 2007**	**Nine Months ended Sept. 30, 2006**
Non-cash Operating, Investing and Financing Activities:		
Change in investment and paid-in-capital resulting from other investors activity in MTI Micro stock	$(433)	$(936)

11. Segment Information

The Company operates in two business segments**,** New Energy and Test and Measurement Instrumentation. The New Energy segment is focused on commercializing DMFCs. The Test and Measurement Instrumentation segment designs, manufactures, markets and services computer-based balancing systems for aircraft engines, high performance test and measurement instruments and systems, and wafer characterization tools for the semiconductor industry. The Company s principal operations are located in North America.

The accounting policies of the New Energy and Test and Measurement Instrumentation segments are consistent with those described in the summary of significant accounting policies. The Company evaluates performance based on profit or loss from operations before income taxes, accounting changes, items management does not deem relevant to segment performance, and interest income and expense. Inter-segment sales and expenses are not significant.

Summarized financial information concerning the Company s reportable segments is shown in the following table. The Other column includes corporate-related items and items such as income taxes or unusual items, which are not allocated to reportable segments. The Reconciling Items column includes minority interests in a consolidated subsidiary. In addition, segments non-cash items include any depreciation and amortization in reported profit or loss. The New Energy segment figures include the Company s micro fuel cell operations, equity securities of Plug Power, and gains on the sale of these securities.

(Dollars in thousands)	**New Energy**	**Test and Measurement Instrumentation**	**Other**	**Reconciling Items**	**Condensed Consolidated Totals**
Three months ended September 30, 2007					
Product revenue	$	$ 2,196	$	$	$ 2,196
Funded research and development revenue	357				357
Research and product development expenses	2,272	405			2,677
Selling, general and administrative expenses	268	615	833		1,716
Gain on sale of securities available for sale	417				417
Segment loss from operations before income taxes and minority interests	(2,208)	201	98		(1,909)
Segment (loss) profit	(2,208)	201	(590)	116	(2,481)
Total assets	9,783	3,426	6,563		19,772
Securities available for sale	6,789				6,789
Capital expenditures	22	19			41
Depreciation and amortization	178	30	72		280

13

MECHANICAL TECHNOLOGY INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands)	New Energy	Test and Measurement Instrumentation	Other	Reconciling Items	Condensed Consolidated Totals