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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, 2000

OR

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

FOR THE TRANSITION PERIOD FROM ____________ TO ____________ .

COMMISSION FILE NUMBER: 001-15957

CAPSTONE TURBINE CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

<TABLE>

<S>	<C>
DELAWARE	95-4180883
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

</TABLE>

21211 NORDHOFF STREET, CHATSWORTH, CALIFORNIA 91311
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (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 [ ] No [X]

APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes [ ] No [ ]

APPLICABLE ONLY TO CORPORATE REGISTRANTS:

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 74,938,602 shares of Common Stock, $.001 par value, as of September 30, 2000.

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CAPSTONE TURBINE CORPORATION

INDEX

<TABLE>
<CAPTION>

		PAGE
	PART I -- FINANCIAL INFORMATION	
Item 1.	Financial Statements (Unaudited)	
	Balance Sheets as of December 31, 1999 and September 30, 2000	1
	Condensed Statements of Operations for the Three Months Ended September 30, 1999 and September 30, 2000 and for the Nine Months Ended September 30, 1999 and September 30, 2000	2
	Condensed Statement of Stockholders' (Deficiency) Equity for the Nine Months Ended September 30, 2000	3
	Condensed Statements of Cash Flows for the Nine Months Ended September 30, 1999 and September 30, 2000	4
	Notes to Condensed Financial Statements	5
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	9
	Overview	9
	Three Months Ended September 30, 2000 Compared to Three Months Ended September 30, 1999	9
	Nine Months Ended September 30, 2000 Compared to Nine Months Ended September 30, 1999	10
	Liquidity and Capital Resources	11
Item 3.	Qualitative and Quantitative Disclosures About Market Risk	12
	Risk Factors	12
	PART II -- OTHER INFORMATION	
Item 1.	Legal Proceedings	16
Item 2....	Changes in Securities and Use of Proceeds	16
Item 3.	Defaults Upon Senior Securities	16
Item 4.	Submission of Matters to a Vote of Security Holders	16
Item 5.	Other Information	16
Item 6.	Exhibits and Reports on Form 8-K	16
Signatures		17

</TABLE>

PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CAPSTONE TURBINE CORPORATION

BALANCE SHEETS

ASSETS

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	DECEMBER 31, 1999	SEPTEMBER 30, 2000
		(UNAUDITED)
Current Assets:		
Cash and cash equivalents	$ 6,858,000	$ 229,783,000
Accounts receivable, net of allowance for doubtful accounts of $50,000 at December 31, 1999 and $85,000 at September 30, 2000	2,425,000	3,384,000
Inventory (Note 5)	8,803,000	10,976,000
Prepaid expenses and other current assets	2,217,000	1,440,000
Total Current Assets	20,303,000	245,583,000
Equipment and Leasehold Improvements:		

Machinery, equipment and furniture	11,824,000	13,336,000
Leasehold improvements	137,000	2,902,000
Molds and tooling	541,000	994,000
	12,502,000	17,232,000
Less accumulated depreciation and amortization	4,570,000	6,203,000
Total equipment and leasehold improvements	7,932,000	11,029,000
Deposits on fixed assets	3,374,000	5,296,000
Other assets	422,000	752,000
Intangible assets, net	4,896,000	26,856,000
Total	$ 36,927,000	$ 289,516,000
LIABILITIES AND STOCKHOLDERS' (DEFICIENCY) EQUITY		
Current Liabilities:		
Accounts payable	$ 1,728,000	$ 4,581,000
Accrued salaries and wages	677,000	1,026,000
Other accrued liabilities	2,340,000	978,000
Accrued warranty reserve	3,168,000	6,037,000
Deferred revenue	4,696,000	5,951,000
Current portion of capital lease obligations	1,400,000	1,582,000
Total current liabilities	14,009,000	20,155,000
Non-current Liabilities:		
Long-term portion of capital lease obligations	4,499,000	4,381,000
Other long-term liabilities		161,000
Accrued dividends payable	6,175,000	
Total non-current liabilities	10,674,000	4,542,000
Commitments and Contingencies (Note 8)		
Total redeemable preferred stock (Note 6)	156,469,000	
Stockholders' (Deficiency) Equity (Note 6):		
Common stock, $.001 par value; 415,000,000 shares authorized; 2,377,826 and 74,938,602 shares issued and outstanding at December 31, 1999 and September 30, 2000 respectively	2,000	75,000
Additional paid in capital		495,818,000
Accumulated deficit	(144,227,000)	(231,074,000)
Total stockholders' (deficiency) equity	(144,225,000)	264,819,000
Total	$ 36,927,000	$ 289,516,000

</TABLE>

See accompanying notes to financial statements.

CAPSTONE TURBINE CORPORATION

STATEMENTS OF OPERATIONS
(UNAUDITED)

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	1999	2000	1999	2000
<S>	<C>	<C>	<C>	<C>
Revenues (Note 3)	$ 759,000	$ 6,197,000	$ 1,315,000	$ 16,029,000
Cost of Goods Sold	1,990,000	7,278,000	4,570,000	20,658,000
Gross Profit (Loss)	(1,231,000)	(1,081,000)	(3,255,000)	(4,629,000)
Operating Costs and Expenses:				
Research and development	2,259,000	2,953,000	6,681,000	8,416,000

Selling, general and administrative	2,748,000	7,203,000	7,818,000	17,264,000
Total operating costs and expenses	5,007,000	10,156,000	14,499,000	25,680,000
Income (Loss) from Operations	(6,238,000)	(11,237,000)	(17,754,000)	(30,309,000)
Interest Income	133,000	3,385,000	350,000	6,007,000
Interest Expense	(151,000)	(197,000)	(463,000)	(733,000)
Other Income (Expense)	3,000	(32,000)	5,000	(31,000)
Profit (Loss) Before Income Taxes	(6,253,000)	(8,081,000)	(17,862,000)	(25,066,000)
Provision for Income Taxes			1,000	1,000
Net Income (Loss)	(6,253,000)	(8,081,000)	(17,863,000)	(25,067,000)
Preferred Stock Dividends, Accretion, and Repurchase	(5,167,000)		(6,287,000)	(559,862,000)
Net Loss Attributable to Common Shareholders	$(11,420,000)	$ (8,081,000)	$(24,150,000)	$(584,929,000)
Weighted Average Common Shares Outstanding	2,352,736	74,931,668	2,267,993	36,317,944
Net Loss Per Share of Common Stock -- Basic and Diluted	$ (4.85)	$ (0.11)	$ (10.65)	$ (16.11)

</TABLE>

See accompanying notes to financial statements.

CAPSTONE TURBINE CORPORATION

STATEMENTS OF STOCKHOLDERS' (DEFICIENCY) EQUITY
NINE MONTHS ENDED SEPTEMBER 30, 2000
(UNAUDITED)

<TABLE>
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	COMMON STOCK				
	SHARES OUTSTANDING	AMOUNT	ADDITIONAL PAID IN CAPITAL	ACCUMULATED DEFICIT	TOTAL
<S>	<C>	<C>	<C>	<C>	<C>
Balance, December 31, 1999	2,377,826	$ 2,000	$ --	$(144,227,000)	$(144,225,000)
Common stock warrants granted			8,132,000		8,132,000
Common stock options granted			1,239,000		1,239,000
Exercise of options and warrants	10,793,693	12,000	2,831,000		2,843,000
Repurchase of preferred stock			2,209,000	454,000	2,663,000
Accretion of preferred stock			(13,883,000)	(457,593,000)	(471,476,000)
Dividends accrued for preferred stock				(1,028,000)	(1,028,000)
Beneficial conversion feature preferred stock				(89,567,000)	(89,567,000)
Dividends waived on preferred stock			440,000	6,309,000	6,749,000
Conversion of preferred stock	51,312,037	51,000	341,296,000	479,645,000	820,992,000
Issuance of common stock	10,455,046	10,000	153,554,000		153,564,000
Net loss				(25,067,000)	(25,067,000)
Balance, September 30, 2000	74,938,602	$75,000	$495,818,000	$(231,074,000)	$ 264,819,000

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</TABLE>

See accompanying notes to financial statements.

CAPSTONE TURBINE CORPORATION

STATEMENTS OF CASH FLOWS
(UNAUDITED)

<TABLE>
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	NINE MONTHS ENDED SEPTEMBER 30,	
	1999	2000
<S>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(17,863,000)	$(25,067,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,829,000	4,847,000
Provision for inventory reserve		407,000
Loss on sale of equipment	179,000	35,000
Non-employee stock compensation	74,000	60,000
Employee stock compensation	70,000	1,239,000
Changes in operating assets and liabilities:		
Accounts receivable	(699,000)	(959,000)
Prepaid expenses and other assets	(284,000)	447,000
Inventory	(968,000)	(2,580,000)
Accounts payable	(300,000)	2,853,000
Accrued salaries and wages	215,000	349,000
Other accrued liabilities	(3,192,000)	(1,201,000)
Accrued warranty reserve	410,000	2,869,000
Deferred revenue	665,000	1,255,000
Net cash used in operating activities	(19,864,000)	(15,446,000)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of equipment and leasehold improvements	(3,020,000)	(5,251,000)
Proceeds from sale of equipment	1,445,000	1,253,000
Deposits on fixed assets	907,000	(1,922,000)
Intangible assets	(1,000,000)	(16,550,000)
Net cash used in investing activities	(1,668,000)	(22,470,000)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of capital lease obligations	(790,000)	(1,150,000)
Exercise of stock options and warrants	44,000	3,549,000
Net proceeds from issuance of common stock		153,572,000
Net proceeds from issuance of Series F preferred stock	21,789,000	
Net proceeds from issuance of Series G preferred stock		120,362,000
Repurchase of preferred stock		(15,492,000)
Net cash provided by financing activities	21,043,000	260,841,000
Net Increase in Cash and Cash Equivalents	(489,000)	222,925,000
Cash and Cash Equivalents, Beginning of Period	4,943,000	6,858,000
Cash and Cash Equivalents, End of Period	$ 4,454,000	$229,783,000
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 463,000	$ 588,000
Income taxes	$ 1,000	$ 1,000

</TABLE>

See accompanying notes to financial statements.

CAPSTONE TURBINE CORPORATION

NOTES TO FINANCIAL STATEMENTS

1. BUSINESS AND ORGANIZATION

Business. Capstone Turbine Corporation (the "Company") develops, manufactures, and markets microturbine generator sets for use in stationary, vehicular, and other electrical distributed generation applications. The Company was organized in 1988 and has been commercially producing its microturbine generator since 1998.

Organization. On June 22, 2000, the Company reincorporated as a Delaware Corporation. On June 28, 2000, the Company's Registration Statement on Form S-1, File No. 333-33024, became effective, and the Company consummated the sale of 10,454,545 shares of common stock in an initial public offering (See Note 5).

2. BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Regulation S-X promulgated under the Securities and Exchange Act of 1934. Correspondingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The balance sheet at December 31, 1999 was derived from audited financial statements included in the Company's Registration Statement on Form S-1. In the opinion of management the 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 financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Registration Statement on Form S-1.

3. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

The Securities and Exchange Commission staff (the "Staff") issued Staff Accounting Bulletin Number 101 -- Revenue Recognition in Financial Statements ("SAB 101") in December 1999. Under the Company's revenue recognition policy, product revenue is recognized upon shipment of the product to the customer. There are no rights of return privileges on product sales. Therefore, there was no impact on the Company's operating results as a result of its adoption of SAB 101.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instrument and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments. It requires the recognition of all derivatives as either assets or liabilities in the statement of position and measurement of the instruments at fair value. The Company is required to adopt SFAS No. 133, as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities -- Deferral of the Effective Date of SFAS No. 133," on January 1, 2001 and is currently evaluating the impact on the financial statements.

4. SEGMENT REPORTING

The Company has a single operating segment under Statement of Financial Accounting Standards No. 131, "Disclosure about Segments of an Enterprise and Related Information." The Company's business activities in its operating segment are the development, manufacture and sale of microturbine generator sets. Set forth below is a breakdown of the Company's revenues by region:

<TABLE>
<CAPTION>

	THREE-MONTHS ENDED SEPTEMBER 30, 1999	THREE-MONTHS ENDED SEPTEMBER 30, 2000	NINE-MONTHS ENDED SEPTEMBER 30, 1999	NINE-MONTHS ENDED SEPTEMBER 30, 2000

<S>	<C>	<C>	<C>	<C>
North America................	$590,000	$4,009,000	$1,059,000	$10,261,000
Asia.........................	99,000	1,867,000	161,000	5,264,000
Europe.......................	70,000	321,000	95,000	504,000
Total..............	$759,000	$6,197,000	$1,315,000	$16,029,000

</TABLE>

5. INVENTORIES

Inventories are stated at the lower of standard cost (which approximates actual cost on the first-in, first-out method) or market value. The amounts below are net of $3,243,000 and $2,120,000 of obsolescence reserves at December 31, 1999 and September 30, 2000, respectively.

<TABLE>
<CAPTION>

<S>	DECEMBER 31, 1999 <C>	SEPTEMBER 30, 2000 <C>
Raw materials..	$7,579,000	$ 8,788,000
Work in process..	1,036,000	1,694,000
Finished goods...	188,000	494,000
Total..	$8,803,000	$10,976,000

</TABLE>

6. CAPITAL STRUCTURE

On June 28, 2000, the Company entered into an agreement to sell approximately 10.5 million shares of common stock at an offering price of $16.00 per share through an initial public stock offering. All of the shares sold in the offering were sold by the Company. The gross proceeds from the initial public offering were $167.3 million and the Company incurred $13.7 million in costs in connection with the offering. All of the proceeds from the offering were received July 5, 2000.

Prior to the public offering, the Company had several series of preferred stock outstanding. It therefore accreted the difference between the redemption value of each series of preferred stock and the net proceeds received in each preferred stock offering under the effective interest method from the respective stock issuance date of each series to the respective redemption date. The accretion was recorded as a component of earnings attributable to common shareholders. The Company also recorded the accrual of preferred stock dividends under the effective interest method. In February 2000, the Company issued its Series G preferred stock, which was issued with an $89.6 million beneficial conversion feature, as the fair value of the common stock into which the preferred stock was convertible exceeded the carrying value.

As a result of the Company's public offering, the remaining fair value accretion with respect to its preferred stock of $471.5 million was recorded as a component of loss attributable to common shareholders during the nine-month period ended September 30, 2000. All outstanding shares of the Company's preferred stock converted into approximately 51.3 million shares of common stock as a result of the public offering. Of the $821.0 million carrying value of the preferred stock, $479.6 million was recorded as an increase to accumulated deficit and $341.3 million was recorded as an increase to additional paid-in capital, amounts

equal to previously recorded accretion charges. The following summarizes the Redeemable Preferred Stock as of December 31, 1999:

<TABLE>
<S> <C>

Series A preferred stock, $.001 par value; 6,570,000 shares issued and outstanding (involuntary liquidation preference of $6,570,000, net of unamortized accretion of origination fees of $37,000)	$ 15,183,000
Series B preferred stock, $.001 par value; 3,333,334 shares issued and outstanding (involuntary liquidation preference of $5,000,000, net of unamortized accretion of origination fees of $34,000)	$ 8,928,000
Series C preferred stock, $.001 par value; 7,655,018 shares issued and outstanding (involuntary liquidation preference of $15,310,000, net of unamortized accretion of origination fees of $266,000)	$ 23,324,000
Series D preferred stock, $.001 par value; 3,125,000 shares issued and outstanding (involuntary liquidation preference of $12,500,000, net of unamortized accretion of origination fees of $14,000)	$ 14,313,000
Series E preferred stock, $.001 par value; 10,664,111 shares issued and outstanding (involuntary liquidation preference of $63,985,000, net of unamortized accretion of origination fees of $995,000)	$ 62,984,000
Series F preferred stock, $.001 par value; 11,129,246 shares issued and outstanding (involuntary liquidation preference of $22,258,000, net of unamortized accretion of origination fees of $2,697,000)	$ 20,903,000
Promissory notes associated with Series G preferred stock	$ 10,834,000
Total redeemable preferred stock	$156,469,000

</TABLE>

The Company accrued $1.0 million in preferred stock dividends, which were recorded as a component of earnings attributable to common shareholders during the nine-month period ended September 30, 2000. $6.7 million in accrued preferred stock dividends were waived as a result of the automatic conversion of preferred stock into common stock and were also reversed, which resulted in an increase to accumulated deficit of $6.3 million and an increase to additional paid-in capital of $440,000, amounts equal to previously recorded dividend accrual charges.

As part of a stock repurchase and settlement agreement entered into by the Company in May 2000, the Company reacquired 2,319,129 shares of Series E preferred stock for $6.68 per share, which was less than the carrying value on the reacquisition date. The excess carrying value over the reacquisition price of $2.2 million was recorded as additional paid-in capital and included as a component of net earnings attributable to common shareholders during the nine-months ended September 30, 2000.

10,793,693 shares of common stock were issued from the exercise of common and preferred stock warrants during the nine-month period ended September 30, 2000.

7. STOCK OPTION PLANS

In June 2000, the Company adopted the 2000 Equity Incentive Plan, as a successor plan to the 1993 Incentive Stock Plan. The 2000 Plan provides for awards of up to 3,300,000 shares of common stock, plus the number of shares previously authorized and remaining available under the 1993 Plan. In June 2000, the Company adopted the 2000 Employee Stock Purchase Plan, which provides for the issuance of up to 900,000 shares.

The Company has elected to continue to apply Accounting Principle Board Opinion ("APB Opinion") No. 25, "Accounting for Stock Issued to Employees," in its employee stock-based compensation arrangements. Under APB Opinion No. 25, compensation cost is recognized based on the intrinsic value of the equity instrument awarded. Expense for common stock options granted to non-employees is recorded based upon the fair value of the equity instrument awarded calculated through the use of an option-pricing model.

During 1999 and the nine-months ended September 30, 2000, the Company issued common stock options at less than the fair value of its common stock. Accordingly, the Company recorded stock-based compensation expense of $44,000 and $488,000 for the three-month periods ended September 30, 1999 and September 30, 2000, and $70,000 and $1,239,000 for the nine-month periods ended September 30, 1999 and September 30, 2000, respectively. Stock-based compensation expense for the nine-month period ended September 30, 1999 was included in cost of goods sold, research and development and selling, general, and administrative expenses in the amounts of $1,000, $13,000 and $56,000, respectively. Stock-based compensation expense for the nine-month period ended September 30, 2000 was included in cost of goods sold, research and development, and selling, general, and administrative expenses in the amounts of $43,000, $233,000, and $963,000, respectively. As of September 30, 2000, the Company had $6.6 million in deferred stock compensation related to stock options, which will be recognized as stock-based compensation expense through 2004 as the amortization is based on the vesting period.

8. COMMITMENTS AND CONTINGENCIES

In August 2000, the Company entered into a Transition Agreement and Amended and Restated License Agreement with a supplier, requiring a total of $9.1 million in payments. $3.1 million was paid in August 2000 and the balance is owed based on various milestones through April 2001. Under the terms of the Agreements, the Company will acquire fixed assets and manufacturing technology, which will provide the Company with the ability to manufacture components previously purchased from the supplier. The Agreements require the Company to pay a per unit royalty fee over a seventeen-year period. As a result of these agreements, the Company and supplier mutually terminated any obligations under their prior agreements.

9. RELATED PARTY TRANSACTIONS

In 1999, the Company reacquired contractual marketing rights for certain territories from a shareholder. As part of the agreement, the Company paid $5.0 million in 1999 and $4.0 million in January 2000. In February 2000, the Company issued 1,250,000 shares of preferred stock with a fair value of $8.3 million as part of the consideration paid to reacquire the marketing rights. Because the stock issuance was part of the consideration, it was recorded at its fair value in accordance with SFAS 123. In addition, the agreement for the repurchase of the marketing rights provided for the acceleration of future royalty payments in the event of an initial public offering. In July 2000, the Company paid $11.0 million in royalty payments, consisting of $204,000 in previously recorded royalty liability and $10.8 million in accelerated royalty liability. As of September 30, 2000, the Company has recorded as an intangible asset $25.3 million reflecting the repurchase of the marketing rights, which are being amortized over the original agreement period of 6 years. The Company recorded $1.4 million and $2.8 million in amortization expense relating to this intangible asset to selling, general, and administrative expenses for the three-month and nine-month periods ended September 30, 2000, respectively.

During June and July 2000, the Company loaned an aggregate of $300,000 to two of its senior vice presidents. The loans are secured by deeds of trusts and bear interest at 6.80%. As of September 30, 2000, $300,000 of the principal amount of the loans were outstanding. The notes require repayment in four annual installments beginning in 2001.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Financial Statements and Notes thereto appearing elsewhere in this Form 10-Q and within Capstone's Registration Statement on Form S-1, File No. 333-33024. When used in the following discussion, the words "believes", "anticipates", "intends", "expects" and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those projected. These risks include those identified under "Risk Factors" in Capstone's Registration Statement on Form S-1, File No. 333-33024 and those identified at the end of this discussion in this filing. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof.

OVERVIEW

Capstone develops, manufactures and markets microturbine technology for use in stationary, combined heat and power generation, resource recovery, hybrid electric vehicle, and other power and heat applications in the multi-billion dollar market for distributed power generation. Our microturbines provide power at the site of consumption and to hybrid electric vehicles that combine a primary source battery with an auxiliary power source, such as a microturbine, to enhance performance. We believe the simple and flexible design of our microturbines will enable our distributors and end users to develop an increasingly broad range of applications to fit their particular power needs. Capstone expects its microturbines to provide the commercial power generation industry with clean, multifunctional, and scalable distributed power sources.

We began commercial sales of our units in 1998 targeting the emerging distributed generation industry that is being driven by fundamental changes in power requirements. We are currently focusing on strengthening our sales and marketing efforts, development of new products, acquisition of intellectual property rights and manufacturing facility expansion, which will result in higher operating expenses. We intend to achieve long-run profitability through production efficiencies and economies of scale. Specifically, we have consolidated our administrative and production operations into one building, we are entering into new supplier contracts to reduce overall unit costs and we are developing new higher profit margin products.

We sell complete microturbine units subassemblies and components. Our microturbines can be fueled by natural gas, propane, sour gas, kerosene and diesel. We will continue investing significant resources to develop new products and enhancements, including enhancements that enable greater kilowatt power production, additional fuel capabilities and additional distributed power generation solutions such as co-generation applications.

Since inception through September 30, 2000, we generated cumulative operating losses of approximately $141.5 million and we expect to continue to sustain operating losses through fiscal year 2001. Our sales cycles vary by application and geographic region, and in many cases require long lead times between identifying customer needs and providing commercially available solutions. As a result of anticipated increases in our operating expenses resulting from our expansion and the difficulty in forecasting revenue levels, we expect our quarterly performance to fluctuate. We are also a young company with respect to sales growth, and therefore period-to-period comparisons between years may not necessarily be meaningful.

THREE MONTHS ENDED SEPTEMBER 30, 2000 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 1999

Revenues. Revenues for the three-months ended September 30, 2000 increased $5.4 million to $6.2 million compared to $759,000 for the three months ended September 30, 1999. The increase in revenues is attributable to our expanding marketing efforts, which have resulted in a larger customer base. Revenues for the three-month periods ending September 30, 2000 and 1999 were derived primarily from unit sales of our 30-kilowatt product for various commercial applications and fuel types. In September 2000, we shipped our first 60-kilowatt unit. During the three months ended September 30, 2000, we shipped 211 units, an increase of 189 units over the 22 units we shipped in the three months ended September 30, 1999.

Gross Profit (Loss). Cost of goods sold includes direct material costs, assembly and testing, compensation and benefits, overhead allocations for facilities and administration, and warranty reserve charges. Our

gross loss for the three months ended September 30, 2000 decreased $176,000 to ($1.1) million compared to ($1.2) million for the three months ended September 30, 1999. Gross loss as a percentage of revenue declined as production overhead costs were allocated over larger volumes of production. Costs for replacement parts and systems are charged against our warranty reserve, which is accrued through charges to costs of goods sold. The warranty reserve charge increased $804,000 to $1.1 million for the three-months ended September 30, 2000 from $247,000 for the three months ended September 30, 1999 due to an increase in unit shipments. Warranty charges continued to decline on a per unit basis and we

reduced our per unit warranty charge during the third quarter of fiscal year 2000 based on our actual warranty loss experience.

Research and Development Expenses. Research and development expenses include compensation, the engineering department overhead allocations for administration and facilities, and material costs associated with development. Research and development expenses are for existing products line expansion and for next generation products. Research and development expenses for the three-months ended September 30, 2000 increased $694,000, or 31%, to $3.0 million compared to $2.3 million for the three-months ended September 30, 1999. Research and development expenses related primarily to the development of our 60-kilowatt unit and the broadening of our existing product line for new fuel types and applications.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses include compensation and related expenses in support of our general corporate functions, which include human resources, finance and accounting, information systems and legal services. Selling, general, and administrative expenses for the three months ended September 30, 2000 increased $4.5 million, or 162%, to $7.2 million compared to $2.7 million for the three months ended September 30, 1999. The Company continues to expand its selling and marketing efforts through increases in staff headcount and related overhead expenses, which contributed to most of the increases versus last year during the same period. We anticipate this trend to continue as we enter into new markets and develop sales and marketing programs. $444,000 of the increase is attributable to non-cash, stock-based compensation expense and $1.8 million to marketing rights amortization expense. Stock-based compensation expenses will continue at least through 2004, as the expense is based on the vesting period of the underlying instruments. Marketing rights amortization expenses will continue through 2005, as the expense is amortized over the original tenure of the contract.

Interest and Other Income (Expense). Interest and other income (expense) for the three months ended September 30, 2000 increased $3.2 million to $3.2 million compared to ($15,000) for the three months ended September 30, 1999. The increase is primarily attributable to higher interest income from higher average investment balances due to the funds received from the Series G preferred stock issuance in February 2000 and the initial public offering in July 2000.

NINE MONTHS ENDED SEPTEMBER 30, 2000 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 1999

Revenues. Revenues for the nine-months ended September 30, 2000 increased $14.7 million to $16.0 million compared to $1.3 million for the nine-months ended September 30, 1999. The increase in revenues is attributable to greater sales to a larger customer base, which has resulted from expanding our marketing efforts. Revenues for the nine-month periods ending September 30, 2000 and 1999 were derived almost entirely from unit sales of our 30-kilowatt products. These units were used for various commercial applications and operated using different fuel types. During the nine months ended September 30, 2000, we shipped 548 units, an increase of 508 units over the 40 units we shipped in the nine months ended September 30, 1999. Our backlog of orders at September 30, 2000 was 890 units, as compared to 173 units at September 30, 1999. In September, 2000, we shipped our first 60-kilowatt unit.

Gross Profit (Loss). Cost of goods sold includes direct material costs, assembly and testing, compensation and benefits, overhead allocations for facilities and administration, and warranty reserve charges. Our gross loss increased $1.3 million, or 39%, to ($4.6) million for the nine months ended September 30, 2000 from a gross loss of ($3.3) million for the nine months ended September 30, 1999. Gross loss as a percentage of revenue declined as production overhead costs were allocated over larger volumes of production. Costs for replacement parts and systems are charged against our warranty reserve, which is accrued through charges to costs of goods sold. The warranty reserve charge increased $3.5 million to $4.1 million for the nine months

ended September 30, 2000 from $622,000 for the nine months ended September 30, 1999 due to an increase in unit shipments. Warranty charges continued to decline on a per unit basis, as we reduced our per unit warranty charge based on our actual warranty loss experience.

Research and Development Expenses. Research and development expenses include compensation, the engineering department overhead allocations for administration and facilities, and material costs associated with development. Research and development expenses were for expanding the functionality of our 30-kilowatt family of products, development of the 60-kilowatt family of products and for next generation products. Research and development expenses for the nine months ended September 30, 2000 increased $1.7 million, or 26%, to $8.4 million compared to $6.7 million for the nine-months ended September 30, 1999.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses include compensation and related expenses in support of our general corporate functions, which include human resources, finance and accounting, information systems and legal services. Selling, general, and administrative expenses for the nine months ended September 30, 2000 increased $9.5 million, or 121%, to $17.3 million compared to $7.8 million for the nine months ended September 30, 1999. The primary cause of the increase was 15 new employees and general overhead associated with our growth. $1.2 million of the increase was attributable to non-cash, stock-based compensation expense and $2.8 million to marketing rights amortization expense relating to the repurchase of marketing rights from Fletcher Challenge Limited. Stock-based compensation expenses will continue at least through 2004, as the expense is based on the vesting period of the underlying instruments. Marketing rights amortization expenses will continue through 2005, as the expense is being amortized over the original tenure of the contract.

Interest and Other Income (Expense). Interest and other income (expense) consists primarily of interest income earned on our cash and cash equivalents and interest charges in connection with our capital leases. Interest and other income (expense) for the nine months ended September 30, 2000 increased $5.3 million to $5.2 million compared to ($108,000) for the nine months ended September 30, 1999. The increase is primarily attributable to higher interest income from higher average investment balances due to the funds received from our Series G preferred stock issuance in February 2000 and our initial public offering in July 2000.

LIQUIDITY AND CAPITAL RESOURCES

We expect to continue to devote substantial capital resources to the development of our sales and marketing programs, to expand our production facilities and staffing, and to expand our research and development activities. Cash flow from operations is likely to remain negative in the foreseeable future.

Our net cash used by operating activities was ($15.4) million for the nine months ended September 30, 2000 compared to ($20.0) million for the nine months ended September 30, 1999. Net cash used in investing activities was ($22.5) million for the nine months ended September 30, 2000 compared to net cash used by investing activities of ($2.0) million for the nine months ended September 30, 1999. Investing activities in 2000 primarily consisted of equipment purchases, leasehold improvements associated with our new facility, deposits on assets to be used in recuperator core production and the acquisition of marketing rights.

We have financed our operations and investing activities primarily through equity issuances. Our net cash provided by financing activities was $260.8 million for the nine months ended September 30, 2000, compared to $21.0 million for the nine months ended September 30, 1999. The primary source of cash provided by financing activities was from the issuance of Series G preferred stock and the issuance of common stock in our initial public offering. The cash provided by financing activities was partially reduced as we reacquired $15.5 million of Series E preferred stock as part of a stock repurchase and settlement agreement.

We have invested our cash in U.S. Government securities with maturities of less than 90 days and overnight government funds.

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

FOREIGN CURRENCY

We currently develop products in the United States and market our products

in North America, Europe and Asia. As a result, factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets could affect our financial results. As all of our sales and supplies are currently made in U.S. dollars, we do not utilize foreign exchange contracts to reduce our exposure to foreign currency fluctuations. We also have no foreign currency translations in our reported financial statements. In the future, as our customers and vendor bases expand, we anticipate that we will enter into transactions that are denominated in foreign currencies.

INTEREST

We have no long-term debt outstanding and do not use any derivative instruments.

INFLATION

We do not believe that inflation has had a material effect on our financial position or results of operations during the past three years. However, we cannot predict the future effects of inflation, including interest rate fluctuations and market fluctuations.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instrument and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments. It requires the recognition of all derivatives as either assets or liabilities in the statement of position and measurement of the instruments at fair value. We are required to adopt SFAS No. 133, as amended, on January 1, 2001 and we are currently evaluating the impact on the financial statements.

The Securities and Exchange Commission staff (the "Staff") issued Staff Accounting Bulletin Number 101 -- Revenue Recognition in Financial Statements ("SAB 101") in December 1999. There was no impact on the Company's operating results as a result of its adoption of SAB 101.

RISK FACTORS

WE HAVE A LIMITED OPERATING HISTORY CHARACTERIZED BY NET LOSSES, WE ANTICIPATE CONTINUED LOSSES THROUGH AT LEAST 2001 AND WE MAY NEVER BECOME PROFITABLE.

Since our inception in 1988, we have reported net losses for each year. Our net losses were $30.6 million in 1997, $33.1 million in 1998, $29.5 million in 1999, and $25.1 million for the nine-months ended September 30, 2000. We anticipate incurring additional net losses through at least 2001. Since inception through September 30, 2000, we have recorded cumulative losses of approximately $141.5 million. We have only been commercially producing Capstone Microturbines since December 1998 and have made only limited sales to date. Also, because we are in the early stages of selling our products, we have relatively few customers. Even if we do achieve profitability, we may be unable to increase our sales and sustain or increase our profitability in the future.

IF WE ARE UNABLE TO MANUFACTURE RECUPERATOR CORES INTERNALLY, OUR ASSEMBLY AND PRODUCTION OF MICROTURBINES MAY SUFFER DELAYS AND INTERRUPTIONS.

Solar Turbines Incorporated has been our sole supplier of recuperator cores, which are heat exchangers that preheat incoming air before it enters the combustion chamber and are an essential component of our microturbines. Solar is a wholly-owned subsidiary of Caterpillar Inc. At present we are not aware of any other suppliers which could produce these cores to our specifications within our time requirements. In September

2000, we exercised contractual rights to begin using Solar's intellectual property to manufacture recuperator cores ourselves. We estimate that the transition from purchasing recuperator cores from Solar to manufacturing them ourselves will take approximately nine to twelve months to complete. However, since we have never before manufactured recuperator cores, the transition period may be longer. We cannot assure you that this transition will be without disruption. Any delays or disruptions in this transition process may result in interruptions of assembly and shipment of our products. Also, we cannot assure you that Solar will honor the license agreement, that a court would enforce it,

or that we will be able to meet our obligations under it. If we had to develop and produce our own recuperator cores without using Solar's intellectual property, we estimate it could take up to three years to begin production.

WE MAY NOT BE ABLE TO CONTROL OUR WARRANTY EXPOSURE AND OUR WARRANTY RESERVE MAY NOT BE SUFFICIENT TO MEET OUR WARRANTY EXPENSE, WHICH COULD IMPAIR OUR FINANCIAL CONDITION.

We sell our products with warranties. However, these warranties vary from product to product with respect to the time period covered and the extent of the warranty protection. Malfunctions of our product could expose us to significant warranty expenses. Because we are in the early stages of production and few of our products have completed a full warranty term, we cannot be certain that we have adequately determined our warranty exposure. Moreover, as we develop new configurations for our microturbines or as our customers place existing configurations in commercial use for long periods of time, we expect to experience product malfunctions that cause our products to fall substantially below our 98% availability target level. While our microturbines have often achieved this availability target when using high pressure natural gas, we are still working to achieve this availability target across all of our units and for all fuel sources. We recorded a warranty reserve charge of $4.1 million or 26% of revenue for the nine months ended September 30, 2000 and $2.6 million or 39% of revenue for the year ended December 31, 1999. While management believes that the warranty reserve is reasonable, there can be no assurance that the reserve will be sufficient to cover our warranty expenses in the future. Although we attempt to reduce our risk of warranty claims through warranty disclaimers, we cannot assure you that our efforts will effectively limit our liability. Any significant incurrence of warranty expense could have a material adverse effect on our financial condition.

IF WE DO NOT EFFECTIVELY IMPLEMENT OUR SALES AND MARKETING EXPANSION PROGRAM, OUR SALES WILL NOT GROW AND OUR PROFITABILITY WILL SUFFER.

We need to increase our internal sales and marketing staff in order to enhance our sales efforts. We cannot assure you that the expense of such internal expansion will not exceed the net revenues generated, or that our sales and marketing team will successfully compete against the more extensive and well-funded sales and marketing operations of our current and future competitors. In addition, to grow our sales, we have begun to hire new management team members to provide more sales and marketing expertise. Since these management team members will not have a proven track record with us, we cannot assure you that they will be successful in overseeing their functional areas. Our inability to recruit, or our loss of, important sales and marketing personnel, or the inability of new sales personnel to effectively sell and market our microturbine system could materially adversely affect our business and results of operations.

WE MAY NOT BE ABLE TO ESTABLISH STRATEGIC MARKETING RELATIONSHIPS, IN WHICH CASE OUR SALES WOULD NOT INCREASE AS EXPECTED.

We are in the early stages of developing our distribution network. In order to expand our customer base, we believe that we must enter into strategic marketing alliances or similar collaborative relationships, in which we ally ourselves with companies that have particular expertise in or more extensive access to desirable markets. Providing volume price discounts and other allowances along with significant costs incurred in customizing our products may reduce the potential profitability of these relationships. We may not be able to identify appropriate distributors on a timely basis, and we cannot assure you that the distributors with which we partner will focus adequate resources on selling our products or will be successful in selling them. In addition, we cannot assure you that we will be able to negotiate collaborative relationships on favorable terms

or at all. The lack of success of our collaborators in marketing our products may adversely affect our financial condition and results of operations.

THE 60-KILOWATT CAPSTONE MICROTURBINE MAY NOT REACH THE LEVEL OF SALES THAT WE ANTICIPATE OR IT MAY ERODE SALES OF OUR 30-KILOWATT UNIT.

The successful launch of our next generation 60-kilowatt microturbine, the Capstone 60, is very important to our market penetration strategy. Factors that

could hinder the successful launch of our Capstone 60 microturbine include potential engineering, production or performance problems, including problems in developing the ability to operate on multiple fuels or in multiple modes of operation and an unstable supply or unsatisfactory quality of components from vendors. We cannot guarantee you that demand for our 60+ kilowatt unit will develop or that if it does develop, that it will not diminish over time. It is also possible that production of the 60-kilowatt unit could replace or diminish the sales of our 30-kilowatt unit. If so, our results of operations would be adversely affected.

WE MAY NOT BE ABLE TO EFFECTIVELY MANAGE OUR GROWTH OR IMPROVE OUR MANAGEMENT INFORMATION SYSTEMS, WHICH WOULD IMPAIR OUR PROFITABILITY.

If we are successful in executing our business plan, we will experience growth in our business that could place a significant strain on our management and other resources. Our ability to manage our growth will require us to continue to improve our operational, financial and management information systems, to implement new systems and to motivate and effectively manage our employees. We cannot assure that our management will be able to effectively manage this growth.

WE MAY NOT EFFECTIVELY EXPAND OUR PRODUCTION CAPABILITIES, WHICH WOULD NEGATIVELY IMPACT OUR SALES.

We anticipate a significant increase in our business operations, which will require expansion of our internal and external production capabilities. We may experience delays or problems in our expected production expansion that could significantly impact our business. Several factors could delay or prevent our expected production expansion, including our:

- *inability to purchase parts or components in adequate quantities or sufficient quality;*
- *failure to increase our assembly and test operations;*
- *failure to hire and train additional personnel;*
- *failure to develop and implement manufacturing processes and equipment;*
- *inability to find and train proper partner companies in other countries with whom we can build product distribution, marketing, or development relationships; and*
- *inability to acquire new space for additional production capacity.*

OUR SUPPLIERS AND MANUFACTURERS MAY NOT SUPPLY US WITH A SUFFICIENT AMOUNT OF COMPONENTS OR COMPONENTS OF ADEQUATE QUALITY, AND WE MAY NOT BE ABLE TO PRODUCE OUR PRODUCT.

Although we generally attempt to use standard parts and components for our products, some of our components are currently available only from a single source or from limited sources. Also, we cannot guarantee that any of the parts or components that we purchase will be of adequate quality or that the prices we pay for these parts or components will not increase. We may experience delays in production of our Capstone Microturbines if we fail to identify alternate vendors, or any parts supply is interrupted or reduced or there is a significant increase in production costs, each of which could materially adversely affect our business and operations.

OUR PRODUCTS INVOLVE A LENGTHY SALES CYCLE AND WE MAY NOT ANTICIPATE SALES LEVELS APPROPRIATELY, WHICH COULD IMPAIR OUR PROFITABILITY.

The sale of our products typically involves a significant commitment of capital by customers, with the attendant delays frequently associated with large capital expenditures. We are targeting, in part, customers in the utility industry, which generally commit to a larger number of products when ordering and which have a lengthy process for approving capital expenditures. We have also targeted the hybrid electric vehicle market, which requires a significant amount of lead-time due to implementation costs incurred. For these and other reasons, the sales cycle associated with our products is typically lengthy and subject to a number of significant risks over which we have little or no

control. We expect to plan our production and inventory levels based on internal forecasts of customer demand, which is highly unpredictable and can fluctuate substantially. If sales in any period fall significantly below anticipated levels, our financial condition and results of operations could suffer. In addition, our operating expenses are based on anticipated sales levels, and a high percentage of our expenses are generally fixed in the short term. As a result of these factors, a small fluctuation in timing of sales can cause operating results to vary from period to period.

Because we are in the early stages of selling our products, with relatively few customers, we expect our order flow to continue to be uneven from period to period. Because a significant portion of our expenses are fixed, a small variation in the timing of recognition of revenue can cause significant variations in operating results from quarter to quarter.

POTENTIAL INTELLECTUAL PROPERTY, SHAREHOLDER OR OTHER LITIGATION MAY ADVERSELY IMPACT OUR BUSINESS.

Because of the nature of our business, we may face litigation relating to intellectual property matters, labor matters, product liability and shareholder disputes. Any litigation could be costly, divert management attention or result in increased costs of doing business. Although we intend to vigorously defend any future lawsuits, we cannot assure you that we would ultimately be successful. An adverse judgment could negatively impact the price of our common stock and our ability to obtain future financing on favorable terms or at all.

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On June 28, 2000 the Commission declared effective Registration Statement (Registration Statement No. 333-33024) as filed with the Commission in connection with our initial public offering of Common Stock, which was managed by Goldman, Sachs & Co., Merrill Lynch & Co., and Morgan Stanley Dean Witter. Pursuant to such Registration Statement, on July 5, 2000 we consummated the issuance and sale of an aggregate of 10,454,545 shares our Common Stock, for a gross aggregate offering price of $167.3 million. We incurred underwriting commissions of approximately $11.7 million and other expenses of approximately $2.0 million.

From the date of receipt through September 30, 2000, the net proceeds of our initial public offering were used to fund operating losses, the repurchase of marketing rights from Fletcher Challenge Limited, capital expenditures and for general corporate purposes. With the exception of marketing rights acquired from Fletcher Challenge Limited for $11,000,000, none of the net proceeds of the offering were paid, directly or indirectly, to any director or officer of Capstone or any of their associates, or to persons owning ten percent or more of any class of our equity securities, or any affiliates.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K:

EXHIBIT 27.1 -- Financial Data Schedule.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CAPSTONE TURBINE CORPORATION

By: /s/ JEFFREY WATTS

Jeffrey Watts,
Senior Vice President Finance and Administration
and Chief Financial Officer

Date: October 24, 2000

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