UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2008

or

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

For the transition period from to

Commission file number: 001-15957

Capstone Turbine Corporation

(Exact name of registrant as specified in its charter)

Delaware	**95-4180883**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

21211 Nordhoff Street, Chatsworth, California 91311
(Address of principal executive offices and 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 ☐

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

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

The number of shares outstanding of the registrant's common stock as of January 31, 2009 was 173,968,096.

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PART I — FINANCIAL INFORMATION

Item 1. ***Financial Statements***

CAPSTONE TURBINE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)
(Unaudited)

	December 31, 2008	March 31, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 24,388	$ 42,605
Accounts receivable, net of allowance for doubtful accounts and sales returns of $686 at December 31, 2008 and $629 at March 31, 2008	13,184	6,768
Inventories	29,766	14,472
Prepaid expenses and other current assets	1,577	1,614
Total current assets	68,915	65,459

Property, plant and equipment, net	8,385	5,536
Non-current portion of inventories	3,534	2,221
Intangible asset, net	423	624
Other assets	219	206
Total	$ 81,476	$ 74,046
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and accrued expenses	$ 10,858	$ 7,964
Accrued salaries and wages	1,737	1,519
Accrued warranty reserve	3,254	4,591
Deferred revenue	1,033	780
Current portion of notes payable	16	13
Other current liabilities	2,558	5,658
Total current liabilities	19,456	20,525
Long-term portion of notes payable	30	5
Other long-term liabilities	337	463
Commitments and contingencies (Note 11)	—	—
Stockholders' Equity:		
Preferred stock, $.001 par value; 10,000,000 shares authorized; none issued	—	—
Common stock, $.001 par value; 415,000,000 shares authorized; 174,751,857 shares issued and 173,968,096 shares outstanding at December 31, 2008; 148,238,852 shares issued and 147,578,311 shares outstanding at March 31, 2008	175	148
Additional paid-in capital	665,556	626,952
Accumulated deficit	(603,146)	(573,383)
Treasury stock, at cost; 783,761 shares at December 31, 2008 and 660,541 shares at March 31, 2008	(932)	(664)
Total stockholders' equity	61,653	53,053
Total	$ 81,476	$ 74,046

See accompanying notes to condensed consolidated financial statements.

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CAPSTONE TURBINE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
Revenue	$ 11,482	$ 9,217	$ 32,127	$ 22,051
Cost of goods sold	12,083	9,257	34,550	25,320
Gross loss	(601)	(40)	(2,423)	(3,269)
Operating expenses:				
Research and development	2,048	1,761	6,049	6,943
Selling, general and administrative	7,441	6,462	21,699	18,263
Total operating expenses	9,489	8,223	27,748	25,206
Loss from operations	(10,090)	(8,263)	(30,171)	(28,475)
Interest income	135	575	490	1,931
Loss before income taxes	(9,955)	(7,688)	(29,681)	(26,544)
Provision for income taxes	80	—	82	2
Net loss	$ (10,035)	$ (7,688)	$ (29,763)	$ (26,546)
Net loss per common share — Basic and Diluted	$ (0.06)	$ (0.05)	$ (0.18)	$ (0.18)
Weighted average shares used to calculate Basic and Diluted net loss per common share	173,851	145,512	161,277	144,978

See accompanying notes to condensed consolidated financial statements.

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CAPSTONE TURBINE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)
(Unaudited)

	Nine Months Ended December 31, 2008	2007
Cash Flows from Operating Activities:		
Net loss	$ (29,763)	$ (26,546)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,056	1,660
Provision for allowance for doubtful accounts and sales returns	57	30
Inventory write-down	555	712
Provision for warranty expenses	(477)	659
Loss on disposal of equipment	5	17
Stock-based compensation	2,659	2,304
Changes in operating assets and liabilities:		
Accounts receivable	(6,473)	(3,306)
Inventories	(17,162)	4,987
Prepaid expenses and other assets	24	(10)
Accounts payable and accrued expenses	3,193	(1,754)
Accrued salaries and wages and long term liabilities	92	(216)
Accrued warranty reserve	(860)	(1,898)
Deferred revenue	253	(126)
Other current liabilities	(3,100)	4,848
Net cash used in operating activities	(48,941)	(18,639)
Cash Flows from Investing Activities:		
Acquisition of and deposits on equipment and leasehold improvements	(4,988)	(549)
Proceeds from disposal of equipment	20	3
Net cash used in investing activities	(4,968)	(546)
Cash Flows from Financing Activities:		
Repayment of notes payable	(12)	(24)
Net proceeds from employee stock-based transactions	2,144	1,556
Net proceeds from issuance of common stock and warrants	29,436	—
Proceeds from exercise of common stock warrants	4,124	—
Net cash provided by financing activities	35,692	1,532
Net Decrease in Cash and Cash Equivalents	(18,217)	(17,653)
Cash and Cash Equivalents, Beginning of Period	42,605	60,322
Cash and Cash Equivalents, End of Period	$ 24,388	$ 42,669
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 2	$ 5
Income taxes	$ 2	$ 2

Supplemental Disclosures of Non-Cash Information:

During the nine months ended December 31, 2008 and 2007, the Company purchased on account $197 and $98 of fixed assets, respectively.

During the nine months ended December 31, 2008, the Company purchased fixed assets with a note payable of $40.

See accompanying notes to condensed consolidated financial statements.

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CAPSTONE TURBINE CORPORATION
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 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") for interim financial information and with 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, 2008 was derived from audited financial statements included in the Company's Annual Report on Form 10-K for the year ended March 31, 2008. 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, 2008. 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. As of December 31, 2008, the Company had $57.0 million, or 567 units, in backlog, of which $53.2 million, or 512 units, are 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. The Company believes that existing cash and cash equivalents are sufficient to meet the Company's anticipated cash needs for working capital and capital expenditures for at least the next twelve months. However, based on the Company's cash usage over the last twelve months and if anticipated cash needs of the Company change, it is possible, if not likely, that the Company may need or elect to raise additional funds to fund its activities. A significant use of cash in the third quarter of Fiscal 2009 was attributable to the timing of shipments and the delivery and payment of inventory purchases with long lead times. Based on the current estimated inventory delivery schedules, scheduled inventory purchases for the fourth quarter of Fiscal 2009 are currently $12.7 million. However, we are in the process of rescheduling the timing of certain deliveries from suppliers and expect inventory deliveries to decrease during the fourth quarter of Fiscal 2009. As a result, we expect total inventory levels to decrease by the end of Fiscal 2009. Therefore, anticipated cash needs of the Company may change based on the Company's ability to manage inventory costs and the timing of inventory purchases and deliveries. The Company could seek to raise such funds by selling additional securities to the public or to selected investors, or by obtaining debt financing. The Company cannot be assured that it will be able to obtain additional funds on commercially favorable terms, or at all, especially given the state of worldwide capital markets. 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, 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.

3. Recently Issued Accounting Standards

In May 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 162 "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles. SFAS No. 162 became effective as of November 15, 2008. This standard is not expected to have an impact on the Company's consolidated financial position or results of operations.

In April 2008, the FASB issued FASB Staff Position ("FSP") No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). FSP 142-3 removes the requirement of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. The intent of FSP 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations," ("SFAS No. 141(R)") and other U.S. generally accepted accounting principles. FSP 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity considers its own experience in renewing similar arrangements. FSP 142-3 applies to all intangible assets, whether acquired in a business combination or otherwise and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and applied prospectively to intangible assets acquired after the effective date. The Company is currently evaluating the requirements of this standard; however, this standard is not expected to have a material impact on the Company's consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), which changes accounting principles for business acquisitions. SFAS No. 141(R) requires the recognition of all the assets acquired and liabilities assumed in the transaction based on the acquisition-date fair value. Certain provisions of this standard will, among other things, impact the determination of consideration paid or payable in a business combination and change accounting practices for transaction costs, acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. SFAS No. 141(R) is effective for business combinations and adjustments to all acquisition-related deferred tax asset and liability balances occurring after December 15, 2008. Adoption of this standard has not had an impact on the Company's consolidated financial position or results of operations. Adoption of this statement is, however, expected to have a significant effect on how acquisition transactions, subsequent to March 31, 2009, are reflected in the financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51" ("SFAS No. 160"). This statement establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This standard is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the requirements of this standard; however, this standard is not expected to have an impact on the Company's consolidated financial position or results of operations.

In January 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value, with the objective of mitigating volatility in reported earnings caused by measuring related assets and liabilities differently (without being required to apply complex hedge accounting provisions), amends SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" and expands disclosures related to the use of fair value measures in financial statements. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company adopted SFAS No. 159 with no impact on its consolidated financial position or results of operations.

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In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. While SFAS No. 157 did not impact the Company's valuation methods, it expanded disclosures of assets and liabilities that are recorded at fair value. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company adopted this standard in Fiscal 2009, and the adoption did not impact the Company's consolidated financial position or results of operations. On April 1, 2009, the Company will implement the previously-deferred provisions of SFAS No. 157 for nonfinancial long-lived assets or asset groups measured at fair value for an impairment assessment under FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" as required. The Company does not believe that the remaining provisions will have an impact on the Company's consolidated financial position or results of operations when they are implemented.

4. Customer Concentrations and Accounts Receivable

Individually, two customers accounted for 18% and 15% of revenue, respectively, for the three months ended December 31, 2008, totaling approximately 33% of revenue. For the three months ended December 31, 2007, three customers accounted for 25%, 16% and 12% of revenue, respectively, totaling approximately 53% of revenue.

Individually, two customers accounted for 14% and 11% of revenue, respectively, for the nine months ended December 31, 2008, totaling approximately 25% of revenue. For the nine months ended December 31, 2007, three customers accounted for 16%, 14% and 11% of revenue, respectively, totaling approximately 41% of revenue.

Individually, two customers accounted for 25% and 10% of net accounts receivable, respectively, as of December 31, 2008, totaling approximately 35% of net accounts receivable. Two customers accounted for 33% and 11%, respectively, of net accounts receivable as of March 31, 2008, totaling approximately 44%.

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:

	December 31, 2008	March 31, 2008
	(In thousands)	
Raw materials	$ 30,359	$ 15,516
Work in process	167	236
Finished goods	2,774	941
Total	33,300	16,693
Less non-current portion	(3,534)	(2,221)
Current portion	$ 29,766	$ 14,472

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:

	December 31, 2008	March 31, 2008
	(In thousands)	
Machinery, equipment and furniture	$ 22,226	$ 18,727
Leasehold improvements	9,398	8,753
Molds and tooling	4,133	3,805
	35,757	31,285
Less accumulated depreciation and amortization	(27,372)	(25,749)
Total property, plant and equipment, net	$ 8,385	$ 5,536

7. Intangible Asset

The Company's sole intangible asset is a manufacturing license. The gross carrying amount is $3.7 million. The balance of the intangible asset was $0.4 million and $0.6 million as of December 31 and March 31, 2008, respectively. The intangible asset is being amortized over its estimated useful life of ten years. The Company recorded amortization expense of $67,000 and $0.2 million for each of the three months and nine months ended December 31, 2008 and 2007, respectively. The manufacturing license is scheduled to be fully amortized by Fiscal 2011 with corresponding amortization estimated to be $67,000 for the remainder of Fiscal 2009, $0.3 million for Fiscal 2010, and $0.1 million for Fiscal 2011.

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 $13,400 and $12,000 were earned by the supplier for the three months ended December 31, 2008 and 2007, respectively. Royalties of $39,700 and $29,000 were earned by the supplier for the nine months ended December 31, 2008 and 2007, respectively. Earned royalties of $13,400 and $14,300 were unpaid as of December 31, 2008 and March 31, 2008, respectively, and are included in accrued expenses in the accompanying balance sheets.

8. Stockholders' Equity

Stock-Based Compensation

As of December 31, 2008, the Company had outstanding 4,200,000 non-qualified common stock options issued outside of the Amended and Restated 2000 Equity Incentive Plan ("2000 Plan"). These stock options were granted at exercise prices equal to the fair market value of the Company's common stock on the grant date as inducement grants to new executive officers and employees of the Company. Included in the 4,200,000 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, 500,000 options granted to the Company's former Senior Vice President of Operations and 200,000 options granted to the Company's Senior Vice President of Human Resources and Information Technology. Additionally, the Company had outstanding 512,500 restricted stock units issued outside of the 2000 Plan. These restricted stock units were issued as inducement grants to new officers of the Company. Included in the 512,500 units were 250,000 units granted to the Company's President and Chief Executive Officer, 150,000 units granted to the Company's Executive Vice President of Sales and Marketing, and 112,500 granted to the Company's Senior Vice President of Customer Service. Although the options and units were not granted under the 2000 Plan, they are governed by terms and conditions identical to those under the 2000 Plan. All options granted outside of the plan 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

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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 issued outside of the plan vest in equal installments over a period of four years. The four year vesting occurs as follows: one-fourth vests one year after the issuance date and one-fourth vests on the first day of each full year thereafter, so that all shall be vested on the completion of the fourth year after the issuance date.

Valuation and Expense Information under SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)")

For the three months ended December 31, 2008 and 2007, the Company recognized stock-based compensation expense of $0.8 million and $0.9 million, respectively. For the nine months ended December 31, 2008 and 2007, the Company recognized stock-based compensation expense of $2.6 million and $2.3 million, respectively. The following table summarizes, by statement of operations line item, stock-based compensation expense (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
Cost of goods sold	$ 123	$ 111	$ 378	$ 307
Research and development	150	152	469	415
Selling, general and administrative	602	638	1,812	1,582
Stock-based compensation expense	$ 875	$ 901	$ 2,659	$ 2,304

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 December 31,		Nine Months Ended December 31,	
	2008	2007	2008	2007
Risk-free interest rates	1.9%	4.2%	1.9%	4.5%
Expected lives (in years)	4.9	8.8	4.9	6.5
Dividend yield	—%	—%	—%	—%
Expected volatility	98.1%	97.4%	98.1%	99.2%

The Company's computation of expected volatility for the three months and nine months ended December 31, 2008 and 2007 was based on historical volatility. The Company estimated the expected life of each stock option granted in the three months and nine months ended December 31, 2007 using the simplified method permissible under Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB 107"), which utilizes the weighted average expected life of each tranche of the stock option, determined based on the sum of each tranche's vesting period plus one-half of the period from the vesting date of each tranche to the stock option's expiration. For options granted after December 31, 2007, the expected life, or term, of options granted is derived from historical exercise behavior and represents the period of time that stock option awards are expected to be outstanding. The Company has selected a risk-free rate based on the implied yield available on U.S. Treasury Securities with a maturity equivalent to the options' expected term. Included in the calculation is the Company's estimated forfeiture rate. SFAS No. 123(R) requires that equity-based compensation expense be based on awards that are ultimately expected to vest and accordingly, equity-based compensation recognized in the three and nine months ended December 31, 2008 and 2007 has been reduced by estimated forfeitures. The Company's estimate of forfeitures is based on historical forfeitures.

Information relating to all outstanding stock options, except for rights associated with the 2000 Employee Stock Purchase Plan, is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Options outstanding at March 31, 2008	9,182,923	$ 1.89		
Granted	1,155,000	1.06		
Exercised	(1,142,395)	2.05		
Forfeited	(122,000)	1.59		
Expired	(178,321)	1.81		
Options outstanding December 31, 2008	8,895,207	$ 1.77	7.74	$ 11,102
Options exercisable at December 31, 2008	4,476,971	$ 2.23	6.88	$ 11,102
Options fully vested at December 31, 2008 and those expected to vest beyond December 31, 2008	8,022,102	$ 1.84	7.61	$ 11,102

The weighted average per share grant date fair value of options granted during the three months ended December 31, 2008 and 2007 was $0.69 and $1.04, respectively. The weighted average per share grant date fair value of options granted during the nine months ended December 31, 2008 and 2007 was $0.78 and $0.86, respectively. There were no options exercised during the three months ended December 31, 2008 and 2007. The total intrinsic value of options exercised during the nine months ended December 31, 2008 and 2007 was approximately $1.3 million and $0.2 million, respectively. As of December 31, 2008, there was approximately $4.2 million of total compensation cost related to nonvested stock option awards not yet recognized. It is expected to be recognized over a weighted average period of 2.6 years.

During the nine months ended December 31, 2008, the Company issued 53,877 shares of stock to non-employee directors in lieu of cash for those directors who elected to take payment of all or any part of their directors' fees in stock. The shares of stock were valued based on the closing price of the Company's common stock on the date of grant, and the weighted average grant date fair value for these shares was $1.43.

A summary of restricted stock unit activity for the nine months ended December 31, 2008 is as follows:

	Shares		Weighted Average Grant-Date Fair Value
Nonvested restricted stock units outstanding at March 31, 2008	2,296,638	$	1.19
Granted	1,310,597		1.28
Vested and issued	(603,519)		1.92
Forfeited	(137,881)		1.26
Nonvested restricted stock units outstanding at December 31, 2008	2,865,835	$	1.08
Restricted stock units expected to vest beyond December 31, 2008	2,062,861		

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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 such units vest one year after the issuance date and the other half vest two years after the issuance date. For restricted stock units with four year vesting, one-fourth vest annually beginning one year after the issuance date. The restricted stock units were valued based on the closing price of the Company's common stock on the date of issuance, and compensation cost is recorded on a straight-line basis over the vesting period. The related compensation expense recognized has been reduced by estimated forfeitures. The Company's estimate of forfeitures is based on historical forfeitures.

The total fair value of restricted stock units vested and issued by the Company during the three months ended December 31, 2008 and 2007 was approximately $0.4 million and $0.2 million, respectively. The total fair value of restricted stock units vested and issued by the Company during the nine months ended December 31, 2008 and 2007 was approximately $1.2 million and $0.3 million, respectively. The Company recorded expense of approximately $0.2 million associated with its restricted stock awards for each of the three months ended December 31, 2008 and 2007. The Company recorded expense of approximately $0.6 million and $0.4 million associated with its restricted stock awards and units during the nine months ended December 31, 2008 and 2007, respectively. As of December 31, 2008, there was approximately $2.3 million of total compensation cost related to nonvested restricted stock units not yet recognized. It is expected to be recognized over a weighted average period of 3.06 years.

Registered Direct Offerings and Placements of Common Stock

Effective September 23, 2008, the Company completed a registered direct placement in which it sold 21.5 million shares of the Company's common stock, par value $.001 per share, and warrants to purchase 6.4 million shares of common stock with an initial exercise price of $1.92 per share, at a price of $14.90 per unit. Each unit consisted of ten shares of common stock and warrants to purchase three shares of common stock. The five-year warrants are immediately exercisable and include anti-dilution provisions, subject to certain limitations. Additionally, the Company has the right, at its option, to accelerate the expiration of the exercise period of the outstanding warrants issued in the offering, in whole or from time to time in part, at any time after the second anniversary of the original issue date of the warrants, subject to certain limitations. The sale resulted in gross proceeds of $32.0 million and proceeds net of direct incremental costs of the offering of $29.5 million. During the nine months ended December 31, 2008, none of the warrants issued in September 2008 were exercised. Warrants to purchase 6.4 million shares were outstanding as of December 31, 2008.

Effective January 24, 2007, the Company completed a registered direct placement in which it sold 40 million shares of the Company's common stock, par value $.001 per share, and warrants to purchase 20 million shares of common stock with an initial exercise price of $1.30 per share, at a price of $1.14 per unit. Each unit consisted of one share of common stock and warrants to purchase 0.5 shares of common stock. The five-year warrants are immediately exercisable and include anti-dilution provisions, subject to certain limitations. During the nine months ended December 31, 2008, warrants to purchase 3.2 million shares were exercised resulting in proceeds of $4.1 million. No warrants were exercised during the same period last year. Warrants to purchase 15.3 million and 18.5 million shares were outstanding as of December 31 and March 31, 2008, respectively.

9. Accrued Warranty Reserve

The Company provides for the estimated costs of warranties at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the product sold, geography of sale and the length of extended warranties sold. The Company's product warranties generally start from the delivery date and continue for up to eighteen months. Factors that affect the Company's warranty obligation include product failure rates, anticipated hours of product operations and costs of repair or replacement in correcting product failures. These factors are estimates that may change based on new information that becomes available each period. Similarly, the Company also accrues the estimated costs to address reliability repairs on products no longer in warranty when, in the Company's judgment, and in accordance with a specific plan developed by the Company, it is prudent to provide such repairs. The Company assesses the adequacy of recorded warranty liabilities quarterly and makes adjustments to the liability as necessary. When the Company has sufficient evidence that product changes are altering the historical failure occurrence rates, the impact of such changes is then taken into account in estimating future warranty liabilities.

Changes in accrued warranty reserve during the nine months ended December 31, 2008 are as follows:

		(In thousands)
Balance, March 31, 2008	$	4,591
Warranty provision relating to products shipped during the period		267
Changes for accruals related to preexisting warranties or reliability repair programs		(744)
Deductions for warranty claims		(860)
Balance, December 31, 2008	$	3,254

10. Other Current Liabilities

In September 2007, the Company entered into a Development and License Agreement (the "Development Agreement") with UTC Power Corporation ("UTCP"). The Development Agreement engages UTCP to fund and support the Company's continued development and commercialization of the Company's 200 kilowatt ("kW") microturbine product, the C200. Pursuant to the terms of the Development Agreement, UTCP agreed to contribute $12.0 million in cash and approximately $800,000 of in-kind services toward the Company's efforts to develop the C200. In return, the Company agreed to pay to UTCP an ongoing royalty of 10% of the sales price of the C200 sold to customers other than UTCP until the aggregate of UTCP's cash and in-kind services investment has been recovered and, thereafter, the royalty will be reduced to 5% of the sales price. UTCP earned $71,700 in royalties for C200 system sales for the three months ended December 31, 2008. During the three months ended December 31, 2007, no royalties were earned by UTCP. Royalties of $71,700 were unpaid as of December 31, 2008 and are included in accrued expenses in the accompanying balance sheet. The Company received $1.5 million upon the signing of the Development Agreement in September 2007. During the year ended March 31, 2008, the Company achieved three of the development milestones and received $2.0 million for the systems requirements review, $2.5 million for the preliminary design review, and $2.5 million for the critical design review. During the three months ended June 30, 2008, the Company achieved the physical verification development milestone and received $0.5 million. During the three months ended September 30, 2008, the Company achieved the microturbine build completion milestone and received $1.5 million. During the three months ended December 31, 2008 the Company completed 90% of the qualification results milestone and received $1.0 million. The Company is scheduled to receive the remaining $0.5 million at completion of the qualification results milestone. As of December 31, 2008, the Company received $11.5 million and offset approximately $8.9 million of research and development ("R&D") expenses with this funding. The remaining $2.6 million is recorded in other current liabilities in the accompanying condensed consolidated balance sheet. The Company records the benefits from this Development Agreement as a reduction of R&D expenses. There were approximately $2.0 million and $0.9 million of such benefits for the three months ended December 31, 2008 and 2007, respectively, which included $0.2 million of in-kind services performed by UTCP under the cost-sharing program for the three months ended December 31, 2008. For the nine months ended December 31, 2008 and 2007, the Company recognized approximately $6.5 million and $1.1 million of such benefits, respectively, which included $0.5 million of in-kind services performed by UTCP under the cost-sharing program for the nine months ended December 31, 2008. In-kind services performed by UTCP under the cost-sharing program are recorded as consulting expense within R&D expenses. No such services were provided during the three and nine months ended December 31, 2007. The reduction of R&D expenses is recognized on a percentage of completion basis, limited by the amount of funding received and/or earned based on milestone deliverables. If the Company fails to complete the development and commercialization of the C200, UTCP will receive a non-exclusive, perpetual, world-wide license to the C200 and the Company would receive royalty payments of 3% per unit of the burdened manufacturing cost for C200s sold by UTCP.

11. Commitments and Contingencies

Operating Lease Commitments

The Company leases offices and manufacturing facilities under various non-cancelable operating leases expiring at various times through the year ending March 31, 2011. All of the leases require the Company to pay maintenance, insurance and property taxes. The lease agreements for primary office and manufacturing facilities provide for rent escalation over the lease term and renewal options for five year periods. Rent expense is recognized on a straight-line basis over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent which is included in Other Long-Term Liabilities in the accompanying consolidated balance sheets. Deferred rent amounted to $0.3 million and $0.5 million at December 31, 2008 and March 31, 2008, respectively.

Purchase Commitments

As of December 31, 2008, the Company had firm commitments to purchase inventories of approximately $23.9 million through Fiscal 2011. Based on the current estimated inventory delivery schedules, scheduled inventory purchases for the fourth quarter of Fiscal 2009 currently total $12.7 million. However, the Company is in the process of rescheduling the timing of certain deliveries from suppliers and expects inventory deliveries to decrease during the fourth quarter of Fiscal 2009. Certain inventory delivery dates and related payments are not firmly scheduled; therefore amounts under these firm purchase commitments will be payable concurrent with the receipt of the related inventories.

Legal Matters

In December 2001, a purported shareholder class action lawsuit was filed in the United States District Court for the Southern District of

New York (the "District Court") against the Company, two of its then officers, and the underwriters of the Company's initial public offering. The suit purports to be a class action filed on behalf of purchasers of the Company's common stock during the period from June 28, 2000 to December 6, 2000. An amended complaint was filed on April 19, 2002. The Plaintiffs allege that the underwriter defendants agreed to allocate stock in the Company's June 28, 2000 initial public offering and November 16, 2000 secondary offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. The Plaintiffs allege that the prospectuses for these two public offerings were false and misleading in violation of the securities laws because they did not disclose these arrangements. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998; the complaints have been consolidated into an action captioned In re Initial Public Offering Securities Litigation, No. 21 MC 92. On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all the actions, including the action involving the Company. On July 15, 2002, the Company, along with other non-underwriter defendants in the coordinated cases, moved to dismiss the litigation. On October 9, 2002, the Plaintiffs dismissed, without prejudice, the claims against the named officers and directors in the action against the Company. On February 19, 2003, the District Court issued an order denying the motion to dismiss the claims against the Company under Rule 10b-5. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including the Company. In June 2004, a committee of our Board of Directors approved a proposed partial settlement with the plaintiffs in this matter. A stipulation of partial settlement and release of claims against the issuer defendants and the issuer officers and directors named as defendants was submitted to the District Court for preliminary approval in June 2004. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005, the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The settlement fairness hearing occurred on April 24, 2006, and the District Court reserved decision at that time. While the partial settlement was pending approval, the Plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of "focus cases" rather than all of the 310 cases that had been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied the Plaintiffs' petition for rehearing. In light of the Second Circuit opinion, liaison counsel for all issuer defendants, including the Company, informed the District Court that this settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 25, 2007, the District Court entered an order terminating the proposed settlement. On August 14, 2007, the Plaintiffs filed their second consolidated amended complaints against the six focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008. On December 28, 2007, the underwriter defendants moved to strike class allegations in 26 cases, including the

Company's, in which the Plaintiffs failed to identify proposed class representatives, and the issuer defendants joined in the motion. On May 13, 2008, the District Court granted the motion in part and struck the class allegations in eight cases in which the proposed class representative was not a member of the class. The District Court denied the motion with respect to the remaining 18 cases, including the Company's case. For those 18 cases, the Plaintiffs must notify the Defendants and the District Court of the identity of the putative class representatives and the basis of each putative representative's claim, and indicate whether the putative representatives are members of the proposed class. The deadline for the Plaintiffs to provide this information was January 30, 2009, but the Plaintiffs have asked the District Court for additional time. The Defendants may renew their motion to strike class allegations if the Plaintiffs fail to identify the putative class representatives within the allocated time or if the putative representatives are not members of the proposed class. Because of the inherent uncertainties of litigation, the ultimate outcome of the matter is uncertain.

On October 9, 2007, Vanessa Simmonds, a purported stockholder of the Company, filed suit in the U.S. District Court for the Western District of Washington against The Goldman Sachs Group, Inc., Merrill Lynch & Co., Inc., and Morgan Stanley, the lead underwriters of the Company's initial public offering in June 1999, and the secondary offering of common stock in November 2000, alleging violations of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The complaint seeks to recover from the lead underwriters any "short-swing profits" obtained by them in violation of Section 16(b). The suit names the Company as a nominal defendant, contains no claims against the Company, and seeks no relief from the Company. Simmonds filed an Amended Complaint on February 27, 2008 (the "Amended Complaint"), naming as defendants Goldman Sachs & Co. and Merrill Lynch Pierce, Fenner & Smith Inc. and again naming Morgan Stanley. The Amended Complaint asserts substantially similar claims as those set forth in the initial complaint. On July 25, 2008, the Company joined with 29 other issuers to file the Issuer Defendants' Joint Motion to Dismiss. Underwriter Defendants also filed a Joint Motion to Dismiss on July 25, 2008. Plaintiff filed oppositions to both motions on September 8, 2008. All replies in support of the motions to dismiss were filed on October 23, 2008. Oral argument on the motions to dismiss was held on January 16, 2009. The Judge has stayed discovery pursuant to the Private Securities Litigation Reform Act (PSLRA) until he rules on all motions to dismiss. Because of the inherent uncertainties of this litigation, the Company cannot accurately predict the ultimate outcome of the matter.

From time to time, the Company may become subject to additional legal proceedings, claims and litigation arising in the ordinary course of business. Other than the matters discussed above, the Company is not a party to any other material legal proceedings, nor is the Company aware of any other pending or threatened litigation that would have a material adverse effect on the Company's business, operating results, cash flows or financial condition should such litigation be resolved unfavorably.

12. Related Party Transactions

Mr. Eliot Protsch is the Chairman of the Company's Board of Directors. Mr. Protsch is Senior Executive Vice-President and Chief Financial Officer of Alliant Energy Corporation. Alliant Energy Resources, Inc. ("Alliant"), a subsidiary of Alliant Energy Corporation, was a distributor for the Company. The Company purchased $0.1 million of inventory from Alliant during the three months ended June 30, 2007. This amount was paid as of September 30, 2007. There have been no other transactions between the Company and Alliant during Fiscal 2008 or Fiscal 2009.

13. Net Loss Per Common Share

Basic loss per share of common stock is computed using the weighted average number of common shares outstanding for the period. Diluted loss per share is also computed without consideration to potentially dilutive instruments because the Company incurred losses in the periods covered by this Form 10-Q which would make these instruments antidilutive. As of December 31, 2008 and 2007, the number of antidilutive stock options and restricted stock units excluded from diluted net loss per common share computations was approximately 11.8 million and 11.7 million shares, respectively.

14. Subsequent Event

On February 9, 2009, the Company entered into two Credit and Security Agreements (the “Agreements”) with Wells Fargo Bank, National Association (“Wells Fargo”). The Agreements provide the Company with a line of credit (the “Credit Facility”) that will not at any time exceed in the aggregate $10 million. The amount actually available to the Company may be substantially less and may vary from time to time, depending on, among other factors, the amount of its eligible inventory and accounts receivable. As security for the payment and performance of the Credit Facility, the Company has granted a security interest in favor of Wells Fargo in all or substantially all of the assets of the Company and its subsidiaries. The Agreements will terminate in accordance with their terms on February 9, 2012, unless terminated sooner.

The Agreements include affirmative covenants as well as negative covenants that prohibit a variety of actions without Wells Fargo’s consent, including covenants that limit the Company’s ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another entity, (d) pay dividends on, or purchase, acquire, redeem or retire shares of, its capital stock, (e) sell, assign, transfer or otherwise dispose of all or substantially all of its assets, (f) change its accounting method or (g) enter into a different line of business. Furthermore, the agreements contain financial covenants, including (a) a requirement to maintain a specified minimum book worth, (b) a requirement not to exceed specified levels of losses, (c) a requirement to maintain a specified ratio of minimum cash balances to unreimbursed line of credit advances and (d) limitations on the Company’s capital expenditures.

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Item 2. ***Management’s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes included in this Form 10-Q and in our Annual Report on Form 10-K for the year ended March 31, 2008. When used in this Form 10-Q, and 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 Item 1A of Part II of this Form 10-Q. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. All dollar amounts are approximate.

Overview

We develop, manufacture, market and service 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, our microturbines can be used as generators for hybrid electric vehicle applications. Microturbines allow customers to produce power on-site in parallel with the electric grid or stand alone when no utility grid is available. There are several technologies which are used to provide “on-site power generation,” (also called “distributed generation”) such as reciprocating engines, solar power, wind powered systems and fuel cells. For customers who do not have access to the electric utility grid, microturbines can provide clean, on-site power with lower scheduled maintenance intervals and greater fuel flexibility than competing technologies. For customers with access to the electric grid, microturbines can provide an additional source of continuous duty power, thereby providing additional reliability and potential cost savings. With our stand-alone feature, customers can produce their own energy in the event of a power outage and can use the microturbines as their primary source of power for extended periods. Because our microturbines also produce clean, usable heat energy, they can provide economic advantages to customers who can benefit from the use of hot water, air conditioning and direct hot air. Our microturbines are sold primarily through our distributors. We, along with our Authorized Service Companies (“ASCs”), install and service the microturbines. Successful implementation of the microturbine relies on the quality of the microturbine, the ability to sell into appropriate applications, and the quality of the installation and support.

We believe we were the first company to offer a commercially available power source using microturbine technology. Capstone offers microturbines from 30 kilowatts up to 1 megawatt in electric power output, designed for commercial, industrial, and utility users. Our 30-kilowatt (“C30”) microturbine can produce enough electricity to power a small convenience store. The 60-and 65-kilowatt (“C60 Series”) microturbine can produce enough heat to provide hot water to a 100-room hotel while also providing about one-third of its electrical requirements, based on our estimates. Our 200-kilowatt (“C200”) microturbine is well suited for larger hotels, office buildings, and wastewater treatment plants. By packaging the C200 microturbine power modules into an International Standards Organization (ISO) sized container, Capstone has created a family of microturbine offerings from 600-kilowatts up to one megawatt in a compact footprint. Our 1000-kilowatt (“C1000 Series”) microturbines are well suited for utility substations, larger commercial and industrial facilities and remote oil and gas applications. Our microturbines combine patented air-bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and super low emission electricity and heat production systems. Because of our air-bearing technology, our microturbines do not require liquid lubricants. This means they do not require routine maintenance to change and dispose of oil or other liquid lubricants, as do the most common competing products. Capstone microturbines can be fueled by various sources including natural gas, propane, sour gas, renewable fuels such as landfill or digester gas, kerosene and diesel. The C60 Series and C200 microturbines are available with heat exchangers, making them easy to engineer and install in applications where hot water is used. Our products produce exceptionally clean power. Our C60 Series was certified by the California Air Resources Board ("CARB") to meet its stringent 2007 emissions requirements — the same emissions standard used to certify fuel cells and the same emissions levels as a state-of-the-art central power plant. Our C65 Landfill and Digester Gas systems were certified in January 2008 by CARB to meet 2008 waste gas emissions requirements for landfill and digester gas applications.

The market for our products is highly competitive and is changing rapidly. Our microturbines compete with existing technologies, such as reciprocating engines and may also compete with emerging distributed generation technologies, including solar power, wind-powered systems, fuel cells and other microturbines. Many companies who could be our customers today rely on the utility grid for their power. As many of our distributed generation competitors are large, well-established companies, they derive advantages from production economies of scale, worldwide presence and greater resources, which they can devote to product development or promotion.

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An overview of our direction, targets and key initiatives follows:

1) *Focus on Vertical Markets*— Within the distributed generation markets that we serve, we focus on vertical markets that we identify as having the greatest near-term potential. In our primary products and applications, we identify specific targeted vertical market segments. Within each of these markets, we identify what we believe to be the critical factors to penetrating these markets and have based our plans on those factors.

During the three months ended December 31, 2008, we booked total orders of $16.0 million for 172 units or 17.1 megawatts. We shipped 116 units with an aggregate of 8.4 megawatts for revenue of $7.7 million. As of December 31, 2008, we had 567 units, or 65.6 megawatts, valued at $57.0 million in total backlog, of which 512 units, or 61.0 megawatts, valued at $53.2 million were current and expected to be shipped within the next twelve months. The timing of shipments is subject to change based on several variables (including customer payments and customer delivery schedules), some of which are not in our control and can affect our quarterly revenue and backlog. Our actual product shipments during the three months ended December 31, 2008 were: 45.9% for use in CHP applications, 7.2% for use in CCHP applications, 32% for use in resource recovery applications and 14.9% for use in other markets (including secure power).

The following table summarizes our backlog:

	Three Months ended December 31, 2008		Three Months ended December 31, 2007	
	Megawatts	**Units**	**Megawatts**	**Units**
Current				
C30	6.7	223	0.9	31
C60 Series	13.5	208	4.4	68
C200	9.6	48	6.4	32
C600	1.8	3	—	—
C800	2.4	3	—	—
C1000	27	27	—	—
Total Current Backlog	61.0	512	11.7	131
Long-term				
C30	0.8	25	—	—
C60 Series	1.8	28	—	—
C200	—	—	2.6	13
C1000	2	2	—	—
Total Long-term Backlog	4.6	55	2.6	13
Total Backlog	65.6	567	14.3	144

2) *Sales and Distribution Channels*— We seek out distributors and representatives that have business experience and capabilities to support our growth plans in our targeted markets. In North America, we currently have 26 distributors. Internationally, outside of North America, we currently have 33 distributors. We continue to refine the distribution channels to address our specific targeted markets.

3) *Geographic Focus*— Within the United States, our focus is on California and the Northeast. We use our corporate headquarters to serve the California market and our sales and service office in New Jersey to expand our penetration in the Northeastern market. Based on our belief that the European countries and Russia will offer significant opportunities, we opened an office in England in Fiscal 2007. Accordingly, we expect to continue to develop our distribution base and market presence in Europe. In Japan, we are focused on developing niche opportunities that we believe offer the potential for increasing sales volumes over the next three years. Throughout Asia we are focusing resources on increased distribution channels to the market with the expectation that China will become a significant market in the years ahead. Additionally, we have established an office in Mexico.

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4) *Service*— During Fiscal 2005, we entered the direct service business. Previously, our service strategy was to serve all customers through our distributors and ASCs. Distributors were expected to sell the products, provide engineering solutions, and perform as ASCs by providing installation, commissioning and service. Several of our distributors did not provide the level of service desired and a number of end users requested to work directly with us. As a result, we are pursuing a strategy to serve customers directly, as well as through qualified distributors and ASCs, all of whom will perform their service work using technicians specifically trained by Capstone. In Fiscal 2009, we continue to present alternatives to customers under-served by our distributor and ASC base through Capstone factory direct service. For both Fiscal 2008 and for the nine months ended December 31, 2008 service revenue was approximately 8% of total revenue. We also intend to establish spare parts distribution centers in strategic locations to ensure timely delivery of parts.

5) *Product Robustness and Life Cycle Maintenance Costs*— To provide us with the ability to evaluate microturbine performance in the field, we developed a "real-time" remote monitoring and diagnostic feature. This feature allows us to monitor installed units and rapidly collect operating data on a continual basis. We use this information to anticipate and more quickly respond to field performance issues, evaluate component robustness and identify areas for continuous improvement. This feature is important in allowing us to better serve our customers.

6) *New Product Development*— Our new product development is targeted specifically to meet the needs of our selected vertical markets. We expect that our existing product platforms, the C30 and C60 Series microturbines, will be our foundational product lines for the foreseeable future. Our product development efforts are centered on enhancing the features of these base products. Our C200 product beta testing was successfully implemented during Fiscal 2005 and the first commercial shipment was on August 28, 2008. Our C1000 Series product was developed based on Capstone's C200 microturbine product line. This product family can be configured into 1,000-kW, 800-kW and 600-kW solutions in a single ISO container. Our C1000 product beta testing was successfully implemented during Fiscal 2009 and the first commercial shipment was on December 29, 2008.

7) *Cost and Core Competencies*— We believe that we can achieve overall cost improvements through design changes, automation, parts commonality across multiple product lines, and by outsourcing areas not consistent with our core competencies. In conjunction with these changes, we launched a strategic supply chain initiative to develop suppliers on a global basis. The Company continues to review avenues for cost reduction by sourcing to the best value supply chain option. We have made progress diversifying our suppliers in the international "marketplace" as well as within the United States. We expect to leverage our costs as product volumes increase.

We believe that effective execution in each of these key areas will be necessary to leverage Capstone's promising technology and early market leadership into achieving positive cash flow with growing market presence and improving financial performance. Based on our recent progress and assuming achievement of targeted contribution margins, our financial model indicates that we will achieve positive cash flow when we ship approximately 280 units in a quarter, depending on product mix. We believe our manufacturing facilities located in Chatsworth and Van Nuys, California have a combined production capacity of approximately 2,000 units per year, depending on product mix. With approximately $10 million to $15 million of capital expenditures, we believe we can expand our combined production capacity to approximately 4,000 units per year, depending on product mix. We have not committed to this expansion nor identified a source for its funding, if available.

Critical Accounting Policies and Estimates

The preparation of our condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Management believes the most complex and sensitive judgments, because of their significance to the condensed consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Actual results could

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differ from management's estimates. We believe the critical accounting policies listed below affect our more significant accounting judgments and estimates used in the preparation of the condensed consolidated financial statements. These policies are described in greater detail in our Annual Report on Form 10-K for Fiscal 2008 and continue to include the following areas:

- Impairment of long-lived assets, including intangible assets;
- Inventory write-downs and classification of inventories;
- Estimates of warranty obligations;
- Sales returns and allowances;
- Allowance for doubtful accounts;

- Deferred tax assets and valuation allowance;
- Stock-based compensation expense; and
- Loss contingencies.

Results of Operations

Three Months Ended December 31, 2008 and 2007

Revenue. Revenue is reported net of sales returns and allowances. Revenue for the third quarter of Fiscal 2009 increased $2.3 million, or 25%, to $11.5 million from $9.2 million for the third quarter of Fiscal 2008. Revenue from microturbine product shipments increased $1.5 million, or 24%, to $7.7 million for 116 units during the third quarter of Fiscal 2009 from $6.2 million for 121 units during the third quarter of Fiscal 2008. Shipments of microturbine units were 8.4 megawatts during the third quarter of Fiscal 2009 compared with 5.6 megawatts during the third quarter of Fiscal 2008. Revenue from C30 product shipments decreased $2.0 million, or 71%, to $0.8 million for 23 units during the third quarter of Fiscal 2009 from $2.8 million for 63 units during the third quarter of Fiscal 2008. Shipments of C30 product were 0.7 megawatts during the third quarter of Fiscal 2009 compared with 1.8 megawatts during the third quarter of Fiscal 2008. Revenue from C60 Series product shipments increased $2.1 million, or 62%, to $5.5 million for 87 units during the third quarter of Fiscal 2009 from $3.4 million for 58 units during the third quarter of Fiscal 2008. Shipments of C60 Series products were 5.7 megawatts during the third quarter of Fiscal 2009 compared with 3.8 megawatts during the third quarter of Fiscal 2008. Revenue from C200 product shipments was $0.8 million for five units, or 1.0 megawatt, during the third quarter of Fiscal 2009. There were no C200 product shipments in the same period last year. Revenue from C1000 product shipments was $0.6 million for one unit, or 1.0 megawatt, during the third quarter of Fiscal 2009. There were no C1000 product shipments in the same period last year. Revenue from accessories, parts and service during the third quarter of Fiscal 2009 increased $0.8 million to $3.8 million from $3.0 million during the third quarter of Fiscal 2008.

The overall revenue increase in the third quarter of Fiscal 2009 compared to the same period last year included a $2.9 million increase in revenue from the North American market, a $1.8 million increase in revenue from the Asian market and a $0.3 million increase in revenue from the European market, all primarily the result of improved distribution channels. South American market revenue in the third quarter of Fiscal 2009 was $2.7 million lower than the same period last year because the third quarter of Fiscal 2008 included an unusually large product sale for this historically small revenue market. The timing of shipments is subject to change based on several variables (including customer payments and customer delivery schedules), some of which are not in our control and can affect our quarterly revenue and backlog. Therefore, we evaluate historical revenue in conjunction with backlog to anticipate the growth trend of our revenue.

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The following table summarizes our revenue:

	Three Months ended December 31, 2008			Three Months ended December 31, 2007		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
C30	$ 0.8	0.7	23	$ 2.8	1.8	63
C60 Series	5.5	5.7	87	3.4	3.8	58
C200	0.8	1.0	5	—	—	—
C1000	0.6	1.0	1	—	—	—
Total from Microturbine Products	$ 7.7	8.4	116	$ 6.2	5.6	121
Accessories, Parts, and Service	3.8	—	—	3.0	—	—
Total	$ 11.5	8.4	116	$ 9.2	5.6	121

Two customers accounted for 18% and 15% of revenue, respectively, for the third quarter of Fiscal 2009, totaling approximately 33% of revenue. For the third quarter of Fiscal 2008, three customers accounted for 25%, 16% and 12% of revenue, respectively, totaling approximately 53% of revenue. UTCP accounted for 2% and 16% of revenue for the three months ended December 31, 2008 and 2007, respectively.

Gross Loss. Cost of goods sold includes direct material costs, production labor and overhead, inventory charges and provision for estimated product warranty expenses. The gross loss was $0.6 million, or 5% of revenue, for the third quarter of Fiscal 2009 compared to $40,000, or less than 1% of revenue, for the third quarter of Fiscal 2008. The increase in the gross loss and gross loss percentage reflects a net increase of $0.2 million as a result of a lower margin product mix, primarily because of the product launch of the C200 and C1000 systems, along with an increase in manufacturing costs of $1.9 million, offset by a decrease in warranty expense of $0.9 million and an increase in overhead absorption into inventory of $0.6 million. Warranty expense is a combination of a per-unit warranty accrual recorded at the time revenue is recognized and changes, if any, in estimates for warranty programs. These program estimates are recorded in the period that new information, such as design changes, cost of repair and product enhancements, becomes available. Warranty expense decreased $0.9 million as a result of reductions to warranty programs because of product enhancements and technology changes.

We expect to continue to incur gross losses until we are able to achieve higher unit sales volumes to cover our fixed manufacturing costs. We have taken initiatives to further reduce direct material costs and other manufacturing and warranty costs as we work to achieve profitability.

Research and Development ("R&D") Expenses. R&D expenses include compensation expense, including stock-based compensation, engineering department expenses, overhead allocations for administration and facilities and materials costs associated with development. R&D expenses for the third quarter of Fiscal 2009 increased $0.3 million, or 17%, to $2.1 million from $1.8 million for the same period last year. R&D expenses are reported net of benefits from cost-sharing programs such as the Department of Energy (the "DOE") and UTCP funding. There were approximately $2.0 million of such benefits in the third quarter of Fiscal 2009 and $0.9 million for the same period last year. In-kind services performed by UTCP under the cost-sharing program during the three months ended December 31, 2008 were valued at $0.2 million and recorded as consulting expense within R&D expenses. No such services were provided during the same period last year. The overall net increase in R&D expenses of $0.3 million resulted from increased spending for supplies of $0.6 million, labor expense of $0.3 million, consulting of $0.2 million and facility costs of $0.1 million partially offset by the increased recognition of $0.9 million of funding from UTCP for the cost-sharing program. Cost-sharing programs vary from period to period depending on the phases of the programs. We expect R&D expense in Fiscal 2009 to be lower than in Fiscal 2008 as a result of increased benefits from cost-sharing programs.

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Selling, General, and Administrative ("SG&A") Expenses. SG&A expenses for the third quarter of Fiscal 2009 increased $1.0 million, or 16%, to $7.4 million from $6.4 million for the same period last year. The net increase in SG&A expenses was comprised of an increase of $0.5 million related to labor expense, $0.5 million of travel expense, $0.2 million in marketing expense and $0.2 million of professional services expense, including legal, accounting and insurance expenses, offset by decreased spending for supplies of $0.2 million and shared costs of $0.2 million. The increase in labor and travel costs reflects the continued effort to develop worldwide distributors and the launch of the C200 and C1000 Series products. We expect SG&A expenses for Fiscal 2009 to be higher than the prior year because of these increased efforts.

Interest Income. Interest income for the third quarter of Fiscal 2009 decreased $0.5 million, or 83%, to $0.1 million from $0.6 million for the same period last year. The decrease during the period was attributable to lower average cash balances and lower interest rates over the same period last year. We expect interest income to decline for Fiscal 2009 as we continue to use cash to support our operations.

Nine Months Ended December 31, 2008 and 2007

Revenue. Revenue for the nine months ended December 31, 2008 increased $10.0 million, or 45%, to $32.1 million from $22.1 million for the same period last year. Revenue from microturbine product shipments increased $7.6 million, or 51%, to $22.6 million for 377 units during the nine months ended December 31, 2008 from $15.0 million for 294 units during the same period last year. Shipments of microturbine units were 23.8 megawatts during the nine months ended December 31, 2008 compared with 15.1 megawatts during the same period last year. Revenue from C30 product shipments decreased $1.3 million, or 28%, to $3.3 million for 83 units during the nine months ended December 31, 2008 from $4.6 million for 113 units during the same period last year. Shipments of C30 product were 2.5 megawatts during the nine months ended December 31, 2008 compared with 3.4 megawatts during the same period last year. Revenue from C60 Series product shipments increased $6.9 million, or 66%, to $17.3 million for 284 units during the nine months ended December 31, 2008 from $10.4 million for 181 units during the same period last year. Shipments of C60 Series products were 18.5 megawatts during the nine months ended December 31, 2008 compared with 11.7 megawatts during the same period last year. Revenue from C200 product shipments was $1.4 million for nine units, or 1.8 megawatts during the nine months ended December 31, 2008. There were no C200 product shipments in the same period last year. Revenue from C1000 product shipments was $0.6 million for one unit, or 1.0 megawatt, during the nine months ended December 31, 2008. There were no C1000 product shipments in the same period last year. Revenue from accessories, parts and service during the nine months ended December 31, 2008 increased $2.4 million to $9.5 million from $7.1 million during the same period last year.

The overall revenue increase in the nine months ended December 31, 2008 compared to the same period last year included a $6.9 million increase in revenue from the North American market, a $3.9 million increase in revenue from the Asian market and a $1.6 million increase in revenue from the European market, all primarily the result of efforts to improve distribution channels. South American market revenue during the nine months ended December 31, 2008 was $2.4 million lower than the same period last year because the nine months ended December 31, 2007 included an unusually large product sale for this historically small revenue market. The timing of shipments is subject to change based on several variables (including customer payments and customer delivery schedules), some of which are not in our control and can affect our quarterly revenue and backlog. Therefore, we evaluate historical revenue in conjunction with backlog to anticipate the growth trend of our revenue.

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The following table summarizes our revenue:

	Nine Months ended December 31, 2008			Nine Months ended December 31, 2007		
	Revenue	Megawatts	Units	Revenue	Megawatts	Units
C30	$ 3.3	2.5	83	$ 4.6	3.4	113
C60 Series	17.3	18.5	284	10.4	11.7	181
C200	1.4	1.8	9	—	—	—

C1000	0.6	1.0	1	—	—	—
Total from Microturbine Products	$ 22.6	23.8	377	$ 15.0	15.1	294
Accessories, Parts, and Service	9.5	—	—	7.1	—	—
Total	$ 32.1	23.8	377	$ 22.1	15.1	294

Individually, two customers accounted for 14% and 11% of revenue, respectively, for the nine months ended December 31, 2008, totaling approximately 25% of revenue. For the same period last year, individually, three customers accounted for 16%, 14% and 11% of revenue, respectively, totaling approximately 41% of revenue. Banking Production Centre ("BPC Energy Systems") accounted for 14% of revenue for each of the nine months ended December 31, 2008 and 2007, respectively. UTCP accounted for 9% and 16% of revenue for the nine months ended December 31, 2008 and 2007, respectively.

Gross Loss. The gross loss was $2.4 million, or 7% of revenue, for the nine months ended December 31, 2008 compared to $3.3 million, or 15% of revenue, for the same period last year. The decrease in the gross loss and gross loss percentage reflects a net decrease of $1.3 million as a result of a higher margin product mix, primarily because of increased sales of C60 Series systems, reduced warranty expense of $1.1 million and higher absorption of overhead costs into ending inventory of $2.6 million, offset by increased manufacturing costs of $4.1 million. The remaining $1.1 million in reductions to warranty expense relates to reductions to warranty programs because of product enhancements and technology changes.

Research and Development ("R&D") Expenses. R&D expenses for the nine months ended December 31, 2008 decreased $0.9 million, or 13%, to $6.0 million from $6.9 million for the same period last year. R&D expenses are reported net of benefits from cost-sharing programs such as the DOE and UTCP funding. There were approximately $6.5 million of such benefits for the nine months ended December 31, 2008 and $1.0 million of such benefits for the same period last year. In-kind services performed by UTCP under the cost-sharing program during the nine months ended December 31, 2008 were valued at $0.5 million and recorded as consulting expense within R&D expenses. No such services were provided during the same period last year. The overall net decrease in R&D expenses of $0.9 million resulted from the increased recognition of $5.2 million of funding from UTCP for the cost-sharing program. This benefit was offset by increased spending for supplies of $1.9 million, consulting of $1.3 million, labor costs of $0.5 million, facility expense of $0.3 million, shared costs of $0.2 million and $0.1 million related to travel expense. Cost-sharing programs vary from period to period depending on the phases of the programs.

Selling, General, and Administrative ("SG&A") Expenses. SG&A expenses for the nine months ended December 31, 2008 increased $3.4 million, or 19%, to $21.7 million from $18.3 million for the same period last year. The net increase in SG&A expenses was comprised of an increase of $2.3 million in labor expense, $1.4 million related to travel expense, $0.3 million of marketing expense and $0.2 million in facility expense, offset by decreased spending for supplies of $0.2 million and shared costs of $0.6 million. The increase in labor and travel costs reflects the continued effort to develop worldwide distributors and the launch of the C200 and C1000 Series products.

Interest Income. Interest income for the nine months ended December 31, 2008 decreased $1.4 million, or 74%, to $0.5 million from $1.9 million for the same period last year. The decrease during the period was attributable to lower average cash balances and lower interest rates over the same period last year.

Liquidity and Capital Resources

Our cash requirements depend on many factors, including the execution of our plan. We expect to continue to devote substantial capital resources to running our business and creating the strategic changes summarized herein. Based on our current forecasts and assumptions, we believe that our existing cash and cash equivalents are sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next twelve months. Our planned capital expenditures for Fiscal 2009 include approximately $5.0 million for plant and equipment costs related to the production of the C200 and C1000 Series. We have invested our cash in institutional funds that invest in high quality short-term money market instruments to provide liquidity for operations and for capital preservation.

Our cash and cash equivalent balances decreased $18.2 million during the nine months ended December 31, 2008, compared to a decrease of $17.6 million for the same period last year. The cash was generated from or used in:

Operating Activities. During the nine months ended December 31, 2008, we used $48.9 million in cash in our operating activities, which consisted of a net loss for the period of $29.8 million, and cash used for working capital of $24.0 million offset by non-cash adjustments (primarily depreciation, warranty, stock-based compensation and inventory charges) of $4.9 million. During the same period last year, operating cash usage was $18.6 million, which consisted of a net loss for the period of $26.5 million, offset by non-cash adjustments of $5.4 million and cash generated from working capital of $2.5 million. The increase in working capital cash usage of $26.6 million is primarily attributable to inventory which increased by $22.2 million as a result of the C200 and C1000 commercialization and to support an overall increase in sales and backlog. Additionally, the timing of shipments and the delivery and payment of inventory purchases with long lead times resulted in an increase in cash usage from inventory in the third quarter. Based on the current estimated inventory delivery schedules, scheduled inventory purchases for the fourth quarter of Fiscal 2009 are currently $12.7 million. However, we are in the process of rescheduling the timing of certain deliveries from suppliers and expect inventory deliveries to decrease during the fourth quarter of Fiscal 2009. As a result, we expect total inventory levels to decrease by the end of Fiscal 2009. Additionally, the change in working capital is attributable to an increase in net accounts payable and accrued liabilities of $4.9 million resulting primarily from inventory purchases and an increase in accounts receivable of $3.2 million offset by decreased accrued warranty reserve of $1.0 million. Accounts receivable increased as a result of the timing of collections and sales. Additionally, warranty claims spending has decreased because of a continued focus on product quality and the timing of claims.

Investing Activities. Net cash used in investing activities relates primarily to the acquisition of fixed assets of $5.0 million and $0.5 million for the nine months ended December 31, 2008 and 2007, respectively. Our historical cash usage for investing activities has been relatively low related to capital expenditures. However, in Fiscal 2009 we have increased cash usage for investing activities as a result of investments in production equipment and leasehold improvements related to the C200 and C1000 Series products.

Financing Activities. During the nine months ended December 31, 2008 and 2007, we generated $35.7 million and $1.5 million, respectively, in cash from financing activities. The funds generated from financing activities in the nine months ended December 31, 2008 were primarily the result of a registered offering of our common stock, which was completed effective September 23, 2008. Pursuant to the offering, we issued a total of 21.5 million shares of common stock and warrants to purchase 6.4 million shares of common stock with an initial exercise price of $1.92 per share, resulting in gross proceeds of approximately $32.0 million. We incurred approximately $2.5 million in direct costs in connection with the offering. The exercise of stock options and warrants and employee stock purchases, net of repurchases of shares for employee taxes on vesting of restricted stock units, yielded $6.3 million in cash for the nine months ended December 31, 2008 compared to $1.6 million for the same period last year.

There have been no material changes in our remaining commitments under non-cancelable operating leases and capital leases disclosed in our Annual Report on Form 10-K for Fiscal 2008. As more fully described below, because of the increase in backlog and long lead times for certain materials, as of December 31, 2008, we had firm commitments to purchase inventories of approximately $23.9 million. This represents an $8.5 million increase from the purchase commitment disclosed in our Annual Report on Form 10-K for Fiscal 2008.

We believe that our existing cash and cash equivalents are sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next twelve months. However, based on our cash usage over the last twelve months and if our anticipated cash needs change it is possible, if not likely, that we may need or elect to raise additional funds to fund our activities. Anticipated cash needs may change based on our ability to manage inventory costs and the timing of inventory purchases and deliveries. We could seek to raise such funds by selling additional securities to the public or to selected investors, or by obtaining debt financing. We cannot be assured that we will be able to obtain additional funds on commercially favorable terms, or at all, especially given the state of worldwide capital markets. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing stockholders would be reduced (on a fully diluted basis in the case of convertible securities). In addition, any equity or debt securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock.

On February 9, 2009, we entered into two Credit and Security Agreements (the "Agreements") with Wells Fargo Bank, National Association ("Wells Fargo"). The Agreements provide us with a line of credit (the "Credit Facility") that will not at any time exceed in the aggregate $10 million. The amount actually available to us may be substantially less and may vary from time to time, depending on, among other factors, the amount of its eligible inventory and accounts receivable. As security for the payment and performance of the Credit Facility, we have granted a security interest in favor of Wells Fargo in all or substantially all of our assets and our subsidiaries. The Agreements will terminate in accordance with their terms on February 9, 2012, unless terminated sooner.

The Agreements include affirmative covenants as well as negative covenants that prohibit a variety of actions without Wells Fargo's consent, including covenants that limit our ability to (a) incur or guarantee debt, (b) create liens, (c) enter into any merger, recapitalization or similar transaction or purchase all or substantially all of the assets or stock of another entity, (d) pay dividends on, or purchase, acquire, redeem or retire shares of, its capital stock, (e) sell, assign, transfer or otherwise dispose of all or substantially all of its assets, (f) change its accounting method or (g) enter into a different line of business. Furthermore, the agreements contain financial covenants, including (a) a requirement to maintain a specified minimum book worth, (b) a requirement not to exceed specified levels of losses, (c) a requirement to maintain a specified ratio of minimum cash balances to unreimbursed line of credit advances and (d) limitations on our capital expenditures.

Although we believe we have sufficient capital to fund our working capital and capital expenditures, depending on the timing of our future sales and collection of related receivables, managing inventory costs and the timing of inventory purchases and deliveries required to fulfill the current backlog, our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will require us to achieve dramatically increased sales volume which is dependent on many factors, including:

- the market acceptance of our products and services;
- our business, product and capital expenditure plans;
- capital improvements to new and existing facilities;
- our competitors' response to our products and services;
- our relationships with customers, distributors and project resellers; and
- our customers' ability to afford and/or finance our products.

Additionally, the continued credit crisis could prevent our customers from purchasing our products or delay their purchases, which would adversely affect our business, financial condition and results of operations. In addition, our ability to access the capital markets may be severely restricted or made very expensive at a time when we need, or would like, to do so, which could have a material adverse impact on our liquidity and financial resources. Certain industries in which our customers do business and certain geographic areas could be adversely affected by a recession in economic activity.

Should the Company be unable to execute its plans or obtain additional financing, 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.

Recently Issued Accounting Standards

In May 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 162 "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles. SFAS No. 162 became effective on November 15, 2008. This standard is not expected to have an impact on the consolidated financial position or results of operations.

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In April 2008, the FASB issued FASB Staff Position ("FSP") No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). FSP 142-3 removes the requirement of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. The intent of FSP 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations," ("SFAS No. 141(R)") and other U.S. generally accepted accounting principles. FSP 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity considers its own experience in renewing similar arrangements. FSP 142-3 applies to all intangible assets, whether acquired in a business combination or otherwise and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and applied prospectively to intangible assets acquired after the effective date. We are currently evaluating the requirements of this standard; however, this standard is not expected to have a material impact on the consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), which changes accounting principles for business acquisitions. SFAS No. 141(R) requires the recognition of all the assets acquired and liabilities assumed in the transaction based on the acquisition-date fair value. Certain provisions of this standard will, among other things, impact the determination of consideration paid or payable in a business combination and change accounting practices for transaction costs, acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. SFAS No. 141(R) is effective for business combinations and adjustments to all acquisition-related deferred tax asset and liability balances occurring after December 15, 2008. Adoption of this standard has not had an impact on the consolidated financial position or results of operations. Adoption of this statement is, however, expected to have a significant effect on how acquisition transactions subsequent to March 31, 2009 are reflected in the financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51" ("SFAS No. 160"). This statement establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This standard is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the requirements of this standard; however, this standard is not expected to have an impact on the consolidated financial position or results of operations.

In January 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value, with the objective of mitigating volatility in reported earnings caused by measuring related assets and liabilities differently (without being required to apply complex hedge accounting provisions), amends SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" and expands disclosures related to the use of fair value measures in financial statements. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We have adopted SFAS No. 159 with no impact on our consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. While SFAS No. 157 did not impact the Company's valuation methods, it expanded disclosures of assets and liabilities that are recorded at fair value. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We adopted this standard in Fiscal 2009, and the adoption did not impact on our consolidated financial position or results of operations. On April 1, 2009, we will implement the previously-deferred provisions of SFAS No. 157 for nonfinancial long-lived assets or asset groups measured at fair value for an impairment assessment under FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" as required. We do not believe that the remaining provisions will have an impact on the Company's consolidated financial position or results of operations when they are implemented.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

No material changes have occurred in the quantitative and qualitative market risk disclosure presented in our Annual Report on Form 10-K for Fiscal 2008.

Item 4. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation of the effectiveness of the design and operation of our "disclosure controls and procedures" (as defined in Rule 13a-15(e) under the Exchange Act), under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting

Additionally, our Chief Executive Officer and Chief Financial Officer have determined that there have been no changes to our internal control over financial reporting during the three months ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. ***Legal Proceedings***

In December 2001, a purported shareholder class action lawsuit was filed in the United States District Court for the Southern District of New York (the "District Court") against the Company, two of its then officers, and the underwriters of the Company's initial public offering. The suit purports to be a class action filed on behalf of purchasers of the Company's common stock during the period from June 28, 2000 to December 6, 2000. An amended complaint was filed on April 19, 2002. The Plaintiffs allege that the underwriter defendants agreed to allocate stock in the Company's June 28, 2000 initial public offering and November 16, 2000 secondary offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. The Plaintiffs allege that the prospectuses for these two public offerings were false and misleading in violation of the securities laws because they did not disclose these arrangements. Similar complaints have been filed against hundreds of other issuers that have had initial public offerings since 1998; the complaints have been consolidated into an action captioned In re Initial Public Offering Securities Litigation, No. 21 MC 92. On July 1, 2002, the underwriter defendants in the consolidated actions moved to dismiss all the actions, including the action involving the Company. On July 15, 2002, the Company, along with other non-underwriter defendants in the coordinated cases, moved to dismiss the litigation. On October 9, 2002, the Plaintiffs dismissed, without prejudice, the claims against the named officers and directors in the action against the Company. On February 19, 2003, the District Court issued an order denying the motion to dismiss the claims against the Company under Rule 10b-5. The motions to dismiss the claims under Section 11 of the Securities Act were denied as to virtually all of the defendants in the consolidated cases, including the Company. In June 2004, a committee of our Board of Directors approved a proposed partial settlement with the plaintiffs in this matter. A stipulation of partial settlement and release of claims against the issuer defendants and the issuer officers and directors named as defendants was submitted to the District Court for preliminary approval in June 2004. The District Court granted the preliminary approval motion on February 15, 2005, subject to certain modifications. On August 31, 2005, the District Court issued a preliminary order further approving the modifications to the settlement and certifying the settlement classes. The settlement fairness hearing occurred on April 24, 2006, and the District Court reserved decision at that time. While the partial settlement was pending approval, the Plaintiffs continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of "focus cases" rather than all of the 310 cases that had been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied the Plaintiffs' petition for rehearing. In light of the Second Circuit opinion, liaison counsel for all issuer defendants, including the Company, informed the District Court that this settlement could not be approved because the defined settlement class, like the litigation class, could not be certified. On June 25, 2007, the District Court entered an order terminating the proposed settlement. On August 14, 2007, the Plaintiffs filed their second consolidated amended complaints against the six focus cases and on September 27, 2007, again moved for class certification. On November 12, 2007, certain of the defendants in the focus cases moved to dismiss the second consolidated amended class action complaints. On March 26, 2008, the District Court denied the motions to dismiss except as to Section 11 claims raised by those plaintiffs who sold their securities for a price in excess of the initial offering price and those who purchased outside the previously certified class period. Briefing on the class certification motion was completed in May 2008. That motion was withdrawn without prejudice on October 10, 2008. On December 28, 2007, the underwriter defendants moved to strike class allegations in 26 cases, including the Company's, in which the Plaintiffs failed to identify proposed class representatives, and the issuer defendants joined in the motion. On May 13, 2008, the District Court granted the motion in part and struck the class allegations in eight cases in which the proposed class representative was not a member of the class. The District Court denied the motion with respect to the remaining 18 cases, including the Company's case. For those 18 cases, the Plaintiffs must notify the Defendants and the District Court of the identity of the putative class representatives and the basis of each putative representative's claim, and indicate whether the putative representatives are members of the proposed class. The deadline for the Plaintiffs to provide this information was January 30, 2009, but the Plaintiffs have asked the District Court for additional time. The Defendants may renew their motion to strike class allegations if the Plaintiffs fail to identify the putative class representatives within the allocated time or if the putative representatives are not members of the proposed class. Because of the inherent uncertainties of litigation, the ultimate outcome of the matter is uncertain.

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On October 9, 2007, Vanessa Simmonds, a purported stockholder of the Company, filed suit in the U.S. District Court for the Western District of Washington against The Goldman Sachs Group, Inc., Merrill Lynch & Co., Inc., and Morgan Stanley, the lead underwriters of the Company's initial public offering in June 1999, and the secondary offering of common stock in November 2000, alleging violations of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The complaint seeks to recover from the lead underwriters any "short-swing profits" obtained by them in violation of Section 16(b). The suit names the Company as a nominal defendant, contains no claims against the Company, and seeks no relief from the Company. Simmonds filed an Amended Complaint on February 27, 2008 (the "Amended Complaint"), naming as defendants Goldman Sachs & Co. and Merrill Lynch Pierce, Fenner & Smith Inc. and again naming Morgan Stanley. The Amended Complaint asserts substantially similar claims as those set forth in the initial complaint. On July 25, 2008, the Company joined with 29 other issuers to file the Issuer Defendants' Joint Motion to Dismiss. Underwriter Defendants also filed a Joint Motion to Dismiss on July 25, 2008. Plaintiff filed oppositions to both motions on September 8, 2008. All replies in support of the motions to dismiss were filed on October 23, 2008. Oral argument on the motions to dismiss was held on January 16, 2009. The Judge has stayed discovery pursuant to the Private Securities Litigation Reform Act (PSLRA) until he rules on all motions to dismiss. Because of the inherent uncertainties of this litigation, we cannot accurately predict the ultimate outcome of the matter.

Item 1A. ***Risk Factors***

The risk factors disclosed in our Annual Report on Form 10-K for the Year Ended March 31, 2008 were updated in our Quarterly Report on Form 10-Q for the Three Months Ended September 30, 2008 (the "Second Quarter 10-Q"). We refer you to the Second Quarter 10-Q for our updated risk factors.

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

None

Item 3. ***Defaults Upon Senior Securities***

None

Item 4. ***Submission of Matters to a Vote of Security Holders***

None

Item 5. ***Other Information***

None

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Item 6. ***Exhibits***

The following exhibits are filed with, or incorporated by reference into, this Form 10-Q:

Exhibit Number	Description
3.1	Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation (a)
3.2	Amended and Restated Bylaws of Capstone Turbine Corporation (b)
4.1	Specimen stock certificate (c)
4.2	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock (d)
4.3	Rights Agreement, dated July 7, 2005, between Capstone Turbine Corporation and Mellon Investor Services LLC (d)
4.4	Amendment No. 1 to Rights Agreement, dated July 3, 2008, between Capstone Turbine Corporation and Mellon Investor Services LLC (e)
4.5	Form of Warrant (f)
4.6	Form of Warrant (g)
10.1	General Release and Separation Agreement with Leigh L. Estus dated December 1, 2008
10.2	Consulting Agreement with Leigh L. Estus dated December 1, 2008
31.1	Certification of Chief Executive Officer

31.2	Certification of Chief Financial Officer
32	Certification of Chief Executive Officer and Chief Financial Officer

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(a) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated May 8, 2000 (File No. 333-33024).

(b) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, dated February 9, 2006 (File No. 001-15957).

(c) Incorporated by reference to Capstone Turbine Corporation's Registration Statement on Form S-1/A, dated June 21, 2000 (File No. 333-33024).

(d) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 8, 2005 (File No. 001-15957).

(e) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on July 10, 2008 (File No. 001-15957).

(f) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on September 18, 2008 (File No. 001-15957).

(g) Incorporated by reference to Capstone Turbine Corporation's Current Report on Form 8-K, filed on January 19, 2007 (File No. 001-15957).

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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/ EDWARD I. REICH

Edward I. Reich
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: February 9, 2009

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Exhibit Index

Exhibit Number	Description of Document
3.1	Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation (a)
3.2	Amended and Restated Bylaws of Capstone Turbine Corporation (b)
4.1	Specimen stock certificate (c)
4.2	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock (d)
4.3	Rights Agreement, dated July 7, 2005, between Capstone Turbine Corporation and Mellon Investor Services LLC (d)
4.4	Amendment No. 1 to Rights Agreement, dated July 3, 2008, between Capstone Turbine Corporation and Mellon Investor Services LLC (e)
4.5	Form of Warrant (f)
4.6	Form of Warrant (g)

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10.1	General Release and Separation Agreement with Leigh L. Estus dated December 1, 2008
10.2	Consulting Agreement with Leigh L. Estus dated December 1, 2008
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32	Certification of Chief Executive Officer and Chief Financial Officer

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GENERAL RELEASE AND SEPARATION AGREEMENT

This General Release and Separation Agreement ("Agreement") is entered into by and between Capstone Turbine Corporation ("Capstone") on the one hand, and Leigh Estus ("Employee"), on the other hand. Capstone and Employee shall be referred to herein, collectively, as the "Parties." Employee enters into this Agreement in accordance with Section 4.04 of the 2002 Capstone Turbine Corporation Severance Pay Plan (the "Plan") and in exchange and consideration for the applicable severance payment for which Employee is eligible to receive under the Plan, which in the case of Employee is $115,450.01 (the "Severance Payment"). The Severance Payment will be paid in accordance with Section 4.03 of the Plan which currently provides for payment in the same manner as Capstone's regular payroll practices.

1. Employee's last day of employment will be December 1, 2008 at which time Employee will be paid all regular payroll earnings and accrued vacation through that date.

2. Employee agrees and warrants that, as of the time of execution of this Agreement, he/she has not filed any complaints, Charges, applications, grievances, or lawsuits against Capstone with any governmental agency or court, including, but not limited to, Department of Fair Employment and Housing, the United States Equal Employment Opportunity Commission, the Division of Labor Standards Enforcement, the California Superior Court or the United States District Court, or in any other forum whatsoever.

3. Employee warrants and represents that he/she has not heretofore assigned or transferred, or purported to assign or transfer, to any person or entity, any claim or portion thereof, or interest therein, which Employee may have against Capstone. Employee agrees to indemnify, defend and hold Capstone harmless from and against any and all claims, based on or arising out of any such assignment or transfer, or purported assignment or transfer of any claims or portion thereof or interest therein.

4. Except for obligations created herein and by the Plan, Employee on behalf of himself/herself, his/her agents, spouse, heirs, assigns, attorneys and representatives, hereby irrevocably and unconditionally releases, acquits and forever discharges Capstone and each of its owners, parents, subsidiaries, predecessors, successors, affiliates, administrators, representatives, executors, assigns, and insurers and each and all of their agents, directors, officers, employees, former employees, representatives, attorneys, partners, and stockholders, and all persons acting by, through, under, or in concert with any of them, (collectively, the "Capstone Releasees") from any and all Charges, complaints, claims, liabilities, obligations, promises, agreements, controversies, damages, actions, causes of action, suits, rights, demands, costs, losses, judgments, debts and expenses of any nature whatsoever, known or unknown, suspected or unsuspected, fixed or contingent which Employee now has, owns, holds, or claims to have, claims to own, or

claims to hold, or which Employee at any time heretofore had, owned, held or claimed to have, claimed to own, or claimed to hold, or which Employee at any time hereafter may have, own, hold or claim to have, claim to own, or claim to hold, against the Capstone Releasees through the date of the execution of this Agreement, and further including, without limitation, any and all claims which might arise, or might have arisen, against the Capstone Releasees, under any contract or policy, whether such contract or policy is written or oral, express or implied, and any claims based upon any Federal, State or Local common law, statutes, orders or regulations including, but not limited to, those prohibiting discrimination on account of race, color, creed, religion, sex, sexual harassment, national origin, age (including the Age Discrimination in Employment Act of 1967 ("ADEA"), as amended), handicap or mental or physical disability, perceived handicap or perceived mental or physical disability, marital status, height, weight or sexual preference or orientation including, but not limited to, the California Fair Employment and Housing Act, Cal. Gov't Code §§ 12900 et seq., 42 U.S.C. §§ 2000e et seq. ("Title VII"), the Americans with Disabilities Act, 42 U.S.C. § 12101 et seq. ("ADA"), the California Moore—Brown—Roberti Family Rights Act, Cal. Gov't Code § 12945.2, the Family and Medical Leave Act, 29 U.S.C. §§ 2601 et seq., Labor Code §§ 132a 1101, 1102 and 1102.2, the Workers' Compensation Act, Labor Code §§ 3600 et seq., and/or any claims arising under any federal or state labor law.

5. All rights under California Civil Code section 1542, are hereby expressly waived. Section 1542 of the California Civil Code reads as follows:

> A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR.

6. Employee agrees and represents that he/she understands that by executing this General Release he/she is releasing all claims he/she may have against Capstone arising under the Age Discrimination in Employment Act, 29 U.S.C. § 621 et seq. ("ADEA"). Employee acknowledges that, before signing this General Release, he/she is entitled to twenty-one (21) full calendar days to consider the terms of this Agreement, but, in signing this Agreement, specifically waives that twenty-one (21) full calendar days consideration period. Employee also acknowledges that Capstone has advised him/her to consult with an attorney, and that he/she has in fact consulted with an attorney, concerning this General Release in general, and in particular with respect to Employee's release of claims under the ADEA. Employee further acknowledges that, following his/her signing of this General Release, he/she is entitled to seven (7) full calendar days to revoke his/her release of any claims under the ADEA – which seven (7) day period is non-waivable (the "Revocation Period"). Accordingly, this Agreement shall not become effective or enforceable until the Revocation Period has expired. In the event Employee revokes his/her release of his/her ADEA claims within the Revocation Period, at Capstone's election the entire Agreement may become null and void in its entirety and any and all of Capstone's obligations hereunder, including, specifically, any obligation to tender the Severance Payment may expire and become null and void.

7. Except for the Confidential Information and Invention Assignment Agreement (the “Confidentiality Agreement”) signed by Employee at the time of hire, this General Release sets forth the entire agreement between the Parties hereto, and fully supersedes any and all prior agreements or understandings between the Parties hereto pertaining to the subject matter hereto. Employee hereby acknowledges and certifies that Employee will abide by all the terms and conditions of the Confidentiality Agreement.

Having had a reasonable time in which to review and consider these terms, and acknowledging that I have had full opportunity to consult with independent counsel, I hereby agree and accept the above terms and conditions.

Dated: November 19, 2008	/s/ LEIGH ESTUS Leigh Estus
	Capstone Turbine Corporation
Dated: December 1, 2008	By: /s/ LARRY COLSON Larry Colson Sr. VP, Human Resources

Exhibit 10.2

CAPSTONE TURBINE CORPORATION

CONSULTING AGREEMENT

This Consulting Agreement ("**Agreement**") is entered into as of December 1, 2008, by and between Capstone Turbine Corporation (the "**Company**") and Leigh Estus ("**Consultant**"). The Company desires to retain Consultant as an independent contractor to perform consulting services for the Company, and Consultant is willing to perform such services, on the terms described below. In consideration of the mutual promises contained herein, the parties agree as follows:

1. *Services and Compensation*. Consultant agrees to perform for the Company the services described in Exhibit A (the "**Services**"), and the Company agrees to pay Consultant the compensation described in Exhibit A for Consultant's performance of the Services.

2. *Confidentiality.*

A. *Definition*. "**Confidential Information**" means any non-public information that relates to the actual or anticipated business or research and development of the Company, technical data, trade secrets or know-how, including, but not limited to, research, product plans or other information regarding Company's products or services and markets therefor, customer lists and customers (including, but not limited to, customers of the Company on whom Consultant called or with whom Consultant became acquainted during the term of this Agreement), software, developments, inventions, processes, formulas, technology, designs, drawings, engineering and hardware configuration information, marketing, finances or other business information. Confidential Information does not include information that (i) is known to Consultant at the time of disclosure to Consultant by the Company as evidenced by written records of Consultant, (ii) has become publicly known and made generally available through no wrongful act of Consultant or (iii) has been rightfully received by Consultant from a third party who is authorized to make such disclosure.

B. *Nonuse and Nondisclosure*. Consultant will not, during or subsequent to the term of this Agreement, (i) use the Confidential Information for any purpose whatsoever other than the performance of the Services on behalf of the Company or (ii) disclose the Confidential Information to any third party. Consultant agrees that all Confidential Information will remain the sole property of the Company. Consultant also agrees to take all reasonable precautions to prevent any unauthorized disclosure of such Confidential Information, including, but not limited to, informing each of Consultant's employees and contractors, if any, with access to any Confidential Information of the terms of this provision. Without the Company's prior written approval, Consultant will not directly or indirectly disclose to anyone the existence of this Agreement or the fact that Consultant has this arrangement with the Company.

C. *Former Client Confidential Information*. Consultant agrees that Consultant will not, during the term of this Agreement, improperly use or disclose any proprietary information or trade secrets of any former or current employer of Consultant or other person or entity with which Consultant has an agreement or duty to keep in confidence information acquired by Consultant, if any. Consultant also agrees that Consultant will not bring onto the Company's premises any unpublished document or proprietary information belonging to any such employer, person or entity unless consented to in writing by such employer, person or entity.

D. *Third Party Confidential Information*. Consultant recognizes that the Company has received and in the future will receive from third parties their confidential or proprietary information subject to a duty on the Company's part to maintain the confidentiality of such information and to use it only for certain limited purposes. Consultant agrees that, during the term of this Agreement and thereafter, Consultant owes the Company and such third parties a duty to hold all such confidential or proprietary information in the strictest confidence and not to disclose it to any person, firm or corporation or to use it except as necessary in carrying out the Services for the Company consistent with the Company's agreement with such third party.

E. *Return of Materials*. Upon the termination of this Agreement, or upon Company's earlier request, Consultant will deliver to the Company all of the Company's property, including but not limited to all electronically stored information and passwords to access such property, or Confidential Information that Consultant may have in Consultant's possession or control.

3. *Ownership*.

A. *Assignment*. Consultant agrees that all copyrightable material, notes, records, drawings, designs, inventions, improvements, developments, discoveries and trade secrets conceived, discovered, developed or reduced to practice by Consultant, solely or in collaboration with others, during the term of this Agreement that relate in any manner to the business of the Company that Consultant may be directed to undertake, investigate or experiment with or that Consultant may become associated with in work, investigation or experimentation in the Company's line of business in performing the Services under this Agreement (collectively, "**Inventions**"), are the sole property of the Company. Consultant also agrees to assign (or cause to be assigned) and hereby assigns fully to the Company all Inventions and any copyrights, patents, mask work rights or other intellectual property rights relating to all Inventions.

B. *Further Assurances*. Consultant agrees to assist Company, or its designee, at the Company's expense, in every proper way to secure the Company's rights in Inventions and any copyrights, patents, mask work rights or other intellectual property rights relating to all Inventions in any and all countries, including the disclosure to the Company of all pertinent information and data with respect to all Inventions, the execution of all applications, specifications, oaths, assignments and all other instruments that the Company may deem necessary in order to apply for and obtain such rights and in order to assign and convey to the Company, its successors, assigns and nominees the sole and exclusive right, title and interest in and to all Inventions, and any copyrights, patents, mask work rights or other intellectual property rights relating to all Inventions. Consultant also agrees that Consultant's obligation to execute or cause to be executed any such instrument or papers shall continue after the termination of this Agreement.

C. *Pre-Existing Materials*. Subject to **Section 3.A**, Consultant agrees that if, in the course of performing the Services, Consultant incorporates into any Invention developed under this Agreement any pre-existing invention, improvement, development, concept, discovery or other proprietary information owned by Consultant or in which Consultant has an interest, (i) Consultant will inform Company, in writing before incorporating such invention, improvement, development, concept, discovery or other proprietary information into any Invention, and (ii) the Company is hereby granted a nonexclusive, royalty-free, perpetual, irrevocable, worldwide license to make, have made, modify, use and sell such item as part of or in connection with such Invention. Consultant will not incorporate any invention, improvement, development, concept, discovery or other proprietary information owned by any third party into any Invention without Company's prior written permission.

D. *Attorney-in-Fact.* Consultant agrees that, if the Company is unable because of Consultant's unavailability, dissolution, mental or physical incapacity, or for any other reason, to secure Consultant's signature for the purpose of applying for or pursuing any application for any United States or foreign patents or mask work or copyright registrations covering the Inventions assigned to the Company in **Section 3.A**, then Consultant hereby irrevocably designates and appoints the Company and its duly authorized officers and agents as Consultant's agent and attorney-in-fact, to act for and on Consultant's behalf to execute and file any such applications and to do all other lawfully permitted acts to further the prosecution and issuance of patents, copyright and mask work registrations with the same legal force and effect as if executed by Consultant.

4. *Conflicting Obligations*.

A. *Conflicts*. Consultant certifies that Consultant has no outstanding agreement or obligation that is in conflict with any of the provisions of this Agreement or that would preclude Consultant from complying with the provisions of this Agreement. Consultant will not enter into any such conflicting agreement during the term of this Agreement. Consultant's violation of this Section 4.A will be considered a material breach under **Section 6.B**.

B. *Substantially Similar Designs*. In view of Consultant's access to the Company's trade secrets and proprietary know-how, Consultant agrees that Consultant will not, without Company's prior written approval, design identical or substantially similar designs as those developed under this Agreement for any third party during the term of this Agreement and for a period of 12 months after the termination of this Agreement. Consultant acknowledges that the obligations in this **Section 4** are ancillary to Consultant's nondisclosure obligations under **Section 2**.

5. *Reports*. Consultant also agrees that Consultant will, from time to time during the term of this Agreement or any extension thereof, keep the Company advised as to Consultant's progress in performing the Services under this Agreement. Consultant further agrees that Consultant will, as requested by the Company, prepare written reports with respect to such progress. The Company and Consultant agree that the time required to prepare such written reports will be considered time devoted to the performance of the Services.

6. *Term and Termination*.

A. *Term*. The term of this Agreement will begin on the date of this Agreement and will continue until the earlier of (i) final completion of the Services or (ii) termination as provided in **Section 6.B**.

B. *Termination*. Either party may terminate this Agreement upon giving the other party 14 days' prior written notice of such termination pursuant to **Section 11.E** of this Agreement. The Company may terminate this Agreement immediately and without prior notice if Consultant refuses to or is unable to perform the Services or is in breach of any material provision of this Agreement.

C. *Survival*. Upon such termination, all rights and duties of the Company and Consultant toward each other shall cease except:

(1) The Company will pay, within 30 days after the effective date of termination, all amounts owing to Consultant for Services completed and accepted by the Company prior to the termination date and related expenses, if any, submitted in accordance with the Company's policies and in accordance with the provisions of Section 1 of this Agreement; and

(2) Section 2 (Confidentiality), Section 3 (Ownership), Section 4 (Conflicting Obligations), Section 7 (Independent Contractor; Benefits), Section 8 (Indemnification), Section 9 (Nonsolicitation) and Section 10 (Arbitration and Equitable Relief) will survive termination of this Agreement.

7. *Independent Contractor; Benefits*.

A. *Independent Contractor*. It is the express intention of the Company and Consultant that Consultant perform the Services as an independent contractor to the Company. Nothing in this Agreement shall in any way be construed to make Consultant an agent, employee or representative of the Company. Without limiting the generality of the foregoing, Consultant is not authorized to bind the Company to any liability or obligation or to represent that Consultant has any such authority. Consultant agrees to furnish (or reimburse the Company for) all tools and materials necessary to accomplish this Agreement and shall incur all expenses associated with performance, except as expressly provided in Exhibit A. Consultant acknowledges and agrees that Consultant is obligated to report as income all compensation received by Consultant pursuant to this Agreement. Consultant agrees to and acknowledges the obligation to pay all self-employment and other taxes on such income.

B. *Benefits*. The Company and Consultant agree that Consultant will receive no Company-sponsored benefits from the Company. If Consultant is reclassified by a state or federal agency or court as Company's employee, Consultant will become a reclassified employee and will receive no benefits from the Company, except those mandated by state or federal law, even if by the terms of the Company's benefit plans or programs of the Company in effect at the time of such reclassification, Consultant would otherwise be eligible for such benefits.

8. *Indemnification*. Consultant agrees to indemnify and hold harmless the Company and its directors, officers and employees from and against all taxes, losses, damages, liabilities, costs and expenses, including attorneys' fees and other legal expenses, arising directly or indirectly from or in connection with (i) any negligent, reckless or intentionally wrongful act of Consultant or Consultant's assistants, employees or agents, (ii) a determination by a court or agency that the Consultant is not an independent contractor, (iii) any breach by the Consultant or Consultant's assistants, employees or agents of any of the covenants contained in this Agreement, (iv) any failure of Consultant to perform the Services in accordance with all applicable laws, rules and regulations, or (v) any violation or claimed violation of a third party's rights resulting in whole or in part from the Company's use of the work product of Consultant under this Agreement.

9. *Nonsolicitation*. From the date of this Agreement until 12 months after the termination of this Agreement (the "**Restricted Period**"), Consultant will not, without the Company's prior written consent, directly or indirectly, solicit or encourage any employee or contractor of the Company or its affiliates to terminate employment with, or cease providing services to, the Company or its affiliates. During the Restricted Period, Consultant will not, whether for Consultant's own account or for the account of any other person, firm, corporation or other business organization, intentionally interfere with any person who is or during the period of Consultant's engagement by the Company was a partner, supplier, customer or client of the Company or its affiliates.

10. *Arbitration and Equitable Relief.*

A. *Arbitration*. Consultant agrees that any and all controversies, claims or disputes with anyone (including the Company and any employee, officer, director, shareholder or benefit plan of the Company, in its capacity as such or otherwise) arising out of, relating to or resulting from Consultant's performance of the Services under this Agreement or the termination of this Agreement, including any breach of this Agreement, shall be subject to binding arbitration under the Arbitration Rules set forth in California Code of Civil Procedure Section 1280 through 1294.2, including Section 1283.05 (the "**Rules**") and pursuant to California law. CONSULTANT AGREES TO ARBITRATE, AND THEREBY AGREES TO WAIVE ANY RIGHT TO A TRIAL BY JUDGE OR JURY WITH RESPECT TO, ALL DISPUTES ARISING FROM OR RELATED TO THIS AGREEMENT, INCLUDING BUT NOT LIMITED TO: ANY STATUTORY CLAIMS UNDER STATE OR FEDERAL LAW, CLAIMS UNDER TITLE VII OF THE CIVIL RIGHTS ACT OF 1964, THE AMERICANS WITH DISABILITIES ACT OF 1990, THE AGE DISCRIMINATION IN EMPLOYMENT ACT OF 1967, THE OLDER WORKERS BENEFIT PROTECTION ACT, THE CALIFORNIA FAIR EMPLOYMENT AND HOUSING ACT, THE CALIFORNIA LABOR CODE, CLAIMS OF HARASSMENT, DISCRIMINATION OR WRONGFUL TERMINATION AND ANY STATUTORY CLAIMS. Consultant understands that this Agreement to arbitrate also applies to any disputes that the Company may have with Consultant.

B. *Procedure*. Consultant agrees that any arbitration will be administered by the American Arbitration Association ("**AAA**"), and that a neutral arbitrator will be selected in a manner consistent with its National Rules for the Resolution of Employment Disputes. Consultant agrees that the arbitrator will have the power to decide any motions brought by any party to the arbitration, including discovery motions, motions for summary judgment and/or adjudication and motions to dismiss and demurrers, prior to any arbitration hearing. Consultant agrees that the arbitrator will issue a written decision on the merits. Consultant also agrees that the arbitrator will have the power to award any remedies, including attorneys' fees and costs, available under applicable law.

Consultant understands that the Company will pay for any administrative or hearing fees charged by the arbitrator or AAA, except that Consultant shall pay the first $200.00 of any filing fees associated with any arbitration Consultant initiates. Consultant agrees that the arbitrator will administer and conduct any arbitration in a manner consistent with the Rules and that, to the extent that the AAA's National Rules for the Resolution of Employment Disputes conflict with the Rules, the Rules will take precedence.

C. *Remedy.* Except as provided by the Rules, arbitration will be the sole, exclusive and final remedy for any dispute between the Company and Consultant. Accordingly, except as provided for by the Rules, neither the Company nor Consultant will be permitted to pursue court action regarding claims that are subject to arbitration. Notwithstanding the foregoing, the arbitrator will not have the authority to disregard or refuse to enforce any lawful Company policy, and the arbitrator shall not order or require the Company to adopt a policy not otherwise required by law which the Company has not adopted.

D. *Availability of Injunctive Relief.* In addition to the right under the Rules to petition the court for provisional relief, Consultant agrees that any party may also petition the court for injunctive relief where either party alleges or claims a violation of Sections 2 (Confidentiality), 3 (Ownership) or 4 (Conflicting Obligations) of this Agreement or any other agreement regarding trade secrets, confidential information, nonsolicitation or Labor Code §2870 (Inventions). In the event either the Company or Consultant seeks injunctive relief, the prevailing party will be entitled to recover reasonable costs and attorneys' fees.

E. *Administrative Relief.* Consultant understands that this Agreement does not prohibit Consultant from pursuing an administrative claim with a local, state or federal administrative body such as the Department of Fair Employment and Housing, the Equal Employment Opportunity Commission or the workers' compensation board. This Agreement does, however, preclude Consultant from pursuing court action regarding any such claim.

F. *Voluntary Nature of Agreement.* Consultant acknowledges and agrees that Consultant is executing this Agreement voluntarily and without any duress or undue influence by the Company or anyone else. Consultant further acknowledges and agrees that Consultant has carefully read this Agreement and has asked any questions needed to understand the terms, consequences and binding effect of this Agreement and fully understand it, including that Consultant is waiving its right to a jury trial. Finally, Consultant agrees that Consultant has been provided an opportunity to seek the advice of an attorney of its choice before signing this Agreement.

11. *Miscellaneous.*

A. *Governing Law.* This Agreement shall be governed by the laws of California without regard to California's conflicts of law rules.

B. *Assignability.* Except as otherwise provided in this Agreement, Consultant may not sell, assign or delegate any rights or obligations under this Agreement.

C. *Entire Agreement.* This Agreement constitutes the entire agreement between the parties with respect to the subject matter of this Agreement and supersedes all prior written and oral agreements between the parties regarding the subject matter of this Agreement.

D. *Headings.* Headings are used in this Agreement for reference only and shall not be considered when interpreting this Agreement.

E. *Notices.* Any notice or other communication required or permitted by this Agreement to be given to a party shall be in writing and shall be deemed given if delivered personally or by commercial messenger or courier service, or mailed by U.S. registered or certified mail (return receipt requested), or sent via facsimile (with receipt of confirmation of complete transmission) to the party at the party's address or facsimile number written below or at such other address or facsimile number as the party may have previously specified by like notice. If by mail, delivery shall be deemed effective three business days after mailing in accordance with this Section 11(E).

(1) If to the Company, to:
21211 Nordhoff Street, Chatsworth, CA 91311
Attention:
Telephone: (818) 734-5300
Facsimile: (818) 734-5320

(2) If to Consultant, to the address for notice on the signature page to this Agreement or, if no such address is provided, to the last address of Consultant provided by Consultant to the Company.

F. *Severability.* If any provision of this Agreement is found to be illegal or unenforceable, the other provisions shall remain effective and enforceable to the greatest extent permitted by law.

(Remainder of page intentionally left blank.)

IN WITNESS WHEREOF, the parties hereto have executed this Consulting Agreement as of the date first written above.

CONSULTANT	**CAPSTONE TURBINE CORPORATION**
By: /s/ LEIGH ESTUS	By: /s/ LARRY COLSON

Name: Leigh Estus

Title:

Tax ID #:

Address for Notice:

Name: Larry Colson, Sr. VP Human Resources

By: /s/ DARREN JAMISON

Name: Darren Jamison, President & CEO

EXHIBIT A

Services and Compensation

1. *Contact.* Consultant's principal Company contact:

   Name: Larry Colson

   Title: Sr. Vice President, Human Resources

2. *Services*. The Services shall include, but shall not be limited to, the following:

   Operations consulting services as requested by Larry Colson, or his designee, not to exceed 8 hours on average per month.

3. Consultant will provide services at the rate of $1,000 per month for seven months. Consultant will receive payment for services at the end of each month beginning December 31, 2008 with the last payment being June 30, 2009.

4. During the consultancy period, consultant will continue to vest in the stock options and restricted stock units (RSU) previously granted. All vesting will end on June 30, 2009 at which time the consultant is responsible for contacting the company for a closing statement. Consultant may exercise stock options throughout the consultancy period or within 90 days from the end of the consultancy agreement, in accordance with the Plan documentation. Consultant will receive RSU's as applicable during the term of the consultancy period.

CONSULTANT

By: /s/ LEIGH ESTUS

Name: Leigh Estus

Title:

CAPSTONE TURBINE CORPORATION

By: /s/ LARRY COLSON

Name: Larry Colson, Sr. VP Human Resources

By: /s/ Darren Jamison

Name: Darren Jamison, President & CEO

Exhibit 31.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER

I, Darren R. Jamison, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capstone Turbine Corporation (the "Company");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;

4. The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's quarter ended December 31, 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and

5. The Company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: February 9, 2009

By: /s/ DARREN R. JAMISON

Darren R. Jamison

President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

I, Edward I. Reich, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capstone Turbine Corporation (the “Company”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;

4. The Company’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the Company’s internal control over financial reporting that occurred during the Company’s quarter ended December 31, 2008 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting; and

5. The Company’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the audit committee of the Company’s board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

Date: February 9, 2009

By: /s/ EDWARD I. REICH
Edward I. Reich
Executive Vice President and
Chief Financial Officer

Exhibit 32

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER AND THE CHIEF FINANCIAL OFFICER

In connection with the quarterly report on Form 10-Q of Capstone Turbine Corporation ("the Company") for the period ended December 31, 2008, as filed with the Securities and Exchange Commission on the date hereof ("the Report"), Darren R. Jamison, as Chief Executive Officer of the Company, and Edward I. Reich, as Chief Financial Officer, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to his knowledge, that:

1. The Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 9, 2009

/s/ DARREN R. JAMISON
Darren R. Jamison
President and Chief Executive Officer

Date: February 9, 2009

/s/ EDWARD I. REICH
Edward I. Reich
Executive Vice President and Chief Financial Officer