

POWER EFFICIENCY CORP
Form 10KSB
April 02, 2007

Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-KSB

Annual report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2006

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number: 000-31805

Power Efficiency Corporation

(Name of Small Business Issuer in its Charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

22-3337365
(I.R.S. Employer Identification No.)

3960 Howard Hughes Pkwy, Ste 460
Las Vegas, NV
(Address of Principal Executive Offices)

89169
(Zip Code)

(702) 697-0377

(Issuer's Telephone Number, Including Area Code)

Securities Registered under Section 12(g) of the Exchange Act:

Common Stock, \$.001 Par Value

(Title of Class)

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Check whether the Company: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of Company's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

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

The issuer's revenues for the year ended December 31, 2006 were \$188,811.

As of March 31, 2007, the aggregate market value of the common stock held by non-affiliates of the issuer was approximately \$7,503,010. This amount is based on the closing price of \$0.255 per share for the Company's common stock as of such date.

On March 31, 2007 there were 38,516,676 shares of the Company's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

In this report, references to we, us or our collectively refer to Power Efficiency Corporation.

SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

This report and the documents incorporated into this report contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), including, but not limited to, statements relating to the Company's business objectives and strategy. Such forward-looking statements are based on current expectations, management beliefs, certain assumptions made by the Company's management, and estimates and projections about the Company's industry. Words such as anticipates, expects, intends, plans, believes, estimates, forecasts, is likely, predicts, projects, judgment, variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict with respect to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may differ materially from those expressed, forecasted, or contemplated by any such forward-looking statements.

Factors that could cause actual events or results to differ materially include, but are not limited to, the following: continued market acceptance of the Company's products; the Company's ability to expand and/or modify its products on an ongoing basis; general demand for the Company's products, intense competition from other developers, manufacturers and/or marketers of energy reduction and/or power saving products; the Company's negative net tangible book value; the Company's negative cash flow from operations; delays or errors in the Company's ability to meet customer demand and deliver products on a timely basis; the Company's lack of working capital; the Company's need to upgrade its facilities; changes in laws and regulations affecting the Company and/or its products; the impact of technological advances and issues; the outcomes of pending and future litigation and contingencies; trends in energy use and consumer behavior; changes in the local and national economies; and other risks inherent in and associated with doing business in an engineering and technology intensive industry. See Management's Discussion and Analysis or Plan of Operation. Given these uncertainties, investors are cautioned not to place undue reliance on any such forward-looking statements.

Unless required by law, the Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. However, readers should carefully review the risk factors set forth in other reports or documents that the Company files from time to time with the Securities and Exchange Commission (the "SEC"), particularly Annual Reports on Form 10-KSB, Quarterly Reports on Form 10-QSB and any Current Reports on Form 8-K.

GLOSSARY OF TERMS

Set forth below are technical terms used in the discussion in this document and explanations of the meanings of those terms.

Alternating Current (AC)	A type of electrical current, the direction of which is reversed at regular intervals or cycles; in the U.S. the standard is 120 reversals or 60 cycles per second; typically abbreviated as AC.
Ampere (amp)	A unit of measure for an electrical current; the amount of current that flows in a circuit; abbreviated as amp.
Current (Electrical)	The flow of electrical energy (electricity) in a conductor, measured in amperes.
Cycle	In an alternating current, the current goes from zero potential (or voltage) to a maximum in one direction, back to zero, and then to a maximum potential (or voltage) in the other direction. The number of complete cycles per second determines the current frequency; in the U.S. the standard for alternating current is 60 cycles.
Efficiency	Efficiency is the ratio of work (or energy) output to work (or energy) input, and cannot exceed 100 percent.
Energy	The capability of doing work.
Horsepower (HP)	A unit for measuring the power of motors or the rate of doing work. One horsepower equals 33,000 foot-pounds of work per minute or 746 watts.
Induction	The production of an electric current in a conductor by the variation of a magnetic field in its vicinity.
Induction Motor	The simplest and most rugged electric motor, it consists of a wound stator and a rotor assembly. The AC induction motor is so named because the electric current flowing in its secondary member (the rotor) is induced by the alternating current flowing in its primary member (stator). The power supply is connected only to the stator. The combined electromagnetic efforts of the two currents produce the force to create rotation.
Inrush Current	The current that flows at the instant of connection of a motor to the power source. Usually expressed as a multiple of motor full-load current.
Kilowatt (kW)	A standard unit of electrical power equal to one thousand watts.
Load	The demand on an energy producing system. The energy consumption or requirement of a piece or group of equipment.
Motor	A machine supplied with external energy that is converted into force and/or motion.
Power	The rate at which work is done, typically measured in watts or horsepower.
Power Factor	The ratio of watts to volt-amperes of an AC electric circuit.
Soft-start	Soft-start is the regulation of the supply voltage from an initial low value to full voltage during the starting process.
Torque (Motor)	The rotating force provided by a motor. The units of torque may be expressed as pound-foot, pound-inch (English system), or newton-meter (metric system).

Torque (Starting)	This torque is what is available to initially get the load moving and begin its acceleration.
Transformer	An electromagnetic device that changes the voltage of alternating current electricity; it consists of an induction coil having a primary and secondary winding and a closed iron core.
Voltage	The amount of electromotive force, measured in volts, that exists between two points.
Watt	The amount of power required maintaining a current of one ampere at a pressure of one volt when the two are in phase with each other. One horsepower is equal to 746 watts.

PART I

Item 1. Description of Business.

(a) Business Development

Formation

Power Efficiency Corporation (the Company) was incorporated in Delaware on October 19, 1994. From inception through 1997, the Company was a development stage entity that was engaged in the design, development, marketing and sale of proprietary solid state electrical components designed to effectively reduce energy consumption in alternating current induction motors. Alternating current induction motors are commonly found in industrial and commercial facilities throughout the world.

(b) Business of the Company

The Company's Principal Products

In 1995, the Company commenced the sale of the *Power Commander*[®], more recently branded as the *Power Genius*, its principal and proprietary product that reduces energy consumption in alternating current induction motors in certain applications. The technology and circuitry included in the Company's *Power Genius* is the subject of a United States Patent granted in 1998. The Company offers the *Power Genius* principally as a three phase product, which is used in industrial and commercial applications. The Company also has a single phase version of the product, based on analog technology, which is intended for consumer applications such as home appliances and the like, but this is not a commercialized product. The Company is currently developing software and microprocessor based versions of the three phase and single phase products.

The Company's product is designed to soft start a motor, save energy, and protect and conserve the motor.

The Company's marketing efforts have been initially focused on the Three-Phase version. The *Power Genius* reduces energy consumption on electrical equipment by electronically sensing and controlling the amount of energy the motor consumes. A motor with a *Power Genius* installed only uses the energy it needs to perform its work task, thereby increasing its efficiency. The result is a reduction of energy consumption of up to 15% to 35% in certain applications which do not always run at peak load levels.

The Company's management believes that the *Power Genius* line offers certain advantages over competing products for the following reasons:

The *Power Genius* extends motor life, minimizes maintenance, results in cooler running, reduces stress and strain on the motor, and reduces stress and strain on accompanying electrical and mechanical systems.

The *Power Genius* is the result of field and laboratory engineering refinements undertaken since 1994. These refinements enable the *Power Genius* to offer a control system which measures and monitors key motor operating conditions and adapts motor operating parameters during rapid changes in motor load, all without excessive vibration, synchronization problems or other material adverse effects to the motor or surrounding electrical and mechanical systems.

Paragon Consulting Services, a contractor for Nevada Power Company, performed field tests on the *Power Genius* installed on two escalators and one elevator in a major Las Vegas casino. The tests resulted in energy savings of approximately 35% on the escalators and 21% on the elevator.

Medsker Electric, Inc., an independent electric motor repair and test laboratory, performed a series of inrush current and energy savings tests on the *Power Genius*, then known as the Performance Controller. The tests compared the Company's product to the products of three competitors. In its conclusions, Medsker stated that the Company's product exhibited twice the energy savings of the next nearest competitor. In addition, Medsker concluded that the product exhibited the best soft-start performance, reducing the motor inrush current by 71%. Finally, Medsker concluded that the product was the simplest to install and test, and was the best

performer in terms of energy savings and inrush current reduction.

In addition to the tests performed by independent laboratories, the *Power Genius* has been tested by numerous end users, original equipment manufacturers (OEMs), and other utilities.

Three-Phase Power Genius

The initial market for the Three-Phase *Power Genius* is the elevator and escalator industry, although the Company is actively marketing this product to other industries such as recycling, mining, plastics, manufacturing and distribution. Industries that operate other equipment such as conveyor systems, machine tools, mining equipment, metal stamping presses, granulators, grinders, crushing machines and shredders, are believed to be viable target markets for the Three-Phase *Power Genius* and the Company is seeking to target markets with applications and market access, using direct sales, independent sales representatives and OEMs to address these markets.

Single-Phase Product

Like the Company's Three-Phase product described above, the Company's Single-Phase product reduces energy consumption in electric motors by sensing and controlling the amount of energy the motor consumes. Many motors commonly used in home appliances and other consumer goods are single-phase motors. Since the single-phase product is usable in a broad variety of contexts and can be installed with little effort and expense, the Company believes it is a product most suitable for installation at the OEM level.

Product Development

The Company's development efforts include primarily the transformation of the three phase and single phase products into a digitized form so that the Company's key technology becomes an algorithm on a microchip. Currently, the Company's products are based on analog technology, and the Company anticipates that digitizing the products will have several distinct advantages, including:

Increased ease of installation and reduced technical support requirements. Instead of approximated and manual adjustments during installation, which can require technical support from the Company, the digitized unit will allow more simplified and precise adjustments by customers and third party installers.

Reduced product size, which is important for many installations.

Input-output communications capabilities, so the device can communicate with external control systems.

Increased functionality. With a microchip and software driving the Company's products, the Company expects to be able to ultimately add new functionality to the products. These new functions may include such things as:

Recording and reporting of actual energy savings;

Prediction of maintenance problems by reading and reporting on changes in the motor's operating characteristics; and

More secure intellectual property protection through the use of secured chips and software.

Marketing and Sales

The Company's marketing efforts for the *Power Genius* have historically been concentrated in the elevator and escalator industry, primarily to OEMs of elevator and escalator equipment. End users of the Company's products include retail chains, hotels, airports, the recycling, mining and manufacturing industries and federal government facilities.

As the Company's operations are scaled up and revenues from the sale of the *Power Genius* grow, the Company intends to simultaneously (i) market the *Power Genius* through sales reps to owners and operators of escalator and elevator equipment, such as gaming companies, airports, and transit facilities, as well as (ii) market the *Power Genius* through OEMs of equipment using motor starters, and target select

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industrial markets, such as mining, recycling, distribution or food processing, that have many applications for the Company's products, and (iii) private label and license the Company's products to OEMs of motor controllers.

Manufacturing and Distribution

The Company has an arrangement with one manufacturer in the electronics industry, Cole Industries, Inc (Cole). Cole produces units for the Company on an as-needed basis. Under the arrangement, the Company issues a purchase order outlining, among other things, the number of units to be manufactured and the desired delivery date. Cole sources all components, except for circuit boards, for the units from their own suppliers or those specified by the Company. Once Cole completes the units the Company orders, they ship them directly to the Company's customer. Cole is under no obligation to accept the order and the Company is under no obligation to use Cole for its manufacturing needs. Management believes the arrangement between the Company and Cole has been mutually beneficial to both parties. Management also believes Cole has the ability to meet the Company's production needs and the Company would be successful in finding alternative manufacturers should Cole not be available to manufacture our product.

The Company directly sources its own circuit boards from a contract circuit board manufacturer. Over the past year, the Company has primarily sourced circuit boards from RMF Design and Manufacturing (RMF), based outside of Toronto, Canada. The Company believes RMF has the ability to meet the Company's production needs and the Company would be successful in finding alternative manufacturers should RMF not be available to manufacture our product.

Product cost-reduction and quality improvement efforts are, and will remain, an objective of the Company. One key element of these efforts includes an aggressive engineering effort to move to the use of microchips and algorithms to replace expensive analog circuit boards, as well as the overall reengineering of the product to reduce the size and cost of the units. A second element of this manufacturing and engineering effort is to reduce inventory levels by simplifying the product offering with the ultimate goal of holding little or no inventory. A third element of the program has been to outsource manufacturing, so that fewer resources are spent managing manufacturing and inventory.

Competition

Power Efficiency believes the principal competitive factors in the Company's markets include innovative product development, return on investment from energy savings, product quality, product performance, utility rebate acceptance, established customer relationships, name recognition, distribution and price.

Soft starts and other motor control equipment are made by a number of companies, many of which have longer operating histories, established markets and far greater financial, advertising, research and development, manufacturing, marketing, personnel and other resources than the Company currently has or may reasonably be expected to have in the foreseeable future. This competition may have an adverse effect on the ability of the Company to commence and expand its operations or operate in a profitable manner.

Three-Phase Competition. Although the Company has not completed any formal market study, the Company believes its Three-Phase *Power Genius* has the following competitive advantages:

It combines soft start features with energy savings features in a single integrated unit that is CSA and CE certified and achieves energy savings levels of up to 15% to 35% in independent, third party testing;

Its circuitry is proprietary and protected by a patent. The Company has also filed one provisional patent;

It has been tested extensively by utilities with documented energy savings;

It is accepted by OEMs in the escalator and granulator industries.

Single-Phase Competition. There have been several companies that have, with different technologies, attempted to exploit this market due to the enormous opportunity in single-phase motor applications. These products include among others, Green Plug (voltage clamping), Power Planner (digital microchip) and Econelectric (power factor control).

High Efficiency Motors. Insofar as high efficiency motor replacement is concerned, management believes that the energy savings gain attributable to high efficiency motors is materially lower than that of the *Power Genius* on underloaded motor applications, which is the prime target for the Company's products. Furthermore, the Company's products are able to save energy on underloaded high efficiency motors, so that such motors and the Company's technology are not mutually exclusive.

Source of Supply and Availability of Raw Materials

The *Power Genius* motor controller has been designed to use standard, off-the-shelf, easily acquired components, except for the custom made circuit boards. Such off-the-shelf components are basic items readily available worldwide at competitive prices. They come in standard and miniature versions and offer the Company latitude in product design. Although the Company believes most of the key components required for the production of its products are currently available in sufficient production quantities from multiple sources, there can be no assurance they will remain so readily available or at comparable prices.

Customers

The Company currently does business with approximately 20 customers. Of this number, four, including KONE, Inc., Caesar's Palace, Rinker Materials, and Rapid Granulator, presently account for approximately 75% of the Company's gross revenues. These customers and their respective gross revenue percentages are KONE, Inc. 53%; Rapid Granulator 13%; Caesar's Palace 5%; and Rinker Materials 4%. In light of the Company's intentions to focus its business on a limited number of markets, the Company is, and may continue to be, dependent upon a limited number of customers. Accordingly, the loss of one or more of these customers may have a material adverse effect upon the Company's business.

Patents and Proprietary Rights

The Company currently relies on a combination of trade secrets, non-disclosure agreements and patent protection to establish and protect its proprietary rights in its products. There can be no assurance these mechanisms will provide the Company with any competitive advantages. Furthermore, there can be no assurance others will not independently develop similar technologies, or duplicate or reverse engineer the proprietary aspects of the Company's technology.

The Company has one U.S. patent issued with respect to its products. The Balanced and Synchronized Phase Detector for an AC Induction Motor Controller, No. 5,821,726, was issued on October 13, 1998 and expires in 2017. This patent covers improvements to the technology under the NASA License Agreement (described below), which were developed by the Company. Management believes this patent protects the Company's intellectual property position beyond the expiration of the NASA License Agreement because:

the circuitry covered by the Company's patent more effectively reduces the motor vibration; and

the circuitry eliminates most of the balance and synchronization problems that are created by other energy saving motor controllers, including those that would eventually use the licensed NASA technology upon the expiration of the underlying NASA patents.

The Company has filed three provisional patents on new inventions associated with the development of its digital products. The Company has additional proprietary technology being assessed for patent filing and the Company expects to make additional filings in the future.

NASA License Agreement

The Company had been the exclusive United States licensee of certain power factor controller technology owned by the United States of America, as represented by NASA. This license agreement covered the United States and its territories and possessions and did not require the Company to pay royalties to NASA in connection with the Company's sale of products employing technology utilizing the licensed patents. The Company's rights under the license agreement were non-transferable and were not to be sublicensed without NASA's consent. The license agreement terminated on December 16, 2002 upon expiration of all of the licensed patents.

The Company believes its products and other proprietary rights do not infringe any proprietary rights possessed by third parties. There can be no assurance, however, that third parties will not assert infringement claims in the future, the defense costs of which could be substantial.

The Company has obtained U.S. Trademark registration of the *Power Commander*[®] mark.

Government Regulation

The Company is not required to be certified by any government agencies. However, most of the Company's products are manufactured to comply with specific Underwriters' Laboratory codes that meet national safety standards. Presently, the Company's products comply with UL 508 Industrial Control Equipment and the Company has also received certification meeting CSA (Canadian Standards Association) B44.1-96/ASME-17.5-1996 Elevator and Escalator Electrical Equipment for many of the Company's products. Many of the Company's products are also CE marked. The CE certificate number is C1282PEC1.TLS.doc. The Department of Commerce does not require the Company's technology to be certified for export. The Company's industrial code is 421610 and the SIC code is 5063.

Deregulation of Electrical Energy

Sales of the Company's product are not dependent on continued deregulation of the electrical energy market as the Company's product can be sold in regulated and deregulated markets.

Research and Development

The Company intends to continue its research and development effort to introduce new products based on its energy saving technology. Towards this end, the Company spent \$567,591 and \$418,016 in fiscal years 2006 and 2005, respectively, on research and development activities, virtually none of which was borne by customers. A major focus of the Company's foreseeable research and development activities will be on completing and then improving the digital versions of the three phase and single phase products.

Effect of Environmental Regulations

The Company is not aware of any federal, state, or local provisions regulating the discharge of materials into the environment or otherwise relating to the protection of the environment with which compliance by the Company has had, or is expected to have, a material effect upon the capital expenditures, earnings, or competitive position of the Company.

Employees

At the date of this document, the Company employs eight people on a full time basis. Of this number, one is engaged in accounting and finance, three in operations management, three in sales and marketing, and one in research and development, engineering and manufacturing. At such time as business conditions dictate, the Company may hire additional personnel for, among other things, increased marketing and sales. The Company has no collective bargaining agreements and considers its relationship with its employees to be good. The Company utilizes consultants in the areas of marketing, product and technology development and finance on a regular basis.

(c) Reports to Security Holders

The Company is a small business issuer, and as such files Annual Reports on Form 10-KSB, Quarterly Reports on Form 10-QSB and Current Reports on Form 8-K on a regular basis with the SEC.

The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>.

RISK FACTORS

RISKS RELATED TO OUR BUSINESS

Unless The Company Achieves Profitability and Related Positive Cash Flow, It May Not Be Able To Continue Operations, And Its Auditors Have Questioned Its Ability To Continue As A Going Concern .

The Company has suffered recurring losses from operations, experienced approximately a \$2,760,000 deficiency of cash from operations for the year ended December 31, 2006 and lacks sufficient liquidity to continue our operations without external financing. For the years ended December 31, 2006 and December 31, 2005, we had net losses of \$5,020,775 and \$2,570,563, respectively. In our Auditor's Report dated March 31, 2007 on our December 31, 2006 financial statements included in this report, our auditors have stated that these factors raise substantial doubt about our ability to continue as a going concern . Our financial statements do not include any adjustments relating to the

recoverability and classification of recorded asset amounts or the amount of liabilities that might be necessary should we be unable to continue in existence.

The Company's continuation as a going concern is dependent upon achieving profitable operations and related positive cash flow and satisfying our immediate cash needs by external financing until we are profitable. Our plans to achieve profitability include developing new products, obtaining new customers and increasing sales to existing customers. We are seeking to raise additional capital through equity issuance, debt financing and other types of financing, but we cannot guarantee that sufficient capital will be raised. In that regard, we have granted the holders of our senior secured notes in the aggregate principal amount of \$2,000,000 a first priority security interest in substantially all our assets, which may hinder our ability to raise additional funds.

The Company Has A Limited Operating History, Has Experienced Recurring Losses And Has Limited Revenue.

To date, and due principally to a lack of working capital, our operations have been limited in scale. Although we have an arrangement with an outsourced production facility to manufacture our products, have established relationships with suppliers, and have received contracts for our products, we may experience difficulties in production scale-up, product distribution, and obtaining and maintaining working capital until such time as our operations have been scaled-up to normal commercial levels. We have not had a profitable quarter in the past three years and we cannot guarantee we will ever operate profitably. In addition, we have limited revenue. For the year ended December 31, 2006, our total revenues were \$188,811, and for the year ended December 31, 2005, our total revenues were \$276,405.

The Company's Present Cash Flow Is Not Adequate To Pay Accrued Liabilities.

The Company had accrued payables, salaries and expenses totaling approximately \$585,000 as of December 31, 2006. Approximately \$210,000 of these accrued liabilities represents disputed claims, which we expect to partially pay, settle for equity, or dispute entirely. The remainder of the accrued payables, salaries and expenses are primarily current trade payables and accruals. However, these figures are only estimates and because we may not be able to negotiate successfully with creditors, creditor claims may cause a restriction in the amount of funds available for our operations.

The Company's Principal Obligations On Notes Payable Total \$2,011,111 and This Indebtedness Is Subject To Acceleration.

In addition to the accrued payables, salaries and expenses described immediately above, as of December 31, 2006, the Company had \$2,011,111 in aggregate principal amount of notes payable outstanding. The specific components of this indebtedness are as follows:

The Company owes \$2,000,000 in senior secured notes, before discount. They mature in November 2008, bear interest at 15%, and are secured by a first lien on substantially all our assets. Interest payments are due and payable quarterly. The entire balance of these notes will become due and payable if we cannot pay any past due amount within 7 days of a written notice that payment is in default. As of the date of this report, we do not have any past due payments on these senior secured notes.

The Company owes its former landlord in Livonia, Michigan \$11,111, before discount, in settlement of our lease dispute litigation. As of the date of this report, we do not have any past due payments on this settlement.

The Company Does Not Have A Bank Line Of Credit And Substantially All Of Its Assets Are Pledged.

At the present time, the Company does not have a bank line of credit, which further restricts its financial flexibility and it is unlikely the Company will be able to obtain a line of credit in the foreseeable future. As noted above, substantially all the Company's assets are subject to existing liens.

The Company Will Require Additional Funds To Meet Its Cash Operating Expenses And Achieve Its Current Business Strategy.

The Company continues to have limited working capital and will be dependent upon additional financing to meet capital needs and repay outstanding debt. We cannot guarantee additional financing will be available on acceptable terms, if at all. We also need additional financing to raise the capital required to fully implement our business plan. Our current fixed operating expense level is approximately \$250,000 to \$300,000 per month, not considering non-cash expenses and payments to certain creditors, including accrued salaries and expenses, and may increase in the near future. We will need to issue additional debt or equity to raise required funds, and as a result existing equity owners would be diluted.

When our operations require additional financing, if we are unable to obtain it on reasonable terms, we would be forced to restructure, file for bankruptcy or cease operations, any of which could cause you to lose all or part of your investment in us.

The Company's Management Group Owns Or Controls A Significant Number Of The Outstanding Shares Of Our Common Stock And Will Continue To Have Significant Ownership Of Our Voting Securities For The Foreseeable Future.

As of the date of this report, management controls approximately twenty-three percent (23%) of our issued and outstanding Common Stock and voting equivalents. As a result, these persons will have the ability, acting as a group, to effectively control our affairs and business, including the election of directors and, subject to certain limitations, approval or preclusion of fundamental corporate transactions. This concentration of ownership of our common stock may:

delay or prevent a change in the control;

impede a merger, consolidation, takeover, or other transaction involving the Company; or

discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of the Company.

Additionally, Summit Energy Ventures, LLC (Summit) owns nineteen percent (19%) of our common stock and voting equivalents, which is included in the above number. Summit is controlled by Steven Strasser, our Chairman and CEO, and he has the right to vote all shares owned by Summit. The remaining equity in Summit is owned by BJ Lackland, our CFO. These relationships are discussed in more detail under Certain Relationships And Related Party Transactions herein.

The Company's License From NASA Has Expired.

The basic technology upon which our products are based is derived from a patent license agreement by and between us and NASA, which expired on December 16, 2002. The license expired upon expiration of NASA's underlying patents, at which time anyone, including us, became free to use the underlying NASA technology. However, we have also made certain improvements to the basic technology covered by the NASA license and we have obtained a patent on this improved technology that runs through 2017. Management believes this improved technology places us in a competitively superior position. However, we cannot guarantee that others will not seek to improve the basic technology in a similar or different manner which may result in a superior product.

The Company's Business Depends Upon The Maintenance Of Our Proprietary Technology, And We Rely, In Part, On Contractual Provisions To Protect Our Trade Secrets And Proprietary Knowledge.

The Company depends upon its proprietary technology, relying principally upon trade secret and patent law to protect this technology. The Company also regularly enters into confidentiality agreements with key employees, customers, potential customers, and vendors and limits access to and distribution of trade secrets and other proprietary information. However, these measures may not be adequate to prevent misappropriation of our technology. Additionally, our competitors may independently develop technologies substantially equivalent or superior to our technology. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States. We also are subject to the risk of adverse claims and litigation alleging infringement of intellectual property rights of others.

Confidentiality agreements to which we are party may be breached, and we may not have adequate remedies for any breach. Our trade secrets may also be known without breach of such agreements or may be independently developed by competitors. Our inability to maintain the proprietary nature of our technology and processes could allow our competitors to limit or eliminate any competitive advantages we may have.

The Company Is Potentially Dependent On Third-Party Suppliers.

Although we believe most of the key components required for the production of our products are currently available in sufficient production quantities from multiple sources, they may not remain so readily available. It is possible that other components required in the future may necessitate custom fabrication in accordance with specifications developed or to be developed by us. Also, in the event that we, or our contract manufacturer, as applicable, are unable to develop or acquire components in a timely fashion, our ability to achieve production yields, revenues and net income can be expected to be adversely affected. Additionally, we are solely dependent on Cole as our exclusive manufacturer. While we believe we would be successful in finding alternative manufacturers should this manufacturer not be available to manufacture our product, it could take substantial time and effort to locate such alternatives and, depending on the timing of the loss of Cole, could result in disruption in

delivery schedules and harm to our clients and our reputation and future prospects.

The Company Is Developing And Commercializing New Energy Saving Technologies And Products Which Will Involve Uncertainty And Risks Related To Product Development And Market Acceptance.

Our success is dependent, to a large degree, upon our ability to fully develop and commercialize our technology and gain industry acceptance of our products based upon our technology and its perceived competitive advantages. Accordingly, our prospects must be considered in light of the risks, expenses and difficulties frequently encountered in connection with the establishment of a new business in a highly competitive industry, characterized by frequent new product introductions. We anticipate that we will incur substantial expense in connection with the development and testing of our proposed products and expect these expenses to result in continuing and significant losses until such time, if ever, that we are able to achieve adequate levels of sales or license revenues.

The Company Has Expanded Its Marketing Strategy.

Our products have been distributed primarily through OEMs. We have recently begun pursuing an expanded distribution strategy designed to reduce our reliance on OEMs. Pursuant to this strategy, we are increasing our direct sales and sales through independent representatives into new markets. Our future growth and profitability will depend upon the successful development of business relationships with additional OEMs, manufacturing representatives and distributors and their ability to penetrate the market with our products.

The Company Currently Depends On A Small Number Of Customers And Expect To Continue To Do So.

The Company currently does business with approximately 20 customers. Of this number, four customers accounted for approximately 75% of our gross revenues in 2006. We are, and may continue to be, dependent upon a small number of customers. Accordingly, the loss of one or more of these customers is likely to have a material adverse effect on our business.

Most Of The Company's Current And Potential Competitors Have Greater Name Recognition, Financial, Technical And Marketing Resources, And More Extensive Customer Bases And Industry Relationships Than We Do, All Of Which Could Be Leveraged To Gain Market Share To Our Detriment, Particularly In An Environment Of Rapid Technological Change.

Although we believe we have limited competition for our specific technology, we compete against a number of companies for dollars in the electric motor energy savings market, many of which have longer operating histories, established markets and far greater financial, advertising, research and development, manufacturing, marketing, personnel and other resources than we currently have or may reasonably expect to have in the foreseeable future. This competition may have an adverse effect on our ability to expand our operations or operate profitably. The motor control industry is also highly competitive and characterized by rapid technological change. Our future performance will depend in large part upon our ability to become and remain competitive and to develop, manufacture and market acceptable products in these markets. Competitive pressures may necessitate price reductions, which can adversely affect revenues and profits. If we are not competitive in our ongoing research and development efforts, our products may become obsolete, or be priced above competitive levels. However, management believes, based upon their performance and price, our products are attractive to customers. We cannot guarantee that competitors will not introduce comparable or technologically superior products, which are priced more favorably than our products.

Changes In Retail Energy Prices Could Affect The Company's Business.

We have found that a customer's decision to purchase the Power Genius (or similar product) is primarily driven by the payback on the investment resulting from the increased energy savings. Although management believes that current retail energy prices support an attractive return on investment for our products, the future retail price of electrical energy may not remain at such levels, and price fluctuations reducing energy expense could adversely affect product demand.

Loss Of Key Personnel Could Have Significant Adverse Consequences.

We currently depend on the services of Steve Strasser, and BJ Lackland, Chief Executive Officer, and Chief Financial Officer, respectively. The loss of the services of either of these persons could have an adverse effect on our business. As discussed under "Management", we have entered into long-term employment contracts with Messrs. Strasser and Lackland, but such contracts do not guarantee they will remain with us.

The Company Does Not Have Key Man Life Insurance.

The Company presently does not have any key man life insurance policies. As soon as practicable following the commencement of profitable operations (which may never occur), we intend to purchase key man life insurance on the life of our principal executive officer, Steven Strasser. Upon purchase of such insurance, we intend to pay the premiums and be the sole beneficiary. The lack of such insurance may have a material adverse effect upon our business.

Delaware Law Limits The Liability Of Our Directors.

Pursuant to our Certificate of Incorporation, the Company's directors are not liable to us or our stockholders for monetary damages for breach of fiduciary duty, except for liability in connection with a breach of the duty of loyalty, for acts or omissions not in good faith or which involved intentional misconduct or a knowing violation of law for dividend payments or stock repurchases illegal under Delaware law or any transaction in which a director has derived an improper personal benefit.

The Company Has Elected Not To Adopt Various Voluntary Corporate Governance Measures, And As A Result Stockholders May Have Limited Protections Against Interested Director Transactions, Conflicts Of Interest And Similar Matters.

Recent Federal legislation, including the Sarbanes-Oxley Act of 2002, has resulted in the adoption of various corporate governance measures designed to promote the integrity of corporate management and the securities markets. Because our securities are not yet listed on a national securities exchange or NASDAQ, we are not required to adopt these corporate governance measures and have not done so voluntarily in order to avoid incurring the additional costs associated with such measures. However, to the extent we seek to have our common stock listed on a national securities exchange or NASDAQ, such legislation will require us to make changes to our current corporate governance practices. Those changes may be costly and time-consuming. Furthermore, the absence of the governance measures referred to above with respect to our Company may leave our stockholders with more limited protection in connection with interested director transactions, conflicts of interest and similar matters.

Potential Product Liability Claims May Not Be Fully Covered By Insurance.

The Company may be subject to potential product liability claims that could, in the absence of sufficient insurance coverage, have a material adverse impact on us. Presently, we have general liability coverage that includes product liability up to \$2,000,000. Any large product liability suits occurring early in our growth may significantly and adversely affect our ability to expand the market for our products.

RISKS RELATED TO OUR COMMON STOCK AND CAPITAL STRUCTURE

Trading In Our Common Stock Over The Last 12 Months Has Been Limited, So Investors May Not Be Able To Sell As Many Of Their Shares As They Want At Prevailing Prices.

Shares of our common stock are traded on the OTC Bulletin Board. Approximately 58,000 shares were traded on an average daily trading basis for the 12 months ended December 31, 2006. If limited trading in our common stock continues, it may be difficult for shareholders, to sell their shares. Also, the sale of a large block of our common stock could depress the market price to a greater degree than a company that typically has a higher volume of trading of its securities.

The Limited Public Trading Market May Cause Volatility In The Company's Stock Price.

The Company's common stock is currently traded on a limited basis on the OTC Bulletin Board under the symbol PEFF. The quotation of our common stock on the OTC Bulletin Board does not assure that a meaningful, consistent and liquid trading market currently exists, and in recent years such market has experienced extreme price and volume fluctuations that have particularly affected the market prices of many smaller companies like us. Our common stock is thus subject to this volatility. Sales of substantial amounts of our common stock, or the perception that such sales might occur, could adversely affect prevailing market prices of our common stock.

An Active And Visible Trading Market For Our Common Stock May Not Develop.

We cannot predict whether an active market for our common stock will develop in the future. In the absence of an active trading market:

Investors may have difficulty buying and selling or obtaining market quotations;

Market visibility for our common stock may be limited; and

A lack of visibility for our common stock may have a depressive effect on the market price for our common stock. The OTC Bulletin Board is an inter-dealer, over-the-counter market that provides significantly less liquidity than NASDAQ, and quotes for stocks included on the OTC Bulletin Board are not listed in the financial sections of newspapers, as are those for the NASDAQ Stock Market. The trading price of the common stock is expected to be subject to significant fluctuations in response to variations in quarterly operating results, changes in analysts' earnings estimates, announcements of innovations by the Company or its competitors, general conditions in the industry in which we operate and other factors. These fluctuations, as well as general economic and market conditions, may have a material or adverse effect on the market price of our common stock.

Penny Stock Regulations May Impose Certain Restrictions On Marketability Of The Company's Securities.

The SEC has adopted regulations which generally define a penny stock to be any equity security that has a market price of less than \$5.00 per share or an exercise price of less than \$5.00 per share, subject to certain exceptions. As a result, our common stock is subject to rules that impose additional requirements on broker-dealers who sell such securities to persons other than established customers and accredited investors (generally those with net worth in excess of \$1,000,000 or annual income exceeding \$200,000, or \$300,000 together with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of such securities and have received the purchaser's written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the rules require the delivery, prior to the transaction, of a risk disclosure document relating to the penny stock market. The broker-dealer must also disclose the commission payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Consequently, the penny stock rules may restrict the ability of broker-dealers to sell the Company's securities and may affect the ability of investors to sell the Company's securities in the secondary market and the price at which such purchasers can sell any such securities.

Stockholders should be aware that, according to the Commission, the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include:

Control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer;

Manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases;

Boiler room practices involving high pressure sales tactics and unrealistic price projections by inexperienced sales persons;

Excessive and undisclosed bid-ask differentials and markups by selling broker-dealers; and

The wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the inevitable collapse of those prices with consequent investor losses.

The Company's management is aware of the abuses that have occurred historically in the penny stock market.

The Company May Never Pay Cash Dividends On Our Common Stock.

We have not paid or declared any dividends on our common stock and do not anticipate paying or declaring any cash dividends on our common stock in the foreseeable future.

Sales Of Common Stock Under Rule 144 May Adversely Affect The Market Price Of Our Common Stock.

Possible Resales under Rule 144. Of the 38,516,676 shares of the Company's common stock outstanding on the date of this report, 14,292,962 shares are freely trading in the market place (the Free Trading Shares). The Free Trading Shares are comprised mostly of shares (1) originally issued in private offerings of common stock from June through August 2005, that were later registered in the Company's SB-2 Registration Statement (the Registration Statement) effective December 19, 2005, and (2) shares originally issued in transactions exempt from registration under the Securities Act.

The remaining 24,223,714 shares of our common stock outstanding are restricted securities as defined in Rule 144 and under certain circumstances may be resold without registration pursuant to Rule 144. These shares include the 7,970,569 shares held by Summit and Steven Strasser in the aggregate, 3,333,334 shares held by a private investor, and the 3,249,049 shares of common stock held by Commerce Energy Group (Commerce), an affiliate of the Company.

In addition, the Company had approximately 23,996,693 common stock purchase warrants outstanding and approximately 13,284,896 common stock options outstanding as of the date of this report, including the warrants issued in connection with the recent private offer and sale of the senior secured notes. The shares issuable on exercise of the options and warrants may, under certain circumstances, be available for public sale in the open market under the Registration Statement or pursuant to Rule 144, subject to certain limitations.

In general, under Rule 144, a person (or persons whose shares are aggregated) who has satisfied a one-year holding period may, under certain circumstances, sell within any three-month period a number of securities which does not exceed the greater of 1% of the then outstanding shares of common stock or the average weekly trading volume of the class during the four calendar weeks prior to such sale. Rule 144 also permits, under certain circumstances, the sale of securities, without any limitation, by a person who is not an Affiliate, as such term is defined in Rule 144(a)(1), of the Company and who has satisfied a two-year holding period. Any substantial sale of the common stock pursuant to Rule 144 may have an adverse effect on the market price of the Company's shares.

Exercise Of Outstanding Options And Warrants Will Dilute Ownership Of Outstanding Shares.

As of the date of this report, the Company has reserved 71,429 shares of common stock for issuance upon exercise of stock options or similar awards which may be granted pursuant to the 1994 Plan, of which no options are outstanding. Furthermore, we have reserved 20,000,000 shares of our common stock for issuance upon exercise of stock options or similar awards which may be granted pursuant to the 2000 Plan, of which options to purchase an aggregate of 13,284,896 shares are outstanding. The outstanding options under the 2000 Plan have a weighted average exercise price of \$0.35. As of the date of this report, we have issued warrants exercisable for 23,996,693 shares of common stock to financial consultants, investors, former employees and other business partners, having a weighted average exercise price of \$0.41 and expiring on various dates from June 2007 to November 2011. Exercise of these options and warrants in the future will reduce the percentage of common stock held by the public stockholders. Furthermore, the terms on which we could obtain additional capital during the life of the options and warrants may be adversely affected, and it should be expected that the holders of the options and warrants would exercise them at a time when we would be able to obtain equity capital on terms more favorable than those provided for by such options and warrants.

The Company's Issuance Of Blank Check Preferred Stock Could Adversely Affect Our Common Stockholders.

The Company's Certificate of Incorporation authorizes the issuance of blank check preferred stock with such designations, rights and preferences as may be determined from time to time by the board of directors. Accordingly, our Board of Directors is empowered, without stockholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the relative voting power or other rights of the holders of our common stock. In the event of issuance, the preferred stock could be used as a method of discouraging, delaying or preventing a change in control of the Company, which could have the effect of discouraging bids for the Company and thereby prevent stockholders from receiving the maximum value for their shares. Although we have no present intention to issue any shares of our preferred stock, there can be no assurance that we will not do so in the future.

Line of Credit

At the present time, the Company does not have a bank line of credit.

Item 2. Description of Property.

The Company's corporate office space is located at 3960 Howard Hughes Pkwy, Suite 460, Las Vegas, Nevada 89169. The office lease calls for rent of \$11,292 per month through the end of the lease term in February 2011.

Item 3. Legal Proceedings.

At the present time, the Company is not involved in any litigation.

In 2005, the Company settled litigation with the owner of its former office space in Livonia, Michigan. The Company vacated this space in 2004. Under the settlement the Company has paid its former landlord \$50,000 in cash and is currently paying the former landlord an additional \$50,000 in 18 monthly installments of \$2,778 each month. After application of the Company's accrued loss contingency reserve, it recognized a loss of approximately \$65,000 on its December 31, 2005 financial statements. The Company owes the landlord \$10,087, net, as of December 31, 2006.

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

None.

PART II**Item 5. Market for Common Equity and Related Stockholder Matters.
Market for Common Stock**

The Company's common stock is thinly traded on the National Association of Securities Dealers' Over the Counter Bulletin Board (OTCBB) under the symbol "PEFF".

The following table sets forth the high and low bid information for quarterly periods in the two twelve month periods ended December 31, 2006 and December 31, 2005, as reported by Yahoo.com.

Twelve months Ended December 31, 2005	High	Low
October 1, 2005 - December 31, 2005	\$ 0.80	\$ 0.25
July 1, 2005 - September 30, 2005	0.50	0.22
April 1, 2005 - June 30, 2005	0.25	0.19
January 1, 2005 - March 31, 2005	0.52	0.22

Twelve months Ended December 31, 2006	High	Low
October 1, 2006 - December 31, 2006	\$ 0.40	\$ 0.21
July 1, 2006 - September 30, 2006	0.30	0.18
April 1, 2006 - June 30, 2006	0.43	0.20
January 1, 2006 - March 31, 2006	0.40	0.20

As of the date of this report, there were 175 shareholders of record of the Company's common stock.

The Company has not paid dividends on its common stock since its incorporation. The Company does not expect to pay cash dividends on its common stock in the foreseeable future. The Company intends to invest funds otherwise available for dividends, if any, on improving the Company's capital assets.

EQUITY COMPENSATION PLAN INFORMATION

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under 2000 Stock Option and Restricted Stock Plan (excluding securities reflected in column (a))(c)
2000 Stock Option and Restricted Stock Plan approved by security holders	13,284,896	\$ 0.35	6,715,104
Equity compensation plans not approved by security holders	0	0.00	0
Total	13,284,896	\$ 0.35	6,715,104

The Company maintains a Stock Option Equity Compensation Plan. (See Note 12 to the Financial Statements)

Recent Sales of Unregistered Securities

Sales Made to Summit Energy Ventures, Commerce Energy Group and Commonwealth Energy Corporation

The following details several different sales of unregistered securities the Company made to Summit, Commonwealth Energy Corporation, a former member of Summit (Commonwealth) and Commerce Energy Group, the parent corporation of Commonwealth (Commerce). All of the sales were exempt from registration under the Securities Act of 1933, as amended (the Securities Act), pursuant to section 4(2) of the Securities Act.

On June 7, 2004, Summit Energy Ventures notified the Company that it had transferred 1,747,587 of the Company's Series A-1 Convertible Preferred Stock and 1,645,404 of the Company's common stock to Commonwealth. This transfer makes Commonwealth the Company's single largest shareholder.

On April 28, 2005, the Company issued 1,204,819 shares of Series A-1 Convertible Preferred Stock, convertible into 1,000,000 shares of common stock, and warrants to purchase 500,000 shares of common stock to Summit for an aggregate purchase price of \$200,000. The requisite percentage of current holders consented and waived the anti-dilution provisions.

On April 28, 2005, the Company issued 180,723 shares of Series A-1 Convertible Preferred Stock, convertible into 150,000 shares of common stock, and warrants to purchase 75,000 shares of common stock, to Commerce, in consideration of Commerce's cancellation of a license agreement with the Company. The requisite percentage of current holders consented and waived the anti-dilution provisions.

On July 8, 2005, the Company issued 3,000,000 shares of common stock and 1,500,000 warrants to Summit for \$300,000 in cash and the conversion of a \$300,000 note payable.

On July 8, 2005, the Company converted all 4,714,279 outstanding shares of its Series A-1 Convertible Preferred Stock owned by Summit and Commonwealth into 3,918,848 shares of common stock.

Sales Made to Purchasers Other than Summit Energy Ventures, Commerce Energy Group and Commonwealth Energy Corporation

On various dates from December 2003 to February 27, 2004, the Company issued 15,103 shares of common stock to Richard Koch. The shares were issued in exchange for the cancellation of debt owed to Mr. Koch in the amount of \$60,866. The issuances were exempt from registration under the Securities Act pursuant to Regulation D. At the time, Mr. Koch was the Chief Executive Officer and a director of the Company.

On various dates from May 2003 to February 2004, the Company issued 682,156 shares of common stock to Starz Investments Limited, a Belize company. The Company received \$1,423,760 for these shares and paid \$88,276 in commissions to Burnham Securities. The Company also issued Burnham Securities 48,303 common stock purchase warrants as compensation related to these transactions. The warrants had strike prices that varied from approximately \$1.40 to \$1.75. These warrants were exercised cashlessly resulting in 32,958 shares being issued. The sales of stock to Starz Investments Limited were exempt from registration under the Securities Act pursuant to Regulation S promulgated under the Securities Act. The issuance of the warrants to Burnham Securities was exempt from registration under the Securities Act pursuant to section 4(2) of the Securities Act.

On January 8, 2004, the Company issued 15,397 shares of common stock to Raymond Skiptunis. The shares were issued in exchange for the cancellation of debt owed to Mr. Skiptunis in the amount of \$71,130. The issuance was exempt from registration under the Securities Act pursuant to Regulation D. Mr. Skiptunis is a director of the Company.

On February 26, 2004, the Company issued 174 shares of common stock to Leonard Bellezza. The shares were issued in exchange for the cancellation of debt owed to Mr. Bellezza in the amount of \$800. The issuance was exempt from registration under the Securities Act pursuant to Regulation D. Mr. Bellezza is a director of the Company.

On various dates from February 2004 to June 2004, the Company issued 13,580 shares of common stock to Richard Koch, the former President and Chief Executive Officer of the Company. These shares were issued in conjunction with the settlement of certain accounts payable and accrued expenses related to his employment agreement.

On July 8, 2005, the Company issued 9,150,000 shares of common stock to several accredited investors in a private offering for \$1,830,000.

On August 31, 2005, the Company issued 2,350,000 shares of common stock to several accredited investors in the second and final closing of this private offering for \$470,000.

On November 30, 2006, the Company issued 10,700,008 shares of common stock to several accredited investors in the first closing of a private offering of common stock for \$3,210,000, of which approximately \$2,760,000 was from new cash and \$450,000 was from the exchange of debt. Of this amount, the CEO, CFO and one Director of the Company invested a total of \$510,000, of which approximately \$260,000 was from new cash and \$250,000 was from the exchange of debt.

On January 19, 2007, the Company issued 666,668 shares of common stock to several accredited investors in the second closing of a private offering of common stock for \$200,000 in cash.

On March 2, 2007, the Company issued 1,583,336 shares of common stock to several accredited investors in the third closing of a private offering of common stock for \$475,000 in cash.

On March 7, 2007, the Company issued 333,334 shares of common stock to an accredited investor in the fourth closing of a private offering of common stock for \$100,000 in cash.

On March 30, 2007, the Company issued 500,000 shares of common stock to several accredited investors in the fifth closing of a private offering of common stock for \$150,000 in cash.

On March 31, 2007, the Company issued 333,334 shares of common stock to an accredited investor on the sixth and final closing of a private offering of common stock for \$100,000 in cash.

Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations or Plan of Operation. OVERVIEW

The Company generates revenues from a single business segment: the design, development, marketing and sale of proprietary solid state electrical components designed to reduce energy consumption in alternating current induction motors.

The Company began generating revenues from sales of its patented *Power Genius* line of motor controllers in late 1995. As of December 31, 2006, the Company had total stockholders' equity of \$2,044,913 primarily due to the Company's sale of 10,700,008 shares of common stock in a private stock offering that closed on November 30, 2006, 14,500,000 shares of common stock in a private stock offering in July and August of 2005, the Company's sale of 2,346,233 shares of Series A-1 Convertible Preferred stock to Summit Energy Ventures, LLC in June of 2002 and the conversion of notes payable of approximately \$1,047,000 into 982,504 shares of Series A-1 Convertible Preferred stock in October of 2003. In addition, in August 2000, the Company purchased the assets of Percon, formerly the largest distributor of the Company's products. The transaction was accounted for as a purchase and the Company's Statements of Operations includes Percon's results of operations since the date of acquisition. The consolidation of the operations of both entities allowed the Company to integrate the administrative, sales, marketing and manufacturing operations of Percon. Percon had developed sales contacts with major OEM's in the elevator/escalator industry and transferred those agreements to the Company as part of the sale.

RESULTS OF OPERATIONS: FISCAL YEAR 2006 COMPARED TO FISCAL YEAR 2005

REVENUES

Revenues for the year ended December 31, 2006, were \$188,811 compared to \$276,405 for the year ended December 31, 2005, a decrease of \$87,594, or 32%. This decrease is mainly attributable to changes in sales personnel and the resulting disruptions to sales efforts in 2006.

COST OF REVENUES

Cost of revenues for the year ended December 31, 2006 were \$136,240 compared to \$245,789 for the year ended December 31, 2005, a decrease of \$109,549 or 45%. As a percentage of product revenues, total costs of product revenues decreased to approximately 72% for the year ended December 31, 2006 compared to approximately 89% for the year ended December 31, 2005. The decrease in the costs as a percentage of product revenues was primarily due to raising some unit prices mid-year in 2006 and the sale of higher margin units in 2006.

GROSS MARGIN

Gross margin for the year ended December 31, 2006 was \$52,571 compared to \$30,616 for the year ended December 31, 2005, an increase of \$21,955 or 72%. This increase was primarily due to the raising some unit prices mid-year in 2006 and the sale of higher margin units in 2006, as well as the Company utilizing a new turn-key manufacturer for production that required less oversight by Company personnel in 2006.

OPERATING EXPENSES

Research and Development Expenses

Research and development expenses were \$567,591 for the year ended December 31, 2006 compared to \$418,016 for the year ended December 31, 2005, an increase of \$149,575 or 36%. This increase is mainly attributable to the Company's research and development efforts on its digital controller for both its single-phase and three-phase products and payment of higher salaries to personnel, particularly for the first half of 2006, due to significantly reduced salaries in the first six months of 2005. Research and development salaries decreased in the second half of 2006. Additionally, the Company recognized a non-cash charge of approximately \$56,000 related to the adoption of SFAS 123R (See Note 2 to the financial statements) in 2006.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$3,118,233 for the year ended December 31, 2006, compared to \$1,641,307 for the year ended December 31, 2005, an increase of \$1,476,926 or 90%. The increase in selling, general and administrative expenses over the prior year was due primarily to an increase in payroll and payroll related costs, comprised of: non-cash expenses associated with the Company's adoption of SFAS 123R (See Note 2 to the financial statements) which resulted in a non-cash charge of approximately \$1,019,000, the increase in the Company's workforce in connection with the Company's new sales and marketing plan, and higher salaries paid to personnel due to significantly reduced salaries in the first and second quarters of 2005, as well as increases in the Company's investor relations expenses and professional fees.

Interest expense was approximately \$1,354,195 for the year ended December 31, 2006, as compared to \$529,387 for the year ended December 31, 2005, an increase of \$824,808 or 156%. The increase in interest expense is primarily related to a non-cash finance charge related to the value of stock warrants issued in connection with a line of credit, recorded earlier in 2006. Total non-cash interest expense for the year ended December 31, 2006 was \$1,039,451.

Prior to 2006, the Company accounted for employee stock options under the intrinsic method of APB No. 25, and presented fair value disclosure as pro forma as provided by SFAS No. 123, as permitted under accounting principles generally accepted in the United States of America. Beginning in 2006, the Company is accounting for employee stock options as compensation expense, in accordance with SFAS No. 123R, Share Based Payments. SFAS No. 123R requires companies to expense the value of employee stock options and similar awards for periods beginning after December 15, 2005, and applies to all outstanding and vested stock-based awards at a company's adoption date. Results from prior periods have not been restated in the Company's historical financial statements.

In computing the impact, the fair value of each option is estimated on the date of grant based on the Black-Scholes options-pricing model utilizing certain assumptions for a risk free interest rate; volatility; and expected remaining lives of the awards. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and the Company uses different assumptions, the Company's stock-based compensation expense could be materially different in the future. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. In estimating the Company's forfeiture rate, the Company analyzed its historical forfeiture rate, the remaining lives of unvested options, and the amount of vested options as a percentage of total options outstanding. If the Company's actual forfeiture rate is materially different from its estimate, or if the Company reevaluates the forfeiture rate in the future, the stock-based compensation expense could be significantly different from what we have recorded in the current period. The impact of applying SFAS No. 123R approximated \$1,075,000 in additional compensation expense during the year ended December 31, 2006. Such amount is included in research and development expenses, and selling, general and administrative expenses on the statement of operations.

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The following table represents the Company's Condensed Statement of Operations for the years ended December 31, 2006 and December 31, 2005 on a pro forma basis, with non-cash compensation and non-cash interest expense stated separately:

	For the year ended December 31	
	2006	2005
	(Unaudited)	
Total Revenues	\$ 188,811	\$ 276,405
Total Cost of Product Revenues	136,240	245,789
Gross Margin	52,571	30,616
Costs and Expenses:		
Research and development	513,449	418,016
Selling, general and administration	2,016,069	1,613,758
SFAS 123 stock option expense*	999,320	683,533
Other non-cash consideration*	165,528	27,549
Depreciation and amortization	34,028	22,470
Total Costs and Expenses	3,728,394	2,765,329
Loss From Operations	(3,675,823)	(2,734,710)
Other (Expense) Income:		
Cash interest (expense) income, net	(305,501)	(263,525)
Non-cash interest (expense) income, net*	(1,039,451)	(252,015)
Total Other (Expense) Income	(1,344,952)	(515,540)
Net Loss	\$ (5,020,775)	\$ (3,250,250)
*Sum of non-cash compensation and non-cash interest expense	2,204,299	963,097
Net Loss excluding non-cash compensation and non-cash interest	\$ (2,816,476)	\$ (2,287,153)

Financial Condition, Liquidity, and Capital Resources: For the Year Ended December 31, 2006

Since inception, the Company has financed its operations primarily through the sale of its securities. In 2006, the Company received approximately \$3,210,000 in gross proceeds from a private placement of its common stock and warrants to purchase common stock, as to which the Company is required to file a registration statement on Form SB-2. As of December 31, 2006 the Company has received a total of approximately \$12,564,800 from public and private offerings of its equity securities, received \$300,000 from a bridge note with a shareholder (which was converted into 3,000,000 shares of common stock and 1,500,000 warrants with an additional investment of \$300,000 on July 8, 2005), received approximately \$445,386 under a bank line of credit (which was repaid during 2002), and received \$1,000,000 under a line of credit with a shareholder (which was converted to Series A-1 Preferred Convertible shares during 2003). In October 2004 and February 2005, the Company received \$1,589,806 in debt financing through a debt offering arranged by a placement agent, Pali Capital. Of this total, \$300,000 plus accrued interest was converted from borrowings with the same shareholder as referenced above. In April 2006, the Company received \$1,000,000 in debt financing from EMTUCK, LLC, in which the managing member is a management company wholly owned and controlled by Steven Strasser, the Company's CEO. In May 2006, the Company received an additional \$500,000 in debt financing from EMTUCK. In November 2006, the Company received \$2,000,000 in debt financing. Of this amount, \$1,450,000 was converted from borrowings from prior investors. As of December 31, 2006 the Company had cash of \$1,693,584.

Net cash used for operating activities for the twelve months ended December 31, 2006 was \$2,756,724 which primarily consisted of: a net loss of \$5,020,775; less bad debt expense of \$11,470, depreciation and amortization of \$34,028, loss on disposal of fixed assets of \$585, amortization of debt discounts of \$1,039,451, amortization of deferred financing costs of \$70,364, warrants and options issued in connection with settlements, services from consultants, vendors, the forgiveness of indebtedness, the issuance of debt to employees and consultants of \$1,074,848, common stock issued for consulting services of \$90,000, decreases in accounts receivable of \$26,464, and inventory of \$14,487, increases in prepaid expenses of \$3,206, deposits of \$33,875, and restricted cash related to a note payable of \$4,688. In addition, these amounts were partially offset by decreases in accounts payable and accrued expenses of \$55,454, customer deposits of \$5,105 and an increase in accrued salaries and payroll taxes of \$4,682.

Net cash used for operating activities for the twelve months ended December 31, 2005 was \$2,080,509 which primarily consisted of: a net loss of \$2,570,563; less bad debt expense of \$14,963, depreciation and amortization of \$22,470, amortization of debt discounts of \$252,015, amortization of deferred financing costs of \$80,584, warrants and options issued in connection with settlements, services from consultants, vendors, the forgiveness of indebtedness and the issuance of debt of \$140,502, increases in accounts receivable of \$53,556, prepaid expenses of \$65,337 and other assets of \$6,339, decreases in inventory of \$16,478 and restricted cash related to a note payable of \$215,033. In addition, these amounts were partially offset by an increase in customer deposits of \$5,105 and decreases in accounts payable and accrued expenses of \$46,685 and accrued salaries and payroll taxes of \$85,179.

Net cash used in investing activities for fiscal year 2006 was \$90,567, compared to \$4,613 in fiscal year 2005. The amounts for both fiscal years 2006 and 2005 consisted of the purchase of fixed assets.

Net cash provided by financing activities for fiscal year 2006 was \$3,531,755 which primarily consisted of proceeds from the issuance of equity securities, net of costs, of \$3,180,000, proceeds from the issuance of debt securities of \$2,000,000 and proceeds from a line of credit of \$1,500,000. These amounts were offset by payments on notes payable of \$1,648,245 and payments on a line of credit of \$1,500,000.

Net cash provided by financing activities for fiscal year 2005 was \$2,701,771 which primarily consisted of proceeds from the issuance of equity securities of \$2,677,153, proceeds from the issuance of debt securities of \$125,000 and a note payable from a legal settlement of \$38,297. These amounts were offset by an increase in deferred financing costs of \$63,457 and payments on loans from stockholders officers and former officers of \$75,222.

The Company expects to increase its operating expenses, particularly in research and development and selling, general and administrative expenses, for the foreseeable future in order to execute its business strategy. As a result, the Company anticipates that operating expenses will constitute a material use of any cash resources.

Cash Requirements and Need for Additional Funds

The Company anticipates a substantial need for cash to fund its working capital requirements. In accordance with the Company's prepared expansion plan, it is the opinion of management that approximately \$3.0 - \$3.6 million will be required to cover operating expenses, including, but not limited to, marketing, sales, research and operations during the next twelve months. If the Company is unable to obtain funding on reasonable terms or finance its need through current operations, the Company will be forced to restructure, file for bankruptcy or cease operations.

Notable changes to expenses are expected to include an increase in the Company's sales personnel and efforts, and developing more advanced versions of the Company's technology and products.

Recent Accounting Pronouncements

See Note 2 - Summary of Significant Accounting Policies to the Financial Statements for an explanation of recent accounting pronouncements impacting the Company.

Item 7. Financial Statements and Supplementary Data.

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POWER EFFICIENCY CORPORATION

FINANCIAL STATEMENTS

DECEMBER 31, 2006 AND 2005

POWER EFFICIENCY CORPORATION

DECEMBER 31, 2006 AND 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Power Efficiency Corporation

Las Vegas, Nevada

We have audited the accompanying balance sheet of Power Efficiency Corporation, (a Delaware corporation) (the Company) as of December 31, 2006, and the related statements of operations, changes in stockholders' equity, and cash flows for each of the years ended December 31, 2006 and 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Power Efficiency Corporation at December 31, 2006 and the results of its operations and its cash flows for the years ended December 31, 2006 and 2005 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company has suffered recurring losses from operations, the Company has experienced a deficiency of cash from operations and lacks sufficient liquidity to continue its operations. These matters raise substantial doubt as to the Company's ability to continue as a going concern. Management's plans in regard to these matters are also discussed in Note 3. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

March 31, 2007

Livingston, New Jersey

/s/ Sobel & Co., LLC
Certified Public Accountants

POWER EFFICIENCY CORPORATION

BALANCE SHEET

DECEMBER 31, 2006

ASSETS

CURRENT ASSETS:

Cash	\$ 1,693,584
Accounts receivable, net of reserve and allowance of \$40,916	32,193
Inventories, net	117,639
Prepaid expenses and other current assets	70,468
Total Current Assets	1,913,884

PROPERTY AND EQUIPMENT, Net 76,056

OTHER ASSETS:

Deposits	33,875
Patents, net	33,811
Goodwill	1,929,963
Inventories long-term, net	39,213
Deferred financing costs, net	11,228
	2,048,090
	\$ 4,038,030

LIABILITIES AND STOCKHOLDERS EQUITY

CURRENT LIABILITIES:

Accounts payable and accrued expenses	\$ 537,133
Accrued salaries and payroll taxes	47,970
Notes payable Arens Investment Company, net	10,087
Total Current Liabilities	595,190

LONG-TERM LIABILITIES:

Notes Payable 2008, net	1,397,927
Total Long-Term Liabilities	1,397,927

Total Liabilities 1,993,117

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS EQUITY:

Series A-1 Convertible Preferred Stock, \$0.001 par value 10,000,000 shares authorized, none issued or outstanding	
Common stock, \$0.001 par value, 100,000,000 shares authorized, 35,042,009 shares issued and outstanding	35,042
Additional paid-in capital	24,927,839
Accumulated deficit	(22,917,968)
Total Stockholders Equity	2,044,913

\$ 4,038,030

See report of independent registered public accounting firm and notes to financial statements.

POWER EFFICIENCY CORPORATION

STATEMENTS OF OPERATIONS

	Year Ended December 31,	
	2006	2005
REVENUES	\$ 188,811	\$ 276,405
COMPONENTS OF COST OF SALES:		
Material, labor and overhead	136,240	245,789
GROSS MARGIN	52,571	30,616
COSTS AND EXPENSES:		
Research and development	567,591	418,016
Selling, general and administrative	3,118,233	1,641,307
Depreciation and amortization	34,028	22,470
Total Costs and Expenses	3,719,852	2,081,793
LOSS FROM OPERATIONS	(3,667,281)	(2,051,177)
OTHER INCOME (EXPENSE):		
Interest income	9,243	13,847
Interest expense	(1,354,195)	(529,387)
Total Other Expenses, Net	(1,344,952)	(515,540)
LOSS BEFORE PROVISION FOR TAXES	(5,012,233)	(2,566,717)
PROVISION FOR TAXES	(8,542)	(3,846)
NET LOSS	\$ (5,020,775)	\$ (2,570,563)
BASIC AND FULLY DILUTED LOSS PER COMMON SHARE	\$ (0.20)	\$ (0.18)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING BASIC	25,150,386	14,254,029

See report of independent registered public accounting firm and notes to financial statements.

POWER EFFICIENCY CORPORATION

STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

YEAR ENDED DECEMBER 31, 2006 AND 2005

	Common Stock		Preferred Stock		Additional	Accumulated	Total
	Shares	Amount	Shares	Amount	Paid-in Capital	Deficit	Stockholders Equity
Balance, January 1, 2005	5,020,418	\$ 5,020	3,328,737	\$ 3,329	\$ 16,386,611	\$ (15,326,630)	\$ 1,068,330
Issuance of preferred stock			1,385,542	1,386	238,638		240,024
Issuance of common stock	14,500,000	14,500			1,360,633		1,375,133
Common stock issued upon conversion of preferred stock	3,918,848	3,919	(4,714,279)	(4,715)	796		
Warrants and options issued in connection with services from consultants and vendors and the forgiveness of indebtedness					140,502		140,502
Warrants and options issued in connection with the issuance of common stock					1,487,891		1,487,891
Expenses related to issuance of common stock					(425,894)		(425,894)
Net loss						(2,570,563)	(2,570,563)
Balance, December 31, 2005	23,439,266	\$ 23,439		\$	\$ 19,189,177	\$ (17,897,193)	\$ 1,315,423
Issuance of common stock	11,000,008	11,000			3,199,300		3,210,300
Common stock issued upon exercise of warrants	602,735	603			(603)		
Warrants and options issued in connection with the issuance of common stock, debt securities and to employees and consultants					2,569,965		2,569,965
Expenses related to issuance of common stock					(30,000)		(30,000)
Net loss						(5,020,775)	(5,020,775)
Balance, December 31, 2006	35,042,009	\$ 35,042		\$	\$ 24,927,839	\$ (22,917,968)	\$ 2,044,913

See report of independent registered public accounting firm and notes to financial statements.

POWER EFFICIENCY CORPORATION

STATEMENTS OF CASH FLOWS

	Year Ended December 31,	
	2006	2005
CASH FLOWS PROVIDED BY (USED FOR):		
OPERATING ACTIVITIES:		
Net loss	\$ (5,020,775)	\$ (2,570,563)
Adjustments to reconcile net loss to net cash used for operating activities:		
Bad debt expense	11,470	14,963
Depreciation and amortization	34,028	22,470
Loss on disposition of fixed assets	585	
Debt discount related to issuance of debt securities		