Lifevantage Corp
Form 10-Q
November 04, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

ý QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015

¨ 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 001-35647

LIFEVANTAGE CORPORATION
(Exact name of Registrant as specified in its charter)

COLORADO	90-0224471
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

9785 S. Monroe Street, Ste 300, Sandy, UT 84070
(Address of principal executive offices)
(801) 432-9000
(Registrant's telephone number)

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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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	ý
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 ý
The number of shares outstanding of the issuer's common stock, par value $0.001 per share, as of October 30, 2015 was 13,996,906.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q, in particular "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," and the information incorporated by reference herein contains “forward-looking statements” (as such term is defined in Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended). These statements, which involve risks and uncertainties, reflect our current expectations, intentions, or strategies regarding our possible future results of operations, performance, and achievements. Forward-looking statements include, without limitation: statements regarding future products or product development; statements regarding future selling, general and administrative costs and research and development spending; statements regarding the future performance of our network marketing efforts; statements regarding our expectations regarding ongoing litigation; statements regarding international growth; and statements regarding future financial performance, results of operations, capital expenditures and sufficiency of capital resources to fund our operating requirements. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and applicable rules of the Securities and Exchange Commission and common law.

These forward-looking statements may be identified in this report and the information incorporated by reference by words such as “anticipate”, “believe”, “could”, “estimate”, “expect”, “intend”, “plan”, “predict”, “project”, “should” and simila expressions, including references to assumptions and strategies. These statements reflect our current beliefs and are based on information currently available to us. Accordingly, these statements are subject to certain risks, uncertainties, and contingencies, which could cause our actual results, performance, or achievements to differ materially from those expressed in, or implied by, such statements.

The following factors are among those that may cause actual results to differ materially from our forward-looking statements:

- Inability to strengthen our business and properly manage distractions among our distributors in Japan;
- Inability to manage existing markets, open new international markets or expand our operations;
- Inability of new products to gain distributor or market acceptance;
- Our inability to execute our product launch process due to increased pressure on our supply chain, information systems and management;
- Disruptions in our information technology systems;
- Inability to comply with financial covenants imposed by our credit facility;
- Inability to protect against cyber security risks and to maintain the integrity of data;
- The impact of our debt service obligations and restrictive debt covenants;
- Claims against us as a result of our independent distributors failing to comply with applicable legal requirements or our policies and procedures;
- International trade or foreign exchange restrictions, increased tariffs, foreign currency exchange;
- Deterioration of global economic conditions;
- Inability to maintain appropriate level of internal control over financial reporting;
- Inability to raise additional capital if needed;
- Exposure to environmental liabilities stemming from past operations and property ownership;
- Significant dependence upon a few products for revenue;
- Inability to retain independent distributors or to attract new independent distributors on an ongoing basis;
- High quality material for our products may become difficult to obtain or expensive;
- Improper actions by our independent distributors that violate laws or regulations;
- Dependence on third parties to manufacture our products;
- Disruptions to the transportation channels used to distribute our products;

- We may be subject to a product recall;
- Government regulations on direct selling activities may prohibit or severely restrict our business model;
- Unfavorable publicity on our business or products;
- Our direct selling program could be found to not be in compliance with current or newly adopted laws or regulations;
- Legal proceedings may be expensive and time consuming;
- Strict government regulations on our business;
- Regulations governing the production or marketing of our products;
- Risk of investigatory and enforcement action by the federal trade commission;
- Government authorities may question our tax positions or transfer pricing policies or change their laws in a manner that could increase our effective tax rate or otherwise harm our business;
- Failure to comply with anti-corruption laws;
- Inability to build and integrate our new management team could harm our business;
- Loss of, or inability to attract, key personnel;
- We could be held responsible for certain taxes or assessments relating to the activity of our independent distributors;
- Competition in the dietary supplement market;
- Our inability to protect our intellectual property rights;
- Third party claims that we infringe on their intellectual property;
- Product liability claims against us;
- Economic, political, foreign exchange and other risks associated with international operations;
- Volatility of the market price of our common stock;
- Substantial sales of shares may negatively impact the market price of our common stock;
- Significant dilution of outstanding voting shares if holders of our existing warrants and options exercise their securities for shares of common stock;
- We have not paid dividends on our capital stock, and we do not currently anticipate paying dividends in the foreseeable future; and
- Other factors not specifically described above, including the other risks, uncertainties, and contingencies described under “Business”, “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Items 1, 1A and 7 of our Annual Report on Form 10-K for the year ended June 30, 2015 and under "Risk Factors" in Part II, Item 1A of this Quarterly Report on Form 10-Q.

When considering these forward-looking statements, you should keep in mind the cautionary statements in this report and the documents incorporated by reference. We have no obligation and, except as required by law, do not undertake to update or revise any such forward-looking statements to reflect events or circumstances after the date of this report.

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PART I Financial Information
Item 1. Financial Statements
LIFEVANTAGE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands, except per share data)	As of, September 30, 2015	June 30, 2015
ASSETS		
Current assets		
Cash and cash equivalents	$13,686	$13,905
Accounts receivable	1,144	1,031
Income tax receivable	2,811	2,179
Inventory	8,538	9,248
Current deferred income tax asset	1,086	1,117
Prepaid expenses and deposits	3,596	2,995
Total current assets	30,861	30,475
Property and equipment, net	5,267	5,759
Intangible assets, net	1,845	1,879
Long-term deferred income tax asset	229	235
Other long-term assets	1,400	1,433
TOTAL ASSETS	$39,602	$39,781
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities		
Accounts payable	$2,502	$2,614
Commissions payable	6,450	6,505
Other accrued expenses	7,280	5,600
Current portion of long-term debt	11,723	11,141
Total current liabilities	27,955	25,860
Long-term debt		
Principal amount	6,786	10,484
Less: unamortized discount and deferred offering costs	(1,767)	(1,951)
Long-term debt, net of unamortized discount and deferred offering costs	5,019	8,533
Other long-term liabilities	2,051	2,063
Total liabilities	35,025	36,456
Commitments and contingencies - Note 6		
Stockholders’ equity		
Preferred stock — par value $0.001 per share, 50,000 shares authorized, no shares issued or outstanding	—	—
Common stock — par value $0.001 per share, 250,000 shares authorized and 13,981 and 13,958 issued and outstanding as of September 30, 2015 and June 30, 2015, respectively	14	14
Additional paid-in capital	117,826	117,657
Accumulated deficit	(113,029)	(114,095)
Accumulated other comprehensive loss	(234)	(251)
Total stockholders’ equity	4,577	3,325

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$39,602	$39,781

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

LIFEVANTAGE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Unaudited)

	For the Three Months Ended September 30,	
	2015	2014
(In thousands, except per share data)		
Revenue, net	$45,352	$51,633
Cost of sales	6,975	5,679
Gross profit	38,377	45,954
Operating expenses:		
Commissions and incentives	22,043	24,574
Selling, general and administrative	13,663	13,615
Total operating expenses	35,706	38,189
Operating income	2,671	7,765
Other income (expense):		
Interest expense	(749)	(808)
Other income (expense), net	(216)	203
Total other income (expense)	(965)	(605)
Income before income taxes	1,706	7,160
Income tax expense	(640)	(2,444)
Net income	$1,066	$4,716
Net income per share:		
Basic	$0.08	$0.33
Diluted	$0.08	$0.32
Weighted-average shares outstanding:		
Basic	13,709	14,228
Diluted	13,830	14,837
Other comprehensive income, net of tax:		
Foreign currency translation adjustment	17	57
Other comprehensive income, net of tax	17	57
Comprehensive income	$1,083	$4,773

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

LIFEVANTAGE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
(In thousands)						
Balances, June 30, 2015	13,958	$14	$117,657	$(114,095)	$ (251)	$3,325
Stock-based compensation	—	—	188	—	—	188
Exercise of options and warrants	—	—	(19)	—	—	(19)
Issuance of shares related to restricted stock	43	—	—	—	—	—
Shares canceled or surrendered as payment of tax withholding	(20)	—	—	—	—	—
Currency translation adjustment	—	—	—	—	17	17
Net income	—	—	—	1,066	—	1,066
Balances, September 30, 2015	13,981	$14	$117,826	$(113,029)	$ (234)	$4,577

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

LIFEVANTAGE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Three Months Ended September 30,	
	2015	2014
(In thousands)		
Cash Flows from Operating Activities:		
Net income	$1,066	$4,716
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	531	585
Stock-based compensation	192	474
Amortization of deferred financing fees	104	61
Amortization of debt discount	81	48
Deferred income tax	37	—
Changes in operating assets and liabilities:		
Decrease / (increase) in receivables	(739)	1,469
Decrease / (increase) in inventory	657	(2,379)
Increase in prepaid expenses and deposits	(606)	(1,467)
Decrease in long-term assets	50	563
Increase / (decrease) in accounts payable	(109)	1,392
Increase / (decrease) in accrued expenses	1,304	(379)
Increase / (decrease) in other long-term liabilities	273	(21)
Net Cash Provided by Operating Activities	2,841	5,062
Cash Flows from Investing Activities:		
Purchase of equipment	(3)	(236)
Net Cash Used in Investing Activities	(3)	(236)
Cash Flows from Financing Activities:		
Excess tax benefit from stock-based compensation	(19)	—
Repurchase of company stock	—	(2,000)
Payment on term loan	(3,116)	(1,175)
Exercise of options and warrants	—	35
Net Cash Used in Financing Activities	(3,135)	(3,140)
Foreign Currency Effect on Cash	78	62
(Decrease) Increase in Cash and Cash Equivalents:	(219)	1,748
Cash and Cash Equivalents — beginning of period	13,905	20,387
Cash and Cash Equivalents — end of period	$13,686	$22,135
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	$559	$699
Cash paid for income taxes	$1,207	$372

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

LIFEVANTAGE CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
These unaudited Condensed Consolidated Financial Statements and Notes should be read in conjunction with the audited financial statements and notes of LifeVantage Corporation (the “Company”) as of and for the year ended June 30, 2015 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on September 1, 2015.
Note 1 — Organization and Basis of Presentation
LifeVantage Corporation is a company dedicated to helping people achieve their health, wellness and financial independence goals. We provide quality, scientifically-validated products and a financially rewarding direct sales business opportunity to customers and independent distributors who seek a healthy lifestyle and financial freedom. We sell our products to preferred customers, retail customers and independent distributors located in the United States, Japan, Hong Kong, Australia, Canada, Philippines, Mexico and Thailand.
We engage in the identification, research, development and distribution of advanced nutraceutical dietary supplements and skin care products, including Protandim®, our scientifically-validated dietary supplement, LifeVantage TrueScience®, our line of anti-aging skin care products, Canine Health®, our companion pet supplement formulated to combat oxidative stress in dogs, and Axio®, our energy drink mixes.
The condensed consolidated financial statements included herein have been prepared by the Company’s management, without audit, pursuant to the rules and regulations of the SEC. In the opinion of the Company’s management, these interim Financial Statements include all adjustments, consisting of normal recurring adjustments, that are considered necessary for a fair presentation of its financial position as of September 30, 2015, and the results of operations for the three months ended September 30, 2015 and 2014 and the cash flows for the three months ended September 30, 2015 and 2014. Interim results are not necessarily indicative of results for a full year or for any future period. Certain amounts in the prior year financial statements have been reclassified for comparative purposes in order to conform with current year presentation.
The condensed consolidated financial statements and notes included herein are presented as required by Form 10-Q, and do not contain certain information included in the Company’s audited financial statements and notes for the fiscal year ended June 30, 2015 pursuant to the rules and regulations of the SEC. For further information, refer to the financial statements and notes thereto as of and for the year ended June 30, 2015, and included in the Annual Report on Form 10-K on file with the SEC.
Note 2 — Summary of Significant Accounting Policies
Consolidation
The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation.
Use of Estimates
We prepare our consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America (GAAP). In preparing these statements, we are required to use estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates and assumptions. On an ongoing basis, we review our estimates, including those related to inventory obsolescence, sales returns, income taxes and tax valuation reserves, share-based compensation, and loss contingencies.
Translation of Foreign Currency Statements
A portion of the Company’s business operations occurs outside the United States. The local currency of each of the Company’s subsidiaries is generally its functional currency. All assets and liabilities are translated into U.S. dollars at exchange rates existing at the balance sheet dates, revenue and expenses are translated at weighted-average exchange rates and stockholders’ equity is recorded at historical exchange rates. The resulting foreign currency translation adjustments are recorded as a separate component of stockholders’ equity in the condensed consolidated balance sheets and as a component of comprehensive income. Transaction gains and losses and currency translation gains and losses

on intercompany balances denominated in a foreign currency are included in other income (expense), net in the condensed consolidated statements of operations and comprehensive income. Net foreign currency losses of $0.2 million and $0.1 million are recorded in other income (expense), net for the three months ended September 30, 2015 and 2014, respectively.

Derivative Instruments and Hedging Activities

The Company's subsidiaries enter into transactions with each other which may not be denominated in the respective subsidiaries' functional currencies. The Company seeks to reduce its exposure to fluctuations in foreign exchange rates through the use of derivatives. The Company does not use such derivative financial instruments for trading or speculative purposes.

To hedge risks associated with the foreign-currency-denominated intercompany transactions, the Company entered into forward foreign exchange contracts which were settled in September 2015 and were not designated for hedge accounting. For the three months ended September 30, 2015 and 2014 , the Company realized a loss of $9,000 and a gain of $0.3 million, respectively, related to forward contracts which is recorded in other income (expense), net. The Company did not hold any derivative instruments at September 30, 2015.

Cash and Cash Equivalents

The Company considers only its monetary liquid assets with original maturities of three months or less as cash and cash equivalents.

Concentration of Credit Risk

Accounting guidance for financial instruments requires disclosure of significant concentrations of credit risk regardless of the degree of such risk. Financial instruments with significant credit risk include cash and investments. At September 30, 2015, the Company had $11.2 million in cash accounts that were held primarily at one financial institution and $2.5 million in accounts at other financial institutions. As of September 30, 2015 and June 30, 2015, and during the periods then ended, the Company’s cash balances exceeded federally insured limits.

Accounts Receivable

The Company’s accounts receivable as of September 30, 2015 and June 30, 2015 consist primarily of credit card receivables. Based on the Company’s verification process for customer credit cards and historical information available, management has determined that an allowance for doubtful accounts on credit card sales as of September 30, 2015 is not necessary. No bad debt expense has been recorded for the periods ended September 30, 2015 and September 30, 2014.

Inventory

As of September 30, 2015 and June 30, 2015, inventory consisted of (in thousands):

	September 30, 2015	June 30, 2015
Finished goods	$4,283	$5,783
Raw materials	4,255	3,465
Total inventory	$8,538	$9,248

Inventories are carried and depicted above at the lower of cost or net realizable value, using the first-in, first-out method, which includes a reduction in inventory values of $0.2 million and $0.3 million at September 30, 2015 and June 30, 2015, respectively, related to obsolete and slow-moving inventory.

Revenue Recognition

The Company ships the majority of its product directly to the consumer and receives substantially all payment for these sales in the form of credit card receipts. Revenue from direct product sales to customers is recognized upon passage of title and risk of loss. Estimated returns are recorded when product is shipped. Subject to some exceptions based on local regulations, the Company’s return policy is to provide a full refund for product returned within 30 days if the returned product is unopened or defective. After 30 days, the Company generally does not issue refunds to direct sales customers for returned product. The Company allows terminating distributors to return up to 30% of unopened, unexpired product that they have purchased within the prior twelve months for a full refund, less a 10% restocking fee. The Company establishes the returns reserve based on historical experience. The returns reserve is evaluated on a quarterly basis. As of September 30, 2015 and June 30, 2015, the Company’s reserve balance for returns and allowances was approximately $0.1 million and $0.1 million, respectively.

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Shipping and Handling

Shipping and handling costs associated with inbound freight and freight out to customers, including independent distributors, are included in cost of sales. Shipping and handling fees charged to customers are included in sales.

Research and Development Costs

The Company expenses all costs related to research and development activities as incurred. Research and development expenses for the three months ended September 30, 2015 and 2014 were approximately $0.2 million and $0.5 million, respectively.

Stock-Based Compensation

The Company recognizes stock-based compensation by measuring the cost of services to be rendered based on the grant date fair value of the equity award. The Company recognizes stock-based compensation, net of any estimated forfeitures, over the period an employee is required to provide service in exchange for the award, generally referred to as the requisite service period. For awards with market based performance conditions, the cost of the awards is recognized as the requisite service is rendered by employees, regardless of when, if ever, the market based performance conditions are satisfied.

The Black-Scholes option pricing model is used to estimate the fair value of stock options. The determination of the fair value of stock options is affected by the Company's stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. The Company uses historical volatility as the expected volatility assumption required in the Black-Scholes model. The Company utilizes a simplified method for estimating the expected life of the options. The Company uses this method because it believes that it provides a better estimate than the Company’s historical data as post vesting exercises have been limited. The risk-free interest rate assumption is based on observed interest rates appropriate for the expected terms of the stock options.

The fair value of restricted stock grants is based on the closing market price of the Company's stock on the date of grant less the Company's expected dividend yield. The fair value of performance stock units that include market based performance conditions is based on the closing market price of the Company's stock on the date of grant less the Company's expected dividend yield, with further adjustments made to reflect the market conditions that must be satisfied in order for the units to vest by using a Monte-Carlo simulation model. Key assumptions for the Monte-Carlo simulation model include the risk-free rate, expected volatility, expected dividends and the correlation coefficient. The fair value of cash-settled performance based awards, accounted for as liabilities, is remeasured at the end of each reporting period and is based on the closing market price of the Company’s stock on the last day of the reporting period. The Company recognizes compensation costs for awards with performance conditions when it concludes it is probable that the performance conditions will be achieved. The Company reassesses the probability of vesting at each balance sheet date and adjusts compensation costs accordingly.

Reverse Stock Split

In October 2015, following approval of the Company's shareholders, the Company's board of directors approved the filing of an amendment to the Company's amended and restated articles of incorporation to effectuate a reverse split of the issued and outstanding shares of the Company's common stock on a one-for-seven basis. The reverse stock split was effective on October 19, 2015. The par value and authorized number of shares of common stock were not adjusted as a result of the reverse split. All fractional shares resulting from the reverse stock split were rounded up. All issued and outstanding common stock and per share amounts contained within the Company's consolidated financial statements and footnotes have been retroactively adjusted to reflect this reverse stock split for all periods presented.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using statutory tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in income in the period that includes the effective date of the change.

For the three months ended September 30, 2015 and 2014, the Company recognized income tax expense of $0.6 million and $2.4 million, respectively, which is reflective of the Company's current estimated federal, state and foreign effective tax rate. Realization of deferred tax assets is dependent upon future earnings in specific tax jurisdictions, the timing and amount of which are uncertain. The Company continues to evaluate the realizability of the deferred tax asset based upon achieved and estimated future results. The difference between the three months ended September 30, 2015 effective rate of 37.5% and the Federal statutory rate of 35.0% is due primarily to the effect of state taxes and certain permanent differences.

Income Per Share

Basic income per common share is computed by dividing the net income by the weighted-average number of common shares outstanding during the period, less unvested restricted stock awards. Diluted income per common share is computed by dividing net income by the weighted-average common shares and potentially dilutive common share equivalents using the treasury stock method.

For the three months ended September 30, 2015 the effects of approximately 0.5 million common shares issuable upon exercise of options and non-vested shares of restricted stock granted pursuant to the Company’s 2007 and 2010 Long-Term Incentive Plans are not included in computations because their effect was anti-dilutive. For the three months ended September 30, 2014 the effects of approximately 0.3 million common shares issuable upon exercise of options granted pursuant to the Company’s 2007 and 2010 Long-Term Incentive Plans were not included in computations because their effect was anti-dilutive.

The following is a reconciliation of net income per share and the weighted-average common shares outstanding for purposes of computing basic and diluted net income per share (in thousands except per share amounts):

	For the Three Months Ended September 30,	
	2015	2014
Numerator:		
Net income	$1,066	$4,716
Denominator:		
Basic weighted-average common shares outstanding	13,709	14,228
Effect of dilutive securities:		
Stock awards and options	59	228
Warrants	62	381
Diluted weighted-average common shares outstanding	13,830	14,837
Net income per share, basic	$0.08	$0.33
Net income per share, diluted	$0.08	$0.32

Segment Information

The Company operates in a single operating segment by selling products to an international network of independent distributors that operates in an integrated manner from market to market. Commissions and incentives expenses are the Company’s largest expense comprised of the commissions paid to its worldwide independent distributors. The Company manages its business primarily by managing its international network of independent distributors. The Company does not use profitability reports on a regional or divisional basis for making business decisions. However, the Company does report revenue in two geographic regions: Americas and Asia/Pacific. Revenues by geographic area are as follows (in thousands):

	For the Three Months Ended September 30,	
	2015	2014
Americas	$34,726	$36,456
Asia/Pacific	10,626	15,177
Total revenues	$45,352	$51,633

Additional information as to the Company’s revenue from operations in the most significant geographical areas is set forth below (in thousands):

	For the Three Months Ended September 30,	
	2015	2014
United States	$33,496	$35,009
Japan	$8,593	$12,194

As of September 30, 2015 long-lived assets were $6.1 million in the United States and $1.4 million in Japan. As of June 30, 2015 long-lived assets were $6.5 million in the United States and $1.5 million in Japan.

Effect of New Accounting Pronouncements

In April 2015, FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 825-30): Simplifying the Presentation of Debt Issuance Costs. This guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The Company adopted this updated standard in the current year during the interim period ended September 30, 2015 by reclassifying the debt issue costs from long-term assets to a direct reduction from the related debt, consistent with the debt discount. All prior period balances have been retrospectively adjusted.

Note 3 — Long-Term Debt

On October 18, 2013 the Company entered into a Financing Agreement providing for a term loan facility in an aggregate principal amount of $47 million (the “Term Loan”) and a delayed draw term loan facility in an aggregate principal amount not to exceed $20 million (the “Delayed Draw Term Loan” and collectively with the Term Loan, the “Credit Facility”). The Delayed Draw Term Loan was available for borrowing in specified minimum amounts from time to time beginning after the effective date (as defined in the Financing Agreement) until October 18, 2014. The Company did not borrow any amounts under the Delayed Draw Term Loan.

On May 1, 2015 the Company entered into an Amendment No. 1 to Financing Agreement ("Amendment No. 1"). Amendment No. 1 revised the March 31, 2015 and June 30, 2015 consolidated EBITDA covenants from $20.6 million and $21.3 million, respectively, to $17.0 million for each quarter end. Amendment No. 1 also revised the minimum unrestricted cash and cash equivalents that the Company is required to hold from $10.0 million to $8.0 million for the reporting periods ended March 31, 2015 and June 30, 2015. In addition, Amendment No. 1 required that the Company make certain accelerated principal payments on the Term Loan totaling $4.5 million during the fourth quarter of fiscal year 2015.

On August 27, 2015 the Company entered into an Amendment No. 2 to Financing Agreement ("Amendment No. 2" and collectively, with the Term Loan, as previously amended by Amendment No. 1, the "Credit Facility"). Amendment No. 2 revised the covenants related to minimum consolidated EBITDA (as defined in the amended Financing Agreement) for the four consecutive fiscal quarters ending September 30, 2015, December 31, 2015, March 31, 2016 and June 30, 2016 from $22.2 million, $23.1 million, $24.4 million and $25.6 million, respectively, to $14.5 million, $15.0 million, $17.0 million and $17.5 million, respectively. In addition, Amendment No. 2 requires that the Company make additional monthly accelerated principal payments on the Term Loan in the amount of $0.5 million commencing on October 15, 2015 and continuing until the Term Loan has been paid in full. Amendment No. 2 also requires that the Company make additional accelerated payments at the end of each fiscal quarter in the amount of all unrestricted cash on hand as of the close of business on the last day for the quarter in excess of $12.5 million.

The principal amount of the Term Loan is payable in consecutive quarterly installments beginning with the calendar quarter ended March 31, 2014 and matures on the earlier of October 18, 2018 or such date as the outstanding loans become payable in accordance with the terms of the Financing Agreement (the “Final Maturity Date”). The Term loan bears interest at a rate equal to 7.5% per annum plus the greater of (i) 1.25% or (ii) LIBOR, or at the Company’s option, a reference rate (as defined in the Financing Agreement) plus 6.5% per annum, with such interest payable monthly. For the three months ended September 30, 2015 the average interest rate was 8.75%.

The Company’s obligations under the Credit Facility are secured by a security interest in substantially all of the Company’s assets. Loans outstanding under the Credit Facility (1) must be prepaid based on certain cash flow metrics and with any net proceeds of certain permitted asset sales and (2) may be prepaid in whole or in part at any time, with any prepayments made prior to the first anniversary of the effective date subject to a prepayment premium. Any principal amount of the loans which is prepaid or repaid may not be re-borrowed.

The Credit Facility contains customary negative covenants that, among other things, restrict the Company from undertaking specified corporate actions such as the creation of liens, incurrence of additional indebtedness, making certain investments with affiliates, changes of control, having excess foreign cash, issuance of equity, repurchasing the Company's equity securities, and making certain restricted payments, including dividends, without prior approval from the lender. The Credit Facility also contains various financial covenants that require the Company to maintain a certain consolidated EBITDA, certain leverage and fixed charges ratios as well as a minimum level of liquidity. Additionally, the Credit Facility contains cross-default provisions, whereby a default pursuant to the terms and conditions of certain indebtedness will cause a default on the remaining indebtedness under the Credit Facility. As of September 30, 2015, the Company was in compliance with all applicable covenants including those under the amended Credit Facility.

During the three months ended September 30, 2015, the Company recorded interest expense of $0.2 million related to transaction costs associated with the 2013 Credit Facility. At September 30, 2015, the Company had unamortized transaction costs totaling $1.8 million included in the consolidated balance sheet. The remaining balance will be amortized to interest expense using the interest method.

The Company’s book value for the Credit Facility approximates the fair value. Aggregate future principal payments required in accordance with the terms of the Credit Facility are as follows (in thousands):

Year Ending June 30,	Amount
2015 (remaining nine months ending June 30, 2016)	$9,048
2016	9,461
	$18,509

Note 4 — Stockholders’ Equity

During the three months ended September 30, 2015 the Company issued 43,000 shares of restricted stock and no shares of common stock upon the exercise of warrants and options. During the three months ended September 30, 2015, 20,000 shares of restricted stock were canceled or surrendered as payment of tax withholding upon vesting.

The Company’s Articles of Incorporation authorize the issuance of preferred shares. However, as of September 30, 2015, none have been issued nor have any rights or preferences been assigned to the preferred shares by the Company’s Board of Directors.

Note 5 — Stock-based Compensation

Long-Term Incentive Plans

The Company adopted and the shareholders approved the 2007 Long-Term Incentive Plan (the “2007 Plan”), effective November 21, 2006, to provide incentives to certain eligible employees, directors and consultants. A maximum of 1.4 million shares of the Company's common stock can be issued under the 2007 Plan in connection with the grant of awards. Awards to purchase common stock have been granted pursuant to the 2007 Plan and are outstanding to various employees, officers, directors, Scientific Advisory Board members and independent distributors at prices between $1.47 and $10.50 per share, with initial vesting periods of one to three years. Awards expire in accordance with the terms of each award and the shares subject to the award are added back to the 2007 Plan upon expiration of the award. The contractual term of stock options granted is generally ten years. As of September 30, 2015 there were awards outstanding, net of awards expired, for the purchase in aggregate of 0.3 million shares of the Company's common stock.

The Company adopted and the shareholders approved the 2010 Long-Term Incentive Plan (the “2010 Plan”), effective September 27, 2010, as amended on August 21, 2014, to provide incentives to eligible employees, directors and consultants who contribute to the strategic and long-term performance objectives and growth of the Company. A maximum of 1.5 million shares of the Company's common stock can be issued under the 2010 Plan in connection with the grant of awards. Awards to purchase common stock have been granted pursuant to the 2010 Plan and are outstanding to various employees, officers and directors. Outstanding stock options awarded under the 2010 Plan have exercise prices between $4.41 and $24.71 per share, and vest over one to four year vesting periods. Awards expire in accordance with the terms of each award and the shares subject to the award are added back to the 2010 Plan upon expiration of the award. The contractual term of stock options granted is generally ten years. As of September 30, 2015 there were awards outstanding, net of awards expired, for an aggregate of 0.1 million shares of the Company’s common stock.

The Company adopted a Performance Incentive Plan effective July 1, 2013 (the "Fiscal 2014 Performance Plan"). The Fiscal 2014 Performance Plan is intended to provide selected employees an opportunity to earn performance-based cash bonuses whose value is based upon the Company’s stock value and to encourage such employees to provide services to the Company and to attract new individuals with outstanding qualifications. The Fiscal 2014 Performance Plan seeks to achieve this purpose by providing for awards in the form of performance share units (the “Units”). No shares will be issued under the Fiscal 2014 Performance Plan. Awards may be settled only with cash and will be paid subsequent to award vesting. The fair value of share-based compensation awards, that include performance shares, are accounted for as liabilities. Vesting for the Units is subject to achievement of both service-based and performance-based vesting requirements. Performance-based vesting occurs in three installments if the Company meets certain performance criteria generally set for each year of a three-year performance period. The service-based vesting criteria occurs in three annual installments which are achieved at the end of a given fiscal year only if the participant has continuously remained in service from the date of award through the end of that fiscal year. The fair value of these awards is based on the trading price of our common stock and is remeasured at each reporting period date until settlement. The Company adopted a separate Performance Incentive Plan effective July 1, 2014 (the "Fiscal 2015 Performance Plan"). The Fiscal 2015 Performance Plan is substantially similar to the Fiscal 2014 Performance Plan except that the service-based vesting criteria occurs in a single installment and is achieved at the end of the third fiscal year after the award is granted if the participant has continuously remained in service from the date of the award through the end of the third fiscal year.

Stock-Based Compensation

In accordance with accounting guidance for stock-based compensation, payments in equity instruments for goods or services are accounted for under the fair value method. For the three months ended September 30, 2015, stock-based compensation of $0.2 million was reflected as an increase to additional paid-in capital and an increase of $4,000 was included in other accrued expenses, all of which was employee related. For the three months ended September 30, 2014, stock-based compensation of $0.4 million was reflected as an increase to additional paid-in capital, all of which was employee related.

Note 6 — Commitments and Contingencies

From time to time, the Company is involved in lawsuits and disputes arising in the normal course of business. The Company regularly reviews all pending litigation matters in which it is involved and establishes accruals deemed appropriate by management for these litigation matters when a probable loss estimate can be made. In the opinion of management, the amounts accrued for as of September 30, 2015 are appropriate based on the probable outcome of currently pending matters.

Note 7 — Subsequent Events

On October 19, 2015 the Company effected a 1 for 7 reverse stock split as approved by the Company's shareholders and Board of Directors. All issued and outstanding common stock and per share amounts contained within the Company's consolidated financial statements and footnotes have been retroactively adjusted to reflect this reverse stock split for all periods presented.

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

Overview

We are a company dedicated to helping people achieve their health, wellness and financial independence goals. We sell quality, scientifically validated products and provide a financially rewarding direct sales business opportunity to preferred customers, retail customers and independent distributors who seek a healthy lifestyle and financial freedom. We engage in the identification, research, development and distribution of advanced nutraceutical dietary supplements and skin care products. We sell our products to preferred customers and independent distributors in two geographic regions: Americas and Asia/Pacific.

Our revenue depends on the number and productivity of our independent distributors and the number of our retail and preferred customers. When we are successful in attracting and retaining independent distributors and preferred customers, it is largely because of:

•Our scientifically-validated products, including Protandim®, LifeVantage TrueScience®, Canine Health® and Axio®;
•Our compensation plan and other sales initiatives; and
•Our delivery of superior customer service.

As a result, it is vital to our success that we leverage our product development resources to develop and introduce innovative products and provide opportunities for our independent distributors to sell these products in a variety of markets.

We have begun selling our products and attracting new independent distributors and preferred customers in several new markets since the beginning of our direct selling activities in 2009, including Japan, Australia, Canada, Mexico, Hong Kong, Thailand and, on a limited basis, the Philippines. Entering a new market requires a considerable amount of time, resources and continued support. If we are unable to properly support an existing or new market, our revenue growth will be negatively impacted.

Our Products

Our products are Protandim®, the LifeVantage TrueScience® skin care regimen, Canine Health®, and Axio®. Protandim® contains a proprietary blend of ingredients and has been shown to combat oxidative stress by increasing the body’s natural antioxidant protection at the genetic level, inducing the production of naturally-occurring protective antioxidant enzymes including superoxide dismutase, catalase, and glutathione synthase. Our LifeVantage TrueScience® skin care regimen includes TrueScience® Ultra Gentle Facial Cleanser, TrueScience® Perfecting Lotion, TrueScience® Eye Corrector Serum, and our enhanced TrueScience® Anti-Aging Cream. Axio® is our energy drink mix formulated to promote alertness and support mental performance. Canine Health® is a supplement specially formulated to combat oxidative stress in dogs through Nrf2 activation.

We currently have additional products in development. Any delays or difficulties in introducing compelling products or attractive initiatives or tools into our markets may have a negative impact on our revenue and our ability to attract new preferred customers and independent distributors.

Customers

Because we utilize a direct selling model for the distribution of our products, the success and growth of our business is primarily based on the effectiveness of our independent distributors in selling our products and on our ability to attract new and retain existing independent distributors. Changes in our product sales are typically the result of variations in product sales volume relating to fluctuations in the number of active independent distributors and preferred customers purchasing our products. The number of active independent distributors and preferred customers is, therefore, used by management as a key non-financial measure.

The following tables summarize the changes in our active customer base by geographic region. These numbers have been rounded to the nearest thousand as of the dates indicated. For purposes of this report, we only count as active customers those independent distributors and preferred customers who have purchased from us at any time during the most recent three-month period, either for personal use or for resale.

	Active Preferred Customers By Region September 30,										
	2015			2014			Change from Prior Year		Percent Change	
Americas	93,000	81.6	%	104,000	82.5	%	(11,000	)	(10.6	)%
Asia/Pacific	21,000	18.4	%	22,000	17.5	%	(1,000	)	(4.5	)%
	114,000	100.0	%	126,000	100.0	%	(12,000	)	(9.5	)%

	Active Independent Distributors By Region September 30,						
	2015			2014			Change from Prior Year	Percent Change
Americas	44,000	68.7	%	44,000	64.7	%		

It is contemplated that the Company's subsidiary, EPC Corporation, will enter into a contemporaneous agreement with Crystal Creek Coalpower Funding LLC, an affiliate of ArcLight Capital Partners, L.P., to cancel $3.0 million of EPC Corporation indebtedness.

Closing is expected to be conditioned on obtaining normal project financing consents, none of which is expected to be withheld or materially delayed. The Company expects the closing to occur in the second half of 2007.

In the course of their negotiations, Scrubgrass and Buzzard entered into an interim agreement to amend the Forbearance Agreement between them dated as of December 11, 2006, in order to provide for an extension of the Forbearance Termination Date (as defined therein) to August 31, 2007. As reported in Form 8-K dated December 11, 2006, as filed with the U.S. Securities and Exchange Commission, under the Forbearance Agreement, Scrubgrass agrees that, until the Forbearance Termination Date, it will forbear from exercising its rights and remedies under the Lease Agreement with respect to certain missed rental payments. Should the parties not reach agreement by August 31, 2007, Scrubgrass may elect to pursue its remedies for default based on the missed rental payment and, in addition, Crystal Creek Coalpower may pursue a claim of default against EPC Corporation related to its alleged failure to make payments of interest when due in connection with the EPC Corporation 20.0% Senior Secured Note Due December 31, 2012. Default by Buzzard under the Lease Agreement and by EPC Corporation in connection with the referenced Note is without recourse against Environmental Power Corporation.

Prior to the Board s decision to authorize management to enter into negotiations regarding the disposition of the lease on the Scrubgrass facility, the Company was reporting financial results in three operating segments, Buzzard, Microgy, and All Other Segments, the last of which is comprised of corporate items that are not directly tied to either the Buzzard or Microgy operating segments. Upon disposition of the lease for the Scrubgrass facility, the company will have only two reporting segments. The assets and liabilities of Buzzard have been reported as discontinued operations on the accompanying consolidated balance sheets and consolidated statements of operations of Environmental Power.

Approximately $51.7 million, or 95.9%, of the Company s $53.9 million in total consolidated revenues for the fiscal year ended December 31, 2006 were derived from Buzzard. The disposition of Buzzard s leasehold interest in the Scrubgrass facility will substantially reduce the Company s revenue base and continue its trend of operating losses and uses of cash until the revenue base for Microgy grows to sufficient levels to support the Company s expense base.

RESULTS OF OPERATIONS

The following Management s Discussion and Analysis of Financial Condition and Results of Operations compares the results of operations for the three and six month periods ended June 30, 2007 with the results of operations for the three and six month periods ended June 30, 2006. Unless otherwise indicated, all references to 2007 pertain to the three months ended June 30, 2007 and all references to 2006 pertain to the three months ended June 30, 2006. Historical results and trends that might be discussed below should not be taken as indicative of future operations.

Six months ended June 30, 2007 compared to six months ended June 30, 2006.

For the six months ended June 30, 2007, we had a net loss available to common shareholders of $5.9 million, or loss available per common share of $0.60 from continuing operations, compared to net loss available to common shareholders of $4.1 million, or loss per common share of $0.43, for the six months ended June 30, 2006. The increase in net loss was primarily attributable to an increase in costs and expenses of $1.0 million, a decrease in revenue of $631,000, and a $667,000 increase in preferred dividend requirements that we did not have in the 2006 period. These amounts were partially offset by a $583,000 increase in other income related to the release of the Sunnyside contingent liabilities. These changes are discussed in more detail below.

Revenues from continuing operations decreased by $631,000, or 54%, to $542,000 for the six months ended June 30, 2007, as compared to $1.2 million for the same period in 2006. This decrease in revenue is due mainly to the change in business model from a model where facilities are sold, to the current ownership model, where we build and operate facilities for our own account. Revenues from the operation and maintenance of facilities increased to $542,000 for the six months ended June 30, 2007, compared to $242,000 for the same period in the prior year. This increase is primarily due to increased gas production at the Wisconsin facilities, and the fact that not all of the Wisconsin facilities were operational in the six months ended June 30, 2006. In 2006, we recognized $1 million from the sale of the Wisconsin facilities whereas there were no such sales in 2007.

Costs and expenses from continuing operations increased by $1.0 million to $6.6 million for the six months ended June 30, 2007, as compared to $5.6 million for the same period in 2006. A $759,000 increase in non-cash compensation expense and a $338,000 increase in payroll related expenses including severance were partially offset by a $152,000 decrease in travel and entertainment expenses.

We have one primary business segment, Microgy. The results of operations for this business segment, as well as All Other Segments, which is comprised of parent company expenses and non-current business segments, and discontinued operations, comprised of the results of our Buzzard subsidiary, are discussed below.

Microgy

Pre-tax losses at Microgy increased to $3.0 million for the six months ended June 30, 2007, as compared to $2.9 million for the six months ended June 30, 2006. A $630,000 decrease in revenue was offset by a $649,000 decrease in costs of revenue. In addition, a $300,000 increase in development expenses was offset by a $300,000 decrease in payroll expenses. These changes are discussed in more detail below.

Microgy recognized revenues of $542,000 for the six months ended June 30, 2007, compared to $1.2 million for the same period in 2006. This decrease is due primarily to the shift in corporate emphasis from a sales model, where we sell facilities to third parties, to an ownership model, where we construct facilities for our own account. In the six months ended June 30, 2006, $1.0 million of revenues for the period were associated with the construction of facilities for the account of third parties under our relationship with Dairyland using the percentage of completion method, and $242,000 of revenues for the period related to the management of these facilities. In the six months ended June 30, 2007, all $542,000 of revenue was from our contracts to provide operations and maintenance services for the Wisconsin facilities.

Microgy s cost of revenue decreased to $461,000 for the six months ended June 30, 2007, as compared to $1.1 million for the same period in 2006. This decrease is due primarily to the shift in emphasis from a sales model to an ownership model, as discussed above. In the six months ended June 30 2006, $476,000 of the $1.1 million in costs of revenue was related to the construction of facilities constructed for sale to third parties. Operations and maintenance costs decreased from $634,000 in the six months ended June 30, 2006 to $461,000 in the six months ended June 30, 2007, due primarily to lower repair costs at the Wisconsin facilities.

General and administrative expenses for Microgy increased by $134,000 to $3.0 million for the six months ended June 30, 2007, as compared to $2.8 million for the same period in 2006. This increase was primarily due to a $338,000 increase in corporate overhead allocation to $1.2 million in the six months ended June 30, 2007 from $880,000 in the same period in 2006. The increase is also attributable in part to an increase in development costs of $300,000 during the six months ended June 30, 2007. These increases were partially offset by a $300,000 decrease in payroll expenses and a $136,000 decrease in travel and entertainment expenses.

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In the six months ended June 30, 2007, our construction in progress balance increased by $7.8 million to a total of $21.9 million. Of the $21.9 million, $18.4 million of this balance is related to the Huckabay Ridge facility. In the six months ended June 30, 2006, our construction in progress balance increased by $3.3 million to $4.2 million.

All Other Segments

All other segments are comprised of corporate expenses and non-current business segments. The expenses in this segment are comprised of corporate items that are not directly tied to Microgy or our discontinued operations. We did not have any revenues in these segments for the six months ended June 30, 2007 or 2006. We had a pre-tax loss in this segment of $2.2 million for the six months ended June 30, 2007, compared to a pre-tax loss of $1.2 million for the same period in 2006. The increase in pre-tax loss is primarily due to increases in non-cash compensation expense of $759,000, as described in more detail below.

In the six months ended June 30, 2007, we recognized $1.4 million of non-cash compensation expenses due primarily to the FAS 123R treatment of options and stock appreciation rights issued to employees. In the six months ended June 30, 2006, we recognized non-cash compensation expense of $677,000 due primarily to the variable accounting treatment of performance-based options.

As the result of the issuance of our Series A 9% cumulative convertible preferred stock in November 2006, we experienced an increase in preferred security dividend requirements from $2,500 for the six months ended June 30, 2006 to $669,790 for the six months ended June 30, 2007.

The foregoing expenses were offset in part by total other income in this segment of $866,000 for the six months ended June 30, 2007, compared to income of $279,000 for the same period in 2006. The increase in other income is primarily due to the expiration of the statute of limitations regarding the Sunnyside project liability, which provided $583,000 in other income.

Discontinued Operations

Discontinued Operations accounted for a pre-tax loss of $2.9 million for the six months ended June 30, 2007, compared to a $232,000 pre-tax loss for the same period in 2006. This increase in pre-tax loss is primarily due to an increase in operating expenses of $3.3 million, and a decrease in power revenues of $1.2 million. These changes were partially offset by a $1.7 million dollar decrease in lease expense.

Billed power generation revenues at Buzzard increased by $255,000 to $28.8 million for the six months ended June 30, 2007 as a result of increased power rates, as compared to $28.6 million for the six months ended June 30, 2006. Buzzard operated at 91.7% of capacity for this period, compared to 96.9% of capacity for the same period in 2006. The decrease was a result of a twelve day maintenance outage in the month of May. The decrease in capacity was offset by a 7% increase in billed power rates in 2007. This increase in billed power generation revenues was completely offset by a decrease in accrued power generation revenues of $1.4 million. The accrued power generation revenues result from the FASB 13 accounting treatment of the Scrubgrass lease. In accordance with generally accepted accounting principles in the United States, we are required to treat our power sales agreement with Penelec as a lease, aggregate the minimum lease payments expected to be received over its life, and recognize it on a straight-line basis over the 22-year lease term. However, we have limited the recognition of accrued power revenues to the recognition of the deemed minimum payments of the facility lease so that we do not recognize any profits early related to executory costs or payment for goods and services other than solely for the right to use the facility. This minimum lease payment component will continue to decrease in subsequent years, lowering our reported power generation revenues. This adjustment has no effect on pre-tax income because it is completely offset by an accrued lease expense.

Total operating expenses at Buzzard for the six months ended June 30, 2007 increased by $3.3 million to $17.4 million, as compared to $14.1 million for the same period in 2006. This increase was primarily a result of increases in maintenance costs of $2.7 million and labor costs of $573,000. Lease expenses at Buzzard decreased by $1.7 million to $9.3 million in the six months ended June 30, 2007, compared to $11.0 million in the six months ended June 30, 2006. General and administrative expenses decreased by $139,000 to $1.2 million in the six months ended June 30, 2007, as compared to $1.3 million in the same period in 2006, primarily due to a decrease in corporate overhead.

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Three months ended June 30, 2007 compared to three months ended June 30, 2006.

For the three months ended June 30, 2007, we had a net loss available to common stockholders of $3.9 million, or $0.39 per common share, compared to a loss of $2.4 million, or $0.25 per common share, for the three months ended June 30, 2006. The increase in net loss was due to a $1.2 million increase in general and administrative expenses, primarily due to increased non-cash compensation expense, and a $332,672 increase in preferred dividend requirements.

Revenues from continuing operations increased slightly to $327,000 for the three months ended June 30, 2007, as compared to $290,000 from the same period in 2006.

Costs and expenses from continuing operations increased by $1.1 million to $4.0 million for the three months ending June 30, 2007, as compared to $2.9 million for the same period in 2006. The increase was primarily attributable to a $1.2 million increase in general and administrative expenses, due primarily to a $385,000 increase in non-cash compensation expense and a $571,000 increase in payroll expenses as a result of severance contracts entered into during the 2007 period. These increases were partially offset by a $93,000 decrease in costs of revenue at Microgy.

The reasons for the foregoing changes are discussed in more detail below.

Microgy

Pre-tax losses at Microgy were $1.6 million for both the three months ended June 30, 2007 and the three months ended June 30, 2006. A $37,000 increase in revenue and a $93,000 decrease in costs of revenue were partially offset by an $80,000 increase in general and administrative expenses.

Microgy recognized revenues of $327,000 for the three months ended June 30, 2007, up slightly from $290,000 for the same period in 2006. This increase is due to higher gas revenues at the Wisconsin facilities, as these facilities operated at a higher average capacity, due principally to the fact that all three facilities produced gas in the second quarter of 2007 while only two facilities produced gas in the second quarter of 2006.

Cost of revenue at Microgy decreased to $244,000 for the three months ended June 30, 2007, as compared to $337,000 for the same period in 2006. This decrease is due primarily to the shift in emphasis from a sales model to an ownership model. General and administrative expenses at Microgy remained essentially flat at $1.6 million for the three months ended June 30, 2007, compared to $1.5 million for the three months ended June 30, 2006. A $300,000 increase in development costs was partially offset by a $111,000 decrease in salary costs and an $64,000 decrease in travel and entertainment expenses.

All Other Segments

All other segments are comprised of corporate expenses and non-current business segments. We did not have any revenues in these segments for the three months ended June 30, 2007. We had pre-tax loss in this segment of $2.0 million for the three months ended June 30, 2007, compared to a pre-tax loss of $817,000 for the three months ended June 30, 2006. This increase in pre-tax loss is primarily attributable to a $385,000 increase in non-cash compensation expense as well as a $682,000 increase in payroll expenses.

The accounting for non-cash compensation expense, in accordance with FAS 123R resulted in a non-cash compensation expense of $898,000 for the three months ended June 30, 2007. Please see Note E to the condensed consolidated financial statements included in this report for more information.

As the result of the issuance of our series A 9% cumulative convertible preferred stock in November 2006, we experienced an increase in preferred security dividend requirements from $1,250 for the three months ended June 30, 2006, as compared to $333,922 for the three months ended June 30, 2007.

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The foregoing expenses were offset in part by total other income in this segment of $130,000 for the three months ended June 30, 2007, compared to income of $181,000 for the same period in 2006. The decrease in total other income was due to decreased interest income.

Discontinued Operations

We experienced a pre-tax loss from Discontinued Operations of $3.2 million for the three months ended June 30, 2007, compared to a pre-tax loss of $503,000 for the three months ended June 30, 2006.

Billed power revenues at Buzzard, which consist of power generation revenues decreased to $13.1 million for the three months ended June 30, 2007, compared to $14.0 million for the same period in 2006. Buzzard operated at 82.93% of capacity for this period, compared to 94.6% of capacity for the same period in 2006. The decrease in capacity was the result of a 12 day maintenance outage in the month of May. Billed power rates also increased by 7% as compared to the prior year period. Accrued power generation revenues were a $1.8 million offset to Buzzard revenue, compared to a $1.1 million offset in the previous year. The accrued power generation revenues result from the FASB 13 accounting treatment of the Scrubgrass lease. In accordance with generally accepted accounting principles in the United States, we are required to treat our power sales agreement with Penelec as a lease, aggregate the minimum lease payments expected to be received over its life, and recognize it on a straight-line basis over the 22-year lease term. However, we have limited the recognition of accrued power revenues to the recognition of the deemed minimum payments of the facility lease so that we do not recognize any profits early related to executory costs or payment for goods and services other than solely for the right to use the facility. This minimum lease payment component is higher in the early years, decreases in the subsequent years, and reverses itself in the later years of the power purchase agreement. This adjustment has no effect on pre-tax income because it is completely offset by an accrued lease expense.

Total operating expenses at Buzzard for the three months ended June 30, 2007 increased by $2.9 million to $10.0 million, as compared to $7.1 million for the same period in 2006 due to a $2.7 million dollar increase in maintenance costs and a $488,000 dollar increase in labor costs associated with May s maintenance outage. These increases were partially offset by a $310,000 decrease in fuel costs compared to the same period in the prior year.

Lease expenses at Buzzard for the three months ended June 30, 2007 decreased to $3.8 million, compared to $5.6 million for the same period in 2006. General and administrative expenses decreased to $595,000 in the three months ended June 30, 2007, compared to $654,000 in the same period in the prior year, due primarily to a $54,000 decrease in general overhead fees.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities

Our net cash used in operating activities was $6.7 million for the six months ended June 30, 2007, compared to cash used in operating activities of $5.2 million for the same period in 2006. We reported a net loss from continuing operations of $5.2 million and a net loss from discontinued operations of $2.9 million for 2007. The following adjustments need to be considered in order to reconcile our net loss in the six months ended June 30, 2007 to our net cash used in operating activities:

Depreciation and amortization During the six months ended June 30, 2007, we recognized depreciation and amortization expense for lease rights of $74,502, licensed technology rights of $92,750, and property plant and equipment of $63,209.

Interest expense, accrued and added to the balance of borrowing During the six months ended June 30, 2007, we had $286,000 of interest expense that was added to the outstanding principal balance of the ArcLight loan.

Stock-based compensation The accounting for options issued to employees resulted in non-cash compensation expenses of $1,436,592 for the six months ended June 30, 2007.

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We also offer the following information regarding changes in operating assets and liabilities that most notably impacted our cash position during the first two quarters of 2007:

Receivables Microgy receivables increased to $267,000 on June 30, 2007 from $110,000 on December 31, 2006 primarily due to increased gas production at the Wisconsin facilities in the second quarter of 2007. Receivables at Buzzard increased to $13.1 million on June 30, 2007 from $12.9 million on December 31, 2006 due to increased power generation revenues in the second quarter of 2007 compared to power generation revenues in the fourth quarter of 2006.

Fuel Inventory Fuel inventory at Buzzard remained relatively flat at $1.2 million on June 30, 2007, compared to $1.2 million on December 31, 2006.

Accounts payable and accrued expenses Our accounts payable and accrued expenses not related to accrued preferred dividends remained relatively flat at $13.5 million on June 30, 2007 compared to $13.3 million on December 31, 2006.

Investing Activities

Our cash used for investing activities was $1.2 million for the six months ended June 30, 2007, as compared to $3.5 million in the same period in 2006. Our investing activities were concentrated primarily in the following areas:

Restricted cash We are required to hold cash associated with our tax-exempt bond financing with a third party disbursement agent. On June 30, 2007, the disbursement agent was holding a balance of $48.8 million in bond proceeds, compared to $52.2 million on December 31, 2006. Additionally, we are contractually required to make scheduled deposits to a restricted maintenance fund for Scrubgrass to ensure that funds are available in the future for scheduled major equipment overhauls. We are allowed to use cash from this restricted maintenance fund for major equipment overhauls at Scrubgrass, subject to certain restrictions. Our restricted cash balance was $2.2 million on June 30, 2007, compared to $3.2 million on December 31, 2006. These funds will be used to pay for future major maintenance expenses.

Construction on projects Expenditures on our facilities were $5.7 million for the six months ended June 30, 2007. As of June 30, 2007 the company had incurred expenditures of $18.4 million related to the construction of the Huckabay Ridge facility, including $3.5 million of capitalized start-up and commissioning costs due to the delay of six months in commissioning. Expenditures for projects other than Huckabay were approximately $1.1 million in the six months ended June 30, 2007.

Property, plant and equipment Property, plant and equipment expenditures were $69,000 for the six months ended June 30, 2007, compared to expenditures of $130,000 for the same period in 2006. This decrease is primarily a result of the fact that several vehicles required for the operation of the Wisconsin facilities were purchased in the first six months of 2006.

Financing Activities

Our cash provided by financing activities was $2.2 million in the six months ended June 30, 2007, compared to cash provided by financing activities of $3.5 million in the six months ended June 30, 2006. We offer the following information concerning the financing activities for our business:

Dividend payments to preferred stock of subsidiary Buzzard paid dividends of $2,500 to its preferred stockholder during the six months ended June 30, 2007. Environmental Power paid dividends of $195,000 to its Series A preferred stock holders during the six months ended June 30, 2007.

Exercise of Stock Options and Warrants We received $2.9 million of gross proceeds from the exercise of stock options and warrants in the six months ended June 30, 2007.

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Working Capital Loan and Current Notes Payable for Scrubgrass
Buzzard may borrow up to $6 million under a Lessee Working Capital Loan Agreement with the lessor of the Scrubgrass facility for ongoing working capital requirements of this project. The outstanding borrowings under this loan were $5.4 million as of June 30, 2007.

2007 Outlook

Operations

The following forward-looking information concerning our results of operations for the full year 2007 is being compared to our historical results of operations for 2006:

Microgy

We expect increased revenues from Microgy in late 2007, as we expect sales of RNG from our Huckabay Ridge facility in Texas. The company has incurred an extended period of startup and commissioning costs at Huckabay, and management currently believes the Huckabay Ridge facility will reach full commercial operations late in the third quarter or early in the fourth quarter of 2007. Our revenues related to the Wisconsin facilities are expected to increase slightly. All three Wisconsin digesters will be fully operational for the entire year, whereas some facilities were still in construction for part of 2006.

Management currently believes the Huckabay Ridge facility will reach full commercial operations late in the third quarter or early in the fourth quarter of 2007. Despite achieving biogas levels which met expectations earlier this year when the gas conditioning and compression equipment was not operating reliably, we have not been able to achieve targeted biogas output on five of the eight digesters. The main cause of the diminished production has been identified and directly relates to excessive recycling of water in our system for the purpose of conditioning dry-lot manure. The level of recycling was necessary because of the unprecedented rainfall and flooding that had filled our onsite storage lagoons and limited our ability to add fresh water to the system. We have identified and begun implementing an alternate strategy which will add some operating costs but which will facilitate our reaching commercial operations and support uninterrupted operations in the future

We have also learned valuable lessons regarding the balancing of substrate supply in this first large-scale operation of its kind. We believe that substrate imbalances may have contributed to some of the biogas production issues that we have recently encountered. While the process is ongoing, we will be continuing to improve the reliability of the gas conditioning and compression system and delivering RNG to the pipeline to the maximum extent possible.

Our operating expenses are expected to increase in late 2007 to reflect the commercial operation of the Huckabay Ridge facility. Start-up and commissioning costs are currently being capitalized prior to the commencement of commercial operations. General and administrative expenses are expected to increase relative to last year as we prepare for the construction of additional planned digester facilities. We will continue to incur substantial costs associated with the growth of the business.

As of June 30, 2007, we had a total cost of $18.4 million associated with the Huckabay project, of which $588,000 was made up of capitalized finance costs and approximately $3.5 million of capitalized startup and commissioning costs due to the six month delay in commissioning. In the three months ended June 30, 2007, we received proceeds of approximately $156,000 from sales of the RNG produced by the Huckabay Ridge facility, which has operated intermittently at various production levels. As these sales have been incurred prior to the facility achieving full-scale commercial production, these sales have been credited against Huckabay capital expenditures.

Construction of additional facilities in Texas is pending the successful completion of the application of lessons learned from the Huckabay project, including permitting, substrate management and supply, and off-take opportunities. The timing of the commencement of new construction related to other announced projects in California and other locations is dependent on the receipt of applicable permits and arrangement of financing. The company further anticipates heightened capital expenditures late in the fourth quarter of 2007 associated with the commencement of the construction phase of other projects.

All Other Segments

For the remainder of 2007, we expect a significant increase in general and administrative expenses for 2007 as compared to 2006, as we make payment under various severance arrangements and incur expenses associated with the planned relocation of our corporate headquarters from Portsmouth, New Hampshire to the White Plains, New York area in the fourth quarter of 2007.

Cash Flow Outlook

During 2007, we expect to fund our business activities principally from available cash balances, investment earnings, raising additional funds through debt and or equity financings by Environmental Power or Microgy and project-specific financing, to the extent available. The requirement for additional financing will be in direct proportion to the number of projects on which we begin construction over the next twelve months. We do not expect to receive cash from the operations of Buzzard, insofar as any available cash would be used to repay interest and principal on the ArcLight loan and, in any event, we expect this leasehold interest to be terminated.

On June 30, 2007, our unrestricted cash balance was $8.0 million, as compared to $13.8 million as of December 31, 2006. In addition, our restricted cash balances were $48.8 million and $52.2 million from continuing operations, at June 30, 2007 and December 31, 2006, respectively. We are allowed to spend restricted cash contributed to the Scrubgrass maintenance fund to fund the cost of major equipment overhauls at Scrubgrass, subject to certain restrictions, and to use restricted cash representing the remaining proceeds of our $60 million tax-exempt bond financing to construct up to four planned RNG facilities in Texas, subject to certain restrictions.

We believe that our current cash balance will be sufficient to fund our minimum lease, debt obligations, current construction commitments, and our corporate overhead requirements through at least the end of 2007. However, our current cash balance and our cash flows from operations will not be sufficient to fund the construction of currently planned facilities in the absence of obtaining additional financing.

Our present business strategy generally anticipates direct or indirect participation in the ownership of all facilities. We anticipate that project or corporate financing may be obtained in the form of a credit facility with one or more lenders, the sale of tax exempt or taxable bonds to investors, equity, other financing, or a combination of the foregoing. We will need to raise significant additional financing in the very near future. However, we cannot assure you that we will be able to secure corporate, project or other financing in the amount required to fulfill any development or construction requirements, that financing will be obtained in time to meet such requirements, or that any such proposed financing, if obtained, will be on terms favorable to us or any other prospective project owner. Furthermore, to the extent Microgy or an affiliate is a direct or indirect owner of facilities, Microgy will need to obtain substantial additional financing to allow it to develop and construct such facilities. While we also intend to seek debt or equity financing at the parent company level in order to fund Microgy s operations, we cannot assure you that we will be successful in obtaining such financing or that, if obtained, such financing will be on terms favorable to us.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our most significant risk exposure is changing interest rates, which may affect our short term investments, debt and certain of our lease expenses. We expect to become increasingly exposed to commodity price risk relating to our gas production. We offer the following information about these market risks:

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Short-term investments

We invest cash balances that are in excess of our normal operating requirements in short term investments generally with maturities of three months or less. Because of the credit quality and short duration of these investments, we do not believe our short-term investments are subject to material market risk.

Debt

Our discontinued operations have borrowings that bear interest at variable rates that are based on LIBOR.

Lease Expense

As a lease cost of the Scrubgrass plant, Buzzard is required to fund the lessor s debt service which consists primarily of borrowings which bear interest at variable rates based on either quoted bond rates or LIBOR. The manager of Scrubgrass monitors market conditions for interest rates and, from time to time, enters into interest rate swaps to manage the interest payments for Scrubgrass. The interest rate swaps have the effect of converting the variable rate borrowings to fixed rate borrowings for specified time periods.

As of June 30, 2007, the aggregate outstanding balance of the lessor s variable rate debt obligations, which are passed along to us as a lease expense, was $112,489,000. Based on these balances, an immediate change of one percent for the variable interest rates would cause a change in lease expense of $1,124,890. Our objective in maintaining these variable rate borrowings is to achieve a lower overall cost when compared to fixed-rate borrowings. We believe the lessor has the same objective for maintaining its variable rate borrowings.

Commodity Price Risk

As Microgy begins to focus a significant portion of its development efforts on multi-digester projects for the production of gas for sale as a commodity, we will become increasingly exposed to market risk with respect to the commodity pricing applicable to our gas production. Realized commodity prices received for such production are expected to be primarily driven by spot prices applicable to natural gas. Historically, natural gas prices have been volatile, and we expect such volatility to continue. Fluctuations in the commodity price of natural gas may have a materially adverse impact on the profitability of some of our facilities, particularly where we do not have a long-term contract for the sale of the facility s output at a fixed or predictable price. At such time as Microgy s facilities begin to produce commercial quantities of gas for sale as a commodity, we intend to explore various strategies, including hedging transactions and the like, in order to mitigate the associated commodity price risk. In connection with our Texas bond financing, we are required to maintain certain gas price protection arrangements for the gas output of our Texas facilities. In connection with this obligation, Microgy Holdings LLC has entered into an agreement to sell up to 2,000 MMBTUs per day of the output of our Huckabay Ridge facility to a counterparty under a collared product pricing arrangement for a term of 18 months beginning April 2007 and ending in October 2008. In addition, as previously announced, Microgy, Inc. has also entered into a long-term fixed price arrangement with PG&E to purchase the gas produced from our planned California facilities in an amount up to 8,000 MMBTUs per day.

Substrate Costs

We rely on significant quantities of substrate materials that provide proteins, fats, and carbohydrates that enhance the biological process in our digesters. Notwithstanding any supply agreements we may have, we are currently unable to forecast the costs associated with acquiring and transporting substrate, and are exposed to market risk relating to availability of these materials. Substrate availability is affected by industry supply and demand, including competition by other users and recyclers of these materials, weather, and many other factors. Fluctuations in the availability of substrate and the cost to transport it to our projects are expected and could have a materially adverse effect on the profitability of our facilities. For example, Microgy has recently experienced an unfavorable shift in the availability of certain types of substrates as a result of increases in corn and animal-feed prices. In the absence of substrate of sufficient quality at an affordable cost, our anaerobic digester facilities would operate less efficiently, which would materially and adversely affect our overall profitability. A substantial portion of the gas production of Microgy s facilities is derived from the co-digestion contribution enabled by substrate. The company is aggressively pursuing efforts to secure reliable substrate supplies on cost effective terms for projects.

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Item 4. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2007. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. While our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only such reasonable assurance, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2007, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended June 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are not a party to any material legal proceedings.

Item 1A. Risk Factors

You should carefully consider the following risk factors, in addition to other information included in this quarterly report on Form 10-Q and the other reports that we file with the Securities and Exchange Commission, in evaluating our business. If any of the following risks occur, our business, financial condition and operating results could be materially adversely affected. The following risk factors include any material changes to and supersede the risk factors previously disclosed in our annual report on Form 10-K for the year ended December 31, 2006.

Microgy has very little operating history from which to evaluate its business and products.

Microgy was formed in 1999 and remains in the early stages of its development. Microgy is developing facilities that use environmentally friendly anaerobic digestion and other technologies to produce biogas from animal and organic wastes. However, none of the facilities to be owned by Microgy has yet been completed. Although Microgy has developed and is operating three single digester facilities in Wisconsin, Microgy has limited experience in the construction and operation of multiple digester facilities such as those Microgy is currently constructing or intends to construct, and limited experience in gas conditioning or the sale of gas as a commodity. Because of this limited experience, Microgy may never be profitable.

Microgy has experienced losses to date, and we anticipate it will continue to experience losses into at least 2008.

Microgy has a history of losses. For the six months ended June 30, 2007, we incurred a net loss of $3.0 million. For the years ended December 31, 2006, 2005 and 2004, we incurred net losses of $6.8 million, $11.4 million and $4.0 million, respectively. We expect our Microgy subsidiary to continue to incur losses, reduce our earnings or, as the case may be, add to our earnings deficit as we seek to further develop its business. These ongoing losses will adversely affect our financial condition into at least 2008. As a result of these losses, we anticipate that we will, in all likelihood, have to rely on external financing for most of our capital and operational requirements. Future losses are likely to continue unless we successfully implement our business plan. If we are not successful in reaching and maintaining profitable operations, we may not be able to attract sufficient capital to continue our operations. Our inability to obtain adequate financing would likely result in the need to curtail or cease our business operations and, consequently, a much lower stock price.

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Microgy cannot predict when any facility will be completed, what Microgy s costs will be or, consequently, whether Microgy or any facility developed by Microgy will be profitable.

Development of Microgy s facilities is an inherently risky activity, subject to significant uncertainties and a lengthy development cycle. Uncertainties and risks include those relating to costs and availability of supplies and labor, costs and quality of facility components and installation services, fluctuations in the prices available for the sale of facility output and timing of completion of construction and commencement of commercial operations. For instance, Microgy has encountered problems with the quality of the gas conditioning and compression equipment supplied to it for the Huckabay Ridge facility. Furthermore, obtaining the large number of agreements, permits and approvals necessary to develop, install, operate and manage any of Microgy s facilities, as well as to market the energy and other co-products and to provide necessary related resources and services, involves a long development cycle and decision-making process. Microgy is required to enter into or obtain some or all of the following in connection with the development of its facilities:

- Site agreements;
- Supply contracts;
- Design/build or other construction-related agreements;
- Off-take agreements for gas produced;
- Power sales contracts;
- Various co-product sales agreements;
- Waste disposal agreements;
- Licenses;
- Environmental and other permits;
- Local government approvals; and

Financing commitments required for the successful completion of facilities under consideration.

Microgy s failure to accomplish any of these objectives could materially increase the cost, or prevent the successful completion of, development or operation of facilities and incur the loss of any investment made. Many of these objectives are dependent upon decisions by third parties. Delays in such parties decision-making process are outside of our control and may have a negative impact on our development costs, cost of operations, receipt of revenue and sales projections. We expect that, in some cases, it may take a year or more to obtain decisions on permits and approvals and to negotiate and close these complex agreements. Such delays could harm our operating results and financial condition.

As a result of the foregoing uncertainties we are unable to project with certainty Microgy s organizational, structural, staffing or other overhead costs, the construction or operating costs associated with any facility, or whether any facility, or Microgy as a whole, will generate a profit. If Microgy fails to generate a profit, your investment in our securities will be materially adversely affected.

If we are unable to obtain needed financing for Microgy s facilities, the value of our Microgy investment may be reduced significantly.

Because we have not yet generated sufficient positive cash flow, and do not expect to do so until at least 2008, we do not have adequate funds on hand to complete construction of the facilities we currently have planned. We are seeking and will require corporate, project or group financing to fund the cost of any development we may decide to pursue for Microgy s facilities. This financing may be difficult or impossible for us to obtain. If we are unable to obtain such financing, the value of our Microgy investment may be reduced significantly, and we may be required to substantially curtail our business or completely cease construction or operation of any facilities. This financing will depend on prospective lenders or investors review of our financial capabilities as well as specific facilities and other factors, including assessment of our ability to construct and manage each facility successfully. If we are unable to obtain the required financing, your investment in our securities will be materially adversely affected.

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If Microgy is unable to obtain sufficient manure and substrate for its facilities at an acceptable cost, such facilities, and Microgy as a whole, will likely not be profitable.

The performance of Microgy s facilities is dependent on the availability of large quantities of animal manure and substrates derived from animal and other organic waste resources to produce raw energy and meet performance standards in the generation of renewable natural gas. A substantial portion of the gas production of Microgy s facilities is derived from the co-digestion contribution enabled by substrate. While Microgy has or is expected to have agreements relating to the supply of manure and substrate, these agreements may not cover all of Microgy s requirements for such resources, and Microgy will be subject to the ability of the counterparties to such agreements to perform their obligations thereunder. Lack of manure or substrate or adverse changes in the nature or quality of such waste resources or the cost to supply them would seriously affect the ability of Microgy s facilities to produce gas at profitable levels and, consequently, its ability to develop and finance facilities and to operate efficiently and generate income. As a result, its revenue and financial condition would be materially and negatively affected. For example, Microgy has recently experienced an unfavorable shift in the availability at a reasonable costs of certain types of substrates as a result of increases in corn and animal-feed prices, and is unable to determine how long this shift will continue or what its long term effects may be on the cost of substrates and the operating costs of its facilities. We cannot assure you that the waste resources Microgy s facilities require will be available in the future for free or at prices that make them affordable or accessible.

Microgy is expected to derive a significant portion of its revenues from the sale of gas as a commodity; as a result, it will be exposed to risk relating to volatility in the commodity price of natural gas, which could have a material adverse impact on its profitability.

Microgy is expected to derive a significant portion of its revenues from the sale of renewable natural gas as a commodity. As a result, Microgy will be exposed to market risk with respect to the commodity pricing applicable to its gas production. Realized commodity prices received for such production are expected to be primarily driven by spot prices applicable to natural gas. Historically, natural gas prices have been volatile, with recent significant price declines, and Microgy expects such volatility to continue. Furthermore, future supply of and demand for natural gas is unpredictable. There are many players in the markets for natural gas and other energy commodities that natural gas tends to track, including large energy companies and foreign cartels, that are of far greater size than Microgy and which can often cause significant movement in the short- and long-term supply and prices of natural gas. Fluctuations in the commodity price of natural gas may have a materially adverse impact on the profitability of some of Microgy s facilities, particularly where the facility does not have a long-term contract for the sale of its output at a fixed or predictable price. At such time as Microgy s facilities begin to produce commercial quantities of gas for sale as a commodity, it intends to explore various strategies, including hedging transactions and long-term sale agreements, in order to mitigate the associated commodity price risk. Microgy, Inc. has entered into a long-term fixed price arrangement with PG&E to purchase the gas produced from our planned California facilities in an amount up to 8,000 MMBTUs per day.

Furthermore, Microgy Holdings is required by the terms of its tax-exempt bonds to maintain certain gas price protection arrangements for specified periods of time. However, we cannot assure you that any such risk management vehicles will be available or successful. As a result, any such facility, and Microgy as a whole, may become unprofitable.

We expect Microgy to derive substantial revenues from sales of carbon sequestration credits and other environmental attributes, but the market for such attributes is nascent and may not develop in a manner that allows Microgy to profit from the sales of such credits to the level projected, or at all.

The multiple digester facilities that we plan to implement through Microgy Holdings and our other subsidiaries are expected to produce carbon sequestration credits and other marketable environmental attributes. While there exist trading markets for these attributes, and additional trading markets or other commercial avenues may develop, the existing trading markets are new and experience thin trading and price volatility, which can hinder sales of credits and make their value unpredictable. Furthermore, much of the participation in these markets is voluntary, in response to social and environmental ethical concerns, as opposed to being driven by regulatory requirements. While many states are pursuing carbon emissions limits and related initiatives that may spur greater development of and participation in these markets, we are unable to determine the effect of these initiatives on these markets. We cannot assure you that these trading markets will develop further, or even that they will continue to exist. In addition, many of our agreements with our business partners and investors require us to share such credits or any revenues we derive from sales of such credits, and agreements we negotiate in the future may also include such requirements. As a result of the foregoing, we may recognize significantly smaller revenues than we anticipate from the sale of carbon sequestration credits or other environmental attributes.

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We have pledged all of our interest in our facilities in Texas as security for the loan relating to Microgy Holdings tax-exempt bond financing in Texas.

We have invested, and expect to invest, substantial funds and resources in the development of four multi-digester, renewable natural gas facilities in Texas modeled on the facility located in Stephenville, Texas, commonly known as the Huckabay Ridge facility. We have pledged all of our interest in these facilities as collateral security for the loan to our subsidiary, Microgy Holdings, from the Gulf Coast Industrial Development Authority of Texas relating to the $60 million tax-exempt bond financing we completed in November 2006. While the loan is not recourse to Environmental Power, Environmental Power is required to provide at least 20% of the construction costs of these facilities, as well as to cover any cost overruns in construction, which represents a substantial investment of corporate resources. If Microgy Holdings were to default on this loan, we would lose some or all of our investment in the Texas facilities, which would have a material adverse effect on our business, financial condition and results of operations.

Microgy faces competition in the renewable energy market as well as for the resources necessary to operate its facilities.

Microgy plans to generate revenue from the development and ownership of facilities that market renewable, green energy in addition to providing pollution control features to the agricultural and food industry markets. Microgy s green competitors include other energy producers using biomass combustion, biomass anaerobic digestion, geothermal, solar, wind, new hydro and other renewable sources. These companies represent a significant class of competitors because they will compete with Microgy for sale of marketable renewable energy credits and participation in various renewable portfolios and other programs.

Microgy also faces many forms of competition with respect to the resources required to operate its facilities. Such competition includes other providers of pollution control, including environmental engineers, providers of pollution control systems, private companies, public companies, associations, cooperatives, government programs, foreign companies, and educational pilot programs. Furthermore, there are many companies that offer anaerobic digester systems. We believe that at least 60 companies offer complete systems or components to these systems in the U.S. market. A number of competitors have more mature businesses and have successfully installed anaerobic digester systems in the United States. Microgy may be forced to compete with any of these competitors for access to equipment, construction supplies, skilled labor for the construction and operation of its facilities and the supplies of manure and substrate required to operate its facilities. In addition, Microgy may also have to compete for access to substances that make desirable substrates with other users of these substances, such as recyclers of waste grease and producers of biodiesel and other biofuels. The effect of such competition could be reflected in higher costs associated with obtaining access to these resources, as well as an insufficient supply of these resources for the profitable operation of Microgy s facilities. If Microgy cannot obtain and maintain these supplies, or cannot obtain or maintain them at reasonable costs, the profitability of Microgy s business will be adversely affected.

Extreme weather events may have a material adverse effect on the operation on our facilities.

Microgy s facilities, and the anaerobic digestion process on which they are based, are complex and, therefore, sensitive to extreme weather events. For instance, the anaerobic digestion process requires temperatures within a certain band, and extreme cold or heat may negatively impact the process or increase operating costs as a result of the need to counter such temperatures. For instance, Texas experienced record cold temperatures in early 2007 which negatively impacted the startup of the Huckabay Ridge facility. In addition, unusually heavy rains can upset the proper mix of inputs necessary for the anaerobic digestion process, and facilities can also be sensitive to lightning strikes. While Microgy considers typical local weather conditions in the design of its facilities, Microgy cannot anticipate unusual weather events, and such events have had and are likely to continue to have a material adverse effect on the operation of its facilities.

Microgy is a small company, and the entrance of large companies into the alternative fuels and renewable energy business will likely harm its business.

Competition in the traditional energy business from electric utilities and other energy companies is well established, with many substantial entities having multi-billion dollar, multi-national operations. Competition in the alternative fuels and renewable energy business is expanding with the growth of the industry and the advent of many new technologies. Larger companies, due to their better capitalization, will be better positioned than Microgy to develop new technologies and to install existing or more advanced renewable energy facilities, which could harm Microgy s business.

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Because the market for renewable energy is unproven, it is possible that we may expend large sums of money to bring Microgy s offerings to market and that the revenue that Microgy derives from these offerings may be insufficient to fund our operations.

Microgy s business approach to the renewable energy may not produce results as anticipated, be profitable or be readily accepted by the marketplace. We cannot estimate whether the gas produced by facilities based on Microgy s technology will materialize at anticipated prices, or whether satisfactory profit margins will be achieved. If such pricing levels are not achieved or sustained, or if Microgy s technologies and business approach to Microgy s markets do not achieve or sustain broad acceptance, our business, operating results and financial condition will be materially and negatively impacted.

Because we have not filed patents to protect Microgy s intellectual property, we might not be able to prevent others from using Microgy s technology; conversely, others who have filed for patent or other protection might be able to prevent Microgy from using its technology.

Neither Microgy nor, we believe, Microgy s licensor has filed any patent applications on the intellectual property which forms the basis of Microgy s technology. Should Microgy or its licensor decide to file patent applications, we cannot assure you that any patent applications relating to Microgy s existing or future products or technologies will result in patents being issued, that any issued patents will afford adequate protection to Microgy, or that such patents will not be challenged, invalidated, infringed or circumvented. Furthermore, we cannot assure you that others have not developed, or will not develop, similar technologies that will compete with Microgy s without infringing upon Microgy s intellectual property rights or those of its licensor.

Third parties, including potential competitors, may already have filed patent applications relating to the subject matter of Microgy s current or future technology. In the event that any such patents are issued to such parties, such patents may preclude Microgy or its licensor from obtaining patent protection for its technologies, products or processes. In addition, such patents may hinder or prevent Microgy from commercializing its technology and could require Microgy to enter into licenses with such parties. We cannot assure you that any required licenses would be available to us on acceptable terms, or at all.

Microgy relies heavily on confidentiality agreements and licensing agreements to maintain the proprietary nature of its technology. To compete effectively, Microgy may have to defend the rights to its intellectual property from time to time. Such defense costs may be significant and have a negative impact on our financial condition. In addition, we may lack the financial resources to adequately defend Microgy s intellectual property.

If Microgy s relationship with the licensor of its technology was terminated for any reason or such licensor ceased doing business,

our Microgy business would be negatively impacted.

Microgy licenses its anaerobic digester technology from Danish Biogas Technology, A.S., referred to as DBT, a Danish company. DBT is a single purpose entity formed to hold the license agreement by Dansk Biogas, A.S. Dansk Biogas, A.S. was merged with DDH Contractors in 2004 and the combined entity is now known as Xergi, A.S. DBT is now a wholly owned entity of Xergi, A.S. The license agreement grants to Microgy a perpetual, exclusive license to develop facilities based on this technology in North America. Pursuant to the licenses agreement, Microgy is required to pay a one-time licensing fee per facility and engineering and design fees to DBT in connection with the development of facilities. Over the course of development of the Microgy facilities to date, Microgy has become less and less dependent on the technical and operating experience of DBT and Xergi and the exclusivity provisions of the license agreement have become a valuable component of Microgy s business as it limits entrance of other competitors or Xergi itself into the market space. Therefore, if DBT or Xergi were to cease doing business or the license agreement itself was abandoned, our Microgy business may be negatively impacted due to the loss of our ability to control dissemination of the technology through the loss of the exclusivity provisions.

Microgy s facilities are likely to be subject to numerous governmental regulations.

We expect that Microgy s facilities are likely to be subject to various local, state and federal government regulations, including regulations covering air and water quality, solid waste disposal and related pollution issues. These regulations are mandated by the United States Environmental Protection Agency, or EPA, and state and local

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governments and are usually implemented through a permitting process, with ongoing compliance requirements thereafter. In addition, our activities will fall under a number of health and safety regulations and laws and regulations relating to farming and zoning. Compliance with these regulations and permitting requirements could delay the development of facilities and could be costly and harm our financial condition.

As producers of carbon dioxide, Microgy s facilities may become subject to regulations or taxes based on carbon emissions.

Microgy s facilities produce and emit into the atmosphere carbon dioxide as a result of the anaerobic digestion process that they employ. While such facilities capture a significantly greater amount of carbon, in the form of methane, than they produce in the form of carbon dioxide, Microgy s facilities may still be subject to future federal or state legislation or regulation, or the implementation of international treaties, which seek to limit or impose a cost on carbon emissions. If any such legislation, regulations or treaties were implemented, Microgy s may be required to expend resources to capture the carbon dioxide it produces, pay a tax on its carbon emissions, purchase carbon emissions credits or take similar actions. Any of the foregoing could harm the profitability of Microgy s facilities.

Our operating results are difficult to predict in advance and may fluctuate significantly, which may result in a substantial decline in our stock price.

Our operating results are difficult to predict in advance and may fluctuate significantly, and a failure to meet the expectations of analysts or our stockholders would likely result in a substantial decline in our stock price.

Factors that are likely to cause our results to fluctuate include the following:

- the amount and timing of our operating expenses and capital expenditures;
- the success or failure of the facilities currently underway;
- our ability to specify, develop and complete facilities, and to introduce and market the energy created by such facilities and bring them to volume production in a timely manner;
- the rate of adoption and acceptance of new industry standards in our target markets; and

other unforeseen activities or issues.

If our operating results fluctuate greatly, our business may be materially adversely affected and our stock price will likely decline.

Our facilities may be subject to numerous governmental regulations.

We expect that our facilities will be subject to various government regulations, including regulations covering air and water quality, solid waste disposal and related pollution issues. These regulations are mandated by the United States Environmental Protection Agency, or EPA, and various state and local governments and are usually implemented through a permitting process, with ongoing compliance requirements thereafter. In addition, our activities will fall under a number of health and safety regulations and laws and regulations relating to farms and zoning. Compliance with these regulations and permitting requirements could delay the development of facilities, increase the construction and operating costs of our facilities and harm our financial condition.

Risks Relating to Our Capital Stock

We have numerous outstanding shares of restricted common stock, as well as options, warrants and shares of preferred stock exercisable or convertible into a substantial number of shares of our common stock; the resale of outstanding restricted shares, as well as the exercise or conversion of these securities and the resale of the underlying shares, may adversely affect the price of our common stock.

The resale by our stockholders of shares of our restricted common stock or securities exercisable for or convertible into shares of our common stock could cause the market price of our common stock to decline.

A significant portion of our outstanding shares of common stock had been restricted from immediate resale, but are now available for sale in the market pursuant to Rule 144 under the Securities Act of 1933. As of June 30, 2007, we had approximately 1,104,924 shares of restricted common stock outstanding, all of which shares are eligible for resale without volume and manner of sale restrictions in accordance with Rule 144(k). The company is currently authorized to issue 21,400,000 shares of common stock.

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Furthermore, we currently have on file with the Securities and Exchange Commission an effective registration statement that permits the resale by certain of our stockholders of up to 1,677,688 shares of our restricted common stock, of which 1,066,928 shares are currently issued and outstanding and 610,760 shares were subject to outstanding warrants, of which warrants for 446,108 shares have been exercised and warrants for 164,652 shares have now expired. We also currently have on file with the Securities and Exchange Commission an effective registration statement that permits the resale of up to 100,000 shares of our common stock subject to warrants exercisable at a price of $6.33 per share by the holders of such warrants. In addition, in connection with our sale of shares of our series A preferred stock and common stock warrants on November 9, 2006, we filed a registration statement to permit the resale of up to 4,387,360 shares of common stock issuable upon conversion of such shares of series A preferred stock and exercise of such warrants. The shares of series A preferred stock are convertible at a conversion price of $5.27 per share, and the common stock warrants are exercisable at a price of $5.52 per share as to 1,406,205 of the warrants, and $5.27 per share as to 168,745 of the warrants.

In addition, pursuant to our business development agreement with Cargill, Incorporated, we may issue warrants to Cargill from time to time to acquire up to an aggregate of 4.99% of our outstanding common stock on a fully diluted basis, at an exercise price equal to 75% of the closing price of our common stock on the date on which such warrants are issued. In May 2007, we issued 175,912 warrants, representing 1% our fully diluted common stock at the time to Cargill as required by the business development agreement.

As of June 30, 2007, we had outstanding options and warrants to acquire up to approximately 2,939,213 shares of our common stock at prices ranging from $1.75 to $10.50 per share. The shares of common stock issuable upon exercise of these options will be freely transferable without restriction, except to the extent that they are held by our affiliates. Any shares held by our affiliates may only be sold in compliance with the volume limitations of Rule 144. These volume limitations restrict the number of shares that may be sold by an affiliate in any three-month period to the greater of 1% of the number of shares then outstanding, which equals approximately 102,000 shares as of June 30, 2007, or the average weekly trading volume of our common stock during the four calendar weeks preceding the filing of a notice on Form 144 with respect to the sale.

As a result of the resale of outstanding shares of our common stock, including restricted shares and shares issuable upon exercise or conversion of the foregoing securities, the price of our common stock may be adversely affected.

The issuance of preferred stock may adversely affect the price of our common stock.

We are authorized to issue up to 2,000,000 shares of preferred stock, of which 281,241 shares have been designated as series A 9% cumulative convertible preferred stock, referred to as the series A preferred stock, and which are currently issued and outstanding. The preferred stock not already designated and issued may be issued in series from time to time with such designations, rights, preferences and limitations as our board of directors may determine by resolution without stockholder approval. While the terms of the series A preferred stock do not currently allow for the issuance of preferred stock having dividend and liquidation preferences greater than or senior to the series A preferred stock, any future issuances of preferred stock may enjoy dividend and liquidation preferences over our common stock, thereby diminishing the value of our common stock.

Our management and directors, as well as the holders of our series A preferred stock, are able to exercise significant control over our management and affairs.

As of June 30, 2007, management and directors, including Richard E. Kessel, Joseph E. Cresci, Kamlesh R. Tejwani, Robert I. Weisberg, John R. Cooper, August Schumacher, Jr., Lon Hatamiya, Steven Kessner, Michael E. Thomas and Dennis Haines, beneficially owned approximately 10.9% of our outstanding common stock. In addition, the three holders of our series A preferred stock, two of which are affiliated with each other, control approximately 21.7% of the total number of votes currently entitled to be cast at any meeting of our stockholders. While there are no voting agreements among them, such persons, as a group, may be able to exercise some level of control over the outcome of matters submitted for stockholder action, including the election of members to our board of directors and the approval of significant change in control transactions. This may have the effect of delaying or preventing a change in control of our company and, therefore, your opportunity to sell your shares in such a transaction. Furthermore, the holders of our series A preferred stock have special approval rights with respect to certain changes to our certificate of incorporation and certain other corporate actions.

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The lack of a developed trading market may make it difficult for you to sell shares of our common stock.

While our common stock is currently listed for trading on the American Stock Exchange, trading activity in our common stock has fluctuated and has at times been limited. For example, for the one-month period from June 1, 2007 to June 30, 2007, our daily trading volume ranged from a low of 9,800 shares to a high of 259,100 shares, and averaged 69,819 shares. We cannot guarantee that a consistently active trading market will develop in the future. As a result, a holder of our common stock may find it difficult to dispose of our common stock.

The market price for our common stock has been and will likely continue to be volatile.

The market price for our common stock has been volatile, and it is likely to continue to be so. In addition, the market price for our common stock could be subject to significant fluctuations in response to variations in quarterly operating results, announcements of technological innovations or new facilities and products by us or our competitors, or our failure to achieve operating results consistent with any securities analysts projections of our performance. Furthermore, the stock market has experienced extreme price and volume fluctuations and volatility that have particularly affected the market price of many emerging growth and development stage companies such as ours. Such fluctuations and volatility have often been unrelated or disproportionate to the operating performance of such companies. As a result of fluctuations related or unrelated to our performance, the value of our common stock may be materially adversely affected.

We will require and are actively seeking significant additional financing, which may result in our issuing a significant number of shares of our common stock or preferred stock, which in turn may dilute the value of your shares.

We have historically needed to raise capital to fund our operating losses. We expect to continue to incur operation losses into at least 2008. In November 2006, we completed a tax-exempt bond financing in Texas to finance a portion of the construction costs of our Texas facilities, as well as a $15 million private placement of our series A preferred stock and common stock warrants, we will require and will continue to seek corporate and project financing to fund our ongoing operations and growth plans as well as and the cost of any development we may decide to pursue for our facilities. We cannot assure you that such capital will be available in sufficient amounts or on terms acceptable to us, if at all. Any such financing could be in the form of debt or equity instruments or a combination of debt and equity instruments. To the extent any such financing involves equity convertible debt, we may issue a significant number of shares of our common stock or preferred stock, which will dilute your investment in our common stock, and we may issue such shares at prices that may be lower than the price you paid for our common stock. In addition, if we issue shares of preferred stock, such preferred stock may have rights and preferences that are superior to those of our common stock. Indeed, the shares of series

A preferred stock issued in our November 2006 private placement have rights and preferences that are superior to those of our common stock. Because we are authorized to issue shares of additional series of preferred stock, as designated by our board of directors, subject to certain limitations included in the terms of our series A preferred stock, we may issue more shares of preferred stock in the future.

Issuances of common stock or securities convertible into common stock in the future could dilute existing stockholders and adversely affect the market price of our common stock. We have the authority to issue up to 21,400,000 shares of common stock, of which 10,122,491 are issued and outstanding and 4,811,289 have been reserved for issuance upon the exercise of options and warrants outstanding as of June 30, 2007. An additional 2,812,410 shares have been reserved for issuance in connection with the conversion of shares of our series A preferred stock issued in our November 2006 private placement. We may also issue warrants to purchase up to 4.99% of our common stock, on a fully diluted basis, to Cargill, Incorporated pursuant to the terms of our business development agreement. In May 2007, we issued 175,912 warrants, representing 1% our fully diluted common stock at the time to Cargill as required by the business development agreement.

We also have the authority to issue preferred stock as previously described, debt securities convertible into common stock, and options and warrants to purchase shares of our common stock. We may issue shares of common stock or securities convertible into common stock at values below our market price up to a maximum of 19.9% of our outstanding common stock without stockholder approval, which values may be substantially below the price paid for our common stock by our stockholders. We also do not need stockholder approval to issue an unlimited number of shares of common stock or securities convertible into common stock (provided sufficient shares of

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common stock are authorized and unreserved) at or above our market price pursuant to certain American Stock Exchange requirements. Any such issuances could be at values below the price paid for our common stock by our stockholders.

Our outstanding series A preferred stock has rights and preferences superior to that of our common stock, may impair our ability to raise additional financing, may harm our financial condition if we are required to redeem it and could have the effect of discouraging an acquisition or reducing the amount of proceeds available to common stockholders upon such an acquisition.

Our shares of series A preferred stock have rights and preferences which are superior to those of our common stock, including:

- an accruing dividend of 9% on the stated value of each outstanding share of series A preferred stock, payable before the payment of any dividends on our common stock;
- a preference upon liquidation, dissolution or winding up of Environmental Power equal to two times the stated value of each share of preferred stock, plus any accrued but unpaid dividends;
- the right to consent to certain changes to our certificate of incorporation and bylaws, and certain other significant corporate actions; and
- the right to a payment equal to 150% of the stated value of each outstanding share of Series A Preferred Stock upon certain change-in-control events.

Our series A preferred stock may also have a material adverse effect on our financial condition and results of operations. We have agreed not to issue securities senior to or on a par with the series A preferred stock and to limit our ability to incur additional indebtedness while such preferred stock is outstanding, which could materially and adversely affect our ability to raise funds necessary to continue our business. In addition, the series A preferred stock provides for various triggering events, such as our common stock not being listed for trading on the American Stock Exchange, Nasdaq Global Market or New York Stock Exchange, the failure to deliver shares of our common stock upon conversion and specified change of control transactions. Several other triggering events are described in the certificate of designations, preferences and rights of the series A preferred stock. If one of these triggering events occurs, we may be required to redeem all or part of the outstanding shares of series A preferred stock at 120% of their stated value (150% in the case of certain change in control transactions), including payment of accrued dividends and penalties. Some of the triggering events include matters over which we may have some, little, or no control. Any such redemption could leave us with little or no working capital for our business. Furthermore, by virtue of their voting power and other rights and preferences, the outstanding series A preferred stock could have the effect of blocking or discouraging certain acquisitions of the company or reducing the proceeds available to common stockholders as a result of any such acquisitions.

We do not intend to pay cash dividends on our common stock.

We have not paid cash dividends on our common stock since 2001, and we do not expect to pay cash dividends on our common stock at any time in the foreseeable future. The future payment of dividends directly depends upon the future earnings, capital requirements, financial requirements and other factors that our board of directors will consider, and is subject to the prior payment of all accrued but unpaid dividends on our series A preferred stock. Furthermore, the terms of our series A preferred stock prohibit the payment of dividends on our common stock while any shares of our series A preferred stock are outstanding. Because we do not anticipate paying cash dividends on our common stock, the return on investment on our common stock will depend solely on a change, if any, in the market value of our common stock.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information
Not Applicable

Item 6. Exhibits
The exhibits listed in the accompanying exhibit index are filed as part of this Quarterly Report on Form 10-Q and are incorporated herein by reference.

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.

ENVIRONMENTAL POWER CORPORATION

By: /s/ Michael E. Thomas
Michael E. Thomas
Senior Vice President, Chief Financial Officer and Treasurer
(principal financial and accounting officer and authorized officer)

August 13, 2007

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Exhibit Index

3.1	Restated Certificate of Incorporation of the Registrant (Incorporated by reference to Exhibit 3.01 to the Registrant s Current Report on Form 8-K dated November 30, 2004, as filed with the SEC on December 2, 2004 (SEC File No. 000-15472))
3.2	Restated Bylaws of the Registrant (Incorporated by reference to Exhibit 3.02 to the Registrant s Current Report on Form 8-K/A dated June 2, 2003, as filed on June 10, 2003 (SEC File No. 000-15472))
3.3	Certificate of Designations, Preferences and Rights of the Registrant s Series A 9% Cumulative Convertible Preferred Stock (Incorporated by reference to exhibit 3.1 to the Registrant s Current Report on Form 8-K dated November 9, 2006, as filed with the SEC on November 14, 2006 (SEC File No. 001-32393))
10.1	Employment Offer Letter, dated May 10, 2007, between the Registrant and Michael E. Thomas.
10.2	Form of Stock Appreciation Right Agreement under the 2005 Equity Incentive Plan and 2006 Equity Incentive Plan.
10.3	Release and Severance Agreement, dated May 9, 2007, between the Registrant and John F. O Neill.
31.1	Rule 13a-14(a)/15d-14(a) Certifications of the Registrant s Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certifications of the Registrant s Chief Financial Officer.
32.1	Section 1350 Certifications of the Registrant s Chief Executive Officer.
32.2	Section 1350 Certifications of the Registrant s Chief Financial Officer.