

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Report contains statements that constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act. These statements appear in a number of places in this Report and include statements regarding our plans, beliefs or current expectations; including those plans, beliefs and expectations of our officers and directors with respect to, among other things, the development of markets for our products, the adequacy of our cash balances and liquidity to meet future operating needs, and our ability to issue equity or debt securities.

Introduction

We generate revenue from two principal activities: 1) research, development and application engineering services that are paid for by our customers; and 2) the sale of motors, generators and electronic controls. The sources of engineering revenue typically vary from year to year and individual projects may vary substantially in their periods of performance and aggregate dollar value. Our product sales consist of both prototype low volume sales, which are generally sold to a broad range of customers, and annually recurring higher volume production. During the fiscal year ended March 31, 2008 our total revenue increased 12.9 percent to \$7,508,322, driven primarily by increased product sales which rose 31.3 percent to \$4,916,383. Gross profit margins on contract services improved to 21.3 percent this fiscal year versus 8.3 percent last fiscal year, while gross profit margins on product sales declined slightly to 10.7 percent.

During the fiscal year, we allocated substantially greater engineering resources to internally funded research and development and production engineering activities. Research and development expenditures, which increased 43.8 percent this fiscal year versus last fiscal year, were primarily focused on software enhancements to our motor controllers. Production engineering expenses for the year ended March 31, 2008 rose 32.7 percent to \$1,706,978, reflecting engineering activities associated with the launch of production for Phoenix Motorcars, Inc. under a \$9.25 million purchase order and associated supply agreement both of which were unilaterally cancelled by Phoenix in October 2007. As a result of this cancellation, we have filed a \$5.1 million arbitration claim against Phoenix for breach of contract which we expect to be heard by an arbitration panel in the fall of calendar 2008.

Loss from continuing operations for the current fiscal year rose to \$4,572,646 or \$0.18 per common share versus \$3,402,566, or \$0.14 per common share and \$2,757,386, or \$0.11 per common share for the fiscal years ended March 31, 2007 and 2006, respectively. The increase in losses versus last fiscal year and the fiscal year ended March 31, 2006 is attributable to higher levels of research and development expenditures, production engineering expenses and selling, general and administrative expenses.

In May 2004, we divested a contract electronics manufacturing business. Operating losses from this business for all periods presented have been reclassified to discontinued operations and contributed nil per common share to our consolidated net loss for the fiscal years ended March 31, 2008, 2007 and 2006.

During the last half of the fiscal year there were three significant industry events that we believe may lead to a significant expansion of the market for hybrid electric products. In November 2007, International Truck and Engine Corporation, a Navistar Company announced that it was the first company to enter line production of hybrid electric commercial trucks, introducing the International® DuraStar™ Hybrid, a diesel electric medium-duty truck. In March 2008, Peterbilt Motors Company, a division of PACCAR Inc. announced plans for full production of its Model 330 and Model 335 medium-duty hybrid trucks at its manufacturing facility in Ste. Therese, Quebec, Canada in summer 2008 and Freightliner Trucks recently introduced its Business Class® M2e Hybrid truck. All of these truck manufacturers use the Eaton Corporation hybrid electric system and related electronic products. The automotive certified DC-to-DC converter manufactured by us for Eaton Corporation will be on board many of these recently introduced hybrid trucks which will contribute to higher levels of product sales in fiscal 2009 and beyond. Also in March 2008, Caterpillar, Inc. introduced the D7E crawler tractor incorporating an electric drive system for track-type tractors with an electric system that provides power to electric auxiliaries so that no engine belts are required. We believe that these industry developments signal the beginning of a potentially large-scale deployment of electric propulsion and related electronic products into markets other than mass-market passenger automobiles. Should these products receive broad customer acceptance over time, as we expect they will, potentially large opportunities will likely develop for our company and other similarly situated companies that have developed technologically advanced products in anticipation of the emergence of these market opportunities.

These industry developments as well as the potential production requirements of our existing customers will require us to

invest a substantially greater amount of financial and human resources in fiscal 2009 and beyond on the commercial launch of products. Specifically, we currently expect to potentially double the size of our production engineering group and to significantly increase the level of our capital expenditures for manufacturing equipment and tooling, and potentially the expansion of our manufacturing facility in Frederick, Colorado. We believe these investments are necessary to support our strategy of aggressively rolling out automotive certified products to satisfy our customers requirements as these new market opportunities emerge and expand.

As the markets for these advanced vehicles continue to emerge and expand into additional vehicle platforms over the next several years, we expect to experience potentially rapid growth in our revenue coincident with the introduction of electric products for our customers.

We believe our existing cash and short-term investments, which amounted to approximately \$9.8 million at fiscal year end, will be adequate to fund our anticipated growth for the fiscal year ended March 31, 2009 and likely beyond, however, if our growth continues to accelerate beyond fiscal 2009 we may require additional capital.

Financial Condition

Cash and cash equivalents and short-term investments at March 31, 2008 were \$9,765,892 and working capital (the excess of current assets over current liabilities) was \$10,510,175 compared with \$7,934,005 and \$8,909,577, respectively, at March 31, 2007. The increase in cash and short-term investments and working capital is primarily attributable to the completion of a private placement of 1,250,000 shares of common stock during the first quarter which resulted in net cash proceeds of \$5,183,677, offset by higher operating losses, investments in property and equipment, and slower invoicing on certain contract service programs in progress at March 31, 2008.

Accounts receivable decreased \$130,547 to \$1,304,139 at March 31, 2008 from \$1,434,686 at March 31, 2007. The decrease is primarily attributable to lower levels of contract service billings as of March 31, 2008 and a slower payment profile by one customer during the fourth quarter of fiscal 2008. During the fiscal year ended March 31, 2006 a customer with an outstanding account receivable balance filed for bankruptcy protection resulting in a charge to bad debt expense of \$63,000. Despite the occurrence of this event, substantially all of our customers are large well-established companies of high credit quality. Accordingly, we have not established an allowance for bad debts at March 31, 2008 and similarly, no allowance for bad debts was deemed necessary at March 31, 2007.

Costs and estimated earnings on uncompleted contracts increased \$461,757 to \$649,670 at March 31, 2008 versus \$187,913 at March 31, 2007. The increase is due to less favorable billing terms on certain contracts in process at March 31, 2008 versus March 31, 2007. Estimated earnings on contracts in process increased to \$377,822 or 11.1 percent of contracts in process of \$3,396,292 at March 31, 2008 compared to estimated earnings on contracts in process of \$155,436 or 7.5 percent of contracts in process of \$2,071,818 at March 31, 2007. The increase in estimated margins on contracts in process is attributable to improved overhead absorption.

Inventories increased \$61,604 to \$961,489 at March 31, 2008 principally due to increased levels of raw materials and work-in-process inventories which increased \$69,303 and \$69,469, respectively, reflecting higher levels of scheduled product shipments. Finished goods inventory decreased \$77,168, reflecting lower levels of auxiliary motors on hand at March 31, 2008.

Prepaid expenses and other current assets decreased to \$119,647 at March 31, 2008 from \$279,343 at March 31, 2007 primarily due to lower levels of prepayments on capital equipment purchases at the end of the current fiscal year versus the prior fiscal year end.

We invested \$616,488 for the acquisition of property and equipment during the fiscal year compared to \$397,008 last fiscal year. The increase in capital expenditures is primarily due to building improvements and increased purchases of manufacturing equipment during the year ended March 31, 2008.

Patent and trademark costs decreased \$34,538 to \$447,765 at March 31, 2008 versus \$482,303 at March 31, 2007 due to systematic amortization of patent issuance costs, which was partially offset by the costs associated with the initiation of two new patent applications.

Other assets increased \$185,899 to \$241,549 at March 31, 2008 from \$55,650 at March 31, 2007 due to higher levels of prepayments on capital equipment purchases at the end of the current fiscal year versus the prior fiscal year end.

Accounts payable decreased \$242,404 to \$740,527 at March 31, 2008 from \$982,931 at March 31, 2007, primarily due to improved payment processing during the current fiscal year.

Other current liabilities increased \$27,333 to \$372,285 at March 31, 2008 from \$344,952 at March 31, 2007. The increase is primarily attributable to higher levels of accrued warranty reserves arising from increased product sales.

Short-term deferred compensation under executive employment agreements increased to \$364,000 at March 31, 2008 versus \$149,325 at March 31, 2007 reflecting an amendment to an executive employment agreement during the current year which accelerated the recording of future severance obligations under the agreement.

Liabilities and commitments of discontinued operations were zero at March 31, 2008 compared to \$13,847 at March 31, 2007. The decrease is attributable to payments during the fiscal year on the master lease for the facility previously occupied by our discontinued contract electronics business. See also Results of Discontinued Operations below and note 11 to the consolidated financial statements.

Billings in excess of costs and estimated earnings on uncompleted contracts increased \$395,311 to \$707,848 at March 31, 2008 from \$312,537 at March 31, 2007 reflecting increased levels of billings on certain engineering contracts in process at the end of the fiscal year ended March 31, 2008 in advance of the performance of the associated work versus the prior fiscal year.

Long-term debt, less current portion decreased \$106,002 to \$416,923 at March 31, 2008 from \$522,925 at March 31, 2007 reflecting scheduled principal repayments on the mortgage debt for our Frederick, Colorado facility.

Long-term deferred compensation under executive employment agreements increased \$237,659 to \$633,873 at March 31, 2008 from 396,214 at March 31, 2007 primarily due to an amendment to executive employment agreements during the current fiscal year, which accelerated the recording of future severance obligations under the agreements.

Common stock and additional paid-in capital increased to \$265,267 and \$77,819,041, respectively, at March 31, 2008 compared to \$251,769 and \$71,376,462 at March 31, 2007. The increases were primarily attributable to the completion of a private placement of 1,250,000 shares of common stock during the first quarter this fiscal year and the recording of non-cash share based payments under Statement of Financial Accounting Standards No. 123 (revised), Share-Based Payment ("SFAS 123(R)").

Results of Continuing Operations

Continuing operations for the fiscal year ended March 31, 2008, resulted in a loss of \$4,572,646, or \$0.18 per common share, compared to a loss from continuing operations of \$3,402,566, or \$0.14 per common share, and \$2,757,386, or \$0.11 per common share, for the fiscal years ended March 31, 2007 and 2006, respectively. The increase in the current year loss from continuing operations is primarily attributable to higher levels of equity-based compensation, internally funded research and development, production engineering activities, and higher levels of compensation expense. Noncash stock option expense for the fiscal year ended March 31, 2008 required by SFAS 123R was allocated as follows:

Cost of contract services	\$ 113,507
Cost of product sales	60,933
Research and development	25,652
Production engineering	132,494
Selling, general and administrative	<u>842,349</u>
	\$ <u>1,174,935</u>

Stock option expense for the fiscal year ended March 31, 2007 required by the adoption of SFAS 123R was allocated as follows:

Cost of contract services	\$ 154,828
Cost of product sales	48,606
Research and development	22,612
Production engineering	113,013
Selling, general and administrative	<u>618,697</u>
	\$ <u>957,756</u>

No stock option expense was recorded in our consolidated statements of operations for the fiscal years ended March 31, 2006.

Revenue from contract services decreased \$315,597, or 10.9 percent, to \$2,591,939 for the fiscal year ended March 31, 2008 versus \$2,907,536 for the fiscal year ended March 31, 2007. The decrease is attributable to the increased allocation of engineering resources to production engineering activities this fiscal year versus last fiscal year. Revenue from contract services increased 16.2 percent to \$2,907,536 for the fiscal year ended March 31, 2007 compared to \$2,502,098 for the fiscal year ended March 31, 2006. The increase was primarily attributable to higher levels of material and subcontract revenue during fiscal 2007 versus fiscal 2006.

Product sales this fiscal year increased to \$4,916,383 compared to \$3,745,658 for the fiscal year ended March 31, 2007. Product sales for the fiscal year ended March 31, 2007 more than doubled to \$3,745,658 compared to \$1,820,468 for the year ended March 31, 2006. Power products segment revenue for the year ended March 31, 2008 increased \$490,170, or 18.7 percent, to \$3,117,109 compared to \$2,626,939 for fiscal year ended March 31, 2007 due to increased shipments of vehicle auxiliary motors and the shipment of electric propulsion systems. Power products segment revenue for the year ended March 31, 2007 more than tripled to \$2,626,939 versus \$862,666 for fiscal year ended March 31, 2006 due to increased production levels for auxiliary motors and the launch of production of DC-to-DC converters for hybrid electric trucks. Technology segment product revenue for the fiscal year ended March 31, 2008 increased to \$1,799,274 compared to \$1,118,719 for fiscal year ended March 31, 2007 due to higher levels of shipments of low volume propulsion systems. Technology segment product revenue for the fiscal year ended March 31, 2007 increased \$160,917, or 16.8 percent, to \$1,118,719 compared to \$957,802 for fiscal year ended March 31, 2006 due to increased shipments of low volume generators and controllers to the Denver Regional Transportation District for use in their hybrid electric shuttle buses.

Gross profit margins for the current fiscal year increased to 14.3 percent compared to 10.0 percent for the fiscal year ended March 31, 2007. Gross profit margins for the fiscal year ended March 31, 2007 increased to 10.0 percent compared to 4.2 percent for the fiscal year ended March 31, 2006. Gross profit margins on contract services increased to 21.3 percent this fiscal year compared to 8.3 percent for the fiscal year ended March 31, 2007 due to improved program execution during the current fiscal year. Gross profit margins on contract services increased to 8.3 percent for the fiscal year ended March 31, 2007 compared to 1.2 percent for the fiscal year ended March 31, 2006 due to fewer cost overruns on programs during the fiscal year ended March 31, 2007. Gross profit margins on product sales this fiscal year decreased to 10.7 percent compared to 11.3 percent for fiscal 2007. The decrease is primarily due to decreased overhead absorption. Gross profit margins on product sales for the fiscal year ended March 31, 2007 increased to 11.3 percent compared to 8.2 percent for the fiscal year ended March 31, 2006 due to improved overhead absorption.

Research and development expenditures for the fiscal year ended March 31, 2008 increased to \$461,791 compared to \$321,160 and \$241,563 for the fiscal years ended March 31, 2007 and 2006, respectively. The increase in research and development expenditures for the fiscal year ended March 31, 2008 compared to the prior fiscal year was primarily due to increased levels of internally funded software development projects. The increase in research and development expenditures for fiscal 2007 versus fiscal 2006 was primarily due to expenditures to enhance the capability and function of the embedded microprocessor that manages the operation of our motor controllers and additional compensation expense arising from the expensing of stock options.

Production engineering costs were \$1,706,978 for the fiscal year ended March 31, 2008 versus \$1,286,761 and \$783,579 for the prior two fiscal years. The increase for the fiscal year ended March 31, 2008 versus fiscal 2007 is primarily attributable to additional staffing during the current year. The increase for the fiscal 2007 versus fiscal 2006 is primarily attributable to the debugging and activation of our semi-automated motor production cell, production engineering activities related to the launch of high volume production for the Phoenix Motorcars propulsion system and additional compensation expense arising from the expensing of stock options.

Selling, general and administrative expense this fiscal year was \$3,905,495 compared to \$2,855,213 and \$2,191,289 for the fiscal years ended March 31, 2007 and 2006, respectively. The increase for this fiscal year versus last fiscal year is primarily attributable to increased levels of compensation and bonuses, and the amendment of executive employment agreements, which accelerated the recording of deferred compensation expense associated with the severance provisions of these agreements. The increase for fiscal 2007 versus fiscal 2006 is primarily attributable to deferred compensation expense associated with executive employment agreements, higher levels of selling expenses, and additional compensation expense arising from the expensing of stock options.

Impairment of long-lived assets for the fiscal year ended March 31, 2008 of \$11,155 is primarily attributable to the impairment of obsolete equipment. The impairment of long-lived assets for the fiscal years ended March 31, 2007 and

March 31, 2006 were \$889 and \$2,963, respectively, and are attributable to the write-down of costs associated with abandoned patent applications.

Interest income rose to \$463,248 for the current fiscal year compared to \$445,578 and \$344,751 for the fiscal years ended March 31, 2007 and 2006, respectively. The increase for fiscal 2008 versus fiscal 2007 is attributable to higher invested balances during the current fiscal year. The increase for fiscal 2007 versus fiscal 2006 is attributable to higher returns on invested cash balances.

Interest expense decreased to \$40,652 for the year ended March 31, 2008 compared to \$47,422 and \$63,003 for the fiscal years ended March 31, 2007 and 2006, respectively. The decrease is due to lower average mortgage borrowings outstanding throughout the fiscal year as compared to the prior fiscal year.

Results of Discontinued Operations

In January 2004, we committed to a plan to exit our contract electronics manufacturing business whose results were reported as the electronic products segment. In May 2004, we completed the divestiture of equipment and inventory of this business for \$0.9 million in cash and a 15 percent ownership interest in the purchaser. We did not record any value for the common stock of the purchaser received in this transaction due to uncertainty regarding our ability to realize economic value on the resale of our ownership interest. In addition, the purchaser executed a sublease on our St. Charles, Missouri manufacturing facility for the remaining term of our lease. Due to substantial doubt regarding the purchaser's financial capability to meet its obligation under the sublease, we recorded a liability, at that time, of \$204,985, which represented our best estimate of the present value of future cash outflows that may arise if the purchaser defaulted on the sublease prior to the completion of its term. During the year ended March 31, 2006, we wrote-off uncollectible past due rent receivables from the sublessee in the amount of \$95,880 and reduced the fair value estimate of our potential liability under the master lease at that time by \$67,122 to reflect our expectations regarding our ability to identify a new tenant and complete a new sublease on the facility. In December 2005, the purchaser sold the assets of its business to another business at a price, which rendered our equity investment worthless. Coincident with this transaction we received a promissory note in the amount of \$98,420 from the original purchaser together with an assignment of future commission income to be earned under a commission agreement between the buyer and the original purchaser. Income assignments are to cease when the promissory note is paid in full. Due to substantial doubt regarding our ability to receive payments under the assignment agreement and promissory note, we have fully reserved the value of the promissory note on our books reducing its recorded value to zero. The acquiring business entered into a sublease agreement on the facility with us for the remaining term of our master lease, which expired by its terms on March 31, 2007.

The operating results of this business for the year ended March 31, 2008, 2007 and 2006 have been reported separately as discontinued operations. Loss from discontinued operations includes interest expense on debt used to acquire manufacturing machinery and equipment but does not include allocations of general corporate overheads, which have been allocated to other business segments. Operating results of all prior periods presented have been adjusted to reflect the contract electronics manufacturing as discontinued operations.

Loss from discontinued operations for the fiscal year ended March 31, 2008 was \$13,459, or nil per common share compared to a loss from discontinued operations of \$28,791, or nil per common share, and \$27,584, or nil per common share, for the fiscal years ended March 31, 2007 and 2006, respectively. See also Note 11 to the consolidated financial statements.

Liquidity and Capital Resources

Our cash balances and liquidity throughout the fiscal year ended March 31, 2008 were adequate to meet operating needs. At March 31, 2008, we had working capital (the excess of current assets over current liabilities) of \$10,510,175 compared to \$8,909,577 at March 31, 2007.

For the year ended March 31, 2008, net cash used in operating activities of continuing operations was \$2,560,514 compared to net cash used in operating activities of continuing operations of \$2,579,911 and \$1,597,381 for the years ended March 31, 2007 and 2006, respectively. The decrease in cash used for the year ended March 31, 2008 is primarily attributable to higher non-cash charges for equity-based compensation, higher levels of deferred compensation and higher levels of billings in excess of costs and estimated earnings on certain uncompleted contracts, offset by higher operating losses. The increase in cash used for the year ended March 31, 2007 is primarily attributable to higher operating losses, higher levels of accounts receivables and inventories offset by non-cash charges for depreciation and amortization and equity-based compensation and higher levels of accounts payable and other current liabilities and deferred compensation.

Net cash used in investing activities of continuing operations for the fiscal year ended March 31, 2008 was \$1,446,752 compared to \$428,914 for the previous fiscal year and \$4,246,130 for fiscal 2006. The change this fiscal year versus last fiscal year was primarily due to higher expenditures for building improvements and manufacturing equipment and increased purchases of short-term investment securities. Net cash used in investing activities of continuing operations for fiscal 2007 decreased to \$428,914 versus \$4,246,130 for fiscal 2006 primarily due to increased purchases of short-term investment securities during the fiscal year ended March 31, 2006.

Net cash provided by financing activities of continuing operations was \$5,182,382 for the fiscal year ended March 31, 2008 versus \$1,037,241 for the preceding fiscal year. The increase this fiscal year versus fiscal year 2007 is attributable to the completion of a private placement in the first quarter, which resulted in 5.2 million in cash proceeds. Net cash provided by financing activities of continuing operations was \$1,037,241 for the fiscal year ended March 31, 2007 versus \$4,309,003 for the fiscal year ended March 31, 2006. The decrease in fiscal 2007 versus 2006 is attributable to the effect of a follow-on offering of \$3.9 million in fiscal 2006, which was partially offset by increased cash proceeds from the exercise of stock options and warrants in fiscal 2007.

We expect to invest substantially greater financial and human resources during fiscal 2009 on the commercialization of our products in emerging markets, including a significant increase in the amount of capital expenditures for equipment and tooling. As a result of these activities our losses are expected to increase and our working capital requirements may increase substantially during fiscal 2009 as a result of an increase in our losses and total revenue. Although we expect to manage our operations and working capital requirements to minimize the future level of operating losses and working capital usage consistent with execution of our business plan, our planned working capital requirements may consume a substantial portion of our cash reserves at March 31, 2008. We expect to fund our operations over the next year from existing cash and short-term investment balances and from available bank financing, if any. We can, however, not provide any assurance that our existing financial resources will be sufficient to execute our business plan beyond next fiscal year. If our existing financial resources are not sufficient to execute our business plan, we may issue equity or debt securities in the future. In the event financing or equity capital to fund future growth is not available on terms acceptable to us, we will modify our strategy to align our operation with then available financial resources.

Contractual Obligations

The following table presents information about our contractual obligations and commitments as of March 31, 2008:

	<u>Total</u>	<u>Payments due by Period</u>			
		<u>Less Than 1 Year</u>	<u>2 - 3 Years</u>	<u>4 - 5 Years</u>	<u>More than 5 Years</u>
Long-term debt obligations	\$ 522,925	106,002	416,923	-	-
Interest on long-term debt obligations	52,052	33,737	18,315	-	-
Purchase obligations	901,097	901,097	-	-	-
Executive employment agreements ⁽¹⁾	<u>997,873</u>	<u>364,000</u>	<u>628,000</u>	-	<u>5,873</u>
Total	<u>\$ 2,473,947</u>	<u>1,404,836</u>	<u>1,063,238</u>	<u>-</u>	<u>5,873</u>

(1) Includes severance pay obligations under executive employment agreements, but not annual cash compensation under the agreements.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that effect the dollar values reported in the consolidated financial statements and accompanying notes. Note 1 to the consolidated financial statements describes the significant accounting policies and methods used in preparation of the consolidated financial statements. Estimates are used for, but not limited to, allowance for doubtful accounts receivables, costs to complete contracts, and recoverability of inventories. Actual results could differ materially from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in preparation of the consolidated financial statements.

Accounts Receivable

Our trade accounts receivable are subject to credit risks associated with the financial condition of our customers and their liquidity. We evaluate all customers periodically to assess their financial condition and liquidity and set appropriate credit limits based on this analysis. As a result, the collectibility of accounts receivable may change due to changing general economic conditions and factors associated with each customer's particular business. During fiscal 2006 a large, well established customer filed for bankruptcy protection. As a result we charged-off \$63,000 owed to us by the customer as a bad debt expense. Because substantially all of our customers are large well-established companies with excellent credit worthiness and our view that the bad debt expense associated with our customer's bankruptcy filing is an isolated, customer specific event, we have not established a reserve at March 31, 2008 and 2007 for potentially uncollectible trade accounts receivable. It is reasonably possible, that future events or changes in circumstances could cause the realizable value of our trade accounts receivable to decline materially, resulting in material losses.

Inventories

We maintain raw material inventories of electronic components, motor parts and other materials to meet our expected manufacturing needs for proprietary products and for products manufactured to the design specifications of our customers. Some of these components may become obsolete or impaired due to bulk purchases in excess of customer requirements. Accordingly, we periodically assesses our raw material inventory for potential impairment of value based on then available information, expectations and estimates and establish impairment reserves for estimated declines in the realizable value of our inventories. The actual realizable value of our inventories may differ materially from these estimates based on future occurrences. It is reasonably possible that future events or changes in circumstances could cause the realizable value of our inventories to decline materially, resulting in additional material impairment losses.

Percentage of Completion Revenue Recognition on Long-term Contracts: Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts

We recognize revenue on development projects funded by our customers using the percentage-of-completion method. Under this method, contract services revenue is based on the percentage that costs incurred to date bear to management's best estimate of the total costs to be incurred to complete the project. Many of these contracts involve the application of our technology to customers' products and other applications with demanding specifications. Management's best estimates have sometimes been adversely impacted by unexpected technical challenges requiring additional analysis and redesign, failure of electronic components to operate in accordance with manufacturers published performance specifications, unexpected prototype failures requiring the purchase of additional parts and a variety of other factors that may cause unforeseen delays and additional costs. It is reasonably possible that total costs to be incurred on any of the projects in process at March 31, 2008 could be materially different from management's estimates, and any modification of management's estimate of total project costs to be incurred could result in material changes in the profitability of affected projects or result in material losses on any affected projects.

New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board ("*FASB*") issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ("*FIN No. 48*"). FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken, in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. We adopted FIN No. 48 in connection with the preparation of our annual financial statements for the fiscal year ending March 31, 2008. The adoption of this standard did not have a material impact on our financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("*SFAS No. 157*"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires additional disclosures about fair value measurements. In February 2008 the FASB issued FASB Staff Position (FSP) 157-2 *Effective Date of FASB Statement No. 157*. Under the terms of FSP 157-2, the provisions of SFAS 157 will be adopted by us for financial instruments on April 1, 2008, and when required for nonfinancial assets and nonfinancial liabilities on April 1, 2009 (except for those that are recognized or disclosed at fair value in the financial statements on a recurring basis). We do not expect the provisions of this standard to be adopted by us on April 1, 2008 to have a material effect on our financial statements and have not yet determined the impact on our financial statements of adopting the provisions related to nonfinancial assets and liabilities.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ("SFAS No. 158"). SFAS No. 158 requires an employer to recognize a plan's overfunded or underfunded status in its balance sheets and recognize the changes in a plan's funded status in comprehensive income in the year which the changes occur. These provisions of SFAS No. 158 were adopted last fiscal year. In addition, SFAS No. 158 requires an employer to measure plan assets and obligations that determine its funded status as of the end of its fiscal year, with limited exceptions. This provision of SFAS No. 158 is effective for our fiscal year ending March 31, 2009. The provisions that were effective last fiscal year did not have a material effect on our financial statements and the provisions effective for our fiscal year ending March 31, 2009 are not expected to have a material effect on our financial statements.

In February 2007 the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159"). This standard permits companies to choose to measure many financial instruments and certain other items at fair value, following the provisions of SFAS No. 157. SFAS No. 159 is effective for our fiscal year beginning April 1, 2008. We do not expect the adoption of this standard to have a material impact on our financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* ("FAS 141(R)") and Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements* ("FAS 160"). These standards goal are to improve, simplify, and converge internationally the accounting for business combinations and the reporting of noncontrolling interests in consolidated financial statements. The provisions of FAS 141(R) and FAS 160 are effective for the fiscal year beginning April 1, 2009. We have not yet determined the impact of adopting these standards.

In December 2007, The Securities and Exchange Commission issued Staff Accounting Bulletin 110 (SAB 110). SAB 110 permits entities, under certain conditions, the continued use of a simplified method to estimate the expected term of certain stock options. SAB 110 amended SAB 107 to permit the use of this simplified method beyond December 31, 2007. The adoption of this standard did not have a material effect on our financial statements.

In September 2006 the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ("SAB 108"). Historically, there have been two widely used methods for quantifying the effects of financial statement misstatements. These methods are referred to as the "roll-over" and "iron-curtain" method. The "roll-over" method quantifies the amount by which the current year income statement is misstated. Exclusive reliance on an income statement approach can result in the accumulation of errors on the balance sheet that may or may not have been material to any individual income statement, but which may misstate one or more balance sheet accounts. The "iron curtain" method quantifies the error as the cumulative amount by which the current year balance sheet is misstated. Exclusive reliance on a balance sheet approach can result in disregarding the effects of errors in the current year income statement that result from the correction of an error existing in previously issued financial statements. SAB 108 provides that prior year uncorrected immaterial misstatements be evaluated under both the "roll-over" and "iron-curtain" approaches. In the event a misstatement is deemed material to the current period financial statements and the related financial statement disclosures under either approach, SAB 108 requires that the misstatement be corrected by either retroactively adjusting prior financial statements as if the dual approach had always been used, or by correcting it in the current period financial statements by presenting the cumulative effect of the prior period errors as an adjustment to the beginning balance of accumulated deficit and the related assets or liabilities for the current fiscal year. We adopted SAB 108 using the cumulative effect transition method in connection with the preparation of our annual financial statements for the fiscal year ending March 31, 2007. As a result, we recorded a cumulative effect charge to the beginning balance of accumulated deficit as of April 1, 2006 of \$208,911 and a corresponding increase to the liability for long-term deferred compensation under executive employment agreements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the potential loss arising from adverse changes in market rates and prices, such as foreign currency exchange and interest rates. We do not use financial instruments to any degree to manage these risks and do not hold or issue financial instruments for trading purposes. All of our product sales, and related receivables are payable in U.S. dollars. We are not subject to interest rate risk on our debt obligations.

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