A123 SYSTEMS, INC.
Form 10-Q
May 10, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

OR

o **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: 001-34463

A123 Systems, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**04-3583876**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

A123 Systems, Inc.
200 West Street
Waltham, Massachusetts **02451**
(Address of principal executive offices) (Zip Code)

617-778-5700

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 x No o

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 x No o

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. (Check one):

Large accelerated filer x Accelerated filer o

Non-accelerated filer o Smaller reporting company o
(Do not check if a 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 o No x

As of May 5, 2011, there were 125,960,259 shares of the registrant s Common Stock, par value $.001 per share, outstanding.

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Quarterly Report on Form 10-Q
For the Quarterly Period Ended March 31, 2011

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Part I. Financial Information

Item 1. Financial Statements

A123 Systems, Inc.
Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

	December 31, 2010	March 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 216,841	$ 136,805
Restricted cash and cash equivalents	9,367	10,086
Accounts receivable, net	28,106	26,383
Inventory	48,787	63,892
Prepaid expenses and other current assets	8,006	10,589
Total current assets	311,107	247,755
Property, plant and equipment, net	143,998	171,270
Goodwill	9,581	9,581
Intangible assets, net	413	361
Long-term grant receivable	75,790	79,714
Deposits and other assets	11,768	10,703
Restricted cash and cash equivalents, net of current portion	1,993	2,001
Investments	21,508	22,684
Total assets	$ 576,158	$ 544,069
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Revolving credit lines	$ 8,000	$ 8,000
Current portion of long-term debt	5,379	5,088
Current portion of capital lease obligations	1,571	1,849
Accounts payable	43,523	69,644
Accrued expenses	48,179	38,860
Other current liabilities	1,322	2,191
Deferred revenue	11,109	11,156
Deferred rent	132	194
Total current liabilities	119,215	136,982
Long-term debt, net of current portion	4,603	3,600
Capital lease obligations, net of current portion	18,655	18,513
Deferred revenue, net of current portion	29,836	29,639
Deferred rent, net of current portion	1,452	1,338

Other long-term liabilities		3,865		4,676
Total liabilities		177,626		194,748
Commitments and contingencies (Note 6)				
Stockholders equity:				
Preferred stock, $0.001 par value 5,000,000 shares authorized; 0 shares issued and outstanding at December 31, 2010 and March 31, 2011				
Common stock, $0.001 par value 250,000,000 shares authorized; 105,194,073 and 105,755,929 shares issued and outstanding at December 31, 2010 and March 31, 2011, respectively		105		106
Additional paid-in capital		790,256		795,425
Accumulated deficit		(391,228)		(444,874)
Accumulated other comprehensive loss		(935)		(1,336)
Total A123 Systems, Inc. stockholders equity		398,198		349,321
Noncontrolling interest		334		
Total stockholders equity		398,532		349,321
Total liabilities and stockholders equity	$	576,158	$	544,069

See notes to condensed consolidated financial statements.

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A123 Systems, Inc.
Condensed Consolidated Statements of Operations

(in thousands, except per share data)

	Three Months Ended March 31,	
	2010	**2011**
Revenue:		
Product	$ 19,774	$ 15,458
Services	4,694	2,639
Total revenue	24,468	18,097
Cost of revenue:		
Product	22,354	31,096
Services	4,155	2,478
Total cost of revenue	26,509	33,574
Gross loss	(2,041)	(15,477)
Operating expenses:		
Research, development and engineering	14,116	20,359
Sales and marketing	2,800	4,082
General and administrative	8,240	9,111
Production start-up	1,811	4,621
Total operating expenses	26,967	38,173
Operating loss	(29,008)	(53,650)
Other income (expense):		
Interest, net	(218)	(641)
Gain on foreign exchange	245	2
Other income, net		1,026
Total other income, net	27	387
Loss from operations, before tax	(28,981)	(53,263)
Provision for income taxes	121	410
Net loss	(29,102)	(53,673)
Less: Net loss attributable to the noncontrolling interest	77	27
Net loss attributable to A123 Systems, Inc.	$ (29,025)	$ (53,646)
Net loss per share attributable to A123 Systems, Inc. - basic and diluted:	$ (0.28)	$ (0.51)
Weighted average number of common shares outstanding - basic and diluted	103,312	105,515

See notes to condensed consolidated financial statements.

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A123 Systems, Inc.

Condensed Consolidated Statements of Stockholders Equity

(in thousands, except per share data)

	Common Stock, $0.001 Par Value		Additional Paid-in		Accumulated Other Comprehensive	Total Stockholders		
	Shares	Amount	Capital	Accumulated Deficit	Loss	Equity	Noncontrolling Interest	Comprehensive Loss
BALANCE - January 1, 2010	$ 102,606	$ 103	$ 767,694	$ (238,668)	$ (909)	$ 528,220	$ 110	
Stock-based compensation			2,487			2,487		
Issuance of common stock	1,218	1	5,907			5,908		
Comprehensive loss:								
Net loss				(29,025)		(29,025)	(77)	$ (29,102)
Foreign currency translation adjustment					(148)	(148)		(148)
Total comprehensive loss								$ (29,250)
BALANCE - March 31, 2010	103,824	$ 104	$ 776,088	$ (267,693)	$ (1,057)	$ 507,442	$ 33	
BALANCE - January 1, 2011	$ 105,194	$ 105	$ 790,256	$ (391,228)	$ (935)	$ 398,198	$ 334	
Stock-based compensation			3,299			3,299		
Exercise of stock options	562	1	1,870			1,871		
Purchase of subsidiary shares by noncontrolling interest holder							600	
Deconsolidation of subsidiary							(907)	
Comprehensive loss:								
Net loss				(53,646)		(53,646)	(27)	$ (53,673)
Foreign currency translation adjustment					(401)	(401)		(401)
Total comprehensive loss								$ (54,074)
BALANCE - March 31, 2011	105,756	$ 106	$ 795,425	$ (444,874)	$ (1,336)	$ 349,321	$	

See notes to condensed consolidated financial statements.

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A123 Systems, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

	Three Months Ended March 31,	
	2010	**2011**
Cash flows from operating activities:		
Net loss	$ (29,102)	(53,673)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,749	4,923
Noncash rent	371	(52)
Noncash foreign exchange gain on intercompany loan	(335)	(354)
Noncash loss on equity investments		220
Impairment of long-lived and intangible assets	530	
Gain on asset transfer and subsequent deconsolidation of Variable Interest Entity		(1,255)
Loss on disposal of property and equipment		28
Amortization of debt issuance costs and noncash interest expense		437
Stock-based compensation	2,487	3,299
Changes in current assets and liabilities, excluding the effect of deconsolidation of Variable Interest Entity:		
Accounts receivable	178	1,328
Inventory	3,684	(15,285)
Prepaid expenses and other assets	42	(4,720)
Accounts payable	(1,987)	18,744
Accrued expenses	(417)	(3,123)
Deferred revenue	(4,109)	301
Other liabilities	944	704
Net cash used in operating activities	(23,965)	(48,478)
Cash flows from investing activities:		
Increase in restricted cash	(336)	(724)
Purchases of and deposits on property, plant and equipment	(13,885)	(42,743)
Proceeds from government grant	5,693	12,154
Purchases of investments	(13,000)	(1,891)
Net cash used in investing activities	(21,528)	(33,204)
Cash flows from financing activities:		
Deferred offering costs		(113)
Proceeds from government grant	1,250	900
Proceeds from exercise of stock options	503	1,876
Payments on long-term debt	(2,691)	(1,303)
Payments on capital lease obligations	(154)	(301)
Contributions from noncontrolling interest		600
Net cash (used in) provided by financing activities	(1,092)	1,659
Effect of foreign exchange rates on cash and cash equivalents	(20)	(13)
Net decrease in cash and cash equivalents	(46,605)	(80,036)
Cash and cash equivalents at beginning of period	457,122	216,841

Cash and cash equivalents at end of period	$	410,517	$	136,805
Supplemental cash flow information - cash paid for interest	$	253	$	224
Noncash investing and financing activities:				
Purchase of equipment under capital leases	$	560	$	
Equipment purchases included in accounts payable and accrued expenses	$	7,556	$	54,505
Deferred offering costs included in accounts payable and accrued expenses	$		$	1,134
Issuance of common stock for investment	$	5,553	$	
Fulfillment of government grants with advance proceeds	$		$	226

See notes to condensed consolidated financial statements.

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A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies

A123 Systems, Inc. (the Company) was incorporated in Delaware on October 19, 2001 and has its corporate offices in Waltham, Massachusetts. The Company designs, develops, manufactures and sells advanced rechargeable lithium-ion batteries and battery systems and provides research and development services to government agencies and commercial customers.

Management Plan Note In April 2011, the Company raised a total of $253.9 million of net proceeds from the issuance of convertible subordinated notes and shares of the Company s common stock to fund the Company s growth and expansion plans, including funding anticipated future losses, purchase commitments and capital expenditures. See Note 10 for additional details.

Basis of Presentation The accompanying condensed consolidated financial statements and the related disclosures as of March 31, 2011 and for the three months ended March 31, 2010 and 2011 are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and the applicable rules and regulations of the Securities and Exchange Commission (SEC) for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K filed with the SEC on March 11, 2011. The December 31, 2010 condensed consolidated balance sheet included herein was derived from the audited financial statements as of that date, but does not include all disclosures, including notes, required by GAAP for complete financial statements.

The interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to present fairly the Company s financial position as of March 31, 2011 and results of its operations for the three months ended March 31, 2010 and 2011, and its cash flows for the three months ended March 31, 2010 and 2011. The interim results for the three months ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

Principles of Consolidation The accompanying condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In February 2011, the Company entered into an agreement to transfer certain of its assets held by its wholly owned Korean subsidiary to its joint venture with a quasi governmental entity in the Peoples Republic of China. For the three months ended March 31, 2010 and as of December 31, 2010, the joint venture was consolidated as a variable-interest entity, but did not have a material impact on the Company s consolidated financial operations and did not represent a material portion of the Company s total consolidated assets. Subsequent to the transfer in February 2011, the Company no longer is significantly involved in the operations of the joint venture and therefore no longer consolidates the joint venture; however, the Company retains a minority ownership stake in the entity which is accounted for as a cost method investment as of March 31, 2011. The asset transfer and subsequent deconsolidation of the joint venture resulted in a $1.2 million gain recognized in other income for the three months ended March 31, 2011.

Use of Estimates The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expense and related disclosures. The Company bases estimates and assumptions on historical experience and on various other factors that it believes to be reasonable under the circumstances. The Company evaluates its estimates and assumptions on an ongoing basis. The Company s actual results may differ from these estimates under different assumptions or conditions.

Government Grants The Company recognizes government grants when there is reasonable assurance that the Company will comply with the conditions attached to the grant arrangement and the grant will be received. Government grants are recognized in the condensed consolidated statements of operations on a systematic basis over the periods in which the Company recognizes the related costs for which the government grant is intended to compensate. Specifically, when government grants are related to reimbursements for cost of revenues or operating expenses, the government grants are recognized as a reduction of the related expense in the condensed consolidated statements of operations. For government grants related to reimbursements of capital expenditures, the government grants are recognized as a reduction of the basis of the asset and recognized in the condensed consolidated statements of operations over the estimated useful life of the depreciable asset as reduced depreciation expense.

The Company records government grants receivable in the condensed consolidated balance sheets in prepaid expenses and other current assets or long-term grant receivable, depending on when the amounts are expected to be received from the government agency. The Company does not discount long-term grant receivables. Proceeds received from government grants prior to expenditures being incurred are recorded as restricted cash and other current liabilities or other long-term liabilities, depending on when the Company expects to use the proceeds.

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A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements

The Company classifies in the condensed consolidated statements of cash flows grant proceeds received in advance of spending for qualified expenditures as a cash flow from financing activities, as the proceeds are used to assist in funding future expenditures. Grant proceeds received as reimbursements for capital expenditures previously incurred are classified in cash flows from investing activities and grant proceeds received as reimbursements for operating expenditures previously incurred are classified in cash flows from operating activities.

Revenue Recognition The Company recognizes revenue from the sale of products and delivery of services, including governmental contracts. Revenue is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the price to the buyer is fixed or determinable, and collectability is reasonably assured. If sales arrangements contain multiple elements, the Company evaluates the agreements to determine if separate units of accounting exist within the arrangement. If separate units of accounting exist within an arrangement, the Company allocates revenue to each element based on the relative selling price of each of the elements.

The Company s multiple element arrangements typically include prototypes, production units and/or engineering and design work. Generally, provided all other revenue recognition criteria have been met, the Company recognizes revenue from prototype and production units upon shipment to the customer and revenue from engineering and design work upon the completion of milestones based on the proportional performance method or based on the completed contract method if the Company does not have the ability to reasonably estimate contract costs or progress toward completion of the contract. The Company s customers may generally cancel orders at any time prior to product shipment.

Each deliverable within a multiple-element revenue arrangement is accounted for as a separate unit of accounting if both of the following criteria are met: (1) the delivered item or items have value to the customer on a standalone basis, and (2) for an arrangement that includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the Company s control. The Company considers a deliverable to have standalone value if the Company sells this item separately, if the item is sold by another vendor, or if the item could be resold by the customer. Further, the Company s revenue arrangements generally do not include a general right of return relative to delivered products. Deliverables not meeting the criteria for being a separate unit of accounting are combined with a deliverable that does meet that criterion. The appropriate allocation of arrangement consideration and recognition of revenue is then determined for the combined unit of accounting.

The Company allocates arrangement consideration to each deliverable in an arrangement based on its relative selling price. The Company determines selling price using vendor-specific objective evidence (VSOE), if it exists; otherwise, the Company uses third-party evidence (TPE). If neither VSOE nor TPE of selling price exists for a unit of accounting, the Company uses estimated selling price (ESP).

VSOE is generally limited to the price charged when the same or similar product is sold separately. If a product or service is seldom sold separately, it is unlikely that the Company can determine VSOE for the product or service. In most cases, VSOE of selling price is an average price of recent actual transactions that are priced within a reasonable range. TPE is determined based on the prices charged by the Company s competitors for a similar deliverable when sold separately. It may be difficult for the Company to obtain sufficient information on competitor pricing to substantiate TPE and, therefore, the Company may not always be able to use TPE.

If the Company is unable to establish selling price using VSOE or TPE, and the new or materially modified arrangement was entered into after January 1, 2010, the Company will use ESP in the allocation of arrangement consideration. The objective of ESP is to determine the price at which the Company would transact if the product or service were sold on a standalone basis. The Company s determination of ESP involves a weighting of several factors based on the specific facts and circumstances of the arrangement. Because of the nature of the business and history with providing services and manufacturing products for various applications, the Company performs an initial assessment on the nature of the services that will be provided by estimating the cost to provide those services plus an estimated profit margin. The Company performs the same assessment on new products by estimating the per unit cost to manufacture the product plus an estimated profit margin. The estimated profit margins initially used in the assessment are based on the Company s profit objectives which will be adjusted based on other considerations such as pricing of similar products and services, characteristics of the specific market, ongoing pricing strategy and policies and value of any enhancements in functionality included in the deliverable.

The Company plans to analyze the selling prices used in the allocation of arrangement consideration at a minimum on an annual basis. Selling prices will be analyzed on a more frequent basis if a significant change in the business necessitates a more timely analysis or if the Company experiences significant variances in selling prices.

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Notes to Condensed Consolidated Financial Statements

Product Revenue

Product revenue is generally recognized upon transfer of title and risk of loss, which is generally upon shipment, unless an acceptance period exists. In general, the Company s customary shipping terms are FOB shipping point or free carrier. In instances where customer acceptance of a product is required, revenue is either recognized (i) upon shipment when the Company is able to demonstrate that the customer specific objective criteria have been met or (ii) upon the earlier of customer acceptance or expiration of the acceptance period.

The Company provides warranties for its products and records the estimated costs as a cost of revenue in the period the revenue is recorded. The Company s standard warranty period extends one to eight years from the date of delivery, depending on the type of product purchased and its application. The warranties provide that the Company s products will be free from defects in material and workmanship and will, under normal use, conform to the specifications for the product. The warranties further provide that the Company will repair the product or provide replacement parts at no charge to the customer. The Company s warranty liability is based on projected product failure rates and estimated costs of fulfilling warranty claims. Projections are based on the Company s actual warranty experience and other known factors. The Company monitors its warranty liability and adjusts the amounts as necessary. When the Company is unable to reasonably determine its obligation for warranty of new products, revenue from the sale of the products is deferred until expiration of the warranty period or until such time as the warranty obligation can be reasonably estimated.

In instances where the Company has deferred revenue under various arrangements, the Company also defers the associated costs of revenue until such time that it is able to recognize the revenue. Deferred costs of revenue are classified in the condensed consolidated balance sheets in inventory as all deferred costs are expected to be recognized as cost of revenue in the condensed consolidated statement of operations within one year. As of December 31, 2010 and March 31, 2011, the Company had deferred cost of revenue, primarily related to finished goods inventory, of $1.3 million and $1.7 million, respectively.

Services Revenue

Revenue from services is recognized as the services are performed consistent with the performance requirements of the contract using the proportional performance method if the Company is able to reasonably estimate the contract cost and progress toward completion of the contract. Where arrangements include milestones or governmental approval that impact the fees payable to the Company, revenue is limited to those amounts whereby collectability is reasonably assured. The Company recognizes revenue earned under time and materials contracts as services are provided based upon actual costs incurred plus a contractually agreed-upon profit margin. The Company recognizes revenue from fixed-price contracts using the proportional performance method based on the ratio of costs incurred to estimates of total expected project costs in order to determine the amount of revenue earned to date if reasonably dependable estimates of the revenues and costs applicable to various stages of a contract can be made. Estimates made are based on historical experience and deliverables identified in the contract and are indicative of the level of benefit provided to the Company s clients. Project costs are based on the direct salary and associated fringe benefits of the employees on the project plus all direct expenses incurred to complete the project including sub-contractual and equipment costs where the Company is the principal in the arrangement. Under the proportional performance method, there are no costs that are deferred and amortized over the contract term. If the Company does not have the ability to reasonably estimate contract costs or progress toward completion of the contract, the Company defers the related revenue and costs and recognizes the revenues and costs based on the completed contract method.

Service revenue includes revenue derived from the execution of contracts awarded by the U.S. federal government, other government agencies and commercial customers. The Company s research and development arrangements with the federal government or other government agencies typically require the Company to provide pure research, in which the Company investigates design techniques on new battery technologies. The Company s arrangements with commercial customers consist of arrangements where the Company is paid to enhance or modify an existing product or to develop or jointly develop a new product to meet a customer s specifications.

Production start-up Production start-up expenses consist of manufacturing salaries and personnel-related costs, site selection costs, including legal and regulatory costs, rent and the cost of operating a production line before it has been qualified for production, including the cost of raw materials run through the production line during the qualification phase. During the three months ended March 31, 2010 and 2011, the Company incurred production start-up expenses related to its facility in Romulus, Michigan. During the three months ended March 31, 2010, the Company also incurred production start-up expenses related to its facility in Livonia, Michigan. The Livonia facility began qualification for production in the third quarter of 2010 and the first production line was qualified in December 2010. Since qualification, expenses related to the first production line in the Livonia facility are no longer included in production start-up expenses. The Romulus facility began qualification for production in the first quarter of 2011 and the Company expects to continue to incur production start-up expenses related to the Romulus facility and costs to qualify the second production line in Livonia in the near term. A portion of production start-up expenses was offset primarily by government grant

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A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements

funding. The following table presents production start-up expenditures included in the Company s condensed consolidated statements of operations (in thousands):

	Three Months Ended March 31,	
	2010	2011
Aggregated production start-up expenditures	$ 2,105	$ 6,997
Production start-up reimbursements	(294)	(2,376)
Production start-up expenses	$ 1,811	$ 4,621

Fair Value of Financial Instruments The carrying amount of cash, cash equivalents, restricted cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximates fair value due to the short-term nature of these items. Management believes that the Company s debt obligations and the Company s capital lease obligations accrue interest at rates which approximate prevailing market rates for instruments with similar characteristics and, accordingly, the carrying values for these instruments approximate fair value. Investments are accounted for using the cost or equity method.

Fair value is an exit price, representing the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, GAAP establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value, including the Company s cash equivalents.

The Company did not have any material items that are measured at fair value on a non-recurring basis under this requirement as of December 31, 2010 or March 31, 2011.

The following tables show assets measured at fair value on a recurring basis and the input categories associated with those assets (in thousands):

		As of December 31, 2010		
	Fair Value at December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Asset:				
Money market funds	$ 174,603	$ 174,603	$	$
U.S. Treasury and government agency securities	17,333		17,333	

	Fair Value at March 31, 2011	As of March 31, 2011 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	$ 110,614	$ 110,614	$	$
U.S. Treasury and government agency securities	8,334		8,334	

The Company s holds money market fund investments that are classified as cash equivalents and are measured at fair value on a recurring basis based on quoted prices in active markets for identical assets. The Company holds investments in U.S. Treasury and government agency securities that are classified as either cash equivalents or restricted cash equivalents and are measured at fair value based on inputs (other than quoted prices) that are observable for securities, either directly or indirectly.

Stock-Based Compensation The Company accounts for all awards, including employee and director awards, by recognizing compensation expense based on the fair value of share-based transactions in the condensed consolidated financial statements. The

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A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements

Company recognizes compensation expense over the vesting period using a ratable method (providing the minimum amount of compensation recorded is equal to the vested portion of the award, requiring a ratable method when necessary) and classifies these amounts in the condensed consolidated statements of operations based on the department to which the related employee reports. The Company uses the Black-Scholes valuation model to calculate the fair value of stock options, utilizing various assumptions.

Net Loss Per Share Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding during the fiscal year. Diluted net loss per share is computed by dividing net loss by the weighted-average number of dilutive common shares outstanding during the fiscal year. Dilutive shares outstanding are calculated by adding to the weighted shares outstanding any potential (unissued) shares of common stock and warrants based on the treasury stock method.

The following potentially dilutive securities were excluded from the calculation of diluted net loss per share, as the effect would have been anti-dilutive (in thousands):

	March 31,	
	2010	**2011**
Warrants to purchase common stock	45	45
Options to purchase common stock	9,465	10,258
Unvested restricted stock units		183
	9,510	10,486

New Accounting Pronouncements In April 2010, an update was issued to the accounting and reporting guidance for milestone based revenue arrangements. This update provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Research or development arrangements frequently include payment provisions whereby a portion or all of the consideration is contingent upon the achievement of milestone events. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. Milestones should be considered substantive in their entirety and may not be bifurcated. An arrangement may contain both substantive and non-substantive milestones, and each milestone should be evaluated individually to determine if it is substantive. This update is effective prospectively for milestones achieved in fiscal years beginning on or after June 15, 2010. The adoption of this update did not have a material impact on the Company s financial position, results of operations or cash flows.

2. Government Grants

Center of Energy and Excellence Grant

In February 2009, the State of Michigan awarded the Company a $10.0 million Center of Energy and Excellence grant. Under the agreement, the State of Michigan will provide cost reimbursement for 100% of qualified expenditures incurred through November 30, 2011. There are no substantive conditions attached to this award that will require repayment of amounts received, if those conditions are not met. The Company received $3.0 million of this grant in March 2009 and $6.0 million of this grant in July 2010, with additional payments to be made based on the achievement of certain milestones in the facility development. Through March 31, 2011, the Company has used $8.3 million of these funds, of which $7.9 million and $0.4 million was recorded as an offset to property, plant and equipment and operating expenses, respectively. For both the three months ended March 31, 2010 and 2011, $0.1 million was recorded as an offset to operating expenses in the condensed consolidated statements of operations. As of December 31, 2010 and March 31, 2011, $0.8 million and $0.7 million of these funds are recorded in short-term restricted cash and other current liabilities on the condensed consolidated balance sheets, respectively.

Michigan Economic Growth Authority

In April 2009, Michigan Economic Growth Authority (MEGA) offered the Company certain tax incentives, which can be used to offset the Michigan Business Tax owed in a tax year, carried forward for the number of years specified by the agreement, or be paid to the Company in cash at the time claimed to the extent the Company does not owe a tax. The terms and conditions of the *High-Tech Credit* were established in October 2009 and the *Cell Manufacturing Credit* in November 2009.

High Tech Credit The *High-Tech Credit* agreement provides the Company with a 15-year tax credit, based on qualified wages and benefits multiplied by the Michigan personal income tax rate beginning with payments made for the 2011 fiscal year. The tax credit has an estimated value of up to $25.3 million, depending on the number of jobs created in Michigan. The proceeds to be received by the Company will be based on the number of jobs created, qualified wages paid and tax rates in effect over the 15 year period. The tax credit is subject to a repayment provision in the event the Company relocates a substantial portion of the jobs outside

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the state of Michigan on or before December 31, 2026. For the three months ended March 31, 2011, $0.3 million was recorded as a receivable in long-term grant receivable with an offsetting balance in other long-term liabilities in the condensed consolidated balance sheet at March 31, 2011. The balance will be recognized in the condensed consolidated statements of operations over the term that the Company is required to maintain the required number of jobs in Michigan.

Cell Manufacturing Credit The *Cell Manufacturing Credit* agreement authorizes a tax credit or cash for the Company equal to 50% of capital investment expenses related to the construction of the Company s integrated battery cell manufacturing facilities in Michigan, commencing with costs incurred from January 1, 2009, up to a maximum of $100.0 million over a four year period. The tax credit shall not exceed $25.0 million per year and can be submitted for reimbursement beginning in tax year 2012. The Company is required to create 300 jobs no later than December 31, 2016 for the tax credit to be non-refundable. The tax credit is subject to a repayment provision in the event the Company relocates 51% or more of the 300 jobs outside of the state of Michigan within three years after the last year the tax credit is received. Through March 31, 2011, the Company has incurred $158.8 million in qualified expenses related to the construction of the Livonia and Romulus facilities. When the Company has met the filing requirements for the tax year ending December 31, 2012, the Company expects to begin receiving $79.4 million in proceeds related to these expenses. As of December 31, 2010 and March 31, 2011, the Company has recorded undiscounted receivables of $75.8 million and $79.4 million, as it is reasonably assured that the Company will comply with the conditions of the tax credit and will receive the proceeds. Upon recording the receivables, the Company reduced the basis in the fixed assets acquired in accordance with the tax credit and this will be recognized in the condensed consolidated statements of operations over their estimated useful lives of the depreciable asset as reduced depreciation expense.

U.S. Department of Energy Battery Initiative

In December 2009, the Company entered into an agreement establishing the terms and conditions of a $249.1 million grant awarded under the Department of Energy (DOE) Battery Initiative to support manufacturing expansion of new lithium-ion battery manufacturing facilities in Michigan. Under the agreement, the DOE will provide cost reimbursement for 50% of qualified expenditures incurred from December 1, 2009 to November 30, 2012. The agreement also provides for reimbursement of pre-award costs incurred from June 1, 2009 to November 30, 2009. There are no substantive conditions attached to this award that will require repayment of amounts received if those conditions are not met. Through March 31, 2011, the Company has incurred $201.2 million in qualified expenses, of which 50%, or $100.6 million, are allowable costs for reimbursement. For the three months ended March 31, 2010, the Company incurred allowable costs of $3.1 million, of which $2.5 million and $0.6 million was recorded as an offset to property, plant and equipment and operating expenses, respectively. For the three months ended March 31, 2011, the Company incurred allowable costs of $11.6 million, of which $7.7 million and $3.9 million was recorded as an offset to property, plant and equipment and operating expenses, respectively. As of December 31, 2010 and March 31, 2011, the Company recorded $2.1 million and $3.1 million, respectively, as receivables in prepaid expenses and other current assets in the condensed consolidated balance sheets.

3. Inventory

Inventory consists of the following (in thousands):

	December 31, 2010	March 31, 2011
Raw materials	$ 18,929	$ 32,424
Work-in-process	27,226	29,222
Finished goods	2,632	2,246
	$ 48,787	$ 63,892

4. Property, Plant and Equipment

For government grants related to capital expenditures, the Company recognizes the reimbursement as a reduction of the basis of the asset and a reduction to depreciation expense over the useful life of the asset. Property, plant and equipment consists of the following (in thousands):

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	December 31, 2010	March 31, 2011
Computer equipment and software	$ 11,913	$ 15,204
Furniture and fixtures	3,415	4,981
Automobiles	404	390
Machinery and equipment	122,187	131,477
Buildings	26,810	27,115
Leasehold improvements	34,540	46,746
Equipment not in service	154,357	171,644
Property, plant and equipment, basis	353,626	397,557
Less reduction for costs reimbursable under government grants	164,999	182,061
Property, plant and equipment, carrying value	188,627	215,496
Less net accumulated depreciation and amortization	44,629	44,226
Property, plant and equipment, net	$ 143,998	$ 171,270

The Company has deposits for equipment not yet received of $11.6 million and $6.6 million at December 31, 2010 and March 31, 2011, respectively, included within deposits and other assets in the condensed consolidated balance sheets. These deposits are reported net of contra deposit balances related to reimbursements under government grants of $1.7 million and $0.1 million at December 31, 2010 and March 31, 2011, respectively.

Property, plant and equipment under capital lease consists of the following (in thousands):

	December 31, 2010	March 31, 2011
Computer equipment and software, at cost	$ 2,758	$ 2,758
Buildings, at cost	16,446	16,446
Leasehold improvements, at cost	2,091	2,091
Accumulated depreciation and amortization	(1,631)	(2,324)
Property, plant and equipment under capital lease, net	$ 19,664	$ 18,971

Net depreciation expense for the three months ended March 31, 2010 and 2011, was $3.6 million and $4.9 million, respectively. For the three months ended March 31, 2010 and 2011, the Company recorded $0 and $2.7 million, respectively, as a reduction to depreciation expense related to reduced carrying value due to government grant reimbursements.

5. Investments

Cost-Method Investments

In January 2010, the Company entered into an agreement to purchase preferred stock of a maker of plug-in hybrid electric vehicles in the United States (the Automaker). The Company agreed to invest cash of $13.0 million and shares of the Company s common stock, which, when transferred to the Automaker, had a fair market value of $7.5 million. As of December 31, 2010 and March 31, 2011, the Company has recorded an investment of $20.5 million in the condensed consolidated balance sheets. The Company is accounting for its investment under the cost method. Through March 31, 2011, there have been no changes in circumstances that may have a significant adverse effect on the fair value of the investment.

Equity-Method Investments

In December 2009, the Company entered into a joint venture agreement with an automaker in China to assist the Company in growing the Company s business and sales in China s transportation industry and created Shanghai Advanced Traction Battery Systems, Co. Ltd. (the Joint Venture). Under the terms of the joint venture agreement, the Company is required to invest $4.7 million into the Joint Venture over a period of approximately 15 months, in return for a 49% interest in the Joint Venture. The Company made the first capital contribution of $1.9 million to the Joint Venture in July 2010 and the second capital contribution of $1.4 million in January 2011. As of March 31, 2011, no other capital contributions have been required under the terms of the agreement. The Company expects to make the final capital contribution of $1.4 million in the second half of 2011. The Company is accounting for its investment under the equity method.

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In August 2010, the Company entered into an agreement to transfer certain patents held by the Company to a privately-held company, 24M Technologies, Inc. (24M), in return for a 12% ownership interest in 24M. The Company has recorded the investment on the condensed consolidated balance sheet at the fair value of the ownership interest received of approximately $0.2 million. The Company is accounting for its investment under the equity method as it has determined it has significant influence over the operating and financial decisions of the third party.

For the three months ended March 31, 2011, the Company recorded $0.2 million of equity method losses included in other income in the condensed consolidated statement of operations.

6. Commitments and Contingencies

Litigation In November 2005, the Company received a letter asserting that it was infringing upon certain U.S. patents. In April 2006, the Company commenced an action in the United States District Court for the District of Massachusetts seeking a declaratory judgment that the patents in question were not infringed by the Company s products and that the patents claiming to be infringed upon are invalid. On September 11, 2006, a countersuit was filed against the Company and two of its business partners in the United States District Court for the Northern District of Texas alleging infringement of these patents. In October 2006 and January 2007, the U.S. Patent and Trademark Office (PTO) granted the Company s request for reexamination of the two patents. In January and February 2007, the two suits were stayed pending the reexamination. The reexaminations of the two patents were concluded on April 15, 2008 and May 12, 2009, respectively. As a result, the scope of the claims in each patent were narrowed from those of the original claims made. The Company filed a motion to re-open the litigation in the United States District Court for the District of Massachusetts on June 11, 2009. On September 28, 2009, the Massachusetts court entered an order denying that motion, which the Company appealed on October 27, 2009 to the United States Court of Appeals for the Federal Circuit. The United States Court of Appeals for the Federal Court upheld the Massachusetts Court s decision on November 10, 2010. On July 22, 2009, the Company was sent a proposed Second Amended Complaint which the complainants intend to seek leave to file with the Texas court in light of the PTO s reexaminations. On August 27, 2009, Hydro-Quebec and The University of Texas (UT) filed a Motion for Leave to File Second Amended Complaint and Jury Demand in the United States District Court for the Northern District of Texas and the Company was granted several unopposed extensions to file its response. Hydro-Quebec and UT filed for leave to file an Amended Motion for Leave to File Second Amended Complaint and Jury Demand on April 1, 2010 and the Company filed its opposition to this application on April 22, 2010. The judge held a status hearing with the parties on May 14, 2010 and entered a schedule for the case leading to a claim construction hearing, which was held on December 2, 2010. On March 29, 2011, the United States District Court for the Northern District of Texas issued a Memorandum Opinion and Order on Claim Construction. The judge has ordered the parties to submit their joint status report on or before April 26, 2011. The parties submitted the joint status report on April 26, 2011 in accordance with the court s order, which included the proposed deadlines for discovery and pre-trial motions. The court issued a scheduling order on April 27, 2011 with trial set to begin in December 2011. The Company has agreed to defend and indemnify the other named business partner for its legal costs in defending this litigation and any damages that may be awarded. The Company is unable to predict the outcome of this matter, and therefore no accrual has been established for this contingency.

7. Financing Arrangements

Long-Term Debt Long-term debt consists of the following (in thousands):

	December 31, 2010	March 31, 2011
Term loan	$ 7,069	$ 5,819
Mass Clean Energy loan	2,534	2,573
Korean subsidiary debt		
Technology funds loan	44	30
Korean government loans	335	266
Total	9,982	8,688
Less amounts classified as current	5,379	5,088
Long-term debt	$ 4,603	$ 3,600

Term Loan The Company has an agreement with a financial institution for a term loan facility of $15.0 million. The term loan facility is repayable over a 36-month period and accrues interest at the financial institution s prime rate (which was 4.0% at December 31, 2010 and March 31, 2011) plus 0.75%. This term loan facility matures in September 2012.

The term loan agreement requires the Company to comply with certain financial covenants, which include a minimum liquidity ratio calculation. The term loan agreement is collateralized by substantially all assets of the Company, excluding intellectual property, property and equipment owned as of December 31, 2005 and certain equipment located in China.

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Mass Clean Energy Loan The Company has a forgivable loan from the Massachusetts Clean Energy Technology Center for $5.0 million. If the Company complies with certain capital expenditure conditions, $2.5 million of the loan will be forgiven and if the Company complies with certain employment conditions an additional $2.5 million will be forgiven. As of December 31, 2010 and March 31, 2011, $2.5 million is recorded as an offset to property, plant and equipment in the condensed consolidated balance sheets as the Company is reasonably assured that the Company will comply with the conditions for the forgiveness related to the capital expenditure condition. As of December 31, 2010 and March 31, 2011, the remaining $2.5 million is recorded as long-term debt. The loan has a fixed interest rate of 6.0% and all funds borrowed under the agreement and accrued interest is due upon maturity in October 2017 if the Company has not complied with the forgiveness conditions.

Korean debt The Company has the following outstanding obligations for its Korean subsidiary:

• *Technology funds loan* The Company has a technology funds loan agreement with a variable interest rate. The weighted average interest rate for the loan as of March 31, 2011 was 4.54%. The loan matures in August 2011.

• *Korean government loans* As a part of the Korean government s initiative to promote and encourage the development of start-up companies in certain high technology industries, high technology start-up companies with industry leading technology or products are eligible for government loans. Certain grants are refundable, depending on the successful development and commercialization of the technology or products, and a company receiving such government grants is required to refund between 20% and 30% of the grants received for such development.

Revolving Credit Facilities The Company entered into a line of credit (LOC) for $8.0 million with a financial institution. The line of credit accrues interest at the financial institution s prime (4.0% at December 31, 2010 and March 31, 2011). The outstanding balance at December 31, 2010 and March 31, 2011 was $8.0 million. The LOC has a maturity date of June 20, 2011, and the Company is required to comply with the same financial covenants required under the Term Loan mentioned above.

8. Stock-Based Compensation

During 2009, the Company s Board of Directors approved the 2009 Stock Incentive Plan (the 2009 Plan) which became effective on the closing of the Company s initial public offering (IPO) on September 24, 2009. The 2009 Plan originally provided for the grant of qualified incentive stock options and nonqualified stock options or other awards to the Company s employees, officers, directors, and outside consultants. Up to an aggregate of 3,000,000 shares of Company s common stock, subject to increase on an annual basis, are reserved for future issuance under the 2009 Plan. Shares of common stock reserved for issuance under the Company s 2001 Stock Incentive Plan (the 2001 Plan) that remained available for issuance immediately prior to closing of the IPO and any shares of common stock subject to awards under the 2001 Plan that expired, terminated, or were otherwise forfeited, canceled or repurchased by the Company prior to being fully exercised were added to the number of shares available under the 2009 Plan, up to a maximum of 500,000 shares. Through March 31, 2010, 500,000 shares from the 2001 Plan were added to the number of shares available under the 2009 Plan. On January 1, 2010 and 2011, 5,000,000 and 3,000,000 shares were

added to the 2009 Plan in connection with the annual increases, respectively. As of March 31, 2011, the Company had 7,903,153 stock-based awards available for future grant under the 2009 Plan and no stock-based awards available for future grant under the 2001 Plan.

Stock-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the service period (generally the vesting period of the equity grant). The Company estimates forfeitures at the time of grant and revises the estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The following table presents stock-based compensation expense included in the Company s condensed consolidated statements of operations (in thousands):

	Three Months Ended March 31,	
	2010	2011
Cost of sales	$ 415	$ 587
Research, development and engineering	962	1,322
Sales and marketing	298	386
General and administrative	812	1,004
Total	$ 2,487	$ 3,299

The Company has capitalized an immaterial amount of stock-based compensation as a component of inventory.

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As of March 31, 2011, there was approximately $29.8 million of total unrecognized compensation cost related to non-vested stock-based compensation arrangements granted under the plans, which is expected to be recognized over a weighted-average period of 2.63 years.

Stock Options The stock options generally vest over a four-year period and expire 10 years from the date of grant. Upon option exercise, the Company issues shares of common stock.

The following table summarizes stock option activity for the three months ended March 31, 2011:

	Shares (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Outstanding - January 1, 2011	10,783	$ 7.64	7.41	$ 27,743
Granted	340	9.57		
Exercised	(562)	3.33		
Forfeited	(303)	10.08		
Outstanding - March 31, 2011	10,258	$ 7.87	7.43	$ 9,789
Vested or expected to vest - March 31, 2011	9,803	$ 7.77	7.34	$ 9,785
Options exercisable - March 31, 2011	5,177	$ 6.00	6.19	$ 9,508

The Company estimates the fair value of stock options granted using the Black-Scholes option-pricing model and assumptions as to the fair value of the common stock on the grant date, expected term, expected volatility, risk-free rate of interest and an assumed dividend yield.

The Black-Scholes model assumptions for the periods set forth below are as follows:

	Three Months Ended March 31,	
	2010	2011
Risk-free interest rate	3.15%	2.68 - 3.03%

Expected term	6.25	6.25
Expected volatility	73.8%	73.6%
Expected dividends	0%	0%

The Company derived the risk-free interest rate assumption from the U.S. Treasury s rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the awards being valued. The Company based the assumed dividend yield on its expectation of not paying dividends in the foreseeable future. The Company calculated the weighted average expected term of options using the simplified method as prescribed by the Stock Compensation Subtopic of the Codification. This decision was based on the lack of relevant historical data due to the Company s limited operating experience. In addition, due to the Company s limited historical data, the estimated volatility also reflects the application of the Stock Compensation Subtopic, incorporating the historical volatility of comparable companies with publicly-available share prices.

The weighted average grant date fair value of options granted during the three months ended March 31, 2011 was $6.45. The intrinsic value of options exercised during the three months ended March 31, 2010 and 2011 was $17.1 million and $3.4 million, respectively. The Company received $0.5 million and $1.9 million in cash from option exercises during the three months ended March 31, 2010 and 2011, respectively.

Restricted Stock Units During the three months ended March 31, 2011, the Company granted restricted stock unit awards to certain executives. The restricted stock unit awards generally vest over a four-year period and upon vesting the Company issues shares of common stock. The following table summarizes the Company s restricted stock unit award activity for the three months ended March 31, 2011:

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	Shares (In thousands)	Weighted Average Fair Value
Non-vested - January 1, 2011	203	$ 10.13
Granted		
Vested		
Forfeited	(20)	10.11
Non-vested - March 31, 2011	183	$ 10.13

The fair value of restricted stock unit awards is determined based on the closing price of the Company s common stock on the Nasdaq Global Select Market on the grant date.

9. Related Party Transactions

Transactions with Joint Venture Partner s Affiliate In December 2009, the Company entered into a joint venture (the Joint Venture) with an automaker in China (the Chinese Automaker) to assist the Company in growing business and sales in China s transportation industry. The Company entered into two development agreements with the Chinese Automaker. During the three months ended March 31, 2010 and 2011, the Company recorded revenue related to the development and supply agreements with the Chinese Automaker of $0.7 and $0.1 million, respectively. As of December 31, 2010 and March 31, 2011, $0.5 million and $0.2 million, respectively, is recorded in deferred revenue on the condensed consolidated balance sheets related to the development and supply agreements, which will be recognized upon completion and acceptance of the deliverables. As of December 31, 2010 and March 31, 2011, the balance due from the automaker was $1.9 million and $0.3 million, respectively, which is included within accounts receivable, net on the condensed consolidated balance sheets.

Transactions with Cost-Method Investment In January 2010, the Company entered into a supply agreement with the Automaker in which the Company also holds an investment of preferred stock. The Company recognizes revenue on product shipments to the Automaker, within the condensed consolidated statements of operations, when all revenue recognition criteria are met. During the three months ended March 31, 2010 and 2011, the Company recorded $0 and $1.7 million of revenue from the Automaker, respectively. The balance due from the Automaker as of December 31, 2010 and March 31, 2011, of $0.6 million and $2.1 million, respectively, is included within accounts receivable, net on the condensed consolidated balance sheets.

Transactions with Equity-Method Investment During March 2010, the Company entered into a technology license contract to license certain patents and technology to the Company s Joint Venture for the term of the Joint Venture, which extends to April 28, 2030. In conjunction with the license agreement, the Joint Venture paid the Company the first payment of the license fee of $1.0 million in 2010. Revenue on the license fee will be amortized over the term of the license. Revenue recognition is expected to commence upon the successful completion of training provided to employees of the Joint Venture. As of December 31, 2010 and March 31, 2011, the $1.0 million of the license fee is recorded in

deferred revenue on the condensed consolidated balance sheets. During December 2010, the Company entered into a service agreement to provide technical development, design, analysis and consultation services to the Joint Venture. Additionally, the Company entered into an agreement to provide sample battery system packs to the Joint Venture. For the three months ended March 31, 2011, the Company recognized $0.3 million of revenue and at December 31, 2010 and March 31, 2011 the Company deferred $0.2 million and $0 million, respectively, of service and product revenue related to the service agreement and initial sample shipments. As of December 31, 2010 and March 31, 2011, $0.5 million and $0.6 million are included within accounts receivable, net on the condensed consolidated balance sheets for amounts due from the Joint Venture.

10. Subsequent Events

In April 2011, the Company issued $143.8 million in principal of convertible unsecured subordinated notes (the Convertible Notes) and issued 20.2 million shares of the Company s common stock at $6.00 per share for net proceeds after deducting issuance costs of $138.8 million and $115.1 million, respectively. The Convertible Notes bear interest at 3.75%, which shall be payable semi-annually in arrears on April 15 and October 15 each year, beginning on October 15, 2011, and mature on April 15, 2016. Holders may surrender their Convertible Notes, in integral multiples of $1,000 principal amount, for conversion any time prior to the close of business on the third business day immediately preceding the maturity date. The initial conversion rate of 138.8889 shares of common stock per $1,000 aggregate principal amount of Convertible Notes, equivalent to a conversion price of approximately $7.20 per share of our common stock, is subject to adjustment in certain events. Upon conversion, the Company will deliver shares of common stock. If the Company undergoes a fundamental change (as defined in the prospectus supplement relating to the notes), holders of the Convertible Notes have the option to require the Company to repurchase all or any portion of their Convertible Notes. The Company

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may not redeem the Convertible Notes prior to the maturity date. The Company intends to use the net proceeds from the offerings for general corporate purposes and to fund the manufacturing expansion. Pending use, the Company intends to invest the net proceeds from the common stock and Convertible Notes offerings in interest-bearing investment-grade securities.

The Company has evaluated the period from March 31, 2011, the date of the condensed consolidated financial statements, to the date of the issuance and filing, and has determined that, other than disclosed above, no material subsequent events have occurred that would affect the information presented in these condensed consolidated financial statements or require additional disclosure.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and management s discussion and analysis of financial condition and results of operations for the year ended December 31, 2010 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 11, 2011. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements are often identified by the use of words such as may, expect, believe, anticipate, intend, could, estimate, or continue, and similar expressions or variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled Risk Factors, set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and elsewhere in this Quarterly Report. The forward-looking statements in this Quarterly Report on Form 10-Q represent our views as of the date of this Quarterly Report on Form 10-Q. We anticipate that subsequent events and developments will cause our views to change. However, while we may elect to update these forward-looking statements at some point in the future, we have no current intention of doing so except to the extent required by applicable law. You should, therefore, not rely on these forward-looking statements as representing our views as of any date subsequent to the date of this Quarterly Report on Form 10-Q.

Overview

We design, develop, manufacture and sell advanced, rechargeable lithium-ion batteries and battery systems. Our target markets are the transportation, electric grid services and commercial markets.

We market and sell our products primarily through a direct sales force. In the transportation market, we are focusing sales of our batteries and battery systems to automotive and heavy duty vehicle manufacturers either directly or through tier 1 suppliers. We work with automotive and heavy duty vehicle manufacturers directly to educate and inform them about the benefits of our technology for use in hybrid electric vehicles, or HEVs, plug-in hybrid electric vehicles, or PHEVs, and electric vehicles, or EVs, and are engaged in design and development efforts with several automotive and heavy duty vehicle manufacturers and tier 1 suppliers. At the same time, we work with tier 1 suppliers who are developing integrated solutions using our batteries. In the electric grid services market, our sales have been initiated directly by our sales force. In the commercial market, our sales are made both directly and indirectly through distributors with key accounts managed by our sales personnel. We have entered into an exclusive agreement to license certain of our technology in the field of commercial electronic devices (excluding power tools and certain other consumer products) and expect to receive royalty fees on net sales of licensed products that include our technology. We expect to continue to expand our sales presence in Europe and Asia as our business in those regions continues to grow. We expect international markets to provide increased opportunities for our products.

Our sales cycles vary by product and market segment. Most of our batteries and battery systems typically undergo a lengthy development and qualification period prior to commercial production. We expect that the total time from customer introduction to commercial production will range up to five years depending on the specific product and market served. Our long and unpredictable sales cycles and the potential large size of battery supply and development contracts cause our period-to-period financial results to be susceptible to significant variability. Since most of our operating and capital expenses are incurred up-front based on the anticipated timing of estimated design wins and customer orders, the loss or delay of any such orders could have a material adverse effect on our results of operations for any particular period. The variability in our period-to-period results will also be driven by likely period-to-period variations in product mix and by the seasonality experienced by some of the end markets into which we sell our products. In the electric grid market, revenue recognition will be volatile due to the timing of deployment, delivery, and commissioning. As such, the timing of these events will significantly affect the comparison of period-to-period

revenues.

We have been expanding our manufacturing capacity since inception, including the current expansion of our Livonia and Romulus, Michigan facilities, and we intend to further expand our manufacturing capacity by constructing more manufacturing lines, primarily in Michigan. We are currently in transition, as we are expanding capacity in anticipation of increased demand for our prismatic cells as we expect transportation product revenues to increase in future periods. We intend to further accelerate the expansion of our manufacturing capacity subject to actual and anticipated future demand for our products and the receipt of additional stimulus funds from the U.S. and state governments. In the first quarter of 2010, we began making investments against plans to further expand the final assembly capacity of our Michigan facilities. Based on new design wins and our demand estimates, we have approved plans to increase our capacity in Michigan, resulting in a worldwide capacity of over 760 million watt hours. We believe that increases in production capacity have had, and will continue to have, a significant effect on our financial condition and results of operations. We have made and continue to make significant up-front investments in our manufacturing capacity, which negatively impact earnings and cash balances, but we expect these investments will increase our revenue in the long term.

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Our research and development efforts are focused on developing new products and improving the performance of existing products. We fund our research and development initiatives both from internal and external sources. As part of our development strategy, certain customers fund or partially fund research and development efforts to design and customize batteries and battery systems for their specific application.

We have continued to experience significant losses since inception, as we have continued to invest significantly to support the anticipated growth in our business. In particular, we have invested in product development and sales and marketing in order to meet product requirements of our target markets and to secure design wins that may lead to strong revenue growth and general and administrative overhead to develop the infrastructure to support the business. We have also invested in the expansion of our manufacturing capacity to meet anticipated demand and our battery systems capabilities to provide battery systems solutions to our customers. As our business grows, the key factors to improving our financial performance will be revenue growth and revenue diversification into the transportation and electric grid services markets. Our revenue growth and revenue diversification will depend on our ability to secure design wins in the transportation and electric grid services markets. Higher revenue will also increase gross margin, as higher production volumes will provide for increased absorption of manufacturing overhead and will reduce, on a percentage basis, the costs associated with our production capacity.

In December 2009, we executed an agreement with the DOE regarding the terms and conditions of the $249.1 million grant awarded under the DOE s Battery Initiative to fund the construction of new lithium-ion battery manufacturing facilities in Michigan. Under the agreement, the DOE will provide cost reimbursement for 50% of qualified expenditures incurred from December 1, 2009 to November 30, 2012 and for reimbursement of pre-award costs incurred from June 1, 2009 to November 30, 2009. Through March 31, 2011, we have received $97.4 million in reimbursement for costs incurred. As of March 31, 2011, we have incurred additional allowable costs entitling us to receive $3.1 million in reimbursements, which have been recorded as a receivable.

We are also negotiating a loan under the Advanced Technology Vehicles Manufacturing Loan Program, or the ATVM Program, to support this manufacturing expansion. Based on the amount of our grant award under the DOE Battery Initiative and the guidelines associated with the ATVM Program, we believe we will be permitted to borrow up to $233 million under the ATVM Program. We expect we will be required to spend one dollar of our own funds for every four dollars we borrow under the ATVM Program. The timing and the amount of any loan we may receive under the ATVM Program, as well as the specific terms and conditions applicable to any loan we may receive are currently not known by us, and, once disclosed to us, are subject to change and negotiation with the federal government.

In October 2009, we entered into a *High-Tech Credit* agreement with the Michigan Economic Growth Authority, or MEGA, pursuant to which we are eligible for a 15-year tax credit, beginning with payments made for the 2011 fiscal year. This credit has an estimated value of up to $25.3 million, depending on the number of jobs we create in Michigan. In November 2009, we entered into a *Cell Manufacturing Credit* agreement with MEGA pursuant to which we are eligible for a credit equal to 50% of our capital investment expenses commencing January 2009, up to a maximum of $100 million over a four-year period related to the construction of our integrated battery cell manufacturing plant. The tax credit proceeds shall not exceed $25.0 million per year beginning with the tax year of 2012. We are required to create 300 jobs no later than December 31, 2016 in order for the tax credit proceeds to be non-refundable. The tax credit is subject to a repayment provision in the event we relocate 51% or more of the 300 jobs outside of the State of Michigan within three years after the last year we received the tax credit. Through March 31, 2011 we have incurred expenses of $158.8 million in qualified expenses related to the construction of the Livonia and Romulus facilities. When we have met the filing requirements for the tax year ending December 31, 2012, we expect to begin receiving $79.4 million in proceeds related to these expenses limited to $25.0 million per year over a four year period. As of March 31, 2011, we have recorded an undiscounted receivable of $79.4 million, as it is reasonably assured that we will comply with the conditions of the tax credit and will receive proceeds. Upon recording the receivable, we reduced the basis in the fixed assets acquired in accordance with the tax credit and this will be recognized in the condensed consolidated statements of operations over their estimated useful lives of the depreciable asset as reduced depreciation expense.

Financial Operations Overview

Revenue

We derive revenue from product sales and providing services.

Product Revenue. Product revenue is derived from the sale of our batteries and battery systems. For the three months ended March 31, 2010 and 2011, product revenue represented 81% and 85% of our total revenue, respectively.

A significant portion of our revenue is generated from a limited number of customers. Two of our largest customers (BAE Systems, or BAE, and AES Energy Storage, LLC, or AES) accounted for approximately 56% and 11% of our total revenue during the three months ended March 31, 2010 and 2011, respectively. Additionally, we had one customer which represented 12% of our total revenue during the three months ended March 31, 2011. We expect that most of our revenue will continue to come from a relatively small number of customers for the foreseeable future. As we increase our focus on the transportation and electric grid markets, BAE,

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AES and Fisker are expected to represent a significant portion of our revenue in the near term, and the loss of BAE, AES or Fisker as a customer could have a material adverse effect on our short-term revenue. We expect the transportation market and the electric grid market to represent the largest portion of our revenue in the near and long term.

Services Revenue. Services revenue is primarily derived from contracts awarded by the U.S. federal government, other government agencies and commercial customers. These activities range from pure research, in which we investigate design techniques on new battery technologies at the request of a government agency or commercial customer, to custom development projects in which we are paid to enhance or modify an existing product or develop a new product to meet a customer s specifications. We expect to continue to perform funded research and development work and to use the technology developed to advance our new product development efforts. We expect that revenue from services will vary period-to-period depending on the timing of cash payments received and, if applicable, the achievement of milestones. We expect that services revenue will decrease as a percentage of our total revenue due to the expected increase in product revenue over the long-term.

Deferred Revenue. We record deferred revenue for product sales and services in several different circumstances. These circumstances include (i) the products have been delivered or services have been performed but other revenue recognition criteria have not been satisfied, (ii) payments have been received in advance of products being delivered or services being performed and (iii) when all other revenue recognition criteria have been met, but we are not able to reasonably estimate the warranty expense. Deferred revenue includes customer deposits and up-front fees associated with service arrangements. Deferred revenue expected to be recognized as revenue more than one year subsequent to the balance sheet date is classified as long-term deferred revenue. Deferred revenue will vary depending on the timing and amount of cash receipts from customers and can vary significantly depending on specific contractual terms. As a result, deferred revenue is likely to fluctuate from period-to-period. We have received and recorded as deferred revenue a total of $28.0 million in up-front, support and additional payments in connection with our license agreement with Gillette. In addition, the agreement requires Gillette to pay us royalty fees on net sales of products that include our technology. We have agreed with Gillette that if, during a certain period following execution of the license agreement, we enter into an agreement with a third party that materially restricts Gillette s license rights under the license agreement, then we may be required to refund to Gillette all license and support fees paid to us by Gillette under the license agreement, plus, in certain cases, an additional amount to cover Gillette s capital and other expenses paid and/or committed by Gillette in reliance upon its rights under the license agreement. Revenue recognition is expected to commence upon successful transfer of technology know how to Gillette. The license and support fee will be recognized on a straight-line basis over the longer of the patent term or the expected customer relationship.

Cost of Revenue and Gross Profit

Cost of product revenue includes the cost of raw materials, labor and components that are required for the production of our products, as well as manufacturing overhead costs (including depreciation), inventory obsolescence charges, and warranty costs. Raw material costs, which are our most significant cost item over the past two years, have historically been stable, but increasing energy costs for some of our materials are expected to increase this cost. This increase may be partially offset by process innovation, dual sourcing of materials and increased volume if we achieve better economies of scale. We incur costs associated with unabsorbed manufacturing expenses prior to a factory operating at normal operating capacity. We expect these unabsorbed manufacturing costs, which include certain personnel, rent, utilities, materials, testing and depreciation costs, to increase in absolute dollars and as a percentage of revenue in the near term.

Cost of services revenue includes the direct labor costs of engineering resources committed to funded service contracts, as well as third-party consulting, and associated direct material and equipment costs. Additionally, we include overhead expenses such as occupancy costs associated with the project resources, engineering tools and supplies and program management expense.

Our gross profit/(loss) is affected by a number of factors, including the mix of products sold, customer diversification, the mix between product revenue and services revenue, average selling prices, foreign exchange rates, our actual manufacturing costs and costs associated with increasing production capacity until full production is achieved. As we continue to grow and build out our manufacturing capacity, and as new product designs come into production, our gross profit will continue to fluctuate from period-to-period.

We are rapidly expanding our capacity to meet anticipated customer demand, including building out additional manufacturing capacity at our Livonia and Romulus, Michigan facilities. During 2010, we more than doubled our worldwide manufacturing capacity from 169 MWh to approximately 345 MWh. This expansion is part of our plan to support annual manufacturing capacity of 760 MWh. During December 2010, we qualified the first production line at our Livonia facility and we expect to qualify our Romulus facility during the first half of 2011. Also, we have put into place manufacturing overhead, including supply chain and quality organizations, which are sized to support significantly higher production volumes than we are currently producing. Increasing our production volume will allow us to reduce per-unit cell costs, improve the absorption of manufacturing overhead costs, and improve our gross margins.

However, pending the qualification and production ramp-up at our Michigan facilities, we are currently producing the majority of our cells in a low-volume pilot production plant. Utilizing a pilot production plant imposes capacity constraints, limiting our ability to

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produce at higher volumes and decrease our per-unit cost of goods sold, thereby contributing to our negative gross margins. As we ramp-up production at our Michigan facilities, we anticipate a significant increase in production volumes and therefore lower per-unit costs.

Our long-term financial objective is to achieve and support sustained profitable growth. To meet this objective, we are currently focusing on completing the expansion of our manufacturing capacity and increasing production volumes to achieve lower material costs due to volume purchase discounts and improved absorption of our manufacturing overhead costs, thereby reducing per-unit production cost.

Operating Expenses

Operating expenses consist of research, development and engineering, sales and marketing, general and administrative and production start-up expenses. Personnel-related expenses comprise the most significant component of these expenses. We hired a significant number of new employees in order to support our growth and increase in our infrastructure. In any particular period, the timing of additional hires could materially affect our operating expenses, both in absolute dollars and as a percentage of revenue. During the third quarter of 2010, we opened our manufacturing facility in Livonia, Michigan, and our Livonia facility was qualified for production in December 2010. The Romulus facility began qualification for production in the first quarter of 2011.

Research, Development and Engineering Expenses. Research, development and engineering expenses consist primarily of expenses for personnel engaged in the development of new products and the enhancement of existing products, as well as lab materials, quality assurance activities and facilities costs and other related overhead. These expenses also include pre-production costs related to long-term supply agreements unless reimbursement from the customer is contractually guaranteed. Pre-production costs consist of engineering, design and development costs for products sold under long-term supply arrangements. We expense all of our research, development and engineering costs as they are incurred. In the near term, we expect research, development and engineering expenses to increase in large part due to personnel-related expenses as we seek to hire additional employees, as well as contract-related expenses as we continue to invest in the development of our products. Accordingly, we expect that our research, development and engineering expenses will continue to increase in absolute dollars but decrease as a percentage of revenue in the long term. Research, development and engineering expense is reported net of any funding received under contracts with governmental agencies and commercial customers that are considered to be cost sharing arrangements with no contractually committed deliverable.

Sales and Marketing Expenses. Sales and marketing expenses consist primarily of personnel-related expenses, travel and other out-of-pocket expenses for marketing programs, such as trade shows, industry conferences, marketing materials and corporate communications, facilities costs and other related overhead. We intend to hire additional sales personnel, initiate additional marketing programs and build additional relationships with resellers, systems integrators and strategic partners on a global basis. Accordingly, we expect that our sales and marketing expenses will continue to increase in absolute dollars but decrease as a percentage of revenue in the long term.

General and Administrative Expenses. General and administrative expenses consist primarily of personnel-related expenses related to our executive, legal, finance, human resource and information technology functions, as well as fees for professional services and allocated facility overhead expenses. Professional services consist principally of external legal, accounting, tax, audit and other consulting services. We expect to continue to incur general and administrative expenses related to operating as a publicly-traded company, including increased audit and legal fees, costs of compliance with securities, corporate governance and other regulations, investor relations expenses and higher insurance premiums, particularly those related to director and officer insurance. In addition, we expect to incur additional costs as we hire personnel and enhance our infrastructure to support the anticipated growth of our business. Accordingly, we expect that our general and administrative expenses will continue to increase in absolute dollars but decrease as a percentage of revenue in the long term.

Production Start-up Expenses. Production start-up expenses consist of salaries and personnel-related costs, site selection costs, including legal and regulatory costs, rent and the cost of operating a production line before it is qualified for production, including the cost of raw materials, and the related labor and overhead, run through the production line during the qualification phase. We expect to incur additional production start-up expenses in the near term related to our facility in Romulus, Michigan and the qualification of our second production line in Livonia, Michigan. The Livonia facility began qualification for production in the third quarter of 2010 and the first production line was qualified in December 2010. The Romulus facility began qualification for production in the first quarter of 2011.

Other Income (Expense), Net. Other income (expense), net consists primarily of interest income on cash balances, interest expense on borrowings, foreign currency-related gains and losses, equity earnings and other gains or losses. We have historically invested our cash in money market investments. Our interest income will vary each reporting period depending on our average cash balances during the period and the current level of interest rates. Similarly, our foreign currency-related gains and losses will also vary depending upon movements in underlying exchange rates. Other income includes equity losses related of our proportional share of earnings in investments accounted for under the equity method and will vary each reporting period depending on the earnings or losses of these entities and gains or losses on long-term investments will vary each reporting period depending on the timing of any joint

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ventures or other equity investments we may enter into, the investment made by us, and the ongoing operations of the investee. Additionally, for the three months ended March 31, 2011, other income includes the gain recognized on the deconsolidation of our joint venture previously consolidated as a variable interest entity.

Provision for Income Taxes. Through March 31, 2011, we incurred net losses since inception and have not recorded provisions for U.S. federal income taxes since the tax benefits of our net losses have been offset by valuation allowances.

We have recorded a tax provision for foreign taxes associated with our foreign subsidiaries and state income taxes where our net operating loss deductions are limited by statutes.

Watt Hours Operating Metric

We measure our product shipments in watt hours, or Wh, which refers to the aggregate amount of energy that could be delivered in a single complete discharge by a battery. We calculate Wh for each of our battery models by multiplying the battery s amp hour, or Ah, storage capacity by the battery s voltage rating. For example, our 26650 battery is a 2.3 Ah battery that operates at 3.3 V, resulting in a 7.6 Wh rating. We determine a battery s Ah storage capacity at a specific discharge rate and a specific depth of discharge. We do this by charging the battery to its top voltage and by discharging it to zero capacity (2 volt charge level). The Wh metric allows us and our investors to measure our manufacturing capacity and shipments, regardless of battery voltages and Ah specifications, utilizing a uniform and consistent metric.

Certain Trends and Uncertainties

The following represents a summary of certain trends and uncertainties, which could have a significant impact on our financial condition and results of operations. This summary is not intended to be a complete list of potential trends and uncertainties that could impact our business in the long or short term. The summary, however, should be considered along with the factors identified in the section titled *Risk Factors* set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and in Part I, Item 1A of our Annual Report on Form 10-K filed with the SEC on March 11, 2011, and elsewhere in this report.

- We believe that our future revenues depend on our ability to develop, manufacture and market products that improve upon existing battery technology and gain market acceptance. If our battery technology is not adopted by our customers, or if our battery technology does not meet industry requirements for power and energy storage capacity in an efficient and safe design, our batteries will not gain market acceptance.
- We build our manufacturing capacity based on estimated demand from existing supply agreements, from our projection of future development and supply agreement wins and from anticipated timelines of customer orders. Increases in production capacity have had, and will continue to have, an effect on our financial condition and results of operations. Our business revenues and profits will depend upon our ability to enter into and complete development and supply agreements, successfully complete these capacity expansion projects, achieve competitive manufacturing yields and drive volume sales consistent with our demand expectations.
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Our revenues are expected to continue to come from a relatively small number of customers for the foreseeable future. The loss of one of our two most significant customers, several of our smaller customers, or one of our existing supply agreements for significant future revenues, could materially harm our business.

Critical Accounting Policies

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our financial statements and related disclosures requires us to make estimates, assumptions and judgments that affect the reported amount of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates and assumptions on historical experience and other factors that we believe to be reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ from these estimates under different assumptions and conditions. Our most critical accounting policies are listed below.

- Revenue recognition;
- Product warranty obligations;
- Inventory;
- Impairment of long-lived assets;
- Government grants;

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- Investments in non-public companies.

During the three months ended March 31, 2011, there were no significant changes in our critical accounting policies or estimates. See our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 11, 2011, for additional information about these critical accounting policies, as well as a description of our other significant accounting policies.

Results of Consolidated Operations

The following table sets forth selected condensed consolidated statements of operations data for each of the periods (in thousands):

	March 31,	
	2010	**2011**
Revenue:		
Product	$ 19,774	$ 15,458
Services	4,694	2,639
Total revenue	24,468	18,097
Cost of revenue:		
Product	22,354	31,096
Services	4,155	2,478
Total cost of revenue	26,509	33,574
Gross loss	(2,041)	(15,477)
Operating expenses:		
Research, development and engineering	14,116	20,359
Sales and marketing	2,800	4,082
General and administrative	8,240	9,111
Production start-up	1,811	4,621
Total operating expenses	26,967	38,173
Operating loss	(29,008)	(53,650)
Other income (expense):		
Interest, net	(218)	(641)
Gain on foreign exchange	245	2
Other income, net		1,026
Total other income, net	27	387
Loss from operations, before tax	(28,981)	(53,263)
Provision for income taxes	121	410

Net loss		(29,102)		(53,673)
Less: Net loss attributable to the noncontrolling interest		77		27
Net loss attributable to A123 Systems, Inc.	$	(29,025)	$	(53,646)
Other Operating Data:				
Shipments (in watt hours, or Wh) (in thousands)		16,252		14,326

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Three Months Ended March 31, 2010 and 2011

Revenue

	Three Months Ended March 31, 2010	2011	$ Change	% Change
	(Dollars in thousands)			
Revenue				
Product				
Transportation	$ 10,250	$ 12,314	$ 2,064	20.1%
Commercial	4,284	3,134	(1,150)	-26.8%
Electric grid	5,240	10	(5,230)	-99.8%
Total product	19,774	15,458	(4,316)	-21.8%
Services	4,694	2,639	(2,055)	-43.8%
Total revenue	$ 24,468	$ 18,097	$ (6,371)	-26.0%

Product Revenue. The increase in sales in the transportation industry of $2.1 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 was primarily due to the transition of several of our customers from development programs to prototype production programs. These increases were partially offset by a decrease of $6.4 million in sales to BAE. In the future, we expect sales to BAE to decrease as a percentage of revenue as revenue from other customers increases. The decrease in sales in the commercial industry of $1.2 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 was primarily due to a decrease in sales to a commercial customer and its affiliates of $1.6 million, partially offset by an increase of $0.4 million in sales to other commercial customers. Sales to customers in the electric grid industry decreased by $5.2 million due to the timing of electric grid storage system shipments and the timing of revenue recognition.

Services Revenue. The decrease in services revenue was related to the decrease in revenue from government agency research contracts, which was primarily due to the timing of project milestones and revenue recognition on active projects.

Cost of Revenue and Gross Profit (Loss)

	Three Months Ended March 31, 2010	2011	$ Change	% Change
	(Dollars in thousands)			
Cost of revenue				
Product	$ 22,354	$ 31,096	$ 8,742	39.1%
Services	4,155	2,478	(1,677)	-40.4%
Total cost of revenue	$ 26,509	$ 33,574	$ 7,065	26.7%
Gross profit (loss)				

Product	$	(2,580)	$	(15,638)	$	(13,058)	506.1%
Services		539		161		(378)	-70.1%
Total gross profit (loss)	$	(2,041	$	(15,477	$	(13,436	658.3

Cost of Product Revenue. The increase in cost of product revenue was primarily due to an unfavorable change in the mix of products sold in the three months ended March 31, 2011, which included a higher ratio of prismatic cell products to cylindrical cell products, as compared to the three months ended March 31, 2010. In addition, due to low factory utilization, unabsorbed manufacturing expenses were $4.9 million for the three months ended March 31, 2010, compared to $9.5 million for the three months ended March 31, 2011.

Cost of Services Revenues. The decrease in costs of services revenue resulted from the decrease in services revenues in addition to the mix of government and non-government contracts for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010.

Product Gross Profit (Loss). We experienced a product gross loss during the three months ended March 31, 2011, primarily due to low factory utilization and an unfavorable change in the mix of products sold in the three months ended March 31, 2011 as the three months ended March 31, 2011 included a higher ratio of prismatic cell products to cylindrical cell products, as compared to the three months ended March 31, 2010. Our future gross profit will be affected by numerous factors, including the build-out of our manufacturing capacity, the timing of the production of new product designs and our ability to reduce cell costs. While we complete the expansion of our manufacturing capacity and ramp-up production volume of prismatic cells, our gross loss will be negatively

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affected by higher per-unit costs. When we increase our prismatic production volumes we anticipate lower per-unit costs due to lower material costs, improved absorption of our manufacturing overhead costs, and improved efficiencies that will all drive down the per-unit prismatic cell costs, and positively impact our gross profit. Unabsorbed manufacturing expenses were $9.5 million during the three months ended March 31, 2011. Due to unabsorbed manufacturing costs, we anticipate our gross profit or loss will vary significantly from period-to period going forward.

Services Gross Profit. Services gross profit decreased in the three months ended March 31, 2011 as compared to the three months ended March 31, 2010 due to the decrease in services revenue and the timing of project milestones. We recognize services project costs as incurred and, for programs which include milestones, we recognize services revenue upon the completion of project milestones when collectability is reasonably assured. As such, our services gross profit will fluctuate period over period.

Operating Expenses

	Three Months Ended March 31,			
	2010	2011	$ Change	% Change
	(Dollars in thousands)			
Operating expenses				
Research, development and engineering	$ 14,116	$ 20,359	$ 6,243	44.2%
Sales and marketing	2,800	4,082	1,282	45.8%
General and administrative	8,240	9,111	871	10.6%
Production start-up	1,811	4,621	2,810	155.2%
Total operating expenses	$ 26,967	$ 38,173	$ 11,206	41.6%

Research, Development and Engineering Expenses. A portion of research, development and engineering expenses was offset by cost-sharing funding. Our research, development and engineering expenditures are summarized as follows:

	Three Months Ended March 31,			
	2010	2011	$ Change	% Change
	(Dollars in thousands)			
Research, development and engineering expenses				
Aggregated research, development and engineering expenditures	$ 14,655	$ 21,311	$ 6,656	45.4%
Research, development and engineering reimbursements	(539)	(952)	(413)	76.6%
Research, development and engineering expenses	$ 14,116	$ 20,359	$ 6,243	44.2%

The increase in research, development and engineering expenses for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 was primarily attributable to an increase of $5.3 million in personnel-related expenses associated with an increase in research, development and engineering personnel who primarily focus on process improvement, material science chemistry and battery and battery systems technology and who support the increase in customer product development programs. Also, other research, development and engineering cost increased by $0.9 million in the three months ended March 31, 2011. Research, development and engineering expense was 58% of revenue for the three months ended March 31, 2010, compared to 112% for the three months ended March 31, 2011.

Sales and Marketing Expenses. The increase in sales and marketing expenses for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 was primarily attributable to an increase of $1.3 million in personnel-related expenses associated with an increase in sales and marketing personnel. Sales and marketing expense was 11% of revenue for the three months ended March 31, 2010, compared to 23% for the three months ended March 31, 2011.

General and Administrative Expenses. The increase in general and administrative expenses for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 was primarily due to an increase in personnel-related expenses of $0.9 million, associated with an increase in general and administrative personnel. General and administrative expense was 34% of revenue for the three months ended March 31, 2010, compared to 50% for the three months ended March 31, 2011.

Production start-up. A portion of production start-up expenses was offset primarily by government grant funding. Our production start-up expenditures are summarized as follows:

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	Three Months Ended March 31, 2010	2011	$ Change	% Change
	(Dollars in thousands)			
Production start-up expenditures				
Aggregated production start-up expenditures	$ 2,105	$ 6,997	$ 4,892	232.4%
Production start-up reimbursements	(294)	(2,376)	(2,082)	708.2%
Production start-up expenses	$ 1,811	$ 4,621	$ 2,810	155.2%

The increase in production start-up expenses for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 was primarily due to increased production start-up expenses related to our manufacturing expansion at our Romulus, Michigan facility. This increase was partially offset by cost offsets from government grant funding totaling $2.4 million. Production start-up expenses were 7% of revenue for the three months ended March 31, 2010, compared to 26% for the three months ended March 31, 2011.

Other Income (Expense), Net

	Three Months Ended March 31, 2010	2011	$ Change	% Change
	(Dollars in thousands)			
Other income (expense), net				
Interest income, net	$ (218)	$ (641)	$ (423)	194.0%
Gain on foreign exchange	245	2	(243)	99.2%
Other income, net		1,026	1,026	100.0%
Total other income, net	$ 27	$ 387	$ 360	1333.3%

The change in interest, net for the three months ended March 31, 2011 was due to an increase in interest expense due to capital lease obligations outstanding during the three months ended March 31, 2011. The decrease in net foreign exchange gains for the three months ended March 31, 2011, compared to the three months ended March 31, 2010, is due to the effect of currency exchange rate changes on transactions that are non U.S. dollar denominated and charged or credited to earnings. Other income is primarily due to a gain of $1.2 million recognized on the deconsolidation of our joint venture which was previously consolidated as a variable interest entity. This gain is partially offset by losses recognized on our Chinese joint venture and losses recognized on our investment in 24M Technologies, Inc., a privately-held company, both accounted for under the equity method.

Provision for Income Taxes. The provision for income taxes for the three months ended March 31, 2010 and 2011 was primarily related to foreign and state income taxes. We did not report a benefit for federal income taxes in the condensed consolidated financial statements as the deferred tax asset generated from our net operating loss has been offset by a full valuation allowance because it is more likely than not that the tax benefits of the net operating loss carry forward may not be realized.

Liquidity and Capital Resources

The following table sets forth the major sources and uses of cash for each of the periods set forth below (in thousands):

	Three Months Ended March 31,	
	2010	2011
Net cash used in operating activities	$ (23,965)	$ (48,478)
Net cash used in investing activities	(21,528)	(33,204)
Net cash (used in) provided by financing activities	(1,092)	1,659
Effect of foreign exchange rates on cash and cash equivalents	(20)	(13)
Net decrease in cash and cash equivalents	$ (46,605)	$ (80,036)

Since inception, we have funded our operations primarily through private placements of preferred stock and common stock, public offerings of common stock and convertible debt securities, demand notes, term loans, credit facilities and government grants. As of March 31, 2011, we had cash and cash equivalents of $136.8 million and accounts receivable of $26.4 million. During the three months ended March 31, 2011, we received proceeds from government grants of $15.0 million. As described in Note 10 to our condensed consolidated financial statements, in April 2011 we received funds of $253.9 million from the issuance of convertible subordinated debt and common stock in a public issuance, net of underwriter s commissions and discounts and offering expenses. In 2011 and beyond, we expect to use a significant portion of our cash for capital expenditures to increase manufacturing capacity in anticipation of increased demand for our products, including the current expansion of our manufacturing facilities in Michigan.

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Cash Flows From Operating Activities

Operating activities used $48.5 million of net cash during the three months ended March 31, 2011. We incurred a net loss of $53.7 million in the three months ended March 31, 2011, which included non-cash share-based compensation expense of $3.3 million and depreciation and amortization of $4.9 million. Changes in asset and liability accounts used $2.1 million of net cash during the three months ended March 31, 2011.

Operating activities used $24.0 million of net cash during the three months ended March 31, 2010. We incurred a net loss of $29.1 million in the three months ended March 31, 2010, which included non-cash share-based compensation expense of $2.5 million and depreciation and amortization of $3.7 million. Changes in asset and liability accounts used $1.7 million of net cash during the three months ended March 31, 2010.

We anticipate negative cash flow from operations in the near future as we continue to support the anticipated growth of our business.

Cash Flows From Investing Activities

Cash flows from investing activities primarily relate to capital expenditures to support our growth.

Cash used in investing activities totaled $33.2 million during the three months ended March 31, 2011 and consisted of capital expenditures of $42.7 million primarily related to the purchase of manufacturing equipment, expenditures of $1.9 million related to the purchases of investments, an increase in restricted cash of $0.7 million, and the receipt of government grant proceeds of $12.2 million.

Cash used in investing activities totaled $21.5 million during the three months ended March 31, 2010 and consisted of capital expenditures of $13.9 million primarily related to the purchase of manufacturing equipment, expenditures of $13.0 million related to the purchase of a long-term investment and amounts held in escrow, receipt of government grant proceeds of $5.7 million, and an increase in restricted cash $0.3 million.

We anticipate higher capital expenditure levels in future periods as we continue to fund the expansion of our facilities to support the anticipated growth of our business. Additionally, we anticipate investing cash outflows in future periods as we invest in joint ventures and other equity investments in order to establish strategic relationships.

Cash Flows From Financing Activities

Cash flows from financing activities totaled $1.7 million during the three months ended March 31, 2011 and included proceeds from government grants of $0.9 million, proceeds from exercise of stock options of $1.9 million and contribution to our subsidiary from a noncontrolling interest of $0.6 million. These proceeds were partially offset by repayments on long-term debt of $1.3 million, repayments on capital lease obligations of $0.3 million and payments of $0.1 million of deferred offering costs.

Cash flows from financing activities totaled $1.1 million during the three months ended March 31, 2010 and included proceeds from government grants of $1.3 million and proceeds from exercise of stock options of $0.5 million. These proceeds were partially offset by repayments on long-term debt of $2.7 million, and repayments on capital lease obligations of $0.2 million. In future periods, we expect financing activities such as proceeds from grants, equity offerings and debt issuances to continue to be a significant source of cash.

Off-Balance Sheet Arrangements

In June 2010, we entered into a supply agreement under which we committed to minimum purchase volumes for each of the years ending December 31, 2010 through December 31, 2013 for a raw material component. If our purchase volumes during any year fail to meet the minimum purchase commitments, we are required to pay the seller a variance payment for the difference between the amount actually purchased in that calendar year and the annual minimum purchase commitment for that calendar year. We will receive a credit for the amount of the variance payment to be applied to purchases in the following year and we will have until April 1, 2015 to reclaim any variance payment resulting from the minimum purchase commitments for calendar years 2012 or 2013. The table shown below in the section titled Contractual Obligations shows the amount of our purchase commitments payable by year inclusive of our commitment under the supply agreement described above. For the three months ended March 31, 2011, we have purchased $2.2 million under this supply agreement.

During the periods presented, we did not have and do not currently have, any off-balance sheet arrangements, as defined under SEC rules, such as relationships with unconsolidated entities or financial partnerships, which are often referred to as structured finance or special purpose entities, established for the purpose of facilitating financing transactions that are not required to be reflected on our condensed consolidated balance sheet, other than the arrangement described above.

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Contractual Obligations

Our contractual obligations relate primarily to borrowings under long-term debt obligations, capital leases, operating leases, and purchase obligations which include agreements or purchase orders to purchase goods or services that are enforceable and legally binding. A table summarizing the amounts and estimated timing of these future cash payments was provided in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the SEC on March 11, 2011. During the three months ended March 31, 2011, there were no material changes outside the ordinary course of business in our contractual obligations or the estimated timing of the future cash payments, except as noted below.

The following is a summary of our purchase obligations as of March 31, 2011:

		Payments Due in			
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
			(in thousands)		
Purchase obligations (1)	$ 132,502	$ 95,502	$ 37,000		
	$ 132,502	$ 95,502	$ 37,000	$	$

(1) Capital expenditure purchase obligations include agreements or purchase orders to purchase capital goods that are enforceable and legally binding and specify all significant terms. Purchase obligations exclude agreements that are cancelable without penalty.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of March 31, 2011, we have not experienced any adverse changes in market risk exposures that materially affected the quantitative and qualitative disclosures presented in the Company s Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the SEC on March 11, 2011.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. Our management, with the participation of our chief executive officer and interim chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2011. 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 a 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 SEC 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. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives 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 March 31, 2011, our chief executive officer and our interim chief financial officer concluded that, as of such date, our disclosure controls and procedures were not effective at the reasonable assurance level.

As disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 11, 2011, we identified a material weakness in our internal control over financial reporting. We intend to take appropriate and reasonable steps to make necessary improvements to our internal control over financial reporting. We expect that our remediation efforts, including design, implementation and testing will continue throughout fiscal year 2011, although the material weakness will not be considered remediated until our controls are operational for a period of time, tested, and management concludes that these controls are operating effectively.

Changes in Internal Controls. No changes 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 quarterly period ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting other than described below. As disclosed in Item 9A: *Controls and Procedures,* of our Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the SEC on March 11, 2011, our former Chief Financial Officer left the company in January 2011 and, as a result, on an interim basis, our Vice President of Finance and Corporate Controller is also fulfilling the role as the interim Chief Financial Officer. Consequently, we have a lack of continuity of senior financial management.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In 2005 and 2006, we received communications from Hydro-Quebec, a Canadian utility company, alleging that the cathode material of our batteries infringes U.S. Patent No. 5,910,382 and U.S. Patent No. 6,514,640 that had been granted to The University of Texas, or UT, and that relate to certain electrode materials used in lithium-ion batteries. We refer to these patents by the last three digits of the patent number. The 382 and 640 patents include claims that claim to cover battery cathode material having a particular crystal structure and chemical formula. We contend that our cathode material has a different crystal structure and chemical formula.

We believe that UT subsequently licensed the patents to Hydro-Quebec, which in turn licensed the technology to companies that make and sell electrode materials for batteries. On April 7, 2006, we commenced an action in the United States District Court for the District of Massachusetts seeking a declaratory judgment that our products do not infringe these patents and that the patents are invalid. On September 8, 2006, we also requested ex parte reexamination of the two patents by the U.S. Patent & Trademark Office, or PTO, to determine whether the subject matter they claim is patentable. The reexamination process does not result in findings of infringement. In order to have a patent reexamined, the party of interest must submit prior art that raises a substantial new question of patentability . If the PTO determines that there is a substantial new question of patentability, it will order a reexamination. In an ex parte reexamination, a third party requesting reexamination does not participate further in the reexamination proceedings. Once a reexamination is ordered, a new examiner is assigned to the case and the patent goes through another examination similar in procedure to the examination it received leading up to the issuance of the patent in the first instance. If any claims are rejected in light of the new questions raised, then the patent owner can narrow or cancel the rejected claims to try to avoid rejection of the claims. The patent owner can also submit new claims, provided they are not broader than the claims in the original patent. Once the reexamination has been concluded and if any claims are considered patentable, a Certificate of Reexamination is issued.

On September 11, 2006, Hydro-Quebec and UT commenced an action in the United States District Court for the Northern District of Texas against us, one of our customers, Black & Decker, whom we have agreed to indemnify, and one of our suppliers alleging infringement of the two patents and, in a later amended complaint, false advertising. The plaintiffs complaint alleges infringement of various claims of the 382 Patent and various claims of the 640 Patent and that we and Black & Decker have engaged in false advertising by making representations about the source and nature of our technology. The complaint seeks injunctive relief, including against making, using or selling any product containing the patented technology, actual damages in an unspecified amount, increased and/or treble damages, interest, costs and attorney fees.

In October 2006 and January 2007, the PTO granted our requests for reexamination of the two patents. In January and February 2007, the two litigations in Massachusetts and Texas were stayed pending the PTO reexaminations. Various motions to dismiss, filed by parties on both sides of the dispute, remain undecided.

During the reexamination, the PTO rejected all of the original claims of the 382 Patent as unpatentable. UT then amended the claims of the 382 Patent to make them narrower than the original claims in order to distinguish the claimed invention from the prior art and added two new and narrower claims. The PTO determined that the narrower amended and new claims of the 382 Patent submitted during reexamination are patentable and concluded the reexamination of the 382 Patent. On April 15, 2008, the PTO issued a reexamination certificate with the amended claims and the two new claims. During the reexamination of the 640 Patent, the PTO rejected all of the original claims of the 640 Patent as unpatentable. UT then amended the claims of the 640 Patent to make them narrower than the original claims in order to distinguish the claimed invention from the prior art.

On December 22, 2008, the parties jointly requested that the stay of the litigation continue pending resolution of the reexamination of the 640 Patent. On May 12, 2009, the PTO issued a Certificate of Reexamination for the 640 Patent with the amended narrower claims, thus removing the last condition for staying this litigation. As a result, while Hydro-Quebec and UT may assert the narrower claims of the Certificate of Reexamination against any alleged infringer, including us, they are unable to continue to assert the original claims of the 382 Patent and the 640 Patent against us. On June 11, 2009, we filed a motion to reopen the lawsuit in Massachusetts pursuant to the court s deadline to file within 30 days of the conclusion of the PTO s reexamination. On September 28, 2009, the Massachusetts court entered an order denying that motion, which we appealed on October 27, 2009 to the United States Court of Appeals for the Federal Circuit. The United States Court of Appeals for the Federal Circuit upheld the Massachusetts court s decision on November 10, 2010. On July 22, 2009, Hydro-Quebec and UT sent us a proposed Second Amended Complaint in the Texas litigation, which was filed with the Texas court on August 27, 2009 and we were granted several unopposed extensions to file our response. The Texas court re-opened the case and lifted the stay on October 26, 2009. The Texas court held a hearing with the parties on May 14, 2010 and extended a schedule for the case leading to a claim construction hearing, which was held on December 2, 2010. On March 29, 2011, the Texas court issued a Memorandum Opinion and Order on Claim Construction. Although the Texas court did not adopt all of our constructions, we believe that the Texas court s claim constructions are favorable to us on the key claim terms at issue and support our non-infringement position. The judge ordered the parties to submit their joint status report on or before April 26, 2011. The parties submitted the joint status report on April 26, 2011 in accordance with the court s order, which included the proposed deadlines for discovery and pre-trial motions. The court issued a scheduling order on April 27, 2011 with trial set to begin in December 2011.

We expect that the Texas litigation could take as long as seven months or more to reach trial, if at all. We believe that we do not infringe either UT patent, including the 382 Patent and the 640 Patent following reexamination, and that we have other meritorious defenses, and we intend to continue to vigorously defend our products and intellectual property rights. The 382 and 640 Patents

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include claims that claim to cover battery cathode material having a particular crystal structure and chemical formula, which Hydro-Quebec and UT claim our cathode material infringes. We believe, and contend in the lawsuits, that our cathode material has a different crystal structure and chemical formula that is not covered by the 382 and 640 patents. However, due to the nature of the litigation, we cannot determine the total expense or possible loss, if any, that may ultimately be incurred either in the context of a trial or as a result of a negotiated settlement. Although Hydro-Quebec and UT have not specified in their complaint the nature or extent of their damages, they have asked for injunctive relief and we believe that they would likely seek substantial damages that could involve both one-time payments and on-going amounts. Regardless of the ultimate outcome of the litigation, it could result in significant legal expenses and diversion of time by our technical and managerial personnel. Additionally, we have agreed to defend and indemnify the other named business partner for its legal costs in defending this litigation and any damages that may be awarded. The results of these proceedings are uncertain, and there can be no assurance that they will not have a material adverse effect on our business, operating results, and financial condition.

Item 1A. Risk Factors

Our business is subject to numerous risks. We caution you that the following important factors, among others, could cause our actual results to differ materially from those expressed in forward-looking statements made by us or on our behalf in filings with the SEC, press releases, communications with investors and oral statements. Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in the discussion below will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may differ materially from those anticipated in forward-looking statements. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosure we make in our reports filed with the SEC.

Risks Related to Our Business

We have had a history of losses, and we may be unable to achieve or sustain profitability.

We have never been profitable. We experienced net losses of $86.6 million for 2009, $152.9 million for 2010 and $53.7 million for the three months ended March 31, 2011. We expect we will continue to incur net losses in the near term. We expect to incur significant future expenses as we develop and expand our business and our manufacturing capacity. In addition, as a public company, we have incurred and will continue to incur additional significant legal, accounting and other expenses that we did not incur as a private company. These increased expenditures will make it harder for us to achieve and maintain future profitability. We may incur significant losses in the future for a number of reasons, including the other risks described in this section, and we may encounter unforeseen expenses, difficulties, complications, delays and other unknown events. Accordingly, we may not be able to achieve or maintain profitability.

We have yet to achieve positive cash flow, and our ability to generate positive cash flow is uncertain.

To rapidly develop and expand our business, we have made significant up-front investments in our manufacturing capacity and incurred research and development, sales and marketing and general and administrative expenses. In addition, our growth has required a significant investment in working capital over the last several years. We have had negative cash flow before financing activities of $114.7 million for 2009,

$250.4 million for 2010 and $81.7 million for the three months ended March 31, 2011. We anticipate that we will continue to have negative cash flow for the foreseeable future as we continue to make significant future capital expenditures to expand our manufacturing capacity and incur increased research, development and engineering, sales and marketing, general and administrative and production start-up expenses. Our business will also require significant amounts of working capital to support our growth. Therefore, we may need to raise additional capital from investors to achieve our expected growth, and we may not achieve sufficient revenue growth to generate positive future cash flow. An inability to generate positive cash flow for the foreseeable future or raise additional capital on reasonable terms may decrease our long-term viability.

If we are unable to obtain supplies of materials we use in the electrode coating process of our batteries sufficient to meet our planned demand levels, our results of operations could be materially adversely affected.

Our supply of materials we use in the electrode coating process of our batteries was disrupted by the earthquake and tsunami that occurred in Japan on March 11, 2011. We currently have inventory of these materials on hand and in transit that we believe will support our manufacturing operations through July 20, 2011. However, if we are not able to obtain these or additional materials from our supplier, or if there is a prolonged disruption in our suppliers manufacturing capability and we are delayed or are not able to qualify a second source of supply, our results of operations would be materially adversely affected and we would not be able to achieve our planned financial results. In addition, although we are not currently aware of any other supply issue related to the earthquake in Japan affecting our business, there have been many reports of disruption in the automotive supply chain as a result of the earthquake. Our automotive customers comprise a substantial portion of our current and projected future revenue, and any such disruption in their

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supply chain or further disruption in our supply chain, or even the potential for such disruption, could cause delays in our programs and have a material adverse affect on our business, results of operations and financial outlook.

Our limited operating history makes it difficult to evaluate our current business and future prospects.

We have been in existence since 2001, but much of our growth has occurred in recent years. Our limited operating history may make it difficult to evaluate our current business and our future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing companies in rapidly changing industries, including increasing expenses as we continue to grow our business. If we do not manage these risks successfully, our business will be harmed.

In addition, we are targeting new and emerging markets for our batteries and battery systems. However, historically, a significant portion of the products that we have sold were designed for the consumer tool market, which is a more mature market with different growth prospects than our other target markets. Several of our products are still under development, including a battery in prismatic form and related battery systems designed for use in the transportation and electric grid industries, and the timing of the ultimate release, if any, of new production quality products is not determinable. Our efforts to expand beyond our existing markets may never result in new products that achieve market acceptance, create additional revenue or become profitable. Therefore, our recent historical growth trajectory may not provide an accurate representation of the market dynamics we may be exposed to in the future, making it difficult to evaluate our future prospects.

The demand for batteries in the transportation and other markets depends on the continuation of current trends resulting from dependence on fossil fuels. Extended periods of low gasoline prices could adversely affect demand for electric and hybrid electric vehicles.

We believe that much of the present and projected demand for advanced batteries in the transportation and other markets results from increases in the cost of oil over the last several years, the dependency of the United States on oil from unstable or hostile countries, government regulations and economic incentives promoting fuel efficiency and alternate forms of energy, as well as the belief that climate change results in part from the burning of fossil fuels. If the cost of oil decreased significantly, the outlook for the long-term supply of oil to the United States improved, the government eliminated or modified its regulations or economic incentives related to fuel efficiency and alternate forms of energy, or if there is a change in the perception that the burning of fossil fuels negatively impacts the environment, the demand for our batteries could be reduced, and our business and revenue may be harmed.

Gasoline prices have been extremely volatile, and this continuing volatility is expected to persist. Lower gasoline prices over extended periods of time may lower the perception in government and the private sector that cheaper, more readily available energy alternatives should be developed and produced. If gasoline prices remain at deflated levels for extended periods of time, the demand for hybrid and electric vehicles may decrease, which would have a material adverse effect on our business.

If we are unable to develop, manufacture and market products that improve upon existing battery technology and gain market acceptance, our business may be adversely affected. In addition, many factors outside of our control may affect the demand for our batteries and battery systems.

We are researching, developing, manufacturing and selling lithium-ion batteries and battery systems. The market for advanced rechargeable batteries is at a relatively early stage of development, and the extent to which our lithium-ion batteries will be able to meet our customers requirements and achieve significant market acceptance is uncertain. Rapid and ongoing changes in technology and product standards could quickly render our products less competitive, or even obsolete if we fail to continue to improve the performance of our battery chemistry and systems. Other companies that are seeking to enhance traditional battery technologies have recently introduced or are developing batteries based on nickel metal-hydride, liquid lithium-ion and other emerging and potential technologies. These competitors are engaged in significant development work on these various battery systems. One or more new, higher energy rechargeable battery technologies could be introduced which could be directly competitive with, or superior to, our technology. The capabilities of many of these competing technologies have improved over the past several years. Competing technologies that outperform our batteries could be developed and successfully introduced, and as a result, our products may not compete effectively in our target markets. If our battery technology is not adopted by our customers, or if our battery technology does not meet industry requirements for power and energy storage capacity in an efficient and safe design, our batteries will not gain market acceptance.

In addition, the market for our products depends upon third parties creating or expanding markets for their end-user products that utilize our batteries and battery systems. If such end-user products are not developed, if we are unable to have our products designed into these end user products, if the cost of these end-user products is too high, or the market for such end-user products contracts or fails to develop, the market for our batteries and battery systems would be expected similarly to contract or collapse. Our customers operate in extremely competitive industries, and competition to supply their needs focuses on delivering sufficient power and capacity in a cost, size and weight efficient package. The ability of our customers to adopt new battery technologies will depend on many factors outside of our control. For example, in the automotive industry, we depend on our customers ability to develop HEV, PHEV and EV platforms that gain broad appeal among end users.

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Many other factors outside of our control may also affect the demand for our batteries and battery systems and the viability of widespread adoption of advanced battery applications, including:

- performance and reliability of battery power products compared to conventional and other non-battery energy sources and products;

- success of alternative battery chemistries, such as nickel-based batteries, lead-acid batteries and conventional lithium-ion batteries and the success of other alternative energy technologies, such as fuel cells and ultra capacitors;

- end-users perceptions of advanced batteries as relatively safe and reliable energy storage solutions, which could change over time if alternative battery chemistries prove unsafe or become the subject of significant product liability claims and negative publicity is generated on the battery industry as a whole;

- cost-effectiveness of our products compared to products powered by conventional energy sources and alternative battery chemistries;

- availability of government subsidies and incentives to support the development of the battery power industry;

- fluctuations in economic and market conditions that affect the cost of energy stored by batteries, such as increases or decreases in the prices of electricity;

- continued investment by the federal government and our customers in the development of battery powered applications;

- heightened awareness of environmental issues and concern about global warming and climate change; and

- regulation of energy industries.

Our principal competitors have, and any future competitors may have, greater financial and marketing resources than we do, and they may therefore develop batteries or other technologies similar or superior to ours or otherwise compete more successfully than we do.

Competition in the battery industry is intense. The industry consists of major domestic and international companies, most of which have existing relationships in the markets into which we sell as well as financial, technical, marketing, sales, manufacturing, scaling capacity, distribution and other resources and name recognition substantially greater than ours. These companies may develop batteries or other technologies that perform as well as or better than our batteries. We believe that our primary competitors are existing suppliers of cylindrical lithium-ion, nickel cadmium, nickel metal-hydride and in some cases, non-starting/lighting/ignition lead-acid batteries. A number of our competitors have existing and evolving relationships with our target customers. For example, Bosch and Samsung formed SB LiMotive to focus on the development, production and marketing of lithium-ion battery systems for application in hybrid and other electric vehicles, and Dow Chemical has entered into a joint venture with Kokam America and others, to build a facility in Michigan for the manufacture of lithium polymer batteries for use in HEVs and EVs. In addition, NEC Corporation and Nissan entered into a joint venture to develop lithium-ion batteries in prismatic form, Sanyo and Volkswagen agreed to develop lithium-ion batteries for HEVs, Sanyo already provides nickel metal hydride batteries for Ford and Honda, and Toyota and Panasonic are engaged in a joint venture to make batteries for HEVs and EVs. LG Chem and its subsidiary, Compact Power, have also developed lithium-ion battery systems for hybrid and other electric vehicles. These competitors may be able to offer lower prices for their batteries than we can offer, and may even sell their batteries at below their production costs in order to compete with us, particularly in the transportation market. In addition, we expect new competitors will enter the markets for our products in the future. Potential customers may choose to do business with our more established competitors, because of their perception that our competitors are more stable, are more likely to complete various projects, can scale operations more quickly, have greater manufacturing capacity, are more likely to continue as a going concern and lend greater credibility to any joint venture. If we are unable to compete successfully against manufacturers of other batteries or technologies in any of our targeted applications, our business could suffer, and we could lose or be unable to gain market share.

Adverse business or financial conditions affecting the automobile industry may have a material adverse effect on our development and marketing partners and our battery business.

Much of our business depends on and is directly affected by the general economic state of the United States and global automobile industry. The effect of the continued economic difficulties of the major automobile manufacturers on our business is unclear. Two major auto manufacturers have emerged from bankruptcy, and it is possible that more of these companies may encounter financial difficulties. The impact of any such financial difficulties on the automobile industry and its suppliers is unclear and difficult to predict. Possible effects could include reduced spending on alternative energy systems for automobiles, a delay in the introduction of new, or the cancellation of new and existing, hybrid and electric vehicles and programs, and a delay in the conversion of existing batteries to lithium-ion batteries, each of which would have a material adverse effect on our business.

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We have entered into agreements relating to joint design and development efforts with several automotive manufacturers and tier 1 suppliers regarding their HEV, PHEV and EV development efforts. Certain of these manufacturers and suppliers have in recent years experienced static or reduced revenues, increased costs, net losses, loss of market share, bankruptcy, labor issues and other business and financial challenges. As a result, these or other automotive manufacturers may discontinue or delay their planned introduction of HEVs, PHEVs or EVs as a result of adverse changes in their financial condition or other factors. Automotive manufacturers may also seek alternative battery systems from other suppliers which may be more cost-effective or require fewer modifications in standard manufacturing processes than our products. We may also experience delays or losses with respect to the collection of payments due from customers in the automotive industry experiencing financial difficulties.

We have experienced rapid growth in recent periods. If we fail to manage our growth effectively, we may be unable to execute our business plan, maintain high levels of service or address competitive challenges adequately.

We increased our number of full-time employees from 904 at January 1, 2008 to 2,032 at December 31, 2010, and our revenue increased from $68.5 million in 2008 to $97.3 million in 2010. Our growth has placed, and may continue to place, a significant strain on our managerial, administrative, operational, financial, information technology and other resources. We intend to further expand our overall business, customer base, headcount and operations both domestically and internationally. Expanding a global organization and managing a geographically dispersed workforce will require substantial management effort and significant additional investment in our infrastructure. We will be required to continue to improve our operational, financial and management controls and our reporting procedures and we may not be able to do so effectively. As such, we may be unable to manage our expenses effectively in the future, which may negatively impact our operating results in any particular quarter.

Our failure to raise additional capital necessary to expand our operations and invest in our products and manufacturing facilities could reduce our ability to compete successfully.

We may require additional capital in the future to fund our growth and expansion plans and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests, and the per-share value of our common stock could decline. For example, in April 2011, we issued 20.2 million shares of common stock and $143.8 million in principal of convertible unsecured subordinated notes. The issuance of shares pursuant to these transactions resulted in dilution to stockholders who held our common stock prior to such transactions. Stockholders will also experience further dilution if holders of the convertible notes choose to convert such notes into shares of our common stock.

If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness and force us to maintain specified liquidity or other ratios. We are also seeking federal and state grants, loans and tax incentives some of which we intend to use to expand our operations. We may not be successful in obtaining these funds or incentives. If we need additional capital and cannot raise or otherwise obtain it on acceptable terms, we may not be able to, among other things:

- develop or enhance our products or introduce new products;

- continue to expand our development, sales and marketing and general and administrative organizations and manufacturing operations;

- attract top-tier companies as customers or as our technology and product development partners;

- acquire complementary technologies, products or businesses;

- expand our operations, in the United States or internationally;

- expand and maintain our manufacturing capacity;

- hire, train and retain employees; or

- respond to competitive pressures or unanticipated working capital requirements.

Because we build our manufacturing capacity based on our projection of future design wins and supply agreements, our business revenue and profits will depend upon our ability to enter into and complete these agreements, successfully complete these expansion projects, achieve competitive manufacturing yields and drive volume sales consistent with our demand expectations.

In order to fulfill the anticipated demand for our products, we invest in capital expenditures in advance of actual customer orders, based on estimates of future demand. We plan to continue the expansion of our manufacturing capacity across multiple product lines. The build-up of our internal manufacturing capabilities, such as the current expansions in Livonia and Romulus, Michigan, exposes us

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to significant up-front fixed costs. If market demand for our products does not increase as quickly as we have anticipated and align with our expanded manufacturing capacity, or if we fail to enter into and complete projected development and supply agreements, we may be unable to offset these costs and to achieve economies of scale, and our operating results may be adversely affected as a result of high operating expenses, reduced margins, underutilization of capacity and asset impairment charges. Alternatively, if we experience demand for our products in excess of our estimates, our installed capital equipment may be insufficient to support higher production volumes, which could harm our customer relationships and overall reputation. In addition, we may not be able to expand our workforce and operations in a timely manner, procure adequate resources, or locate suitable third-party suppliers, to respond effectively to changes in demand for our existing products or to the demand for new products requested by our customers, and our current or future business could be materially and adversely affected. Our ability to meet such excess customer demand could also depend on our ability to raise additional capital and effectively scale our manufacturing operations.

We utilize standard manufacturing equipment that we modify and customize in order to meet our production needs. While this equipment may be available from various suppliers, its procurement requires long lead times. Therefore, we may experience delays, additional or unexpected costs and other adverse events in connection with our capacity expansion projects, including those associated with potential delays in the procurement and customization of manufacturing equipment and various components required for our products.

If we are unable to achieve and maintain satisfactory production yields and quality as we expand our manufacturing capabilities, our relationships with certain customers and overall reputation may be harmed, and our sales could decrease.

We expect to rely on our supply agreement with Fisker Automotive, Inc., or Fisker, to represent a significant portion of our revenue in future periods. If Fisker is unable to fulfill its commitment under the supply agreement our revenues could be materially lower than our forecasts and we may have under-utilized manufacturing capacity.

We have a supply agreement with Fisker pursuant to which we are providing Fisker with advanced automotive battery systems over a multi-year period. If Fisker is not successful in executing on its strategic plan or does not meet the anticipated demand for our products, our revenues and profitability may be materially impacted. As we invest in capital expenditures and build our manufacturing capacity in anticipation of demand, including anticipated demand from Fisker under the supply agreement, our operating results may be adversely affected by underutilization of capacity, failure to achieve economies of scale, and reduced margins if actual orders are less than expected.

We may not be able to obtain, or to agree on acceptable terms and conditions for, all or a significant portion of the government grants, loans and other incentives for which we have applied and may in the future apply. Our customers and potential customers applying for government grants, loans and other incentives may condition purchases of our products upon their receipt of these funds or delay purchases of our products until their receipt of these funds.

We have applied for federal and state grants, loans and tax incentives under government programs designed to stimulate the economy and support the production of electric vehicles and advanced battery technologies, including a loan under the DOE ATVM Program. Much of our planned domestic manufacturing capacity expansion depends on receipt of these funds and other incentives, and the failure to obtain these funds or other incentives could materially and adversely affect our ability to expand our manufacturing capacity and meet planned production levels. We anticipate that in the future there will be new opportunities for us to apply for grants, loans and other incentives from the United States, state and foreign governments. Our ability to obtain funds or incentives from government sources is subject to the availability and continued availability of funds under applicable government programs and approval of our applications to participate in such programs. The application process for these funds and other incentives is and will be highly competitive. While we have received a grant under the DOE Battery Initiative

and have received some state incentives, we cannot assure you that we will be successful in obtaining additional grants, loans and other incentives. Moreover, we may not be able to satisfy or continue to satisfy the requirements and milestones imposed by the granting authority as conditions to receipt of the funds or other incentives, the timing of the receipt of the funds may not meet our needs and we nevertheless may be unable to successfully execute on our business plan. Moreover, not all of the terms and conditions associated with these incentive funds have been disclosed to us, and once disclosed, there may be terms and conditions with which we are unable to comply or which are commercially unacceptable to us. In addition, the DOE Battery initiative grant and any other federal government programs which may make additional awards to us will require us to spend a portion of our own funds for every incentive dollar we receive or are permitted to borrow from the government and will impose time limits during which we must use the funds awarded to us. If we are unable to raise sufficient additional capital so that we are able to receive all of the amounts which have and may be awarded to us in a timely manner, our ability to expand our manufacturing capacity could be materially adversely affected. In addition, less than expected actual and anticipated future demand for our products may cause us to slow the pace of the expansion of our manufacturing capacity such that we are not able to use the government incentive funds awarded or made available to us in the time periods required by the granting authorities.

Our customers and potential customers applying for these government grants, loans and other incentives may condition purchases of our products upon receipt of these funds or delay purchases of our products until receipt of these funds, and if our customers and

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potential customers do not receive these funds or the receipt of these funds is significantly delayed, our results of operations could suffer.

We are subject to government audits related to the government grants, loans and other incentives we have received. If the findings of the audit determine we have not met the requirements of the grant, loan or other incentive, we may be required to repay all or part of the amount received to the government authority.

We have received funds under federal and state grant and loan programs. Under the terms and conditions of the programs, we are subject to governmental audits of the amounts submitted for reimbursement of costs incurred. Although we expect to satisfy the requirements of the grants, loans, and other incentives received, we cannot assure that the government audits will not result in determining that a portion of the costs submitted for reimbursement do not comply with the conditions of the grant. If we do not meet the conditions of the grants, loans or other incentives, we may be required to repay all or a portion of the proceeds received to date from the federal or state agencies.

We rely on a limited number of customers for a significant portion of our revenue, and the loss of, or delay in the production process, of one or both of our two most significant customers, or several of our smaller customers, or one of our existing supply agreements with customers for significant future revenues, could materially harm our business.

A significant portion of our revenue is generated from a limited number of customers. For the years ended December 31, 2009 and 2010, revenue from BAE represented 35% and 28% of our revenue, respectively. For the years ended December 31, 2009 and 2010, revenue from AES accounted for 9% and 13% of our revenue, respectively. Although the composition of our significant customers will vary from period to period, we expect that most of our revenue will continue, for the foreseeable future, to come from a relatively small number of customers. In addition, our contracts with our customers generally do not include long-term commitments or minimum volumes that ensure future sales of our products. Consequently, our financial results may fluctuate significantly from period-to-period based on the actions of one or more significant customers. A customer may take actions that affect us for reasons that we cannot anticipate or control, such as reasons related to the customer s financial condition, changes in the customer s business strategy or operations, the introduction of alternative competing products, or as the result of the perceived quality or cost-effectiveness of our products. Our agreements with these customers may be cancelled if we fail to meet certain product specifications or materially breach the agreement or for other reasons outside of our control. In addition, our customers may seek to renegotiate the terms of current agreements or renewals. The loss of or a reduction in sales or anticipated sales to our most significant or several of our smaller customers could have a material adverse effect on our business, financial condition and results of operations. Additionally, if one of our significant customers, several of our smaller customers, or one of our existing supply agreements with customers for significant future revenues experiences a delay in production, or their product is not successful, our business, financial condition and results of operations could be materially harmed.

Our financial results may vary significantly from period-to-period due to the long and unpredictable sales cycles for some of our products, the seasonality of certain end markets into which we sell our products, and changes in the mix of products we sell during a period, which may lead to volatility in our stock price.

The size and timing of our revenue from sales to our customers is difficult to predict and is market dependent. Our sales efforts often require us to educate our customers about the use and benefits of our products, including their technical and performance characteristics. Customers typically undertake a significant evaluation process that has in the past resulted in a lengthy sales cycle, which is typically many months and in some cases up to five years. In some markets such as the transportation market, there is usually a significant lag time between the design phase and commercial production. We spend substantial amounts of time and money on our sales efforts and there is no assurance that these investments will produce any sales within expected time frames or at all. For example, we have previously spent substantial time and money on

several designs with auto manufacturers that were ultimately awarded to another supplier. Given the potentially large size of battery development and supply contracts, the loss of or delay in the signing of a contract or a customer order could significantly reduce our revenue in any period. Since most of our operating and capital expenses are incurred based on the estimated number of design wins and their timing, they are difficult to adjust in the short term. As a result, if our revenue falls below our expectations or is delayed in any period, we may not be able to reduce proportionately our operating expenses or manufacturing costs for that period, and any reduction of manufacturing capacity could have long-term implications on our ability to accommodate future demand.

Our profitability from period-to-period may also vary significantly due to the mix of products that we sell in different periods. While we have sold most of our products to date into the commercial market, we are also focusing our sales efforts on applications in the transportation and electric grid markets. Products in these other markets have different cost profiles and are governed by different business dynamics. Consequently, sales of individual products may not necessarily be consistent across periods, which could affect product mix and cause gross and operating profits to vary significantly.

In addition, since our batteries and battery systems are incorporated into our customers products for sale into their respective end markets, our business is exposed to the seasonal demand that may characterize some of our customers own product sales. Because

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many of our expenses are based on anticipated levels of annual revenue, our business and operating results could also suffer if we do not achieve revenue consistent with our expectations for this seasonal demand.

As a result of these factors, we believe that quarter-to-quarter comparisons of our operating results are not necessarily meaningful and that these comparisons cannot be relied upon as indicators of future performance. Moreover, our operating results may not meet expectations of equity research analysts or investors. If this occurs, the trading price of our common stock could fall substantially either suddenly or over time.

If our products fail to perform as expected, or have technical issues, we could lose existing and future business, and our ability to develop, market and sell our batteries and battery systems could be harmed.

Our products are complex and could have unknown defects or errors, which may give rise to claims against us, diminish our brand or divert our resources from other purposes. Despite testing, new and existing products have contained defects and errors and may in the future contain manufacturing or design defects, errors or performance problems when first introduced, when new versions or enhancements are released, or even after these products have been used by our customers for a period of time. These problems could result in expensive and time-consuming design modifications or warranty charges, delays in the introduction of new products or enhancements, significant increases in our service and maintenance costs, exposure to liability for damages, damaged customer relationships and harm to our reputation, any of which may adversely affect our business and our operating results. For example, in 2010, we identified several significant technical issues in the manufacturing scale-up of our prismatic batteries. Although we identified and have taken corrective actions for these issues, the problems encountered resulted in a higher yield loss in ramp-up production, temporary halts in the production process and the distraction of personnel, some or all of which could re-occur.

Our success in the transportation market depends, in part, on our ability to design, develop and commercially manufacture lithium-ion batteries in prismatic form for use in HEVs, PHEVs and EVs currently being developed and that may be developed in the future. The design and development of a lithium-ion battery in prismatic form for use in the transportation industry is complex, expensive, time-consuming and subject to rigorous quality and performance requirements. If we are unable to design, develop and commercially manufacture lithium-ion batteries in prismatic form in a timely fashion and that are accepted for use in the transportation industry, our business and operating results may be adversely affected.

We entered into a strategic investment agreement with an early stage entity with which we have a commercial relationship.

In January 2010, we entered into an agreement with Fisker, a privately-held company, to invest $13.0 million in cash and 479,282 shares of our common stock, which when transferred to Fisker had a value of approximately $7.5 million. In exchange, we received shares of convertible preferred stock in Fisker which are not liquid, and we do not expect that they will be liquid for some time. Our investment in Fisker exposes us to equity price risk; if Fisker does not execute on its strategic plan, our investment may not be recovered. This investment is subject to risk of changes in fair value, which could result in a material realized impairment loss.

We have identified a material weakness in our internal control over financial reporting which are unremediated and if we fail to remediate these weakness and maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired, which could harm our operating results, our ability to operate our business and investors views of us.

Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be evaluated frequently. We have identified a material weakness in our internal control over financial reporting. A material weakness is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis by the company s internal controls.

Management identified a material weakness in our internal controls and information technology controls over the financial statement close and reporting process for the year ended December 31, 2010. Also, our former Chief Financial Officer left the company in January 2011 and, as a result, on an interim basis, our Vice President of Finance and Corporate Controller is also fulfilling the role as the interim Chief Financial Officer. Consequently, we had a lack of continuity of senior financial management during the preparation of our annual report for the year ended December 31, 2010. For a detailed discussion of the material weakness, see *Controls and Procedures* section within Part II, Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 11, 2011.

We are in the process of taking the necessary steps to remediate the material weakness that we identified and have made enhancements to our control procedures; however, the material weakness will not be remediated until the necessary controls have been implemented and are determined to be operating effectively. We do not know the specific time frame needed to fully remediate the material weakness identified.

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We cannot assure you that our efforts to fully remediate these internal control weakness will be successful or that similar material weaknesses will not recur.

Implementing any appropriate changes to our internal controls may distract our officers and employees, entail substantial costs to implement new processes and modify our existing processes and take significant time to complete. Moreover, these changes do not guarantee that we will be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and harm our business. In addition, investors perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements on a timely basis may harm our stock price and make it more difficult for us to effectively market and sell our products to new and existing customers.

If our warranty expense estimates differ materially from our actual claims, or if we are unable to estimate future warranty expense for new products, our business and financial results could be harmed.

Our warranty for our products ranges from one to eight years from the date of sale, depending on the type of product and its application. We expect that in the future some of our warranties could extend beyond eight years. In the commercial market, we typically provide a warranty against certain potential manufacturing defects, which may cause high rates of self-discharge, inaccurate voltage, and other product irregularities. In the electric grid services and transportation markets, we may also provide a warranty against a certain percentage decline in the initial power and energy density specifications of a particular product and for a warranty for system availability. Since we began selling our first products in the commercial market in the first quarter of 2006, in the transportation market in the first quarter of 2007 and in the electric grid services market in the third quarter of 2009, we have a limited product history on which to base our warranty estimates. Because of the limited operating history of our batteries and battery systems, our management is required to make assumptions and to apply judgment regarding a number of factors, including anticipated rate of warranty claims, the durability and reliability of our products, and service delivery costs. Our assumptions could prove to be materially different from the actual performance of our batteries and battery systems, which could cause us to incur substantial expense to repair or replace defective products in the future and may exceed expected levels against which we have reserved. If our estimates prove incorrect, we could be required to accrue additional expenses from the time we realize our estimates are incorrect and also face a significant unplanned cash burden at the time our customers make a warranty claim, which could harm our operating results.

In addition, with our new products and products that remain under development, we will be required to base our warranty estimates on historical experience of similar products testing of our batteries and performance information learned during our development activities with the customer. If we are unable to estimate future warranty costs for any new product, we will be required to defer recognizing revenue for that product until we are reasonably able to estimate the associated warranty expense. As a result, our financial results could vary significantly from period-to-period.

Product liability or other claims could cause us to incur losses or damage our reputation.

The risk of product liability claims and associated adverse publicity is inherent in the development, manufacturing, marketing and sale of batteries and battery systems. Certain materials we use in our batteries, as well as our batteries and battery systems, could, if used improperly, cause injuries to others. Improperly charging or discharging our batteries could cause fires. Any accident involving our batteries or other products could decrease or even eliminate demand for our products. Because some of our batteries are designed to be used in vehicles, and because vehicle accidents can cause injury to persons and damage to property, we are subject to a risk of claims for such injuries and damages. In addition, we could be harmed by adverse publicity resulting from problems or accidents caused by third party products that incorporate our batteries. For example, our business and operating results could be harmed by adverse publicity resulting from injury to persons or damage to property caused by a defective electronic system on a battery system manufactured by a third party that incorporates our batteries.

Although we have product liability insurance for our products, this may be inadequate to cover all potential product liability claims. In addition, while we often seek to limit our product liability in our contracts, such limits may not be enforceable or may be subject to exceptions. Any product recall or lawsuit seeking significant monetary damages either in excess of our coverage, or outside of our coverage, may have a material adverse affect on our business and financial condition. We may not be able to secure additional product liability insurance coverage on acceptable terms or at reasonable costs when needed. If we were to experience a large insured loss or business interruption, it might exceed our coverage limits or may not be covered, or our insurance carriers could decline to further cover us or raise our insurance rates to unacceptable levels, any of which could impair our financial position and results of operations. A successful product liability claim against us could require us to pay a substantial monetary award. We cannot assure that such claims will not be made in the future.

We are subject to financial and reputational risks due to product recalls resulting from product quality and liability issues.

The risk of product recalls, and associated adverse publicity, is inherent in the development, manufacturing, marketing, and sale of batteries and battery systems. Our products and the products of third parties in which our products are a component are becoming increasingly sophisticated and complicated as rapid advancements in technologies occur, and as demand increases for lighter and more

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powerful rechargeable batteries. At the same time, product quality and liability issues present significant risks. Product quality and liability issues may affect not only our own products but also the third-party products in which our batteries and battery systems are a component. Our efforts and the efforts of our development partners to maintain product quality may not be successful, and if they are not, we may incur expenses in connection with, for example, product recalls and lawsuits, and our brand image and reputation as a producer of high-quality products may suffer. Any product recall or lawsuit seeking significant monetary damages could have a material adverse effect on our business and financial condition. A product recall could generate substantial negative publicity about our products and business, interfere with our manufacturing plans and product delivery obligations as we seek to replace or repair affected products, and inhibit or prevent commercialization of other future product candidates. Although we do have product liability insurance, we do not have insurance to cover the costs associated with a product recall and the expenses we would incur in connection with a product recall could have a material adverse affect on our operating results.

We depend on third parties to deliver raw materials, parts, components and services in adequate quality and quantity in a timely manner and at a reasonable price.

Our manufacturing operations depend on obtaining raw materials, parts and components, manufacturing equipment and other supplies including services from reliable suppliers in adequate quality and quantity in a timely manner. It may be difficult for us to substitute one supplier for another, increase the number of suppliers or change one component for another in a timely manner or at all due to the interruption of supply or increased industry demand. This may adversely affect our operations. The prices of raw materials, parts and components and manufacturing equipment may increase due to changes in supply and demand. In addition, currency fluctuations and a weakening of the U.S. dollar against foreign currencies may adversely affect our purchasing power for raw materials, parts and components and manufacturing equipment from foreign suppliers.

We depend on sole source suppliers or a limited number of suppliers for certain key raw materials and component parts used in manufacturing and developing our products. We generally purchase raw materials pursuant to purchase orders placed from time to time and if we deem necessary, we will enter into long-term contracts or other guaranteed supply arrangements with our sole or limited source suppliers. Therefore, our operating margins may be impacted by price fluctuations in the commodities we use as raw materials in our batteries. As a result, our suppliers may not be able to meet our requirements relative to specifications and volumes for key raw materials, and we may not be able to locate alternative sources of supply at an acceptable cost. In the past, we have experienced delays in product development due to the delivery of raw materials from our suppliers that do not meet our specifications. In addition, if a sole source supplier ceased to continue to produce a component with little or no notice to us, our business could be harmed. Any future inability to obtain high quality raw materials or manufacturing equipment in sufficient quantities on competitive pricing terms and on a timely basis, due to global supply and demand or a dispute with a supplier, may delay battery production, impede our ability to fulfill existing or future purchase orders and harm our reputation and profitability.

Our inability to obtain federal and state government environmental permits and approvals for our planned U.S. manufacturing facilities could negatively impact our ability to obtain federal and state incentive funding and materially harm our business.

Pursuant to applicable environmental and safety laws and regulations, we are required to obtain and maintain certain governmental permits and approvals and to comply with applicable federal and state environmental laws and regulations. There is no guarantee that required determinations, permits and approvals will ultimately be obtained; the failure to obtain and/or maintain required federal and state environmental permits could have an adverse effect on our financial results and could also delay or prevent us from obtaining matching fund reimbursement from the $249.1 million grant we were awarded under the DOE Battery Initiative, as well as funding under the DOE ATVM loan program.

If obtained, permits and approvals may be subject to revocation, modification or denial under certain circumstances. Our operations or activities could result in administrative or private actions, revocation of required permits or licenses, or fines, penalties or damages, which could have an adverse effect on us. In addition, environmental laws will likely become more stringent over time, thereby requiring new capital expenditures and increases in operating costs.

Our working capital requirements involve estimates based on demand expectations and may decrease or increase beyond those currently anticipated, which could harm our operating results and financial condition.

In order to fulfill the product delivery requirements of our customers, we plan for working capital needs in advance of customer orders. As a result, we base our funding and inventory decisions on estimates of future demand. If demand for our products does not increase as quickly as we have estimated or drops off sharply, our inventory and expenses could rise, and our business and operating results could suffer. Alternatively, if we experience sales in excess of our estimates, our working capital needs may be higher than those currently anticipated. Our ability to meet this excess customer demand depends on our ability to arrange for additional financing for any ongoing working capital shortages, since it is likely that cash flow from sales will lag behind these investment requirements.

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Credit market volatility and illiquidity may affect our ability to raise capital to finance our operations, plant expansion and growth.

The credit markets have experienced extreme volatility in recent years, and worldwide credit markets have remained unstable despite injections of capital by the federal government and foreign governments. Despite the capital injections and government actions, banks and other lenders, such as equipment leasing companies, have significantly increased credit requirements and reduced the amounts available to borrowers. Companies with low credit ratings may not have access to the debt markets until the liquidity improves, if at all. If current credit market conditions do not improve, we may not be able to access debt or leasing markets to finance our plant expansion plans.

We may be unable to successfully implement or manage our planned manufacturing expansion of capability or realize the expected benefits of an expansion.

We expect to aggressively expand our battery manufacturing capacity to meet expected demand for our product. Much of our planned domestic expansion, such as our current expansion in Livonia and Romulus, Michigan, depends upon our receipt of sufficient federal and state incentive funding and our ability to successfully ramp our manufacturing operations, particularly in the production of prismatic batteries. We may not receive the federal and state funding necessary for our planned expansion at all or on a timely basis. In addition, such funding could be subject to conditions that are commercially unacceptable to us or for which we are unable to comply. Even if we succeed in aggressively expanding our manufacturing capacity, we may not have enough demand for our products to justify the increased capacity.

Any such expansion will place a significant strain on our senior management team and our financial and other resources. Any expansion will expose us to greater overhead and support costs and other risks associated with the manufacture and commercialization of new products. Our ability to manage our growth effectively will require us to continue to improve our operations and our financial and management information systems and to train, motivate and manage our employees. Difficulties in effectively managing the budgeting, forecasting and other process control issues presented by such a rapid expansion could harm our business, prospects, results of operations and financial condition.

We may not be able to successfully recruit and retain skilled employees, particularly scientific, technical and management professionals.

We believe that our future success will depend in large part on our ability to attract and retain highly skilled technical, managerial and marketing personnel who are familiar with our key customers and experienced in the battery industry. Additionally, we plan to continue to expand our work force both domestically and internationally. Industry demand for such employees, especially employees with experience in battery chemistry and battery manufacturing processes, however, exceeds the number of personnel available, and the competition for attracting and retaining these employees is intense. This competition will intensify if the advanced battery market continues to grow, possibly requiring increases in compensation for current employees over time. We compete in the market for personnel against numerous companies, including larger, more established competitors who have significantly greater financial resources than we do and may be in a better financial position to offer higher compensation packages to attract and retain human capital. We cannot be certain that we will be successful in attracting and retaining the skilled personnel necessary to operate our business effectively in the future. Because of the highly technical nature of our batteries and battery systems, the loss of any significant number of our existing engineering and project management personnel could have a material adverse effect on our business and operating results.

Our future success depends on our ability to retain key personnel.

Our success will depend to a significant extent on the continued services of our senior management team, and in particular David Vieau, our chief executive officer, and Gilbert N. Riley, Jr., our chief technical officer. The loss or unavailability of either of these individuals could harm our ability to execute our business plan, maintain important business relationships and complete certain product development initiatives, which could harm our business. We do not have agreements requiring any of our senior management team to remain with our company. In addition, each of these individuals could terminate his or her relationship with us at any time, and we may be unable to enforce any applicable employment or non-compete agreements.

If we do not continue to form and maintain economic arrangements with original equipment manufacturers, or OEMs, to commercialize our products, our profitability could be impaired.

Our business strategy requires us to integrate the design of our products into products being developed by OEMs, and therefore to identify acceptable OEMs and enter into agreements with them. In addition, we will need to meet their requirements and specifications by developing and introducing new products and enhanced or modified versions of our existing products on a timely basis. OEMs often require unique configurations or custom designs for batteries or battery systems which must be developed and integrated into a product well before the product is launched. This development process requires not only substantial lead time between the commencement of design efforts for a customized battery system and the commencement of volume shipments of the battery systems

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to the customer, but also the cooperation and assistance of the OEMs in order to determine the requirements for each specific application. Technical problems may arise that affect the acceptance of our product by OEMs. If we are unable to design and develop products that meet OEMs requirements, we may lose opportunities to obtain purchase orders, and our reputation may be damaged. In addition, we may not receive adequate assistance from OEMs to successfully commercialize our products, which could impair our profitability.

Declines in product prices may adversely affect our financial results.

Our business is subject to intense price competition worldwide, which makes it difficult for us to maintain product prices and achieve adequate profits. Such intense price competition may adversely affect our ability to achieve profitability, especially during periods of decreases in demand. In addition, because of their purchasing size, our larger automotive customers can influence market participants to compete on price terms. If we are not able to offset pricing reductions resulting from these pressures by improved operating efficiencies and reduced expenditures, those pricing reductions may have an adverse impact on our business.

Implementations of new software platforms or modifications to existing platforms may disrupt our business and operations and could harm our operating results.

The implementation of new software management platforms and the addition of these platforms at new locations, especially overseas, require significant management time, support and cost. As our business continues to develop, we expect to add and enhance existing management platforms in the areas of financial, inventory control, engineering, and customer support and warranty management. We cannot be sure that these platforms will be fully or effectively implemented on a timely basis, if at all. If we do not successfully implement or modify these platforms, our operations may be disrupted and our operating expenses could be harmed. In addition, the new systems may not operate as we expect them to, and we may be required to expend significant resources to correct problems or find alternative sources for performing these functions.

Our inability to effectively and quickly transfer, replicate and scale our new product manufacturing processes from low volume prototype production to high volume manufacturing facilities, could adversely affect our results of operations.

Under our manufacturing model, we develop and establish manufacturing processes and systems for the low volume prototype production of our new products. As demand increases for a product, we transfer these processes and systems to, and replicate and scale these processes and systems in our high volume manufacturing facilities. If we are unable to effectively and quickly transfer, replicate and scale these manufacturing processes and systems, such as replicating our prismatic pilot facility in Korea to our new facilities in Livonia and Romulus, Michigan, we may be unable to meet our customers product quality and quantity requirements and lower our costs of goods sold and our results of operations could be adversely affected.

In addition, our costs of goods sold for some of our new products exceed the purchase price for that product paid to us by our customers. If we are unable to decrease unit production costs for these products by increasing volumes, improving the manufacturing process, reducing transportation and handling costs or obtaining lower cost raw materials or component parts, we will not realize a profit from these products and our business will be harmed.

Problems in our manufacturing and assembly processes could limit our ability to produce sufficient batteries to meet the demands of our customers.

Regardless of the process technology used, the manufacturing and assembly of safe, high-power batteries and battery systems is a highly complex process that requires extreme precision and quality control throughout a number of production stages. Any defects in battery packaging, impurities in the electrode materials used, contamination of the manufacturing environment, incorrect welding, excess moisture, equipment failure or other difficulties in the manufacturing process could cause batteries to be rejected, thereby reducing yields and affecting our ability to meet customer expectations.

As we have scaled up our production capacity, we have experienced production problems that limited our ability to produce a sufficient number of batteries to meet the demands of certain customers. For example, in 2010, we identified several significant technical issues in the manufacturing scale-up of our prismatic batteries. Although we identified and have taken corrective actions for these issues, the problems encountered resulted in a higher yield loss in ramp-up production, temporary halts in the production process and distraction of personnel. If these or other production problems recur and we are unable to resolve them in a timely fashion, our business could suffer and our reputation may be harmed.

Our failure to cost-effectively manufacture our batteries and battery systems in quantities which satisfy our customers demand and product specifications and their expectations for product quality and reliable delivery could damage our customer relationships and result in significant lost business opportunities for us.

We manufacture a substantial percentage of our products rather than relying upon third-party outsourcing. To be successful, we must cost-effectively manufacture commercial quantities of our complex batteries and battery systems that meet our customer

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specifications for quality and timely delivery. To facilitate the commercialization of our products, we will need to further reduce our manufacturing costs, which we intend to do by working with manufacturing partners and by improving our manufacturing and development operations in our wholly-owned operations in China. We manufacture our batteries and assemble our products in China, Korea, Massachusetts and Michigan. We depend on the performance of our manufacturing partners, as well as our own manufacturing operations, to manufacture and deliver our products to our customers. If we or any of our manufacturing partners are unable to manufacture products in commercial quantities on a timely and cost-effective basis, we could lose our customers and be unable to attract future customers.

In addition, we are shifting most of our battery assembly and all of our battery system manufacturing from contract manufacturing to in-house manufacturing, so our in-house experience with battery assembly and battery system manufacturing is limited.

We may be unable to complete or integrate acquisitions effectively, which may adversely affect our growth, profitability and results of operations.

We may pursue acquisitions as part of our business strategy. However, we cannot be certain that we will be able to identify attractive acquisition targets, obtain financing for acquisitions on satisfactory terms or successfully acquire identified targets. Additionally, we may not be successful in integrating acquired businesses into our existing operations and achieving projected synergies. Competition for acquisition opportunities in the various industries in which we operate may rise, thereby increasing our costs of making acquisitions or causing us to refrain from making further acquisitions. These and other acquisition-related factors could negatively and adversely impact our growth, profitability and results of operations.

We entered into a joint venture in China that, if not successful, could adversely impact our business, business prospects and operating results.

In December 2009, we formed a joint venture with SAIC Motor Co. Ltd., or SAIC, a leading automaker in China. We have a 49 percent minority interest in the joint venture, Shanghai Advanced Traction Battery Systems Co., Ltd., or ATBS, which is domiciled in Shanghai, China. Pursuant to the joint venture agreements, we will supply ATBS with battery cells and, as requested by ATBS, we have granted necessary advanced technology licenses to ATBS for the development, manufacture and service of battery systems. As of December 31, 2010, we have made the first capital contributions to ATBS in the amount of $1.9 million and expect to fund the remaining $2.8 million of required capital contribution over approximately the next twelve months.

The business of ATBS is subject to all the operational risks that normally arise for a technology company with global operations pertaining to research and development, manufacturing, sales, service, marketing and corporate functions. In addition, there could be disagreements between us and SAIC with respect to important strategic and operational decisions. Operating a business as a joint venture often requires additional organizational formalities as well as time-consuming procedures for sharing information and making decisions. We may be required to pay more attention to our relationship with SAIC, as the co-owner of ATBS, and if SAIC ceases to be the co-owner of ATBS, our relationship with ATBS may be adversely affected. Additionally, as we are sharing intellectual property with ATBS, we face the risks that we may not be able to maintain or enforce the rights to our intellectual property.

If the joint venture terminates, the joint venture could retain technical knowhow relating to battery systems transferred by us as part of the agreement. Additionally, we would have to find new partners or separately pursue market opportunities in China which could cause us to incur additional time and expense.

Laws regulating the manufacture or transportation of batteries may be enacted which could result in a delay in the production of our batteries or the imposition of additional costs that could harm our ability to be profitable.

Laws and regulations exist today, and additional laws and regulations may be enacted in the future, which impose environmental, health and safety controls on the storage, use and disposal of certain chemicals and metals used in the manufacture of lithium-ion batteries. Complying with any laws or regulations could require significant time and resources from our technical staff and possible redesign of one or more of our products, which may result in substantial expenditures and delays in the production of one or more of our products, all of which could harm our business and reduce our future profitability. The transportation of lithium and lithium-ion batteries and applicable customs duties are regulated both domestically and internationally. Compliance with these regulations, when applicable, increases the cost of producing and delivering our products.

We depend on contracts with the U.S. government and its agencies or on subcontracts with the U.S. government s prime contractors for revenue and research grants to fund or partially fund our research and development programs, and our failure to retain current or obtain additional contracts could preclude us from achieving our anticipated levels of revenue growth and profitability, increase our research, development and engineering expenses and delay or halt certain research and development programs.

Our ability to develop and market some of our products depends upon maintaining our U.S. government contract revenue and research grants obtained, which are recorded as incremental revenue and an offset to our research, development and engineering

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expenses, respectively. Many of our U.S. government contracts are funded incrementally, with funding decisions made on an annual basis. Approximately 12.3% of our total revenue and 7.5% of our research, development and engineering expenses during the year ended December 31, 2010 were derived from or funded by government contracts and subcontracts. Changes in government policies, priorities or programs that result in budget reductions could cause the government to cancel existing contracts or eliminate follow-on phases in the future which would severely inhibit our ability to successfully complete the development and commercialization of some of our products. In addition, there can be no assurance that, once a government contract is completed, it will lead to follow-on contracts for additional research and development, prototype build and test or production. Furthermore, there can be no assurance that our U.S. government contracts or subcontracts will not be terminated or suspended in the future. A reduction or cancellation of these contracts, or of our participation in these programs, would increase our research, development and engineering expenses, which could materially and adversely affect our results of operations and could delay or impair our ability to develop new technologies and products.

If we are unable to develop manufacturing facilities for our products in the United States, we may lose business opportunities and our customer relationships may suffer.

We believe that developing manufacturing facilities for our products in the United States is important, in order to address national security and economic imperatives, such as job creation, as well as to more efficiently address the needs of our U.S.-based customers. This expansion depends upon our receiving federal and state financial incentives, primarily in the form of direct grants and loans, to provide the necessary capital for facilities and equipment. If we are unable to obtain this government assistance on a timely basis and in the amounts requested, we will not be able to scale our capacity to meet current and future customer demand for our products.

Because of the funding we receive from U.S. government entities and our government business initiatives, we are subject to U.S. federal government audits and other regulation, and our failure to satisfy audit requirements or comply with applicable regulations could subject us to material adjustments or penalties that could negatively impact our business.

The accuracy and appropriateness of our direct and indirect costs and expenses under our contracts with the U.S. government are subject to extensive regulation and audit by appropriate agencies of the U.S. government. These agencies have the right to challenge our cost estimates or allocations with respect to any such contract. Additionally, substantial portions of the payments to us under U.S. government contracts are provisional payments that are subject to potential adjustment upon audit by such agencies. Adjustments that result from inquiries or audits of our contracts could have a material adverse impact on our financial condition or results of operations. Since our inception, we have not experienced any material adjustments as a result of any inquiries or audits, but there can be no assurance that our contracts will not be subject to material adjustments in the future.

As we grow our government business, we may also need to comply with U.S. laws regulating the export of our products, particularly in our government business. We cannot be certain of our ability to obtain any licenses required to export our products or to receive authorization from the U.S. federal government for international sales or domestic sales to foreign persons. Moreover, the export regimes and the governing policies applicable to our business are subject to change. Our failure to comply with these and other applicable regulations, rules and approvals could result in the imposition of penalties, the loss of our government contracts or our suspension or debarment from contracting with the federal government generally, any of which would harm our business, financial condition and results of operations.

Our ability to sell our products to our direct, OEM and tier 1 supplier customers depends in part on the quality of our engineering and customization capabilities, and our failure to offer high quality engineering support and services could have a material adverse effect on our sales and operating results.

A high level of support is critical for the successful marketing and sale of our products. The sale of our batteries and battery systems is characterized by significant co-development and customization work in certain applications. This development process requires not only substantial lead time between the commencement of design efforts for a customized battery system and the commencement of volume shipments of the battery systems to the customer, but also the cooperation and assistance of the OEMs to determine the requirements for each specific application. Once our products are designed into an OEM or tier 1 supplier customer s products or systems, the OEM or tier 1 supplier customer depends on us to resolve issues relating to our products. If we do not effectively assist our OEM or tier 1 supplier customers in customizing, integrating and deploying our products in their own systems or products, or if we do not succeed in helping them quickly resolve post-deployment issues and provide effective ongoing technical support, our ability to sell our products would be adversely affected.

In addition, while we have supply and co-development agreements with customers located in different regions of the world, we do not have a globally distributed engineering support and services organization. Currently, any issue resolution related to our products, system deployment or integration is channeled back to our responsible business units in Massachusetts and in Michigan, from which engineers and support personnel are deployed. As we grow our business with our existing customers and beyond the markets into which we currently sell our battery technologies, we may need to increase the size of our engineering support teams and deploy them closer to our customers. Our inability to deliver a consistent level of engineering support and overall service as we expand our operations could have a material adverse effect on our business and operating results. Moreover, despite our internal quality testing,

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our products may contain manufacturing or design defects or exhibit performance problems at any stage of their lifecycle. These problems could result in expensive and time-consuming design modifications and impose additional needs for engineering support and maintenance services as well as significant warranty charges.

Our past and future operations may lead to substantial environmental liability.

The handling and use of some of the materials used in the development and manufacture of our products are subject to federal, state and local environmental laws, as well as environmental laws in other jurisdictions in which we operate. Under applicable environmental laws, we may be jointly and severally liable with prior property owners for the treatment, cleanup, remediation and/or removal of any hazardous substances discovered at any property we use. In addition, courts or government agencies may impose liability for, among other things, the improper release, discharge, storage, use, disposal or transportation of hazardous substances. If we incur any significant environmental liabilities, our ability to execute our business plan and our financial condition would be harmed. Our facilities or operations could be damaged or adversely affected as a result of disasters or unpredictable events, including widespread public health problems.

Our headquarters, including administrative offices and research and development centers, are located in Massachusetts. We also operate manufacturing, logistics, sales and research and development facilities in Michigan, Missouri, China, Korea, Germany and Japan. If major disasters such as earthquakes, fires, floods, hurricanes, wars, terrorist attacks, computer viruses, pandemics or other events occur, or our information system or communications network breaks down or operates improperly, our facilities may be seriously damaged, or we may have to stop or delay production and shipment of our products. We may incur expenses relating to such damages. In addition, a renewed outbreak of a widespread public health problem in China or the United States could have a negative effect on our operations.

Risks Related to Intellectual Property

Third parties have asserted that they own or control patents that are infringed by our products.

We are presently involved in patent litigation with Hydro-Québec and the University of Texas, or UT, involving certain patents Hydro- Québec has licensed from UT, related to electrode materials used in lithium-ion batteries. After discussions with Hydro-Québec about the relevance of two of these patents to our products, we brought an action in the Federal District Court of Massachusetts seeking a declaratory judgment that our products do not infringe these two UT patents. In response, Hydro-Québec and the UT countersued us in the United States District Court for the Northern District of Texas. The Texas judge requested a status hearing with the parties on May 14, 2010 and entered a schedule for the case leading to a claim construction hearing which was held on December 2, 2010. On March 29, 2011, the Texas court issued a Memorandum Opinion and Order on Claim Construction. For a more detailed discussion of our patent litigation, see Item 1 of Part II: Legal Proceedings.

We believe that we have valid non-infringement defenses against both of these patents and that at least one of the patents is invalid. If we were to challenge the validity of any issued United States patent in court, we would need to overcome a presumption of validity that attaches to every patent. This burden is high and would require us to present clear and convincing evidence as to the invalidity of the patent s claims. There is no assurance that a court would find in our favor on infringement or validity and, if this case is not resolved in our favor, we may be required to pay substantial damages. In addition, an adverse ruling could cause us, and our customers, development partners and licensees, to stop, modify or delay activities in the United States such as research, development, manufacturing and sales of products based on technologies covered by these

patents. We would need to develop products and technologies that design around these patents or obtain a license to the appropriate patent. There is no certainty that such design-arounds exist or if they exist that they would be commercially competitive, and there is no certainty that a license from the appropriate parties could be obtained. Also, the mere existence, and the uncertainty with respect to the ultimate outcome, of this patent litigation or any other patent litigation that we may become involved with, could cause our current and potential customers, development partners, the federal or state governments and licensees to stop, delay or avoid doing business with us or modify the extent to which they are willing to do business with us, and this loss or delay of business could harm our operating results and our ability to execute on our business plan. Additionally, we have agreed to defend and indemnify the other named business partner for its legal costs in defending this litigation and any damages that may be awarded.

Other parties may also bring intellectual property infringement claims against us which would be time-consuming and expensive to defend, and if any of our products or processes is found to be infringing, we may not be able to procure licenses to use patents necessary to our business at reasonable terms, if at all.

Our success depends in part on avoiding the infringement of other parties patents and proprietary rights. We may inadvertently infringe existing third-party patents or third-party patents issued on existing patent applications. In the United States and most other countries, patent applications are published 18 months after filing. As a result, there may be third-party pending patent applications of which we are unaware, and which we may infringe once they issue. These third parties could bring claims against us that, even if resolved in our favor, could cause us to incur substantial expenses and, if resolved against us, could cause us to pay substantial damages. Under some circumstances in the United States, these damages could be triple the actual damages the patent holder incurs. If

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we have supplied infringing products to third parties for marketing or licensed third parties to manufacture, use or market infringing products, we may be obligated to indemnify these third parties for any damages they may be required to pay to the patent holder and for any losses the third parties may sustain themselves as the result of lost sales or damages paid to the patent holder. In addition, we may have, and may be required to, make representations as to our right to supply and/or license intellectual property and to our compliance with laws. Such representations are usually supported by indemnification provisions requiring us to defend our customers and otherwise make them whole if we license or supply products that infringe on third party technologies or violate government regulations. Further, if a patent infringement suit were brought against us, we and our customers, development partners and licensees could be forced to stop or delay research, development, manufacturing or sales of products based on our technologies in the country or countries covered by the patent we infringe, unless we can obtain a license from the patent holder. Such a license may not be available on acceptable terms, or at all, particularly if the third party is developing or marketing a product competitive with products based on our technologies. Even if we were able to obtain a license, the rights may be nonexclusive, which would give our competitors access to the same intellectual property.

Any successful infringement action brought against us may also adversely affect marketing of products based on our technologies in other markets not covered by the infringement action. Furthermore, we may suffer adverse consequences from a successful infringement action against us even if the action is subsequently reversed on appeal, nullified through another action or resolved by settlement with the patent holder. As a result, any infringement action against us would likely harm our competitive position, be costly and require significant time and attention of our key management and technical personnel.

We may be involved in lawsuits to protect or enforce our patents, which could be expensive and time consuming.

Competitors or others may infringe our patents. To counter infringement or unauthorized use, we may be required to file patent infringement claims, which can be expensive and time-consuming. In addition, in an infringement proceeding, a court may decide that a patent of ours is not valid or is unenforceable, or may refuse to stop the other party from using the technology at issue on the grounds that our patents do not cover that technology. An adverse determination of any litigation or defense proceedings could put one or more of our patents at risk of being invalidated or interpreted narrowly and could put our patent applications at risk of not issuing.

Interference proceedings brought by the United States Patent and Trademark Office may be necessary to determine the priority of inventions with respect to our patent applications. Litigation or interference proceedings may fail and, even if successful, may result in substantial costs and be a distraction to our management. We may not be able to prevent misappropriation of our proprietary rights, particularly in countries where the laws may not protect such rights as fully as in the United States.

Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure. In addition, during the course of this litigation, there could be public announcements of the results of hearings, motions or other interim proceedings or developments. If securities analysts or investors perceive these results to be negative, it could have a substantial adverse effect on the price of our common stock.

We may not prevail in any litigation or interference proceeding in which we are involved. Even if we do prevail, these proceedings can be expensive and distract our management.

Our patent applications may not result in issued patents, which may have a material adverse effect on our ability to prevent others from commercially exploiting products similar to ours.

Patent applications in the United States are maintained in secrecy until the patents are published or are issued. Since publication of discoveries in the scientific or patent literature tends to lag behind actual discoveries by several months, we cannot be certain that we are the first creator of inventions covered by pending patent applications or the first to file patent applications on these inventions. We also cannot be certain that our pending patent applications will result in issued patents or that any of our issued patents will afford protection against a competitor. In addition, patent applications filed in foreign countries are subject to laws, rules and procedures that differ from those of the United States, and thus we cannot be certain that foreign patent applications related to issued U.S. patents will be issued. Furthermore, if these patent applications issue, some foreign countries provide significantly less effective patent enforcement than in the United States.

The status of patents involves complex legal and factual questions and the breadth of claims allowed is uncertain. Accordingly, we cannot be certain that the patent applications that we file will result in patents being issued, or that our patents and any patents that may be issued to us in the near future will afford protection against competitors with similar technology. In addition, patents issued to us may be infringed upon or designed around by others and others may obtain patents that we need to license or design around, either of which would increase costs and may adversely affect our operations.

Our patents and other protective measures may not adequately protect our proprietary intellectual property.

We regard our intellectual property, particularly our proprietary rights in our battery and battery system technology, as critical to our success. We have received a number of patents, and filed other patent applications, for various applications and aspects of our

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technology or processes and other intellectual property. In addition, we generally enter into confidentiality and invention agreements with our employees and consultants. Such patents and agreements and various other measures we take to protect our intellectual property from use by others may not be effective for various reasons, including the following:

- our pending patent applications may not be granted for various reasons, including the existence of conflicting patents or defects in our applications;

- the patents we have been granted may be challenged, invalidated or circumvented because of the pre-existence of similar patented or unpatented intellectual property rights or for other reasons;

- parties to the confidentiality and invention agreements may have such agreements declared unenforceable or, even if the agreements are enforceable, may breach such agreements;

- the costs associated with enforcing patents, confidentiality and invention agreements or other intellectual property rights may make aggressive enforcement prohibitive;

- even if we enforce our rights aggressively, injunctions, fines and other penalties may be insufficient to deter violations of our intellectual property rights; and

- other persons may independently develop proprietary information and techniques that are functionally equivalent or superior to our intellectual proprietary information and techniques but do not breach our patented or unpatented proprietary rights.

We may be unable to adequately prevent disclosure or misappropriation of trade secrets and other proprietary information.

We rely on trade secrets to protect our proprietary technologies, especially where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to protect. We rely in part on confidentiality and non-compete agreements with our employees, former employees, contractors, consultants, outside scientific collaborators and other advisors to protect our trade secrets and other proprietary information. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. Such unauthorized disclosure may also be difficult to prevent or enforce against current or former employees in locations outside of the United States (e.g., in China) where the legal systems and law enforcement are less developed and business practices differ. In addition, others may independently discover our trade secrets or independently develop processes or products that are similar or identical to our trade secrets, and courts outside the United States may be less willing to protect trade secrets. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and failure to obtain or maintain trade secret protection could adversely affect our competitive business position.

Risks Associated With Doing Business Internationally and Specifically in China and Korea

Our substantial international operations subject us to a number of risks, including unfavorable political, regulatory, labor and tax conditions.

We have significant manufacturing facilities and operations in China and Korea that are subject to the legal, political, regulatory and social requirements and economic conditions in these jurisdictions. In addition, we expect to sell a significant portion of our products to customers located outside the United States. Risks inherent to international operations and sales, include, but are not limited to, the following:

- difficulty in enforcing agreements, judgments and arbitration awards in foreign legal systems;

- state ownership and/or support of competitive business entities;

- fluctuations in exchange rates may affect product demand and may adversely affect our profitability in U.S. dollars to the extent the cost of raw materials and labor is denominated in a foreign currency;

- impediments to the flow of foreign exchange capital payments and receipts due to exchange controls instituted by certain foreign governments and the fact that the local currencies of these countries are not freely convertible;

- inability to obtain, maintain or enforce intellectual property rights;

- changes in general economic and political conditions;

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- changes in foreign government regulations and technical standards, including additional regulation of rechargeable batteries, power technology, or the transport of lithium or phosphate, which may reduce or eliminate our ability to sell or license in certain markets;

- requirements or preferences of foreign nations for domestic products could reduce demand for our products;

- trade barriers such as export requirements, tariffs, taxes and other restrictions and expenses, which could increase the prices of our products and make us less competitive; and

- longer payment cycles typically associated with international sales and potential difficulties in collecting accounts receivable, which may reduce the future profitability of foreign sales.

Our business in foreign jurisdictions requires us to respond to rapid changes in market conditions in these countries. Our overall success as a global business depends on our ability to succeed in different legal, regulatory, economic, social and political situations and conditions. We may not be able to develop and implement effective policies and strategies in each foreign jurisdiction where we do business. Also, each of the foregoing risks will likely take on increased significance as we implement plans to expand foreign manufacturing operations.

Since many of our products are manufactured in China, we own and lease manufacturing facilities in China and the Chinese market is of growing importance for our products, we face risks if China loses normal trade relations status with the United States or if US-China trade relations are otherwise adversely impacted.

We manufacture and export our products from China and own and lease manufacturing facilities in China. We also sell our products in China. Our products sold in the United States have normal trade relations status and are currently not subject to United States import duties. As a result of opposition to certain policies of the Chinese government and China s growing trade surpluses with the United States, there has been, and in the future may be, opposition to normal trade relations status with China. The United States Congress may also introduce China trade legislation targeting currency manipulation, which may adversely affect our business in China. The loss of normal trade relations status for China, changes in current tariff structures or adoption in the United States of other trade policies adverse to China, and any retaliatory measures that impact our products in the Chinese market, could have an adverse effect on our business.

A change in exchange rates mandated by legislation could negatively impact the cost of imported raw materials and products.

Furthermore, our business and operations may be adversely affected by deterioration of the diplomatic and political relationships between the United States and China. If the relationship between the United States and China were to materially deteriorate, it could negatively impact our ability to control our operations and relationships in China, enforce any agreements we have with Chinese partners or otherwise deal with any assets or investments we may have in China.

Our ongoing manufacturing operations in China are complex and having these remote operations may divert management s attention, lead to disruptions in operations, delay implementation of our business strategy and make it difficult to establish adequate management and financial controls in China. Our plans to grow our business to include sales to Chinese customers may necessitate additional management attention to establishing and maintaining one or more joint venture relationships with Chinese parties.

Currently, we have significant manufacturing operations in China, including a joint venture. We may not be able to find or retain suitable employees in China and we may have to train personnel to perform necessary functions for our manufacturing, senior management and development operations. This may divert management s attention, lead to disruptions in operations and delay implementation of our business strategy, all of which could negatively impact our profitability.

China has only recently begun to adopt management and financial reporting concepts and practices like those with which investors in the United States are familiar. We may have difficulty in hiring and retaining employees in China who have the experience necessary to implement the kind of management and financial controls that are expected of a United States public company. If we cannot establish and implement such controls, we may experience difficulty in collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices that meet U.S. standards.

In order to grow our business and sales to Chinese customers we have entered into a Chinese-foreign joint venture with a Chinese partner. A Chinese-foreign joint venture can be a complex business arrangement requiring substantial management attention to the joint venture relationship. The joint venture will also require capital contributions and due to China s foreign exchange controls, uncertainty as to the ability to repatriate profits and principal out of China.

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Because of the relative weakness of the Chinese legal system in general, and the intellectual property regime in particular, we may not be able to enforce intellectual property rights in China.

The legal regime protecting intellectual property rights in China is weak. Because the Chinese legal system in general, and the intellectual property regime in particular, are relatively weak, it is often difficult to create and enforce intellectual property rights in China. Accordingly, we may not be able to effectively protect our intellectual property rights in China against business entities, individuals and current and former employees.

Enforcing agreements and laws in China is difficult and may be impossible because China does not have a comprehensive system of laws.

We depend on our relationships with our Chinese manufacturing partners and suppliers. In China, enforcement of contractual agreements may be sporadic, and implementation and interpretation of laws may be inconsistent. The Chinese judiciary is relatively inexperienced in interpreting agreements and enforcing China s laws, leading to a higher than usual degree of uncertainty as to the outcome of any litigation. Even where adequate law exists in China, it may not be possible to obtain swift and equitable enforcement of such law, or to obtain enforcement of a judgment or an arbitration award by a court of another jurisdiction.

The government of China may change or even reverse its policies of promoting private industry and foreign investment, in which case our assets and operations may be at risk.

Our existing and planned operations in China are subject to risks related to the business, economic and political conditions in China, which include the possibility that the central government of China will change or even reverse its policies of promoting private industry and foreign investment in China. The government of China has exercised and continues to exercise substantial control over virtually every section of the Chinese economy through regulation and state ownership. Many of the current reforms which support private business in China are of recent origin or provisional in nature. Other political, economic and social factors, such as political changes, changes in the rates of economic growth, unemployment or inflation, or in the disparities of per capita wealth among citizens of China and between regions within China, could also lead to further readjustment of the government s reform measures. It is not possible to predict whether the Chinese government will continue to be as supportive of private business in China, nor is it possible to predict how any future reforms will affect our business. For example, if the government were to limit the number of foreign personnel who could work in the country, substantially increase taxes on foreign businesses, eliminate export processing zones, restrict the transportation of goods in and out of the country, adopt policies favoring competitors or impose other restrictions on our operations, the impact may be significant.

Significantly, a reversal of current liberalizations of foreign exchange controls by the Chinese government could be disruptive and costly to our cross-border operations and our business as a whole.

Business practices in China and Korea may entail greater risk and dependence upon the personal relationships of senior management than is common in North America, and therefore some of our agreements with other parties in China and Korea could be difficult or impossible to enforce.

The business cultures of China and Korea are, in some respects, different from the business cultures in Western countries and may present some difficulty for Western investors reviewing contractual relationships among companies in China and Korea and evaluating the merits of an investment. Personal and family relationships among business principals of companies and business entities in China and Korea are very significant in their business cultures. In some cases, because so much reliance is based upon personal relationships, written contracts among businesses in China and Korea may be less detailed and specific than is commonly accepted for similar written agreements in Western countries. In some cases, material terms of an understanding are not contained in the written agreement but exist as oral agreements only. In other cases, the terms of transactions which may involve material amounts of money are not documented at all. In addition, in contrast to Western business practices where a written agreement specifically defines the terms, rights and obligations of the parties in a legally-binding and enforceable manner, the parties to a written agreement in China or Korea may view that agreement more as a starting point for an ongoing business relationship which will evolve and require ongoing modification. As a result, written agreements in China or Korea may appear to the Western reader to look more like outline agreements that precede a formal written agreement. While these documents may appear incomplete or unenforceable to a Western reader, the parties to the agreement in China or Korea may feel that they have a more complete understanding than is apparent to someone who is only reading the written agreement without having attended the negotiations. As a result, contractual arrangements in China and Korea may be more difficult to review and understand.

China has introduced sweeping reforms to its income tax, turnover tax and other tax laws and regulations. Some of the changes increase the taxes for foreign-invested and other businesses in China will incur on specific types of transactions as well as arising from operations generally in China. Our earnings may be affected by tax adjustments to reflect such changes in the law.

Pursuant to a comprehensive reform of China s tax system that took effect on January 1, 2008, income tax incentives granted to foreign-invested enterprises, and geographically-based incentives, have largely been eliminated and have been replaced with

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incentives designed to encourage enterprises, domestic and foreign-invested alike, in selected industries. For example, dividends paid by foreign-invested enterprises to foreign shareholders are no longer exempt from withholding tax. A 10% withholding tax applies to dividends, although the rate is reduced to 5% by certain tax treaties. The tax holidays and tax reduction periods and the reduced national income tax rate that foreign-invested enterprises engaged in production used to enjoy have also been removed. The tax incentives promised to our wholly foreign-owned subsidiaries located in export processing zones at the time of inception will be phased-out by the end of 2012. At that time, these subsidiaries and any new foreign-invested enterprises we might establish as part of our strategy to expand the market for our products will no longer have income tax advantages over Chinese domestic businesses.

China s turnover tax system consists of VAT, consumption tax and business tax. VAT is primarily imposed on import and sales of goods and certain services, such as repairing, processing and replacement. Export sales are exempt under VAT rules, and an exporter who incurs VAT on the purchase or manufacture of goods should be able to claim a refund from Chinese tax authorities. Depending on whether VAT export refund rates are raised or reduced for relevant goods, exporters might bear part of the VAT they incurred in conjunction with producing the exported goods. To mitigate the effects of the global economic downturn on China s export industry, the PRC Ministry of Finance and the State Administration of Taxation have raised VAT rebates on numerous exported labor-intensive and high-value-added products. However, the Chinese government may also lower rebate rates in future in response to different economic and policy objectives.

China has also introduced sweeping VAT policy reforms with effect from January 1, 2009, which facilitate China s shift from a production-based VAT scheme to a consumption-based system. Generally, the new system reduces the total output VAT of production enterprises as fixed-asset investment costs related to VAT-eligible output are no longer subject to VAT. However, our VAT costs will depend on our ability to pass on input VAT to our local suppliers and customers. As the relevant VAT law and implementing regulations are new, there may be a period of adjustment before any cost-savings are realized.

Business tax is usually a fee of 3-5 percent levied on services such as transport, construction, education, finance, and insurance transfer of intangible assets, and sales of fixed assets, none of which are generally eligible for VAT. Business tax regulations, which took effect January 1, 2009, may impose business on services exchanged among China- and foreign-based entities which previously were not subject to business tax, and the potential overall impact is to increase the tax burden of cross-border service transactions.

Frequent changes to China s tax laws can result in uncertainty and unpredictability in financial results of our operations in China. China s tax laws are supplemented with detailed implementation rules and circulars. However, the interpretation of the rules may vary among local tax authorities.

Risks Related to Ownership of Our Common Stock

We are incurring increased costs and demands upon management as a result of complying with the laws and regulations affecting public companies, which could harm our operating results.

As a public company, we are incurring significant additional legal, accounting and other expenses that we did not incur as a private company, including costs associated with public company reporting requirements. We also have incurred and will incur costs associated with current corporate governance requirements, including requirements under Section 404 and other provisions of the Sarbanes-Oxley Act, as well as

rules implemented by the Securities and Exchange Commission, or SEC, and the NASDAQ Global Select Market. The expenses incurred by public companies for reporting and corporate governance purposes have increased dramatically in recent years. These rules and regulations to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. These new rules and regulations also make it more difficult and more expensive for us to obtain and maintain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur higher costs to obtain the same or similar coverage previously available. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as our executive officers.

An active trading market for our common stock may not be sustained, and you may not be able to resell your shares at or above the price at which you purchased them.

We have a limited history as a public company. An active trading market for our shares may not be sustained. In the absence of an active trading market for our common stock, investors may not be able to sell their common stock at or above the price they paid or at the time that they would like to sell.

Our stock price may be volatile.

The market price of our common stock could be subject to significant fluctuations, and it may decline below the price at which you purchased it. Market prices for securities of early stage companies have historically been particularly volatile. As a result of this volatility, you may not be able to sell your common stock at or above the price you paid. Some of the factors that may cause the market price of our common stock to fluctuate include:

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- fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;
- fluctuations in our recorded revenue, even during periods of significant sales order activity;
- changes in estimates of our financial results or recommendations by securities analysts;
- failure of any of our products to achieve or maintain market acceptance;
- product liability issues involving our products or our competitors products;
- changes in market valuations of similar companies;
- success of competitive products or technologies;
- changes in our capital structure, such as future issuances of securities or the incurrence of debt;
- announcements by us or our competitors of significant services, contracts, acquisitions or strategic alliances;
- developments or announcements related to our application for government stimulus funds;
- regulatory developments in the United States, foreign countries or both;
- litigation involving us, our general industry or both;

- additions or departures of key personnel;

- investors general perception of us; and

- changes in general economic, industry and market conditions.

In addition, if the market for technology stocks or the stock market in general experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations. If any of the foregoing occurs, it could cause our stock price to fall and may expose us to class action lawsuits that, even if unsuccessful, could be costly to defend and a distraction to management.

A significant portion of our total outstanding shares may be sold into the public market at any time, which could cause the market price of our common stock to drop significantly, even if our business is doing well.

Sales of a substantial number of shares of our common stock in the public market could occur at any time. These sales, or the market perception that the holders of a large number of shares intend to sell shares, could reduce the market price of our common stock. As of March 31, 2011, 31,606,815 shares of our common stock are subject to a 90-day contractual lock-up with the underwriters. These shares will be able to be sold, subject to any applicable volume limitations under federal securities law, after the earlier of the expiration of, or release from, the 90-day lock-up period. Deutsche Bank Securities Inc. and Goldman, Sachs & Co., acting as co-representatives of the underwriters, may permit our officers, directors, employees and current stockholders who are subject to the contractual lock-up to sell shares prior to the expiration of the lock-up agreements.

In addition, as of March 31, 2011, there were 10,258,057 shares subject to outstanding options and 183,046 shares subject to outstanding restricted stock units that are eligible for sale in the public market to the extent permitted by any applicable vesting requirements and Rule 144 under the Securities Act of 1933, as amended. Moreover, certain holders of our common stock have rights, subject to some conditions, to require us to file registration statements covering their shares and to include their shares in registration statements that we may file for ourselves or other stockholders. Additional holders of our common stock have rights, subject to some conditions, to include their shares in registration statements that we may file for ourselves or other stockholders. We have also registered all shares of common stock that we may issue under our equity incentive plans, including 7,903,153 shares reserved for future issuance under our equity incentive plans, pursuant to a registration statement that was filed and became immediately effective on March 31, 2010. Once we issue these shares, they can be freely sold in the public market upon issuance.

Upon the closing of a private placement in connection with a strategic transaction on January 14, 2010, we issued 479,282 shares of common stock to Fisker Automotive Inc., or Fisker. As of March 31, 2011, all of these shares are freely tradable pursuant to a registration statement filed with the SEC that was declared effective by the SEC on March 29, 2010. In addition, in April 2011, we issued 20.2 million shares of common stock and $143.8 million in principal of convertible unsecured subordinated notes. The issuance of shares pursuant to these transactions resulted in dilution to stockholders who held our common stock prior to such

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transactions. Stockholders will also experience further dilution if holders of the convertible notes choose to convert such notes into shares of our common stock.

Additionally, we expect to raise additional capital in the future which would result in dilution to current shareholders and could reduce the market price of our common stock.

If securities or industry analysts do not publish or cease publishing research or reports about us, our business or our market, or if they change their recommendations regarding our stock adversely, our stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts may publish about us, our business, our market or our competitors. If any of the analysts who may cover us change their recommendation regarding our stock adversely, or provide more favorable relative recommendations about our competitors, our stock price would likely decline. If any analyst who may cover us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

Our management has broad discretion over the use of our cash reserves and any government grants and loans we may receive, if any, and might not apply this cash in ways that increase the value of your investment.

Our management has broad discretion to use our cash reserves, if any, and you will be relying on the judgment of our management regarding the application of this cash. Our management might not apply our cash in ways that increase the value of your investment. We expect to use our cash reserves for capital expenditures, including capital expenditures related to the expansion of our manufacturing capacity in Michigan, working capital, and other general corporate purposes, which may in the future include investments in, or acquisitions of, complementary businesses, joint ventures, partnerships, services or technologies. Our management might not be able to yield a significant return, if any, on any investment of this cash. You will not have the opportunity to influence our decisions on how to use our cash reserves.

We do not expect to declare any dividends in the foreseeable future.

We do not anticipate declaring any cash dividends to holders of our common stock in the foreseeable future. Consequently, investors may need to rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase our common stock.

Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our certificate of incorporation, bylaws and Delaware law contain provisions that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our board of directors. Our corporate governance documents include provisions:

- authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to our common stock;

- limiting the liability of, and providing indemnification to, our directors and officers;

- limiting the ability of our stockholders to call and bring business before special meetings and to take action by written consent in lieu of a meeting;

- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;

- controlling the procedures for the conduct and scheduling of board of directors and stockholder meetings;

- providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings;

- establishing a classified board of directors so that not all members of our board are elected at one time;

- limiting the determination of the number of directors on our board of directors and the filling of vacancies or newly created seats on the board to our board of directors then in office; and

- providing that directors may be removed by stockholders only for cause.

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These provisions, alone or together, could delay hostile takeovers and changes in control of our company or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock. Any provision of our amended and restated certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

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

(a) Sales of Unregistered Securities

None

(b) Use of Proceeds from Public Offering of Common Stock

On September 29, 2009, we closed our IPO, in which 32,407,576 shares of common stock were sold at a price to the public of $13.50 per share. We sold 31,727,075 shares of our common stock in the offering and selling stockholders sold 680,501 of the shares of common stock in the offering. The aggregate offering price for all shares sold in the offering, including shares sold by us and the selling stockholders, was $437.5 million. The offer and sale of all of the shares in the IPO were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-152871), which was declared effective by the SEC on September 23, 2009, and a registration statement on Form S-1 (File No. 333-162090) filed pursuant to Rule 424(b) of the Securities Act. The offering commenced as of September 23, 2009 and did not terminate before all of the securities registered in the registration statement were sold. Morgan Stanley & Co. Incorporated and Goldman, Sachs, & Co. acted as co-representatives of the underwriters. We raised approximately $391.8 million in net proceeds after deducting underwriting discounts and commissions of $30.0 million and other estimated offering costs of $6.7 million. No payments were made by us to directors, officers or persons owning ten percent or more of our common stock or to their associates, or to our affiliates, other than payments in the ordinary course of business to officers for salaries and to non-employee directors as compensation for board or board committee service, or as a result of sales of shares of common stock by selling stockholders in the offering. There has been no material change in the planned use of proceeds from our IPO as described in our final prospectus filed with the SEC pursuant to Rule 424(b). From the effective date of the registration statement through March 31, 2011, we used approximately $357.3 million of the net proceeds primarily to fund our operations and the expansion of our facilities to support the anticipated growth of our business. We have invested the remainder of the funds in a registered money market fund.

(c) Restrictions on dividends

We have not paid any cash dividends since inceptions and do not anticipate paying cash dividends in the foreseeable future. Our term loan restricts our ability to pay cash dividends.

Item 6. Exhibits

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed (other than as stated in the Exhibit Index) as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

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SIGNATURES

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

A123 SYSTEMS, INC.

Date: May 10, 2011	By:	/s/ David P. Vieau David P. Vieau Chief Executive Officer (Principal Executive Officer)
Date: May 10, 2011	By:	/s/ John Granara John Granara Interim Chief Financial Officer and Vice President of Finance (Principal Financial and Accounting Officer)

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EXHIBIT INDEX

Listed and indexed below are all Exhibits filed as part of this report.

Exhibit No.	**Description**
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer.
32.1 +	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer.
32.2 +	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Financial Officer.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF*	XTRL Taxonomy Extension Definition

+	This certification shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that Section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.
*	Users of the XBRL data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.