

AMERICAN SUPERCONDUCTOR CORP /DE/

Form 10-Q

November 07, 2008

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended: September 30, 2008

.. **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: 0-19672

**American Superconductor Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

04-2959321  
(I.R.S. Employer  
Identification No.)

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**64 Jackson Road, Devens, Massachusetts**  
(Address of principal executive offices)

**01434**  
(Zip Code)

**(978) 842-3000**

(Registrant's telephone number, including area code)

N/A

(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 "

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 definition of "accelerated filer," "large accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x

Accelerated filer "

Non-accelerated filer "  
(Do not check if a smaller reporting company)

Smaller reporting company "

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES " NO x

Shares outstanding of the Registrant's common stock:

**Common Stock, par value \$0.01 per share**  
Class

**43,276,677**  
Outstanding as of November 3, 2008

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**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

**INDEX**

|   | <b>Page No.</b> |
|---|-----------------|
| <b><u>PART I FINANCIAL INFORMATION</u></b>  |                 |
| Item 1. <u>Financial Statements</u>   |                 |
| <u>Unaudited Condensed Consolidated Balance Sheets as of September 30, 2008 and March 31, 2008</u>                                      | 1               |
| <u>Unaudited Condensed Consolidated Statements of Operations for the three and six months ended September 30, 2008 and 2007</u>         | 2               |
| <u>Unaudited Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended September 30, 2008 and 2007</u> | 3               |
| <u>Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2008 and 2007</u>                   | 4               |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>   | 5               |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                    | 13              |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 22              |
| Item 4. <u>Controls and Procedures</u>  | 22              |
| <b><u>PART II OTHER INFORMATION</u></b>   |                 |
| Item 1A. <u>Risk Factors</u>  | 22              |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 28              |
| Item 6. <u>Exhibits</u>   | 28              |
| <u>Signature</u>  |                 |

**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands)

|  | September 30,<br>2008 | March 31,<br>2008 |
|--|-----------------------|-------------------|
| <b>ASSETS</b>                              |                       |                   |
| Current assets:                            |                       |                   |
| Cash and cash equivalents                  | \$ 55,794             | \$ 67,834         |
| Marketable securities                      | 65,809                | 38,398            |
| Accounts receivable, net                   | 29,908                | 37,108            |
| Inventory                                  | 15,586                | 10,907            |
| Restricted cash                            | 5,879                 | 12,312            |
| Prepaid expenses and other current assets  | 6,023                 | 4,467             |
| Deferred tax assets, net                   | 1,243                 | 2,293             |
| Total current assets                       | 180,242               | 173,319           |
| Property, plant and equipment, net         | 54,697                | 54,308            |
| Goodwill                                   | 26,830                | 18,530            |
| Intangibles, net                           | 10,170                | 11,583            |
| Restricted cash                            | 1,406                 | 860               |
| Other assets                               | 2,836                 | 2,634             |
| Total assets                               | \$ 276,181            | \$ 261,234        |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b> |                       |                   |
| Current liabilities:                       |                       |                   |
| Accounts payable and accrued expenses      | \$ 33,385             | \$ 38,356         |
| Deferred revenue                           | 12,011                | 10,629            |
| Total current liabilities                  | 45,396                | 48,985            |
| Non-current liabilities                    |                       |                   |
| Deferred revenue                           | 3,748                 | 2,043             |
| Deferred tax liabilities, net              | 916                   | 1,244             |
| Other non-current liabilities              | 58                    | 510               |
| Total liabilities                          | 50,118                | 52,782            |
| Commitments and contingencies (Note 8)     |                       |                   |
| Stockholders' equity:                      |                       |                   |
| Common stock                               | 432                   | 415               |
| Additional paid-in capital                 | 646,667               | 615,025           |

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|   |            |            |
|---|------------|------------|
| Deferred contract costs warrant               | (5)        | (8)        |
| Accumulated other comprehensive income (loss) | (358)      | 3,522      |
| Accumulated deficit                           | (420,673)  | (410,502)  |
| Total stockholders equity                     | 226,063    | 208,452    |
| Total liabilities and stockholders equity     | \$ 276,181 | \$ 261,234 |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)**

|  | <b>Three months ended<br/>September 30,</b> |             | <b>Six months ended<br/>September 30,</b> |             |
|--|---|-------------|---|-------------|
|  | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                               | <b>2007</b> |
| Revenues   | \$ 40,375                                   | \$ 21,623   | \$ 80,192                                 | \$ 41,392   |
| Costs and expenses:                                  |   |             |   |             |
| Costs of revenue                                     | 29,670                                      | 16,004      | 57,866                                    | 32,191      |
| Research and development                             | 4,688                                       | 3,792       | 9,601                                     | 8,006       |
| Selling, general and administrative                  | 8,849                                       | 7,151       | 17,742                                    | 13,269      |
| Amortization of acquisition related intangibles      | 481   | 1,772       | 984                                       | 2,934       |
| Restructuring and impairments                        | 500   | 93          | 500                                       | 911         |
| Total costs and expenses                             | 44,188                                      | 28,812      | 86,693                                    | 57,311      |
| Operating loss                                       | (3,813)                                     | (7,189)     | (6,501)                                   | (15,919)    |
| Interest income                                      | 801   | 1,204       | 1,576                                     | 1,550       |
| Other income (expense), net                          | 481   | (151)       | (1,990)                                   | (1,165)     |
| Loss before income tax expense                       | (2,531)                                     | (6,136)     | (6,915)                                   | (15,534)    |
| Income tax expense                                   | 1,537                                       | 537         | 3,256                                     | 792         |
| Net loss   | \$ (4,068)                                  | \$ (6,673)  | \$ (10,171)                               | \$ (16,326) |
| Net loss per common share                            |   |             |   |             |
| Basic and Diluted                                    | \$ (0.10)                                   | \$ (0.17)   | \$ (0.24)                                 | \$ (0.44)   |
| Weighted average number of common shares outstanding |   |             |   |             |
| Basic and Diluted                                    | 42,745                                      | 39,208      | 42,380                                    | 37,249      |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS****(In thousands)**

|   | <b>Three months ended<br/>September 30,</b> |             | <b>Six months ended<br/>September 30,</b> |             |
|---|---|-------------|---|-------------|
|   | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                               | <b>2007</b> |
| Net loss  | \$ (4,068)                                  | \$ (6,673)  | \$ (10,171)                               | \$ (16,326) |
| Other comprehensive income/(loss)               |   |             |   |             |
| Foreign currency translation                    | (3,820)                                     | 846         | (3,755)                                   | 972         |
| Change in unrealized gain/(loss) on investments | 18  | 114         | (125)                                     | 123         |
| Other comprehensive income/(loss)               | (3,802)                                     | 960         | (3,880)                                   | 1,095       |
| Comprehensive loss                              | \$ (7,870)                                  | \$ (5,713)  | \$ (14,051)                               | \$ (15,231) |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

|   | <b>Six months ended September 30,</b> |                  |
|---|---------------------------------------|------------------|
|   | <b>2008</b>                           | <b>2007</b>      |
| <b>Cash flows from operating activities:</b>  |                                       |                  |
| Net loss  | \$ (10,171)                           | \$ (16,326)      |
| <b>Adjustments to reconcile net loss to net cash used in operations:</b>                        |                                       |                  |
| Depreciation and amortization   | 4,134                                 | 5,261            |
| Stock-based compensation expense  | 5,194                                 | 3,023            |
| Stock-based compensation expense non-employee   | 42                                    | 127              |
| Impairment charges on long-lived assets   |                                       | 607              |
| Inventory write-down charges  |                                       | 933              |
| Re-valuation of warrant   | 1,334                                 | 1,256            |
| Deferred income taxes   | 616                                   | (217)            |
| Other non-cash items  | 1,267                                 | 20               |
| <b>Changes in operating asset and liability accounts, excluding the effect of acquisitions:</b> |                                       |                  |
| Accounts receivable   | 4,837                                 | (5,247)          |
| Inventory   | (4,762)                               | (1,992)          |
| Prepaid expenses and other current assets   | (1,780)                               | (1,506)          |
| Accounts payable and accrued expenses   | (1,044)                               | (1,828)          |
| Deferred revenue  | 3,853                                 | 4,428            |
| <b>Net cash provided by (used in) operating activities</b>                                      | <b>3,520</b>                          | <b>(11,461)</b>  |
| <b>Cash flows from investing activities:</b>  |                                       |                  |
| Purchase of property, plant and equipment, net  | (3,305)                               | (3,511)          |
| Proceeds from the sale of property, plant and equipment   | 2                                     | 390              |
| Purchase of marketable securities   | (62,217)                              | (134,552)        |
| Proceeds from the maturity of marketable securities   | 34,679                                | 123,027          |
| Changes in restricted cash  | 5,785                                 | (4,312)          |
| Acquisition costs, net of cash acquired in acquisitions   |                                       | (102)            |
| Purchase of intangible assets   | (612)                                 | (439)            |
| Changes in other assets   | (84)                                  | 34               |
| <b>Net cash used in investing activities</b>  | <b>(25,752)</b>                       | <b>(19,465)</b>  |
| <b>Cash flows from financing activities:</b>  |                                       |                  |
| Proceeds from follow-on public offering, net  |                                       | 93,615           |
| Proceeds from exercise of employee stock options  | 11,997                                | 8,347            |
| <b>Net cash provided by financing activities</b>  | <b>11,997</b>                         | <b>101,962</b>   |
| <b>Effect of exchange rate changes on cash and cash equivalents</b>                             | <b>(1,805)</b>                        | <b>178</b>       |
| <b>Net increase (decrease) in cash and cash equivalents</b>                                     | <b>(12,040)</b>                       | <b>71,214</b>    |
| <b>Cash and cash equivalents at beginning of period</b>   | <b>67,834</b>                         | <b>15,925</b>    |
| <b>Cash and cash equivalents at end of period</b>   | <b>\$ 55,794</b>                      | <b>\$ 87,139</b> |



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Supplemental schedule of cash flow information:

|   |    |       |       |
|---|----|-------|-------|
| Issuance of common stock in connection with acquisitions          | \$ | \$    | 4,349 |
| Non-cash contingent consideration in connection with acquisitions |    | 9,784 |       |
| Non-cash issuance of common stock                                 |    | 301   | 1     |

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of the Business and Basis of Presentation**

American Superconductor Corporation (the Company or AMSC) was founded on April 9, 1987. The Company is an energy technologies company, offering an array of solutions based on two proprietary technologies: programmable power electronic converters and high temperature superconductor ( HTS ) wires. The Company's products, services and system-level solutions enable cleaner, more efficient and more reliable generation, delivery and use of electric power. The programmability and scalability of the Company's power electronic converters differentiate them from most competitive offerings. The two primary markets the Company serves are the wind energy market and the power transmission and distribution or power grid market. The Company operates in two business segments: AMSC Power Systems and AMSC Superconductors.

These unaudited condensed consolidated financial statements of the Company have been prepared in accordance with the Securities and Exchange Commission's ( SEC ) instructions to Form 10-Q. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to those instructions. The year-end condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. The unaudited condensed consolidated financial statements, in the opinion of management, reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the results for the interim periods ended September 30, 2008 and 2007 and the financial position at September 30, 2008. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions are eliminated in consolidation.

The results of operations for an interim period are not necessarily indicative of the results of operations to be expected for the fiscal year. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the fiscal year ended March 31, 2008 (fiscal 2007) which are contained in the Company's Annual Report on Form 10-K, filed with the SEC on May 29, 2008.

**New Accounting Pronouncements**

In May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 162, The Hierarchy of Generally Accepted Accounting Principles. This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles ( GAAP ) in the United States (the GAAP hierarchy ). Currently, GAAP hierarchy is provided in the American Institute of Certified Public Accountants U.S. Auditing Standards ( AU ) Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles ( AU Section 411 ). SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board's amendments to AU Section 411. The Company is in the process of evaluating whether the adoption of this standard will have a material effect on its financial position, results of operations or cash flows.

In April 2008, the FASB issued FASB staff position ( FSP FAS 142-3 ) Determination of the Useful Life of Intangible Assets. FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), and other U.S. GAAP. This FSP applies to all intangible assets, whether acquired in a business combination or otherwise, and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and applied prospectively to intangible assets acquired after the effective date. Early adoption is prohibited. The Company is in the process of evaluating whether the adoption of this standard will have a material effect on its financial position, results of operations or cash flows.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. This statement is intended to help investors better understand how derivative instruments and hedging activities affect an entity's financial position, financial performance and cash flows through enhanced disclosure requirements. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company began hedging activities in October 2008 and will begin disclosing under the provisions of SFAS No. 161 in its next Annual Report on Form 10-K filing.



**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued**

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, which replaces SFAS No. 141. This revised standard requires assets, liabilities and non-controlling interests acquired to be measured at fair value and requires that costs incurred to effect the acquisition be recognized separately from the business combination. In addition, this statement expands the scope to include all transactions and other events in which one entity obtains control over one or more businesses. This statement is effective for all business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Although there are not any current plans for an acquisition, should there be an acquisition in the future, the Company will adopt this statement for acquisitions consummated after its effective date.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51*. This statement establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective for fiscal years beginning on or after December 15, 2008. Although there are not any current plans for an acquisition of a non-controlling interest, should there be such an acquisition in the future, the Company will adopt this statement for acquisitions consummated after its effective date.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. SFAS No. 157 also expands financial statement disclosures about fair value measurements. On February 12, 2008, the FASB issued FSP FAS 157-2 which delays the effective date of SFAS No. 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS No. 157 and FSP 157-2 are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company has elected a partial deferral of SFAS No. 157 under the provisions of FSP 157-2 related to the measurement of fair value used when evaluating goodwill, other intangible assets and other long-lived assets for impairment and valuing asset retirement obligations and liabilities for exit or disposal activities. The partial adoption of SFAS No. 157 on April 1, 2008 did not have a material impact on the Company's condensed consolidated financial statements.

**2. Stock-Based Compensation**

The Company accounts for its stock-based compensation under the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payments*. The following table summarizes employee stock-based compensation expense under SFAS 123(R) by financial statement line item for the three and six months ended September 30, 2008 and 2007 (in thousands):

|                                     | Three months ended<br>September 30, |          | Six months ended<br>September 30, |          |
|-------------------------------------|-------------------------------------|----------|-----------------------------------|----------|
|                                     | 2008                                | 2007     | 2008                              | 2007     |
| Costs of revenue                    | \$ 354                              | \$ 139   | \$ 682                            | \$ 236   |
| Research and development            | 482                                 | 249      | 1,036                             | 503      |
| Selling, general and administrative | 2,059                               | 1,558    | 3,476                             | 2,284    |
| Total                               | \$ 2,895                            | \$ 1,946 | \$ 5,194                          | \$ 3,023 |

During the six months ended September 30, 2008, the Company granted approximately 400,000 shares and 100,000 shares of restricted stock and stock options, respectively, to employees under the 2007 Stock Incentive Plan. The fair value of the grants made during the six months ended September 30, 2008 was \$13.2 million. The restricted stock grant includes approximately 140,000 shares of performance-based restricted stock, which will vest upon achievement of certain financial performance measurements. The remaining shares granted vest upon the passage of time. For awards that vest upon the passage of time, expense is being recorded over the vesting period. For awards that vest upon achievement of performance targets, expense is being recorded over the estimated performance period. At September 30, 2008, the Company determined that achievement of the performance measures is probable and as such, is recognizing the fair value of the performance-based awards over the estimated performance period.

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The total unrecognized compensation cost for unvested employee stock-based compensation awards outstanding, net of forfeitures, was \$15.8 million at September 30, 2008. This expense will be recognized over a weighted-average expense period of 1.7 years.

**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued**

The assumptions used in the Black-Scholes valuation model for stock options granted during the three and six months ended September 30, 2008 and 2007 are as follows:

|                         | Three months ended |                    | Six months ended   |                    |
|-------------------------|--------------------|--------------------|--------------------|--------------------|
|                         | September 30, 2008 | September 30, 2007 | September 30, 2008 | September 30, 2007 |
| Expected volatility     | 62.4%              | 65.9%              | 58.8%              | 58.5%              |
| Risk-free interest rate | 3.1%               | 4.3%               | 3.3%               | 4.8%               |
| Expected life (years)   | 4.9                | 5.3                | 4.9                | 5.3                |
| Dividend yield          | None               | None               | None               | None               |

The expected volatility was estimated based on an equal weighting of the historical volatility of the Company's common stock and the implied volatility of the Company's traded options. The expected life was estimated based on an analysis of the Company's historical experience of exercise, cancellation, and expiration patterns. The risk-free interest rate is based on five-year U.S. Treasury rates. The stock-based compensation expense recognized in the consolidated statements of operations is based on awards that ultimately are expected to vest; therefore, the amount of expense has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience. This analysis is re-evaluated periodically and the forfeiture rate is adjusted as necessary.

**3. Computation of Net Loss per Common Share**

Basic earnings per share (EPS) is computed by dividing net earnings (loss) by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed by dividing the net earnings (loss) by the weighted-average number of common shares and dilutive common equivalent shares outstanding during the period, calculated using the treasury stock method. Common equivalent shares include the effect of restricted stock, exercise of stock options and warrants and contingently issuable shares. For the three and six months ended September 30, 2008 and 2007, common equivalent shares of 3.4 million and 4.6 million shares respectively, were not included in the calculation of diluted EPS as they were considered anti-dilutive.

The following table reconciles the numerators and denominators of the earnings per share calculation for the three and six months ended September 30, 2008 and 2007 (in thousands, except per share data):

|  | Three months ended |                    | Six months ended   |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 30, 2008 | September 30, 2007 | September 30, 2008 | September 30, 2007 |
| Numerator:   |                    |                    |                    |                    |
| Net Loss   | \$ (4,068)         | \$ (6,673)         | \$ (10,171)        | \$ (16,326)        |
| Denominator:   |                    |                    |                    |                    |
| Weighted-average shares of common stock outstanding      | 43,387             | 39,571             | 42,965             | 37,612             |
| Weighted-average shares subject to repurchase            | (642)              | (363)              | (585)              | (363)              |
| Shares used in per-share calculation - basic and diluted | 42,745             | 39,208             | 42,380             | 37,249             |
| Net loss per share - basic and diluted                   | \$ (0.10)          | \$ (0.17)          | \$ (0.24)          | \$ (0.44)          |



**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****4. Marketable Securities**

The Company partially adopted SFAS No. 157 as of April 1, 2008, with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities as allowed under FSP 157-2. The Company has determined that cash equivalents and short-term marketable securities are the only assets affected by the adoption of SFAS No. 157 at this time.

*Valuation Hierarchy*

SFAS No. 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1** - Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
- Level 2** - Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).
- Level 3** - Unobservable inputs that reflect the Company's assumptions that market participants would use in pricing the asset or liability. The Company develops these inputs based on the best information available, including its own data.

A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following table provides the assets carried at fair value measured as of September 30, 2008 (in thousands):

|                       | Total<br>Carrying<br>Value | Quoted Prices in<br>Active<br>Markets<br>(Level 1) | Using Significant Other<br>Observable Inputs<br>(Level 2) | Using Significant<br>Unobservable Inputs<br>(Level 3) |
|-----------------------|----------------------------|--|---|---|
| Cash equivalents      | \$ 37,707                  | \$   | \$ 37,707   | \$  |
| Marketable securities | 65,809                     |  | 65,809  |   |

*Valuation Techniques*

Cash equivalents and marketable securities are measured using such things as quoted prices for identical or similar assets in markets that are not active, inputs other than quoted prices that are observable for the asset (for example interest rates and yield curves observable at commonly quoted intervals) and inputs that are derived principally from or corroborated by observable market data by correlation or other means and are classified within Level 2 of the valuation hierarchy.

**5. Inventory**

The components of inventory are as follows (in thousands):



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|                        | September 30,<br>2008 | March 31,<br>2008 |
|------------------------|-----------------------|-------------------|
| Raw materials          | \$ 4,982              | \$ 2,209          |
| Work-in-progress       | 5,678                 | 4,380             |
| Finished goods         | 3,660                 | 3,474             |
| Deferred program costs | 1,266                 | 844               |
| <b>Net inventory</b>   | <b>\$ 15,586</b>      | <b>\$ 10,907</b>  |

Finished goods inventory of \$3.7 million as of September 30, 2008 and \$3.5 million as of March 31, 2008 includes the cost of products shipped to customers on contracts for which revenue is deferred until final customer acceptance.

Deferred program costs of \$1.3 million as of September 30, 2008 and \$0.8 million as of March 31, 2008 represent costs incurred primarily on wind turbine development programs where the Company needs to achieve certain milestones or complete the contracts on these programs before revenue and costs will be recognized.

**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****6. Product Warranty**

The Company generally provides a one to two year warranty on its products, commencing upon installation. A provision is recorded upon revenue recognition to Costs of revenue for estimated warranty expense based on historical experience.

Product warranty activity was as follows (in thousands):

|   | Three months ended |          | Six months ended |          |
|---|--------------------|----------|------------------|----------|
|   | September 30,      |          | September 30,    |          |
|   | 2008               | 2007     | 2008             | 2007     |
| Balance at beginning of period                | \$ 1,985           | \$ 1,582 | \$ 1,775         | \$ 1,582 |
| Accruals for warranties during the period     | 1,310              | 503      | 2,436            | 1,026    |
| Settlements and adjustments during the period | (852)              | (464)    | (1,768)          | (987)    |
| Balance at end of period                      | \$ 2,443           | \$ 1,621 | \$ 2,443         | \$ 1,621 |

**7. Income Taxes**

The Company recorded income tax expense of \$1.5 and \$3.3 million for the three and six months ended September 30, 2008, respectively, and \$0.5 and \$0.8 million for the three and six months ended September 30, 2007, respectively, related primarily to foreign taxes. The Company has provided a valuation allowance against all current or deferred income tax assets in the U.S. because of the net operating losses incurred by the Company since its inception.

**8. Commitments and Contingencies**

In April 2005, the Company issued to TM Capital (which subsequently assigned it to Provident Premier Master Fund, Ltd. ( Provident )) a common stock purchase warrant for 200,000 shares of the Company's common stock, exercisable for a five-year term, with an exercise price of \$9.50 per share (the Warrant ). The accrued warrant cost was classified as a current liability in accordance with Emerging Issues Task Force (EITF) Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, until such time as the Warrant was exercised or forfeited, and was marked-to-market based primarily on the then current price and expected volatility of the Company's common stock as of the end of each reporting period. In August 2008, Provident utilized the cashless exercise provision and exercised the Warrant in exchange for 148,387 shares of the Company's common stock. The Warrant was re-valued at \$4.3 million at the time of exercise, resulting in a gain of \$1.1 million and a charge of \$1.3 million for the three and six months ended September 30, 2008, respectively (reported in Other income (expense) in the Unaudited Condensed Consolidated Statements of Operations). Accordingly, the liability of \$4.3 million was reclassified to equity upon exercise of the Warrant.

On June 26, 2008, the Company entered into a performance bond for CNY 1.1 million (approximately \$0.2 million) with a Chinese customer to guarantee supply of core components and software, which expires June 30, 2012. The performance bond was issued utilizing a Bank of China CNY 10.0 million (approximately \$1.5 million) unsecured line of credit.

As of September 30, 2008, the Company had outstanding performance bonds issued on behalf of the Company's wholly-owned Austrian subsidiary, AMSC Windtec GmbH ( Windtec ), for 1.5 million (approximately \$2.2 million) in connection with a contract to provide power electronics for two customers. These performance bonds will expire by February 2010. In the event that the payment is made in accordance with the requirements of these performance bonds, the Company would record the payment as an offset to revenue. To secure the performance bonds, the Company has 0.8 million (approximately \$1.1 million) in restricted cash, included in current assets.

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During the fiscal year ended March 31, 2008, the Company entered into several long-term construction contracts with customers that required the Company to obtain performance bonds. The Company is required to deposit an amount equivalent to some or all the face amount of the performance bonds into an escrow account until the termination of the bond. When the performance conditions are met, amounts deposited as collateral for the performance bonds are returned to the Company. At September 30, 2008, the Company

**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued**

has recorded \$5.9 million of restricted cash included in current assets, which includes the restricted cash securing the Windtec bonds noted above, and \$1.4 million of long-term restricted cash. Restricted cash as of the fiscal year ended March 31, 2008 was \$13.2 million.

The Company also has an unused, unsecured line of credit of 0.6 million (or approximately \$0.9 million) which is available until June 30, 2010.

**9. Cost-Sharing Arrangements**

The Company has entered into several cost-sharing arrangements with various agencies of the United States government. Funds paid to the Company under these agreements are not reported as revenues but are used to directly offset the Company's research and development ( R&D ) and selling, general and administrative ( SG&A ) expenses, and to purchase capital equipment.

Costs incurred and funding received under these agreements are as follows (in thousands):

|                  | Three months ended |          | Six months ended |          |
|------------------|--------------------|----------|------------------|----------|
|                  | September 30,      |          | September 30,    |          |
|                  | 2008               | 2007     | 2008             | 2007     |
| Costs incurred   | \$ 895             | \$ 1,497 | \$ 2,777         | \$ 2,925 |
| Funding received | \$ 441             | \$ 600   | \$ 1,266         | \$ 1,223 |

At September 30, 2008, total funding received to date under these agreements was \$27.0 million.

**10. Acquisitions*****Acquisition of Power Quality Systems, Inc.***

On April 27, 2007, the Company acquired Power Quality Systems, Inc. ( PQS ), a Pennsylvania corporation, for \$4.5 million in stock. PQS offers reactive compensation products known as Static VAR Compensators, or SVCs, based on its proprietary thyristor switch technology. These products enhance the reliability of power transmission and distribution grids and improve the quality of power for manufacturing operations.

Under an earn-out provision in the acquisition agreement, the Company recorded contingent consideration related to the acquisition of PQS of \$1.7 million to Goodwill and Additional paid-in capital, representing 75,000 shares earned for the fiscal year ended March 31, 2008, which were issued during the first quarter of the fiscal year ending March 31, 2009.

***Acquisition of Windtec Consulting GmbH***

On January 5, 2007, the Company acquired Windtec Consulting GmbH ( Windtec ), a corporation incorporated according to the laws of Austria. Windtec develops and sells electrical systems for wind turbines. Windtec also provides technology transfer for the manufacturing of wind turbines; documentation services; and training and support regarding the assembly, installation, commissioning, and service of wind turbines.

Under an earn-out provision in the acquisition agreement, in the quarter ended June 30, 2008, the Company issued 350,000 shares for contingent consideration earned during the fiscal year ended March 31, 2008 related to the acquisition of Windtec which was recorded in the fourth quarter of the fiscal year ended March 31, 2008. In addition, the Company recorded contingent consideration of \$5.3 million to Goodwill and Additional paid-in capital based on 225,000 shares earned in the quarter ended September 30, 2008. Contingent consideration of \$9.8 million has been recorded to Goodwill and Additional paid-in capital in the six months ended September 30, 2008, based on 350,000 shares earned during the year ending March 31, 2009, the maximum amount of contingent consideration that can be earned this fiscal year. The shares will be issued in the first quarter of the year ending March 31, 2010.



**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****11. Restructuring and Impairments****Restructurings**

On March 26, 2007, the Company's Board of Directors approved a restructuring plan (the Fiscal 2006 Plan) to reduce future operating costs and to transition its high temperature superconductor products to the manufacturing stage by consolidating the Company's AMSC Wires, SuperMachines and Power Electronic Systems business segments into two operating segments: AMSC Superconductors and AMSC Power Systems.

The Company's aggregate restructuring charges associated with the Fiscal 2006 Plan were \$0.8 million. Of this total, \$0.5 million of the restructuring charges were incurred during the quarter ended March 31, 2007, and \$0.3 million were incurred during the three months ended September 30, 2007. As of September 30, 2007, the plan was substantially completed. The restructuring charge was allocated to the AMSC Superconductors operating segment.

On October 25, 2007, the Company's Board of Directors approved a restructuring plan (the Fiscal 2007 Plan) to reduce operating costs by closing its last remaining facility in Westborough, Massachusetts and consolidating those operations into its Devens, Massachusetts facility. No headcount reductions were associated with this plan.

Aggregate restructuring charges associated with the Fiscal 2007 Plan were \$6.9 million, of which \$6.4 million were recorded in the third and fourth quarters of the fiscal year ended March 31, 2008 and \$0.5 million was recorded in the quarter ended September 30, 2008. The aggregate charges assumed the facility is not subleased. All restructuring charges associated with the Fiscal 2007 Plan are expected to result in cash disbursements and are expected to be completed by the end of the first quarter of the fiscal year ending March 31, 2010.

The following table presents the restructuring expense and cash disbursements for the Fiscal 2007 Plan for the three and six months ended September 30, 2008 (in thousands):

|                            | Lease<br>Termination<br>Costs | Decontamination<br>and Other<br>Facility<br>Closing<br>Costs | Total    |
|----------------------------|-------------------------------|--|----------|
| Balance March 31, 2008     | \$ 3,100                      | \$ 1,909   | \$ 5,009 |
| Cash disbursements         | (664)                         | (182)  | (846)    |
| Balance June 30, 2008      | 2,436                         | 1,727  | 4,163    |
| Charges to operations      |                               | 500  | 500      |
| Cash disbursements         | (861)                         | (476)  | (1,337)  |
| Balance September 30, 2008 | \$ 1,575                      | \$ 1,751   | \$ 3,326 |

**12. Business Segment Information**

The Company reports its financial results in two reportable business segments: AMSC Power Systems and AMSC Superconductors.

AMSC Power Systems supplies power electronic systems used in wind turbines; produces products to increase electrical grid capacity and reliability and to regulate wind farm voltage for the electrical grid; and, through the Company's Windtec subsidiary, licenses proprietary wind turbine designs to manufacturers of such systems and provides consulting services to the wind industry.

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AMSC Superconductors focuses on the manufacturing of HTS wire and coils; the design and development of HTS products, such as power cables, fault current limiters and motors; and the management of large-scale HTS projects, such as HTS power cable system design, manufacturing and installation.

The operating results for the two business segments are as follows (in thousands):

**Table of Contents****AMERICAN SUPERCONDUCTOR CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued**

|                      | Three months ended<br>September 30, |           | Six months ended<br>September 30, |           |
|----------------------|-------------------------------------|-----------|-----------------------------------|-----------|
|                      | 2008                                | 2007      | 2008                              | 2007      |
| <b>Revenues:</b>     |                                     |           |                                   |           |
| AMSC Power Systems   | \$ 35,576                           | \$ 19,186 | \$ 71,506                         | \$ 33,554 |
| AMSC Superconductors | 4,799                               | 2,437     | 8,686                             | 7,838     |
| Total                | \$ 40,375                           | \$ 21,623 | \$ 80,192                         | \$ 41,392 |

|                                 | Three months ended<br>September 30, |            | Six months ended<br>September 30, |             |
|---------------------------------|-------------------------------------|------------|-----------------------------------|-------------|
|                                 | 2008                                | 2007       | 2008                              | 2007        |
| <b>Operating income (loss):</b> |                                     |            |                                   |             |
| AMSC Power Systems              | \$ 5,501                            | \$ 819     | \$ 10,379                         | \$ 203      |
| AMSC Superconductors            | (5,892)                             | (5,427)    | (11,001)                          | (11,877)    |
| Unallocated corporate expenses  | (3,422)                             | (2,581)    | (5,879)                           | (4,245)     |
| Total                           | \$ (3,813)                          | \$ (7,189) | \$ (6,501)                        | \$ (15,919) |

The accounting policies of the business segments are the same as those for the consolidated Company, except that certain corporate expenses which the Company does not believe are specifically attributable or allocable to either of the two business segments have been excluded from the segment operating income (loss). Corporate unallocated expenses include stock-based compensation expense of \$2.9 million and \$1.9 million for the three months ended September 30, 2008 and 2007, respectively, and \$5.2 million and \$3.0 million for the six months ended September 30, 2008 and 2007, respectively. For the three months ended September 30, 2008, corporate unallocated expenses also include \$0.5 million of restructuring charges related to additional costs required to close the Company's facility in Westborough, Massachusetts. Corporate unallocated expense for the three and six months ended September 30, 2007 included rent and occupancy costs associated with the unoccupied portion of the Company's Westborough, Massachusetts corporate headquarters facility.

For the six months ended September 30, 2008 and 2007, Sinovel Wind Co. Ltd. represented 65% and 52% of total revenues, respectively.

Total assets for the two business segments are as follows (in thousands):

|   | September 30,<br>2008 | March 31,<br>2008 |
|---|-----------------------|-------------------|
| AMSC Power Systems                              | \$ 89,052             | \$ 80,844         |
| AMSC Superconductors                            | 58,241                | 60,986            |
| Cash, marketable securities and restricted cash | 128,888               | 119,404           |
| Total   | \$ 276,181            | \$ 261,234        |



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**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*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. For this purpose, any statements contained herein that relate to future events or conditions, including without limitation, the statements under Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations and in Part II, Item 1A. Risk Factors and located elsewhere herein regarding industry prospects our prospective results of operations or financial position, may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, anticipates, plans, expects, and similar expressions are intended to identify forward-looking statements. Such forward-looking statements represent management's current expectations and are inherently uncertain. The important factors discussed below under the caption Risk Factors in Item 1A, among others, could cause actual results to differ materially from those indicated by forward-looking statements made herein and presented elsewhere by management from time to time. Any such forward-looking statements represent management's estimates as of the date of this Quarterly Report on Form 10-Q. While we may elect to update such forward-looking statements at some point in the future, we disclaim any obligation to do so, even if subsequent events cause our views to change. These forward-looking statements should not be relied upon as representing our views as of any date subsequent to the date of this Quarterly Report on Form 10-Q.*

American Superconductor and design, AMSC, D-VAR, PQ-IVR, PowerModule, Secure Super Grids, and Windtec are trademarks or registered trademarks of American Superconductor Corporation. Other trademarks or service marks appearing in this Quarterly Report on Form 10-Q are the property of their respective holders.

**Executive Overview**

American Superconductor Corporation was founded in 1987. We are a leading energy technologies company, offering an array of solutions based on two proprietary technologies: programmable power electronic converters and high temperature superconductor ( HTS ) wires. Our products, services and system-level solutions enable cleaner, more efficient and more reliable generation, delivery and use of electric power. The programmability and scalability of our power electronic converters differentiate them from most competitive offerings. Our HTS wires carry 150 times the electrical current of comparably sized copper wire. The two primary markets we serve are the wind energy market and the power transmission and distribution or power grid market.

Our HTS wire addresses constraints on the power grid by increasing the electric current carrying capacity of the transmission cables comprising these power grids and by providing current limiting functionality in cables and stand-alone devices. In addition, our HTS wire, when incorporated into primary electrical equipment such as motors and generators, can provide increased manufacturing and operating savings due to a significant reduction in the size and weight of this equipment. Also, our power electronic converters increase the quantity, quality and reliability of electric power that is transmitted by electric utilities or consumed by large industrial entities.

Our products are in varying stages of commercialization. Our power electronic converters have been sold commercially, as part of integrated systems, to electric utilities, manufacturers and wind farm developers, owners and operators since 1999. We began production of our first generation, or 1G HTS wire in 2003, although its principal applications (power cables, fault current limiters, rotating machines and specialty magnets) are currently in the prototype stage. Some of these prototypes are funded by U.S. government contracts, primarily with the Department of Defense ( DOD ) and Department of Energy ( DOE ).

We started initial production of 344 superconductors, our brand name for what is generically known as second generation or 2G HTS wire, in November 2007. Our gross production capacity is approximately 720,000 meters of 344 superconductors per year.

Our fiscal year begins on April 1 and ends on March 31. This document refers to fiscal 2008, which is the period beginning on April 1, 2008 and concluding on March 31, 2009. The second quarter of fiscal 2008 began on July 1, 2008 and concluded on September 30, 2008.

Our cash requirements depend on numerous factors, including successful completion of our product development activities, ability to commercialize our product prototypes, rate of customer and market adoption of our products and the continued availability of U.S. government funding during the product development phase. Significant deviations to our business plan with regard to these



**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *Continued*

factors, which are important drivers to our business, could have a material adverse effect on our operating performance, financial condition, and future business prospects. We expect to pursue the expansion of our operations through internal growth and potential strategic alliances and acquisitions.

**Critical Accounting Policies and Estimates**

The preparation of consolidated financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ under different assumptions or conditions. There were no significant changes in the second quarter of fiscal 2008 in our critical accounting policies as disclosed in our Form 10-K for fiscal 2007, which ended on March 31, 2008.

**Results of Operations***Three and six months ended September 30, 2008 compared to the three and six months ended September 30, 2007*

We operate and report our financial results to the Chief Executive Officer in two reportable business segments: AMSC Power Systems and AMSC Superconductors.

AMSC Power Systems supplies power electronic systems used in wind turbines; produces products to increase electrical grid capacity and reliability and to regulate wind farm voltage for the electrical grid; licenses proprietary wind turbine designs to manufacturers of such systems and provides consulting services to the wind industry.

AMSC Superconductors focuses on the manufacturing of HTS wire and coils; the design and development of HTS products, such as power cables, fault current limiters and motors; and the management of large-scale HTS projects, such as HTS power cable system design, manufacturing and installation.

*Revenues*

Total revenues increased by 87% and 94% to \$40.4 million and \$80.2 million for the three months and six months ended September 30, 2008, respectively, from \$21.6 million and \$41.4 million for the three months and six months ended September 30, 2007, respectively. Our revenues are summarized as follows (in thousands):

|                         | <b>Three months ended<br/>September 30,</b> |             | <b>Six months ended<br/>September 30,</b> |             |
|-------------------------|---|-------------|---|-------------|
|                         | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                               | <b>2007</b> |
| <b><u>Revenues:</u></b> |   |             |   |             |
| AMSC Power Systems      | \$ 35,576                                   | \$ 19,186   | \$ 71,506                                 | \$ 33,554   |
| AMSC Superconductors    | 4,799                                       | 2,437       | 8,686                                     | 7,838       |
| Total                   | \$ 40,375                                   | \$ 21,623   | \$ 80,192                                 | \$ 41,392   |

Revenues in our AMSC Power Systems unit consist of revenues from wind turbine electrical systems, wind turbine license and development contracts as well as D-VAR<sup>®</sup>, PQ-IVR<sup>®</sup>, SVC, and PowerModule product sales, service contracts, and consulting arrangements. We also offer to

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engineer, install and commission our products on a turnkey basis for our customers. Our Power Systems business unit accounted for 88% and 89% of total revenues for the three months and six months ended September 30, 2008, respectively, compared to 89% and 81% of total revenues for the same periods of fiscal 2007. Revenues in the Power Systems unit increased by 85% and 113% to \$35.6 million and \$71.5 million in the second quarter and first six months of fiscal 2008 from \$19.2 million and \$33.6 million for the same periods in fiscal 2007, respectively. The increases were primarily due to higher sales of wind electrical systems and core components, including our PowerModule product, primarily in the Asia-Pacific region. The remainder of the increase was primarily due to higher sales related to turnkey power systems projects which included our D-VAR and SVC products.

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *Continued*

A substantial portion of our revenues are derived from one customer, Sinovel Wind Co., Ltd., a manufacturer of wind energy systems based in China. Sales to Sinovel represented 63% and 59% of our total revenues for the second quarter of fiscal 2008 and 2007, respectively, and 65% and 52% of our total revenues for the first six months of fiscal 2008 and 2007, respectively.

Revenues in our AMSC Superconductors business unit consist of contract revenues, HTS wire sales, revenues under government-sponsored electric utility projects, and other prototype development contracts. AMSC Superconductors revenue is primarily recorded using the percentage-of-completion method. Our AMSC Superconductors unit accounted for 12% and 11% of total revenues for the three and six months ended September 30, 2008, respectively, compared to 11% and 19% of total revenues for the same periods of fiscal 2007. AMSC Superconductors revenue increased by 97% and 11% to \$4.8 million and \$8.7 million in the second quarter and first six months of fiscal 2008, respectively. Revenues from significant AMSC Superconductors government funded contract revenues are summarized as follows (in thousands):

| Project Name       | Expected<br>Total<br>Contract Value | Revenue Earned<br>through<br>September 30, 2008 | Revenue Earned for the three months ended September 30, |        | Revenue Earned for the six months ended September 30, |        |
|--------------------|-------------------------------------|---|---|--------|---|--------|
|                    |                                     |   | 2008  | 2007   | 2008  | 2007   |
| HYDRA              | \$ 24,908                           | \$ 6,065  | \$ 1,398  | \$ 434 | \$ 2,420  | \$ 620 |
| LIPA I             | 27,458                              | 27,353  | 23  | 297    | 30  | 3,470  |
| LIPA II            | 9,000                               | 1,744   | 434   |        | 1,266   |        |
| DOE-FCL            | 3,065                               | 2,174   | 688   |        | 1,252   |        |
| 36.5 MW Motor      | 90,150                              | 90,150  |   | 94     |   | 1,283  |
| NAVSEA Motor Study | 5,885                               | 5,352   | 1,792   | 586    | 2,412   | 855    |

The HYDRA project is discussed further below. LIPA I is a project to install an HTS power cable system at transmission voltage using our first generation HTS wire for Long Island Power Authority. LIPA II is an installation of an HTS power cable utilizing our second generation HTS wire for Long Island Power Authority. DOE-FCL is a development and in-grid demonstration of a transmission voltage SuperLimiter FCL. The 36.5 MW Motor project is an HTS motor developed for the U.S. Navy. The NAVSEA Motor Study is a project designed to test the HTS motor.

The increase in AMSC Superconductors revenue for the second quarter of fiscal 2008 was driven primarily by higher revenues from our HYDRA, LIPA II, DOE-FCL and NAVSEA projects.

We are recognizing HTS cable project revenues in fiscal 2008 from the Project HYDRA contract with Consolidated Edison, Inc., which is being funded by the U.S. Department of Homeland Security ( DHS ) and was announced on May 21, 2007. DHS is expected to invest up to a total of \$24.9 million in the development of a new high temperature superconductor power grid technology to enable Secure Super Grids . Secure Super Grids utilize customized HTS wires, HTS power cables and ancillary controls to deliver more power through the grid while also being able to suppress power surges that can disrupt service. While the final contract was being negotiated, we worked under letter contracts with DHS. On January 22, 2008, we executed the final contract with DHS. Of the total \$24.9 million in funding expected from DHS, it has committed funding of \$10.7 million to us through September 30, 2008. We recognized \$1.4 million in revenue related to the Project HYDRA during the second quarter of fiscal 2008. Consolidated Edison and Southwire Company are subcontractors to us on this project.

*Cost-sharing funding*

In addition to reported revenues, we also received funding of \$0.4 million and \$1.3 million for the three and six months ended September 30, 2008, respectively, under U.S. government cost-sharing agreements with the U.S. Air Force and the DOE, compared to \$0.6 million and \$1.2 million for the same periods of fiscal 2007. The increase in cost-sharing funding is primarily due to the Advanced Technology Program ( ATP ), which commenced in November 2007. All of our cost-sharing agreements provide funding in support of development work on 344 superconductors being done in our AMSC Superconductors business unit. We anticipate that a portion of our funding in the future will continue

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to come from cost-sharing agreements as we continue to develop joint programs with government agencies. Funding from government cost-sharing agreements is recorded as an offset to research and development ( R&D ) and selling, general and administrative ( SG&A ) expenses, rather than as revenue. As of September 30, 2008, we anticipate recognizing an additional \$2.3 million offset to R&D and SG&A expenses related to these cost-sharing agreements over the next two years.

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *Continued*

*Costs of Revenue*

Costs of revenue increased by 85% and 80% to \$29.7 million and \$57.9 million, for the three and six months ended September 30, 2008, respectively, compared to \$16.0 million and \$32.2 million for the same periods of fiscal 2007. Gross margin was 26.5% and 27.8% for the three and six months ended September 30, 2008, respectively, compared to 26.0% and 22.2%, respectively, for the same periods of fiscal 2007. The increases in gross margin were due primarily to a higher mix of Power Systems sales as compared to Superconductors sales and a \$0.9 million inventory write-off for a SuperVAR<sup>®</sup> synchronous condenser was recorded in the six months ended September 30, 2007. These factors were partially offset by higher depreciation in the current fiscal year related to the Company's 2G production equipment.

*Operating Expenses**Research and development*

A portion of our R&D expenditures related to externally funded development contracts has been classified as costs of revenue (rather than as R&D expenses). Additionally, a portion of R&D expenses was offset by cost-sharing funding. Our R&D expenditures are summarized as follows (in thousands):

|  | <b>Three months ended</b> |             | <b>Six months ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>    |             |
|  | <b>2008</b>               | <b>2007</b> | <b>2008</b>             | <b>2007</b> |
| R&D expenses per Consolidated Statements of Operations | \$ 4,688                  | \$ 3,792    | \$ 9,601                | \$ 8,006    |
| R&D expenditures reclassified as costs of revenue      | 5,562                     | 3,751       | 10,055                  | 9,725       |
| R&D expenditures offset by cost-sharing funding        | 236                       | 310         | 677                     | 631         |
| Aggregated R&D expenses                                | \$ 10,486                 | \$ 7,853    | \$ 20,333               | \$ 18,362   |

R&D expenses (exclusive of amounts classified as costs of revenue and amounts offset by cost-sharing funding) increased by 24% and 20% to \$4.7 million and \$9.6 million, or 12% of revenue, for each of the three and six months ended September 30, 2008, respectively, from \$3.8 million and \$8.0 million, or 18% of revenue and 19% of revenue, for the same periods of the prior fiscal year, respectively. The increase in R&D expenses was driven by internal product development costs in our Power Systems business unit to support future growth opportunities and our next generation product offerings. The increases in R&D expenditures reclassified to costs of revenue were a result of increased support of government funded programs, primarily HYDRA and NAVSEA. Aggregated R&D expenses, which include amounts classified as costs of revenue and amounts offset by cost-sharing funding, increased 34% and 11% to \$10.5 million and \$20.3 million, or 26% of revenue and 25% of revenue, for the three and six months ended September 30, 2008, respectively, from \$7.9 million and \$18.4 million, or 36% of revenue and 44% of revenue, for the same periods of the prior fiscal year, respectively. The increases in the second quarter and first six months of fiscal 2008 were driven primarily by the factors described above.

*Selling, general, and administrative*

A portion of the SG&A expenditures related to externally funded development contracts has been classified as costs of revenue (rather than as SG&A expenses). Additionally, a portion of SG&A expenses was offset by cost-sharing funding. Our SG&A expenditures are summarized as follows (in thousands):

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|   | Three months ended<br>September 30, |          | Six months ended<br>September 30, |           |
|---|-------------------------------------|----------|-----------------------------------|-----------|
|   | 2008                                | 2007     | 2008                              | 2007      |
| SG&A expenses per Consolidated Statements of Operations | \$ 8,849                            | \$ 7,151 | \$ 17,742                         | \$ 13,269 |
| SG&A expenditures reclassified as costs of revenue      | 335                                 | 215      | 460                               | 579       |
| SG&A expenditures offset by cost sharing funding        | 206                                 | 291      | 590                               | 593       |
| Aggregated SG&A expenses                                | \$ 9,390                            | \$ 7,657 | \$ 18,792                         | \$ 14,441 |



**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *Continued*

SG&A expenses (exclusive of amounts classified as costs of revenue and amounts offset by cost-sharing funding) increased by 24% and 34% to \$8.8 million and \$17.7 million, or 22% of revenue, for each of the three and six months ended September 30, 2008, respectively, from \$7.2 million and \$13.3 million, or 33% of revenue and 32% of revenue, for the same periods of the prior fiscal year, respectively. For the three and six months ended September 30, 2008, the increases in SG&A expenses were due primarily to higher bad debt expense of \$0.6 million and \$0.7 million, respectively, and higher stock-based compensation expense of \$0.5 million and \$1.2 million, respectively. The balance of the SG&A increase were due primarily to higher labor and related costs driven by headcount growth. For these same reasons, Aggregated SG&A expenses, which include amounts classified as costs of revenue and amounts offset by cost sharing funding, increased 23% and 30% to \$9.4 million and \$18.8 million, or 23% of revenue, for each of the three and six months ended September 30, 2008, respectively, from \$7.7 million and \$14.4 million, or 35% of revenue, for each of the same periods of the prior fiscal year, respectively.

We present Aggregated R&D and Aggregated SG&A expenses, which are non-GAAP measures, because we believe this presentation provides useful information on our aggregate R&D and SG&A spending and because R&D and SG&A expenses as reported on the Consolidated Statements of Operations have been, and may in the future be, subject to significant fluctuations solely as a result of changes in the level of externally funded contract development work, resulting in significant changes in the amount of the costs recorded as costs of revenue rather than as R&D and SG&A expenses, as discussed above.

*Amortization of acquisition related intangibles*

Amortization of acquisition related intangibles was \$0.5 million and \$1.0 million in the three and six months ended September 30, 2008, respectively, compared to \$1.8 million and \$2.9 million in the same periods of the prior fiscal year. The decreases were primarily driven by lower amortization related to Windtec's contractual relationships/backlog intangible asset, which was nearly fully amortized as of September 30, 2008.

*Restructuring and impairments*

On March 26, 2007, our Board of Directors approved a restructuring plan (the Fiscal 2006 Plan) to reduce operating costs and to transition our high temperature superconductor products to the manufacturing stage by consolidating AMSC Wires, SuperMachines and Power Electronic Systems business segments into two operating segments: AMSC Superconductors and AMSC Power Systems. We consolidated our manufacturing operations by closing one of our two Westborough, Massachusetts facilities, moving operations from that facility into the Devens, Massachusetts plant, and reducing headcount by 37 employees.

Our aggregate restructuring charges associated with the Fiscal 2006 Plan were \$0.8 million. Of this total, \$0.5 million was incurred during the quarter ended March 31, 2007, and \$0.3 million were incurred during the six months ended September 30, 2007, respectively. As of September 30, 2007, the plan was substantially completed and the balance of the remaining liability was immaterial to our financial statements. The restructuring charge was allocated to the AMSC Superconductors operating segment.

On October 25, 2007, our Board of Directors approved a restructuring plan (the Fiscal 2007 Plan) to reduce operating costs through the closure of our last remaining facility in Westborough, Massachusetts and the consolidation of operations there, including our corporate headquarters, into our Devens, Massachusetts facility. No headcount reductions were associated with this plan.

Restructuring charges associated with the Fiscal 2007 Plan in the three and six months ended September 30, 2008 were \$0.5 million, as additional costs were recorded to complete the closure of our Westborough, Massachusetts facility. There were no restructuring charges in the same periods of fiscal 2007 under this plan. Aggregate charges under this plan are \$6.9 million as of September 30, 2008. This aggregate charge includes an assumption that the Westborough facility will not be subleased. All restructuring charges associated with the Fiscal 2007 Plan are expected to result in the disbursement of cash. Cash payments under this plan in the three and six months ended September 30, 2008 were \$1.3 million and \$2.2 million, respectively.

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Excluding continuing restructuring charges associated with our Westborough, Massachusetts lease through May 2009, we began to realize annual cost savings from the Fiscal 2007 Plan at a rate of approximately \$2.5 million per year beginning in the fourth quarter of fiscal 2007.

As of March 31, 2007, we reclassified our previously impaired first generation wire manufacturing equipment from Property, plant and equipment to Assets held for sale. The estimated salvage value of these assets was \$2.2 million as of March 31, 2007 and

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *Continued*

was recorded as other assets in the consolidated balance sheet. A public auction for the sale of these assets was held in June 2007 and private sales were negotiated with interested parties for the remaining equipment. Based on the results of the auction and our work to sell through private sales, we determined that an additional impairment charge of \$0.6 million was required during the first quarter of fiscal 2007 to write down the value of the assets to their net realizable value. There were no Assets held for sale at March 31, 2008.

*Operating income (loss)*

Our operating income (loss) is summarized as follows (in thousands):

|                                | Three months ended<br>September 30, |            | Six months ended<br>September 30, |             |
|--------------------------------|-------------------------------------|------------|-----------------------------------|-------------|
|                                | 2008                                | 2007       | 2008                              | 2007        |
| AMSC Power Systems             | \$ 5,501                            | \$ 819     | \$ 10,379                         | \$ 203      |
| AMSC Superconductors           | (5,892)                             | (5,427)    | (11,001)                          | (11,877)    |
| Unallocated corporate expenses | (3,422)                             | (2,581)    | (5,879)                           | (4,245)     |
| Total                          | \$ (3,813)                          | \$ (7,189) | \$ (6,501)                        | \$ (15,919) |

The operating income of AMSC Power Systems increased to \$5.5 million and \$10.4 million in the three and six months ended September 30, 2008, respectively, from \$0.8 million and \$0.2 million for the same periods of fiscal 2007. The increases were primarily the result of increased revenues due to higher sales of wind electrical systems and lower amortization of acquisition related intangibles due to an intangible asset related to backlog becoming nearly fully amortized in the fourth quarter of fiscal 2007. This increase was partially offset by higher SG&A and R&D costs resulting from higher bad debt expense and increased headcount to support our growth.

The operating loss of AMSC Superconductors increased to \$5.9 million in the three months ended September 30, 2008 from \$5.4 million for the same period of fiscal 2007 and decreased to \$11.0 million in the six months ended September 30, 2008, from \$11.9 million for the same period of fiscal 2007. The increase in operating loss for the three months ended September 30, 2008 is primarily due to higher 2G production equipment related depreciation. The decrease in the six months ended September 30, 2008 operating loss was primarily a result of costs incurred in fiscal 2007, including a write-off of \$0.9 million for a SuperVAR synchronous condenser in the first quarter of fiscal 2007 and an asset impairment charge of \$0.6 million related to 1G assets held for sale in the first quarter of fiscal 2007, and lower corporate expense allocations in fiscal 2008, partially offset by higher depreciation as mentioned previously.

Corporate unallocated expenses include stock-based compensation expense of \$2.9 million and \$5.2 million for the three and six months ended September 30, 2008, respectively, and \$1.9 million and \$3.0 million for the three and six months ended September 30, 2007, respectively. For the three months ended September 30, 2008, corporate unallocated expenses also include \$0.5 million of restructuring charges related primarily to the closure of our facility in Westborough, Massachusetts. Corporate unallocated expenses for the three and six months ended September 30, 2007 included rent and occupancy costs associated with the unoccupied portion of the Company's Westborough, Massachusetts headquarters facility of \$0.3 million and \$0.7 million, respectively.

*Non-operating expenses/Interest income*

Interest income decreased to \$0.8 million and increased to \$1.6 million in the three and six months ended September 30, 2008, respectively, from \$1.2 million and \$1.6 million in the three and six months ended September 30, 2007, respectively. The decrease in interest income for the three months ended September 30, 2008 is due to lower interest rates. The increase in the interest income for the six months ended September 30, 2008 is due to higher combined cash, cash equivalents and marketable securities available for the full six months of the current fiscal year due to the net proceeds we received in the public offering of 4.7 million shares in July 2007.

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Other income/(expense), net, was income of \$0.5 million and expense of \$2.0 million for the three and six months ended September 30, 2008, respectively, compared to expense of \$0.2 million and \$1.2 million for the same periods of fiscal 2007. The fluctuations were due primarily to mark-to-market adjustments on the revaluation of the warrant issued in April 2005 related to a litigation settlement, which was held by Provident Premier Master Fund ( Provident ). In August 2008, Provident exercised the entire

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *Continued*

warrant in exchange for 148,387 shares of our common stock resulting in a gain of approximately \$1.1 million in the second quarter of the year ending March 31, 2009. Amounts charged to expense from mark-to-market adjustments on the warrant were \$1.3 million and \$1.2 million for the six months ended September 30, 2008 and 2007, respectively.

*Income Taxes*

During the three and six months ended September 30, 2008, we recorded income tax expense of \$1.5 million and \$3.3 million, respectively, compared to \$0.5 million and \$0.8 million for the same periods of fiscal 2007. Income tax expense in all periods was driven primarily by foreign taxes. The increases in income tax expense were driven by increased profits in our foreign jurisdictions. Due to a history of operating losses in the U.S., we do not record a tax benefit on U.S. losses.

Please refer to the *Risk Factors* section in Item 1A for a discussion of certain factors that may affect our future results of operations and financial condition.

**Liquidity and Capital Resources**

At September 30, 2008, we had cash, cash equivalents, marketable securities and restricted cash of \$128.9 million compared to \$119.4 million at March 31, 2008, an increase of \$9.5 million. Our cash, cash equivalents, marketable securities and restricted cash are summarized as follows (in thousands):

|   | <b>September 30,<br/>2008</b> | <b>March 31,<br/>2008</b> |
|---|-------------------------------|---------------------------|
| Cash and cash equivalents   | \$ 55,794                     | \$ 67,834                 |
| Marketable securities   | 65,809                        | 38,398                    |
| Restricted cash   | 7,285                         | 13,172                    |
| Total cash, cash equivalents, marketable securities and restricted cash | \$ 128,888                    | \$ 119,404                |

The increase in cash and cash equivalents, marketable securities and restricted cash was primarily the result of approximately \$12 million in cash received from the exercise of employee stock options in the first six months of fiscal 2008.

For the six months ended September 30, 2008, net cash provided by operating activities was \$3.5 million compared to a use of \$11.5 million for the same period of fiscal 2007. The increase in cash provided by operations is due to a lower net loss and lower cash used for working capital, primarily related to a decrease in accounts receivable as a result of improved collections, partially offset by an increase in inventory as we prepare to meet customer deliveries scheduled in the third and fourth quarters of fiscal 2008.

For the six months ended September 30, 2008, net cash used in investing activities was \$25.8 million compared to \$19.5 million for the same period of fiscal 2007. The increase in cash used in investing activities was driven primarily by the net increase in cash used to purchase marketable securities, net of maturities, partially offset by a reduction in restricted cash.

As of September 30, 2008, we have invested in total approximately \$14.5 million in our 344 superconductors production line. These expenditures were made to enable us to achieve a gross production capacity of approximately 720,000 meters annually of 344 superconductors on our 4 cm manufacturing technology and to prepare to migrate to our 10 cm manufacturing technology. We estimate that an additional \$28.0 million to \$35.0 million of capital expenditures would be needed for a full commercial manufacturing operation with a gross capacity of approximately 9 million meters of wire per year.

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For the six months ended September 30, 2008, cash provided by financing activities was \$12.0 million compared to \$102.0 million in the same period of fiscal 2007. The decrease was due to proceeds received from our secondary offering during the first quarter of fiscal 2007, offset in part by an increase in proceeds from the exercise of employee stock options.

Although our cash requirements fluctuate based on a variety of factors, including customer adoption of our products and our research and development efforts to commercialize our products, we believe that our available cash will be sufficient to fund our working capital, capital expenditures, and other cash requirements for the next several years and will enable us to withstand the current restrictive credit environment.

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**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS** *Continued*

We also have an unused line of credit of 0.6 million (or approximately \$0.9 million), which is available until June 30, 2010.

The possibility exists that we may pursue additional acquisition and joint venture opportunities in the future that may affect liquidity and capital resource requirements.

***Off-Balance Sheet Arrangements***

We do not 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 transactions that are not required to be reflected on our balance sheet except as discussed below.

We occasionally enter into construction contracts that include a performance bond. As these contracts progress, we continually assess the probability of a payout from the performance bond. Should we determine that such a payout is likely, we would record a liability. As of September 30, 2008, amounts recorded with respect to performance-based liabilities are immaterial to our financial statements.

***New Accounting Pronouncements***

In May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 162, The Hierarchy of Generally Accepted Accounting Principles. This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles ( GAAP ) in the United States (the GAAP hierarchy ). Currently, GAAP hierarchy is provided in the American Institute of Certified Public Accountants U.S. Auditing Standards ( AU ) Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles ( AU Section 411 ). SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board's amendments to AU Section 411. We are in the process of evaluating whether the adoption of this standard will have a material effect on our financial position, results of operations or cash flows.

In April 2008, the FASB issued FASB staff position ( FSP FAS 142-3 ) Determination of the Useful Life of Intangible Assets. FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), and other U.S. GAAP. This FSP applies to all intangible assets, whether acquired in a business combination or otherwise, and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and applied prospectively to intangible assets acquired after the effective date. Early adoption is prohibited. We are in the process of evaluating whether the adoption of this standard will have a material effect on our financial position, results of operations or cash flows.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. This statement is intended to help investors better understand how derivative instruments and hedging activities affect an entity's financial position, financial performance and cash flows through enhanced disclosure requirements. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We began hedging activities in October 2008 and will begin disclosing under the provisions of SFAS No. 161 in our next Annual Report on Form 10-K filing.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations, which replaces SFAS No. 141. This revised standard requires assets, liabilities and non-controlling interests acquired to be measured at fair value and requires that costs incurred to effect the acquisition be recognized separately from the business combination. In addition, this statement expands the scope to include all transactions and other events in which one entity obtains control over one or more businesses. This statement is effective for all business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Although there are not any current plans for an acquisition, should there be an acquisition in the future, we will adopt this statement for acquisitions consummated after its effective

date.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements, an



**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS Continued**

Amendment of ARB No. 51. This statement establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective for fiscal years beginning on or after December 15, 2008. Although there are not any current plans for an acquisition of a non-controlling interest, should there be such an acquisition in the future, we will adopt this statement for acquisitions consummated after its effective date.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. SFAS No. 157 also expands financial statement disclosures about fair value measurements. On February 12, 2008, the FASB issued FSP FAS 157-2 which delays the effective date of SFAS No. 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS No. 157 and FSP 157-2 are effective for financial statements issued for fiscal years beginning after November 15, 2007. We elected a partial deferral of SFAS No. 157 under the provisions of FSP 157-2 related to the measurement of fair value used when evaluating goodwill, other intangible assets and other long-lived assets for impairment and valuing asset retirement obligations and liabilities for exit or disposal activities. The partial adoption of SFAS No. 157 on April 1, 2008 did not have a material impact on our condensed consolidated financial statements.

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**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our exposure to market risk through financial instruments, such as investments in marketable securities, is limited to interest rate risk and is not material. Our investments in marketable securities consist primarily of corporate debt instruments and are designed, in order of priority, to preserve principal, provide liquidity, and maximize income. Investments are monitored to limit exposure to mortgage-backed securities and similar instruments responsible for the recent turmoil in the credit markets. Interest rates are variable and fluctuate with current market conditions. We do not believe that a 10% change in interest rates would have a material impact on our financial position or results of operation.

The functional currency of all our foreign entities is the U.S. dollar, except for our wholly-owned Austrian subsidiary, AMSC Windtec GmbH, for which the local currency (Euro) is the functional currency. We monitor foreign currency exposures and hedge currency risk when deemed appropriate. Cumulative translation adjustments are excluded from net loss and reported as a separate component of stockholders' equity. Foreign currency transaction and translation losses were \$0.7 million for the six months ended September 30, 2008. Future operating results could be impacted by material foreign currency fluctuations. In the future, should foreign currency fluctuations become material, management will review options to limit the financial impact to our operations.

**ITEM 4. CONTROLS AND PROCEDURES**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2008. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (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 September 30, 2008, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Changes in Internal Control Over Financial Reporting**

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

While the following risk factors have been updated to reflect developments subsequent to the filing of our Annual Report on Form 10-K for the fiscal year ended March 31, 2008, there have been no material changes to the risk factors included in that report.

**We have a history of operating losses, and we may incur losses in the future.**

We have incurred net losses in each year since our inception, driven primarily by the research and development activities in our AMSC Superconductors business unit. Our net losses were \$10.2 million for the six months ended September 30, 2008 and \$25.4 million for fiscal 2007, \$34.7 million for fiscal 2006 and \$30.9 million for fiscal 2005, respectively. Our accumulated deficit at the end of the second quarter of fiscal 2008 was \$420.7 million. We expect to continue to incur operating losses through our fiscal quarter ending December 31, 2008 but we expect to achieve profitable results in the quarter ending March 31, 2009. However, we cannot be certain that we will achieve or sustain

profitability.

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

We had cash, cash equivalents, marketable securities and restricted cash totaling \$128.9 million at the end of the second quarter of fiscal 2008. We believe our available cash, cash equivalents, marketable securities and restricted cash will be sufficient to fund our working capital, capital expenditures and other cash requirements for the next several years. However, we may need additional funds if our performance deviates significantly from our current business plan, if there are significant changes in competitive or other market factors, or if unforeseen circumstances arise. Such funds may not be available, or may not be available under terms acceptable to us.

**A significant portion of our revenues are derived from a single customer.**

Revenue growth in fiscal 2007 and the first and second quarters of fiscal 2008 were driven largely by our Power Systems business unit, particularly our Windtec subsidiary. Our largest customer is Sinovel in China. Sinovel accounted for approximately 52% of our total revenues for the full year fiscal 2007 and 65% of our total revenues for the six months ended September 30, 2008. Revenues from Sinovel are supported by purchase orders for electrical system components as well as development contracts for the design of wind turbines. If Sinovel cancelled purchase orders or development contracts, or discontinued future purchases from us, we might be unable to replace the related revenues. This would have a serious negative impact on our operating results and financial position.

**Adverse changes in domestic and global economic conditions could adversely affect our operating results.**

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic conditions. The state of both the domestic and global economies has recently become increasingly uncertain due to a significant reduction in the availability of credit, rising interest rates and financial market volatility. If credit continues to become more difficult to obtain, some customers may delay or reduce purchases. This could result in reductions in sales of our products, longer sales cycles, slower adoption of new technologies, increased accounts receivable write-offs and increased price competition. Any of these events would likely harm our business, results of operations and financial condition.

**There are a number of technological challenges that must be successfully addressed before our superconductor products can gain widespread commercial acceptance, and our inability to address such technological challenges could adversely affect our ability to acquire customers for our products.**

Many of our superconductor products are in the early stages of commercialization, while others are still under development. There are a number of technological challenges that we must successfully address to complete our development and commercialization efforts for superconductor products. We also believe that several years of further development in the cable, fault current limiter and motor industries will be necessary before a substantial number of additional commercial applications for our HTS wire in these industries can be developed and proven. We will also need to improve the performance and reduce the cost of our HTS wire to expand the number of commercial applications for it. We may be unable to meet such technological challenges or to sufficiently improve the performance and reduce the costs of our HTS wire. Delays in development, as a result of technological challenges or other factors, may result in the introduction or commercial acceptance of our superconductor products later than anticipated.

**The commercial uses of superconductor products are limited today, and a widespread commercial market for our products may not develop.**

To date, there has been no widespread commercial use of HTS products. Even if the technological hurdles currently limiting commercial uses of HTS products are overcome, it is uncertain whether a robust commercial market for those new and unproven products will ever develop. To date, many projects to install HTS cables and products in power grids have been funded or subsidized by the governmental authorities. If this funding is curtailed, grid operators may not continue to utilize HTS cables and products in their projects. It is possible that the market demands we currently anticipate for our HTS products will not develop and that they will never achieve widespread commercial acceptance.

**We have limited experience manufacturing our Power Systems products in commercial quantities overseas.**

We recently commenced production of our primary Power Systems product, the PM1000, at our new manufacturing facility in China. We do not have significant experience managing foreign manufacturing operations, and such operations are subject to



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**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

complexities that we may not be able to adequately anticipate or manage. Our inability to successfully manufacture our PM1000 product at acceptable cost and quality through our China facility may affect our future revenue and profit.

**We have not manufactured our 344 superconductors in commercial quantities, and a failure to manufacture our 344 superconductors in commercial quantities at acceptable cost and quality levels would substantially limit our future revenue and profit potential.**

We are developing commercial-scale manufacturing processes for our 344 superconductors, which are very different from our 1G HTS wire manufacturing processes and are complex and challenging. In November 2007, we started initial production of our 344 superconductors and completed installation of the manufacturing line, which has an annual capacity of 720,000 meters. However, in order to be able to offer our wire at pricing that we believe will be commercially competitive, we estimate that we will need to develop the capacity to manufacture nine million meters of our 344 superconductors annually. We believe it will cost between approximately \$28 million and \$35 million to purchase and install the additional equipment to achieve this commercial-scale manufacturing capability. We may not be able to manufacture satisfactory commercial quantities of 344 superconductors of consistent quality with an acceptable yield and cost. Failure to successfully scale up manufacturing of our 344 superconductors would result in a significant limitation of the broad market acceptance of our HTS products and of our future revenue and profit potential.

**We have limited experience in marketing and selling our superconductor products and system-level solutions, and our failure to effectively market and sell our products and solutions could adversely affect our revenue and cash flow.**

To date, we have limited experience marketing and selling our superconductor products and system-level solutions, and there are few people who have significant experience marketing or selling superconductor products and system-level solutions. Once our products and solutions are ready for widespread commercial use, we will have to develop a marketing and sales organization that will effectively demonstrate the advantages of our products over both more traditional products and competing superconductor products or other technologies. We may not be successful in our efforts to market this new technology, and we may not be able to establish an effective sales and distribution organization.

We may decide to enter into arrangements with third parties for the marketing or distribution of our products, including arrangements in which our products, such as HTS wire, are included as a component of a larger product, such as a power cable system or a motor. By entering into marketing and sales alliances, the financial benefits to us of commercializing our products are dependent on the efforts of others.

**Our success in addressing the wind energy market is dependent on the manufacturers that license our designs.**

Because an important element of our strategy for addressing the wind energy market involves the license of our wind turbine designs to manufacturers of those systems, the financial benefits to us of our products for the wind energy market are dependent on the success of these manufacturers in selling wind turbines based on our designs. We may not be able to enter into marketing or distribution arrangements with third parties on financially acceptable terms, and third parties may not be successful in selling our products or applications incorporating our products.

**Growth of the wind energy market depends largely on the availability and size of government subsidies and economic incentives.**

At present, the cost of wind energy exceeds the cost of conventional power generation in many locations around the world. Various governments have used different policy initiatives to encourage or accelerate the development and adoption of wind energy and other renewable energy sources. Renewable energy policies are in place in the European Union, most notably Germany and Spain, certain countries in Asia, including China, Japan and South Korea, and many of the states in Australia and the United States. Examples of government sponsored financial incentives include capital cost rebates, feed-in tariffs, tax credits, net metering and other incentives to end-users, distributors, system integrators and manufacturers of wind energy products to promote the use of wind energy and to reduce dependency on other forms of energy. Governments may decide to reduce or eliminate these economic incentives for political, financial or other reasons. Reductions in, or eliminations of, government subsidies and economic incentives before the wind energy industry reaches a sufficient scale to be cost-effective in a non-subsidized marketplace could reduce demand for our products and adversely affect our business prospects and results of operations.

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

**Many of our revenue opportunities are dependent upon subcontractors and other business collaborators.**

Many of the revenue opportunities for our business involve projects, such as the installation of superconductor cables in power grids and electrical system hardware in wind turbines, in which we collaborate with other companies, including suppliers of cryogenic systems, manufacturers of electric power cables and manufacturers of wind turbines. In addition, a key element of our business strategy is the formation of business alliances with motor manufacturers and/or marine propulsion system integrators. As a result, most of our current and planned revenue-generating projects involve business collaborators on whose performance our revenue is dependent. If these business partners fail to deliver their products or perform their obligations on a timely basis or fail to generate sufficient demand for the systems they manufacture, our revenue from the project may be delayed or decreased, and we may not be successful in selling our products.

**We may not realize all of the sales expected from our backlog of orders and contracts.**

At September 30, 2008, we had approximately \$597 million of backlog. There can be no assurances that the revenue we expect to generate from our backlog will be realized in the periods we expect to realize such revenue, or at all. In addition, the backlog of orders, if realized, may not result in profitable revenue. Backlog represents the value of contracts and purchase orders received, less the revenue recognized to date on those contracts and purchase orders. Our customers have the right under some circumstances and with some penalties or consequences to terminate, reduce or defer firm orders that we have in backlog. In addition, our government contracts are subject to the risks described below. If our customers terminate, reduce or defer firm orders, we may be protected from certain costs and losses, but our sales will nevertheless be adversely affected and we may not generate the revenue we expect.

Although we strive to maintain ongoing relationships with our customers, there is an ongoing risk that orders may be cancelled or rescheduled due to fluctuations in our customers' business needs or purchasing budgets.

Our largest customer, Sinovel, accounts for a substantial portion of our backlog. In the event that we either fail to deliver product to Sinovel within 120 days after its specific delivery time, or become bankrupt or insolvent, then Sinovel would have the right to terminate any remaining orders that we have in backlog. If Sinovel cancelled orders, it would have a serious negative impact on our operating results and financial position.

**Our contracts with the U.S. government are subject to audit, modification or termination by the U.S. government, and the continued funding of such contracts remains subject to annual congressional appropriation which, if not approved, could adversely affect our results of operations and financial condition.**

As a company that contracts with the U.S. government, we are subject to financial audits and other reviews by the U.S. government of our costs and performance, accounting and general business practices relating to these contracts. For the six months ended September 30, 2008, 10% of our total revenues were derived from government contracts. Based on the results of these audits, the U.S. government may adjust our contract-related costs and fees. We cannot be certain that adjustments arising from government audits and reviews would not have a material adverse effect on our results of operations.

All of our U.S. government contracts can be terminated by the U.S. government for its convenience. Termination-for-convenience provisions provide only for our recovery of costs incurred or committed, and for settlement of expenses and profit on work completed prior to termination. In addition to the right of the U.S. government to terminate its contracts with us, U.S. government contracts are conditioned upon the continuing approval by Congress of the necessary spending to honor such contracts. Congress often appropriates funds for a program on a fiscal-year basis even though contract performance may take more than one year. Consequently, at the beginning of many major governmental programs, contracts often may not be fully funded, and additional monies are then committed to the contract only if, as and when appropriations are made by Congress for future fiscal years. We cannot be certain that our U.S. government contracts will not be terminated or suspended in the future. The U.S. government's termination of, or failure to fully fund, one or more of our contracts would have a negative impact on our operating results and financial condition. Further, in the event that any of our government contracts are terminated for cause, it could affect our ability to obtain future government contracts which could, in turn, seriously harm our ability to develop our technologies and products.

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**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

**We are becoming increasingly reliant on contracts that require the issuance of performance bonds.**

While we have been required to provide performance bonds in the form of surety bonds or letters of credit in the past, the size of the bonds was not material. Recently, we have entered into contracts that require us to post bonds of significant magnitude. In many instances, we are required to deposit cash in escrow accounts as collateral for these instruments, which is unavailable to us for general use for significant periods of time. At the end of the second quarter of fiscal 2008, \$7.3 million of our cash was classified as restricted, the majority of which is used as collateral for performance bonds. Should we be unable to issue performance bonds in the future, significant future potential contract revenue could become unavailable to us. Further, should our working capital situation deteriorate, we would not be able to access the escrowed cash to meet working capital requirements.

**Our products face intense competition both from superconductor products developed by others and from traditional, non-superconductor products and alternative technologies, which could limit our ability to acquire or retain customers.**

The market for superconductor products is intensely competitive. We face competition both from competitors in the superconductor field and from vendors of traditional products and new technologies. There are many companies in the United States, Europe, Japan, China and Korea engaged in the development of HTS wire, including EHTS (a division of Bruker Biospin), Evico, Fujikura, Furukawa Electric, Innova Superconductor Technology, Nexans, MetOx, Showa, Sumitomo Electric Industries, SuperPower (a subsidiary of Royal Philips Electronics), Zenergy and SuNAM. The superconductor industry is characterized by rapidly changing and advancing technology. Our future success will depend in large part upon our ability to keep pace with advancing HTS technology and developing industry standards.

Our D-VAR and SVC power electronic products compete with a variety of other power reliability products such as dynamic voltage restorers, or DVRs, flywheels, battery-based power quality systems and competing power electronic converter systems. The manufacturers of products that compete with our power electronic products and PowerModule products include ABB, Alstom, Mitsubishi Electric, S&C Electric and Siemens.

Our AMSC Windtec business faces competition for the supply of wind turbine engineering design services from design engineering firms, such as Garrad Hassan, and from licensors of wind turbine systems, such as Aerodyn, DeWind and REpower. We also face indirect competition in the wind energy market from manufacturers of wind energy systems, such as Gamesa, General Electric, Suzlon and Vestas.

The stand-alone Fault Current Limiter ( FCL ) products that we are developing in collaboration with Siemens face competition from several competitors developing alternative solutions, including Beijing Superconductor, Hypertech, Hyundai, Innopower, KEPRI, LS Industrial Systems, Nexans, Rolls-Royce, SC Power, SuperPower and Toshiba. The HTS motor and generator products that we are developing face competition from copper wire-based motors and generators, from permanent magnet motors that are being developed, including by DRS Technologies, and from companies developing HTS rotating machinery, including Baldor Electric, Convertteam, Doosan Heavy Industries & Construction, General Electric, Ishikawajima-Harima Heavy Industries Co. and Siemens. Research efforts and technological advances made by others in the superconductor field, in the wind energy market or in other areas with applications to the power quality and reliability markets may render our development efforts obsolete.

Many of our competitors have substantially greater financial resources, research and development, manufacturing and marketing capabilities than we have. In addition, as the HTS wire, HTS electric motors and generators, and power electronic systems markets develop, other large industrial companies may enter those fields and compete with us. If we are unable to compete successfully, it may harm our business, which in turn may limit our ability to acquire or retain customers.

**Third parties have or may acquire patents that cover the materials, processes and technologies we use or may use in the future to manufacture our HTS products, and our success depends on our ability to license such patents or other proprietary rights.**

We expect that some or all of the HTS materials, processes and technologies we use in designing and manufacturing our products are or will become covered by patents issued to other parties, including our competitors. The owners of these patents may refuse to grant licenses to us, or may be willing to do so only on terms that we find commercially unreasonable. If we are unable to obtain these licenses, we may have to contest the validity or scope of those patents or re-engineer our products to avoid infringement claims by the owners of these patents. It is possible that we will not be successful in contesting the validity or scope of a patent, or that we will not prevail in a patent infringement claim brought against us. Even if we are successful in such a proceeding, we could incur substantial costs and diversion of management resources in prosecuting or defending such a proceeding.





**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

**Our patents may not provide meaningful protection for our technology, which could result in us losing some or all of our market position.**

We own or have licensing rights under many patents and pending patent applications. However, the patents that we own or license may not provide us with meaningful protection of our technologies and may not prevent our competitors from using similar technologies, for a variety of reasons, such as:

the patent applications that we or our licensors file may not result in patents being issued;

any patents issued may be challenged by third parties; and

others may independently develop similar technologies not protected by our patents or design around the patented aspects of any technologies we develop.

Moreover, we could incur substantial litigation costs in defending the validity of or enforcing our own patents. We also rely on trade secrets and proprietary know-how to protect our intellectual property. However, our non-disclosure agreements and other safeguards may not provide meaningful protection for our trade secrets and other proprietary information. If the patents that we own or license or our trade secrets and proprietary know-how fail to protect our technologies, our market position may be adversely affected.

**Our success is dependent upon attracting and retaining qualified personnel, and our inability to do so could significantly damage our business and prospects.**

Our success will depend in large part upon our ability to attract and retain highly qualified research and development, management, manufacturing, marketing and sales personnel. Hiring those persons may be especially difficult due to the specialized nature of our business.

**We may acquire additional complementary businesses or technologies, which may require us to incur substantial costs for which we may never realize the anticipated benefits.**

We may in the future acquire complementary businesses or technologies, although we currently have no commitments or agreements to do so. As a result of any acquisitions we pursue, management's attention and resources may be diverted from our other businesses. An acquisition may also involve a significant purchase price and significant transaction-related expenses.

Achieving the benefits of any acquisition involves additional risks, including:

difficulty assimilating acquired operations, technologies and personnel;

inability to retain management and other key personnel of the acquired business;

changes in management or other key personnel that may harm relationships with the acquired business's customers and employees; and

diversion of management attention as a result of the integration process.

We cannot ensure that we will realize any of the anticipated benefits of any acquisition, and if we fail to realize these anticipated benefits, our operating performance could suffer.

**Our international operations are subject to risks that we do not face in the U.S., which could have an adverse effect on our operating results.**

We are expanding our sales and service operations in Europe and the Asia-Pacific region, including a new operation in China. We expect our revenue and operations outside the United States will continue to expand in the future. For the six months ended

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

September 30, 2008 and for fiscal 2007, 80% and 74%, respectively, of our consolidated revenues were derived from customers outside of the United States. Our international operations are subject to a variety of risks that we do not face in the U.S., including:

difficulties in staffing and managing our foreign offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;

potentially longer payment cycles for sales in foreign countries and difficulties in collecting accounts receivable;

additional withholding taxes or other taxes on our foreign income, and tariffs or other restrictions on foreign trade or investment, including export duties and quotas, trade and employment restrictions;

imposition of, or unexpected adverse changes in, foreign laws or regulatory requirements;

increased exposure to foreign currency exchange rate risk;

reduced protection for intellectual property rights in some countries; and

political unrest, war or acts of terrorism.

Our overall success in international markets depends, in part, upon our ability to succeed in differing legal, regulatory, economic, social and political conditions. We may not be successful in developing and implementing policies and strategies that will be effective in managing these risks in each country where we do business or conduct operations. Our failure to manage these risks successfully could harm our international operations and reduce our international sales, thus adversely affecting our business, operating results and financial condition.

**Our common stock may experience extreme market price and volume fluctuations, which may prevent our stockholders from selling our common stock at a profit and could lead to costly litigation against us that could divert our management's attention.**

The market price of our common stock has historically experienced significant volatility and may continue to experience such volatility in the future. Factors such as technological achievements by us and our competitors, the establishment of development or strategic relationships with other companies, our introduction of commercial products, and our financial performance may have a significant effect on the market price of our common stock. In addition, the stock market in general, and the stock of high technology companies in particular, have in recent years experienced extreme price and volume fluctuations, which are often unrelated to the performance or condition of particular companies. Such broad market fluctuations could adversely affect the market price of our common stock. Due to these factors, the price of our common stock may decline and investors may be unable to resell their shares of our common stock for a profit. Following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. If we become subject to this kind of litigation in the future, it could result in substantial litigation costs, a damages award against us and the diversion of our management's attention.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

On August 5th and 6th, 2008, Provident Premier Master Fund, Ltd. ( Provident ) exercised warrants to purchase an aggregate of 200,000 shares of our common stock at an exercise price of \$9.50 per share on a cashless basis. By exercising on a cashless basis, the number of shares of common

stock that would otherwise have been issuable to Provident upon the exercise of such warrants was reduced by 51,613 shares. Accordingly, we issued 148,387 shares of our common stock to Provident upon such exercise. The issuance of our common stock upon exercise of the warrants described herein was exempt from registration requirements under the Securities Act of 1933, as amended, pursuant to Section 4(2) thereof, because the transaction did not involve a public offering.

**ITEM 6. EXHIBITS**

See the Exhibit Index on the page immediately preceding the exhibits for a list of exhibits filed as part of this quarterly report, which Exhibit Index is incorporated herein by this reference.

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

**SIGNATURE**

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.

AMERICAN SUPERCONDUCTOR CORPORATION

Date November 7, 2008

/s/ DAVID A. HENRY  
David A. Henry  
Senior Vice President and Chief Financial Officer  
  
(Principal Financial and Accounting Officer)

**Table of Contents**

**AMERICAN SUPERCONDUCTOR CORPORATION**

**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 31.1               | Chief Executive Officer Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                            |
| 31.2               | Chief Financial Officer Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                            |
| 32.1               | Chief Executive Officer Certification pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2               | Chief Executive Officer Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                            |