POWER EFFICIENCY CORP
Form 10QSB
August 16, 2004

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: June 30, 2004
OR
[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________ to ___________

Commission File No. 0-31805

POWER EFFICIENCY CORPORATION
(Exact Name of Small Business Issuer as Specified in its Charter)

DELAWARE	22-3337365
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

35432 INDUSTRIAL ROAD LIVONIA, MI 48150	(734) 464-6711
(Address of Principal Executive Offices)	(Issuer's Telephone Number, Including Area Code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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

The number of shares outstanding of the Issuer's Common Stock, $.001 Par Value, as of August 13, 2004 was 5,020,418.

Transitional Small Business Disclosure Format (check one): Yes No X

1

POWER EFFICIENCY CORPORATION
FORM 10-QSB INDEX

PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

POWER EFFICIENCY CORPORATION
CONDENSED BALANCE SHEET
Unaudited

	June 30, 2004
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 16,140
Accounts receivable, net	29,071
Inventory, net of reserve	303,013
Prepaid expenses and other current assets	76,117
Total Current Assets	424,341

PROPERTY AND EQUIPMENT, Net	84,157
OTHER ASSETS:	
Deposits	12,647
Patents, net	13,506
Goodwill	1,929,963
Customer manuals and sales literature, net	20,436
Website, net	13,033
Total Other Assets	1,989,585
Total Assets	$ 2,498,083
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable and accrued expenses	643,692
Accrued salaries and payroll taxes	176,675
Customer deposits	20,907
Note payable-line of credit	300,000
Notes payable- former officer	105,000
Total Current Liabilities	1,246,274
Total Liabilities	1,246,274
STOCKHOLDERS' EQUITY:	
Preferred Stock, $.001 par value, 10,000,000 shares authorized, 3,328,737 shares issued and outstanding	3,329
Common stock, $.001 par value, 7,142,857 shares authorized, 5,020,418 issued and outstanding	5,020
Additional paid-in capital	15,257,830
Accumulated deficit	(14,014,370)
Total Stockholders' Equity	1,251,809
Total Liabilities and Stockholders' Equity	$ 2,498,083

ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

POWER EFFICIENCY CORPORATION
CONDENSED STATEMENTS OF OPERATIONS
Unaudited

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTH
	2004	2003	2004

REVENUES			
Product	$ 57,131	$ 95,283	$ 141,419
Miscellaneous	7,475	--	12,725
Total Revenues	$ 64,606	$ 95,283	$ 154,144
COMPONENTS OF COST OF PRODUCT REVENUES:			
Material and labor	26,614	43,556	67,794
Allocated costs	12,596	24,120	36,529
Inventory obsolescence and other write-offs	--	15,000	29,484
Total Cost of Revenues	39,210	82,676	133,807
GROSS MARGIN	25,396	12,607	20,337
COSTS AND EXPENSES:			
Research and development	94,103	99,712	208,297
Selling, general and administration	472,258	518,657	920,298
Depreciation and amortization	18,982	30,825	37,502
Total costs and expenses	585,343	649,194	1,166,097
LOSS FROM OPERATIONS	(559,947)	(636,587)	(1,145,760)
OTHER EXPENSE			
Interest expense	(6,273)	(14,493)	(7,597)
Total Other Expenses	(6,273)	(14,493)	(7,597)
NET LOSS	$ (566,220)	$ (651,080)	$(1,153,357)
BASIC LOSS PER COMMON SHARE	$ (.11)	$ (.64)	$ (.28)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	5,018,926	1,014,399	4,170,612

ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

4

POWER EFFICIENCY CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS
Unaudited

FOR THE SIX MO
2004

CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss	$(1,153,357)
Adjustments to reconcile net loss to net cash used for operating activities:	
Depreciation and amortization	37,502
Compensation expense	--
Bad debt expense	5,493
Inventory obsolescence reserve and other write-offs	29,484
Changes in assets and liabilities:	
(Increase) Decrease:	
Accounts receivable, net	3,079
Inventory	28,457
Prepaid expenses and other current assets	(761)
Increase (Decrease):	
Accounts payable and accrued expenses	144,564
Customer deposits	20,907
Accrued salaries and payroll taxes	162,040
Net Cash Used for Operating Activities	(722,592)
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of fixed assets	(21,576)
Net Cash Used for Investing Activities	(21,576)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from line of credit	300,000
Proceeds from issuance of equity securities, net of costs	184,800
Loans from (payments to) stockholders and former officers	(10,000)
Net Cash Provided by Financing Activities	474,800
Decrease in cash and cash equivalents	(269,368)
Cash and cash equivalents at beginning of period	285,508
Cash and cash equivalents at end of period	$ 16,140
NON-CASH FINANCING TRANSACTIONS- Common stock issued in conjunction with the settlement of accounts payable and accrued salaries\ payroll\other expenses	$ 37,400

ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

5

POWER EFFICIENCY CORPORATION
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

The accompanying financial statements have been prepared by the Company, without an audit. In the opinion of management, all adjustments have been made, which include normal recurring adjustments necessary to present fairly the condensed financial statements. Operating results for the six months ended June 30, 2004 are not necessarily indicative of the operating results for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The Company believes that the disclosures provided are adequate to make the information presented not misleading. Certain amounts in the financial statements have been reclassified from prior period presentations. These unaudited condensed financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report for the year ended December 31, 2003 on Form 10-KSB. The prior period per share amounts and weighted average number of shares have been adjusted for the one-for-seven reverse stock split effective March 1, 2004.

The preparation of condensed financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2 - GOING CONCERN

The accompanying financial statements have been prepared assuming the Company is a going concern, which assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company suffered recurring losses from operations, a recurring deficiency of cash from operations, including a cash deficiency of approximately $723,000 from operations for the six months ended June 30, 2004, and lacks sufficient liquidity to continue its operations. During June of 2004, the Company suspended substantially all payments to employees and vendors until such time as additional financing can be raised.

These factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amount of liabilities that might be necessary should the Company be unable to continue in existence. Continuation of the Company as a going concern is dependent upon achieving profitable operations in the long-term and raising additional capital to support existing operations for at least the next twelve months. Management's plans to achieve profitability include developing new products, obtaining new customers and increasing sales to existing customers.

On February 25, 2004, the Company signed a formal letter of agreement with an investment banker. Under this letter, the Company appointed the investment banker as its exclusive representative through June 24, 2004, in an attempt to raise additional capital through equity issuance, debt financing or other types of financing for the Company. While the formal letter agreement has expired, the investment banker continues to represent the company under the same terms as the original agreement. However, there are no assurances that sufficient capital can be raised.

NOTE 3 -- NET LOSS PER SHARE

Basic per share amounts are computed by dividing the net loss available to common stockholders by the weighted average number of common shares outstanding during the year. Diluted per share amounts incorporate the incremental shares issuable upon the assumed exercise of the Company's stock options and warrants and assumed conversion of convertible securities. Such incremental amounts have been excluded from the calculation since their effect would be anti-dilutive. Such stock options, warrants and conversions could potentially dilute earnings per share in the future.

NOTE 4 -LINE OF CREDIT AGREEMENT

On April 20, 2004, the Company executed a $300,000 Note and related Security Agreement (the "Financing") with Summit Energy Ventures, LLC, the Company's controlling shareholder.

Pursuant to the terms of the Note, the Registrant received a $300,000 line of credit from Summit, all of which was drawn down during the quarter ended June 30, 2004. The outstanding balance of the Note was originally due on the earlier of (i) May 31, 2004, or (ii) at such time that the Borrower closed on a debt or equity financing of at least $300,000. The note has been subsequently amended so that it is due on the earlier of (i) August 31, 2004, or (ii) at such time that the Borrower closes on a debt or equity financing of at least $300,000. This line of credit is intended to be a bridge to additional outside financing which may be in the form of debt or equity (See Note 2).

During June, 2004, this note was assigned to Commonwealth Energy Corporation, a former member of Summit Energy Ventures LLC (see Note 7).

NOTE 5 -STOCK OPTION PLAN

In June of 2004 the Board of Directors of the Company approved a modification to the 2000 Stock Option and Restricted Plan ("2000 Plan"). The modified 2000 Plan increases the number of authorized shares from 614,286 to 5,000,000. The increase in options will be used as compensation and incentives for employees and non-employee directors.

7

POWER EFFICIENCY CORPORATION
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 6 -STOCKHOLDERS' EQUITY

During January and February 2004, the Company received approximately $162,800, net of fees, for the issuance of shares of Common Stock that were subscribed for prior to January 1, 2004. In January 2004, the Company received approximately $22,000, net of fees, for the issuance of shares of Common Stock that were subscribed for during January 2004.

On various dates during the six months ended June 30, 2004, the Company issued to the Chief Executive Officer shares of common stock totaling 18,001 for settlement related to deferred compensation and certain reimbursable expenses amounting to $29,000.

During February 2004, the Company issued 20,000 shares of common stock valued at $8,400 as part of a contract with an outside vendor.

NOTE 7 - ISSUANCE OF SERIES A-1 CONVERTIBLE PREFERRED STOCK

On June 7, 2004 Summit Energy Ventures notified the Company that it had transferred 1,747,587 of the Company's preferred stock and 1,645,404 of the Company's common stock to Commonwealth Energy Corporation a former member of Summit Energy Ventures LLC.

NOTE 8- SUBSEQUENT EVENTS

Subsequent to June 30, 2004, the Chief Executive Officer, Chief Financial Officer, Chief Technology Officer, and the Vice President of Governmental Operations entered into individual modifications to their existing employment agreements with the Company. The Vice President of Operations also entered an agreement to modify his existing employment relationship with the Company. Under the terms of the new agreements, each individual ("Executive") agrees to reduce their current compensation levels and the Vice President of Finance, Vice President of Governmental Operations, and Vice President of Operations agrees to suspend the Division Incentive Plan, in exchange for additional stock options to be issued under the 2000 Plan (See Note 5). The total stock options to be issued to an Executive is based on a Compensation Reduction component and an Employee Incentive component. The number of stock options issued to an Executive under the Compensation Reduction component is calculated by multiplying five by the amount that their annual salary is reduced. These stock options vest ratably over a twelve month period. The number of stock options issued to an Executive under the Incentive Plan component equals 450,000 for the Chief Executive Officer and 200,000 for the other Executives. These stock options vest ratably over five years. All stock options issued have a ten year life and a strike price of $1.30 per share. The modified agreements resulted in an aggregate reduction of compensation totaling $418,200 and new options to be issued totaling 3,341,000.

The Board of Directors of the Company also approved an unconditional granting of an additional 305,000 stock options to non-executive employees. All current employees will receive stock options. The number issued to non-executives varies by position and ranges from 100,000 stock options to 10,000 stock options. These stock options vest ratably over five years, have a ten year life, and a strike price of $1.30 per share.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

OVERVIEW

The Registrant generates revenues from a single business segment: the design, development, marketing and sale of proprietary solid state electrical components designed to reduce energy consumption in alternating current induction motors. The Registrant began generating revenues from sales of its patented Power Commander(R) line of motor controllers in late 1995.

RESULTS OF OPERATIONS: FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2004 AND 2003.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

We may, in discussions of our future plans, objectives and expected performance in periodic reports filed by us with the Securities and Exchange Commission (or documents incorporated by reference therein) and written and oral presentations made by us, include projections or other forward-looking statements within the meaning of Section 27A of the Securities Exchange Act of 1933 or Section 21E of the Securities Act of 1934, as amended. Such projections and forward-looking statements are based on assumptions, which we believe are reasonable but are, by their nature, inherently uncertain. In all cases, results could differ materially from those projected. Some of the important factors that could cause actual results to differ from any such projections or other forward-looking statements are discussed below, and in other reports filed by us under the Securities Exchange Act of 1934, including under the caption "Risk Factors" in our Annual Report on Form 10-KSB. Our forward looking statements are based on information available to us today, and except as required by law, we undertake no obligation to update any forward looking statement, whether as a result of new information, future events or otherwise.

REVENUES

Total revenues for the three months ended June 30, 2004, were approximately $65,000 compared to $95,000 for the three months ended June 30, 2003, a decrease of $30,000 or 32%. This decrease is mainly attributable to a decrease in sales in the elevator and escalator market segment, due to delays in closing several government installations. The decrease in elevator and escalator sales are partially off-set by sales to new international distributors and revenue from a government grant. Sales to two new international distributors totaled approximately $8,400 during the three months ended June 30, 2004. Revenue of $7,475 was recognized for a government grant received associated with development expenses related to a medium voltage product application during the three months ended June 30, 2004.

Total revenues for the six months ended June 30, 2004, were approximately $154,000 compared to $256,000 for the six months ended June 30, 2003, a decrease of $102,000 or 40%. This decrease is mainly attributable to a decrease in sales in the elevator and escalator market segment, due to delays in closing several government installations. The decrease in elevator and escalator sales are partially off-set by sales to new international distributors and revenue from a government grant. Sales to three new international distributors totaled approximately $39,500 during the six months ended June 30, 2004. Revenue of $12,725 was recognized for a government grant received associated with development expenses related to a medium voltage product application during the six months ended June 30, 2004.

COST OF PRODUCT REVENUES

Total cost of product revenues, which includes material and direct labor, allocated costs, and inventory obsolescence and other write-offs for the three months ended June 30, 2004 were approximately $39,000 compared to approximately $83,000 for the three months ended June 30, 2003, a decrease of $44,000 or 53%. As a percentage of product revenues, total costs of product revenues decreased to approximately 69% for the three months ended June 30, 2004 compared to approximately 87% for the three months ended June 30, 2003. The decrease in the costs as a percentage of product revenues was primarily due to a charge to inventory for obsolescence and other write-offs of approximately $15,000 for the three months ended June 30, 2003.

Total cost of product revenues, which includes material and direct labor, allocated costs, and inventory obsolescence and other write-offs for the six months ended June 30, 2004 were approximately $134,000 compared to approximately $179,000 for the six months ended June 30, 2003, a decrease of $45,000 or 25%. As a percentage of product revenues, total costs of product revenues increased to approximately 95% for the six months ended June 30, 2004 compared to approximately 70% for the six months ended June 30, 2003. The increase in the costs as a percentage of product revenues was primarily due to charges to inventory for obsolescence and other write-offs of approximately $30,000 for the six months ended June 30, 2004 compared to $15,000 for the six months ended June 30, 2003. Also, allocated costs were $37,000 for the six months ended June 30, 2004 compared to $45,000 for the six months ended June 30, 2003, a decrease of $8,000 or 18%. However, as a percentage of product revenue allocated costs were 26% for the six month ended June 30, 2004 compared to 18% for the six months ended June 30, 2003. The allocated costs as a percentage of product revenues increased as the allocated costs were absorbed by a lower amount of product revenues.

OPERATING EXPENSES

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses were approximately $94,000 for the three months ended June 30, 2004, as compared to approximately $100,000 for the three months ended June 30, 2003, a decrease of $6,000 or 6%. This decrease is mainly attributable to closing the New York facility and a cost reduction program implemented in the second half 2003, offset by a $26,000 charge during the three months ended June 30, 2004, related to laboratory testing done for further product development.

Research and development expenses were approximately $208,000 for the six months ended June 30, 2004, as compared to approximately $212,000 for the six months ended June 30, 2003, a $4,000 or a 2% decrease. This decrease is mainly attributable to closing the New York facility and a cost reduction program implemented in the second half 2003, offset by a $26,000 charge during the six months ended June 30, 2004, related to laboratory testing done for further product development.

11

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses were approximately $472,000 for the three months ended June 30, 2004, as compared to $519,000 for the three months ended June 30, 2003 a decrease of $47,000 or 9%. The decrease in selling, general and administrative expenses over the prior year was due primarily to a decrease in sales consulting and travel related expenses.

Selling, general and administrative expenses were approximately $920,000 for the six months ended June 30, 2004, as compared to $872,000 for the six months ended June 30, 2003 an increase of $48,000 or 6%. The increase in selling, general and administrative expenses over the prior year was due primarily to an increase in payroll and payroll related costs related to hiring additional sales staff and consulting fees related to the investment banking agreement with Pali Capital.

FINANCIAL CONDITION, LIQUIDITY, AND CAPITAL RESOURCES: FOR THE SIX MONTHS ENDED JUNE 30, 2004

Since inception, the Registrant has financed its operations primarily through the sale of its equity securities and using available lines of credit. As of June 30, 2004, the Registrant had cash and cash equivalents of $16,140.

Cash used for operating activities for the six months ended June 30, 2004 was $722,592, which consisted of: a net loss of $1,153,357; less depreciation and amortization of $37,502, bad debt expense of $5,493, inventory obsolescence reserve of $29,484, decreases in accounts receivable of $3,079, inventory of $28,457, increases in accounts payable and accrued expenses of $144,564, customer deposits of $20,907, accrued salaries and payroll taxes of $162,040. In addition, these amounts were partially offset by an increase in prepaid expenses of $761.

Net cash used for operating activities for the six months ended June 30, 2003 was $1,032,459, which consisted of: a net loss of $1,090,572; less depreciation and amortization of $64,410, compensation expense of $33,158, decreases in accounts receivable of $10,213, inventory of $92,064, and an increase in accrued salaries and payroll taxes of $43,627. In addition, these amounts were partially offset by increases in prepaid expenses and other current assets of $51,740 and decreases in accounts payable and accrued expenses of $133,619.

Cash used in investing activities for the six months ended June 30, 2004 was $21,576 compared with $6,160 in the six months ended June 30,2003. The amounts for both years consisted of the purchase of fixed assets.

Net cash provided by financing activities for the six months ended June 30, 2004 was $474,800, which primarily consisted of proceeds of $184,800 from the issuance of equity securities related to the Company's Reg "S" stock offering and $300,000 of proceeds from the Summit Energy Ventures line of credit. During the six months ended June 30, 2003, net cash provided from financing activities was $998,935, which primarily consisted of proceeds of $538,560 from the exercise of stock warrants and the issuance of equity securities and $450,000 of proceeds from the Summit Energy Ventures line of credit.

The Registrant expects to experience a reduction in overall expense during the next twelve months as compared to the prior twelve month period. The reduction is a result of cost cutting initiatives that include eliminating four positions and salary reductions of the Chief Executive Officer and four other senior executives. The salary reductions will be effective for a twelve month period beginning in August of 2004, and will aggregate to approximately $418,000. However, the registrant anticipates that operating expenses will continue to exceed anticipated revenues over the next twelve months, and therefore constitute a material use of any cash resources.

Since capital resources are insufficient to satisfy the Registrant's liquidity requirements, management intends to sell additional equity or debt securities or obtain debt financing. The Registrant is also currently meeting with many different potential investors in an attempt to raise additional funds through private placements of equity or debt. However, there are no assurances that sufficient capital or debt can be raised.

CASH REQUIREMENTS AND NEED FOR ADDITIONAL FUNDS

The Registrant anticipates a substantial need for cash to fund its working capital requirements. In accordance with the Registrant's prepared expansion plan, it is the opinion of management that approximately $1.5 million will be required to cover operating expenses, including, but not limited to, marketing, sales and operations during the next twelve months based on the current sales activity.

ITEM 3. CONTROLS AND PROCEDURES

(A) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. Under the supervision and with the participation of its Chief Executive Officer and Chief Financial Officer, management has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed in the Company's Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(B) CHANGES IN INTERNAL CONTROLS. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, nor were there any significant deficiencies or material weaknesses in the Company's internal controls. Accordingly, no corrective actions were required or undertaken.

13

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not involved in any material pending legal proceedings.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

RECENT SALES OF UNREGISTERED SECURITIES -

Sales Made to Summit Energy Ventures
The following details several different sales of unregistered securities the Registrant made to Summit Energy Ventures, LLC, a private equity firm specializing in energy related technologies ("Summit"). All of the sales were exempt from registration under the Securities Act of 1933, as amended (the "Securities Act"), pursuant to section 4(2) of the Securities Act.

On June 14, 2002, the Registrant sold 2,346,233 shares of Series A-1 Convertible

Preferred Stock, $.001 par value per share, for $2,500,000. The shares were convertible into common stock at an initial rate of 2 for 1. The conversion price was subject to anti-dilution provisions and was lowered when the Registrant issued common stock at less than $3.7296 per share. In connection with the above described transaction, Summit also received a stock purchase warrant (the "Summit Warrant") that was exercisable after January 1, 2004 and prior to June 14, 2012, to purchase such number of shares of Series A-2 Convertible Preferred Stock, $.001 par value per share, or common stock, $.001 par value per share, of the Registrant that would result in Summit owning 51% of the Registrant's fully diluted equity. By the terms of the Summit Warrant, the number of shares issuable upon exercise of the Summit Warrant adjusted with the number of shares of the Registrant outstanding and the number of shares issuable pursuant to options and warrants. The exercise price of the Summit Warrant was a function of the Registrant's earnings and was zero when the Summit Warrant was later exercised.

On May 8, 2003, the Registrant closed on a line of credit from Summit. Pursuant to the terms of the revolving credit note entered into between the Registrant and Summit (the "Note"), the Registrant received a $1 million line of credit from Summit. Summit had the ability at any time to give the Registrant notice of its desire to convert any portion of the balance of the Note and interest into Series A-1 Convertible Preferred Stock at the price of $1.0655 per share. At that time, the Registrant would have seven days to repay Summit the amount Summit had indicated it desired to convert. In the event that the amount was not repaid in seven days, Summit would receive Series A-1 Convertible Preferred Stock. Upon conversion, the warrant the Registrant issued to Summit in June of 2002 would be expanded. According to the original terms of the Summit Warrant, Summit had the right to purchase such number of shares of stock in the Registrant that would give Summit a 51% interest in the Registrant. Upon conversion of the Note, the Summit Warrant would be expanded to give Summit the right to purchase an approximately 60% interest in the Registrant. As consideration for the line of credit, the Registrant paid Summit a $50,000 fee which was paid with the proceeds of the Registrant's first draw under the Note. The outstanding balance on the Note accrued interest at 15%.

14

On October 30, 2003, Summit notified the Company that it desired to convert all of the outstanding principal and interest on the note ($1,046,896) into 982,504 shares of Series A-1 Convertible Preferred Stock. The Company did not have the ability to pay off the outstanding balance. As a result, the Company issued 982,504 shares of Series A-1 Convertible Preferred Stock to Summit. As a result of the conversion, the Summit Warrant thereafter gave Summit the right to purchase such number of shares that, when combined with the 2,346,233 shares of Series A-1 Preferred Stock purchased by Summit in June of 2002 but excluding the other shares held by Summit, would give Summit a 60.53% interest in the Company, on a fully diluted basis. The Summit Warrant became exercisable on January 1, 2004 and had an expiration date of June 14, 2012. The conversion of the note also caused the conversion price of the 3,328,737 shares of Series A-1 Convertible Preferred Stock to be lowered to $1.281. As a result, the 3,328,737 outstanding shares of Series A-1 Convertible Preferred Stock are currently convertible into 2,768,849 shares of common stock.

On February 18, 2004, Summit gave notice to exercise the Summit Warrant for shares of the Company's common stock. The number of shares of common stock the Summit Warrant was exercisable for on the date of the notice was 3,461,285. According to the terms of the Summit Warrant, the calculation of the number of shares outstanding on a fully diluted basis includes all shares authorized under the Company's stock option plans and all warrants issued by the Company that are still outstanding. Because not all of the shares authorized under the Company's stock option plans were issued, and because certain options and warrants issued by the Company had strike prices that were considerably higher than the current market price, Summit volunteered to reduce the number of shares it was entitled to under the Summit Warrant. The Company and Summit believe that because these options and warrants were significantly "out of the money", they are unlikely to be exercised. After negotiation between the Company and Summit and an examination of how many options and warrants were significantly "out of the money", the Company and Summit executed a Warrant Agreement, dated February 26, 2004 (see Exhibit 10.34) to exercise the Summit Warrant for 3,134,102 shares of common stock as full performance under the Summit Warrant.

In June 2004 Summit transferred 1,747,587 of the Company's Preferred Stock and 1,645,404 of the Company's Common Stock to Commonwealth Energy Corporation a former member of Summit Energy Ventures LLC.

Sales Made to Purchasers Other than Summit Energy Ventures

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

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

15

On various dates from January 1, 2004 to June 30, 2004, the Company issued 18,001 shares of common stock to Richard Koch. The shares were issued in exchange for the cancellation of debt owed to Mr. Koch in the amount of $29,000. The issuances were exempt from registration under the Securities Act pursuant to Regulation D. Mr. Koch is the Chief Executive Officer and a director of the Company.

During February 2004, the Company issued 20,000 shares of common stock valued at $8,400 as part of a contract with an outside vendor. The issuance was exempt from registration under the Securities Act pursuant to Regulation D.

During the first fiscal quarter, the Company issued 17,034 shares of its Common Stock to foreigners for approximately $23,000 in private placement transactions. The sales were made to foreign investors and were exempt from registration under the Securities Act pursuant to Regulation S. The Company issued 1,193 warrants and paid approximately $1,669 as commission associated with this issuance and issued them at a 70% discount to market.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Nunber	Description of Document	Locatio
3.1	Amended and Restated By-laws of the Company dated March 23, 2004.	Filed h
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed h
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed h
32.1	Certification by the Chief Executive Officer pursuant to Section 1350 of Filed herewith Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	
32.2	Certification by the Chief Financial Officer pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed h

(b) Reports on Form 8-K.

No 8-K reports were filed during the second quarter of 2004.

SIGNATURES

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

POWER EFFICIENCY CORPORATION
(Registrant)

Date: August 16, 2004 By: /s/ Richard Koch

President and Chief Executive Officer

Date: August 16, 2004 By: /s/ Keith G. Collin

Chief Financial Officer (Principal Financial and Accounting Officer)

18