

2004 ANNUAL REPORT

*solid ground.
bright sky.*



plug power
FUEL CELL SYSTEMS™



Plug Power Inc. is a leading provider of clean, reliable on-site energy solutions—focused on a future fueled by distributed energy, and grounded in putting our technology to work today.

Results propel us: engineering and manufacturing commercially viable solutions; forging partnerships with industry leaders; and opening markets worldwide where our technology delivers real value.

By driving the adoption of clean energy in these ways, Plug Power is contributing to global sustainability—helping deliver on the promise of viable new energy products that afford us all a greater degree of independence, comfort and security.



FORWARD-LOOKING STATEMENTS

This 2004 Annual Report, including the President and CEO's letter to the stockholders, contains forward-looking statements about Plug Power and certain matters related to Plug Power within the meaning of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. Please see our discussion titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this 2004 Annual Report for a discussion regarding risks associated with these statements.



Plug Is. Plug Will.

In 2004, Plug Power took care of both.

In the present, our first commercially viable product line, GenCore[®], made ample headway in the marketplace. Key GenCore developments—promising markets, new alliances, critical certifications—set the stage for increased market penetration in 2005. At the same time, we kept building toward the future of fuel cells with a wealth of vital initiatives.

In both dimensions—finding solid ground in the present, envisioning ideas for a bright future—we kept our eye squarely on Plug Power's overarching goal: leadership in developing products for clean, reliable on-site energy solutions. It is from that leadership that Plug Power will ultimately draw its value.



To Our Shareholders.

Several years ago, we defined a concept critical to our success: the concept of a viable path to market adoption of fuel cells—an “adoption curve.” At the same time, we forged a growth model for aligning ourselves with that curve, so we could capture revenue and essential learning at key points along the way.

Our adoption curve has since become an industry standard. Our growth model served as the backdrop for our most significant strides forward in 2004. It helped us zero in on promising industries and customers as we laid the foundation for near-term commercial sales. Concurrently, it allowed us to stay focused on our vision: leadership in the provision of clean, reliable on-site energy.

THE GROWTH MODEL IN ACTION This model validates our past focus while challenging us to innovate. Simply put, by doing what we have always done—focusing on the readiness of our core fuel cell technology and paying close attention to the requirements of potential customers—we can commercialize products that, at each point on the curve, deliver a clear value proposition to the marketplace.

Our model manifested itself in the real world during the past year when we began to reach beyond the early-adopter phase toward the first commercially viable application: backup power in outdoor environments. The potential market here is substantial: in the U.S. wireless telecom industry alone, approximately 174,000 cell sites serve more than 175 million subscribers and each site requires a source of backup power. Equally substantial are the opportunities in other markets, such as wireline, broadband, and utility.

Not surprisingly, then, many of our 2004 activities involved the aggressive promotion of GenCore, the product line we developed specifically for this application. Among other initiatives, we built a small group of partners into a global network of distributors and service providers. While developing that infrastructure, we also enhanced GenCore product features, extended the product line and target markets, and gained key certifications. All these measures will serve us well in bridging the chasm between early adoption and expansive commercial traction.

Yet, because the adoption curve is always moving ahead, we also continued to *think* ahead—so we will stand ready to enter new markets quickly as opportunities arise and the curve evolves. This is why, two years ago, we began developing GenSite™, our on-site hydrogen generation system, the first sale of which took place in 2004. It is why we are preparing to launch the next generation of GenSys®, our continuous-run product. It is also why we have moved ahead in our research and development, investigating such possibilities as home energy stations and high-temperature systems.

Beyond the products themselves, there is the caliber of the people who help us to advance the Plug Power vision—outstanding talents in research and development, in manufacturing, in marketing and sales, in our supply chain, and among our distributors.

THE NUMBERS MOVE AHEAD Integral to the pursuit of our growth model is our quest for the shortest path to profitability. Both initiatives worked together to strengthen our financials in 2004. Total revenue for the year grew over 29%, from \$12.5 million in 2003 to \$16.1 million in 2004. Our net loss shrank to \$46.7 million from \$53.0 million the year before. Significantly, net cash used in operating activities decreased for the fifth consecutive year, from \$34.7 million in 2003 to \$33.9 million in 2004—a reflection of our continuing efforts to achieve cost efficiencies while pushing ahead toward commercial traction.

THE MOVE TO LEADERSHIP—AND A SUSTAINABLE FUTURE What does all this mean, ultimately? That in everything we do, we are following an established path into the future. It is the same path that the microelectronics industry traveled in its journey from PCs to PDAs. Notably, it is also the same path that developing-stage computer companies used to achieve commercial success. Analogously, I see the adoption curve for fuel cells serving as a growth path for Plug Power: a path toward leadership in both fuel cells and clean energy. On a global scale, it will also serve as a vital component of the road map to a hydrogen economy and a sustainable future.

As I have said before, these developments will not occur overnight. Yet I remain confident that they will take place, and my confidence springs from several factors I see at work in Plug Power. Notably, we consistently leverage our learnings from current products to drive our future growth. And beyond the products themselves, there is the caliber of the people who help us to advance the Plug Power vision—outstanding talents in research and development, in manufacturing, in marketing and sales, in our supply chain, and among our distributors.

Other pioneers have shown what it takes to walk this path of innovation: hard work, patience, and people who are at once visionary and practical. I am proud to attest that Plug Power abounds in these qualities. And we are proud to walk the path of innovation with you: visionary and practical investors who recognize the potential, understand our progress, and see our pragmatism opening doors steadily and consistently to an exciting future.



Dr. Roger B. Saillant

President and Chief Executive Officer

today



Envisioning a future for your company is one thing. Building the infrastructure to achieve that future—and realize benefits in the present—is another. While Plug Power actively engages in both, a focus on the near term defined 2004.

By year-end, Plug Power had a product to fuel revenue, a global network through which to sell it, and a market that was beginning to move toward acceptance. Those results prepared the company for an emphasis on growing sales in 2005.

THE PUSH INTO TELECOMS This past year, GenCore—Plug Power's backup power system for outdoor environments—emerged as a commercial product line with a viable economic value proposition for its target customers and applications. By the end of 2004, more than 100 GenCore systems had been shipped to a variety of customers around the globe, including energy users from the telecommunications, utility, and industrial markets.

Among those sales were several notable successes. Early in 2004, Orange, one of the world's fastest-growing mobile communications companies, installed a GenCore unit to provide backup power for a remote cellular communications tower 1,500 feet above sea level at a ski area in Elgin, Scotland. The positive Orange experience allowed GenCore to establish a foothold in Europe while validating its performance in extreme outdoor conditions.

In a different corner of the telecom market, Oneida County Rural Telephone Company, an

independent U.S. local exchange carrier with about 3,900 customers, installed a GenCore unit to support digital switching equipment in one of its remote huts. The unit operated successfully throughout 2004, maintaining power through a midsummer storm that caused power outages in the area.

The Oneida experience is important for the future of GenCore because it opens the independent telecom carrier segment to further GenCore sales. Both the Oneida and Orange installations demonstrate the system's ability to serve the next point on the adoption curve: remote and rural environments. Customers in these environments, who often warm to new technologies before their urban counterparts, hold potential to provide a significant market for Plug Power products in both backup and continuous-run applications.

Meanwhile, a U.S. telecom giant experimented with GenCore in a less remote, but no less critical, setting. In July, an extensive field trial was completed with two GenCore systems at the Albany International Airport in Albany, New York.

What fueled these successes? A major contributor was Plug Power's research into key customers—and its preparation of those customers to accept GenCore as the preferred alternative for backup power. As part of the effort, Plug Power expanded the GenCore portfolio to meet specific industry needs. Most notable in this category was the unveiling of GenCore 5T24, a 24-volt, 5-kilowatt system



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designed specifically for wireless telecom providers, which complements the existing GenCore products for industrial and wireline/wireless applications.

NEW MARKETS EMERGE Though telecommunications was the principal market pursued in 2004, it was by no means the only one. Late in the year, Plug Power introduced three new GenCore configurations designed to provide backup power for electric utility substations. The configurations address a key opportunity in the utility market: the pressing need for extended-run backup power to quickly, reliably and automatically return grid service in the wake of major disruptions (like the Florida hurricanes of 2004).

Plug Power's longtime partners will loom large in the utility initiative. GE Energy continues to introduce the company to key utility customers around the world, paving the way for discussions on GenCore. DTE Energy has purchased GenCore units for its own use, including an initial system to provide backup power at one of its substations.

GenCore systems may also play a role in another rapidly emerging industry: uninterruptible power supply (UPS). GenCore is a more predictable, durable source of backup power than traditional technologies—a distinct advantage in critical situations when other power sources fail. Not surprisingly, in its report on the 2003 blackout, the New York State Public Service Commission recommended that utilities consider fuel cells for mission-critical

A product to fuel revenue.



backup. Plug Power has begun integration testing to validate GenCore's UPS capabilities; as that validation progresses, the company will market the product to government entities with critical functions, such as homeland security, emergency response, and key data centers.

A GLOBAL NETWORK TAKES SHAPE Further penetration into these and other markets—especially across several continents—requires a robust distribution network. In 2004, Plug Power devoted a great deal of attention to building that network on a global scale.

To anchor this effort, the company secured its relationship with a giant in the telecom energy field. Building on discussions in 2003, Plug Power and Tyco Electronics signed two agreements relating to GenCore. Under one agreement, Tyco agreed to market and sell GenCore to telecoms in the U.S. and Canada; under the second agreement Tyco agreed to install and service GenCore systems throughout the U.S. Tyco's broad expertise and relationships with major telecoms bring significant credibility to the GenCore sales process, along with market access to achieve commercial traction.

Agreements with eight other distributors are expected to place GenCore firmly on the global stage:

- siGEN Limited, **Scotland's** only commercial fuel cell system integrator
 - IST Group Limited of **South Africa**, a distributor of GE products and an energy solutions company that serves the telecom premium power market
 - Pianeta of **Italy**, the country's first hydrogen system integrator, which installs and manages stationary fuel cells and hydrogen production equipment
 - H. M. Cragg Company of **Minnesota**, a distributor and manufacturer's representative of power products, batteries, and services
 - J&M Schaefer Inc. of **New York**, a provider of critical backup power for computers, emergency lighting, telecommunications, and utility equipment
 - General Médica de Imágenes CxA (GEMEDICA) of the **Dominican Republic**, which serves the medical health care industry in the Caribbean
 - Tatung of **Taiwan**, a world leader in a diverse range of markets, from information technology to telecommunications
- Two more agreements opened substantial government markets to GenCore. In the third quarter, Plug Power agreed to provide the New York State Office of General Services backup power systems to agencies within the state. Terms of the agreement authorize all state agencies, municipalities, and state-chartered not-for-profits to procure GenCore systems directly from Plug Power. In March 2005, a similar agreement was finalized on the federal level: the U.S. General Services Administration approved GenCore for listing on the Federal
- Hidrener Hydrogen Energy Systems Inc. of **Turkey**, a diversified electrical manufacturer devoted to commercializing hydrogen products

Supply Service Schedule, streamlining purchase of the system within the federal government.

One final agreement serves to complete the GenCore product offering. Plug Power has joined with Airgas, Inc.—the largest U.S. distributor of industrial, specialty, and medical gases—to jointly market Airgas’s hydrogen fuel service products ensuring ready access to fuel throughout the U.S.

TESTS AND STANDARDS BUILD CONFIDENCE

Backup power customers, concerned about the integrity of their mission-critical systems, typically require that new products adhere to strict standards before deploying them. In that context, Plug Power pursued and achieved a key distinction for GenCore: compliance with NEBS (Network Equipment Building Systems) Level 3, an equipment standard that was developed and is recognized by the telecom industry. This achievement helps to assure carriers that they can deploy GenCore in a wide range of demanding applications and environments.

Having achieved the NEBS Level 3 distinction, Plug Power pressed on with additional testing to inspire further confidence in key markets. Together with a telecommunication industry partner, the company completed a more aggressive course of incremental testing to further enhance the marketability of GenCore in harsh-climate applications.

FURTHER STEPS TOWARD PROGRESS Beyond the GenCore initiatives, Plug Power also made progress with its flagship continuous-run product, GenSys, selling 56 units in 2004 while continuing to probe markets and applications.

In the certification arena, the California Air Resources Board (one of the leading air quality management agencies in the United States) certified the GenSys 5C system as meeting its 2007 distributed-generation emission standards requirement. This exempts GenSys from the permitting process in local air pollution control districts—and thus streamlines acceptance of the system in the California market.

Other developments are also expected to open future markets. In the second quarter, the Naval Facilities Engineering Service Center awarded Plug Power a contract for installation of GenSys fuel cell systems at naval bases in New York, California and Hawaii. Throughout the year, the company continued to gather data from its GenSys units in the field, as well as from the potential early adopters of continuous-run fuel cells. The data will result in improvements to the next generation of GenSys.

Many of these activities were designed to lay the groundwork for market penetration in the near term. Yet for Plug Power, the definition of success lies not just in the next year or two, but far beyond as well. This “far beyond” focus was the domain of still other initiatives.



PLUG IS

PLUG WILL

tomorrow



In companies with emerging energy technologies, the most substantial return on investment lies in the future. Leadership in that future requires constant learning from current products, complemented by forward thinking along the adoption curve. In developing and refining its core technology, Plug Power continued its forward thinking in 2004, and the results have begun to take shape.

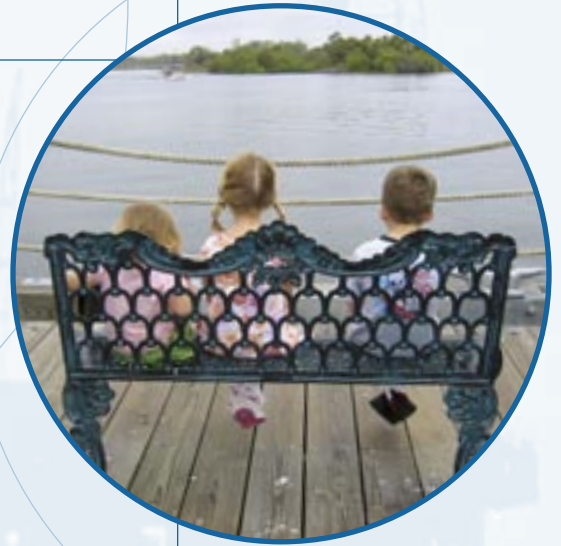
NEXT STOP: HYDROGEN GENERATION One component of Plug Power systems—the reformer—may allow the company to compete at the next point on the adoption curve: industrial on-site hydrogen generation. Today's users of industrial hydrogen gas are considering on-site generation to defray the cost of traditional trucked-in hydrogen. Any successful solution could have profound implications further down the adoption curve: it could serve as the basis of the refueling stations necessary for the hydrogen economy to come to full fruition.

In response to these trends, Plug Power began marketing GenSite late in 2004. The system entered the market with an impressive list of attributes. The reforming technology behind it has logged more than two million hours of field run time in more than 400 fuel cell installations. GenSite produces compressed hydrogen at 99.95% purity, the specification for many applications, while keeping emissions below

required standards. Already, Plug Power has installed its first GenSite system—for generator cooling at The Detroit Edison Company's Saint Clair power plant—and been awarded two programs sponsored by the New York State Energy Research and Development Authority (NYSERDA).

The Detroit Edison contract highlights one potential early market for GenSite. Utilities have long used hydrogen gas to cool power generating equipment, but the loss of hydrogen during runtime necessitates a certain level of refill daily. GenSite can perform this task at a cost of hydrogen at or below current target markets. As Plug Power pursues sales of GenSite to power generators in 2005, it will also explore other early markets, including heat treating and electronics/glass-to-metal sealing.

OFF THE GRID As backup power systems in the field return performance data, and customer requirements come further into focus, Plug Power will consider adapting its technology for yet another stop on the adoption curve: continuous prime power in remote environments. This application, embodied in Plug Power's ongoing development of GenSys, carries an adoption curve all its own: the first adopters will likely be in telecommunications, followed by industrial customers, and finally, commercial and residential customers in rural areas.



In developing and refining its core technology, Plug Power continued its forward thinking in 2004, and the results have begun to take shape.

A plan to take leadership.



Taken together, our two power generation products—GenCore for backup power and GenSys for prime power—could establish a powerful market presence. As GenCore proves its off-grid mettle to such major industries as telecommunications and utility, they are expected to become more favorable to the fuel cell technology itself. This paves the way for GenSys to follow right behind as the corresponding solution for prime power. Such a “one-two punch” may position Plug Power as a leader in off-grid markets with vast potential—like the burgeoning wireless market in developing countries.

FUNDAMENTAL ADVANCES Behind all Plug Power innovations—those already commercialized and those just on the horizon—is a tireless effort to optimize the fundamental components of the company’s core technology. In keeping with that effort, Plug Power has continued its work with key supply-chain partners to improve such system components as the fuel cell stack, the reformer, and the catalysts, with the twin goals of increasing reliability and lowering cost. These ongoing improvements will be seen with the launch of each new product—most immediately in the next generation of GenSys.

TOWARD THE MASS MARKET: RESEARCH AND DEVELOPMENT Even with all these developments, the fuel cell applications that capture the public’s imagination are still, quite naturally, those for the mass market: home and automotive use. These promising markets led Plug Power to continue visionary research and development in an active, yet measured, way throughout 2004.

Nowhere was the effectiveness of our R&D more visible than in the company’s continuing partnership with Honda to develop the Home Energy Station (HES)—a system designed to provide combined heat and power to a home while refueling hydrogen vehicles. HES I, for its part, was successful in establishing the viability of the concept itself. The project entered its second phase in November with the unveiling of HES II at Plug Power’s headquarters. Smaller in size and more efficient in design and operation, the new unit is able to refuel Honda’s FCX fuel cell vehicles leased by the State of New York, as well as a third FCX stationed at Plug Power headquarters, enabling the automaker to test the FCX’s performance in cold weather.

Aside from home refueling, Plug Power research is focusing on a potentially major new technology: high-temperature membrane electrode assemblies (MEAs) designed for use in high-temperature systems. Currently, MEAs in Plug Power fuel cells operate at a temperature of 60–70 degrees Celsius, which sets limitations on performance parameters such as overall system efficiency and simplicity. In an attempt to break through these limitations, the company has teamed with strategic partner PEMEAS to develop a system and MEA that would allow reliable operation at 160–180 degrees C. If successful, this work would lead to major reductions in fuel cell system size, weight and cost, potentially opening the door to substantial new markets—including, perhaps, the grid-dependent residential market.

Even more visionary research is in progress. Plug Power has begun to explore the promising use of nanotechnology to improve the viability of fuel cells. One research project, for example, focuses on nanoscale arrangements of MEA materials; control of these arrangements can optimize key reactions within fuel cells, leading to higher energy efficiencies. In this

and other research directions, the company will continue to draw on its network of private and government partners—such as the U.S. Departments of Defense and Energy, the National Institute of Standards and Technology, and many others—to further the advance of fuel cells in the marketplace.

MAKING SUSTAINABILITY HAPPEN All of this far-forward thinking is designed to place Plug Power in a position of leadership in the provision of clean, reliable on-site energy. As part of that quest, the company aims to make an impact not just in terms of market share or profit, but also in the spheres of people and planet.

In 2004 Plug Power continued to exhibit thought leadership around this “triple bottom line” of people, planet and profit. Such leadership, in both research and advocacy, is essential to bringing about a truly sustainable economy—a way of engaging in commerce that preserves the planet while improving the lot of humankind. At Plug Power, we are proud to assume the privilege, and the responsibility, of that role.

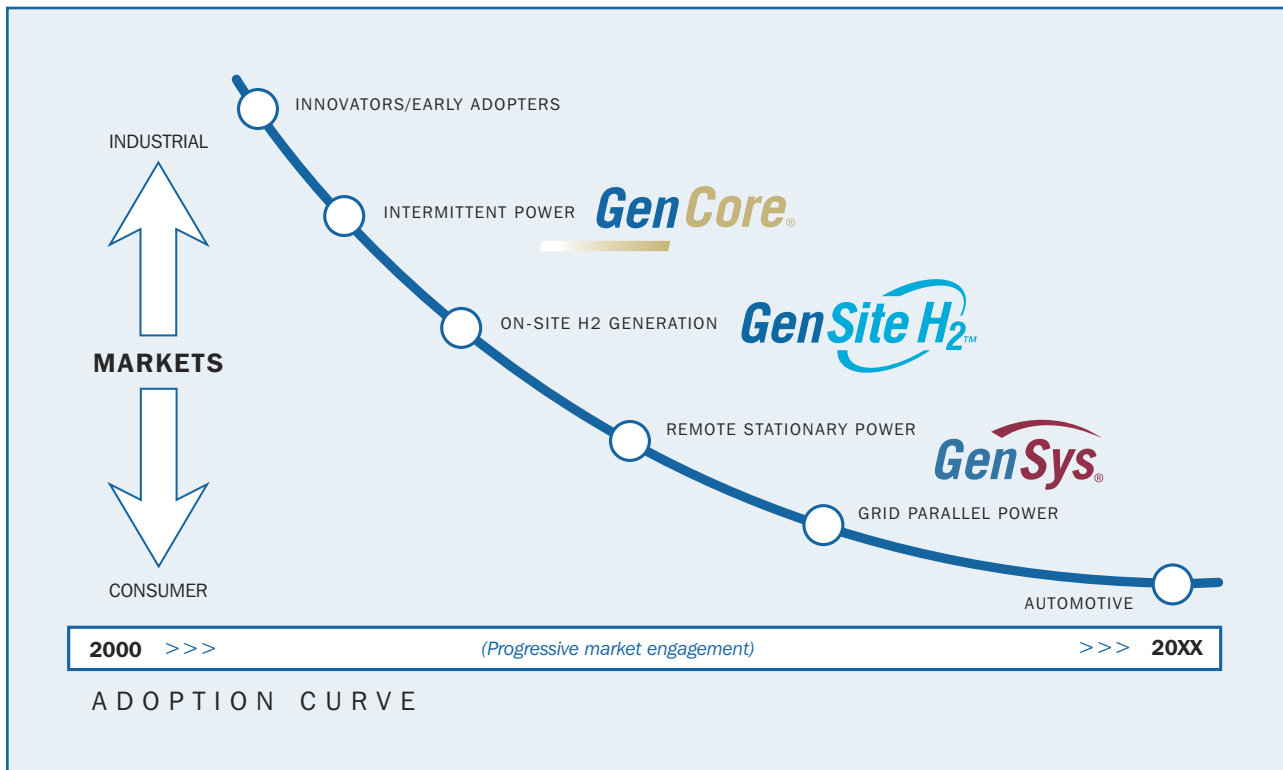


PLUG IS

PLUG WILL

Plug Power Products

		<p>GenCore fuel cell systems are high-performance solutions for the critical backup power needs of the telecommunications, cable broadband, electric utility, and industrial UPS (uninterruptible power supply) markets. The flexible architecture delivers backup power that is scalable to meet unique user needs. Unlike traditional technologies, which can be unpredictable and maintenance-dependent, hydrogen-fueled GenCore systems deliver reliable backup power over a range of operating environments—with zero emissions.</p>
		<p>GenSys combined heat and power systems provide clean, continuous on-site power for light commercial applications. More than 400 systems have been installed around the world, helping organizations adapt to changes in the power generation industry. Designed to run in parallel with the grid, GenSys converts readily available fuels such as natural gas and propane into electricity and heat. During a grid outage, GenSys provides uninterrupted power to critical loads.</p>
		<p>GenSite hydrogen generation systems provide reliable and economical on-site generation of pure, compressed hydrogen gas for industrial gas applications. Based on Plug Power's autothermal reforming technology—which has been proven in more than 400 field installations and two million hours of field run time—GenSite systems reduce the need for transportation and storage of hydrogen gas cylinders and tube trailers, lowering the cost of hydrogen gas while providing a secure source of on-site hydrogen.</p>



SELECTED FINANCIAL DATA

The following tables set forth selected financial data and other operating information of the Company. The selected statement of operations and balance sheet data for 2004, 2003, 2002, 2001 and 2000 as set forth below are derived from the audited financial statements of the Company. The information is only a summary and you should read it in conjunction with the Company's audited financial statements and related notes and other financial information included herein and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	2004	Years Ended December 31,			
		2003	2002	2001	2000
		(in thousands, except per share data)			
STATEMENT OF OPERATIONS:					
Product and service revenue	\$ 5,306	\$ 7,517	\$ 9,427	\$ 2,574	\$ —
Research and development contract revenue	10,835	4,985	2,391	3,168	8,378
Total revenue	16,141	12,502	11,818	5,742	8,378
Cost of product and service revenues	5,368	7,150	7,602	5,080	—
Cost of research and development contract revenues	13,474	7,010	3,739	6,211	13,055
In-process research and development	—	3,000	—	—	4,984
Research and development expense	35,203	40,070	40,289	60,600	65,905
General and administrative expense	8,423	7,183	6,956	7,492	16,167
Other expense (income), net	412	1,128	450	(529)	(5,491)
Net loss	\$ (46,739)	\$ (53,039)	\$ (47,218)	\$ (73,112)	\$ (86,242)
Loss per share, basic and diluted	\$ (0.64)	\$ (0.88)	\$ (0.93)	\$ (1.56)	\$ (1.99)
Weighted average number of common shares outstanding	73,126	60,146	50,645	46,840	43,308

BALANCE SHEET DATA:

(at end of the period)

Unrestricted cash, cash equivalents and marketable securities	\$ 66,849	\$102,004	\$ 55,848	\$ 92,682	\$ 86,733
Total assets	117,997	160,589	108,683	151,374	150,829
Current portion of long-term obligations	427	545	530	530	577
Long-term obligations	4,996	5,306	5,727	6,172	6,707
Stockholders' equity	102,113	144,286	92,697	135,003	134,131
Working capital	64,073	99,286	56,876	90,366	83,352

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

The following discussion should be read in conjunction with our accompanying Financial Statements and Notes thereto included within this Annual Report. In addition to historical information, this Annual Report and the following discussion contain statements that are not historical facts and are considered forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements contain projections of our future results of operations or of our financial position or state other forward-looking information. In some cases you can identify these statements by forward-looking words such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "should," "will" and "would" or similar words. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to accurately predict or control and that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. Investors are cautioned not to rely on forward-looking statements because they involve risks and uncertainties, and actual results may differ materially from those discussed as a result of various factors, including, but not limited to: our ability to develop commercially viable on-site energy products; the cost and timing of developing our on-site energy products; market acceptance of our on-site energy products; our reliance on our relationship with certain affiliates of General Electric (GEFCS); our ability to perform on our multi-generation product plan in a manner satisfactory to GEFCS; our ability to manufacture on-site energy products on a large-scale commercial basis; competitive factors, such as price competition and competition from other traditional and alternative energy companies; the cost and availability of components and parts for our on-site energy products; the ability to raise and provide the necessary capital to develop, manufacture and market our on-site energy products; our ability to establish relationships with third parties with respect to product development, manufacturing, distribution and servicing and the supply of key product components; our ability to protect our intellectual property; our ability to lower the cost of our on-site energy products and demonstrate their reliability; the cost of complying with current and future governmental regulations; the impact of deregulation and restructuring of the electric utility industry on demand for our on-site energy products; fluctuations in the trading price and volume of our common stock and other risks and uncertainties discussed under Item I—Business under the caption "Factors Affecting Future Results." Readers should not place undue reliance on our forward-looking statements. These forward-looking statements speak only as of the date on which the statements were made and are not guarantees of future performance. Except as may be required by applicable law, we do not undertake or intend to update any forward-looking statements after the date of this Annual Report.

OVERVIEW

We are focused on our proprietary proton exchange membrane (PEM) fuel cell and fuel processing technology platforms, from which multiple products are being offered or are under development. We are currently offering for commercial sale our GenCore® product, a back-up power product for telecommunications, broadband, utility and industrial uninterruptible power supply (UPS) applications. We are also developing additional products, including a continuous power product, with optional combined heat and power capability for remote small commercial and remote residential applications; and an on-site hydrogen generation product for use in a variety of industrial gas applications.

We are in the stages of performing field testing and marketing our initial commercial products to a limited number of customers, including telecom, utilities, government entities and our distribution partners. Our initial product is a limited edition fuel cell system (System or Unit) that is intended to offer complementary, quality power while demonstrating the market value of fuel cells as a preferred form of alternative distributed power generation. Subsequent enhancements to our fuel cell systems are expected to expand the market opportunity for fuel cells by lowering the installation cost, and decreasing operating and maintenance costs, increasing efficiency, improving reliability, and adding features such as grid independence and co-generation and uninterruptible power supply (UPS) applications.

Our initial commercial sales are for the delivery of limited edition fuel cell systems and are contract specific arrangements containing multiple obligations, that may include a combination of fuel cell systems, continued service, maintenance and other support, which are limited to a defined operating period, as well as certain cancellation privileges that expire ratably over the stated contractual term. Contract terms on our initial commercial sales require payment upon delivery and installation of the fuel cell system and are not contingent on the achievement of specific milestones or other substantive performance. Under these initial commercial sales, we defer recognition of product and service revenue, as a result of the cancellation privileges, and recognize revenue on a straight line basis as the cancellation privileges expire ratably over the stated contractual term, which are for periods of twelve to twenty-seven months (See Critical Accounting Policies and Estimates, Revenue Recognition).

Our cash requirements depend on numerous factors, including completion of our product development activities, ability to commercialize our systems, market acceptance of our systems and other factors. We expect to pursue the expansion of our operations through internal growth and strategic acquisitions.

Several key indicators of our liquidity are summarized in the following table:

	Years ended December 31,		
	2004	2003	2002
Unrestricted cash, cash equivalents and marketable securities	\$66,849,000	\$102,004,000	\$55,848,000
Working capital	64,073,000	99,285,000	56,876,000
Net loss	46,739,000	53,039,000	47,218,000
Net cash used in operating activities	33,896,000	38,017,000	36,894,000
Purchase of property, plant and equipment	1,617,000	627,000	1,268,000

We have financed our operations through December 31, 2004 primarily from the sale of equity, which has provided cash in the amount of \$349.3 million. During the year ended December 31, 2004, we used \$33.9 million in cash in operating activities, used \$36.7 million in cash for investing activities and received \$840,000 from financing activities. Cash used by operating activities consisted primarily of a net loss of \$46.7 million offset, in part, by non-cash items of \$4.2 million in amortization and depreciation, \$4.1 million in stock based compensation, \$2.8 million in amortization of intangible assets and \$1.8 million in equity losses in affiliates. Cash used in investing activities of \$36.7 million consisted of \$35.0 million from marketable securities and \$1.6 million for the purchase of property plant and equipment. Cash provided by financing activities of \$840,000 consisted primarily of \$911,000 of proceeds from issuance of common stock issued for stock options exercises and under the employee stock purchase plan.

RESULTS OF OPERATIONS

COMPARISON OF THE YEARS ENDED DECEMBER 31, 2004 AND DECEMBER 31, 2003.

PRODUCT AND SERVICE REVENUE. Product and service revenue decreased to \$5.3 million for the year ended December 31, 2004, from \$7.5 million for the year ended December 31, 2003. We defer recognition of product and service revenue at the time of delivery and recognize revenue as the continued service, maintenance and other support obligations expire. The costs associated with the product, service and other obligations are expensed as they are incurred.

Our initial sales of GenSys™ and GenCore™ 5T are contract specific arrangements containing multiple obligations, that may include a combination of fuel cell systems, continued service, maintenance and other support. While contract payment upon delivery and installation of the fuel cell system is not contingent on the achievement of specific milestones or other substantive performance, the multiple obligations within our contractual arrangements are not accounted for separately based on our limited commercial experience and available evidence of fair value. As a result, we defer recognition of product and service revenue and recognize revenue on a straight-line basis as the continued service, maintenance and other support obligations expire, which are generally for periods of twelve to twenty-seven months. Substantially all product and service revenue recognized in 2003 relates to the GenSys product line. In the fourth quarter of 2003, we started making the initial shipments of our GenCore product which is focused on providing backup, direct-current (DC) power products for telecom, broadband and industrial uninterruptible power supply (UPS) applications.

During the year ended December 31, 2004, we delivered 150 fuel cell systems and recognized product and service revenue against these current year deliveries in the amount of \$1.4 million combined with the recognition of \$3.9 million of revenue originally deferred at December 31, 2003. This compares to 145 fuel cell systems delivered for the year ended December 31, 2003, during which we recognized \$2.1 million of product and service revenue against 2002 deliveries combined with the recognition of \$5.4 million of revenue originally deferred at December 31, 2002.

During 2004 and 2003, we invoiced \$5.7 million and \$6.8 million, respectively, for the delivery of fuel cell systems and recognized revenue of \$5.3 million and \$4.7 million in 2004 and 2003, respectively. The difference between the amounts invoiced and the recognized revenue in 2004 and 2003 represents a component of deferred revenue at December 31, 2004 and 2003. During 2005, we expect to recognize substantially all of the deferred revenue as of December 31, 2004.

RESEARCH AND DEVELOPMENT CONTRACT REVENUE. Research and development contract revenue increased to \$10.8 million for the year ended December 31, 2004 from \$5.0 million for the year ended December 31, 2003. The increase is due to the addition of development agreements with the U.S. Department of Defense (DOD) and increased activity under U.S. Department of Energy (DOE), National Institute of Standards and Technology (NIST), New York State Energy Research and Development Authority (NYSERDA) and Honda R&D Co., Ltd. of Japan research and development contracts. We expect to continue certain research and development contract work that is directly related to our current product development efforts. Research and development contract revenue primarily relates to cost reimbursement research and development contracts associated with the development of PEM fuel cell technology. We generally share in the cost of these programs with cost-sharing percentages between 20% and 60%. Revenue from "time and material" contracts is recognized on the basis of hours utilized, plus other reimbursable contract costs incurred during the period.

COST OF PRODUCT AND SERVICE REVENUE. Cost of product and service revenue decreased to \$5.4 million for the year ended December 31, 2004 from \$7.2 million for the year ended December 31, 2003. Cost of product and service revenue includes the direct material cost incurred in the manufacture of the products we sell, as well as the labor and material costs incurred for product maintenance, replacement parts and service under our contractual obligations. These costs consist primarily of production materials and fees paid to outside suppliers for subcontracted components and services. This decrease is primarily related to the decrease in the cost of production materials for the units shipped, offset, in part by an increase in the service costs as a result of the increase in operational field units.

COST OF RESEARCH AND DEVELOPMENT CONTRACT REVENUE. Cost of research and development contract revenue increased to \$13.5 million for the year ended December 31, 2004 from \$7.0 million for the year ended December 31, 2003. Cost of research and development contract revenue includes costs associated with research and development contracts including: compensation and benefits for engineering and related support staff, fees paid to outside suppliers for subcontracted components and services, fees paid to consultants for services, and materials and supplies and other directly allocable general overhead costs allocated to specific research and development contracts. The increase in these costs relates primarily to the additional activity under the development agreements described above under research and development contract revenue.

NONCASH RESEARCH AND DEVELOPMENT EXPENSE. Noncash research and development expense increased to \$2.6 million for the year ended December 31, 2004 from \$1.8 million for the year ended December 31, 2003. Noncash research and development expense represents the fair value of stock grants to employees, consultants and others in exchange for services provided. The increase is primarily the result of stock based compensation associated with the amortization of restricted stock issued in June 2003 under our employee stock option exchange program.

OTHER RESEARCH AND DEVELOPMENT EXPENSE. Other research and development expense decreased to \$32.6 million for the year ended December 31, 2004 from \$38.3 million for the year ended December 31, 2003. The decline in research and development expense is primarily the result of an increase in resources allocated to research and development programs reflected in cost of revenues for research and development under DOE, NYSERDA and Honda R&D Co., Ltd. of Japan research and development contracts (as discussed above). Our approach to the design of our next generation fuel cell system uses advanced modeling and system simulation techniques, which result in lower research and development costs because we build fewer systems for internal test and evaluation.

Other research and development expense also includes amortization in the amount of \$3.5 million and \$4.4 million for the years ended December 31, 2004 and 2003, respectively. For the year ended December 31, 2004, amortization expense includes amortization of prepaid development costs in the amount of \$708,000 under our joint development program with Engelhard, recorded on our balance sheet under the caption "Prepaid development costs," and amortization in the amount of \$2.8 million related to the portion of the H Power purchase price which has been capitalized and recorded on our balance sheet under the caption "Intangible assets." For the year ended December 31, 2003, other research and development expense included amortization of prepaid development costs in the amount of \$1.8 million under our joint development program with Engelhard, amortization in the amount of \$515,000 related to our purchase of certain fuel processing from Gastec and \$2.1 million related to the portion of the H Power purchase price that has been capitalized.

Amortization of capitalized technology acquired as a result of our merger with H Power, is recorded on our balance sheet under the caption "Intangible assets." At December 31, 2004, the carrying value of intangible assets acquired from H Power was \$688,000, and the joint development program with Engelhard was fully amortized.

NONCASH GENERAL AND ADMINISTRATIVE EXPENSE. Noncash general and administrative expense increased to \$1.4 million for the year ended December 31, 2004 from \$896,000 for the year ended December 31, 2003. Noncash general and administrative expense represents the fair value of stock grants to employees, consultants and others in exchange for services provided. The increase is primarily the result of stock based compensation associated with the amortization of restricted stock issued in June 2003 under our employee stock option exchange program.

OTHER GENERAL AND ADMINISTRATIVE EXPENSE. Other general and administrative expenses increased to \$7.0 million for the year ended December 31, 2004 from \$6.3 million for the year ended December 31, 2003. Other general and administrative expense includes compensation, benefits and related costs in support of our general corporate functions including general management, finance and accounting, human resources, marketing, information technology and legal services. The increase in other general and administrative expenses is the result of our increase in our sales and marketing expenses for the year ending December 31, 2004, in support of commercialization of our products. Based on our current level of operations, no significant increase in other general and administrative expenses is anticipated in 2005.

INTEREST INCOME. Interest income, consisting of interest earned on our cash, cash equivalents and marketable securities, increased to \$1.5 million for the year ended December 31, 2004, from \$833,000 for the year ended December 31, 2003. The increase was primarily due to an increase in our investment portfolio for funds received as a result of our March 2003 acquisition of H Power and our common stock offering in November 2003.

INTEREST EXPENSE. Interest expense consists of interest on a long-term obligation related to our facilities and interest paid on capital lease obligations. Interest expense was \$61,000 for the year ended December 31, 2004, compared to \$62,000 for the year ended December 31, 2003. The debt accrues interest at a variable rate of interest that was approximately 2.37% and 1.30% at December 31, 2004 and 2003, respectively.

EQUITY IN LOSSES OF AFFILIATES. Equity in losses of affiliates decreased to \$1.8 million for the year ended December 31, 2004 from \$1.9 million during the year ended December 31, 2003. Equity in losses of affiliates, which we account for under the equity method of accounting, is our proportionate share of the losses of GEFCS in the amount of \$12,000 and amortization of intangible assets in the amount of \$1.8 million.

INCOME TAXES. We did not report a benefit for federal and state income taxes in the consolidated financial statements as the deferred tax asset generated from our net operating loss has been offset by a full valuation allowance because it is more likely than not that the tax benefits of the net operating loss carry forward may not be realized.

COMPARISON OF THE YEARS ENDED DECEMBER 31, 2003 AND DECEMBER 31, 2002.

PRODUCT AND SERVICE REVENUE. Product and service revenue decreased to \$7.5 million for the year ended December 31, 2003, from \$9.4 million for the year ended December 31, 2002. Our initial commercial sales for the delivery of limited edition fuel cell systems are contract specific arrangements containing multiple obligations, that may include a combination of fuel cell systems, continued service, maintenance and other support, which are limited to a defined operating period that does not extend beyond the stated contractual term, as well as certain cancellation privileges that expire ratably over the stated contractual term. Under these initial commercial sales, we defer recognition of product and service revenue, as a result of the cancellation privileges, and recognize revenue on a straight-line basis as the cancellation privileges expire ratably over the stated contractual term, which are for periods of six to twelve months. Substantially all product and service revenue recognized to date relates to the GenSys product line. In the fourth quarter of 2003, we started making the initial shipments of our GenCore product, which is focused on providing backup, DC power products for telecom, broadband and industrial UPS applications.

During the year ended December 31, 2003, we delivered 145 fuel cell systems and recognized product and service revenue against these current year deliveries in the amount of \$2.1 million combined with the recognition of \$5.4 million of revenue originally deferred at December 31, 2002. This compares to 121 fuel cell systems delivered for the year ended December 31, 2002, during which we recognized \$3.9 million of product and service revenue against 2002 deliveries combined with the recognition of \$5.5 million of revenue originally deferred at December 31, 2001.

During 2003 and 2002, we invoiced \$6.8 million and \$9.4 million, respectively, for the delivery of fuel cell systems and recognized revenue of \$4.7 million and \$5.5 million in 2003 and 2002, respectively. The difference between the amounts invoiced and the recognized revenue in 2003 and 2002 represents a component of deferred revenue at December 31, 2003 and 2002. During 2004, we recognized substantially all of the deferred revenue as of December 31, 2003.

RESEARCH AND DEVELOPMENT CONTRACT REVENUE. Research and development contract revenue increased to \$5.0 million for the year ended December 31, 2003, from \$2.4 million for the year ended December 31, 2002. The increase is due to the addition of development agreements with the DOE, NYSERDA and NIST in 2003 and the continuation of commercial agreements including Honda R&D Co., Ltd. of Japan that began in the fourth quarter of 2002. Research and development contract revenue primarily relates to cost reimbursement research and development contracts associated with the development of PEM fuel cell technology. We generally share in the cost of these programs with cost-sharing percentages between 20% and 60%. Revenue from "time and material" contracts is recognized on the basis of hours utilized, plus other reimbursable contract costs incurred during the period.

COST OF PRODUCT AND SERVICE REVENUE. Cost of product and service revenue decreased to \$7.2 million for the year ended December 31, 2003 from \$7.6 million for the year ended December 31, 2002. Cost of product and service revenue includes the direct material cost incurred in the manufacture of the products we sell, as well as the labor and material costs incurred for product maintenance, replacement parts and service under our contractual obligations. These costs consist primarily of production materials and fees paid to outside suppliers for subcontracted components and services. This decrease is primarily related to the decrease in the service costs of units in the field and a decrease in the cost of production materials for the units shipped.

COST OF RESEARCH AND DEVELOPMENT CONTRACT REVENUE. Cost of research and development contract revenue increased to \$7.0 million for the year ended December 31, 2003 from \$3.7 million for the year ended December 31, 2002. Cost of research and development contract revenue includes costs associated with research and development contracts including: compensation and benefits for engineering and related support staff, fees paid to outside suppliers for subcontracted components and services, fees paid to consultants for services provided, materials and supplies used and other directly allocable general overhead costs allocated to specific research and development contracts. The increase in these costs relates primarily to the additional development agreements described above under research and development contract revenue.

IN-PROCESS RESEARCH AND DEVELOPMENT EXPENSE. In-process research and development expense of \$3.0 million for the year ended December 31, 2003 represents the write-off of in-process research and development expense related to the acquisition of intellectual property and certain other assets acquired as a result of the merger with H Power. The amount attributable to in-process research and development was determined using an income approach which reflects the present value of future avoided costs that would otherwise have been spent to acquire the exclusive rights to this technology. The net avoided cost is discounted using a 20% discount rate, which is believed to be consistent with the risk associated with this early stage technology. This amount was further adjusted to reflect the technology's state of completion in order to reflect the fair value of the in-process research and development attributable to the efforts of the seller up to the date of the transaction.

NONCASH RESEARCH AND DEVELOPMENT EXPENSE. Noncash research and development expense increased to \$1.8 million for the year ended December 31, 2003 from \$1.0 million for the year ended December 31, 2002. Noncash research and development expense represents the fair value of stock grants to consultants and others in exchange for services provided. The increase is directly related to the amount of services provided.

OTHER RESEARCH AND DEVELOPMENT EXPENSE. Other research and development expense decreased to \$38.3 million for the year ended December 31, 2003 from \$39.3 million for the year ended December 31, 2002. Research and development expense includes materials to build development and prototype units, compensation and benefits for the engineering and related staff, expenses for contract engineers, fees paid to outside suppliers for subcontracted components and services, fees paid to consultants for services provided, materials and supplies consumed, facility related costs such as computer and network services and other general overhead costs. The decrease is primarily the result of our approach to the design of our next generation fuel cell system using advanced modeling and system simulation techniques which result in lower research and development costs because we build fewer systems for internal test and evaluation.

Other research and development expense also includes amortization in the amount of \$4.4 million and \$1.6 million for the years ended December 31, 2003 and 2002, respectively, for prepaid development costs under our joint development program with Engelhard, recorded on our balance sheet under the caption "Prepaid development costs" and amortization of capitalized technology from our purchase of certain Gastec fuel processing technology and certain other capitalized technology acquired as a result of our merger with H Power, both of which are recorded on our balance sheet under the caption "Intangible assets." At December 31, 2003 the carrying value of intangible assets acquired from H Power was \$3.4 million, and the carrying value of prepaid development costs was \$700,000. The intangible assets acquired from Gastec have been fully amortized as of December 31, 2003.

NONCASH GENERAL AND ADMINISTRATIVE EXPENSE. Noncash general and administrative expense increased to \$896,000 for the year ended December 31, 2003 from \$482,000 for the year ended December 31, 2002. Noncash general and administrative expense represents the fair value of stock grants and vested stock options to employees, consultants and others in exchange for services provided.

OTHER GENERAL AND ADMINISTRATIVE EXPENSE. Other general and administrative expenses decreased to \$6.3 million for the year ended December 31, 2003 from \$6.5 million for the year ended December 31, 2002. Other general and administrative expense includes compensation, benefits and related costs in support of our general corporate functions including general management, finance and accounting, human resources, marketing, information technology and legal services. The decrease in other general and administrative expenses is the result of our continuing effort for more efficient spending in support of operations across the entire organization.

INTEREST INCOME. Interest income, consisting of interest earned on our cash, cash equivalents and marketable securities, decreased to \$833,000 for the year ended December 31, 2003, from \$1.7 million for the same period in 2002. The decrease was due to lower principal balances as well as a lower yield on our investment portfolio during a period of generally declining interest rates offset, in part, by an increase in our investment portfolio for funds received as a result of our March 2003 acquisition of H Power and our public offering of equity in November 2003.

INTEREST EXPENSE. Interest expense consists of interest on a long-term obligation related to our facilities and interest paid on capital lease obligations. Interest expense was \$62,000 for the year ended December 31, 2003, compared to \$97,000 for the year ended December 31, 2002. The debt accrues interest at a variable rate of interest that was approximately 1.30% and 1.55% at December 31, 2003 and 2002, respectively.

EQUITY IN LOSSES OF AFFILIATES. Equity in losses of affiliates decreased to \$1.9 million for the year ended December 31, 2003 from \$2.0 million during the same period last year. Equity in losses of affiliates, which we account for under the equity method of accounting, is our proportionate share of the losses of GEFCs in the amount of \$108,000 and amortization of intangible assets in the amount of \$1.8 million.

INCOME TAXES. We did not report a benefit for federal and state income taxes in the consolidated financial statements as the deferred tax asset generated from our net operating loss has been offset by a full valuation allowance because it is more likely than not that the tax benefits of the net operating loss carry forward may not be realized.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles and related disclosure requires management to make estimates and assumptions that affect:

- the amounts reported for assets and liabilities;
- the disclosure of contingent assets and liabilities at the date of the financial statements; and
- the amounts reported for revenues and expenses during the reporting period.

Specifically, management must use estimates in determining the economic useful lives of assets, including identifiable intangibles, and various other recorded or disclosed amounts. Therefore, the Company's financial statements and related disclosure are necessarily affected by these estimates. Management evaluates these estimates on an ongoing basis, utilizing historical experience and other methods considered reasonable in the particular circumstances. Nevertheless, actual results may differ significantly from estimates. To the extent that actual outcomes differ from estimates, or additional facts and circumstances cause management to revise estimates, the Company's financial position as reflected in its financial statements will be affected.

Any effects on business, financial position or results of operations resulting from revisions to these estimates are recorded in the period in which the facts that give rise to the revision become known.

Management believes that the following are the Company's most critical accounting policies affected by the estimates and assumptions the Company must make in the preparation of its financial statements and related disclosure:

REVENUE RECOGNITION: We are a development stage enterprise in the stages of performing field testing and marketing our initial commercial products to a limited number of customers, including telecom, utilities, government entities and our distribution partners. This initial product is a limited edition fuel cell system (System or Unit) that is intended to offer complementary, quality power while demonstrating the market value of fuel cells as a preferred form of alternative distributed power generation. Subsequent enhancements to our Systems are expected to expand the market opportunity for fuel cells by lowering the installed cost, decreasing operating and maintenance costs, increasing efficiency, improving reliability, and adding features such as grid independence and co-generation and UPS applications.

We apply the guidance within Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements" (SAB 104) to our initial sales contracts to determine when to properly recognize revenue. We defer recognition of product and service revenue at the time of delivery and recognize revenue as the continued service, maintenance and other support obligations expire. The costs associated with the product, service and other obligations are expensed as they are incurred.

Our initial sales of GenSys™ and GenCore™ 5T are contract specific arrangements containing multiple obligations, that may include a combination of fuel cell systems, continued service, maintenance and other support. While contract terms require payment upon delivery and installation of the fuel cell system and are not contingent on the achievement of specific milestones or other substantive performance, the multiple obligations within our contractual arrangements are not accounted for separately based on our limited commercial experience and available evidence of fair value. As a result, we defer recognition of product and service revenue and recognize revenue on a straight-line basis over the stated contractual terms, as the continued service, maintenance and other support obligations expire, which are generally for periods of twelve to twenty-seven months.

As we gain commercial experience, including field experience relative to service and warranty based on the sales of our initial products, the fair values for the multiple elements within our future contracts may become determinable and we may, in future periods, recognize revenue upon delivery of the product or we may continue to defer recognition, based on application of appropriate guidance within EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables," or changes in the manner we structure contractual agreements, including our agreements with distribution partners.

Valuation of long-lived and intangible assets and goodwill: We assess the impairment of identifiable intangible, long-lived assets and goodwill, if any, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include, but are not limited to, the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period; and
- our market capitalization relative to net book value.

When we determine that the carrying value of intangible, long-lived assets and goodwill, if any, may not be recoverable based upon the existence of one or more of the above indicators of impairment, we would measure any impairment based upon the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," as appropriate. Based on the review during the year ended December 31, 2004, we do not believe an impairment charge is required.

ACCOUNTING FOR INCOME TAXES: As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves the estimation of our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. Included in this assessment is the determination of the net operating loss carry forward that has resulted from our cumulative net operating loss since inception. These differences result in a net deferred tax asset. We must assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent that we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the consolidated statement of operations.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We have recorded a valuation allowance of \$178.8 million as of December 31, 2004, due to uncertainties related to our ability to utilize the net deferred tax assets, primarily consisting of net operating losses and credits which may be carried forward, before they expire. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to adjust the recorded valuation allowance, which could materially impact our financial position and results of operations. At December 31, 2004, our net deferred tax assets have been offset in full by a valuation allowance. As a result, the net provision for income taxes is zero for the year ended December 31, 2004.

RECENT ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151 "Inventory Costs, an amendment of ARB No. 43," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We are currently evaluating the statements to determine the effect on our financial statements.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment." SFAS No. 123R requires employee stock options and rights to purchase shares under stock participation plans to be accounted for under the fair value method, and eliminates the ability to account for these instruments under the intrinsic value method prescribed by APB Opinion No. 25, and allowed under the original provisions of SFAS No. 123. SFAS No. 123R requires the use of an option pricing model for estimating fair value, which is amortized to expense over the service periods. The requirements of SFAS No. 123R are effective for fiscal periods beginning after June 15, 2005. If the Company had applied the provisions of SFAS No. 123R to the financial statements for the period ending December 31, 2004, net loss would have been increased by approximately \$7.6 million. SFAS No. 123R allows for either prospective recognition of compensation expense or retrospective recognition, which may be back to the original issuance of SFAS No. 123 or only to interim periods in the year of adoption. We are currently evaluating these transition methods.

LIQUIDITY AND CAPITAL RESOURCES

SUMMARY

Our cash requirements depend on numerous factors, including completion of our product development activities, ability to commercialize our on-site energy products, market acceptance of our systems and other factors. We expect to devote substantial capital resources to continue our development programs directed at commercializing our on-site energy products for worldwide use, hiring and training our production staff, developing and expanding our manufacturing capacity, and continuing expansion of our production and our research and development activities. We expect to pursue the expansion of our operations through internal growth and strategic acquisitions and expect that such activities will be funded from existing cash and cash equivalents and to a lesser extent, issuance of additional equity or debt securities or additional borrowings subject to market and other conditions. The failure to raise the funds necessary to finance our future cash requirements or consummate future acquisitions could adversely affect our ability to pursue our strategy and could negatively affect our operations in future periods. We anticipate incurring additional losses over at least the next several years and believe that our current cash, cash equivalents and marketable securities balances will provide sufficient capital to fund operations for at least the next twelve months.

Several key indicators of liquidity are summarized in the following table:

	Years ended December 31,		
	2004	2003	2002
Unrestricted cash, cash equivalents and marketable securities	\$66,849,000	\$102,004,000	\$55,848,000
Working capital	64,073,000	99,285,000	56,876,000
Net loss	46,739,000	53,039,000	47,218,000
Net cash used in operating activities	33,896,000	38,017,000	36,894,000
Purchase of property, plant and equipment	1,617,000	627,000	1,268,000

We have financed our operations through December 31, 2004 primarily from the sale of equity, which has provided cash in the amount of \$349.3 million. As of December 31, 2004, we had unrestricted cash, cash equivalents and marketable securities totaling \$66.9 million and working capital of \$64.1 million. As a result of our purchase of real estate from Mechanical Technology Incorporated, we have escrowed an additional \$4.3 million in cash to collateralize the \$4.3 million of mortgage debt assumed on the purchase. Since inception, net cash used in operating activities has been \$262.4 million and cash used in investing activities has been \$61.4 million.

During the year ended December 31, 2004, the Company used \$33.9 million in cash for operating activities, used \$36.7 million in cash for investing activities and received \$840,000 from financing activities. Net cash used in operating activities consisted primarily of a net loss of \$46.7 million offset, in part, by non-cash items of \$4.2 million in amortization and depreciation, \$4.1 million in stock based compensation, \$2.8 million in amortization of intangible assets and \$1.8 million in equity losses in affiliates. Cash used in investing activities consisted of \$35.0 million from marketable securities and \$1.6 million for the purchase of property, plant and equipment. Cash provided by financing activities of \$840,000 consisted primarily of \$911,000 received from proceeds on issuance of common stock issued for stock options exercises and under the employee stock purchase plan.

Other significant transactions impacting our liquidity and capital resources are as follows:

MERGERS & ACQUISITIONS

On March 25, 2003, we consummated a merger transaction with H Power pursuant to which we acquired H Power in a stock-for-stock exchange valued at approximately \$46.3 million. In connection with the transaction, H Power stockholders received 0.8305 shares of our common stock for each share of H Power common stock held immediately prior to the transaction. Immediately following the transaction H Power became a wholly owned subsidiary of the Company. As part of the acquisition, we acquired intellectual property and certain other assets including cash, cash equivalents and marketable securities of H Power worth approximately \$29.6 million, after payment of \$7.1 million of certain costs and expenses associated with the consummation of the merger which were accounted for as additional purchase price.

PUBLIC OFFERINGS

In November 1999, we completed an initial public offering of 6,782,900 shares of common stock, which includes additional shares purchased pursuant to exercise of the underwriters' over allotment option. We received proceeds of \$93.0 million, which was net of \$8.7 million of expenses and underwriting discounts relating to the issuance and distribution of the securities.

In July 2001, we completed a follow-on public offering of 4,575,000 shares of common stock, which includes additional shares purchased pursuant to exercise of the underwriters' over allotment option. We received proceeds of \$51.6 million, which was net of \$3.3 million of expenses and underwriting discounts relating to the issuance and distribution of the securities.

In November 2003, the Company completed a public offering of 11,700,000 shares of common stock. We received proceeds of \$55.0 million, net of \$3.5 million of expenses and placement fees relating to the issuance and distribution of the securities.

PRIVATE PLACEMENTS

In July 2001, simultaneous with the closing of the follow-on public offering, we closed a private equity financing of 416,666 shares of common stock to GE Power Systems Equities, Inc., an indirect wholly owned subsidiary of General Electric Company, and 416,666 shares of common stock to Edison Development Corporation, an indirect wholly owned subsidiary of DTE Energy Company, raising an additional \$9.6 million in net proceeds.

CAPITAL CONTRIBUTIONS

We were formed in June 1997 as a joint venture between Mechanical Technology Incorporated and Edison Development Corporation, an indirect wholly owned subsidiary of DTE Energy Company. At formation, Mechanical Technology Incorporated

contributed assets related to its fuel cell program, including intellectual property, 22 employees, equipment and the right to receive government contracts for research and development of PEM fuel cell systems, if awarded. Edison Development Corporation contributed or committed to contribute \$9.0 million in cash, expertise in distributed power generation and marketplace presence to distribute and sell stationary fuel cell systems.

In January 1999, we entered into an agreement with Mechanical Technology Incorporated and Edison Development Corporation pursuant to which we had the right to require Edison Development Corporation and Mechanical Technology Incorporated to make capital contributions of \$22.5 million each, an aggregate of \$45.0 million, through December 31, 2000. In September 1999, we made a capital call of \$4.0 million, and Mechanical Technology Incorporated and Edison Development Corporation each contributed \$2.0 million in cash in exchange for 266,667 shares of common stock. Both Mechanical Technology Incorporated and Edison Development Corporation contributed the remaining \$41.0 million immediately prior to our initial public offering in exchange for an aggregate of 5,466,666 shares of common stock.

In June 1999, we entered into a real estate purchase agreement with Mechanical Technology Incorporated to acquire approximately 36 acres of land, two commercial buildings and a residential building located in Latham, New York. This property is the location of our current facilities, including a newly constructed production facility. As part of the real estate transaction we assumed a \$6.2 million letter of credit issued by KeyBank National Association for the express purpose of servicing \$6.2 million of debt related to Industrial Development Revenue Bonds issued by the Town of Colonie Industrial Development Agency. As consideration for the purchase, we issued 704,315 shares of common stock to Mechanical Technology Incorporated, valued at \$6.67 per share. In connection with this transaction we wrote off deferred rent expense, in the amount of \$1.9 million, related to a 10-year facilities lease on one of the purchased buildings, at a favorable lease rate.

Also in June 1999, Edison Development Corporation purchased 704,315 shares of common stock for \$4.7 million in cash under provisions of our original formation documents that allowed Edison Development Corporation and Mechanical Technology Incorporated to maintain equal ownership percentages in us. Mechanical Technology Incorporated has made aggregate cash contributions of \$27.0 million plus noncash contributions of \$14.2 million, while Edison Development Corporation has made aggregate cash contributions of \$46.2 million, including \$5.0 million in connection with the closing of a private placement of 416,666 shares of our common stock in July, 2001. Mechanical Technology Incorporated and Edison Development Corporation have not made any additional cash or noncash contributions since October 1999 and July 2001, respectively.

GE FUEL CELL SYSTEMS

In February 1999, we entered into a joint venture agreement with GE MicroGen, Inc. to form GE Fuel Cell Systems, LLC (GEFCS), to exclusively market, sell, install and service certain of our PEM fuel cell systems under 35 kW designed for use in residential, commercial and industrial stationary power applications on a global basis, with the exception of the states of Illinois, Indiana, Michigan and Ohio, in which DTE Energy Technologies, Inc., has exclusive distribution rights. GE MicroGen, Inc. is a wholly owned subsidiary of General Electric Company that operates within the GE Energy business.

In connection with the original formation of GEFCS, we issued 2,250,000 shares of our common stock to GE MicroGen, Inc. in exchange for a 25% interest in GEFCS. We capitalized \$11.3 million, the fair value of the shares issued, under the caption "Investment in affiliates" in our consolidated financial statements. We also issued a warrant to GE MicroGen, Inc. to purchase 3,000,000 additional shares of common stock at a price of \$12.50 per share. GEFCS exercised this option immediately prior to our initial public offering for a total exercise price of \$37.5 million in cash.

In August 2001, we amended our agreements with GE MicroGen, Inc. and GEFCS to expand GEFCS' exclusive worldwide distribution rights to include all of our stationary PEM fuel cell systems. In addition, we increased our ownership interest in GEFCS from 25% to 40% and extended the term of the agreement to December 31, 2014. In return, we granted GE Power Systems Equities, Inc. an option to purchase 725,000 shares of our common stock at any time prior to August 21, 2006 at an exercise price of \$15.00 per share. In connection with the amendment, we capitalized \$5.0 million, the fair value of the option to purchase 725,000 shares of Plug Power common stock, under the caption "Investment in affiliates" in our consolidated financial statements.

Under a separate agreement with the General Electric Company, for our product development effort, we have agreed to source technical support services, including engineering, testing, manufacturing and quality control services. Under the initial agreement, the Company was committed to purchase a minimum of \$12.0 million of such services over a five-year period, which began September 30, 1999. During 2004, the Company and General Electric Company extended this period through September 2006. Through December 31, 2004, the Company had purchased approximately \$9.9 million of such services. General Electric Company has agreed to act as the agent in procuring certain equipment, parts and components and in providing training services to our employees regarding procurement activities pursuant to this agreement.

GRANT AGREEMENTS

In 2000 we were awarded and received \$1.0 million under a grant from the State of New York. The grant is for the express purpose of promoting employment. Terms of the grant require us to meet certain employment criteria, as defined, over a five year period. For the year ended December 31, 2004, we were in compliance with the terms and conditions of the grant. The term of the grant ended on December 31, 2004.

In 2003 we finalized contracts with the U.S. Department of Energy (DOE), National Institute of Standards and Technology (NIST) and the New York State Energy Research and Development Authority (NYSERDA), under which we expect to receive approximately \$15.0 million in net funding during the 30-month, cost-share programs ending in 2006.

In 2004 we were awarded a \$1.8 million contract by the U.S. Department of Defense under the Common Core Power Production Program. This one-year program will help develop application and integration platforms for a variety of stationary and light mobility applications for the U.S. military. The program is being funded by the U.S. Air Force, Advanced Power Transformation Office, and managed by the U.S. Army Corps of Engineers, Engineer Research and Development Center.

CONTRACTUAL OBLIGATIONS

The following is a summary of our contractual obligations as of December 31, 2004.

	Total	Less than 1 year	1–3 years	4–5 years	After 5 years
Long-term debt	\$4,363,000	\$ 365,000	\$ 795,000	\$ 895,000	\$2,308,000
Capital lease obligations	62,000	62,000	—	—	—
Operating leases	3,009,000	866,000	1,017,000	768,000	358,000
Total	\$ 7,434,000	\$1,293,000	\$1,812,000	\$1,663,000	\$2,666,000

Other obligations include future payments under our agreement with General Electric Company to source technical support services for our product development effort as described in Note 3 of the Notes to Consolidated Financial Statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We invest our excess cash in government, government backed and interest-bearing investment-grade securities that we generally hold for the duration of the term of the respective instrument. We do not utilize derivative financial instruments, derivative commodity instruments or other market risk sensitive instruments, positions or transactions in any material fashion. Accordingly, we believe that, while the investment-grade securities we hold are subject to changes in the financial standing of the issuer of such securities, we are not subject to any material risks arising from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices or other market changes that affect market risk sensitive instruments.

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organization of the Treadway Commission. Based on our evaluation under the framework in *Internal Control—Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2004.

Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2004 has been audited by KPMG LLP, as independent registered public accounting firm, as stated in their attestation report which is included herein.

Roger B. Saillant
President and Chief Executive Officer
(Principal Executive Officer)

David A. Neumann
Vice President and CFO
(Principal Financial Officer)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Plug Power Inc.:

We have audited the accompanying consolidated balance sheets of Plug Power Inc. and subsidiaries (a development stage enterprise) as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows for each of the years in the three-year period ended December 31, 2004 and for the period June 27, 1997 (inception) to December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. The cumulative consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows for the period June 27, 1997 (inception) to December 31, 2004 include amounts for the period from June 27, 1997 to December 31, 1997 and for each of the years in the three-year period ending December 31, 2000, which were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the period June 27, 1997 through December 31, 2000, is based solely on the report of other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Plug Power Inc. and subsidiaries (a development stage enterprise) as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2004 and for the period June 27, 1997 (inception) to December 31, 2004, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Plug Power Inc.'s internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 4, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Albany, New York
March 4, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Plug Power Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Plug Power Inc. and subsidiaries (a development stage enterprise) maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Plug Power Inc. and subsidiaries (a development stage enterprise) maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by COSO. Also, in our opinion, Plug Power Inc. and subsidiaries (a development stage enterprise) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Plug Power Inc. and subsidiaries as of December 31, 2004 and 2003, and related consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows for each of the years in the three-year period ended December 31, 2004 and for the period June 27, 1997 (inception) to December 31, 2004, and our report dated March 4, 2005 expressed a unqualified opinion on those consolidated financial statements.

KPMG LLP

Albany, New York
March 4, 2005

CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 18,976,767	\$ 88,685,255
Restricted cash	365,000	345,000
Marketable securities	47,872,662	13,318,850
Accounts receivable	2,989,481	3,307,627
Inventory	3,527,140	2,663,741
Prepaid development costs	—	708,481
Prepaid expenses and other current assets	1,230,713	1,253,510
Total current assets	74,961,763	110,282,464
Restricted cash	3,965,274	4,330,274
Property, plant and equipment, net	21,829,254	24,122,266
Intangible asset	687,500	3,437,500
Investment in affiliate	5,785,358	7,588,891
Goodwill	10,388,980	10,388,980
Other assets	379,361	438,396
Total assets	\$ 117,997,490	\$ 160,588,771
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,339,143	\$ 1,975,370
Accrued expenses	2,447,316	3,491,583
Deferred revenue	5,675,227	5,184,932
Current portion of capital lease obligation and long-term debt	427,238	345,000
Total current liabilities	10,888,924	10,996,885
Long-term debt	3,998,391	4,365,955
Other liabilities	997,349	939,810
Total liabilities	15,884,664	16,302,650
Stockholders' equity:		
Preferred stock, \$0.01 par value per share; 5,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.01 par value per share; 245,000,000 shares authorized; 73,350,878 shares issued and outstanding at December 31, 2004 and 72,850,709 shares issued and outstanding at December 31, 2003	733,509	728,506
Additional paid-in capital	457,880,663	454,399,857
Unamortized value of restricted stock	(680,459)	(2,242,573)
Accumulated other comprehensive loss	(482,391)	—
Deficit accumulated during the development stage	(355,338,496)	(308,599,669)
Total stockholders' equity	102,112,826	144,286,121
Total liabilities and stockholders' equity	\$ 117,997,490	\$ 160,588,771

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

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002 AND CUMULATIVE AMOUNTS FROM INCEPTION

	December 31, 2004	December 31, 2003	December 31, 2002	Cumulative Amounts from Inception
Product and service revenue	\$ 5,305,648	\$ 7,517,060	\$ 9,426,803	\$ 24,822,945
Research and development contract revenue	10,835,655	4,985,157	2,391,374	48,493,391
Total revenue	16,141,303	12,502,217	11,818,177	73,316,336
Cost of product and service revenue	5,367,897	7,150,192	7,601,819	25,199,796
Cost of research and development contract revenue	13,474,090	7,009,752	3,738,838	69,077,245
In-process research and development	—	3,000,000	—	12,026,640
Research and development expense:				
Noncash stock-based compensation	2,591,156	1,752,276	1,003,616	7,232,075
Other research and development	32,611,633	38,317,462	39,285,548	261,273,613
General and administrative expense:				
Noncash stock-based compensation	1,398,377	896,018	481,927	14,874,399
Other general and administrative	7,025,063	6,286,894	6,473,957	44,659,615
Operating loss	(46,326,913)	(51,910,377)	(46,767,528)	(361,027,047)
Interest income	1,452,593	833,014	1,655,075	19,512,660
Interest expense	(60,974)	(61,568)	(96,635)	(1,031,717)
Loss before equity in losses of affiliates	(44,935,294)	(51,138,931)	(45,209,088)	(342,546,104)
Equity in losses of affiliates	(1,803,533)	(1,899,871)	(2,009,238)	(12,792,392)
Net loss	\$ (46,738,827)	\$(53,038,802)	\$(47,218,326)	\$(355,338,496)
Loss per share:				
Basic and diluted	\$ (0.64)	\$ (0.88)	\$ (0.93)	
Weighted average number of common shares outstanding	73,125,957	60,145,940	50,644,950	

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002 AND CUMULATIVE AMOUNTS FROM INCEPTION

	December 31, 2004	December 31, 2003	December 31, 2002	Cumulative Amounts from Inception
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	\$(46,738,827)	\$ (53,038,802)	\$ (47,218,326)	\$(355,338,496)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization	4,206,578	4,092,050	5,478,831	23,604,823
Equity in losses of affiliates	1,803,533	1,899,871	2,009,238	12,792,392
Amortization of intangible asset	2,750,000	2,577,347	2,955,292	14,437,001
Noncash prepaid development costs	708,481	1,436,784	1,614,866	10,000,000
Loss on disposal of property, plant and equipment	—	—	(76,132)	32,493
In-kind services	—	—	—	1,340,000
Stock-based compensation	4,137,202	2,966,797	1,485,543	22,140,298
Amortization of deferred grant revenue	(200,000)	(200,000)	(200,000)	(1,000,000)
Amortization and write-off of deferred rent	—	—	—	2,000,000
In-process research and development	—	3,000,000	—	7,042,640
Changes in assets and liabilities, net of effects of acquisition in 2003:				
Accounts receivable	318,146	1,057,043	(1,537,007)	(2,770,140)
Inventory	(863,399)	(277,173)	239,283	(3,172,567)
Prepaid expenses and other current assets	(27,767)	(621,701)	(1,706,911)	(3,267,184)
Accounts payable and accrued expenses	(680,497)	(215,144)	(133,104)	3,107,225
Deferred revenue	690,295	(693,852)	193,991	6,675,227
Net cash used in operating activities	(33,896,255)	(38,016,780)	(36,894,436)	(262,376,288)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Proceeds from acquisition	—	36,521,491	—	36,521,491
Integration costs and expenses associated with acquisition	—	(7,055,750)	—	(7,055,750)
Purchase of property, plant and equipment	(1,616,525)	(627,348)	(1,267,556)	(31,704,799)
Proceeds from disposal of property, plant and equipment	—	—	274,000	310,666
Purchase of intangible asset	—	—	—	(9,624,500)
Investment in affiliate	—	—	—	(1,500,000)
Proceeds from sale of marketable securities	41,181,267	306,179,105	168,823,332	742,465,172
Purchases of marketable securities	(76,217,470)	(290,907,577)	(158,379,396)	(790,820,225)
Net cash provided by (used in) investing activities	(36,652,728)	44,109,921	9,450,380	(61,407,945)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from issuance of common stock	—	55,282,500	—	140,342,782
Proceeds from initial public offering, net	—	—	—	201,911,705
Stock issuance costs	—	(315,296)	—	(2,384,072)
Proceeds from stock option exercises and employee stock purchase plan	910,721	433,578	1,104,610	9,474,842
Cash placed in escrow	345,000	325,000	310,000	(4,330,274)
Principal payments on long-term debt and capital lease obligations	(415,226)	(391,309)	(361,058)	(2,253,983)
Net cash provided by financing activities	840,495	55,334,473	1,053,552	342,761,000
Increase (decrease) in cash and cash equivalents	(69,708,488)	61,427,614	(26,390,504)	18,976,767
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	88,685,255	27,257,641	53,648,145	—
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 18,976,767	\$ 88,685,255	\$ 27,257,641	\$ 18,976,767

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE LOSS

FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

	Common Shares	Stock Amount	Additional Paid-in Capital	Unamortized Value of Restricted Stock	Accumulated Other Comprehensive Loss	Deficit Accumulated During the Development Stage	Total Stockholders' Equity
DECEMBER 31, 2001	50,322,928	\$503,229	\$ 342,842,203	\$ —	\$ —	\$(208,342,541)	\$ 135,002,891
Stock issued for development agreement	243,383	2,434	1,997,566				2,000,000
Stock based compensation	213,987	2,140	1,805,453				1,807,593
Stock option exercises	138,567	1,386	707,545				708,931
Stock issued under employee stock purchase plan	78,208	782	394,897				395,679
Net loss						(47,218,326)	(47,218,326)
DECEMBER 31, 2002	50,997,073	509,971	347,747,664	—	—	(255,560,867)	92,696,768
Public offering, net	11,700,000	117,000	54,850,204				54,967,204
Stock issued in acquisition of H Power	9,063,080	90,631	46,169,945				46,260,576
Stock based compensation	356,839	3,567	2,026,020				2,029,587
Issuance of restricted stock	608,304	6,083	3,173,700	(3,179,783)			—
Amortization of restricted stock				937,210			937,210
Stock option exercises	35,033	350	84,623				84,973
Stock issued under employee stock purchase plan	90,380	904	347,701				348,605
Net loss						(53,038,802)	(53,038,802)
DECEMBER 31, 2003	72,850,709	728,506	454,399,857	(2,242,573)	—	(308,599,669)	144,286,121
Stock based compensation	290,200	2,904	2,353,582				2,356,486
Issuance of restricted stock	42,300	422	218,180	(218,602)			—
Amortization of restricted stock				1,780,716			1,780,716
Stock option exercises	95,960	960	500,348				501,308
Stock issued under employee stock purchase plan	71,709	717	408,696				409,413
Net loss						(46,738,827)	(46,738,827)
Change in unrealized loss on marketable securities					(482,391)		(482,391)
DECEMBER 31, 2004	73,350,878	\$733,509	\$457,880,663	\$ (680,459)	\$(482,391)	\$(355,338,496)	\$102,112,826

Comprehensive loss for the year ended December 31, 2004 is as follows:

Net loss	\$ (46,738,827)
Comprehensive loss	(482,391)
Total comprehensive loss	\$ (47,221,218)

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS

DESCRIPTION OF BUSINESS

Plug Power Inc. and subsidiaries (Company) was originally formed as a joint venture between Edison Development Corporation (EDC) and Mechanical Technology Incorporated (MTI) in the State of Delaware on June 27, 1997 and succeeded by merger to all of the assets, liabilities and equity of Plug Power, L.L.C. in November 1999.

The Company is focused on its proprietary proton exchange membrane (PEM) fuel cell and fuel processing technology platforms, from which multiple products are being offered or are under development. The Company is currently offering for commercial sale its GenCore® product, a back-up power product for telecommunications, broadband, utility and industrial uninterruptible power supply (UPS) applications. The Company is also developing additional products, including a continuous power product, with optional combined heat and power capability for remote small commercial and remote residential applications; and an on-site hydrogen generation product for use in a variety of industrial gas applications.

LIQUIDITY

The Company's cash requirements depend on numerous factors, including completion of our product development activities, ability to commercialize our on-site energy products, market acceptance of our systems and other factors. The Company expects to continue to devote substantial capital resources to continue its development programs directed at commercializing on-site energy products for worldwide use, hiring and training our production staff, developing and expanding our manufacturing capacity, and continuing expansion of our production and our research and development activities. The Company will pursue the expansion of its operations through internal growth and strategic acquisitions and expect that such activities will be funded from existing cash and cash equivalents and to a lesser extent, issuance of additional equity or debt securities or additional borrowings subject to market and other conditions. The failure to raise the funds necessary to finance our future cash requirements or consummate future acquisitions could adversely affect its ability to pursue its strategy and could negatively affect its operations in future periods. The Company anticipates incurring additional losses over at least the next several years and believe that its current cash, cash equivalents and marketable securities balances will provide sufficient capital to fund operations for at least the next twelve months.

In November 2003, the Company completed a public offering of 11.7 million shares of common stock. The Company received net proceeds of \$55.0 million, after payment of \$3.5 million of expenses and placement fees relating to the issuance and distribution of the securities.

On March 25, 2003, the Company consummated a merger transaction with H Power Corp. (H Power) pursuant to which it acquired H Power in a stock-for-stock exchange valued at approximately \$46.3 million. The Company acquired certain intellectual property and other assets including approximately \$29.6 million in net cash, cash equivalents and marketable securities.

At December 31, 2004, the Company had unrestricted cash, cash equivalents and marketable securities in the amount of \$66.8 million and working capital of \$64.1 million. Management believes that the Company's current available cash, cash equivalents and marketable securities will provide sufficient capital to fund operations for at least the next twelve months.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the financial statements of Plug Power Inc. and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to the 2004 presentation.

CASH EQUIVALENTS AND RESTRICTED CASH

Cash equivalents consist of money market accounts, overnight repurchase agreements and certificates of deposit with an initial term of less than three months. For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

At December 31, 2004 and 2003, the Company has restricted cash of \$4.3 million and \$4.7 million, respectively, that is required to be placed in escrow to collateralize debt related to the purchase of real estate. The escrowed amounts are recorded under the captions "Restricted cash" in the accompanying consolidated balance sheets.

MARKETABLE SECURITIES

Marketable securities include investments in equity and debt obligations, which are carried at fair value. These investments are considered available for sale, and the difference between the cost and the fair value of these securities is reflected in other comprehensive income (loss) and as a component of stockholders' equity. At December 31, 2004, the Company recorded unrealized losses of \$482,000. There was no significant difference between cost and fair value of these investments at December 31, 2003 or 2002.

The amortized cost and estimated fair value of the Company's available-for-sale investment securities as of December 31, 2004 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt Securities	\$ 37,555,053	\$ —	\$482,391	\$37,072,662
Equity Securities	10,800,000	—	—	10,800,000
Total	\$ 48,355,053	\$ —	\$482,391	\$47,872,662

The following are estimated fair value of, and the gross unrealized losses of the Company's available-for-sale debt securities as of December 31, 2004:

	Less than 12 months		More than 12 months	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Debt Securities	\$29,330,621	\$439,104	\$2,192,040	\$43,287

The following represents contractual maturities of investments in available for sale debt securities at December 31, 2004:

	Amortized Cost	Estimated Fair Value
Due in 2005	\$20,326,445	\$20,056,436
2006–2009	16,228,608	16,016,226
2010–2014	—	—
2015 and later	1,000,000	1,000,000

INVENTORY

Inventory is stated at the lower of average cost or market value and generally consists of raw materials.

GOODWILL AND OTHER INTANGIBLE ASSETS

The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," as of January 1, 2002. Pursuant to SFAS No. 142, goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets."

Goodwill represents the excess of costs over fair value of H Power net assets acquired. Amortized intangible assets, including purchased technology and other intangible assets, are carried at cost less accumulated amortization. The Company amortizes these intangible assets on a straight-line basis over their estimated useful lives. The range of estimated useful lives on the Company's identifiable intangible assets is two to ten years.

PRODUCT AND SERVICE REVENUE

The Company applies the guidance within SEC Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements" (SAB 104) in the evaluation of its contracts to determine when to properly recognize revenue. Under SAB 104 revenue is recognized when title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, delivery has occurred or services have been rendered, the sales price is determinable, and collectibility is reasonably assured.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

The Company's initial sales of GenSys™ and GenCore™ 5T are contract specific arrangements containing multiple obligations, that may include a combination of fuel cell systems, continued service, maintenance and other support. While contract terms require payment upon delivery and installation of the fuel cell system and are not contingent on the achievement of specific milestones or other substantive performance, the multiple obligations within contractual arrangements are not accounted for separately based on the Company's limited commercial experience and available evidence of fair value. The Company's contractual arrangements under its initial commercial sales are with a limited number of customers and the arrangements are separately negotiated and not combined. As a result, the Company defers recognition of product and service revenue and recognizes revenue on a straight-line basis over the stated contractual terms, as the continued service, maintenance and other support obligations expire, which are generally for periods of twelve to twenty-seven months. At December 31, 2004 and 2003, the Company had deferred product and service revenue in the amount of \$5.3 million and \$4.9 million, respectively.

As the Company gains commercial experience, including field experience relative to service and warranty based on the sales of initial products, the fair values for the multiple elements within future contracts may become determinable and the Company may, in future periods, recognize revenue upon delivery of the product or may continue to defer recognition, based on application of appropriate guidance within EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables," or changes in the manner contractual agreements are structured, including agreements with distribution partners.

RESEARCH AND DEVELOPMENT CONTRACT REVENUE

Research and development contract revenue primarily relates to cost reimbursement research and development contracts associated with the development of PEM fuel cell technology. The Company generally shares in the cost of these programs with cost sharing percentages between 20% and 60%. Revenue from "time and material" contracts is recognized on the basis of hours utilized, plus other reimbursable contract costs incurred during the period. At December 31, 2004 the Company had deferred research and development contract revenue in the amount of \$200,000. At December 31 2003, the Company had no deferred research and development contract revenue.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are originally recorded at cost. Machinery and equipment under capital leases are originally recorded at the present value of minimum lease payments. Maintenance and repairs are expensed as costs are incurred.

Depreciation on plant and equipment is calculated on the straight-line method over the estimated useful lives of the assets. Machinery and equipment under capital leases are amortized straight line over the shorter of the lease term or estimated useful life of the asset.

The Company provides for depreciation and amortization of buildings, building improvements and machinery and equipment over the following estimated useful lives:

Buildings	20 years
Building improvements	5–20 years
Machinery and equipment	3–15 years

INVESTMENT IN AFFILIATE

The Company's investment in GE Fuel Cell Systems LLC is accounted for under the equity method. The Company would recognize a loss when there is a other than a temporary decline in value in the investment.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

INCOME TAXES

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized.

RESEARCH AND DEVELOPMENT

Costs incurred in the research and development of the Company's fuel cell systems are expensed as incurred.

STOCK-BASED COMPENSATION

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations including Financial Accounting Standards Board (FASB) Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation an interpretation of APB Opinion No. 25," to account for its fixed plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above, and has adopted the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net loss if the fair-value-based method had been applied to all outstanding and unvested awards in each period:

	Year Ended December 31,		
	2004	2003	2002
Net loss, as reported	\$(46,738,827)	\$(53,038,802)	\$(47,218,326)
Add: Stock-based employee compensation expense included in reported net loss	3,989,533	2,648,294	1,485,543
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards	(11,619,788)	(12,140,641)	(23,660,210)
Proforma net loss	\$(54,369,082)	\$(62,531,149)	\$(69,392,993)
Loss per share:			
Basic and diluted—as reported	\$ (0.64)	\$ (0.88)	\$ (0.93)
Basic and diluted—pro forma	\$ (0.74)	\$ (1.04)	\$ (1.37)

PER SHARE AMOUNTS

Basic earnings per share excludes dilution and is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company (such as stock options and warrants).

The following table provides calculations of basic and diluted earnings per share:

	Year Ended December 31,		
	2004	2003	2002
Numerator:			
Net loss	\$(46,738,827)	\$(53,038,802)	\$(47,218,326)
Denominator:			
Weighted average number of common shares	73,125,957	60,145,940	50,644,950

No options or warrants outstanding were included in the calculation of diluted loss per share because their impact would have been anti-dilutive. These dilutive potential common shares are summarized below:

Number of dilutive potential common shares	5,437,064	6,163,971	6,522,164
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

USE OF ESTIMATES

The consolidated financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RECENT ACCOUNTING PRONOUNCEMENTS

In November 2004, the FASB issued SFAS No. 151 "Inventory Costs, an amendment of ARB No. 43," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is currently evaluating the effect of the statement on the consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment." SFAS No. 123R requires employee stock options and rights to purchase shares under stock participation plans to be accounted for under the fair value method, and eliminates the ability to account for these instruments under the intrinsic value method prescribed by APB Opinion No. 25, and allowed under the original provisions of SFAS No. 123. SFAS No. 123R requires the use of an option pricing model for estimating fair value, which is amortized to expense over the service periods. The requirements of SFAS No. 123R are effective for fiscal periods beginning after June 15, 2005. If the Company had applied the provisions of SFAS No. 123R to the financial statements for the period ending December 31, 2004, net loss would have been increased by approximately \$7.5 million. SFAS No. 123R allows for either prospective recognition of compensation expense or retrospective recognition, which may be back to the original issuance of SFAS No. 123 or only to interim periods in the year of adoption. The Company is currently evaluating these transition methods.

3. INVESTMENT IN AFFILIATE

In February 1999, the Company entered into an agreement with GE MicroGen, Inc. to form GE Fuel Cell Systems, LLC (GEFCS), to exclusively market, distribute, install and service certain of its PEM fuel cell systems under 35 kW designed for use in residential, commercial and industrial stationary power applications on a global basis, with the exception of the states of Illinois, Indiana, Michigan and Ohio, in which DTE Energy Technologies, Inc. ("DTE"), has exclusive distribution rights. GE MicroGen, Inc. is a wholly owned subsidiary of General Electric Company that operates within the GE Energy.

In connection with the original formation of GEFCS, the Company issued 2,250,000 shares of its common stock to GE MicroGen, Inc. in exchange for a 25% interest in GEFCS. As of the date of issuance of such shares, the Company capitalized \$11.3 million, the fair value of the shares issued, under the caption "Investment in affiliates" in the accompanying consolidated financial statements. In accordance with the terms of the agreement, General Electric Company will provide capital in the form of a loan not to exceed \$8.0 million, to fund the operations of GEFCS.

In August 2001, the Company amended its agreements with GE Microgen, Inc. and GEFCS to expand GEFCS' exclusive worldwide distribution rights to include all of its stationary PEM fuel cell systems. In addition, the Company increased its ownership interest in GEFCS from 25% to 40%. In return, the Company granted GE Power Systems Equities, Inc. an option to purchase 725,000 shares of its common stock at any time prior to August 21, 2006 at an exercise price of \$15.00 per share. The Company also replaced the product specifications, prices and delivery schedule in their distribution agreement with a high-level, multi-generation product plan, with subsequent modifications being subject to mutual agreement, and extended the term of the agreement to December 31, 2014. In connection with these transactions, the Company capitalized \$5.0 million, the fair value, calculated using the Black-Scholes pricing model, of the option to purchase 725,000 shares of Plug Power common stock, under the caption "Investment in affiliates" in the accompanying consolidated financial statements, and is amortizing this amount over the remaining term of the original distribution agreement.

The Company accounts for its interest in GEFCS on the equity method of accounting and adjusts its investment by its proportionate share of income or losses under the caption "Equity in losses of affiliates" in the accompanying consolidated statements of operations. GEFCS had an operating and net loss of \$30,000 for the year ended December 31, 2004. For the years ended December 31, 2004, 2003 and 2002, equity in losses of affiliates, related to GEFCS, was \$1.8 million, \$1.9 million and \$1.9 million including amortization of \$1.8 million, \$1.8 million and \$1.8 million, respectively. Accumulated amortization at December 31, 2004 and 2003 was \$10.5 million and \$8.7 million, respectively.

In October 2003, the Company further amended the distribution agreement to provide for the ability to sell directly or negotiate nonexclusive distribution rights to third parties for its GenCore backup power product line and its GenSite hydrogen generation product line. In exchange the Company agreed to pay a commission, based on sales price, to GEFCS at a rate and schedule prescribed in our amended agreement. The distribution agreement expires on December 31, 2014.

Under a separate agreement with the General Electric Company, for its product development effort, the Company has agreed to source technical support services, including engineering, testing, manufacturing and quality control services. Under the initial agreement, the Company was committed to purchase a minimum of \$12.0 million of such services over a five-year period, which began September 30, 1999. During 2004, the Company and General Electric Company extended this period through September 2006. At December 31, 2004 and 2003, approximately \$262,000 and \$335,000, respectively, was payable to General Electric Company under this arrangement. Through December 31, 2004, the Company had purchased approximately \$9.9 million of such services.

Additionally, General Electric Company has agreed to act as the agent in procuring certain equipment, parts and components and is providing training services to our employees regarding procurement activities pursuant to this agreement.

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at December 31, 2004 and 2003 consists of the following:

	December 31, 2004	December 31, 2003
Land	\$ 90,000	\$ 90,000
Buildings	14,557,080	14,557,080
Building improvements	7,450,936	6,809,585
Machinery and equipment	22,293,614	21,188,540
	44,391,630	42,645,205
Less accumulated depreciation and amortization	(22,562,376)	(18,522,939)
Property, plant, and equipment, net	\$ 21,829,254	\$ 24,122,266

Depreciation expense was \$4.0 million, \$3.9 million and \$5.3 million for the years ended December 31, 2004, 2003 and 2002, respectively.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

No changes in the carrying amount of Goodwill occurred during the year ended December 31, 2004. For the year ended December 31, 2003, the change in the carrying amount of goodwill was \$10.0 million related to acquisition of H Power Corp.

The gross carrying amount and accumulated amortization of the Company's acquired intangible assets as of December 31, 2004 and December 31, 2003 were as follows:

	Weighted Average Amortization Period	December 31, 2004		December 31, 2003	
		Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Distribution Agreement	10 years	\$16,250,000	\$10,464,642	\$16,250,000	\$ 8,661,109
Purchased Technology—H Power	2 years	5,500,000	4,812,500	5,500,000	2,062,500
Total		\$21,750,000	\$15,277,142	\$21,750,000	\$10,723,609

Amortization expense for acquired intangible assets during the years ended December 31, 2004, 2003 and 2002 was \$4.5 million, \$4.4 million, and \$4.7 million, respectively. Estimated amortization expense for 2005 and the four succeeding years is as follows:

	Estimated Amortization Expense
2005	2,479,100
2006	1,791,600
2007	1,791,600
2008	410,558
2009	—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

6. DEBT

In connection with the Company's purchase of real estate in July, 1999, the Company assumed a \$6.2 million letter of credit issued by KeyBank National Association for the express purpose of servicing \$6.2 million of debt related to Industrial Development Revenue Bonds issued by the Town of Colonie Industrial Development Agency in favor of the acquired property. The debt matures in 2013 and accrues interest at a variable rate of interest which was approximately 2.37% at December 31, 2004. Simultaneous with the assumption, the Company was required to escrow \$6.2 million to collateralize the debt. This debt also contains a subjective acceleration clause based on adverse financial conditions. The bank has provided the Company with a waiver through January 1, 2006 for any adverse changes in financial condition occurring prior to December 31, 2004.

The outstanding balance of the debt as of December 31, 2004 was \$4.3 million and the amount of the corresponding escrow requirement as of December 31, 2004 was \$4.3 million and is recorded under the balance sheet captions, "Restricted cash." Principal payments due on long-term debt are: 2005, \$365,000; 2006, \$385,000; 2007, \$410,000; 2008, \$435,000; 2009, \$460,000 and thereafter, \$2.2 million.

7. ACCRUED EXPENSES

Accrued expenses at December 31, 2004 and 2003 consisted of:

	2004	2003
Accrued payroll and compensation related costs	\$ 681,056	\$1,174,562
Accrual for closure of H Power facilities	451,620	470,024
Other accrued liabilities	1,314,640	1,846,997
	\$2,447,316	\$3,491,583

8. INCOME TAXES

There was no current income tax expense for the years ended December 31, 2004, 2003 and 2002. The Company was a Limited Liability Company (LLC) until its merger into Plug Power Inc. effective November 3, 1999. From inception through November 3, 1999, the Company was treated as a partnership for federal and state income tax purposes and accordingly the Company's income taxes or credits resulting from earnings or losses were payable by, or accrued to its members. Therefore, no provision for income taxes has been made prior to November 3, 1999.

Effective November 3, 1999, the Company is taxed as a corporation for Federal and State income tax purposes and the effect of deferred taxes recognized as a result of the change in tax status of the Company have been included in operations. Deferred tax assets and liabilities are determined based on the temporary differences between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates.

The significant components of deferred income tax expense (benefit) for the years ended December 31, 2004, 2003 and 2002 are as follows:

	Years ended December 31,		
	2004	2003	2002
Deferred tax expense/(benefit)	\$ 420,106	\$ 2,083,500	\$ (1,535,911)
Net operating loss carryforward	(17,250,973)	(20,904,800)	(17,090,891)
Valuation allowance	16,830,867	18,821,300	18,626,802
Provision for income taxes	\$ —	\$ —	\$ —

The Company's effective income tax rate differed from the Federal statutory rate as follows:

	Years ended December 31,		
	2004	2003	2002
Federal statutory tax rate	(35.0)%	(35.0)%	(35.0)%
Deferred state taxes, net of federal benefit	(4.9)	(4.9)	(4.9)
Other, net	0.1	0.1	1.0
Tax credits	(3.3)	(1.8)	(0.5)
Adjustment to opening deferred tax balance	7.1	—	—
Change in valuation allowance	36.0	41.6	39.4
	0.0 %	0.0 %	0.0 %

The deferred tax assets and liabilities as of December 31, 2004 and 2003 consist of the following tax effects relating to temporary differences and carryforwards:

	Years ended December 31,	
	2004	2003
Deferred tax assets:		
Intangible assets	\$ 1,090,709	\$ 4,317,623
Stock-based compensation	1,471,893	759,607
Deferred income	2,270,091	1,736,506
Investment in affiliates	3,838,368	3,201,444
Other reserves and accruals	315,508	1,245,082
Capital loss carryforwards	931,100	—
Tax credit carryforwards	10,936,817	9,000,119
Property, plant and equipment	51,455	1,065,666
Net operating loss	157,923,906	140,672,933
Total deferred tax assets	178,829,847	161,998,980
Less valuation allowances	(178,829,847)	(161,998,980)
Net deferred tax assets and liabilities	\$ —	\$ —

The Company has recorded a valuation allowance, as a result of uncertainties related to the realization of its net deferred tax asset, at December 31, 2004 and 2003 of approximately \$178.8 million and \$162.0 million, respectively. The increase of approximately \$16.8 million during 2004 relates primarily to \$17.3 million net operating losses incurred in 2004. The valuation allowance increased approximately \$54.5 million in 2003 primarily due to the acquisition of \$35.7 million of deferred tax assets and the net operating losses incurred during that year. The \$35.7 million includes deferred tax assets acquired as part of the H Power transaction, which may be subject to limitations under Section 382 of the Internal Revenue Code. The deferred tax assets have been offset by a full valuation allowance because it is more likely than not that the tax benefits of the net operating loss carryforwards may not be realized. Included in the valuation allowance as of December 31, 2004 and 2003 are \$14.9 million and \$14.8 million, respectively, of deferred tax assets resulting from the exercise of employee stock options, which upon subsequent realization of the tax benefits, will be allocated directly to paid-in capital.

Under Section 382 of the Internal Revenue Code, the use of loss carryforwards may be limited if a change in ownership of a company occurs. The H Power transaction constituted a change of ownership for the related H Power tax attributes under IRC Section 382 and will result in limitation to the utilization of H Power's net operating loss carryforwards of \$81.6 million.

At December 31, 2004, the Company has unused Federal and State net operating loss carryforwards of approximately \$394.8 million, of which \$81.6 million was generated from the operations of H Power during the period May 31, 1989, through the date of the H Power acquisition and \$313.2 million was generated by the Company during the period October 1, 1999 through December 31, 2004. The net operating loss carryforwards if unused will expire at various dates from 2004 through 2023. In 2004, net operating loss carryforwards of \$297,000 acquired as part of the H Power transaction expired.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

9. STOCKHOLDERS' EQUITY**COMMON STOCK**

The Company has one class of common stock, par value \$.01 per share. Each share of the Company's common stock is entitled to one vote on all matters submitted to stockholders. As of December 31, 2004 there were 73,350,878 shares of common stock issued and outstanding.

Through December 31, 2004, the Company's stockholders in the aggregate have contributed \$349.3 million in cash, including \$93.0 million in net proceeds from the Company's initial public offering, \$51.6 million in net proceeds from the Company's follow-on public offering, \$55.0 million in net proceeds from the Company's second follow-on offering and \$35.4 million in other contributions, consisting of in-process research and development, real estate, other in-kind contributions and equity interests in affiliates.

In November 2003, the Company completed a public offering of 11.7 million shares of common stock. The Company received net proceeds of \$55.0 million, after payment of \$3.5 million of expenses and placement fees relating to the issuance and distribution of the securities. During 2003, the Company also issued approximately 9.0 million shares of common stock with a fair value of approximately \$5.10 per share in connection with its acquisition of H Power.

The following represents a summary of the issuances of shares of common stock since inception.

	No. of Common Shares	Cash Contribution	Noncash Contribution	Total Capital Contribution
1997				
DTE Energy Company	4,750,000	\$ 4,750,000	\$ —	\$ 4,750,000
Mechanical Technology Incorporated	4,750,000	—	4,750,000(a)	4,750,000
	9,500,000	4,750,000	4,750,000	9,500,000
1998				
DTE Energy Company	4,950,000	7,750,000	—	7,750,000
Mechanical Technology Incorporated	2,700,000	3,000,000	550,000(a)	5,500,000
Stock based compensation and other noncash transactions	—	—	212,000(c)	(1,738,000)
	7,650,000	10,750,000	762,000	11,512,000
1999				
Edison Development Corporation	4,004,315	28,697,782	—	28,697,782
Mechanical Technology Incorporated	6,254,315	24,000,000	8,897,782(a)	32,897,782
General Electric Company	5,250,000	37,500,000	11,250,000(b)	48,750,000
Other private investors	3,549,850	25,045,000	—	25,045,000
Initial public offering-net	6,782,900	92,971,878	—	92,971,878
Stock option exercises	24,128	41,907	—	41,907
Stock based compensation and other noncash transactions	—	—	978,800(c)	978,800
	25,865,508	208,256,567	21,126,582	229,383,149
2000				
Stock option exercises	632,378	3,793,028	—	3,793,028
Stock issued under employee stock purchase plan	32,717	408,452	—	408,452
Stock issued for development agreement	104,869	—	5,000,000(d)	5,000,000
Stock issued for equity in affiliate	7,000	—	827,750(e)	827,750
Stock based compensation and other noncash transactions	3,041	—	8,936,779(c)	8,936,779
	780,005	4,201,480	14,764,529	18,966,009

(continued)

(continued)	No. of Common Shares	Cash Contribution	Noncash Contribution	Total Capital Contribution
2001				
Edison Development Corporation	416,666	4,800,000	—	4,800,000
General Electric Company	416,666	4,800,000	—	4,800,000
Public offering-net	4,575,000	51,588,551	—	51,588,551
Stock option exercises	760,531	2,051,954	—	2,051,954
Stock issued under employee stock purchase plan	73,132	730,592	—	730,592
Stock issued for development agreement	96,336	—	3,000,000(d)	3,000,000
Stock option issued to affiliate	—	—	5,000,000(f)	5,000,000
Stock based compensation and other noncash transactions	189,084	—	2,013,177(c)	2,013,177
	6,527,415	63,971,097	10,013,177	73,984,274
2002				
Stock option exercises	138,567	708,931	—	708,931
Stock issued under employee stock purchase plan	78,208	395,679	—	395,679
Stock issued for development agreement	243,383	—	2,000,000(d)	2,000,000
Stock based compensation and other noncash transactions	213,987	—	1,807,593(c)	1,807,593
	674,145	1,104,610	3,807,593	4,912,203
2003				
Public offering, net	11,700,000	54,967,204	—	54,967,204
Stock option exercises	35,033	84,973	—	84,973
Stock issued under employee stock purchase plan	90,380	348,605	—	348,605
Stock issued in acquisition of H Power	9,063,080	—	46,260,576(g)	46,260,576
Stock based compensation	965,143	—	2,966,797(c)	2,966,797
	21,853,636	55,400,782	49,227,373	104,628,155
2004				
Stock option exercises	95,960	501,308	—	501,308
Stock issued under employee stock purchase plan	71,709	409,413	—	409,413
Stock based compensation	332,500	—	4,137,202(c)	4,137,202
	500,169	910,721	4,137,202	5,047,923
Total as of December 31, 2004	73,350,878	\$349,345,257	\$106,804,413	\$457,933,713

a. Since inception, Mechanical Technology Incorporated has contributed in-process research and development of \$4,042,640; certain net assets at inception of \$707,360; \$2,000,000 of deferred rent related to a below market lease for office and manufacturing facilities; \$500,000 of in-kind services; land and buildings valued at approximately \$4,697,782; and research contracts valued at approximately \$2,250,000.

b. In February 1999, the Company issued 2,250,000 shares of common stock to GE MicroGen, Inc. in exchange for a 25% interest in GE Fuel Cell Systems, LLC. The fair value of the shares issued of \$11,250,000 was recorded under the balance sheet caption "Investment in affiliates." See note 3.

c. These issuances primarily represent stock based compensation issued to employees, consultants and others for services performed. These amounts are recorded at the fair value of the issuance on the date the compensation is awarded.

d. Represents the fair value of shares issued to Engelhard Corporation for the development and supply of advanced catalysts as part of a development agreement discussed in note 14.

e. Represents the fair value of shares issued along with cash for a 28% ownership interest in Advanced Energy Incorporated.

f. Represents the fair value of an option to purchase 725,000 shares of the Company's common stock issued to GE Power Systems Equities, Inc. as part of the amendment to the GE Fuel Cell Systems LLC distribution agreement. See note 3.

g. Represents the fair value of shares issued related to the acquisition of H Power.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

PREFERRED STOCK

The Company has authorized 5.0 million shares of preferred stock, par value \$.01 per share. Our certificate of incorporation provides that shares of preferred stock may be issued from time to time in one or more series. Our Board of Directors is authorized to fix the voting rights, if any, designations, powers, preferences, qualifications, limitations and restrictions thereof, applicable to the shares of each series. As of December 31, 2004, there was no preferred stock outstanding.

10. EMPLOYEE BENEFIT PLANS

1999 EMPLOYEE STOCK PURCHASE PLAN

In 1999, the Company adopted the 1999 Employee Stock Purchase Plan (the "Plan") under which employees will be eligible to purchase shares of the Company's common stock at a discount through periodic payroll deductions. The Plan is intended to meet the requirements of Section 423 of the Internal Revenue Code. Purchases occur at the end of six month offering periods at a purchase price equal to 85% of the market value of the Company's common stock at either the beginning of the offering period or the end of the offering period, whichever is lower. Participants may elect to have from 1% to 10% of their pay withheld for purchase of common stock at the end of the offering period, up to a maximum of \$12,500 within any offering period. The Company has reserved 1,000,000 shares of common stock for issuance under the Plan. The Company issued 71,709, 90,380 and 78,208 shares of stock under the Plan during 2004, 2003, and 2002, respectively.

STOCK OPTION PLANS (THE "OPTION PLANS")

Effective July 1, 1997, the Company established a stock option plan to provide employees, consultants, and members of the Board of Directors the ability to acquire an ownership interest in the Company ("1997 Stock Option Plan"). Options for employees issued under this plan generally vested 20% per year and expire ten years after issuance. Options granted to members of the Board generally vested 50% upon grant and 25% per year thereafter. Options granted to consultants generally vested one-third on the expiration of the consultant's initial contract term, with an additional one-third vesting on each anniversary thereafter. At December 31, 2004, there were a total of 910,336 options granted, outstanding, and vested under this plan. Although no further options will be granted under this plan, the options previously granted will continue to vest in accordance with this plan and vested options will be exercisable for shares of common stock.

At December 31, 2004 there were 3,801,728 options granted and outstanding, and an additional 3,622,681 options available to be issued under the 1999 Stock Option and Incentive Plan ("1999 Stock Option Plan"). The number of shares of common stock available for issuance under the Plan will increase by the amount of any forfeitures under the 1999 Stock Option Plan and under the 1997 Stock Option Plan. The number of shares of common stock under the 1999 Stock Option Plan will further increase January 1 and July 1 of each year by an amount equal to 16.4% of any net increase in the total number of shares of stock outstanding. The 1999 Stock Option Plan permits the Company to: grant incentive stock options; grant non-qualified stock options; grant stock appreciation rights; issue or sell common stock with vesting or other restrictions, or without restrictions; grant rights to receive common stock in the future with or without vesting; grant common stock upon the attainment of specified performance goals; and grant dividend rights in respect of common stock. Options for employees issued under this plan generally vest annually over periods of three or four years and expire ten years after issuance. Options granted to members of the Board generally vest one year after issuance. Options granted to consultants generally vested one-third on the expiration of the consultant's initial contract term, with an additional one-third vesting on each anniversary thereafter. To date, options granted under the 1999 Stock Option Plan have vesting provisions ranging from immediate vesting to five years in duration and expire ten years after issuance. These grants may be made to officers, employees, non-employee directors, consultants, advisors and other key persons of the Company.

The following table summarizes information about the stock options outstanding under the Option Plans at December 31, 2004:

	Options Outstanding			Options Exercisable	
	Shares	Average Remaining Life	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
\$ 0.00– 1.00	462,867	2.6	\$ 1.00	462,867	\$ 1.00
1.01– 5.00	181,694	5.1	4.80	165,569	4.81
5.01– 10.00	2,467,983	7.9	7.32	1,823,772	7.38
10.01– 15.00	1,168,080	5.7	11.83	976,705	11.95
15.01– 20.00	131,900	6.0	18.17	131,774	18.17
20.01– 25.00	87,000	6.4	24.46	86,937	24.47
25.01– 50.00	92,500	5.5	43.80	92,500	43.80
50.01– 75.00	23,200	5.4	65.08	23,200	65.08
75.01–100.00	79,240	5.4	94.29	79,240	94.29
100.01–140.00	17,600	5.2	106.75	17,600	106.75
	<u>4,712,064</u>	6.5	11.17	<u>3,860,164</u>	11.87

The following table summarizes activity under the Option Plans:

Option Activity	Number of Shares Subject to Option	Weighted Average Exercise Price per Share
January 1, 2002	6,008,932	23.36
Granted at fair value	206,298	9.08
Forfeited or terminated	(253,720)	37.46
Exercised	(164,346)	4.31
December 31, 2002	5,797,164	21.83
Granted at fair value	1,245,245	6.12
Options exchanged for restricted stock	(1,810,048)	39.48
Forfeited or terminated	(366,161)	23.92
Exercised	(35,033)	2.41
December 31, 2003	4,831,167	12.46
Granted at fair value	337,500	8.03
Forfeited or terminated	(360,643)	23.22
Exercised	(95,960)	5.22
December 31, 2004	<u>4,712,064</u>	11.17

At December 31, 2004, 3,622,681 shares of common stock were reserved for issuance under future stock option exercises.

The per share weighted average fair value of the options granted during 2004, 2003 and 2002 was \$8.16, \$5.85 and \$6.25, respectively, using the Black-Scholes pricing model with the assumptions outlined below.

The dividend yield was assumed to be zero for all periods. The risk free interest rate ranged from 2.8% to 3.9% in 2004, 2.3% to 3.4% in 2003 and 2.9% to 7.4% in 2002. An expected life of 5 years was assumed for each year. Expected volatility of 57% in 2004, 69% in 2003 and 84% in 2002 was used in determining fair value under the Black-Scholes pricing model.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

On June 20, 2003, the Company issued 607,804 shares of restricted common stock and cancelled 1,810,048 options to purchase common stock in connection with the Company's offer to eligible employees to exchange options to purchase shares of common stock with an exercise price of \$8.53 or greater per share for shares of restricted common stock on a three for one basis. The shares of restricted common stock received in this exchange vest in three equal installments effective 21 months, 24 months and 27 months from the date of the exchange and are excluded from the weighted average number of common shares for the calculation of basic and diluted earnings per share until vested. During the years ended December 31, 2004 and 2003, the Company recorded employee compensation expense of \$1.8 million and \$937,000, respectively, relating to the issuance of the restricted stock awards. This amount represents recognition of compensation expense on a straight-line basis over the vesting periods of the restricted stock.

401(K) SAVINGS & RETIREMENT PLAN

The Company offers a 401(k) Savings & Retirement Plan to eligible employees meeting certain age and service requirements. This plan permits participants to contribute up to 15% of their salary, up to the maximum allowable by the Internal Revenue Service regulations. Participants are immediately vested in their voluntary contributions plus actual earnings thereon. Participants are vested in the Company's matching contribution based on the years of service completed. Participants are fully vested upon completion of three years of service. During 2002, the Company began funding its matching contribution in common stock. Accordingly, the Company has issued 139,190, 158,522 and 90,423 shares of common stock to the Plug Power Inc. 401(k) Savings & Retirement Plan during 2004, 2003 and 2002, respectively.

The Company's expense for this plan, including the issuance of shares, was \$950,000, \$867,000 and \$773,000 for years ended December 31, 2004, 2003 and 2002, respectively.

11. OTHER RELATED PARTY TRANSACTIONS

The Company has an exclusive distribution agreement with DTE Energy Technologies, Inc. (an affiliate of EDC and DTE Energy Corporation) for the states of Michigan, Ohio, Illinois, and Indiana. Under the agreement the Company can sell directly or negotiate nonexclusive distribution rights to third parties for the GenCore backup power product line, and the GenSite hydrogen generation product line. Starting in the fourth quarter of 2004 for GenCore and in the fourth quarter of 2005 for GenSite, the Company has agreed to pay a 5% commission to DTE Energy Technologies, Inc., based on sales price of units shipped to the above noted states. The distribution agreement expires on December 31, 2014.

As of December 31, 2004, the Company had a receivable from DTE Energy Technologies, Inc. in the amount of \$51,000. There was no amounts due from or due to DTE Technologies, Inc. at December 31, 2003.

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following disclosure of the estimated fair value of financial instruments is made in accordance with the provision of SFAS No. 107, "Disclosures About Fair Value of Financial Instruments." Although the estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies, the estimates presented are not necessarily indicative of the amounts that the Company could realize in current market exchanges.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

CASH AND CASH EQUIVALENTS, RESTRICTED CASH, ACCOUNTS RECEIVABLES, ACCOUNTS PAYABLES, AND ACCRUED EXPENSES: The carrying amounts reported in the consolidated balance sheets approximate fair value because of the short maturities of these instruments.

LONG-TERM DEBT: The fair value of the Company's long-term debt in the consolidated balance sheets approximates the carrying value at December 31, 2004 and 2003. The debt accrues interest at a variable rate of interest which was approximately 2.37% and 1.30% at December 31, 2004 and 2003, respectively.

13. SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION

The following represents required supplemental disclosures of cash flows information and noncash financing and investing activities which occurred during the years ended December 31, 2004, 2003 and 2002:

	2004	2003	2002
Cash paid for interest	\$ 63,384	\$ 62,805	\$ 97,009
Equipment financed under capital lease obligations	129,900	—	—
Net assets acquired, excluding cash, cash equivalents and marketable securities	—	6,106,293	—
Issuance of shares for property, plant and equipment	—	—	322,050
Issuance of shares under Engelhard Corporation development agreement	—	—	2,000,000

14. COMMITMENTS AND CONTINGENCIES

LITIGATION:

As previously disclosed in September 2000, a shareholder class action complaint was filed in the federal district court for the Eastern District of New York alleging that the Company and various of our officers and directors violated certain federal securities laws by failing to disclose certain information concerning our products and future prospects.

The action was brought on behalf of a class of purchasers of our stock who purchased the stock between February 14, 2000 and August 2, 2000. Subsequently, fourteen additional complaints with similar allegations and class periods were filed. By order dated October 30, 2000, the court consolidated the complaints into one action, entitled Plug Power Inc. Securities Litigation, CV-00-5553(ERK)(RML). By order dated January 25, 2001, the Court appointed lead plaintiffs and lead plaintiffs' counsel. Subsequently, the plaintiffs served a consolidated amended complaint. The consolidated amended complaint extends the class period to begin on October 29, 1999 and alleges claims under the Securities Act and the Exchange Act, and Rule 10b-5 promulgated under the Exchange Act. Subsequently, plaintiffs withdrew their claims under the Securities Act. Plaintiffs allege that the defendants made misleading statements and omissions regarding the state of development of our technology in a registration statement issued in connection with our initial public offering (IPO) and in subsequent press releases. The Company served our motion to dismiss the claims in May 2001. By order dated January 21, 2003, the Court dismissed all claims relating to pre-IPO press releases, the IPO prospectus and all but three post-IPO press releases. The Court ruled that the three remaining press releases raised questions of fact that could not be resolved on a motion to dismiss. The Court also denied the motion to dismiss the claims against the individual defendants at this time.

On December 29, 2004, the plaintiffs and the defendants entered into a Stipulation and Agreement of Settlement, which is subject to final approval by the Court. The settlement does not call for any payment by the defendants and would be covered by directors and officers insurance. The Stipulation and Agreement of Settlement was submitted to the Court on January 5, 2005. On January 19, 2005, the Court entered an order certifying the class for the purposes of settlement pursuant to Federal Rule of Civil Procedure 23, setting forth procedures for notice to the plaintiff class, and scheduling a settlement fairness hearing for April 29, 2005. Pursuant to the Court's January 19, 2005 order, members of the plaintiff class who wish to be excluded from the class must mail a request to be excluded no later than April 11, 2005.

The Company continues to believe that the allegations in the consolidated amended complaint are without merit and intend to vigorously defend against the claims. If the plaintiffs were to prevail, such an outcome could have a material adverse effect on our business, financial condition, results of operations and prospects. However, litigation is inherently uncertain and there can be no assurances as to the ultimate outcome or effect of these actions. As noted, the settlement is still subject to final approval by the Court, and certain plaintiffs may submit requests for exclusion from the settlement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

ALLIANCES AND DEVELOPMENT AGREEMENTS:

VAILLANT: In March 2000, the Company finalized a development agreement with Vaillant GmbH (Vaillant), to develop a combination furnace, hot water heater and fuel cell system that will provide both heat and electricity for the home. Under that agreement, Vaillant will obtain fuel cell subsystems from GEFCS and then will produce the fuel cell heating appliances for its customers in Germany, Austria, Switzerland and the Netherlands, and for GEFCS customers throughout Europe.

In March 2002, the Company amended its agreements with Vaillant to expand their distribution territory, on a non-exclusive basis, to include all of Europe. Also under the amended agreements, the Company will sell fuel cell subsystems directly and exclusively to Vaillant and Vaillant will distribute Fuel Cell Heating Appliances throughout Europe on a non-exclusive basis. In exchange for the right to sell fuel cell subsystems directly and exclusively to Vaillant, The Company agreed to pay GE MicroGen, Inc. a commission, based on a prescribed percentage of sales of fuel cell subsystems as defined in the agreement.

PEMEAS: In April 2000, the Company entered into a joint development agreement with Pemeas (effective April 1, 2004, the fuel cell activity of Celanese AG and former Hoechst AG were combined to form a new company, Pemeas GmbH), to develop, on an exclusive basis, a high temperature membrane electrode unit for stationary fuel cell systems with net electrical output of 750 watts up to 25 kilowatts. Additionally, the Company will work with Pemeas on a non-exclusive basis to develop a high-temperature membrane electrode unit for stationary fuel cell systems with net electrical output of less than 750 watts and greater than 25 kilowatts. Under the agreement, the Company and Pemeas will each fund their own development efforts.

ENGELHARD: In September 2000, the Company finalized a joint development agreement and a supply agreement with Engelhard Corporation for development and supply of advanced catalysts to increase the overall performance and efficiency of the Company's fuel processor. Over the course of the joint development agreement the Company has contributed \$10.0 million to fund Engelhard's development efforts, and Engelhard in turn has acquired \$10.0 million of the Company's common stock. At December 31, 2004, the \$10.0 million has been fully expensed. The supply agreement with Engelhard also specifies the rights and obligations for Engelhard to supply products to the Company over the next 10 years.

HONDA: In October 2002, the Company signed a definitive agreement with Honda R&D Co., Ltd. of Japan, a subsidiary of Honda Motor Co., Ltd., to exclusively and jointly develop and test an initial prototype of a Home Energy Station for fuel cell automobiles. Under the terms of this agreement, the Company's associated research and development efforts will be funded through total installments of \$3.0 million. As part of the program, the Company expects to integrate one of its GenSys™ 5C stationary fuel cell systems with additional components necessary for the home refueling concept. A Home Energy Station is a fuel cell product that is expected to provide heat, hot water, and electricity to a home, while also providing hydrogen fuel for a fuel cell vehicle. The device will be fueled by natural gas, and is expected to be environmentally friendly due to its high and low emissions. The exclusive agreement covers the first phase of what is expected to be a multi-phase development project. In October 2003, the Company successfully demonstrated a prototype Home Energy Station at Honda R&D Americas' facility in Torrance, California. Through December 31, 2003, the Company has invoiced and received \$3.0 million under this agreement and recognized research and development contract revenue and associated cost of revenue in the amount of \$3.0 million.

In March 2004, the Company amended the agreement with Honda to provide for the second phase of product development effort. In September 2004, under the second phase of the work with Honda, the Company successfully demonstrated a second-generation prototype of the Home Energy Station at its Latham N.Y. headquarters. As in the first phase, Honda R&D of Japan is funding Plug Power's work under this new agreement. Through December 31, 2004, the Company has invoiced and received \$4.0 million under this agreement and recognized research and development contract revenue and associated cost of revenue in the amount of \$3.8 million.

LEASES:

In 2004, the Company leased certain equipment under capital lease transactions with an original cost of \$129,900, which had a net book value at December 31, 2004 of \$90,000. The Company had no capital leases at December 31, 2003. The Company also has several noncancelable operating leases, primarily for warehouse facilities and office space that expire over the next five years. Rental expense for operating leases (except those with lease terms of a month or less that were not renewed) during 2004, 2003, and 2002 was \$283,000, \$188,000 and \$496,000, respectively.

Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of December 31, 2004 are:

Year ending December 31,	Operating leases
2005	\$ 866,000
2006	619,000
2007	398,000
2008	384,000
2009	384,000
Thereafter	358,000
Total minimum lease payments	\$3,009,000

At December 31, 2004 the future minimum lease payments due on capital lease obligations are \$62,000 in 2005.

CONCENTRATIONS OF CREDIT RISK:

Concentrations of credit risk with respect to receivables exist due to the limited number of select customers that the Company has initial commercial sales arrangements. To mitigate credit risk, the Company applies standard credit approvals and performs appropriate evaluation of a prospective customer's financial condition. At December 31, 2004, five customers comprise approximately 62.1% of the total accounts receivable balance, with each customer individually representing 15.9%, 14.9%, 13.9%, 8.9% and 8.5% of total accounts receivable, respectively. For the year ended December 31, 2004, product and service revenue recognized on sales arrangements with five customers represented approximately 63.1% of total product and service revenue, with each customer individually representing 18.8%, 17.5%, 13.5%, 7.0% and 6.3% of recognized product and service revenue, respectively.

The Company has cash deposits in excess of federally insured limits. The amount of such deposits is approximately \$9.3 million at December 31, 2004.

EMPLOYMENT AGREEMENTS

The Company is party to employment agreements with certain executives which provide for compensation and certain other benefits. The agreements also provide for severance payments under certain circumstances.

16. UNAUDITED QUARTERLY FINANCIAL DATA (IN THOUSANDS, EXCEPT PER SHARE DATA)

	Quarters Ended			
	March 31, 2004	June 30, 2004	September 30, 2004	December 31, 2004
Product and service revenue	\$ 1,351	\$ 1,508	\$ 1,335	\$ 1,112
Contract revenue	1,935	2,177	3,293	3,430
Net loss	(11,952)	(11,299)	(11,684)	(11,804)
Loss per share:				
Basic and diluted	(0.17)	(0.15)	(0.16)	(0.16)

	Quarters Ended			
	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003
Product and service revenue	\$ 2,033	\$ 2,146	\$ 1,988	\$ 1,350
Contract revenue	919	957	1,477	1,632
Net loss	(13,767)	(12,827)	(12,405)	(14,040)
Loss per share:				
Basic and diluted	(0.27)	(0.21)	(0.20)	(0.21)

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

MARKET INFORMATION. Our common stock is traded on the NASDAQ National Market under the symbol "PLUG." As of March 1, 2005, there were approximately 2,600 record holders of our common stock. However, management believes that a significant number of shares are held by brokers under a "nominee name" and that the number of beneficial shareholders of our common stock exceeds 80,000. The following table sets forth high and low last reported sale prices for our common stock as reported by the NASDAQ National Market for the periods indicated:

	Sales prices	
	High	Low
2003		
1st Quarter	\$ 6.34	\$4.04
2nd Quarter	\$ 6.18	\$4.50
3rd Quarter	\$ 6.58	\$3.85
4th Quarter	\$ 7.50	\$4.88
2004		
1st Quarter	\$10.65	\$6.75
2nd Quarter	\$10.24	\$6.85
3rd Quarter	\$ 7.55	\$4.62
4th Quarter	\$ 7.27	\$5.45

DIVIDEND POLICY. We have never declared or paid cash dividends on our common stock and do not anticipate paying cash dividends in the foreseeable future. Any future determination as to the payment of dividends will depend upon capital requirements and limitations imposed by our credit agreements, if any, and such other factors as our board of directors may consider.

Corporate Information



Plug Power Board of Directors (missing from the photo is Douglas T. Hickey)

PLUG POWER OFFICERS

[Dr. Roger B. Saillant](#)
President and Chief Executive Officer

[Allen K. Bucknam](#)
Vice President of Strategy &
Business Development

[Paul J. Burton](#)
Vice President of GenCore Engineering

[Gerard L. Conway, Jr.](#)
General Counsel and
Corporate Secretary

[Dr. John F. Elter](#)
Chief Technology Officer

[Dr. William D. Ernst](#)
Vice President and Chief Scientist

[David A. Neumann](#)
Chief Financial Officer

[Gregory A. Silvestri](#)
Chief Operating Officer

[Robert A. Sinuc](#)
Vice President of Engineering

[Mark A. Sperry](#)
Chief Marketing Officer

BOARD OF DIRECTORS

[Anthony F. Earley, Jr.](#)
Chairman & CEO
DTE Energy

[Larry G. Garberding](#)
Executive VP & CFO (retired)
DTE Energy

[J. Douglas Grant](#)
Chairman & CEO (retired)
Sceptre Investment Counsel Ltd.

[Maureen O. Helmer](#)
Partner
Couch White, LLP

[Douglas T. Hickey](#)
Partner
Hummer Winblad Venture Partners

[George C. McNamee](#)
Chairman
First Albany Companies, Inc.

[Dr. Roger B. Saillant](#)
President & CEO
Plug Power Inc.

[John M. Shalikhvili](#)
Retired Chairman of the
Joint Chiefs of Staff
U.S. Department of Defense

[Richard R. Stewart](#)
President & CEO
GE Aero Energy

[Gary K. Willis](#)
Chairman (retired)
Zygo Corporation

CORPORATE HEADQUARTERS

PLUG POWER INC.
968 Albany Shaker Road
Latham, N.Y. 12110
(518) 782-7700
website: www.plugpower.com

INDEPENDENT AUDITORS

KPMG LLP
515 Broadway
Albany, N.Y. 12207

STOCK TRANSFER AGENT AND REGISTRAR

**American Stock Transfer
And Trust Company**
6201 15th Avenue
Brooklyn, N.Y. 11219

STOCK EXCHANGE LISTING

Plug Power's common stock is traded on
the NASDAQ national market under the
symbol "PLUG"

ANNUAL MEETING OF SHAREHOLDERS

May 18, 2005, 10:00 a.m. EST
NASDAQ
Four Times Square
(Corner of 43rd and Broadway)
New York, N.Y. 10036

FORM 10-K

Plug Power's Annual Report on
Form 10-K for the fiscal year ended
December 31, 2004 filed with the
Securities Exchange Commission is
available upon request at no charge.
Exhibits to the Form 10-K are available
at a charge sufficient to cover postage
and handling. The Form 10-K and
exhibits may be obtained by writing to
David A. Neumann, our Chief Financial
Officer, at the address of our corporate
headquarters listed above.



HEADQUARTERS

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Fax: (518) 782-9060

<http://www.plugpower.com>

PLUG IS

PLUG WILL

