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POWER EFFICIENCY CORP
Form 10-K
March 31, 2009

Securities and Exchange Commission

Washington, D.C. 20549
FORM 10-K

- x Annual report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2008
- .. Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number: 000-31805

Power Efficiency Corporation
(Exact name of registrant as specified in its Charter)

Delaware
(State or Other Jurisdiction of Incorporation
or Organization)

22-3337365

(I.R.S. Employer Identification No.)

3960 Howard Hughes Pkwy, Ste 460
Las Vegas, NV
(Address of Principal Executive Offices)

89169
(Zip Code)

(702) 697-0377
(Issuer's Telephone Number, Including Area Code)

Securities Registered under Section 12(g) of the Exchange Act:

Common Stock, \$.001 Par Value
(Title of Class)

Check whether the Company: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ..

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-K contained in this form, and no disclosure will be contained, to the best of Company's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer and large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer .. Accelerated filer .. Non-accelerated filer .. Smaller reporting company x

Indicate by check mark whether the Company is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of June 30, 2008, the aggregate market value of the common stock held by non-affiliates of the issuer was \$10,180,314. This amount is based on the closing price of \$0.34 per share for the Company's common stock as of such date.

On March 30, 2009 there were 43,255,441 shares of the Company's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

In this report, references to “we”, “us” or “our” collectively refer to Power Efficiency Corporation.

SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

This report and the documents incorporated into this report contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the “PSLRA”), including, but not limited to, statements relating to the Company’s business objectives and strategy. Such forward-looking statements are based on current expectations, management beliefs, certain assumptions made by the Company’s management, and estimates and projections about the Company’s industry. Words such as “anticipates,” “expects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “forecasts,” “likely,” “predicts,” “projects,” “judgment,” variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict with respect to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may differ materially from those expressed, forecasted, or contemplated by any such forward-looking statements.

Factors that could cause actual events or results to differ materially include, but are not limited to, the following: continued market acceptance of the Company’s products; the Company’s ability to expand and/or modify its products on an ongoing basis; general demand for the Company’s products, intense competition from other developers, manufacturers and/or marketers of energy reduction and/or power saving products; the Company’s negative net tangible book value; the Company’s negative cash flow from operations; delays or errors in the Company’s ability to meet customer demand and deliver products on a timely basis; the Company’s lack of working capital; the Company’s need to upgrade its facilities; changes in laws and regulations affecting the Company and/or its products; the impact of technological advances and issues; the outcomes of pending and future litigation and contingencies; trends in energy use and consumer behavior; changes in the local and national economies; and other risks inherent in and associated with doing business in an engineering and technology intensive industry. See “Management’s Discussion and Analysis or Plan of Operation.” Given these uncertainties, investors are cautioned not to place undue reliance on any such forward-looking statements.

Unless required by law, the Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. However, readers should carefully review the risk factors set forth in other reports or documents that the Company files from time to time with the Securities and Exchange Commission (the “SEC”), particularly Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K.

GLOSSARY OF TERMS

Set forth below are technical terms used in the discussion in this document and explanations of the meanings of those terms.

Alternating Current (AC)	A type of electrical current, the direction of which is reversed at regular intervals or cycles; in the U.S. the standard is 120 reversals or 60 cycles per second; typically abbreviated as AC.
Ampere (amp)	A unit of measure for an electrical current; the amount of current that flows in a circuit; abbreviated as amp.
Current (Electrical)	The flow of electrical energy (electricity) in a conductor, measured in amperes.
Cycle	In an alternating current, the current goes from zero potential (or voltage) to a maximum in one direction, back to zero, and then to a maximum potential (or voltage) in the other direction. The number of complete cycles per second determines the current frequency; in the U.S. the standard for alternating current is 60 cycles.
Efficiency	Efficiency is the ratio of work (or energy) output to work (or energy) input, and cannot exceed 100 percent.
Energy	The capability of doing work.
Horsepower (HP)	A unit for measuring the power of motors or the rate of doing work. One horsepower equals 33,000 foot-pounds of work per minute or 746 watts.
Induction	The production of an electric current in a conductor by the variation of a magnetic field in its vicinity.
Induction Motor	The simplest and most rugged electric motor, it consists of a wound stator and a rotor assembly. The AC induction motor is so named because the electric current flowing in its secondary member (the rotor) is induced by the alternating current flowing in its primary member (stator). The power supply is connected only to the stator. The combined electromagnetic efforts of the two currents produce the force to create rotation.
Inrush Current	The current that flows at the instant of connection of a motor to the power source. Usually expressed as a multiple of motor full-load current.
Kilowatt (kW)	A standard unit of electrical power equal to one thousand watts.
Load	The demand on an energy producing system. The energy consumption or requirement of a piece or group of equipment.
Motor	A machine supplied with external energy that is converted into force and/or motion.

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Power	The rate at which work is done, typically measured in watts or horsepower.
Power Factor	The ratio of watts to volt-amperes of an AC electric circuit.
Soft-start	Soft-start is the regulation of the supply voltage from an initial low value to full voltage during the starting process.
Torque (Motor)	The rotating force provided by a motor. The units of torque may be expressed as pound-foot, pound-inch (English system), or newton-meter (metric system).

Torque (Starting)	This torque is what is available to initially get the load moving and begin its acceleration.
Transformer	An electromagnetic device that changes the voltage of alternating current electricity; it consists of an induction coil having a primary and secondary winding and a closed iron core.
Voltage	The amount of electromotive force, measured in volts that exists between two points.
Watt	The amount of power required maintaining a current of one ampere at a pressure of one volt when the two are in phase with each other. One horsepower is equal to 746 watts.

PART I

Item 1. Description of Business.

(a) Business Development

Formation

Power Efficiency Corporation (the “Company”) was incorporated in Delaware on October 19, 1994. From inception through 1997, the Company was a development stage entity that was engaged in the design, development, marketing and sale of proprietary solid state electrical components designed to reduce energy consumption in alternating current induction motors. Alternating current induction motors are commonly found in industrial and commercial facilities throughout the world.

(b) Business of the Company

The Company’s Principal Products and Technology

In the late 1990s the Company commenced the sale of its initial product, which is based on analog technology and reduces energy consumption in alternating current induction motors in certain applications. This product has been known by several names, including the Power Commander® and Power Genius. In 2005 the Company began development of a digital product that would overcome many of the commercial limitations of the analog product. In 2008 the first generation of the digital product was launched. Going forward, the company has chosen to call its products Motor Efficiency Controllers (“MEC”).

The Company has developed patented and patent-pending technologies for effectively controlling the energy usage of an electric motor. The Company’s first United States Patent was granted in 1998. Over the past three years the Company has undertaken extensive study and computer modeling of motors and their energy use, and has developed digital technologies for its controllers. In the process, the Company has discovered what it believes are significant innovations and has completed numerous patent filings around these new inventions. The Company has branded these collective patented and patent pending technologies as E-SAVE Technology® and has a registered trademark on this name.

The Company has developed technologies and products for use on three-phase and single-phase motors. Three-phase power and motors are generally found in industrial and commercial buildings for larger applications than single-phase power and motors.

The Company’s marketing efforts initially focused on the three-phase version but it is also now marketing the single-phase product. The Company’s digital Three-Phase MEC is designed to have the following functionality:

1. Start a motor
2. Provide a soft start for the motor, bringing it gradually from rest to full speed
3. Provide various motor protection capabilities, such as sensing current overload, phase loss, under- and over-voltage, and more.
4. Save energy when the motor is at full speed but is less than fully loaded

The Company’s digital Single-Phase MEC is designed to have the following functionality:

1. Start a motor
2. Provide a soft start for the motor, bringing it gradually from rest to full speed
3. Save energy when the motor is at full speed but is less than fully loaded

Three-Phase and Single-Phase MECs are unique particularly because of their energy savings capabilities. The product reduces energy consumption by electric motors by electronically sensing and controlling the amount of energy the motor consumes. A motor with an MEC installed only uses the energy it needs to perform its work task, thereby increasing its efficiency. The result is a reduction of energy consumption typically ranging from 15% - 35% in applications that do not always run at peak load levels. The amount of energy savings depends on a variety of factors, including the load on the motor and the motor's characteristics.

The Company's management believes its Motor Efficiency Controllers offer certain advantages over competing products for the following reasons:

- **Motor and Equipment Life:** The MEC extends motor life by reducing the stress and strain on the motor and surrounding equipment, and reduces the amperage to the motor, which results in cooler running.
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- **Successful Utility and Customer Tests:** The MEC has been successfully tested by numerous electric utilities and customers. For example, Paragon Consulting Services, a contractor for Nevada Power Company, the electric utility for southern Nevada, performed 8 field tests on escalators and one on an elevator in major Las Vegas casinos. The tests resulted in average energy savings of over 30% on the escalators and 20% on the elevator.
- **Utility Incentive Financing:** The three-phase product has qualified for rebate incentive financing, most frequently called “rebates”, from many electric utilities. This financing is generally paid to the end user of the MEC as an incentive to invest in energy saving products. As such, this financing effectively decreases the cost of the Company’s MEC for end users. The utilities that have approved the Company’s products for incentive financing include: NV Energy (formerly Nevada Power Company and Sierra Pacific Power Company), the Los Angeles Department of Water and Power, Southern California Edison, Sacramento Municipal Utility District, Anaheim Utilities, the New York Power Authority, Excel Energy and San Diego Gas and Electric.
- **Acceptance by Original Equipment Manufacturers:** The Company’s products have been approved and installed by numerous original equipment manufacturers (“OEMs”) in the escalator and granulator industries.

Three-Phase MEC

The Company initially focused its marketing efforts for the Three-Phase MEC in the elevator and escalator industry, although the Company is also actively marketing this product to other industries such as recycling, mining, plastics, and manufacturing. Industries that operate equipment such as conveyor systems, crushing equipment, stamping presses, granulators, grinders, shredders and other motor driven equipment with varying loads, are believed to be viable target markets for the Three-Phase MEC. The Company is seeking to target markets with appropriate applications and market access, using direct sales, OEMs and select resellers and representatives to address these markets.

Single-Phase Product

Like the Company’s three-phase product described above, the Company’s single-phase product reduces energy consumption in electric motors by sensing and controlling the amount of energy the motor consumes. Many motors commonly used in home appliances and other consumer goods are single-phase AC motors. Since the single-phase product is much smaller, has a much lower price point, and can be incorporated directly into a broad variety of applications, the Company believes it is a product most suitable for installation at the OEM level.

Product Development

The Company has devoted significant time and resources in the past several years toward developing “digital” versions of its three-phase and single-phase products. Through this process, the Company has transformed its technology so that its key technological breakthroughs are primarily incorporated in algorithms and software on a microchip. The Company believes the digital versions of its products have several distinct advantages over the older analog versions, including:

- Motor starter and motor protection capabilities similar to standard solid state starters sold by large motor control companies. The analog product could not start a motor and provided no motor protection, so the customer had to purchase these items at additional costs for components and installation. The digital MEC instead incorporates all these functions and therefore replaces a standard solid state motor control.
- Increased ease of installation and reduced technical support requirements. For example, instead of approximated and manual adjustments during installation, which can require technical support from the Company, the digitized unit will allow more simplified and precise adjustments by customers and third party installers.
 - Reduced product size, which is important for many installations.
 - Input-output communications capabilities, so the device can communicate with external control systems.
- Increased functionality. The Company expects to be able to add new functionality to the products. These new functions may include such things as:

- o Recording and reporting of actual energy savings;
- o Prediction of maintenance problems by reading and reporting on changes in the motor's operating characteristics; and
- o More secure intellectual property protection through the use of secured chips and software.

Marketing and Sales

The Company's marketing efforts have historically been concentrated in the elevator and escalator industry, primarily to OEMs of elevator and escalator equipment and end users that own this equipment. The Company is also focused on the mining and aggregate industry and the plastics industry. End users of the Company's products include retail chains, hotels, airports, transit systems, and mining, plastics and manufacturing companies.

The Company sells products primarily through direct sales and with OEM resellers. The Company is focused on initially penetrating markets through direct sales to end users. Once some market penetration and traction is achieved, the Company will then work with OEMs and other resellers to achieve higher volume sales. The Company's longer term goal is to be a high value supplier of technologies, with numerous OEMs and other resellers engaged with high volume sales and/or licensing agreements.

Manufacturing and Distribution

The Company's products are manufactured internally and by a multi-billion dollar global contract manufacturer, Sanmina SCI ("Sanmina"). The Company's strategy is to manufacture internally products that sell at lower volumes, such as MECs for very large motors, and to have Sanmina manufacture higher volume products, such as smaller units and circuit boards. The Company believes this strategy allows for high quality production, cost efficiencies, and the capability to rapidly increase production volumes. Management believes this strategy has the ability to meet the Company's production needs and the Company would be successful in finding alternative manufacturers should Sanmina not be available to manufacture our product.

Competition

Power Efficiency believes the principal competitive factors in the Company's markets include innovative product development, return on investment from energy savings, product quality, product performance, utility rebate acceptance, established customer relationships, name recognition, distribution and price.

Three-Phase Competition. The Company's Three-Phase MEC's principal capabilities include being a motor starter, providing a soft start and protection for the motor, and reducing the motor's electricity consumption once the motor is at full speed. The Company believes its products are unique primarily because of the last capability – energy savings.

The first two capabilities are commonly found in existing motor control products. There are billions of dollars of motor starters and soft starts sold every year. These products are typically manufactured and marketed by large motor control companies, many of which have longer operating histories, established markets and far greater financial, advertising, research and development, manufacturing, marketing, personnel and other resources than the Company currently has or may reasonably be expected to have in the foreseeable future. This competition may have an adverse effect on the ability of the Company to commence and expand its operations or operate in a profitable manner.

There are also several small companies that reportedly make products that combine motor starting, soft starting and energy savings. The Company is unaware of any large company that makes a product of this nature. Although the Company has not completed any formal market study, the Company believes its Three-Phase MEC has the following competitive advantages over other products:

- It combines soft start features with energy savings features in a single integrated unit that is CSA and CE certified and achieves energy savings levels of up to 15% to 35% in independent, third party testing;
- Its circuitry is proprietary, protected by one patent. Numerous other patent filings on new innovations are pending approval of the U.S. Patent and Trademark Office;
- It has been tested extensively by utilities with documented energy savings and approval for incentive financing rebates;
- It is accepted by OEMs in the escalator and granulator industries.

Single-Phase Competition. There have been several companies that have, with different technologies, attempted to exploit this market due to the enormous opportunity in single-phase motor applications. These products include among others, "Green Plug" (voltage clamping), "Power Planner" (digital microchip) and "Econelectric" (power factor control). The Company has made numerous innovations in the past three years that it believes overcome many of the problems with these and the Company's earlier designs. The Company has filed for patents on these innovations and

has reduced the product in size and cost to the point it can be sold to OEMs of applicable appliances and other equipment driven by single-phase AC motors.

Premium Efficiency Motors. Motors are rated by their efficiency at full load. However, when motors, including “premium efficiency motors” are lightly loaded, they become very inefficient. Management believes that the energy savings gain attributable to premium efficiency motors is materially lower than that of its MEC on underloaded motor applications. Furthermore, the Company’s products are able to save energy on underloaded premium efficiency motors, so that such motors and the Company’s technology are not mutually exclusive.

Source of Supply and Availability of Raw Materials

The MEC has been designed to use standard, off-the-shelf, easily acquired components, except for the custom made circuit boards. Such off-the-shelf components are basic items readily available worldwide at competitive prices. They come in standard and miniature versions and offer the Company latitude in product design and production. Although the Company believes most of the key components required for the production of its products are currently available in sufficient production quantities from multiple sources, there can be no assurance they will remain so readily available or at comparable prices.

Customers

The Company currently does business with approximately 20 customers. Of this number, four customers presently account for approximately 82% of the Company's gross revenues. These customers and their respective gross revenue percentages are KONE – 60%; Berry Plastics – 10%; CED Elevator – 6%; and The Las Vegas Conventions and Visitors Authority – 6%. In light of the Company's intentions to focus its business on a limited number of markets, the Company is, and may continue to be, dependent upon a limited number of customers. Accordingly, the loss of one or more of these customers may have a material adverse effect upon the Company's business.

Patents and Proprietary Rights

The Company currently relies on a combination of trade secrets, non-disclosure agreements and patent protection to establish and protect its proprietary rights in its products. There can be no assurance these mechanisms will provide the Company with any competitive advantages. Furthermore, there can be no assurance others will not independently develop similar technologies, duplicate or "reverse engineer" the proprietary aspects of the Company's technology.

The Company has one U.S. patent issued with respect to its products. The "Balanced and Synchronized Phase Detector for an AC Induction Motor Controller," No. 5,821,726, was issued on October 13, 1998 and expires in 2017. This patent covers improvements to the technology under the NASA License Agreement (described below), which were developed by the Company. Management believes this patent protects the Company's intellectual property position beyond the expiration of the NASA License Agreement.

The Company has filed three utility patents on new inventions associated with the development of its digital products. The Company is continually making improvements to its products and technologies, and anticipates making additional patent filings on new inventions when warranted.

The Company has obtained U.S. Trademark registration of the Power Commander® mark and the E-Save Technology® mark.

NASA License Agreement

The Company had been the exclusive United States licensee of certain power factor controller technology owned by the United States of America, as represented by NASA. This license agreement covered the United States and its territories and possessions and did not require the Company to pay royalties to NASA in connection with the Company's sale of products employing technology utilizing the licensed patents. The Company's rights under the license agreement were non-transferable and were not to be sublicensed without NASA's consent. The license agreement terminated on December 16, 2002 upon expiration of all of the licensed patents.

The Company believes its products and other proprietary rights do not infringe any proprietary rights possessed by third parties. There can be no assurance, however, that third parties will not assert infringement claims in the future, the defense costs of which could be substantial.

Government Regulation

The Company is not required to be certified by any government agencies. However, most of the Company's products are manufactured to comply with specific codes that meet industry accepted safety standards. Presently, many of the Company's products comply with UL 508 Industrial Control Equipment and the Company has also received certification meeting CSA (Canadian Standards Association) B44.1/ASME-17.5 Elevator and Escalator Electrical Equipment for many of the Company's products. Many of the Company's products are also CE marked. The Department of Commerce does not require the Company's technology to be certified for export. The Company's industrial code is 421610 and the SIC code is 5063.

Deregulation of Electrical Energy

Sales of the Company's product are not dependent on deregulation of the electrical energy market as the Company's product can be sold in regulated and deregulated markets.

Research and Development

The Company intends to continue its research and development effort to introduce new products based on its energy saving technology. Towards this end, the Company spent \$1,016,158 and \$667,786 in fiscal years 2008 and 2007, respectively, on research and development activities, virtually none of which was borne by customers. A major focus of the Company's foreseeable research and development activities will be on completing additional features and refinements to the three-phase and single phase products. The Company also anticipates the possibility of working with OEMs that make or purchase motor control equipment, in order to develop products with features or specifications they require.

Effect of Environmental Regulations

The Company is not aware of any federal, state, or local provisions regulating the discharge of materials into the environment or otherwise relating to the protection of the environment with which compliance by the Company has had, or is expected to have, a material effect upon the capital expenditures, earnings, or competitive position of the Company.

Employees

At the date of this document, the Company employs eighteen people. Of this number, two are engaged in accounting and finance, three in operations and general management, five in sales and marketing, and eight in product research and development, engineering and manufacturing. At such time as business conditions dictate, the Company may hire additional personnel for, among other things, increased engineering, marketing and sales. The Company has no collective bargaining agreements and considers its relationship with its employees to be good. The Company utilizes consultants in the areas of marketing, product and technology development and finance on a regular basis.

(c) Reports to Security Holders

The Company is a smaller reporting company, and as such files Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q under the scaled disclosure requirements and Current Reports on Form 8-K on a regular basis with the SEC.

The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>.

Item 1A. Risk Factors.

RISKS RELATED TO OUR BUSINESS

Unless We Achieve Profitability and Related Positive Cash Flow, It May Not Be Able To Continue Operations, And Its Auditors Have Questioned Its Ability To Continue As A "Going Concern".

The Company has suffered recurring losses from operations, and experienced a deficiency of cash of approximately \$3,100,000 and \$2,851,000 from operations for the years ended December 31, 2008 and 2007, respectively. For the years ended December 31, 2008 and December 31, 2007, we had net losses of \$3,948,204 and \$3,891,795, respectively. In our Auditor's Report dated March 30, 2009 on our December 31, 2008 financial statements included in this report, our auditors have stated that these factors raise substantial doubt about our ability to continue as a "going concern". Our financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amount of liabilities that might be necessary should we be unable to continue in existence.

The Company's continuation as a "going concern" is dependent upon achieving profitable operations and related positive cash flow and satisfying our immediate cash needs by external financing until we are profitable. Our plans to achieve profitability include developing new products, obtaining new customers and increasing sales to existing customers.

We are seeking to raise additional capital through equity issuance, debt financing and other types of financing, but we cannot guarantee that sufficient capital will be raised.

We Have A Limited Operating History, Have Experienced Recurring Losses And Have Limited Revenue.

To date, and due principally to a lack of working capital, our operations have been limited in scale. Although we have an arrangement with an outsourced production facility to manufacture our products, have established relationships with suppliers, and have received contracts for our products, we may experience difficulties in production scale-up, product distribution, and obtaining and maintaining working capital until such time as our operations have been scaled-up to normal commercial levels. We have not had a profitable quarter in the past three years and we cannot guarantee we will ever operate profitably. In addition, we have limited revenue. For the year ended December 31, 2008, our total revenues were \$480,513, and for the year ended December 31, 2007, our total revenues were \$490,510.

We Do Not Have A Bank Line Of Credit.

At the present time, the Company does not have a bank line of credit, which further restricts its financial flexibility.

We Will Require Additional Funds To Meet Our Cash Operating Expenses And Achieve Our Current Business Strategy.

The Company continues to have limited working capital and will be dependent upon additional financing to meet capital needs and repay outstanding debt. We cannot guarantee additional financing will be available on acceptable terms, if at all. We also need additional financing to raise the capital required to fully implement our business plan. Our current fixed operating expense level is approximately \$250,000 to \$300,000 per month. Although we currently have several months of working capital, we may nevertheless need to issue additional debt or equity securities to raise required funds, and as a result existing equity owners would be diluted.

When our operations require additional financing, if we are unable to obtain it on reasonable terms, we would be forced to restructure, file for bankruptcy or cease operations, any of which could cause you to lose all or part of your investment in us.

Our Management Group Owns Or Controls A Significant Number Of The Outstanding Shares Of Our Common Stock And Will Continue To Have Significant Ownership Of Our Voting Securities For The Foreseeable Future.

As of the date of this report, management controls approximately nineteen percent (19%) of our issued and outstanding Common Stock and voting equivalents. Additionally, Summit Energy Ventures, LLC (“Summit”) owns twelve percent (12%) of our common stock and voting equivalents, which is included in the above number. Summit is controlled by Steven Strasser, our Chairman and CEO, and he has the right to vote all shares owned by Summit. The remaining equity in Summit is owned by BJ Lackland, our CFO. As a result, these persons will have the ability, acting as a group, to effectively control our affairs and business, including the election of directors and, subject to certain limitations, approval or preclusion of fundamental corporate transactions. This concentration of ownership of our common stock may:

- delay or prevent a change in the control;
- impede a merger, consolidation, takeover, or other transaction involving the Company; or
- discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of the Company.

The relationships between Summit and our executive officers are discussed in more detail under “Certain Relationships And Related Party Transactions” herein.

Our Business Depends Upon The Maintenance Of Our Proprietary Technology, And We Rely, In Part, On Contractual Provisions To Protect Our Trade Secrets And Proprietary Knowledge.

The Company depends upon its proprietary technology, relying principally upon trade secret and patent law to protect this technology. The Company also regularly enters into confidentiality agreements with key employees, customers, potential customers, and vendors and limits access to and distribution of trade secrets and other proprietary information. However, these measures may not be adequate to prevent misappropriation of our technology. Additionally, our competitors may independently develop technologies substantially equivalent or superior to our technology. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States. We also are subject to the risk of adverse claims and litigation alleging infringement of intellectual property rights of others.

Confidentiality agreements to which we are party may be breached, and we may not have adequate remedies for any breach. Our trade secrets may also be known without breach of such agreements or may be independently developed by competitors. Our inability to maintain the proprietary nature of our technology and processes could allow our competitors to limit or eliminate any competitive advantages we may have.

We Are Potentially Dependent On Third-Party Suppliers.

Although we believe most of the key components required for the production of our products are currently available in sufficient production quantities from multiple sources, they may not remain so readily available. It is possible that other components required in the future may necessitate custom fabrication in accordance with specifications developed or to be developed by us. Also, in the event that we, or our contract manufacturer, as applicable, are unable to develop or acquire components in a timely fashion, our ability to achieve production yields, revenues and net income can be expected to be adversely affected. Additionally, we are dependent on Sanmina-Sci to manufacture our higher volume products. While we believe we would be successful in finding alternative manufacturers should this manufacturer not be available to manufacture our product, it could take substantial time and effort to locate such alternatives and, depending on the timing of the loss of Sanmina-Sci, could result in disruption in delivery schedules and harm to our clients, our reputation, and future prospects.

We Are Developing And Commercializing New Energy Saving Technologies And Products Which Will Involve Uncertainty And Risks Related To Product Development And Market Acceptance.

Our success is dependent, to a large degree, upon our ability to fully develop and commercialize our technology and gain industry acceptance of our products based upon our technology and its perceived competitive advantages. Accordingly, our prospects must be considered in light of the risks, expenses and difficulties frequently encountered in connection with the establishment of a new business in a highly competitive industry, characterized by frequent new product introductions. We anticipate that we will incur substantial expense in connection with the development and testing of our proposed products and expect these expenses to result in continuing and significant losses until such time, if ever, that we are able to achieve adequate levels of sales or license revenues.

We Have Limited Experience in Direct Sales.

Our products have been distributed primarily through OEMs. We have recently begun pursuing an expanded distribution strategy designed to reduce our reliance on OEMs. Pursuant to this strategy, we are increasing our direct sales efforts into new markets. Our future growth and profitability will depend upon the successful development of business relationships with additional OEMs, growth in direct sales, and sales through select resellers and reps to penetrate the market with our products.

We Currently Depend On A Small Number Of Customers And Expect To Continue To Do So.

The Company currently does business with approximately 20 customers. Of this number, four customers accounted for approximately 82% of our gross revenues in 2008. We are, and may continue to be, dependent upon a small number of customers. Accordingly, the loss of one or more of these customers is likely to have a material adverse effect on our business.

Most Of Our Current And Potential Competitors Have Greater Name Recognition, Financial, Technical And Marketing Resources, And More Extensive Customer Bases And Industry Relationships Than We Do, All Of Which Could Be Leveraged To Gain Market Share To Our Detriment, Particularly In An Environment Of Rapid Technological Change.

We compete against a number of companies for dollars in the electric motor energy savings market, many of which have longer operating histories, established markets and far greater financial, advertising, research and development, manufacturing, marketing, personnel and other resources than we currently have or may reasonably expect to have in the foreseeable future. This competition may have an adverse effect on our ability to expand our operations or operate profitably. The motor control industry is also highly competitive and characterized by rapid technological change. Our future performance will depend in large part upon our ability to become and remain competitive and to develop, manufacture and market acceptable products in these markets. Competitive pressures may necessitate price reductions, which can adversely affect revenues and profits. If we are not competitive in our ongoing research and development efforts, our products may become obsolete, or be priced above competitive levels. However, management believes, based upon their performance and price, our products are attractive to customers. We cannot guarantee that competitors will not introduce comparable or technologically superior products, which are priced more favorably than our products.

Changes In Retail Energy Prices Could Affect Our Business.

We have found that a customer's decision to purchase an MEC (or similar product) is primarily driven by the payback on the investment resulting from the increased energy savings. Although management believes that current retail energy prices support an attractive return on investment for our products, the future retail price of electrical energy may not remain at such levels, and price fluctuations reducing energy expense could adversely affect product demand.

Loss Of Key Personnel Could Have Significant Adverse Consequences.

We currently depend on the services of Steve Strasser, and BJ Lackland, our Chief Executive Officer and Chief Financial Officer, respectively. The loss of the services of either of these persons could have an adverse effect on our business. As discussed under "Management", we have entered into long-term employment contracts with Messrs. Strasser and Lackland, but such contracts do not guarantee they will remain with us.

We Do Not Have "Key Man" Life Insurance.

The Company presently does not have any key man life insurance policies. As soon as practicable following the commencement of profitable operations (which may never occur), we intend to purchase key man life insurance on the life of our principal executive officer, Steven Strasser. Upon purchase of such insurance, we intend to pay the premiums and be the sole beneficiary. The lack of such insurance may have a material adverse effect upon our business.

Delaware Law Limits The Liability Of Our Directors.

Pursuant to our Certificate of Incorporation, the Company's directors are not liable to us or our stockholders for monetary damages for breach of fiduciary duty, except for liability in connection with a breach of the duty of loyalty, for acts or omissions not in good faith or which involved intentional misconduct or a knowing violation of law for dividend payments or stock repurchases illegal under Delaware law or any transaction in which a director has derived an improper personal benefit.

Potential Product Liability Claims May Not Be Fully Covered By Insurance.

The Company may be subject to potential product liability claims that could, in the absence of sufficient insurance coverage, have a material adverse impact on us. Presently, we have general liability coverage that includes product liability up to \$2,000,000 and umbrella liability up to \$4,000,000. Any large product liability suits occurring early in our growth may significantly and adversely affect our ability to expand the market for our products.

RISKS RELATED TO OUR COMMON STOCK AND CAPITAL STRUCTURE

Trading In Our Common Stock Over The Last 12 Months Has Been Limited, So Investors May Not Be Able To Sell As Many Of Their Shares As They Want At Prevailing Prices.

Shares of our common stock are traded on the OTC Bulletin Board. Approximately 27,000 shares were traded on an average daily trading basis for the 12 months ended December 31, 2008. If limited trading in our common stock continues, it may be difficult for shareholders to sell their shares. Also, the sale of a large block of our common stock could depress the market price to a greater degree than a company that typically has a higher volume of trading of its securities.

The Limited Public Trading Market May Cause Volatility In Our Stock Price.

The Company's common stock is currently traded on a limited basis on the OTC Bulletin Board under the symbol "PEFF". The quotation of our common stock on the OTC Bulletin Board does not assure that a meaningful, consistent and liquid trading market currently exists, and in recent years such market has experienced extreme price and volume fluctuations that have particularly affected the market prices of many smaller companies like us. Our common stock is thus subject to this volatility. Sales of substantial amounts of our common stock, or the perception that such sales might occur, could adversely affect prevailing market prices of our common stock.

An Active And Visible Trading Market For Our Common Stock May Not Develop.

We cannot predict whether an active market for our common stock will develop in the future. In the absence of an active trading market:

- Investors may have difficulty buying and selling or obtaining market quotations;
-

- Market visibility for our common stock may be limited; and
- A lack of visibility for our common stock may have a depressive effect on the market price for our common stock.

The OTC Bulletin Board is an inter-dealer, over-the-counter market that provides significantly less liquidity than NASDAQ, and quotes for stocks included on the OTC Bulletin Board are not listed in the financial sections of newspapers, as are those for the NASDAQ Stock Market. The trading price of the common stock is expected to be subject to significant fluctuations in response to variations in quarterly operating results, changes in analysts' earnings estimates, announcements of innovations by the Company or its competitors, general conditions in the industry in which we operate and other factors. These fluctuations, as well as general economic and market conditions, may have a material or adverse effect on the market price of our common stock.

Penny Stock Regulations May Impose Certain Restrictions On Marketability Of Our Securities.

The SEC has adopted regulations which generally define a "penny stock" to be any equity security that has a market price of less than \$5.00 per share or an exercise price of less than \$5.00 per share, subject to certain exceptions. As a result, our common stock is subject to rules that impose additional requirements on broker-dealers who sell such securities to persons other than established customers and accredited investors (generally those with net worth in excess of \$1,000,000 or annual income exceeding \$200,000, or \$300,000 together with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of such securities and have received the purchaser's written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the rules require the delivery, prior to the transaction, of a risk disclosure document relating to the penny stock market. The broker-dealer must also disclose the commission payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Consequently, the "penny stock" rules may restrict the ability of broker-dealers to sell the Company's securities and may affect the ability of investors to sell the Company's securities in the secondary market and the price at which such purchasers can sell any such securities.

Stockholders should be aware that, according to the Commission, the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include:

- Control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer;
- Manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases;
- "Boiler room" practices involving high pressure sales tactics and unrealistic price projections by inexperienced sales persons;
 - Excessive and undisclosed bid-ask differentials and markups by selling broker-dealers; and
- The wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the inevitable collapse of those prices with consequent investor losses.

The Company's management is aware of the abuses that have occurred historically in the penny stock market.

We May Never Pay Cash Dividends On Our Common Stock.

We have not paid or declared any dividends on our common stock and do not anticipate paying or declaring any cash dividends on our common stock in the foreseeable future.

Sales Of Common Stock Under Rule 144 May Adversely Affect The Market Price Of Our Common Stock.

Possible Resales under Rule 144. Of the 43,255,441 shares of the Company's common stock outstanding on the date of this report, 27,238,284 shares are freely trading in the market place (the "Free Trading Shares"). The Free Trading Shares are comprised mostly of shares (1) originally issued in private offerings of common stock from June through March 2007, that were later registered in the Company's S-1 Registration Statement (the "Registration Statement"), declared effective on October 10, 2008 and (2) shares originally issued in transactions exempt from registration under the Securities Act.

The remaining 15,869,157 shares of our common stock outstanding are restricted securities as defined in Rule 144 and under certain circumstances may be resold without registration pursuant to Rule 144. These shares include the 9,035,294 shares held by Summit and Steven Strasser in the aggregate, and 1,340,539 shares held by directors and insiders

In addition, the Company had approximately 29,994,780 common stock purchase warrants outstanding and approximately 13,579,896 common stock options outstanding as of the date of this report, including the warrants issued in connection with the private offer and sale of preferred stock units in 2007 (See Note 18 to the Financial Statements). The shares issuable on exercise of the options and warrants may, under certain circumstances, be available for public sale in the open market under the Registration Statement or pursuant to Rule 144, subject to certain limitations.

In general, pursuant to Rule 144, after satisfying a six month holding period: (i) affiliated stockholder (or stockholders whose shares are aggregated) may, under certain circumstances, sell within any three month period a number of securities which does not exceed the greater of 1% of the then outstanding shares of common stock or the average weekly trading volume of the class during the four calendar weeks prior to such sale and (ii) non-affiliated stockholders may sell without such limitations, provided we are current in our public reporting obligations. Rule 144 also permits the sale of securities by non-affiliates that have satisfied a one year holding period without any limitation or restriction. Any substantial sale of the common stock pursuant to Rule 144 may have an adverse effect on the market price of the Company's shares.

Exercise Of Outstanding Options And Warrants Will Dilute Ownership Of Outstanding Shares.

As of the date of this report, the Company has reserved 71,429 shares of common stock for issuance upon exercise of stock options or similar awards which may be granted pursuant to the 1994 Plan, of which no options are outstanding. Furthermore, we have reserved 20,000,000 shares of our common stock for issuance upon exercise of stock options or similar awards which may be granted pursuant to the 2000 Plan, of which options to purchase an aggregate of 13,579,896 shares are outstanding. The outstanding options under the 2000 Plan have a weighted average exercise price of \$0.37. As of the date of this report, we have issued warrants exercisable for 29,994,780 shares of common stock to financial consultants, investors, former employees and other business partners, having a weighted average exercise price of \$0.45 and expiring on various dates from October 2009 to July 2013. Exercise of these options and warrants in the future will reduce the percentage of common stock held by the public stockholders. Furthermore, the terms on which we could obtain additional capital during the life of the options and warrants may be adversely affected, and it should be expected that the holders of the options and warrants would exercise them at a time when we would be able to obtain equity capital on terms more favorable than those provided for by such options and warrants.

Our Issuance Of "Blank Check" Preferred Stock Could Adversely Affect Our Common Stockholders.

The Company's Certificate of Incorporation authorizes the issuance of "blank check" preferred stock with such designations, rights and preferences as may be determined from time to time by the board of directors. Accordingly, our Board of Directors is empowered, without stockholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the relative voting power or other rights of the holders of our common stock. In the event of issuance, the preferred stock could be used as a method of discouraging, delaying or preventing a change in control of the Company, which could have the effect of discouraging bids for the Company and thereby prevent stockholders from receiving the maximum value for their shares. From October 29, 2007, through January 21, 2008, the Company sold 140,000 shares of its Series B preferred stock in a private offering of units (See Note 18 to the Financial Statements).

Item 1B. Unresolved Staff Comments.

None

Item 2. Description of Property.

The Company's corporate office space is located at 3960 Howard Hughes Pkwy, Suite 460, Las Vegas, Nevada 89169. The office lease calls for rent of \$11,292 per month, plus annual increases equal to 3%, through the end of the lease term in February 2011.

The Company leased research and development space at 6380 South Valley View Blvd, Suite 412, Las Vegas, Nevada 89118. The lease calls for rent of \$1,995 plus common area maintenance charges, per month, through the end of the lease term in August 2010.

The Company leased manufacturing and warehouse space at 6380 South Valley View Blvd, Suite 402, Las Vegas, Nevada 89118. The lease calls for rent of \$1,605 plus common area maintenance charges, per month, through the end of the lease term in August 2010.

Item 3. Legal Proceedings.

The Company is currently involved in a lawsuit against two of its former directors, who were also employees of the Company, and the company formed by the two former directors (collectively, the “Defendants”). The Company filed this action against the Defendants for misappropriation of trade secrets, false advertising, defamation/libel and other claims primarily arising from the Defendant’s use of the Company’s confidential and proprietary information in the development and marketing of motor control products. The Company seeks a temporary restraining order, preliminary injunction, permanent injunction, damages, exemplary damages, attorneys’ fees and costs against the Defendants. The Company’s original complaint was filed on November 25, 2008, and its amended complaint was filed on January 5, 2009, in the U.S. District Court, District of Nevada.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters.

Market for Common Stock

The Company’s common stock is thinly traded on the National Association of Securities Dealers’ Over the Counter Bulletin Board (“OTCBB”) under the symbol “PEFF”.

The following table sets forth the high and low bid information for quarterly periods in the two twelve month periods ended December 31, 2008 and December 31, 2007

Twelve months Ended December 31, 2008	High	Low
October 1, 2008 — December 31, 2008	\$ 0.25	0.08
July 1, 2008 — September 30, 2008	0.32	0.19
April 1, 2008 — June 30, 2008	0.39	0.26
January 1, 2008 — March 31, 2008	0.55	0.26
Twelve months Ended December 31, 2007	High	Low
October 1, 2007 — December 31, 2007	\$ 0.70	\$ 0.37
July 1, 2007 — September 30, 2007	0.75	0.20
April 1, 2007 — June 30, 2007	0.26	0.20
January 1, 2007 — March 31, 2007	0.30	0.18

As of the date of this report, there were 162 shareholders of record of the Company’s common stock and 647 shareholders who hold the Company’s common stock in street name.

The Company has not paid dividends on its common stock since its incorporation. The Company does not expect to pay cash dividends on its common stock in the foreseeable future. The Company intends to invest funds otherwise available for dividends, if any, on improving the Company's capital assets.

EQUITY COMPENSATION PLAN INFORMATION

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of Securities Remaining available for future issuance under 2000 Stock Option and Restricted Stock Plan (excluding securities reflected in column (a))(c)
2000 Stock Option and Restricted Stock Plan approved by security holders	13,579,869	\$ 0.37	6,420,131
Equity compensation plans not approved by security holders	0	0.00	0
Total	13,579,896	\$ 0.37	6,420,131

The Company maintains a Stock Option Equity Compensation Plan. (See Note 12 to the Financial Statements)

Recent Sales of Unregistered Securities

During the period covered by this report we did not issue any securities that were not registered under the Securities Act of 1933, as amended, except previously disclosed in a quarterly report on Form 10-Q or a current report on Form 8-K.

Item 6. Selected Financial Data

We are a “smaller reporting company” as defined by Regulation S-K and as such, are not providing the information contained in this item pursuant to Regulation S-K.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

OVERVIEW

The Company generates revenues from a single business segment: the design, development, marketing and sale of proprietary solid state electrical components designed to reduce energy consumption in alternating current induction motors.

The Company began generating revenues from sales of its MEC line of motor controllers in the late 1990s. As of December 31, 2008, the Company had total stockholders’ equity of \$4,046,747 primarily due to (i) the Company’s sale of 140,000 shares of Series B Convertible Preferred Stock in a private offering from October of 2007 through January of 2008, (ii) the Company’s sale of 12,950,016 shares of common stock in a private stock offering from November of 2006 through March of 2007, (iii) the Company’s sale of 14,500,000 shares of common stock in a private stock offering in July and August of 2005, (iv) the Company’s sale of 2,346,233 shares of Series A-1 Convertible Preferred stock to Summit Energy Ventures, LLC in June of 2002 and (v) the conversion of notes payable of approximately \$1,047,000 into 982,504 shares of Series A-1 Convertible Preferred Stock in October of 2003.

RESULTS OF OPERATIONS: FISCAL YEAR 2008 COMPARED TO FISCAL YEAR 2007

REVENUES

Revenues for the year ended December 31, 2008, were approximately \$481,000 compared to approximately \$491,000 for the year ended December 31, 2007, a decrease of \$10,000 or 2%. This decrease is mainly attributable to a decrease in sales in the elevator and escalator market segment in 2008. Specifically, escalator manufacturer and service provider sales fell to approximately \$363,000 for the year ended December 31, 2008, from \$466,000 for the year ended December 31, 2007. Sales of the analog product to one escalator manufacturer and service provider, which is one of the Company's largest customers, slowed during this period in anticipation of release of their private label version of our digital product. The digital product is being tested and evaluated for use on a retrofit and OEM basis by this customer. The digital product offers greater features and functionality compared to the analog product, making it more attractive as an OEM product. The decrease in sales to the escalator segment was partially offset by an increase in sales to industrial and other customers, which totaled approximately \$117,000 for the year ended December 31, 2008, compared to \$24,000 for the year ending December 31, 2007. For the year ended December 31, 2008, industrial and other sales, which entirely consisted of digital units, was approximately 21% of total sales, and escalator and elevator sales, which consisted almost entirely of analog units, was approximately 79% of total sales.

COST OF REVENUES

Cost of revenues for the year ended December 31, 2008 were approximately \$398,000 compared to approximately \$340,000 for the year ended December 31, 2007, an increase of \$58,000, or 17%. As a percentage of revenues, total costs of sales increased to approximately 82% for the year ended December 31, 2008 compared to approximately 69% for the year ended December 31, 2007. The increase in the costs as a percentage of revenues was primarily due the Company's replacement of 40 Platform E MECs with more feature rich and expensive Platform 1 MECs for no additional charge to the customer. This transaction added approximately \$22,000 to the Company's cost of sales for the year ended December 31, 2008. All of the Platform E MECs returned to the Company were not installed, and in good working condition. However, with the release of the new digital line of MECs, the Company determined that the Platform E units that were returned were obsolete, and therefore did not record the units back into inventory. Furthermore, during the year ended December 31, 2008, the Company also wrote off the remaining Platform E components, as well as many components that were for analog use only, held in its inventory. In total, the Company recorded a direct write off of inventory of approximately \$41,000 for the year ended December 31, 2008. Excluding the direct write off of inventory of \$41,000 and the \$22,000 charge from replacing Platform E units with Platform 1 units, the Company's cost of sales was approximately \$335,000, or 70% of revenue for the year ended December 31, 2008.

Allocated overhead costs were approximately \$25,000 for the year ended December 31, 2008 compared to approximately \$20,000 for the year ended December 31, 2007, an increase of \$5,000 or 25%. As a percentage of revenues, allocated overhead costs were 5% for the year ended December 31, 2008 compared to 4% for the year ended December 31, 2007. Allocated overhead costs as a percentage of sales increased due to the Company developing in-house light manufacturing and warehousing capabilities in December of 2007.

GROSS PROFIT

Gross profit for the year ended December 31, 2008 was \$83,000 compared to approximately \$150,000 for the year ended December 31, 2007, a decrease of \$67,000 or 45%. This decrease was primarily due to the factors described above.

OPERATING EXPENSES

Research and Development Expenses

Research and development expenses were \$1,016,000 for the year ended December 31, 2008 compared to approximately \$668,000 for the year ended December 31, 2007, an increase of \$348,000 or 52%. This increase is mainly attributable to the Company's continued research and development efforts on its digital controller for both its single-phase and three-phase products. Specifically, the increased costs include additional personnel in the Company's research and development department, which resulted in higher salaries and related payroll costs during the year ended December 31, 2008, as well as new product testing and certification expenses. These increased costs were partially offset by a decrease in stock based compensation expenses during the year ended December 31, 2008.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were approximately \$3,033,000 for the year ended December 31, 2008, compared to approximately \$2,721,000 for the year ended December 31, 2007, an increase of \$312,000 or 11%. The increase in selling, general and administrative expenses compared to the prior year was primarily due to an increase in payroll, and payroll related costs, as well as increases in sales travel expenses, marketing, tradeshow and advertising expenses, and sales related legal and consulting expenses. The increases in payroll expenses were due to the growth of the Company's sales personnel.

Financial Condition, Liquidity, and Capital Resources: For the Year Ended December 31, 2008

Since inception, the Company has financed its operations primarily through the sale of its securities. In 2008 and 2007, the Company received a total of approximately \$8,025,000 in gross proceeds from a private placement of its preferred stock, common stock and warrants to purchase common stock, as to which the Company was required to file a registration statement on Form SB-2 or other relevant registration statement. Of this amount, \$1,850,000 was converted from existing debt securities. Also in 2007, the Company grossed approximately \$680,000 in cash from the exercise of warrants. As of December 31, 2008 the Company has received a total of approximately \$20,305,000 from public and private offerings of its equity securities, received \$300,000 from a bridge note with a shareholder (which was converted into 3,000,000 shares of common stock and 1,500,000 warrants with an additional investment of \$300,000 on July 8, 2005), received approximately \$445,386 under a bank line of credit (which was repaid during 2002), and received \$1,000,000 under a line of credit with a shareholder (which was converted to Series A-1 Preferred Convertible shares during 2003). In October 2004 and February 2005, the Company received \$1,589,806 in debt financing through a debt offering arranged by a placement agent, Pali Capital. Of this total, \$300,000 plus accrued interest was converted from borrowings with the same shareholder as referenced above. In April 2006, the Company received \$1,000,000 in debt financing from EMTUCK, LLC, in which the managing member is a management company wholly owned and controlled by Steven Strasser, the Company's CEO. In May 2006, the Company received an additional \$500,000 in debt financing from EMTUCK. In November 2006, the Company received \$2,000,000 in debt financing. Of this amount, \$1,450,000 was converted from borrowings from prior investors. This \$2,000,000 note was paid off in full in October of 2007. As of December 31, 2008 the Company had cash of \$2,100,013 and has no outstanding debt securities.

Net cash used for operating activities for the year ended December 31, 2008 was \$3,102,847 which primarily consisted of: a net loss of \$3,948,204; less bad debt expense of \$7,770, inventory obsolescence expense of \$40,758, depreciation and amortization of \$74,539, amortization of capitalized manufacturing expenses of \$6,791, warrants and options issued in connection with the issuance of debt securities, and to employees and consultants of \$765,504, common stock issued for consulting services of \$7,960, decreases in accounts receivable of \$57,323 and deposits of \$84,057, increases in inventory of \$155,016 and prepaid expenses of \$12,660. In addition, these amounts were partially offset by decreases in accounts payable and accrued expenses of \$30,669 and customer deposits of \$1,605, and increases in deferred rent of \$605.

Net cash used for operating activities for the year ended December 31, 2007 was \$2,850,927 which primarily consisted of: a net loss of \$3,891,795; less bad debt expense of \$16,934, depreciation and amortization of \$47,036, loss on disposal of fixed assets of \$3,516, amortization of debt discounts of \$419,859, amortization of deferred financing costs of \$11,228, warrants and options issued in connection with the issuance of debt securities, and to employees and consultants of \$655,392, decreases in inventory of \$25,090 and prepaid expenses of \$29,173, increases in accounts receivable of \$93,994, and deposits of \$88,388. In addition, these amounts were partially offset by increases in accounts payable and accrued expenses of \$1,354, and customer deposits of \$1,605 and deferred rent of \$12,063.

Net cash used in investing activities for fiscal year 2008 was \$132,364, compared to \$92,537 in fiscal year 2007. The amount for 2008 consisted of the purchase of fixed assets of \$104,857, and costs related to patent applications of \$27,507. The amount for 2007 consisted of the purchase of fixed assets of \$85,610, and costs related to patent applications of \$6,927.

Net cash provided by financing activities for fiscal year 2008 was \$248,846. The entire amount consisted of the net proceeds from the issuance of equity securities.

Net cash provided by financing activities for fiscal year 2007 was \$6,336,258 which consisted of proceeds from the issuance of equity securities, net of costs, of \$8,347,369. This amount was offset by payments on notes payable of

\$2,011,111.

The Company expects to increase its operating expenses, particularly in research and development and selling, general and administrative expenses, for the foreseeable future in order to execute its business strategy. As a result, the Company anticipates that operating expenses will constitute a material use of any cash resources.

Cash Requirements and Need for Additional Funds

The Company anticipates a substantial need for cash to fund its working capital requirements. In accordance with the Company's prepared expansion plan, it is the opinion of management that approximately \$3 million will be required to cover operating expenses, including, but not limited to, marketing, sales, research and operations during the next twelve months. Although we currently have several months of working capital, we may nevertheless need to issue additional debt or equity securities to raise required funds. If the Company is unable to obtain funding on reasonable terms or finance its needs through current operations, the Company will be forced to restructure, file for bankruptcy or cease operations.

Notable changes to expenses are expected to include an increase in the Company's sales personnel and efforts, and developing more advanced versions of the Company's technology and products.

Recent Accounting Pronouncements

See "Note 2 – Summary of Significant Accounting Policies" to the Financial Statements for an explanation of recent accounting pronouncements impacting the Company.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are a "smaller reporting company" as defined by Regulation S-K and as such, are not providing the information contained in this item pursuant to Regulation S-K.

Item 8. Financial Statements and Supplementary Data.

POWER EFFICIENCY CORPORATION

FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

POWER EFFICIENCY CORPORATION

DECEMBER 31, 2008 AND 2007

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Power Efficiency Corporation
Las Vegas, Nevada

We have audited the accompanying balance sheets of Power Efficiency Corporation, (a Delaware corporation) (the "Company") as of December 31, 2008 and 2007, and the related statements of operations, changes in stockholders' equity, and cash flows for each of the years ended December 31, 2008 and 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and 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 financial statements referred to above present fairly, in all material respects, the financial position of Power Efficiency Corporation at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years ended December 31, 2008 and 2007 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company has suffered recurring losses from operations, and the Company has experienced a deficiency of cash from operations. These matters raise substantial doubt as to the Company's ability to continue as a going concern. Management's plans in regard to these matters are also discussed in Note 3. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

/s/Sobel & Co., LLC
Certified Public Accountants

March 30, 2009
Livingston, New Jersey

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POWER EFFICIENCY CORPORATION
BALANCE SHEETS

	December 31,	
	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash	\$ 2,100,013	\$ 5,086,378
Accounts receivable, net of allowance of \$ 26,082 in 2008 and \$19,648 in 2007	44,159	109,252
Inventories	246,020	131,762
Prepaid expenses and other current assets	47,165	41,296
Total Current Assets	2,437,357	5,368,688
PROPERTY AND EQUIPMENT, Net	144,967	112,106
OTHER ASSETS:		
Deposits	38,206	122,263
Patents, net	64,711	39,746
Goodwill	1,929,963	1,929,963
Total Other Assets	2,032,880	2,091,972
	\$ 4,615,204	\$ 7,572,766
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	\$ 555,789	\$ 586,458
Customer Deposits	-	1,605
Total Current Liabilities	555,789	588,063
LONG-TERM LIABILITIES:		
Deferred Rent	12,668	12,063
Total Long-Term Liabilities	12,668	12,063
Total Liabilities	568,457	600,126
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Series B Convertible Preferred Stock, \$0.001 par value 10,000,000 shares authorized, 140,000 issued and outstanding in 2008 and 134,000 issued and outstanding in 2007	140	134
Common stock, \$0.001 par value, 140,000,000 shares authorized, 43,255,441 shares issued and outstanding in 2008 and 40,367,523 shares issued and outstanding in 2007	43,256	40,368
Additional paid-in capital	35,307,119	33,741,902
Accumulated deficit	(31,303,768)	(26,809,764)

Total Stockholders' Equity	4,096,747	6,972,640
	\$ 4,615,204	\$ 7,572,766

See report of independent registered public accounting firm and notes to financial statements. F-2

POWER EFFICIENCY CORPORATION
STATEMENTS OF OPERATIONS

	Year Ended December 31,	
	2008	2007
REVENUES	\$ 480,513	\$ 490,510
COMPONENTS OF COST OF SALES:		
Material, labor and overhead	356,942	340,468
Inventory obsolescence expense	40,758	-
Total Cost of Sales	397,700	340,468
GROSS PROFIT	82,813	150,042
COSTS AND EXPENSES:		
Research and development	1,016,158	667,786
Selling, general and administrative	3,032,733	2,721,284
Depreciation and amortization	74,539	47,036
Total Costs and Expenses	4,123,430	3,436,106
LOSS FROM OPERATIONS	(4,040,617)	(3,286,064)
OTHER INCOME (EXPENSE):		
Interest income	104,684	80,481
Interest expense	-	(679,306)
Total Other Income (Expenses), Net	104,684	(598,825)
LOSS BEFORE PROVISION FOR TAXES	(3,935,933)	(3,884,889)
PROVISION FOR TAXES	(12,271)	(6,906)
NET LOSS	\$ (3,948,204)	\$ (3,891,795)
BASIC AND FULLY DILUTED LOSS PER COMMON SHARE	\$ (0.10)	\$ (0.10)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING		
BASIC	40,909,504	38,541,012

See report of independent registered public accounting firm and notes to financial statements.

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POWER EFFICIENCY CORPORATION
 STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
 YEAR ENDED DECEMBER 31, 2008 AND 2007

	Common Stock		Preferred Stock		Additional	Accumulated	Total
	Shares	Amount	Shares	Amount	Paid-in Capital	Deficit	Stockholders' Equity
Balance, January 1, 2007	35,042,009	\$ 35,042	-	\$ -	\$ 24,927,839	\$ (22,917,969)	\$ 2,044,912
Issuance of common stock	3,416,672	3,417	-	-	1,021,583	-	1,025,000
Issuance of preferred stock	-	-	134,400	134	6,719,866	-	6,720,000
Common stock issued upon exercise of options and warrants	1,908,842	1,909	-	-	681,591	-	683,500
Warrants and options issued with common stock and debt and to employees and consultants, including debt discount	-	-	-	-	472,153	-	472,153
Expenses related to issuance of preferred and common stock	-	-	-	-	(81,130)	-	(81,130)
Net loss	-	-	-	-	-	(3,891,795)	(3,891,795)
Balance, December 31, 2007	40,367,523	40,368	134,400	134	33,741,902	(26,809,764)	6,972,640
Issuance of common stock	40,000	40	-	-	7,960	-	8,000
Issuance of preferred stock	-	-	5,600	6	279,994	-	280,000
Common stock dividends paid	2,729,000	2,729	-	-	543,071	(545,800)	-
Common stock issued upon exercise of options and warrants	118,918	119	-	-	(119)	-	-
Warrants and options issued with common stock and debt and to employees and consultants,	-	-	-	-	765,504	-	765,504

including debt discount							
Expenses related to issuances of preferred and common stock	-	-	-	-	(31,193)	-	(31,193)
Net loss	-	-	-	-	-	(3,948,204)	(3,948,204)
Balance, December 31, 2008	43,255,441	\$ 43,256					