**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended June 30, 2011**

**Or**

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

**For the transition period from ______ to ______**

**Commission file number: 000-30939**

# ACTIVE POWER, INC.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **74-2961657** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **2128 W. Braker Lane, BK12, Austin, Texas** | **78758** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**(512) 836-6464**
**(Registrant's telephone number, including area code)**

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

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

| | | | |
|---|---|---|---|
| Large Accelerated Filer | ☐ | Accelerated Filer | ☒ |
| Non-Accelerated Filer | ☐ (Do not check if a smaller reporting company) | Smaller Reporting Company | ☐ |

Indicate by check mark whether the registrant is a Shell Company (as defined in Rule 12b-2 of the Exchange Act). ☐ Yes ☒ No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

**The number of shares of common stock, par value of $0.001 per share, outstanding at July 31, 2011 was 80,145,922.**

ACTIVEPOWER, INC.
FORM 10-Q
INDEX

**PARTI – FINANCIAL INFORMATION**

Item 1. **Condensed Consolidated Financial Statements.**

**Active Power, Inc.**
**Condensed Consolidated Balance Sheets**
(in thousands)
(Unaudited)

| | June 30, 2011 (unaudited) | December 31, 2010 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 10,953 | $ 15,416 |
| Short-term investments in marketable securities | 145 | 134 |
| Accounts receivable, net of allowance for doubtful accounts of $302 and $330 at June 30, 2011 and December 31, 2010, respectively | 17,805 | 14,708 |
| Inventories | 12,051 | 6,430 |
| Prepaid expenses and other | 405 | 511 |
| Total current assets | 41,359 | 37,199 |
| Property and equipment, net | 2,589 | 2,005 |
| Deposits and other | 404 | 314 |
| Total assets | $ 44,352 | $ 39,518 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 10,995 | $ 6,022 |
| Accrued expenses | 4,874 | 7,068 |
| Deferred revenue | 2,299 | 2,492 |
| Revolving line of credit | 5,535 | 2,535 |
| Total current liabilities | 23,703 | 18,117 |
| Long-term liabilities | 712 | 579 |
| Stockholders' equity: | | |
| Common stock | 80 | 80 |
| Treasury stock | (115) | (103) |
| Additional paid-in capital | 275,787 | 274,807 |
| Accumulated deficit | (256,261) | (253,801) |
| Other accumulated comprehensive income (loss) | 446 | (161) |
| Total stockholders' equity | 19,937 | 20,822 |
| Total liabilities and stockholders' equity | $ 44,352 | $ 39,518 |

*See accompanying notes.*

**Active Power, Inc.**
**Condensed Consolidated Statements of Operations and Comprehensive Loss**
(in thousands, except per share amounts)
(Unaudited)

| | Three Months Ended June 30, 2011 | Three Months Ended June 30, 2010 | Six Months Ended June 30, 2011 | Six Months Ended June 30, 2010 |
|---|---|---|---|---|
| Revenues: | | | | |
| Product revenue | $ 16,156 | $ 13,307 | $ 30,894 | $ 22,693 |
| Service and other revenue | 3,059 | 2,740 | 5,650 | 4,471 |
| Total revenue | 19,215 | 16,047 | 36,544 | 27,164 |
| Cost of goods sold: | | | | |
| Cost of product revenue | 11,991 | 10,171 | 22,513 | 17,036 |
| Cost of service and other revenue | 2,591 | 1,514 | 4,688 | 2,915 |
| Total cost of goods sold | 14,582 | 11,685 | 27,201 | 19,951 |
| Gross profit | 4,633 | 4,362 | 9,343 | 7,213 |
| Operating expenses: | | | | |
| Research and development | 1,086 | 849 | 2,007 | 1,684 |
| Selling and marketing | 3,400 | 3,526 | 6,870 | 6,784 |
| General and administrative | 1,435 | 1,433 | 2,803 | 2,750 |
| Total operating expenses | 5,921 | 5,808 | 11,680 | 11,218 |
| Operating loss | (1,288) | (1,446) | (2,337) | (4,005) |
| Interest expense, net | (48) | (26) | (81) | (52) |
| Other expense, net | (58) | (64) | (42) | (68) |
| Net loss | $ (1,394) | $ (1,536) | $ (2,460) | $ (4,125) |
| Net loss per share, basic & diluted | $ (0.02) | $ (0.02) | $ (0.03) | $ (0.05) |
| Shares used in computing net loss per share, basic & diluted | 80,045 | 79,656 | 79,934 | 75,540 |
| Comprehensive loss: | | | | |
| Net loss | $ (1,394) | $ (1,536) | $ (2,460) | $ (4,125) |
| Translation gain (loss) on subsidiaries denominated in foreign currencies | 299 | (98) | 609 | (259) |
| Comprehensive loss | $ (1,095) | $ (1,634) | $ (1,851) | $ (4,384) |

**Active Power, Inc.**
**Condensed Consolidated Statements of Cash Flows**
(in thousands)
(Unaudited)

| | Six Months Ended June 30, 2011 | Six Months Ended June 30, 2010 |
|---|---|---|
| **Operating activities** | | |
| Net loss | $ (2,460) | $ (4,125) |
| Adjustments to reconcile net loss to cash used in operating activities: | | |
| Depreciation expense | 700 | 1,012 |
| Change to allowance for doubtful accounts | (28) | (55) |
| Unrealized gain on marketable securities | (11) | — |
| (Gain) Loss on disposal of fixed assets | (2) | 26 |
| Stock-based compensation | 722 | 418 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (3,069) | 941 |
| Inventories | (5,621) | (452) |
| Prepaid expenses and other assets | 16 | 44 |
| Accounts payable | 4,973 | 871 |
| Accrued expenses | (2,194) | 503 |
| Deferred revenue | (193) | 476 |
| Long-term liabilities | 133 | 161 |
| Net cash provided by (used in) operating activities | (7,034) | (180) |
| **Investing activities** | | |
| Purchases of property and equipment | (1,284) | (343) |
| Net cash used in investing activities | (1,284) | (343) |
| **Financing activities** | | |
| Proceeds from private placement of common stock | — | 9,922 |
| Issuance costs of private placement | — | (886) |
| Proceeds from draw on revolving line of credit | 3,000 | — |
| Proceeds from employee stock purchases | 258 | 1 |
| Purchases of treasury stock | (12) | (30) |
| Net cash provided by financing activities | 3,246 | 9,007 |
| Translation gain (loss) on subsidiaries in foreign currencies | 609 | (259) |
| Change in cash and cash equivalents | (4,463) | 8,225 |
| Cash and cash equivalents, beginning of period | 15,416 | 7,489 |
| Cash and cash equivalents, end of period | $ 10,953 | $ 15,714 |

*See accompanying notes.*

**Active Power, Inc.**
**Notes to Condensed Consolidated Financial Statements**
**June 30, 2011**
(Unaudited)

## 1. Significant Accounting Policies

**Organization and Basis of presentation**

Active Power, Inc. and its subsidiaries (hereinafter referred to as “we”, “us”, “Active Power” or the “Company”) manufacture and provide critical power quality solutions that provide business continuity and protect customers in the event of an electrical power disturbance. Our products and solutions are designed to deliver continuous clean power, protecting customers from voltage fluctuations, such as surges and sags and frequency fluctuations, and also to provide ride-through, or temporary, power to bridge the gap between a power outage and the restoration of utility power. Our target customers are those global enterprises requiring “power insurance” because they have zero tolerance for downtime in their mission critical operations. The Uninterruptible Power Supply (“UPS”) products we manufacture use kinetic energy to provide short-term power as a cleaner alternative to electro-chemical battery-based energy. We sell stand-alone UPS products as well as complete continuous power and infrastructure solutions, including containerized continuous power systems that we brand as PowerHouse. We sell our products globally through direct, manufacturer’s representatives, Original Equipment Manufacturer (“OEM”) channels and IT partners. Our current principal markets are Europe, Middle East and Africa (“EMEA”), Asia and North America.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles and include the accounts of the Company and its consolidated subsidiaries. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring items) necessary to present fairly the consolidated financial position of the Company and its consolidated results of operations and cash flows. These interim financial statements should be read in conjunction with the financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010.

## 2. Supplemental Balance Sheet Information

**Receivables**

Accounts receivable consist of the following (in thousands):

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Trade receivables | $ 18,107 | $ 15,038 |
| Allowance for doubtful accounts | (302) | (330) |
| | $ 17,805 | $ 14,708 |

**Inventory**

We state inventories at the lower of cost or market, using the first-in-first-out-method (in thousands):

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Raw materials | $ 6,655 | $ 5,243 |
| Work in process | 5,461 | 2,382 |
| Finished goods | 1,750 | 1,148 |
| Allowances for obsolescence | (1,815) | (2,343) |
| | $ 12,051 | $ 6,430 |

**Property and Equipment**

Property and equipment consist of the following (in thousands):

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Equipment | $ 9,825 | $ 9,574 |
| Demonstration units | 1,670 | 1,195 |
| Computers and purchased software | 3,742 | 3,425 |
| Furniture and fixtures | 367 | 362 |
| Leasehold improvements | 7,418 | 7,328 |
| Construction in progress | 574 | 389 |
| | 23,596 | 22,273 |
| Accumulated depreciation | (21,007) | (20,268) |
| | $ 2,589 | $ 2,005 |

**Accrued Expenses**

Accrued expenses consist of the following (in thousands):

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Compensation and benefits | $ 2,457 | $ 3,985 |
| Warranty liability | 699 | 677 |
| Property, income, state, sales and franchise tax | 390 | 1,193 |
| Professional fees | 318 | 360 |
| Other | 1,010 | 853 |
| | $ 4,874 | $ 7,068 |

**Warranty Liability**

Generally, the warranty period for our power quality products is 12 months from the date of commissioning or 18 months from the date of shipment from Active Power, whichever period is shorter. Occasionally we offer longer warranty periods to certain customers. The warranty period for products sold to our primary OEM customer, Caterpillar, is 12 months from the date of shipment to the end-user, or up to 36 months from shipment. This is dependent upon Caterpillar complying with our storage requirements for our products in order to preserve this warranty period beyond the standard 18-month limit. We provide for the estimated cost of product warranties at the time revenue is recognized and this accrual is included in accrued expenses and long-term liabilities on the accompanying consolidated balance sheet.

Changes in our warranty liability are presented in the following table (in thousands):

| | |
|---|---|
| Balance at December 31, 2010 | $ 734 |
| Warranty expense | 410 |
| Warranty charges incurred | (402) |
| Balance at June 30, 2011 | $ 742 |
| Warranty liability included in accrued expenses | $ 699 |
| Long-term warranty liability | 43 |
| Balance at June 30, 2011 | $ 742 |

**Revenue Recognition**

In general, we recognize revenue when four criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the sales price is fixed or determinable; and (iv) collectability is reasonably assured. In general, revenue is recognized when revenue-generating transactions generally fall into one of the following categories of revenue recognition:

- We recognize product revenue at the time of shipment for substantially all products sold directly to customers and through distributors because title and risk of loss pass on delivery to the common carrier. Our customers and distributors do not have the right to return products. If title and risk of loss pass at some other point in time, we recognize such revenue for our customers when the product is delivered to the customer and title and risk of loss have passed.

- We recognize installation and service and maintenance revenue at the time the service is performed.

- We recognize revenue associated with extended maintenance agreements ("EMAs") over the life of the contracts using the straight-line method, which approximates the expected timing in which applicable services are performed. Amounts collected in advance of revenue recognition are recorded as a current or long-term liability based on the time from the balance sheet date to the future date of revenue recognition.

- We recognize revenue on certain rental programs over the life of the rental agreement using the straight-line method. Amounts collected in advance of revenue recognition are recorded as a current or long-term liability based on the time from the balance sheet date to the future date of revenue recognition.

- Shipping costs reimbursed by the customer are included in revenue.

Multiple element arrangements ("MEAs"). Arrangements to sell products to customers frequently include multiple deliverables. Our most significant MEAs include the sale of one or more of our CleanSource UPS or PowerHouse products, combined with one or more of the following products: design services, project management, commissioning and installation services, spare parts or consumables, and EMAs. Delivery of the various products or performance of services within the arrangement may or may not coincide. Certain services related to design and consulting may occur prior to delivery of product and commissioning and installation typically takes place within six months of product delivery, depending upon customer requirements. EMAs, consumables, and repair, maintenance or consulting services generally are delivered over a period of one to five years. In certain arrangements revenue recognized is limited to the amount invoiced or received that is not contingent on the delivery of future products and services.

When arrangements include multiple elements, we allocate revenue to each element based on the relative selling price and recognize revenue when the elements have stand-alone value and the four criteria for revenue recognition have been met for each element. We establish the selling price of each element based on Vendor Specific Objective Evidence ("VSOE") if available, Third Party Evidence ("TPE") if VSOE is not available, or best estimate of selling price ("BESP") if neither VSOE nor TPE is available. We generally determine selling price based on amounts charged separately for the delivered and undelivered elements to similar customers in stand-alone sales of the specific elements. When arrangements include an EMA, we recognize revenue related to the EMA at the stated contractual price on a straight-line basis over the life of the agreement.

Any taxes imposed by governmental authorities on our revenue-producing transactions with customers are shown in our consolidated statements of operations on a net-basis; that is, excluded from our reported revenues.

### 3. Net Loss Per Share

The following table sets forth the computation of basic and diluted net loss per share (in thousands, except per share data):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Net loss | $ (1,394) | $ (1,536) | $ (2,460) | $ (4,125) |
| Basic and diluted: | | | | |
| Weighted-average shares of common stock outstanding | 80,045 | 79,656 | 79,934 | 75,540 |
| Shares used in computing net loss per share, basic and diluted | 80,045 | 79,656 | 79,934 | 75,540 |
| Net loss per share, basic and diluted | $ (0.02) | $ (0.02) | $ (0.03) | $ (0.05) |

The calculation of diluted loss per share excludes 10,135,398 and 9,159,754 shares of common stock issuable upon exercise of employee stock options as of June 30, 2011 and 2010, respectively, and 19,001 non-vested shares of common stock issuable upon exercise of restricted stock awards as of June 30, 2010, because their inclusion in the calculation would be anti-dilutive. There were no restricted stock awards outstanding at June 30, 2011. As of June 30, 2011 and 2010, respectively, there was no common stock subject to repurchase.

### 4. Fair Value of Financial Instruments

Investments in marketable securities consist of money-market funds, commercial paper and debt securities with readily determinable fair values. Active Power accounts for investments that are reasonably expected to be realized in cash, sold or consumed during the year as short-term investments. We classify investments in marketable securities as available-for-sale and all reclassifications made from unrealized gains/losses to realized gains/losses are determined based on the specific identification method. The carrying amount of investments in marketable securities approximated fair value at December 31, 2010. There were no investments in marketable securities at June 30, 2011.

In accordance with our investment policy and guidelines, our short-term investments are diversified among and limited to high quality securities with a minimum of investment grade ratings. We actively monitor our investment portfolio to ensure compliance with our investment objective to preserve capital, meet liquidity requirements and maximize return on our investments. We do not require collateral or enter into master netting arrangements to mitigate our credit risk.

Effective October 1, 2008, we adopted an accounting standard, which defines fair value, establishes a framework for measuring fair value as well as expands on required disclosures regarding fair value measurements. This standard applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

Level 1—uses quoted prices in active markets for identical assets or liabilities we have the ability to access.

Level 2—uses observable inputs other than quoted prices in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3—uses one or more significant inputs that are unobservable and supported by little or no market activity, and that reflect the use of significant management judgment.

Inputs are referred to as assumptions that market participants would use in pricing the asset or liability. The uses of inputs in the valuation process are categorized into a three-level fair value hierarchy.

Our Level 1 assets and liabilities consist of cash equivalents and short-term investments, which are primarily invested in money-market funds. These assets are classified as Level 1 because they are valued using quoted prices in active markets and other relevant information generated by market transactions involving identical assets and liabilities.

The fair value of our cash equivalents, which are primarily invested in money-market funds, was determined using the following inputs as of June 30, 2011 and December 31, 2010 (in thousands):

**June 30, 2011**

| | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Money-market funds | $ 3,093 | $ — | $ — | $ 3,093 |
| Total | $ 3,093 | $ — | $ — | $ 3,093 |
| Amounts included in: | | | | |
| Cash and cash equivalents | $ 3,093 | $ — | $ — | $ 3,093 |
| Short-term investments | — | — | — | — |
| Total | $ 3,093 | $ — | $ — | $ 3,093 |

**December 31, 2010**

| | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Money-market funds | $ 3,227 | $ — | $ — | $ 3,227 |
| Total | $ 3,227 | $ — | $ — | $ 3,227 |
| Amounts included in: | | | | |
| Cash and cash equivalents | $ 3,093 | $ — | $ — | $ 3,093 |
| Short-term investments | 134 | — | — | 134 |
| Total | $ 3,227 | $ — | $ — | $ 3,227 |

For cash and cash equivalents, marketable securities, accounts receivable, and accounts payable, the carrying amount approximates fair value because of the relative short maturity of those instruments.

## 5. Guarantees

In certain geographical regions, particularly Europe and Africa, we are sometimes required to issue performance guarantees to our customers as a condition of sale. These guarantees usually provide financial protection to our customers in the event that we fail to fulfill our warranty obligations. We secure these guarantees with standby letters of credit through our bank. At June 30, 2011 and December 31, 2010, we had $48 and $547, respectively, of performance guarantees outstanding to customers that were secured with letters of credit.

**Item2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following discussion should be read in conjunction with, and is qualified in its entirety by reference to, the financial statements and notes thereto included in Item 1 of this Form 10-Q and the financial statements and notes thereto and our Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2010 included in our 2010 Annual Report on Form 10-K. This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that involve risks and uncertainties. Our expectations with respect to future results of operations that may be embodied in oral and written forward-looking statements, including any forward-looking statements that may be included in this report, are subject to risks and uncertainties that must be considered when evaluating the likelihood of our realization of such expectations. Our actual results could differ materially. The words "believe," "expect," "intend," "plan," "project," "will" and similar phrases as they relate to us are intended to identify such forward-looking statements. In addition, please see the "Risk Factors" in Part 1, Item 1A of our 2010 Annual Report on Form 10-K and in Part II, Item 1A of this Form 10-Q for a discussion of items that may affect our future results.*

**Overview**

Active Power is headquartered in Austin, Texas, where we manufacture our patented flywheel uninterruptible power supply ("UPS") systems and continuous power and infrastructure solutions. These solutions ensure continuity for business and IT operations for enterprises, data center operations and IT service providers in the event of power disturbances.

Our products and solutions are designed to deliver continuous clean power during power disturbances and outages, voltage sags and surges and provide ride-through power in the event of utility failure, supporting operations until utility power is restored or a longer-term alternative power source, such as a diesel generator, is started. We believe that our products offer an advantage over those of our competitors in the areas of space and energy efficiency, total cost of ownership, system reliability, modular design and the economically green benefits of our solutions.

As of June 30, 2011, we have shipped more than 3,000 flywheels in UPS system installations, delivering more than 750 megawatts of critical power to customers in 42 countries around the world. We are headquartered in Austin, Texas, with international offices in the United Kingdom, Germany, China and Japan.

Our patented flywheel-based UPS systems store kinetic energy by constantly spinning a compact steel wheel ("flywheel") driven from utility power in a low friction environment. When the utility power used to spin the flywheel fluctuates or is interrupted, the flywheel's inertia causes it to continue spinning. The resulting kinetic energy of the spinning flywheel generates electricity known as "bridging power" for short periods, until either utility power is restored or a backup electric generator starts and takes over generating longer-term power in the case of an extended electrical outage. We believe our flywheel products provide many competitive advantages over conventional battery-based UPS systems, including substantial space savings, higher power densities, "green" energy storage, and higher power efficiencies up to 98%. This high energy efficiency reduces operating costs and provides customers a lower total cost of ownership. We offer our flywheel products with load capabilities from 130kVA to 8,400kVA. We typically target higher power applications of 200kVA and above, largely because the majority of customers in this market segment have backup generators. Our flywheel-based UPS systems are marketed under the brand name CleanSource®.

We also sell continuous power systems ("CPS"), which incorporate our UPS products with switchgear and a generator to provide complete short- and long-term protection in the event of a power disturbance. Where the CPS is sold in a containerized package, it is marketed under the brand name PowerHouse™ . PowerHouse can be deployed in either a 20-foot or 40-foot-long container depending upon the customer's power load requirements. These systems are specifically designed to handle the demands of high-tech facilities requiring the highest power integrity available while maximizing up time, useable floor space and operational efficiency. Designed to offer a highly flexible architecture to a customer's constantly changing environment, our PowerHouse systems are offered in four standard modular power configurations, enabling sizing for infrastructure on demand. These systems are highly differentiated as they offer flexibility in placement, space savings, fast deployment time after receipt of order, high energy efficiency, and prompt capital deployment to meet current demands. They also deliver significant value to customers as the entire system is integrated and tested prior to delivery for a repeatable simple solution. We also sell CPS solutions to customers in a non-containerized format, typically deploying such solutions inside buildings.

Leveraging our expertise in containerization and power distribution, in 2010 we began to manufacture continuous infrastructure solutions, designed to specification for select business partners. These solutions serve as the infrastructure for modular data centers, which are self-contained, fully-functional data centers. Modular data centers may be rapidly deployed with other modular infrastructure, such as PowerHouse, as a cost-effective alternative to traditional raised-floor data centers. Active Power designs and delivers the exterior shell and a fully fitted-out interior (including electrical, cooling, monitoring, and other elements) ready for the customer to add its IT racks and servers. After the customer adds its IT equipment to our continuous infrastructure solution, the customer has a functional data center. We expect revenue to grow in coming years from current and future customers as modular data center infrastructure continues to gain acceptance in the market.

We sell our products to a wide array of commercial and industrial customers across a variety of vertical markets, including data centers, manufacturing, technology, broadcast and communications, financial, utilities, healthcare, government and airports. We have expanded our global sales channels and direct sales force, selling in most all major geographic regions of the world, but particularly in North America, Europe and Asia. We sell our products through the following distribution methods:

- Sales made directly by Active Power;
- Manufacturer's representatives;
- Distributors;
- OEM partners; and
- Strategic IT Partners.

We believe a number of underlying macroeconomic trends place Active Power in a strong position to be one of the leading providers of critical power protection. These trends include:

- Ever-increasing demands placed on the public utility infrastructure;
- An inadequate investment in global utility infrastructure;
- Rising costs of energy worldwide;
- Increasing business costs of downtime;
- A rapidly expanding need for data centers that provide reliable, efficient power; and
- An increasing demand for economically green solutions.

We believe that our total revenue will continue to grow from all of our products and as we continue to focus on selling more complete systems rather than just products. In particular, we expect continuing market acceptance of containerized solutions to drive higher sales of our PowerHouse and containerized infrastructure solution products globally. We also believe that the global growth in data center demand will lead to higher sales of our UPS products. We are specifically targeting those customers with large IT and power needs who have the ability to make frequent and large UPS purchases as their global operations expand.

Our commercialization strategy remains focused on the following:

- Building the Active Power brand globally;
- Expanding our distribution channels;
- Creating innovative solutions; and
- Focusing on operating and product cost reduction.

As a result of this strategy, we have been successful in improving our operating and financial performance, broadening our global footprint, diversifying our customer base, broadening our sales channels and partners, and moving higher up the customer value chain with innovative developments of our core underlying product technology.

Index

**Results of Operations**

| ($ in thousands) | Three months ended June 30, | | | | Variance 2011 vs. 2010 | |
|---|---|---|---|---|---|---|
| | 2011 | % of total revenue | 2010 | % of total revenue | $ | % |
| Product revenue | $ 16,156 | 84% | $ 13,307 | 83% | $ 2,849 | 21% |
| Service and other revenue | 3,059 | 16% | 2,740 | 17% | 319 | 12% |
| Total revenue | 19,215 | 100% | 16,047 | 100% | 3,168 | 20% |
| Cost of product revenue | 11,991 | 63% | 10,171 | 63% | 1,820 | 18% |
| Cost of service and other revenue | 2,591 | 13% | 1,514 | 9% | 1,077 | 71% |
| Total cost of revenue | 14,582 | 76% | 11,685 | 73% | 2,897 | 25% |
| Gross profit | 4,633 | 24% | 4,362 | 27% | 271 | 6% |
| Operating expenses: | | | | | | |
| Research and development | 1,086 | 6% | 849 | 5% | 237 | 28% |
| Selling and marketing | 3,400 | 18% | 3,526 | 22% | (126) | (4) % |
| General and administrative | 1,435 | 7% | 1,433 | 9% | 2 | — |
| Total operating expenses | 5,921 | 31% | 5,808 | 36% | 113 | 2% |
| Operating loss | (1,288) | (7)% | (1,446) | (9) % | 158 | 11% |
| Interest expense, net | (48) | — | (26) | — | (22) | (85) % |
| Other income (expense), net | (58) | — | (64) | — | 6 | 9% |
| Net loss | $ (1,394) | (7)% | $ (1,536) | (10) % | $ 142 | 9% |

| ($ in thousands) | Six months ended June 30, | | | | Variance 2011 vs. 2010 | |
|---|---|---|---|---|---|---|
| | 2011 | % of total revenue | 2010 | % of total revenue | $ | % |
| Product revenue | $ 30,894 | 85% | $ 22,693 | 84% | $ 8,201 | 36% |
| Service and other revenue | 5,650 | 15% | 4,471 | 16% | 1,179 | 26% |
| Total revenue | 36,544 | 100% | 27,164 | 100% | 9,380 | 35% |
| Cost of product revenue | 22,513 | 61% | 17,036 | 63% | 5,477 | 32% |
| Cost of service and other revenue | 4,688 | 13% | 2,915 | 11% | 1,773 | 61% |
| Total cost of revenue | 27,201 | 74% | 19,951 | 73% | 7,250 | 36% |
| Gross profit | 9,343 | 26% | 7,213 | 27% | 2,130 | 30% |
| Operating expenses: | | | | | | |
| Research and development | 2,007 | 5% | 1,684 | 6% | 323 | 19% |
| Selling and marketing | 6,870 | 19% | 6,784 | 25% | 86 | 1% |
| General and administrative | 2,803 | 8% | 2,750 | 10% | 53 | 2% |
| Total operating expenses | 11,680 | 32% | 11,218 | 41% | 462 | 4% |
| Operating loss | (2,337) | (6)% | (4,005) | (15)% | 1,668 | 42% |
| Interest expense, net | (81) | — | (52) | — | (29) | (56)% |
| Other income (expense), net | (42) | — | (68) | — | 26 | 38% |
| Net loss | $ (2,460) | (6)% | $ (4,125) | (15)% | $ 1,665 | 40% |

***Product revenue.*** Product revenue primarily consists of sales of our CleanSource power quality products, CPS and other data center infrastructure solutions. Our CleanSource power quality products are comprised of both UPS and DC product lines and our CPS are comprised of our UPS systems and some combination of third party ancillary equipment, such as engine generators and switchgear. The CPS products may be sold in a containerized solution that we call PowerHouse, or as separate equipment. Our data center infrastructure solutions provide power distribution, cooling capabilities, security systems, fire suppression and monitoring capabilities for our IT channel partners. Our product revenue was derived from the following sources:

| ($ in thousands) | Three Months Ended June 30, 2011 | Three Months Ended June 30, 2010 | Variance $ | Variance % |
|---|---|---|---|---|
| Product revenue: | | | | |
| UPS product revenue | $ 5,458 | $ 6,643 | $ (1,185) | (18) % |
| Continuous Power Systems | 8,399 | 4,509 | 3,890 | 86 % |
| Data center infrastructure solutions | 2,299 | 2,155 | 144 | 7 % |
| Total product revenue | $ 16,156 | $ 13,307 | $ 2,849 | 21 % |

| ($ in thousands) | Six Months Ended June 30, 2011 | Six Months Ended June 30, 2010 | Variance $ | Variance % |
|---|---|---|---|---|
| Product revenue: | | | | |
| UPS product revenue | $ 14,773 | $ 14,853 | $ (80) | (1) % |
| Continuous Power Systems | 13,071 | 5,087 | 7,984 | 157 % |
| Data center infrastructure solutions | 3,050 | 2,753 | 297 | 11 % |
| Total product revenue | $ 30,894 | $ 22,693 | $ 8,201 | 36 % |

Product revenue for the three-month period ended June 30, 2011 increased $2.8 million, or 21%, compared to the same period of 2010. This increase is primarily attributable to an increase in sales of continuous power systems, including Powerhouse, of $3.9 million, as our solutions have gained market acceptance, in particular in Asia. Sales related to our CPS products, which are generally larger in value and are purchased by fewer customers relative to our UPS products, comprised 52% of product revenue in the second quarter of 2011, compared to 34% of product revenue in the second quarter of 2010. In addition, sales of our 65-150kVA CleanSource UPS product line increased by $345,000 compared to the second quarter of 2010, and sales of our megawatt class UPS products increased by $325,000 compared to the second quarter of 2010. These increases were offset by a $1.7 million decrease in sales of our 250-900kVA CleanSource UPS product line compared to the same period of 2010. This change in product mix and revenue source was driven by the particular customer orders at any point in time and can vary based upon customer load and space requirements.

Product revenue for the six-month period ended June 30, 2011 increased by $8.2 million, or 36%, compared to the same period in 2010. This increase was driven primarily by an increase of $8.0 million in sales of our CPS products, particularly in Europe and Asia. Sales related to our CPS products comprised 42% of product revenue in the first half of 2011, compared to 22% of product revenue in the same period of 2010. The approximately $80,000 decrease in UPS product revenue for the first half of 2010 was a result of an increase of $2.9 million in our megawatt class UPS products, offset by a larger decrease in our 250-900 kVA CleanSource product line megawatt class UPS products of $3.3 million. This reflects a trend towards higher-power system sales in our end markets.

Product revenue for the second quarter of 2011 increased by $1.4 million, or 10%, compared to the first quarter of 2011, primarily due to higher continuous power system and data center infrastructure solutions revenues, offset by lower UPS product revenues as a result of lower OEM sales. This increase compares to a 42% increase in product revenue in the second quarter of 2010, as compared to the first quarter of 2010, primarily due to an increase in PowerHouse and data center infrastructure solutions revenues in the second quarter of 2010.

Product sales from our OEM channels for the three-month period ended June 30, 2011 decreased by $2.0 million, or 52%, compared to the same period in 2010 and for the six-month period ended June 30, 2011 increased by $841,000, or 13%, as compared to the same period in 2010. Product sales from our OEM channels for the three-month period ended June 30, 2011 decreased by $3.6 million, or 67%, compared to the first quarter of 2011. The size and volume of orders from our OEM channels can fluctuate significantly on a quarterly basis and in 2011 we have seen fewer, but larger value transactions from our OEM channel. We have supported our OEM partners' efforts to sell total solutions to their customers where they can sell generators and switchgear that they manufacture along with our UPS systems as a total solution for their customers. We believe that this will drive an increase in UPS product revenue for us in 2011 as they have more success with this sales strategy although as our OEM partner sells more solutions, the quarterly volume of revenue may increase in variability. Our sales pipeline of potential orders from our OEM channel continues to grow which leads us to believe that sales from this channel will increase in the second half of 2011. Sales to Caterpillar, our primary OEM channel, represented 11% and 23% of our product revenue for the three-month and six-month periods ended June 30, 2011, respectively, as compared to 28% of our product revenue in both the comparable periods of 2010. Caterpillar remains one of our largest customers as well as our largest OEM customer.

During the second quarter of 2011, we delivered 23.4 megawatts of critical power systems, which generated $660,000 in revenue per megawatt. This compares to 24.3 megawatts of critical power systems delivered in the second quarter of 2010, which generated $491,000 in revenue per megawatt. The increase in revenue generated per megawatt of critical power delivered reflects the higher proportion of systems delivered to customers compared to the prior year. We generate more revenue per megawatt of critical power delivered when customers buy complete power systems from us as compared to revenue from UPS systems only.

Our CPS and PowerHouse contracts tend to be larger in value and from a smaller number of customers compared to sales of our UPS products. This smaller number of customers with greater transaction value can contribute to large quarterly fluctuations in revenue from each product family, due to the timing of orders or shipments in any particular accounting period. The size of these transactions has been increasing and individual CPS transactions have been as high as $6 million in 2010 as we have delivered multiple CPS products to a single customer, and our largest single order for continuous infrastructure products was over $7 million. A small number of transactions can therefore lead to significant revenue, but cause greater volatility in our quarterly results and increase liquidity risk for us as we continue to refine and improve the payment terms of these opportunities as part of our working capital management.

North America product sales were 52% of our product revenue for the three-month period ended June 30, 2011, compared to 69% for the same period in 2010, and 53% in the three-month period ended March 31, 2011. For the six-month period ended June 30, 2011, our North America product sales were 53% of our product revenue, which compared to 65% for the same period in 2010.

We also sell products directly to customers in Asia and Western Europe and we have a network of international distributors in other territories that sell products for us. In these markets, customers are more likely to purchase a total power solution from us rather than a stand-alone UPS system. This usually results in a longer selling cycle and makes quarterly results from these regions more volatile. Thus the amount of revenue from our international markets can fluctuate significantly on a quarterly basis. Product sales to customers in Asia represented 25% of our product revenue in the three-month period ended June 30, 2011, compared to 0% for the same period in 2010. Product sales in EMEA represented 23% of product revenue in the three-month period ended June 30, 2011, compared to 31% for the same period in 2010. These fluctuations are primarily attributable to variations in sales of our CPS products in each region in the relevant periods, and illustrate the impact of larger orders from fewer customers on quarterly revenue for each of these regions.

Product sales of Active Power branded products through our direct and manufacturer’s representative channels were 61% of our product revenue for the three-month period ended June 30, 2011, compared to 56% for the same period of 2010, and 51% of our product revenue for the three-month period ended March 31, 2011. For the six-month period ended June 30, 2011, product sales of Active Power branded products through our direct and manufacturer’s representative channels were 56% of our product revenue, compared to 60% for the same period of 2010. As direct sales typically have higher profit margins than sales through our OEM channels, we will continue to focus on our direct sales channel to increase revenue and improve profit margins and to decrease our dependency upon our OEM channel. We believe sales of our Active Power branded products in markets that are not covered by our OEMs will continue to increase over time and will continue to become a larger percentage of our total revenue.

Our products perform well in harsh environments where power quality or reliability is particularly poor, which makes them a good fit for countries with a poor power infrastructure or in harsh manufacturing or process environments, or situations where reliability is paramount, such as mission-critical business applications. Therefore, we have traditionally focused our direct sales efforts on these types of customer situations.

***Service and other revenue.*** Service and other revenue primarily relates to revenue generated from both traditional (after-market) service work and from customer-specific system engineering. This includes revenue from design, installation, startup, repairs or reconfigurations of our products and the sale of spare or replacement parts to our OEM and end-user customers. It also includes revenue associated with the costs of travel of our service personnel and revenues or fees received upon contract deferment or cancellation. Revenue from extended maintenance contracts with our customers is also included in this revenue category.

Service and other revenue increased by approximately $319,000, or 12%, for the three-month period ended June 30, 2011, compared to the same period in 2010, and increased by $1.2 million, or 26%, for the six-month period ended June 30, 2011 as compared to the same period in 2010. These increases reflect higher levels of service and contract work from direct product sales and from professional fees associated with PowerHouse and other CPS sales. For these CPS customers, we provide a full power solution, including design services, site preparation, installation of an entire power solution and provision of all products required to provide a turnkey product to the end user often including maintenance services. We also had increased service revenues from maintenance contracts and repair-related activities as our increasing installed base of UPS customers provides greater opportunities to generate such revenues. Where we make sales through our OEM channel, it is typical for the OEM to provide these types of services to their end-user customers so these revenue opportunities do not typically exist for us on our OEM sales. We anticipate that service and other revenue will continue to grow with product revenue, particularly as our PowerHouse system revenue grows, and as our installed base of UPS product expands, because as more units are sold to customers, more installation, startup and maintenance services will be required.

***Cost of product revenue.*** Cost of product revenue includes the cost of component parts of our products, ancillary equipment that is sourced from external suppliers, personnel, equipment and other costs associated with our assembly and test operations, including costs from having underutilized facilities, depreciation of our manufacturing property and equipment, shipping costs, warranty costs, and the costs of manufacturing support functions such as logistics and quality assurance. The cost of product revenue as a percentage of total product revenue was 74% for the three-month period ended June 30, 2011, compared to 76% for the same period in 2010, and 73% for the six-month period ended June 30, 2011, as compared to 75% for the same period of 2010. These decreases in costs as a percentage of revenue reflect higher average selling prices for our UPS products and a lower level of unabsorbed overhead costs in our manufacturing operation. We continue to operate a manufacturing facility that has a manufacturing and testing capacity significantly greater than our current product revenue levels. A large portion of the costs involved in operating this manufacturing facility are fixed in nature, and we can incur up to $400,000 in unabsorbed overhead each quarter depending on the level of UPS system production. We continue to work on reducing our product costs through design enhancements and modifications, vendor management programs and increasing our sales volume to absorb these expenses. Overall the change in cost of product revenue for the second quarter of 2011 relative to the first quarter of 2011 was consistent with the change in total product revenue for the second quarter of 2011.

***Cost of service and other revenue.*** Cost of service and other revenue includes the cost of component parts that we use in service or sell as spare parts, as well as labor and overhead costs of our service organization, including travel and related costs incurred in fulfilling our service obligations to our customers. Costs paid to third parties in fulfillment of service and design or installation services are also included in costs of service and other revenue. The cost of service and other revenue increased to 85% of service and other revenue in the three-month period ended June 30, 2011, compared to 55% for the same period of 2010, and increased to 83% in the six-month period ended June 30, 2011 as compared to 65% in the same period of 2010. This increase was primarily due to lower margins realized in Europe for design, installation and project management on a number of large CPS system sales in 2011 that resulted in costs being a higher proportion of revenue. We have also had higher costs relative to the increase in service and other revenues as we have continued to expand our service team as we broaden the geographic regions where we have service capability as our total business grows. Operationally, we are challenged to manage the growth of our service organization congruent with the growth in total revenues so that we can meet customer requirements without growing our service organization cost structure too rapidly. The utilization of our service personnel will also be affected by the number of PowerHouse and infrastructure solution products implemented in a particular period and in periods where we have a low number of installation projects, we would expect our costs as a percentage of revenue to increase. A large portion of the costs involved in operating our service organization are fixed in nature and we incur approximately $300,000 to $600,000 in unabsorbed overhead each quarter. We continue to work on reducing our service overhead through better utilization of our service employees and cost control measures. This infrastructure also means that we can leverage this investment and grow our service capabilities substantially by adding direct technical labor only as required.

***Gross profit.*** For the three-month period ended June 30, 2011, our gross profit margin was 24% of revenue, compared to a 27% gross margin for the same period in 2010. For the six-month period ended June 30, 2011, our gross margin was 26% of revenue, compared to 27% for the same period of 2010. The decrease in gross profit margin reflects the results of an increase in the sales of our CPS and infrastructure products as a percentage of our total revenue. These products generally earn lower margins for us than sales of our UPS product because they include a higher proportion of third party ancillary equipment. Our margins were also negatively impacted by lower margins on professional services in Europe related to CPS system installation and management, and from higher unabsorbed overhead costs from our manufacturing operations due to lower UPS product revenue. We also incurred more costs in product design and engineering for our data center infrastructure solutions products as we designed a number of new products for one of our IT partners this quarter, which reduced our gross profit on our infrastructure products. As we build more units of these newly designed solutions, we expect the margins to improve. Our ability to improve our gross profit will depend, in part, on our ability to continue to reduce material costs, improve our sales channel mix in favor of direct sales versus OEM sales, increase sales of higher margin products such as our UPS products, increase product prices, improve our professional service margins through pricing and operating efficiency, and increase our total revenues to a level that will allow us to improve the utilization of our manufacturing and service operations.

***Research and development.*** Research and development expense primarily consists of compensation and related costs for employees engaged in research, development and engineering activities, third party consulting and product development activities, as well as an allocated portion of our occupancy costs. Overall, our research and development expenses were approximately $237,000, or 28%, higher in the second quarter of 2011 compared to the second quarter of 2010 and $165,000, or 18%, higher than the first quarter of 2011. For the six months ended June 30, 2011, our research and development expenses were $323,000, or 19%, higher than the same period in 2010. We are currently developing a new generation of UPS product that we believe will offer greater power modularity and space efficiencies especially as we target the larger power market segments. It is anticipated that the cost structure to produce the new product line will allow improved profit margins. Our research and development cost increases in 2011 are primarily attributable to our design and prototype efforts on this project, as well as design activities around our continuous infrastructure solution products. Our research and development efforts in 2010 were largely focused on new configurations of our existing flywheel technology, as well as refinements and enhancements to the standardization of our PowerHouse and containerized infrastructure solution products. We believe research and development expenses in the third quarter of 2011 will remain at similar levels to those recorded in the second quarter of 2011.

***Selling and marketing.*** Selling and marketing expense primarily consists of compensation, including variable sales compensation, and related costs for sales and marketing personnel, and related travel, selling and marketing expenses, as well as an allocated portion of our occupancy costs and the cost of our foreign sales operations. Selling and marketing costs were approximately $126,000, or 4%, lower in the second quarter of 2011 compared to the second quarter of 2010 and decreased approximately $70,000, or 2%, from the first quarter of 2011. For the six-month period ended June 30, 2011, our selling and marketing expenses were approximately $86,000, or 1%, higher than for approximately same period in 2010. The decrease in quarterly expense in 2011 compared to the prior year and prior quarter reflects lower variable sales compensation due to our lower gross margins, offset by higher salary costs as a result of an increase in headcount for our direct sales organization in the U.S. We believe that sales and marketing expenses will remain at similar levels to those recorded in the second quarter of 2011, except for changes in variable selling expenses that are based on fluctuations in total revenue and gross profit margins.

***General and administrative.*** General and administrative expense is primarily comprised of compensation and related costs for executive and administrative personnel, professional fees, and taxes, including sales, property and franchise taxes. General and administrative expenses for the second quarter of 2011 remained consistent with a slight increase of approximately $2,000, or 0%, compared to the same period in 2010 and increased approximately $67,000, or 5%, as compared to the first quarter of 2011. For the six-month period ended June 30, 2011, our general and administrative costs were 2% higher than the same period of 2010 due to higher headcount.

***Interest expense, net***. Net interest expense has increased from approximately $26,000 in the second quarter of 2010 to approximately $48,000 in the second quarter of 2011, or by 85%. We incurred higher interest expense as we had a larger average outstanding balance on our revolving credit facility. Our average cash and investments balance over the three-month period ending June 30, 2011 has decreased by $4.1 million, or 25%, compared to the average balance over the same period ending June 30, 2010 and has increased by $1.7 million, or 15%, for the six-month period ended June 30, 2011, compared to the average balance over the same period of 2010. The lower cash balances and lower interest rate environment resulted in a decrease in interest income.

***Other income (expense), net.*** Other income (expense) in the second quarter of 2011 and 2010 reflects foreign exchange gains (losses) on a bank account held in foreign currencies by our subsidiary company.

**Liquidity and Capital Resources**

Our primary sources of liquidity at June 30, 2011 are our cash and investments on hand, our bank credit facilities and projected cash flows from operating activities. If we meet our cash flow projections in our current business plan, we expect that we have adequate capital resources in order to continue operating our business for at least the next 12 months. Our business plan and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are scenarios in which our revenues may not meet our projections, our costs may exceed our estimates or our working capital needs may be greater than anticipated. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2011 and beyond or significantly affect our level of liquidity, which may limit our opportunity to pursue certain opportunities to grow our business.

A substantial increase in sales of our PowerHouse or our infrastructure solutions products or a substantial increase in UPS sales may materially impact the amount of liquidity required to fund our operations. The amount of time between the receipt of payment from our customers and our expenditures for raw materials, manufacturing and shipment of products (the cash cycle) for sales of our CleanSource UPS product can be as short as 45 days, and is typically 60 days. However, the cash cycle on a PowerHouse sale can be as much as 210 days, depending upon customer payment terms. We intend to mitigate the financial impact of this longer cash cycle by requiring customer deposits and periodic payments where possible from our customers. This is not always commercially feasible, and in order to increase our PowerHouse sales, we may be required to make larger investments in inventory and receivables. These larger investments may require us to obtain additional sources of working capital, debt or equity financing in order to fund this business.

Should additional funding be required, we would expect to raise the required funds through borrowings or public or private sales of debt or equity securities. If we raise additional funds through the issuance of debt or equity securities, the ownership of our stockholders could be significantly diluted. If we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, and the terms of the debt securities issued could impose significant restrictions on our operations. We do not know whether we will be able to secure additional funding, or funding on terms acceptable to us, to continue our operations as planned. If financing is not available, we may be required to reduce, delay or eliminate certain activities or to license or sell to others some of our proprietary technology.

The following table summarizes the quarterly changes in cash provided by (used in) operating activities:

| ($ in thousands) | Six months ended June 30, 2011 | Six months ended June 30, 2010 | Variance 2011 vs. 2010 $ | Variance 2011 vs. 2010 % |
|---|---|---|---|---|
| Cash provided by (used in) operating activities | $ (7,034) | $ (180) | $ 6,854 | 3808% |

Cash used in operating activities increased by $6.9 million in the six-month period ended June 30, 2011 compared to the same period of 2010. This was primarily due to changes in our working capital requirements caused by the timing of product shipments to our customers and by our operating loss of $2.5 million. Inventories increased by $5.6 million since December 31, 2010, of which $4.3 million was in-progress construction of CPS and infrastructure projects at June 30, 2011 that is being built to order for delivery to customers in our third quarter, and a further $700,000 was in finished goods UPS inventory at June 30, 2011 that was built to order for UPS and CPS system delivery in the third quarter of 2011. Accounts receivable increased by $3.1 million since December 31, 2010, reflecting the higher revenue levels in the first half of 2011 and a higher proportion of CPS revenues that were completed near the end of the second quarter for which we had not yet been paid. Accrued expenses decreased by $2.2 million since December 31, 2010, reflecting payments of annual incentive compensation. These uses of funds were offset by an increase in accounts payable of $5.0 million since December 31, 2010 that primarily reflects the purchase of inventory and components for our CPS and infrastructure solutions late in the second quarter. We anticipate that cash provided by (used in) operations will fluctuate significantly based upon the volume and size of our CPS and infrastructure solutions, and by the timing of product delivery relative to our reporting periods, and that such volatility in sources and uses of funds will continue as our CPS and infrastructure solutions businesses continue to grow.

The following table summarizes the quarterly changes in cash used in investing activities:

| ($ in thousands) | Six months ended June 30, 2011 | Six months ended June 30, 2010 | Variance 2011 vs. 2010 $ | Variance 2011 vs. 2010 % |
|---|---|---|---|---|
| Cash used in investing activities | $ (1,284) | $ (343) | $ 941 | 274% |

Investing activities primarily consist of purchases of property and equipment. Capital expenditures were $1.3 million in the six-month period ending June 30, 2011, compared to $343,000 in the same period of 2010, as we invested in multiple demonstration CPS systems in Asia and Europe and the U.S., for rental equipment to support our sales activities and commenced tooling for our next generation UPS product.

The following table summarizes the quarterly changes in cash provided by financing activities:

| ($ in thousands) | Six months ended June 30, 2011 | Six months ended June 30, 2010 | Variance 2011 vs. 2010 $ | Variance 2011 vs. 2010 % |
|---|---|---|---|---|
| Cash provided by financing activities | $ 3,246 | $ 9,007 | (5,761) | (64)% |

Funds provided by financing activities during the six months ended June 30, 2011 reflect a draw of $3.0 million on our revolving bank line of credit and proceeds from the exercise of employee stock options. An additional $7.3 million was available to draw upon under our current banking relationship. Funds provided by financing activities during the six-months ended June 30, 2010 primarily reflect the sale of common stock in a firm-commitment underwritten offering pursuant to which we sold approximately 13.25 million shares of common stock at a purchase price of $0.75 per share, for proceeds, net of fees and expenses, of approximately $9.0 million.

We believe that our cash and investments and our sources of available liquidity will be sufficient to fund our operations for at least the next 12 months. Our sales cycle is such that we generally have visibility 2-3 quarters in advance for future orders that allows us to predict revenues over this period of time with some degree of confidence. However, a sudden change in business volume or product mix, positive or negative, from any of our business or channel partners or in our direct business could significantly impact our expected revenues. The recent global economic downturn has reduced our confidence at predicting future revenues, and even with improving economic conditions, there is still uncertainty and risk in our forecasting. This 2-3 quarter window of sales visibility does provide us with some opportunity to adjust expenditures or take other measures to reduce our cash consumption if we can see and anticipate a shortfall in revenue or give us time to identify additional sources of funding if we anticipate an increase in our working capital requirements due to increased revenues or changes in our revenue mix. A significant increase in sales, especially in our PowerHouse or our infrastructure solutions business, would likely increase our working capital requirements, due to the longer production time and cash cycle of sales of these products. We established a revolving bank credit facility to help finance a growth in PowerHouse and infrastructure solutions and believe that this will be adequate to sustain further growth in these products.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

None.

**Item 4. Controls and Procedures.**

**Evaluation of disclosure controls and procedures.**

Our Chief Executive Officer and our Chief Financial Officer, based on the evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that, as of June 30, 2011, our disclosure controls and procedures were effective to ensure that the information we are required to disclose in reports that we file or submit under the Exchange Act, (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in internal control over financial reporting.**

During the three months ended June 30, 2011, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and Rule 15d-15(d) under the Exchange Act that have materially affected, or that we believe are reasonably likely to materially affect, our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act.

**PARTII – OTHER INFORMATION**

**Item 1. Legal Proceedings.**

We are, from time to time, subject to various legal proceedings, claims and litigation arising in the ordinary course of business. We do not believe we are party to any currently pending legal proceedings the outcome of which may have a material effect on our operations or consolidated financial position. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse affect on our financial position, results of operations or cash flows.

**Item 1A. Risk Factors.**

*You should carefully consider the risks described in Item 1A of our 2010 Annual Report on Form 10-K before making a decision to invest in our common stock or in evaluating Active Power and our business. The risks and uncertainties described in our 2010 Annual Report on Form 10-K are not the only ones we face. Additional risks and uncertainties that we do not presently know, or that we currently view as immaterial, may also impair our business operations. This report is qualified in its entirety by these risk factors.*

*The actual occurrence of any of the risks described in our 2010 Annual Report on Form 10-K could materially harm our business, financial condition and results of operations. In that case, the trading price of our common stock could decline.*

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

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Reserved.**

**Item 5. Other Information.**

None.

Index

**Item 6. Exhibits.**

The following documents are filed as exhibits to this report:

| | |
|---|---|
| 3.1* | Restated Certificate of Incorporation (filed as Exhibit 3.1 to Active Power's Quarterly Report on Form 10-Q filed on July 28, 2006) |
| 3.2.* | Second Amended and Restated Bylaws (filed as Exhibit 3.2 to Active Power's Current Report on Form 8-K filed on February 2, 2007) |
| 3.3* | Amendment to Second Amended and Restated Bylaws (filed as Exhibit 3.01 to Active Power's Current Report on Form 8-K filed on December 7, 2007) |
| 4.1* | Specimen certificate for shares of Common Stock (filed as Exhibit 4.1 to Active Power's IPO Registration Statement on Form S-l (SEC File No. 333-36946) (the "IPO Registration Statement")) |
| 4.2* | Rights Agreement, dated as of December 13, 2001, between Active Power and Equiserve Trust N.A., which includes the form of Certificate of Designation for the Series A Junior Participating Preferred Stock as Exhibit A, the form of Rights Certificate as Exhibit B and the Summary of Rights to Purchase Series A Preferred Stock as Exhibit C (filed as Exhibit 4.1 to Active Power's Current Report on Form 8-K filed on December 14, 2001) |
| 4.3* | See Exhibits 3.1, 3.2 and 3.3 for provisions of the Certificate of Incorporation and Bylaws of the registrant defining the rights of holders of common stock |
| 31.1 | Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003 |
| 31.2 | Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003 |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003 |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003 |

______________________________
* Incorporated by reference to the indicated filing.

**SIGNATURES**

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

**ACTIVE POWER, INC.**
(Registrant)

| | |
|---|---|
| August 2, 2011 | /s/ JAMES A. CLISHEM |
| (Date) | **James A. Clishem**<br>**President and Chief Executive Officer**<br>**(Principal Executive Officer)** |
| August 2, 2011 | /s/ JOHN K. PENVER |
| (Date) | **John K. Penver**<br>**Vice President of Finance, Chief Financial Officer and Secretary**<br>**(Principal Financial and Accounting Officer)** |

Exhibit 31.1

**CERTIFICATIONS**

I, James A. Clishem, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Active Power, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2011

/s/ James A. Clishem

James A. Clishem
President and Chief Executive Officer
(Principal Executive Officer)

**Exhibit 31.2**

**CERTIFICATIONS**

I, John K. Penver, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Active Power, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2011

/s/ John K. Penver
John K. Penver
Vice President of Finance, Chief Financial
Officer and Secretary
(Principal Financial and Accounting Officer)

**Exhibit 32.1**

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Active Power, Inc. (the "Company") for the period ending June 30, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James A. Clishem, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ James A. Clishem

James A. Clishem
President and Chief Executive Officer
August 2, 2011

**Exhibit 32.2**

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Active Power, Inc. (the "Company") for the period ending June 30, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John K. Penver, Vice President of Finance, Chief Financial Officer and Secretary of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ John K. Penver
John K. Penver
Vice President of Finance, Chief Financial
Officer and Secretary
August 2, 2011