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OCEAN POWER TECHNOLOGIES, INC

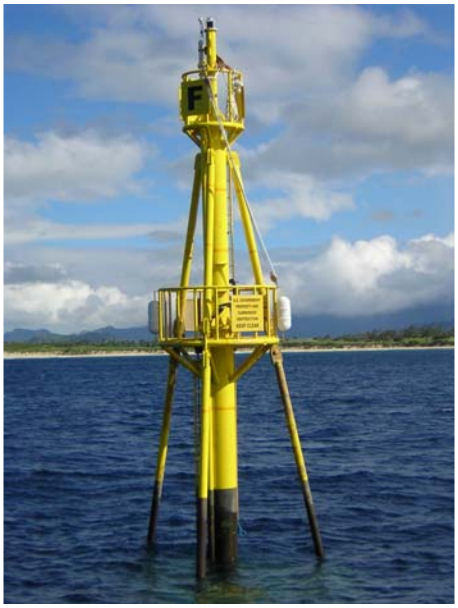
OCEAN POWER TECHNOLOGIES, INC.

Annual Report

For Year Ended 30 April 2006

"Making Waves In Power"

-turning wave power into commercial reality-



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OCEAN POWER TECHNOLOGIES, INC.

Dear Shareholder:

In accord with the rules of the Alternative Investment Market of the London Stock exchange, we are pleased to issue the consolidated financial statements of Ocean Power Technologies, Inc. as of April 30, 2006 and for the two years then ended, as audited by KPMG LLP, the Company's independent auditors.

The highlights of our recent results are as follows:

- In fiscal 2006 revenues were $1.7 million as compared to $5.4 million in fiscal 2005. The decrease in revenues was primarily attributable to delays in contract approvals for the Company's wave power project for the US Navy in Hawaii, the completion of a development and construction contract with Lockheed Martin in the first quarter of fiscal 2006 and the determination by Lockheed not to proceed with a further project that would have involved the Company's autonomous PowerBuoy® System. This was partially offset by revenues from a contract with the US Department of Homeland Security to design and study an autonomous PowerBuoy system for offshore marine surveillance, under which Lockheed is a subcontractor to OPT.

- In response to this reduction in revenues, during fiscal 2006 the Company refocused its engineering and development resources on product development for its current 40kW rated PowerBuoy system and began efforts to increase the maximum rated output of the system to 150kW. Product development costs were $4.2 million in fiscal 2006 compared to $0.9 million in fiscal 2005. In addition, selling, general and administrative costs increased, primarily attributable to additional marketing personnel and to increased professional fees, as the Company expanded its sales and marketing effort. Selling, general and administrative costs were $3.2 million in fiscal 2006, compared to $2.6 million in fiscal 2005.

- The Company incurred a net loss of $7.1 million in fiscal 2006 compared to a net loss of $0.4 million in the prior fiscal year primarily due to the decrease in revenues, the increase in product development costs and the increase in selling, general and administrative costs.

- At July 31, 2006, our contract backlog (order book) was $5.5 million compared to $2.4 million at April 30, 2006. This backlog consists of the aggregate anticipated revenue remaining to be earned from the uncompleted portions of our existing customer contracts.

- At July 31, 2006, our cash, cash equivalents and certificates of deposit were $31.1 million compared to $32.4 million at April 30, 2006.

- OPT has successfully completed for the New Jersey Board of Public Utilities a 12-month testing of a PowerBuoy five miles off the coast of New Jersey. These tests have allowed us to monitor the system and evaluate its performance in actual wave conditions. It has provided us with valuable operational data as well as important marketing opportunities. These tests are an important milestone in the commercialization of OPT's PowerBuoy.

- As an important element of its business strategy, OPT continues to pursue the construction of demonstration wave power stations to encourage market adoption of its wave power technology:

    — In February 2006, OPT was approved by the South West of England Regional Development Agency to install a 5MW demonstration wave power station off the coast of Cornwall, England.

Developments Since the End of Fiscal 2006

- In July 2006, OPT entered into its first commercial construction contract with affiliates of Iberdrola S.A. and Total S.A. and with two Spanish governmental agencies for the first phase of the construction of a 1.39 MW wave power station off the coast of Santona, Spain. OPT and affiliates of Iberdrola and Total are also assessing the viability of a 2 to 5 MW wave power station off the coast of France.

- In July 2006, OPT filed an application with the US Federal Energy Regulatory Commission for a permit to evaluate the feasibility of a location off the coast of Oregon for a 50 MW wave power station.

- In September 2006, OPT entered into a marketing cooperation agreement with Lockheed Martin to identify marketing opportunities for use of OPT's autonomous PowerBuoy system to power Lockheed Martin equipment in remote locations.

OPT continues to develop and commercialize its proprietary technology for the generation of electrical power by harnessing the renewable energy of ocean waves. OPT's PowerBuoy system is based on modular, ocean-going buoys, which have been ocean tested for nearly a decade and which are "intelligent" systems capable of responding to differing wave conditions. We are encouraged by our progress in expanding our market opportunities and in developing our core PowerBuoy technology, and believe that the Company's systems have the potential to provide cost competitive, clean electrical power on a large scale.

The alternative energy marketplace is expanding rapidly. Worldwide interest can be seen in the policies put forward by national and local governments, and in the focus of many utilities and energy-producing companies. OPT is well-positioned, from the standpoint of its technology and its marketing efforts, to take advantage of the accelerating movement to diversify the world's sources of energy.

Seymour S. Preston III Chairman	Dr. George W. Taylor Chief Executive Officer

Independent Auditors' Report

The Board of Directors
Ocean Power Technologies, Inc.:

We have audited the accompanying consolidated balance sheets of Ocean Power Technologies, Inc. and subsidiaries as of April 30, 2005 and 2006, and the related consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ocean Power Technologies, Inc. and subsidiaries as of April 30, 2005 and 2006, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As further discussed in Note 1 (b), the Company has restated its consolidated statement of cash flows for the year ended April 30, 2005.

/s/ **KPMG LLP**

October 30, 2006

Philadelphia, Pennsylvania
USA

OCEAN POWER TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	April 30, 2005	April 30, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 13,584,814	31,957,209
Certificates of deposit	25,202,362	482,156
Accounts receivable	668,424	—
Unbilled receivables	822,037	211,000
Other current assets	464,582	331,139
Total current assets	40,742,219	32,981,504
Property and equipment, net	427,613	544,285
Patents, net of accumulated amortization of $137,693 and $157,451, respectively	334,809	372,448
Other noncurrent assets	91,746	97,901
Total assets	$ 41,596,387	33,996,138
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 876,968	242,624
Accrued expenses	1,891,483	1,726,870
Unearned revenues	16,788	14,405
Other current liabilities	53,773	111,576
Total current liabilities	2,839,012	2,095,475
Long-term debt	245,844	233,959
Deferred credits	675,000	600,000
Total liabilities	3,759,856	2,929,434
Commitments and contingencies (note 13)		
Stockholders' equity:		
Preferred stock, $0.001 par value; authorized 5,000,000 shares; none issued or outstanding	—	—
Common stock, $0.001 par value; authorized 105,000,000 shares; issued and outstanding 51,512,953 and 51,711,941 shares as of April 30, 2005 and 2006, respectively	51,513	51,712
Additional paid-in capital	59,377,593	59,679,236
Accumulated deficit	(21,553,242)	(28,632,153)
Accumulated other comprehensive loss	(39,333)	(32,091)
Total stockholders' equity	37,836,531	31,066,704
Total liabilities and stockholders' equity	$ 41,596,387	33,996,138

See accompanying notes to consolidated financial statements.

OCEAN POWER TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

		Years ended April 30,	
		2005	**2006**
Revenues	$	5,365,235	1,747,715
Cost of revenues		5,170,521	2,059,318
Gross profit (loss)		194,714	(311,603)
Product development costs		904,618	4,224,997
Selling, general, and administrative costs		2,553,911	3,190,687
Operating loss		(3,263,815)	(7,727,287)
Interest income		1,297,156	1,408,361
Other income		1,545	74,294
Foreign exchange gain (loss)		1,507,145	(978,242)
Loss before income taxes		(457,969)	(7,222,874)
Income tax benefit		29,335	143,963
Net loss	$	(428,634)	(7,078,911)

See accompanying notes to consolidated financial statements.

OCEAN POWER TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity and Comprehensive Loss

	Common shares		Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive (loss) income	Stockholders' equity
	Shares	Amount				
Balance, April 30, 2004	51,165,758	$ 51,166	58,959,616	(21,124,608)	(32,928)	37,853,246
Net loss	—	—	—	(428,634)	—	(428,634)
Foreign currency translation adjustment	—	—	—	—	(6,405)	(6,405)
Total comprehensive loss						(435,039)
Compensation related to stock option grants issued to employees	—	—	131,500	—	—	131,500
Compensation related to stock option grants issued for services	—	—	53,174	—	—	53,174
Adjustment for shareholder reduction in shares held	(13,971)	(14)	14	—	—	—
Proceeds from exercise of stock options	361,166	361	233,289	—	—	233,650
Balance, April 30, 2005	51,512,953	51,513	59,377,593	(21,553,242)	(39,333)	37,836,531
Net loss	—	—	—	(7,078,911)	—	(7,078,911)
Foreign currency translation adjustment	—	—	—	—	7,242	7,242
Total comprehensive loss						(7,071,669)
Compensation related to stock option grants issued to employees	—	—	44,000	—	—	44,000
Compensation related to stock option grants issued for services	—	—	85,139	—	—	85,139
Shares issued for amounts received in prior years	27,322	27	49,973	—	—	50,000
Proceeds from exercise of stock options	171,666	172	122,531	—	—	122,703
Balance, April 30, 2006	51,711,941	$ 51,712	59,679,236	(28,632,153)	(32,091)	31,066,704

See accompanying notes to consolidated financial statements.

OCEAN POWER TECHNOLOGIES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Years ended April 30, 2005 (Restated)	Years ended April 30, 2006
Cash flows from operating activities:		
Net loss	$ (428,634)	(7,078,911)
Adjustments to reconcile net loss to net cash used in operating activities:		
Foreign exchange (gain) loss	(1,507,145)	978,242
Depreciation and amortization	140,984	233,132
Compensation expense related to stock option grants	184,674	129,139
Realization of deferred credits	—	(75,000)
Changes in operating assets and liabilities:		
Accounts receivable	(621,499)	668,424
Unbilled receivables	(268,216)	611,037
Other current assets	(239,274)	161,505
Accounts payable	404,491	(632,778)
Accrued expenses	708,022	(121,840)
Unearned revenues	(246,890)	(2,383)
Other current liabilities	—	57,803
Net cash used in operating activities	(1,873,487)	(5,071,630)
Cash flows from investing activities:		
Purchases of certificates of deposit	(58,050,287)	(62,677,400)
Maturities of certificates of deposit	33,573,254	87,397,606
Purchases of equipment	(435,488)	(330,047)
Payments of patent costs	(125,414)	(57,396)
Investments in joint ventures and other noncurrent assets	(78,399)	(30,747)
Net cash (used in) provided by investing activities	(25,116,334)	24,302,016
Cash flows from financing activities:		
Proceeds from exercise of stock options	233,650	122,703
Cash provided by financing activities	233,650	122,703
Effect of exchange rate changes on cash and cash equivalents	1,500,740	(980,694)
Net (decrease) increase in cash and cash equivalents	(25,255,431)	18,372,395
Cash and cash equivalents, beginning of year	38,840,245	13,584,814
Cash and cash equivalents, end of year	$ 13,584,814	31,957,209
Supplemental disclosure of noncash transactions:		
Issuance of shares in connection with amounts received in prior years	$ —	50,000

See accompanying notes to consolidated financial statements.

(1) Background

(a) Organization

Ocean Power Technologies, Inc. (the Company) was incorporated on April 19, 1984 in the State of New Jersey and commenced active operations in 1994. The Company develops and is commercializing proprietary systems that generate electricity by harnessing the renewable energy of ocean waves. The Company markets and sells its products in the United States and internationally.

(b) Restatement

The Company has restated its consolidated statement of cash flows for the year ended April 30, 2005 to correct the presentation in the statement of cash flows of the effect of exchange rate changes on cash balances held in foreign currencies. Pursuant to Statement of Financial Accounting Standards (SFAS) No. 95, *Statement of Cash Flows*, the statement of cash flows should report the effect of exchange rate changes on cash balances held in foreign currencies as a separate part of the reconciliation of the change in cash and cash equivalents during the period. Previously, the effect was included in the net cash used in operating activities. This matter had no impact on the consolidated balance sheet as of April 30, 2005 or the consolidated statements of operations or changes in stockholders' equity for the year then ended. The impact of this matter on the previously issued consolidated statement of cash flows for the year ended April 30, 2005 is as follows –

		As reported		Adjustment		As adjusted
Net cash used in operting activities	$	(366,342)	$	(1,507,145)	$	(1,873,487)
Effect of exchange rate changes on cash and cash equivalents	$	(6,405)	$	1,507,145	$	1,500,740

(2) Summary of Significant Accounting Policies

(a) Consolidation

During the year ended April 30, 2001, the Company established a wholly owned subsidiary based in Australia. In July 2001, the Company sold 11.76% of the subsidiary for approximately $1,020,000 in cash, less costs of approximately $56,000. During the year ended April 30, 2005, the Company established a wholly owned subsidiary based in the United Kingdom. The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions have been eliminated.

In addition, the Company evaluates its relationships with other entities to identify whether they are variable interest entities as defined by Financial Accounting Standards Board (FASB) Interpretation No. 46(R), *Consolidation of Variable Interest Entities* (FIN 46R), and to assess whether it is the primary beneficiary of such entities. If the determination is made that the Company is the primary beneficiary, then that entity is included in the consolidated financial statements in accordance with FIN 46R.

(b) Use of Estimates

The preparation of the consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include the recoverability of the carrying amount of property and equipment and patents; valuation allowances for receivables and deferred income tax assets; and percentage of completion of customer contracts for purposes of revenue recognition. Actual results could differ from those estimates.

(c) Revenue Recognition

The Company recognizes revenue on government and commercial contracts under the percentage-of-completion method. The percentage of completion is determined by relating the costs incurred to date to the estimated total costs. The cumulative effects resulting from revisions of estimated total contract costs and revenues are recorded in the period in which the facts requiring revision become known. Upon anticipating a loss on a contract, the Company recognizes the full amount of the anticipated loss in the current period. During the year ended April 30, 2005, the Company recorded a provision of $21,000 related to an anticipated loss on a contract. Reserves related to loss contracts in the amounts of approximately $806,000 and $785,000 are included in accrued expenses in the accompanying consolidated balance sheets as of April 30, 2005 and 2006, respectively.

Unbilled receivables represent expenditures on contracts, plus applicable profit, not yet billed. Unbilled receivables are normally billed and collected within one year. Billings made on contracts are recorded as a reduction of unbilled receivables, and to the extent that such billings exceed costs incurred plus applicable profit, they are recorded as unearned revenues.

(d) Cash Equivalents

Cash equivalents consist of investments in short-term financial instruments with maturities of three months or less from the date of purchase.

(e) Property and Equipment

Property and equipment is stated at cost, less accumulated depreciation and amortization. Depreciation and amortization is calculated using the straight-line method over the estimated useful lives (three to seven years) of the assets. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful life of the asset or the remaining lease term. Expenses for maintenance and repairs are charged to operations as incurred. Depreciation expense was approximately $112,000 and $213,000 for the years ended April 30, 2005 and 2006, respectively.

(f) Foreign Exchange Gains and Losses

The Company has invested in certain certificates of deposit and has maintained cash accounts that are denominated in British pound sterling, Euros, and Australian dollars. Such certificates of deposit and cash accounts had a balance of approximately $21,788,000 and $16,724,000 as of April 30, 2005 and 2006, respectively. Such positions may result in realized and unrealized foreign exchange gains or losses from exchange rate fluctuations, which are included in foreign exchange gain (loss) on the accompanying consolidated statements of operations.

(g) Patents

External costs related to the filing of patents, including legal and filing fees, are capitalized. Amortization is calculated using the straight-line method over the life of the patents (17 years). Expenses for the development of technology are charged to operations as incurred. Amortization expense was approximately $29,000 and $20,000 for the years ended April 30, 2005 and 2006, respectively. Amortization expense for the next five fiscal years related to amounts capitalized for patents as of April 30, 2006 is estimated to be approximately $20,000 per year.

(h) Other Assets

Other assets consist of deposits and an investment in a joint venture. The carrying value of the investment in the joint venture was approximately $53,000 and $52,000 as of April 30, 2005 and 2006, respectively. The Company evaluated the nature of the joint venture against the provisions of FIN 46R and determined that the joint venture does not need to be consolidated in the Company's consolidated financial statements.

(i) Long-Lived Assets

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets, such as property and equipment, and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated future cash flows, then an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheet. The Company reviewed its long-lived assets for impairment in accordance with SFAS No. 144 and determined that no impairment charge was necessary for the years ended April 30, 2005 or 2006.

(j) Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash balances, bank certificates of deposit, and trade receivables. The Company invests its excess cash in highly liquid investments (principally short-term bank deposits) and does not believe that it is exposed to any significant risks related to its cash accounts or certificates of deposit.

The table below shows the percentage of the Company's revenue derived from significant customers for the periods indicated:

Customer	Year Ended April 30 2005	Year Ended April 30 2006
US Navy	57%	61%
New Jersey Board of Public Utilities	7%	5%
Iberdrola and Total	4%	9%
Lockheed Martin	32%	22%
US Dept. of Interior for Dept. of Homeland Security	----	3%

The loss of, or a significant reduction in revenues from, any of these customers could significantly impact the Company's financial position or results of operations. The Company does not require collateral from its customers.

(k) Stock-Based Compensation

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25*, to account for its fixed-plan stock options. Under this method, compensation expense is recorded only if on the date of grant the market price of the underlying stock exceeded the exercise price. SFAS No. 123, *Accounting for Stock Based Compensation*, and SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure, an Amendment of SFAS No. 123*, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As permitted by existing accounting standards, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123, as amended. The following table illustrates the effect on net loss if the fair-value-based method had been applied to all outstanding and unvested awards in the years ended April 30, 2005 and 2006:

		2005	2006
Net loss, as reported	$	(428,634)	(7,078,911)
Add stock-based employee compensation expense included in reported net loss		131,500	44,000
Deduct total stock-based employee compensation expense determined under fair-value-based method for all awards		(1,367,000)	(680,000)
Pro forma net loss	$	(1,664,134)	(7,714,911)

In accordance with SFAS No. 123, as amended by SFAS No. 148, the fair value of option grants is estimated on the date of grant using the Black-Scholes option-pricing model for pro forma footnote purposes with the following weighted-average assumptions used for grants: dividend yield of 0%; risk-free interest rate of 4% and 4.9% in the years ended April 30, 2005 and 2006, respectively; the expected option life of 8.9 years and 9.3 years in the years ended April 30, 2005 and 2006, respectively; and volatility of 80.8% and 72% in the years ended April 30, 2005 and 2006, respectively.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which addresses the accounting for transactions in which an entity exchanges its equity instruments for goods or services, with a primary focus on transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123R is a revision to SFAS No. 123 and supersedes APB Opinion No. 25 and its related implementation guidance. SFAS No. 123R will require measurement of the cost of employee services received in exchange for stock compensation based on the grant-date fair value of the employee stock options. Incremental compensation costs arising from the subsequent modifications of awards after the grant date will also be recognized. The Company will adopt SFAS No. 123R on May 1, 2006 under the modified prospective method of application. Under that method, the Company will recognize compensation costs for new grants of share-based awards and awards modified, repurchased or cancelled after the adoption date. Additionally, compensation cost for the portion of the awards for which the requisite service had not been rendered that were outstanding as of May 1, 2006 will be recognized in the consolidated statement of operations over the remaining service period after such date based on the award's original estimate of value.

(l) Accounting for Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(m) Accumulated Other Comprehensive Loss

The functional currency for the Company's foreign operations is the applicable local currency. The translation from the applicable foreign currencies to U.S. dollars is performed for balance sheet accounts using the exchange rates in effect at the balance sheet date and for revenue and expense accounts using an average exchange rate during the period. The unrealized gains or losses resulting from such translation are included in accumulated other comprehensive loss within stockholders' equity.

(n) Recent Accounting Pronouncements

In June 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, which requires entities that voluntarily make a change in accounting principle to apply that change retrospectively to prior periods' financial statements, unless this would be impracticable. SFAS No. 154 supersedes APB Opinion No. 20, *Accounting Changes*, which previously required that most voluntary changes in accounting principles be recognized by including the cumulative effect of changing to the new accounting principle in the current period's net income or loss. SFAS No. 154 also makes a distinction between "retrospective application" of an accounting principle and the "restatement" of financial statements to reflect the correction of an error. Another significant change in practice under SFAS No. 154 will be that if an entity changes its method of depreciation, amortization, or depletion of long-lived, nonfinancial assets, the change must be accounted for as a change in accounting estimate. Under APB Opinion No. 20, such a change would have been reported as a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Adoption is not expected to have a material effect on the Company's financial position or results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition and measurement method for tax positions taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently analyzing the effects of FIN 48, but does not expect FIN 48 to have a material effect on its financial position or results of operations.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, or SAB 108. SAB 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB 108 becomes effective during the Company's 2007 fiscal year. The Company does not expect the adoption of SAB 108 to have a material impact on its consolidated financial statements.

(o) Reclassifications

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year presentation.

(3) Certificates of Deposit

Certificates of deposit with maturities in excess of 90 days from purchase are summarized as follows:

	April 30	
	2005	**2006**
4.75% due May 26, 2005	$ 11,194,039	—
2.08% due July 11, 2005	469,789	—
2.90% due July 18, 2005	8,038,548	—
4.73% due July 18, 2005	5,499,986	—
3.92% due August 11, 2006	—	482,156
	$ 25,202,362	482,156

(4) Property and Equipment

The components of property and equipment are as follows:

	April 30	
	2005	**2006**
Computers and software	$ 260,698	402,037
Equipment	335,238	452,448
Office furniture and equipment	206,766	233,178
Leasehold improvements	39,358	59,358
	842,060	1,147,021
Less accumulated depreciation	(414,447)	(602,736)
	$ 427,613	544,285

(5) Accrued Expenses

Included in accrued expenses at April 30, 2005 and 2006 were contract reserves of approximately $806,000, and $785,000, respectively, accrued bonuses of approximately $308,000 and $353,000, respectively, and accrued vacation expense of approximately $71,000 and $84,000, respectively.

(6) Related-Party Transactions

The Company is obligated to pay royalties to G.W. Taylor, a founding stockholder of the Company; M.Y. Epstein; and the estate of J.R. Burns (stockholders of the Company) related to U.S. patent 4404490 entitled, “Power Generation from Waves Near the Surface of Bodies of Water.” Royalty payments are limited to $925,000 in the aggregate, based on revenues related to certain piezoelectric-technology, if any, on the basis of 6% of future licenses sold and 4% of future product sales and development contracts. Through April 30, 2006, approximately $200,000 of royalties had been earned. During the years ended

April 30, 2005 and 2006, no royalties were earned pursuant to these agreements, and no future royalties are expected to be earned. As of April 30, 2005 and 2006, approximately $26,000 was included in other current liabilities related to these agreements.

In August 1999, the Company entered into a consulting agreement with an individual for marketing services at a rate of $600 per day of services provided. The individual became a member of the board of directors in June 2006. The Company expensed approximately $51,000 and $53,000 during the years ended April 30, 2005 and 2006, respectively, under this consulting agreement.

Also see note 8 for an additional related-party transaction.

(7) Debt

In the year ended April 30, 2000, the Company received an award of $250,000 from the State of New Jersey Commission on Science and Technology for the development of a wave power system that was deployed off the coast of New Jersey. Under the terms of this award, the Company must repay the amount funded, without interest, by January 15, 2012. The amounts to be repaid each year are determined as a percentage of revenues, as defined in the loan agreement, which the Company receives that year from its customer contracts that meet criteria specified in the loan agreement, with any remaining amount due on January 15, 2012. Based upon the terms of the award, the Company has repaid approximately $4,000 and is required to repay an additional approximately $12,000 as of April 30, 2006. The total repayment amount of approximately $16,000 reduced the long-term debt balance, and the current payment required was recorded in accrued expenses in the accompanying consolidated balance sheet as of April 30, 2006.

(8) Deferred Credits

During the year ended April 30, 2003, the Company entered into an agreement under which the Company received a payment of $75,000, which was included in deferred credits until the earning process was completed. During the year ended April 30, 2006, the earning process was completed and the nonrefundable payment of $75,000 has been included in other income in the accompanying consolidated statement of operations for the year ended April 30, 2006.

During the year ended April 30, 2001, in connection with the sale of common stock to an investor, the Company received $600,000 from the investor in exchange for an option to purchase up to 500,000 metric tons of carbon emissions credits generated by the Company during the years 2008 through 2012, at a 30% discount from the then-prevailing market rate. This amount has been recorded in deferred credits in the accompanying consolidated balance sheets as of April 30, 2005 and 2006. If, by December 31, 2012, the Company does not become entitled under applicable laws to the full amount of emission credits covered by the option, the Company is obligated to return the option fee of $600,000, less the aggregate discount on any emission credits sold to the investor prior to such date. If the Company receives emission credits under applicable laws and fails to sell to the investor the credits up to the full amount of emission credits covered by the option, the investor is entitled to liquidated damages equal to 30% of the aggregate market value of the shortfall in emission credits (subject to a limit on the market price of emission credits).

(9) Common Stock

During the year ended April 30, 2003, the Company sold 37,500 shares of common stock to an investor at a price of $1.33 per share, which was subject to adjustment based on the pricing of future financings, if any, during calendar year 2003. Based on the price at which the Company's common shares were sold at the time of its offering on the London Stock Exchange, this adjustment, in the form of a reduction of 13,971 shares issued, was resolved and recorded in the year ended April 30, 2005.

During the year ended April 30, 1998, under an agreement with a group of investors, the Company received $50,000 as an advance payment related to a potential future transaction, which was recorded in accrued expenses. During the year ended April 30, 2006, the Company repaid this amount by issuing 27,322 shares of common stock, in accordance with the terms of the agreement.

(10) Preferred Stock

In September 2003, and in connection with the Company's offering on the London Stock Exchange, the Company's stockholders authorized 5,000,000 shares of undesignated preferred stock with a par value of $0.001 per share. At April 30, 2005 and 2006, no shares of preferred stock had been issued.

(11) Stock Options

Prior to August 2001, the Company maintained qualified and nonqualified stock option plans. The Company has reserved 5,101,550 shares of common stock for issuance under these plans. There are no options available for future grant under these plans as of April 30, 2006.

In August 2001, the Company approved the 2001 Stock Plan, which provides for the grant of incentive stock options and nonqualified stock options. A total of 10,000,000 shares are authorized for issuance under the 2001 Stock Plan. As of April 30, 2006, the Company had issued 6,948,807 shares and had 3,051,193 shares of common stock reserved for issuance under the 2001 Stock Plan. Members of the board of directors, who are not full-time employees, receive an annual option grant to acquire 25,000 shares. The options are granted after the annual meeting of shareholders for the year then ended. Vesting of stock options is determined by the board of directors.

Transactions under these option plans are as follows:

	Shares under option	Weighted average exercise price	Weighted average fair value
Outstanding April 30, 2004 (exercisable 8,809,941)	10,325,035	$ 1.39	
Forfeited	(464,242)	1.50	
Exercised	(361,166)	0.65	
Granted	1,663,250	1.65	$ 1.39
Outstanding April 30, 2005 (exercisable 9,321,380)	11,162,877	1.45	
Forfeited	(740,604)	1.68	
Exercised	(171,666)	0.71	
Granted	1,799,750	1.29	1.02
Outstanding April 30, 2006 (exercisable 9,883,626)	12,050,357	1.42	

The following table summarizes information about stock options outstanding at April 30, 2006:

Range of exercise prices	Number outstanding at April 30, 2006	Weighted average remaining life	Weighted average exercise price	Number exercisable at April 30, 2006	Weighted average exercise price
$0.27 to $0.77	3,213,345	4.3	$ 0.69	3,115,803	$ 0.69
$0.85 to $1.67	3,271,647	6.5	1.33	1,801,533	1.39
$1.70 to $2.24	5,565,365	5.1	1.89	4,966,290	1.90
	12,050,357			9,883,626	

Certain stock options granted during the years ended April 30, 2005 and 2006 were granted to employees with exercise prices less than the fair value of the underlying common stock on the date of grant. Additionally, certain options were granted to consultants. The Company has charged compensation expense of $180,674 and $129,139 related to these option grants, which has been included in selling, general, and administrative costs in the accompanying consolidated statements of operations for the years ended April 30, 2005 and 2006, respectively.

Subsequent to April 30, 2006, the Company issued options to purchase 1,849,000 shares of common stock at an exercise price of $1.38.

(12) Income Taxes

The tax effects of temporary differences that give rise to significant portions of the Company's deferred tax assets and deferred tax liabilities are presented below.

	April 30	
	2005	**2006**
Deferred tax assets:		
Federal net operating loss carryforwards	4,588,000	6,638,000
Foreign net operating loss carryforwards	915,000	1,210,000
Research and development tax credits	295,000	505,000
Stock compensation	1,426,000	1,478,000
Unrealized foreign exchange loss	103,000	----
Accrued expenses	322,000	314,000
Gross deferred tax assets	7,649,000	10,145,000
Deferred Tax Liabilities:		
Property and equipment	(31,000)	(31,000)
Unrealized foreign exchange gain	---	(60,000)
Gross deferred tax liabilities	(31,000	(91,000)
Deferred tax assets valuation allowance	(7,618,000)	(10,054,000)
Net deferred tax assets	----	----

Income tax benefit was $29,335 and $143,963 for the years ended April 30, 2005 and 2006, respectively. The effective income tax rate differed from the percentages computed by applying the U.S. Federal income tax rate of 34% to loss before income taxes as a result of the following:

	April 30	
	2005	**2006**
Computed "expected" tax benefit	(34)%	(34)%
Increase (reduction) in income taxes resulting from:		
State income taxes, net of federal benefit	(6)%	(6)%
Federal research and development tax credits	(6)%	(2)%
Sale of state loss carryforwards and tax credits	(6)%	(2)%
Non-deductible expense	9%	1%
Increase in valuation allowance	37%	41%
	(6)%	(2)%

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. As of April 30, 2005 and 2006, based upon the level of historical taxable losses, valuation allowances of $7,618,000 and $10,054,000, respectively, were recorded in accordance with the provisions of SFAS No. 109.

As of April 30, 2006, the Company had net operating loss carryforwards for federal income tax purposes of approximately $19,500,000, which begin to expire in 2009. The Company also had federal research and development credit carryforwards of approximately $505,000, which begin to expire in 2012. The Tax Reform Act of 1986 contains provisions that limit the utilization of net operating loss and tax credit carryforwards if there has been an ownership change, as defined. Such an ownership change, as described in Section 382 of the Internal Revenue Code, may limit the Company's ability to utilize its net operating loss and tax credit carryforwards on a yearly basis. As of April 30, 2006, foreign net operating loss carryforwards were approximately $4,000,000. These losses can be carried forward indefinitely, but the Company's ability to utilize these carryforwards may be limited in the event of an ownership change.

During the years ended April 30, 2005 and 2006, the Company sold a portion of its New Jersey state net operating loss carryforwards and research and development credits to a company for net proceeds of approximately $29,000 and $144,000, respectively, resulting in the recognition of income tax benefits in the accompanying consolidated statements of operations.

(13) Commitments and Contingencies

(a) Operating Lease Commitments

The Company leases office, laboratory, and manufacturing space in Pennington, New Jersey, and office space in Warwick, United Kingdom, under operating leases that expire on various dates through 2013. Rent expense under operating leases was $154,731 and $295,089 for the years ended April 30, 2005 and 2006, respectively. Future minimum lease payments under operating leases as of April 30, 2006 are:

Year ending April 30:		
2007	$	233,094
2008		228,722
2009		206,859
2010		206,859
2011		206,859
Thereafter		413,719
	$	1,496,112

(b) Litigation

The Company is involved from time to time in certain legal actions arising in the ordinary course of business. Management believes that the outcome of such actions will not have a material adverse effect on the Company's financial position or results of operations.

COMPANY INFORMATION

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Charles F. Dunleavy	Chief Financial Officer
Thomas J. Meaney	Non-executive Director
Seymour S. Preston III	Non-executive Chairman
Dr. George W. Taylor	Chief Executive Officer

Company Secretary

Charles F. Dunleavy

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Share Price Information

The Company's share price is quoted on the London Stock Exchange, AIM market under the symbol OPT. Go to www.londonstockexchange.com to access Company share price information, as well as publicly released information on the Regulatory News Service (RNS).

Website address

www.oceanpowertechnologies.com