Ocean Power Technologies, Inc.
Form 424B4
October 14, 2016

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Registration No. 333-213519

PROSPECTUS

2,400,000 Shares of Common Stock

This prospectus relates to the offer and sale of 2,400,000 shares of common stock of Ocean Power Technologies, Inc.

Our common stock is quoted on the NASDAQ Capital Market under the symbol "OPTT." The last reported sale price of our common stock on October 13, 2016 was $4.02 per share.

Investing in our securities involves significant risks that are described in the "Risk Factors" section beginning on page 8 of this prospectus.

	Price to Public	Underwriting Discounts	Proceeds to us

		and Commissions (1)	
Per Share	$2.75	$0.165	$2.585
Total	$6,600,000	$ 396,000	$ 6,204,000

(1) We have also agreed to reimburse the underwriters for certain of their expenses. We refer you to ''Underwriting'' beginning on page 50 for additional information regarding total underwriting compensation.

The underwriters may also purchase up to an additional 360,000 shares of common stock from us at the public offering price above, less the underwriting discounts and commissions, within 30 days of the date of this prospectus to cover any over-allotments.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares of common stock to purchasers on or before October 19, 2016.

The date of this prospectus is October 14, 2016.

Roth Capital Partners Maxim Group LLC

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ABOUT THIS PROSPECTUS

You should rely only on the information contained in or incorporated by reference into this prospectus. We have not authorized anyone to provide you with additional or different information. We are offering to sell, and seeking offers to buy, shares of common stock only in jurisdictions where offers and sales are permitted.

This prospectus contains forward-looking statements that are subject to a number of risks and uncertainties, many of which are beyond our control. Please read "Risk Factors" and "Cautionary Note Regarding Forward-Looking Statements."

Certain industry and market data presented in this prospectus has been derived from data included in various industry publications, surveys and forecasts. We have assumed the correctness and truthfulness of such data, including projections and estimates, when we use them in this prospectus.

PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in or incorporated by reference into this prospectus. Because this summary provides only a brief overview of the key aspects of the offering, it does not contain all of the information that you should consider before investing in our common stock. You should read the entire prospectus carefully, including "Risk Factors" beginning on page 8, "Cautionary Note Regarding Forward-Looking Statements" beginning on page 27 and the documents incorporated by reference, which are described under "Incorporation of Certain Information by Reference," before making an investment decision. As used in this prospectus, unless otherwise indicated, "we," "our," "us," "Company" or similar terms refer collectively to Ocean Power Technologies, Inc. and its operating subsidiaries.

Overview

Nearly 70% of the earth's surface is covered by water, with over 40% of the world's population living within approximately 150 miles of a coast. Thousands of information gathering and/or power systems are deployed in the oceans today to increase understanding of weather, climate change, biological processes, and marine mammal patterns and to support exploration and operations for industries such as oil and gas. Most of these systems are powered by battery, solar, wind, fuel cell, or fossil fuel generators that are expensive to operate while also limited in their electric power delivery. These incumbent systems often require significant tradeoffs in sensor accuracy, data processing and communications bandwidth and frequency in order to operate with available power. More persistent power systems requiring less maintenance, like our systems, may have the ability to save costs over current operating systems. Just as importantly, increases in available power may allow for better sensors and shorter data sampling and communication intervals up to real-time which could as a result improve scientific and economic returns.

Founded in 1994 and headquartered in Pennington, New Jersey, we believe we are the leader in ocean wave power. We are developing and seeking to commercialize our proprietary systems that generate electricity by harnessing the renewable energy of ocean waves. Our PowerBuoys® use proprietary technologies that convert the mechanical energy created by the heaving motion of ocean waves into electricity. We currently have designed and continue to develop our PowerBuoy product line which is based on modular, ocean-going buoys, which we have been periodically ocean testing since 1997.

We have designed our autonomous PowerBuoy to generate power for use in remote locations, independent of an existing power grid. Our current PowerBuoy product, the PB3, incorporates a unique power take-off ("PTO") and onboard system for energy storage and management, and is significantly smaller than our previous iteration utility-scale PowerBuoy. The PowerBuoy provides up to 3 kilowatts (kW) of peak power and 300 watts of continuous average power, which is deployment site dependent whereby average power can increase substantially in higher energy sites. Our standard energy storage system (“ESS”) has an energy capacity of 44 kilowatt hours (kWh), scalable up to 150 kWh to meet specific application requirements. We are continuing to develop and test our PowerBuoys, including incremental scale up in power production. We believe there is a substantial addressable market for the current capabilities of our PB3 model, which we believe could be utilized in a variety of applications.

Our PB3 PowerBuoy design leverages portions of earlier features that we do not believe require further validation prior to implementation in our current products. Currently, our product development and engineering efforts are focusing primarily on developing technologies that will increase the energy output and reliability of our product through design scalability to meet and to maintain quality and speed time to our targeted markets. Our marketing and development efforts are targeting applications that require reliable, persistent, and sustainable power sources operating independently of the utility grid, either by supplying electric power to payloads that are integrated directly in our PowerBuoy or located in its vicinity, including on the seabed.

Based on our market research and available public data, management believes that there is the potential for us to pursue business opportunities in multiple markets that would have a direct need for our PowerBuoys including oil and gas, ocean observing, defense and security, communications, and offshore wind. Depending on power needs, sensor types and other considerations, we believe our PowerBuoy could have the ability to satisfy several application requirements within these markets. We believe that the PB3 generates sufficient persistent power to meet the application needs of many of the potential customers within our target markets. We are continuing our development efforts to increase the energy output of the PowerBuoy to generate more power required for other applications within these markets.

Since fiscal 2002, government agencies have accounted for a significant portion of our revenues. These revenues were largely for the support of our development efforts relating to our technology and development of our PowerBuoys. Our goal is that an increased portion of our revenues be from the sale or lease of our products and sales of services, as compared to revenue from grants to support our business operations. As we continue to develop and commercialize our products, we expect to have a net loss of cash from operating activities unless and until we achieve positive cash flow from the commercialization of our products and services. During fiscal 2015 and 2016, we continued work on projects with the U.S. Department of Energy (“DOE”), and Mitsui Engineering and Shipbuilding Co., Ltd. (“MES”), with whom we signed our first commercial leasing agreement in May 2016, and we continued our efforts to increase the reliability and power output of our PowerBuoys.

Competitive Advantages

We are currently seeking to commercialize our PowerBuoy by targeting customers principally in five markets (as discussed in further detail below) that require reliable, persistent, and sustainable power sources operating independently of the utility grid. We believe that our technology for generating electricity from wave energy and our commercial relationships may offer the following potential competitive advantages in the markets we are targeting for commercial sales and leases of our PowerBuoy and related products and services.

Ocean-tested technology to generate electricity. We have conducted a number of ocean tests of our PowerBuoy since 1997 seeking to validate and demonstrate the viability of our technology, including several ocean trials of our larger scale prototype PowerBuoys. We have also conducted multiple ocean tests of our autonomous PowerBuoy, initially through a previous iteration of our current autonomous PowerBuoy under a contract with the U.S. Navy in 2011. Our PowerBuoy structure is designed to be durable and has survived hurricanes and winter storms while deployed in the ocean.

Efficient design in harnessing wave energy. We have designed our PowerBuoy to optimize the power generated for average ocean wave conditions through efficient mechanical to electrical wave energy conversion. We have designed the onboard ESS to provide several days of continuous rated power during low or no wave periods. Our PowerBuoy is equipped with a variety of communication capabilities including satellite, cellular, and Wi-Fi that transmits data in real time, subject to the limits of the carrier or service provider that is collected by its various payloads (e.g., sensors or equipment that require power and communications capabilities).

Numerous applications within multiple, major market segments. We have designed our PowerBuoy systems to work in multiple offshore applications around the world. In particular, we are targeting our marketing to customers with applications in the oil and gas, ocean observing, defense and security, offshore wind and communications.

Prior commercial relationships enabled the development of our technology. Our prior and existing relationships with the U.S. Navy, DOE, U.S. Department of Homeland Security, and MES have allowed us to develop our PowerBuoys for a variety of needs in various industries. We believe these relationships have helped position us within the industry in support of commercialization, which we believe enhances our market visibility and attractiveness to our prospective customers. For example, our PowerBuoy provided persistent power to an integrated radar and sonar system, signficantly extending the U.S. Navy’s surveillance. We have also demonstrated persistent maritime vessel detection with the U.S. Department of Homeland Security by integrating a hydrophone onto our PowerBuoy and demonstrating enhanced maritime traffic detection. In each instance, resulting critical data have informed our next design iterations to address critical operations and reliability improvements.

Greater and more persitent power compared to certain existing, incumbent solutions. We believe that our PowerBuoy may provide more power than certain existing battery, solar, and other powered systems. This added power could enable additional sensors to be employed at the application site, or allow for a higher rate of sensor data transmission. We also believe that greater and more persistent power could extend the application's operating period.

Potentially considerable life cycle cost savings over incumbent solutions. Our PowerBuoys are designed to operate over extended intervals between required servicing as compared to battery-powered systems which we believe generally require more frequent recharging or replacement. We have developed several case studies around ocean observing applications which illustrate that our PowerBuoy system may reduce costs over multi-year operation of an application as compared with incumbent solutions. These cost reductions are mostly due to lower vessel and personnel servicing costs associated with the retrieval and redeployment of current battery-powered solutions.

Modular and scalable designs. Our PowerBuoy systems are designed with a modular ESS which will allow us to tailor the PowerBuoy configuration to specific application requirements, including expansion of energy storage capacity. We believe that our PowerBuoys are scalable to higher power levels, and may also be installed in an array in order to achieve higher levels of aggregate power generation, although we have not demonstrated a PowerBuoy array to date.

Real-time data communications. Some incumbent solutions with less available power than our PowerBuoy may have limited communication capabilities or may be able to communicate data only over shorter periods due to power limitations. Some incumbent solutions may only make data accessible upon physical retrieval of the sensor. Our PowerBuoys can be equipped with a variety of communications equipment which enables the transmission of data on a more frequent basis as compared to incumbent solutions. We believe that more frequent data communication could enable an end-user to more quickly and proactively make data-driven decisions which could result in economic advantages.

Flexible electrical, mechanical and communication interfaces for sensors. Our PowerBuoys can be equipped with sensor packages, either mounted on or within the PowerBuoy, or tethered to the PowerBuoy. Our PowerBuoys have mechanical and electrical interfaces which may allow for simplified integration of sensors, creating flexibility for the end user.

Standard transportation and deployment. Our PowerBuoy is designed for transportation and handling using conventional means that are readily available and used in standard marine operations. Our PowerBuoy can be packaged inside of a standard 40 foot shipping container which may result in lower transportation and deployment costs than incumbent solutions. Our autonomous PowerBuoy can be transported and deployed using conventional vessels, and can be lifted using conventional marine cranes.

Environmentally benign and aesthetically non-intrusive system design. We believe that our PowerBuoy does not present significant risks to marine life, or emit significant levels of pollutants, and therefore has minimal environmental impact. We believe there is no significant audible impact and such systems have not been shown to have a negative effect on marine life as validated by the US Navy and DOE.

Business Strategy

As part of our strategic pivot toward smaller scale autonomous, remote offshore power, we are currently focused on developing and commercializing our PowerBuoy products and services for use in autonomous power applications. Generally, these applications are independent of the power grid and are situated in remote offshore locations. We have incorporated our prior knowledge and best practices into our product design and validation processes, some of which were gained during the development of utility-scale buoys. Based on market research and available public data, we believe considerable business opportunity could exist in markets which require autonomous offshore power.

Our business strategy is to commercialize our autonomous PowerBuoy systems. In order to achieve this goal, we are pursuing the following business objectives:

Sell and/or Lease PowerBuoys. We believe our autonomous PowerBuoy is well suited for many remote offshore applications. Within our selected markets we intend to sell or lease PowerBuoys, and provide services associated with product sales or leases such as maintenance, application engineering, planning, training, and logistics support required for the PowerBuoy life-cycle.

Concentrate sales and marketing efforts in specific geographic markets. We are currently focusing our sales and marketing efforts in North America, Europe, Australia, and parts of Asia, including Japan. We believe that each of these areas has appropriate wave conditions, political and economic stability, sizeable end market opportunities, and high levels of industrialization and economic development.

Expand our relationships in key market areas. We believe that an important element of our business strategy is to collaborate with other organizations to leverage our combined expertise, market presence and access, and core competences across key markets. We have formed such a relationship with several well-known groups, including MES in Japan, the National Data Buoy Center ("NDBC"), the Wildlife Conservation Society ("WCS"), and Gardline Environmental (an international and multi-disciplinary marine service company at the forefront of marine management with offices on five continents) We continue to seek other opportunities to collaborate with application experts from within our selected markets.

Outsource most of the equipment fabrication and deployment. We outsource all fabrication, anchoring, mooring, cabling supply, and, in most cases, deployment, of our PowerBuoy in order to minimize our capital requirements as we scale our business. However, our PTO is a proprietary subsystem and is assembled and tested at our facility. We believe this distributed manufacturing and assembly approach enables us to focus on our value-adding core competencies while also enabling the cost effectiveness of our PowerBuoy through leveraging a larger more qualified supply base.

Continue to increase PowerBuoy output. Our product development and engineering efforts are focused on increasing the energy output, reliability, and expected operating life of our PowerBuoys, as well as optimizing manufacturability of our designs with a focus on cost competitiveness. We believe that by increasing the energy output we will be able to address larger segments of our target markets.

Market Opportunity

The National Oceanographic and Atmospheric Administration ("NOAA") Ocean Enterprise Report for 2016 estimated that the annual market for what NOAA describes as the "Ocean Enterprise" is $7 billion. The report addressed businesses involved in the for-profit and not-for-profit businesses that support ocean measurement, observation and forecasting. Among the market sectors included in the report are oil and gas, ocean observing and security and defense sectors.

Oil and Gas

We believe the oil and gas industry is undergoing a significant transformation. In light of industry consolidation due to relatively low oil prices, the industry continues to invest in new technologies that enable cost savings as well as the digitization of operations. The industry encompasses more than 10,000 sites, including exploration, production, reservoir management, and sites pending decommissioning based on information from the U.S. Bureau of Safety and Environmental Enforcement and industry organizations and publications. We believe that opportunities exist at a large number of these sites to provide power in applications that are not currently possible, or to displace incumbent power solutions.

Ocean Observing

Ocean observing provides information for the entire ocean enterprise, which supports ocean measurement, observation and forecasting, and is an important provider of information to maritime commerce and the entire “blue economy”. Maritime commerce and the scientific community depend on information about areas such as weather, climate change, ocean seismometry, meteorology, and biological processes in order to inform operations and development and often require a power and communications solution in remote offshore locations. According to the NOAA’s 2016 Ocean Enterprise report, the total U.S. available market over the five years beginning 2017 for ocean based systems infrastructure is $2.0 billion. Annual 2014 revenues for this sector were projected to be $287 million.

Security and Defense

We believe that a PowerBuoy can be used to provide power and communications for multiple applications, based on our current design which allows for multiple payloads to be integrated with or supported by the PowerBuoy. This may be an attractive feature for defense and security, as their systems can hide in plain sight or be easily integrated into other PowerBuoy applications. Example applications for domestic and international defense departments and defense contractors include forward deployed energy and communications outposts, above and below sea surface, early detection and warning systems, remote sensing stations, high frequency radar, sonar, electro-optical and infrared sensors for maritime security, network communications systems, and unmanned underwater vehicle docking stations. According to a 2014 Frost and Sullivan report, market expenditures for global security reached $29 billion in 2012 and are projected to reach $56.5 billion in 2022. Maritime security expenditures were approximately 45% of the market.

Other Markets

We believe that opportunities also exist in markets such as communications and offshore wind.

With regard to communications, the addition of nearshore and offshore cellular and WiFi platforms with persistent power could decrease communications costs for the marine and airline industries. As an example, according to a 2015 Frost & Sullivan Oil & Gas Satellite Communications market report, the estimated 2020 annual spend on satellite communications in this market projected at $459 million.

We also believe that opportunities also exist in the offshore wind market. There are approximately 9 GW of offshore wind installed worldwide as of the first quarter of 2015 according to an U.S. National Renewable Energy Laboratory ("NREL") 2014 - 2015 Offshore Wind Technologies Market report. This cumulative capacity is projected to increase to nearly 45 GW of installed capacity for projects with an announced Commercial Operations Date ("COD") through 2020. The NREL report projected a cumulative pipeline of nearly 250 GW for all projects, including those in the planning or early stages. For offshore wind applications, the PowerBuoy could be equipped with a Light Detection and Ranging system to provide wind data for application in this market, after validation of the integrated system.

Recent Developments

On July 27, 2016, we completed a best efforts public offering of 595,000 units, with each unit consisting of one share of common stock and 0.3 of a warrant to purchase one share of our common stock. Each unit was sold at a combined purchase price of $6.75 per unit. The warrants were immediately exercisable at a price of $9.36 per full share of common stock and are exercisable for a period of five years from the initial exercise date. In the offering, we issued a total of 595,000 shares of its common stock and warrants to purchase up to 178,500 shares of its common stock. We received net proceeds of approximately $3.6 million from the offering which we intend to use for general corporate purposes such as sales and marketing of our PowerBuoys, and which may also include additional development, testing and demonstrations of our PowerBuoy system.

Corporate Information

Our principal executive offices are located at 1590 Reed Road, Pennington, New Jersey 08534, and our telephone number is (609) 730-0400. We were incorporated in New Jersey in 1984 and reincorporated in Delaware in 2007. We maintain a website at www.oceanpowertechnologies.com where general information about us is available. We are not incorporating the contents of the website into this prospectus.

The Offering

Common stock offered by us	2,400,000 shares, or 2,760,000 shares if the underwriters exercise their option to purchase additional shares of our common stock in full.
Issue price	$2.75 per share.
Common stock outstanding immediately after this offering	5,529,992 shares, or 5,889,992 shares if the underwriters exercise their option to purchase additional shares of our common stock in full
Use of proceeds	We estimate that our net proceeds from this offering will be approximately $6.0 million after deducting underwriting discounts and commissions and estimated offering expenses, or approximately $6.9 million if the underwriters' option to purchase additional shares is exercised in full.
	We intend to use the net proceeds from this offering for general corporate purposes, which may include additional development, testing and demonstrations of our PowerBuoy system with the goal of furthering and accelerating our commercialization efforts and expanding our sales and marketing functions. Accordingly, we will retain broad discretion over how the net proceeds are used. For more, see "Use of Proceeds".
Dividend policy	We have not declared or paid any cash or other dividends on our common stock, and do not expect to declare or pay any cash or other dividends on our common stock in the foreseeable future.
Risk factors	You should consider carefully the risks discussed under the "Risk Factors" beginning on page 8 of this prospectus, as well as those described in our Annual Report on Form 10-K for the year ended April 30, 2016, as amended, and our Quarterly Report on Form 10-Q for the quarter ended July 31, 2016 and the other disclosures contained or incorporated by reference herein and therein.
NASDAQ Capital Market symbol	OPTT

The number of shares of common stock to be outstanding after this offering is based on 3,129,992 shares outstanding as of October 13, 2016 and excludes (i) options outstanding as of that date representing the right to purchase a total of 160,872 shares of common stock at a weighted average exercise price of approximately $23.78 per share, (ii) 380,000 shares of common stock that may be issued in the future pursuant to a settlement agreement of certain pending securities litigation, which is subject to court approval and other requirements, (iii) outstanding warrants to purchase up to 145,952 shares of our common stock that will first become exercisable beginning on December 8, 2016 at a price of $6.08, and (iv) outstanding warrants to purchase up to 178,500 shares of our common stock which are currently exercisable at a price of $9.36.

Unless otherwise indicated, all information in this prospectus give effect to the 1-for-10 reverse stock split of the common stock that went into effect on October 27, 2015.

RISK FACTORS

Investing in our common stock involves substantial risk. You should carefully consider the risk factors disclosed below as well as those contained in our most recent Annual Report on Form 10-K, as amended, which is incorporated by reference herein, as updated by our subsequent filings under the Exchange Act and the other information contained in this prospectus before acquiring any of our common stock. These risks could have a material adverse effect on our business, results of operations or financial condition and cause the value of our common stock to decline. You could lose all or part of your investment.

This prospectus also contain or incorporate by reference forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of certain factors, including the risks faced by us described or incorporated by reference in this prospectus. See "Cautionary Statement Regarding Forward-Looking Information."

Risks Related to Growth of our Business

We depend on a limited number of customers for substantially all of our revenues. The loss of, or a significant reduction in revenues from, any of these customers could significantly reduce our revenues and harm our operating results.

Historically, a small number of customers have provided substantially all of our revenues, and these revenues have been generated under development and cost reimbursement agreements rather than commercial contracts. The European Union ("E.U.") accounted for 58%, the DOE accounted for 28% and MES accounted for 14% of our revenues during fiscal 2016. In fiscal 2015, revenues from the E.U. accounted for 23%, revenues from the DOE accounted for 37% and revenues from MES accounted for 40% of our total revenues. Our existing contracts with the DOE were completed in fiscal 2016. In order to receive future funding from the DOE, we would be required to enter into additional contracts with the DOE, which would require appropriation by the U.S. Congress. Additional funding for projects may not be approved or we may not be able to negotiate future agreements on acceptable terms, if at all.

Generally, we recognize revenue using the percentage-of-completion method based on the ratio of costs incurred to total estimated costs at completion. In certain circumstances, revenue under contracts that have specified milestones or other performance criteria may be recognized only when our customer acknowledges that such criteria have been satisfied. In addition, recognition of revenue (and the related costs) may be deferred for fixed-price contracts until contract completion if we are unable to reasonably estimate the total costs of the project prior to completion. Because we currently have a small number of customers and contracts, problems with a single contract would adversely affect our business, financial condition and results of operations.

We currently only have one revenue producing contract, which is our agreement with MES. Historically, we have relied on a small group of customers for substantially all of our revenue, and we expect that such concentration will continue for the foreseeable future. A customer's payment default, or the loss of a customer as a result of competition, creditworthiness, our failure to perform, our inability to negotiate extensions or replacements of contracts, or otherwise, would adversely affect our business, financial condition and results of operations. We cannot assure you that we will be successful in our efforts to secure additional commercial customers, or additional revenue-generating contracts.

Wave energy technology may not gain broad commercial acceptance and, therefore, our revenues may not increase and we may be unable to achieve and, even if achieved, sustain profitability.

Wave energy technology is at an early stage of development, and the extent to which wave energy power generation will be commercially viable is uncertain. Many factors may affect the commercial acceptance of wave energy technology, including the following:

- performance, reliability and cost-effectiveness of wave energy technology compared to autonomous conventional and other renewable energy sources and products;
- developments relating to other renewable energy generation technologies;
- fluctuations in economic and market conditions that affect the cost or viability of conventional and renewable energy sources, such as increases or decreases in the prices of oil and other fossil fuels;
- overall growth in the renewable energy equipment market;
- availability and terms of government subsidies and incentives to support the development of renewable energy sources, including wave energy; and
- the development of new and profitable applications requiring the type of remote electric power provided by our autonomous wave energy systems.

If wave energy technology does not gain broad commercial acceptance, it is unlikely that we will be able to commercialize our PowerBuoy and our business will be materially harmed, in which case, we may curtail or cease operations.

If sufficient demand for our PowerBuoys does not develop or takes longer to develop than we anticipate, our revenue generation will be limited, and it is unlikely that we will be able to achieve and, if achieved, then sustain profitability.

Even if wave energy technology achieves broad commercial acceptance, our PowerBuoys may not prove to be a commercially viable technology for generating electricity from ocean waves. We have invested a significant portion of our time and financial resources since our inception in the development of our PowerBuoys, but have not yet achieved successful commercialization of our PowerBuoys. As we seek to begin to manufacture, market, sell and deploy our PowerBuoys in greater quantities, we may encounter unforeseen hurdles that would limit the commercial viability of our PowerBuoys, including unanticipated manufacturing, deployment, operating, maintenance and other costs. Our target customers and we may also encounter technical obstacles to deploying, operating and maintaining PowerBuoys.

If demand for our PowerBuoys fails to develop sufficiently, it is unlikely that we will be able to grow our business or generate sufficient revenues to achieve and then sustain profitability. In addition, demand for PowerBuoys in our presently targeted markets, including coastal North America, Europe, Australia and Japan, may not develop or may develop to a lesser extent than we anticipate.

If we are not successful in commercializing our PowerBuoy, or are significantly delayed in doing so, our business, financial condition and results of operations will be adversely affected.

***Our strategic pivot in our business may not be successful*.**

Our going forward business strategy is based on the fundamental assumption that our pivot away from the utility-scale PowerBuoys and associated market that was initiated during fiscal year 2015 will be successful. This pivot was fundamentally implemented on the premise that technical and financial risks to our business will be considerably reduced while also assuming that the autonomous offshore applications and markets will provide sufficient business growth opportunities. We have been working diligently over the past two years, to better understand and quantify the autonomous markets, forge commercial partnerships while also developing our autonomous products and validating their performance and estimate that we are now at the tail end of this business transformation. Such markets may however come short of the growth opportunities that we have come to understand and quantify and hence we will not be able to continue as a business.

If we are unable to attract and retain management and other qualified personnel, we may not be able to achieve our business objectives.

Our success depends on the skills, experience and efforts of our senior management and other key product development, manufacturing, and sales and marketing employees. We have limited financial resources and cannot be certain that we will be able to attract, retain and motivate such employees. The loss of the services of one or more of these employees could have a material adverse effect on our business. There is a risk that we will not be able to retain or replace these key employees. Implementation of our business plans will be highly dependent upon our ability to hire and retain senior executives as well as talented staff in various fields of expertise.

Changes in senior management are inherently disruptive, and efforts to implement any new strategic or operating goals may not succeed in the absence of a long-term management team. Changes to strategic or operating goals with the appointment of new executives may themselves prove to be disruptive. Periods of transition in senior management leadership are often difficult as the new executives gain detailed knowledge of our operations and due to cultural differences that may result from changes in strategy and style. Without consistent and experienced leadership, customers, employees, creditors, stockholders and others may lose confidence in us.

To be successful, we need to retain key personnel. Qualified individuals, including engineers and project managers, are in high demand, and we may incur significant costs to attract and retain them. With the exception of our President and Chief Executive Officer, all of our officers and other employees are at-will employees, which means they can terminate their employment relationship with us at any time, and their knowledge of our business and industry would be difficult to replace. If we lose the services of key personnel, or do not hire or retain other personnel for key positions, our business, results of operations and stock price could be adversely affected.

If we are unable to effectively manage our growth, this could adversely affect our business and operations.

The scope of our operations to date has been limited, and we do not have experience operating on the scale that we believe may be necessary to achieve profitable operations. Our current personnel, facilities, systems and internal procedures and controls may not be adequate to support future growth. This factor, when combined with the technical complexity of some of our development efforts, may result in our inability to meet certain customer expectations or deadlines and could result in the amendment to, or termination of, customer contracts or relationships. To realize our desired growth, we may need to add sales, marketing and engineering offices in our existing and/or additional locations, which may include Australia, Japan, and continental Europe, and which may result in additional organizational complexity.

To manage the expansion of our operations, we may be required to improve our operational and financial systems, procedures and controls, increase our manufacturing capacity and throughput and expand, train and manage our employee base, which may need to increase significantly if we are to be able to fulfill our current manufacturing and growth plans. Our management may also be required to maintain and expand our relationships with customers, suppliers and other third parties, as well as attract new customers and suppliers. If we do not meet these challenges, we may be unable to take advantage of market opportunities, execute our business strategies or respond to competitive pressures.

Since our PowerBuoys can only be deployed in certain geographic locations, our ability to grow our business could be adversely affected.

Not all geographic areas have appropriate natural resources for our PowerBuoys to harness wave energy. Seasonal and local variations, water depth and the effect of particular locations of islands and other geographical features may limit our ability to deploy our PowerBuoys in certain coastal areas and deeper waters offshore. If we are unable to identify and deploy PowerBuoys at sufficient sites with appropriate natural resources to permit our PowerBuoys to capture wave energy, our ability to grow our business could be adversely affected.

If we are unable to successfully negotiate and enter into service contracts with our customers on terms that are acceptable to us, our ability to diversify our revenue stream will be impaired.

An important element of our business strategy is to enter into service contracts with our customers under which we would be paid fees for services related to the maintenance and operation of the PowerBuoys purchased from us. In addition, we may offer to lease PowerBuoys, sell power generated by PowerBuoys or sell data gathered by sensors on our PowerBuoys. Even if customers purchase or lease our PowerBuoys, they may not enter into service contracts with us. We may not be able to negotiate service, power sale or other contracts that provide us with any additional profit opportunities. Even if we successfully negotiate and enter into such service contracts, our customers may terminate them prematurely or they may not be profitable for a variety of reasons, including the presence of unforeseen hurdles or costs. In addition, if we were unable to perform adequately under such service contracts our efforts to successfully market the PowerBuoys could be impaired. Any one of these outcomes could have a material adverse effect on our business, financial condition and results of operations.

Failure by third parties to supply or manufacture components of our products or to deploy our systems timely or properly could adversely affect our business, financial condition and results of operations.

We have been and expect to continue to be highly dependent on third parties to supply or manufacture components of our PowerBuoys. If, for any reason, our third-party manufacturers or vendors are not willing or able to provide us with components or supplies in a timely fashion, or at all, our ability to manufacture and sell many of our products could be impaired.

We do not have long-term contracts with our third-party manufacturers or vendors. If we do not develop ongoing relationships with vendors located in different regions, we may not be successful at controlling unit costs as our manufacturing volume increases. We may not be able to negotiate new arrangements with these third parties on acceptable terms, or at all.

In addition, we rely on third parties, under our oversight, for the deployment and mooring of our PowerBuoys. We have utilized several different deployment methods, including towing the PowerBuoy to the deployment location and transporting the PowerBuoy to the deployment location by barge or ocean workboat. If these third parties do not properly deploy our systems, cannot effectively deploy the PowerBuoy on a large, commercial scale, or otherwise do not perform adequately, or if we fail to recruit and retain third parties to deploy our systems in particular geographic areas, our business, financial condition and results of operations could be adversely affected.

Our investments in joint ventures could fail to materialize or could be adversely affected by our lack of sole decision-making authority, our reliance on a co-venture's financial condition and disputes between us and our

co-venture partners.

It is part of our strategy that we may co-invest with third parties through joint ventures or by acquiring non-controlling interests in special purpose entities. In these situations, we may not be in a position to exercise sole decision-making authority regarding the joint venture. Our co-ventures may have economic or other business interests or goals that are inconsistent with our business interests or goals and may be in a position to take actions that are contrary to our policies or objectives. Additionally, investments in joint ventures involve risks that would not be present were a third party not involved, including the possibility that our co-ventures might become bankrupt or fail to fund their share of required capital contributions. Disputes between us and our co-venture partners may result in litigation or arbitration that would increase our expenses and prevent our officers and/or directors from focusing their time and effort on our business. In addition, we may not be able to identify appropriate strategic partners, or successfully negotiate, finance or operate any joint ventures or other collaborative projects to advance this aspect of our strategy. Consequently, both the entrance into a joint venture itself, or the failure to identify appropriate potential opportunities, could materially and adversely affect our business, financial condition and results of operations.

Our targeted markets are highly competitive. We compete against incumbent solutions already being utilized by our customers and potential customers. If we are unable to compete effectively, we may be unable to increase our revenues and achieve or maintain profitability.

Our primary goals are to commercialize our PowerBuoy and become profitable. In our targeted markets, which are highly competitive, we compete against incumbent power solutions already being utilized by our customers and potential customers. If we are unable to demonstrate to our customers and our potential customers that our PowerBuoy is cost competitive to their existing alternative power solutions, or if it takes us longer to do so than we anticipate, we may be unable to continue to expand our business, maintain our competitive position, achieve commercialization of our PowerBuoy, satisfy our contractual obligations, continue to commercialize our PowerBuoy, or become profitable. In addition, if the cost associated with these development efforts exceeds our projections, our results of operations could be materially and adversely affected.

In addition, competition may arise from other companies manufacturing similar products, developing different products that produce energy more efficiently than our products, or making improvements to traditional energy-producing methods or technologies, any of which could make our products less attractive or render them obsolete. If we are not successful in manufacturing systems that generate competitively priced power, we may not be able to respond effectively to competitive pressures from other renewable energy technologies or improvements to existing technologies.

If we are unable to respond effectively to such competitive forces, our business, financial condition and results of operations could be adversely affected. Our targeted markets are subject to their own inherent risks, and if those risks should materialize then our business, financial condition and results of operations could be adversely affected.

We market and plan to market our products in multiple international markets. If we are unable to manage our international operations effectively, our business, financial condition and results of operations could be adversely affected.

We market and plan to market our products in multiple global regions, including Europe, Australia, North America and parts of Asia, and we are therefore subject to risks associated with having international operations. Revenues from customers who are based outside of the U.S. accounted for 72% of our revenues in fiscal 2016 and 63% of our revenues in fiscal 2015. Risks inherent in international operations include, but are not limited to, the following:

- changes in general economic and political conditions in the countries in which we operate;

unexpected adverse changes in foreign laws or regulatory requirements, including those with respect to renewable energy, environmental protection, permitting, export duties and quotas;

trade barriers such as export requirements, tariffs, taxes and other restrictions and expenses, which could increase the prices of our PowerBuoys and make us less competitive in some countries;

fluctuations in exchange rates may affect demand for our PowerBuoys and may adversely affect our profitability in U.S. dollars to the extent the price of our PowerBuoys and cost of raw materials and labor are denominated in a foreign currency;

difficulty with staffing and managing widespread operations;

complexity of, and costs relating to compliance with, the different commercial and legal requirements of the overseas markets in which we offer and sell our PowerBuoys;

- inability to obtain, maintain or enforce intellectual property rights; and
- difficulty in enforcing agreements in foreign legal systems.

Our business in foreign markets requires us to respond to rapid changes in market conditions in these countries. Our overall success as a global business depends, in part, on our ability to succeed in differing legal, regulatory, economic, social and political conditions. We may not be able to develop and implement policies and strategies that will be effective in each location where we do business, which in turn could adversely affect our business, financial condition and results of operations. The current economic environment, particularly the macroeconomic pressures in certain European countries, may increase these risks.

We anticipate that our contracts with our customers will generally include cancellation for convenience clauses that permit our customers to terminate the contract for their convenience; if a customer were to terminate its contract with us for convenience, this could materially adversely affect our business.

We anticipate that our contracts with our customers will be structured as capital equipment contracts or capital equipment leases, and could include a cancellation for convenience clause, which we believe is relatively standard in these types of contracts. Cancellation for convenience clauses allow the customer to cancel the contract or lease at their option without cause prior to defined points in time, generally subject to a reasonable notice period. For example, our agreement with MES includes a cancellation for convenience clause. If MES or any of our future customers were to cancel their contracts with us for convenience, such cancellation could adversely affect our business.

Risks Related to Product Development and Commercialization

Our product development costs are substantial and may increase in the future.

Our product development costs primarily relate to our efforts to increase the output, durability and commercial viability of our PowerBuoy. Our product development costs were $7.0 million in fiscal 2016 and $4.1 million in fiscal 2015. It is our goal to fund the majority of our product development expenses, including cost sharing obligations under some of our customer contracts, over the next several years with sources of external funding, but we do not currently have any such committed sources of funding, and we may not be able to secure any such funding in the future. If we are unable to obtain external funding, our operations may be materially and adversely affected, and we may be required to curtail our product development expenses, among other consequences.

Because we have only manufactured a limited number of PowerBuoys, have not produced PowerBuoys in any significant quantity or for commercial production and are reliant in part on the results of computer modeling and simulation for testing and development, our PowerBuoys may not have a sufficient operating history to confirm how they will perform over their estimated useful life.

We began developing and testing wave energy technology over 15 years ago. However, to date, we have only manufactured a limited number of PowerBuoys for use in ocean testing and development. The longest continuous in-ocean deployment of our PowerBuoy was from December 2009 to January 2012 and was an earlier iteration of our PowerBuoy. We have conducted and plan to continue to conduct practical testing of our PowerBuoy. We also rely on computer modeling and simulation that attempt to predict performance under various ocean wave conditions and other parameters in a deployment environment. Use of accelerated life testing, as well as computer simulation models, has inherent risks and performance could be substantially different than predicted.

As a result of our limited operational testing, accelerated life testing and periodic in-ocean testing, we may later discover one or more significant defects requiring redesign and retrofit into existing systems, which may have a material adverse impact on our operations and revenues. Our technology may not yet have demonstrated that our engineering and test results can be duplicated in volume or in commercial production. If our PowerBuoy ultimately proves ineffective or unfeasible, we may not be able to engage in commercial production of our products or we may become liable to our customers for quantities we are obligated but are unable to produce. If our PowerBuoys perform below expectations, we could lose customers and face substantial repair and replacement expenses which could in turn adversely affect our business, financial condition and results of operations.

We face numerous accident and safety risks and hazards, including extreme environmental hazards, which are inherent in offshore operations.

Portions of our operations are subject to hazards and risks inherent in the building, testing, deploying and maintenance of our PowerBuoys. These hazards and risks could result in personal injuries, loss of life, liberation of a PowerBuoy from its moorings due to extreme environmental conditions and damage caused by its drifting, and other damages, which may include damage to our properties, including our PowerBuoy, and the properties of others and other consequential damages, and could lead to the suspension of certain of our operations, large damage claims, damage to our safety reputation and a loss of business. Some of these risks may be uninsurable and some claims may exceed our insurance coverage. Therefore, the occurrence of a significant accident or other risk event or hazard that is not fully covered by insurance could materially and adversely affect our business and financial results and, even if fully covered by insurance, could materially and adversely affect our business due to the impact on our reputation for safety. In addition, the risks inherent in our business are such that we cannot assure that we will be able to maintain adequate insurance in the future at reasonable rates.

Our relationships with our strategic partners may not be successful, and we may not be successful in establishing additional relationships, either of which could adversely affect our ability to commercialize our products and services.

An important element of our business strategy is to enter into application development agreements and strategic alliances with companies committed to providing products and services which require in-ocean energy sources. Generally, these types of relationships obligate us to provide certain services or perform certain tasks in connection with the relationship with the alliance partner, and we are generally responsible for paying the costs we incur relating to such services or tasks. These relationships generally are not expected to provide us with any revenues or sources of financing. We currently have strategic arrangements with the NDBC, Gardline Environmental and the WCS. If we are unable to reach agreements with other additional suitable alliance partners, we may fail to meet our business objectives for the commercialization of our PowerBuoys. We may face significant competition in seeking appropriate alliance partners. Moreover, these development agreements and strategic alliances are complex to negotiate and time consuming to document. We may not be successful in our efforts to establish additional strategic relationships or other alternative arrangements. The terms of any additional strategic relationships or other arrangements that we establish may not be favorable to us. Furthermore, even if we are able to find, negotiate and enter into these relationships, such arrangements may be conditional upon our receipt of additional funding. There can be no assurance that we will receive such additional funding. In addition, strategic relationships may not be successful, and we may be unable to sell and market our PowerBuoys to these companies and their affiliates and customers in the future, or growth opportunities may not materialize, any of which could adversely affect our business, financial condition and results of operations.

We have limited manufacturing experience. If we are unable to increase our manufacturing capacity in a cost-effective manner, our business will be materially harmed.

We plan to manufacture key components of our PowerBuoys, including the PTO advanced control and generation systems, while outsourcing the manufacturing for other components of our PowerBuoys, including the structure itself. However, we have only manufactured our PowerBuoys in limited quantities for use in development and testing and have limited commercial manufacturing experience, and our work with our vendors has not included work on multiple orders on time-critical deadlines. Our future success depends on our ability to significantly increase both our manufacturing capacity and production throughput in a cost-effective and efficient manner, and to manage multiple vendors with several orders on specific deadlines. In order to meet our growth objectives, we will need to increase our engineering, contract management, and manufacturing staff. There is intense competition for hiring qualified technical and engineering personnel, and we have limited funding available to retain such additional staff. Therefore, we may not be able to hire a sufficient number of qualified personnel to allow us to meet our growth objectives.

We may be unable to develop efficient, low-cost manufacturing capabilities and processes that enable us to meet the quality, price, engineering, design and production standards or production volumes necessary to successfully commercialize our PowerBuoys. If we cannot do so, we may be unable to expand our business, satisfy our contractual obligations or become profitable. Even if we are successful in developing our manufacturing capabilities and processes, we may not be able to do so in time to meet our commercialization schedule or satisfy the requirements of our customers.

Problems with the quality or performance of our PowerBuoys would adversely affect our business, financial condition and results of operations.

Our agreements with customers will generally include guarantees with respect to the quality and performance of our PowerBuoys. Because of the limited operating history of our PowerBuoys, we have been required to make analytical assumptions regarding the durability, reliability and performance of the systems, and we may not be able to predict whether and to what extent we may be required to perform under the guarantees that we expect to give our customers. Our assumptions could prove to be materially different from the actual performance of our PowerBuoys, causing us to incur substantial expense to repair or replace defective systems in the future. We will bear the risk of claims long after we have sold our PowerBuoys and recognized revenue. Moreover, any widespread product failures could adversely affect our business, financial condition and results of operations.

We have not yet deployed a wave power array of two or more PowerBuoys in a single geographic location. If we are unable to successfully deploy a multiple-system wave power array, our capability to generate revenues may be limited, and we may be unable to achieve and then maintain profitability.

We have not yet deployed a wave power array of two or more PowerBuoys. Whether we are able to do so is contingent upon, among other things, our ability to manufacture and produce multiple PowerBuoys in a short period of time, receipt of required governmental permits, obtaining adequate financing, successful array design and implementation and, finally, successful deployment and connection of the PowerBuoys to the remote power application.

We have not yet conducted ocean testing or otherwise installed in the ocean a multiple-system autonomous wave power array. In particular, unlike single-system wave power arrays, multiple-system wave power arrays may require connection to a single cable (such as by use of a subsea pod) or an underwater substation which connects the power transmission cables from, and collect the electricity generated by, each PowerBuoy in the array. We have not yet deployed connecting devices with multiple PowerBuoys. In addition, unanticipated issues may arise with the logistics and mechanics of deploying and maintaining multiple PowerBuoys at a single site and the additional equipment associated with these multiple-system wave power arrays.

The development and deployment of an array of PowerBuoys could require us to incur significant expenses for preliminary engineering, permitting and other expenses before we can determine whether a project is feasible, economically attractive or capable of being financed. We may be unsuccessful in accomplishing any of these tasks or doing so on a timely basis.

Risks Related to Intellectual Property

If we are unable to obtain or maintain intellectual property rights relating to our technology and products, the commercial value of our technology and products may be adversely affected, which could in turn adversely affect our business, financial condition and results of operations.

Our success and ability to compete depends in part upon our ability to obtain protection in the United States and other countries for our products by establishing and maintaining intellectual property rights relating to or incorporated into our technology and products. We own a variety of patents and patent applications in the U.S. and corresponding patents and patent applications in several foreign jurisdictions. However, we have not obtained patent protection in each market in which we plan to compete. In addition, we do not know how successful we would be should we choose to assert our patents against suspected infringers and we do not know what the cost to do so would be. Our pending and future patent applications may not issue as patents or, if issued, may not issue in a form that will be advantageous to us. Even if issued, patents may be challenged, narrowed, invalidated or circumvented, which could limit our ability to stop competitors from marketing similar products or limit the length of term of patent protection we may have for our products. Changes in either patent laws or in interpretations of patent laws in the U.S. and other countries may diminish the value of our intellectual property or narrow the scope of our patent protection, which could in turn adversely affect our business, financial condition and results of operations.

If we are unable to protect the confidentiality of our trade secrets, the value of our technology and products could be adversely affected, which could in turn adversely affect our business, financial condition and results of operations.

In addition to patented technology, we rely upon trade secrets, including unpatented proprietary technology and processes, know-how and other proprietary information, particularly with respect to our PowerBuoy control and electricity generating systems. We generally seek to protect this information in part by proprietary information and inventions agreements with our employees, consultants and third parties. These agreements require these parties to assign to us all rights to any inventions made or conceived during their employment with us. Despite these efforts, there can be no assurance, however, that these agreements will provide meaningful protection or adequate remedies for us in the event of unauthorized use, transfer or disclosure of confidential information or inventions. Our trade secrets may also be obtained by third parties by other means, such as breaches of our physical or computer security systems. Enforcing a claim that a party illegally disclosed or misappropriated a trade secret is difficult, expensive and time-consuming, and the outcome is unpredictable. In addition, some courts inside and outside the United States are less willing or unwilling to protect trade secrets. If any of our trade secrets were to be lawfully obtained or independently developed by a competitor, we would have no right to prevent them, or those to whom they communicate it, from using that technology or information to compete with us. If any of our trade secrets were to be disclosed to or independently developed by a competitor, our competitive position would be harmed.

Foreign laws may not afford us sufficient protections for our intellectual property, and we may not be able to obtain patent protection outside of the United States.

Intellectual property rights protection continues to present significant challenges to foreign businesses in many countries around the world. The body of law is often relatively undeveloped compared to the commercial law in the United States and only limited protection of intellectual property may be available in those jurisdictions. Although we have taken precautions to protect our intellectual property, any local design or manufacture of products that we undertake in a foreign jurisdiction could subject us to an increased risk that unauthorized parties will be able to copy or otherwise obtain or use our intellectual property, which could harm our business. We may also have limited legal recourse in the event we encounter patent or trademark infringement. If we are unable to manage our intellectual property rights, our business and operating results may be seriously harmed.

If we suffer any data breaches involving our designs, schematics, or other sensitive information, our business and financial results could be adversely affected.

We securely store our designs, schematics, and other sensitive information for our products as they are created. A breach, whether physical, electronic or otherwise, of the systems on which this sensitive data is stored could lead to damage or piracy of our products. If we are subject to data security breaches from external sources or from an insider threat, we may have a loss in sales or increased costs arising from the restoration or implementation of additional security measures, either of which could adversely affect our business and financial results. Other potential costs could include loss of brand value, incident response costs, loss of stock market value, regulatory inquiries, litigation, and management distraction. In addition, a security breach that involved classified information could subject us to civil or criminal penalties, loss of a government contract or loss of access to classified information. Similarly, a breach that involved loss of customer-provided data could subject us to loss of a customer, loss of a contract, litigation costs and legal damages, and reputational harm.

If we infringe or are alleged to have infringed upon intellectual property rights of third parties, our business, financial condition and results of operations could be adversely affected.

Our products may infringe, or be claimed to infringe, upon patents or patent applications under which we do not hold licenses or other rights. Third parties may own or control these patents and patent applications in the United States and abroad. From time to time, we receive correspondence from third parties offering to license patents to us. Correspondence of this nature might be used to establish that we received notice of certain patents in the event of subsequent patent infringement litigation. Third parties could bring claims against us that would cause us to incur substantial expenses and, if successfully asserted against us, could cause us to pay substantial damages. Further, if a patent infringement suit were brought against us, we could be forced to stop or delay manufacturing or sales of the product or component that is the subject of the suit.

As a result of patent infringement claims, or in order to avoid potential claims, we may choose or be required to seek a license from the third party and be required to pay license fees, royalties or both. These licenses may not be available on acceptable terms, or at all. Even if we were able to obtain a license, the rights may be non-exclusive, which could result in our competitors gaining access to the same intellectual property. Ultimately, we could be forced to cease some aspect of our business operations if, as a result of actual or threatened patent infringement claims, we are unable to enter into licenses on acceptable terms. This could significantly and adversely affect our business, financial condition and results of operations.

In addition to infringement claims against us, we may become a party to other types of patent litigation and other proceedings, including interference proceedings declared by the U.S. Patent and Trademark Office and opposition proceedings in the European Patent Office, regarding intellectual property rights with respect to our products and technology. The cost to us of any patent litigation or other proceeding, even if resolved in our favor, could be substantial. In addition, if we were to license our intellectual property to others, we may be required to indemnify our licensee if the licensed intellectual property is found to be infringing on a third party's rights. Some of our competitors may be able to sustain the costs of such litigation or proceedings more effectively than we can because of their greater financial resources.

Our contracts with governmental entities could negatively affect our intellectual property rights, and our ability to commercialize our products could be impaired.

Our agreements with government agencies in large part fund the research and development of our PowerBuoy. When new technologies are developed with U.S. government funding, the government obtains certain rights in any resulting patents, technical data and software, generally including, at a minimum, a non-exclusive license authorizing the government to use the invention, technical data or software for non-commercial purposes. These rights may permit the government to disclose our confidential information to third parties and to exercise "march-in" rights. March-in rights refer to the right of the U.S. government to require us to grant a license to the technology to a responsible applicant or, if we refuse, the government may grant the license itself. U.S. government-funded inventions must be reported to the government and U.S. government funding must be disclosed in any resulting patent applications; our rights in such inventions will normally be subject to government license rights, periodic post-contract utilization reporting, foreign manufacturing restrictions and march-in rights.

The government can exercise its march-in rights if it determines that action is necessary because we fail to achieve practical application of the technology or because action is necessary to alleviate health or safety needs, to meet requirements of federal regulations or to give preference to U.S. industry. Our government-sponsored research contracts are subject to audit and require that we provide regular written technical updates on a monthly, quarterly or annual basis, and, at the conclusion of the research contract, a final report on the results of our technical research. A public (non-proprietary) and proprietary reports are generally submitted for these contracts. The non-proprietary reports often edited or redacted to protect proprietary information. However, because these reports are generally available to the public, third parties may obtain some aspects of our sensitive confidential information. Moreover, if we fail to provide these reports or to provide accurate or complete reports, the government may obtain rights to any intellectual property arising from the related research. Funding from government contracts also may limit when and how we can deploy our technology developed under those contracts. Foreign governments with which we contract to provide funding for our research and development may seek similar rights.

Risks Related to Regulatory and Compliance Matters

If we become ineligible for or are otherwise unable to replace our contract with U.S. or foreign governments, our business, financial condition and results of operations could be adversely affected.

Historically we have derived a significant portion of our revenue from U.S. federal government contracts, which are subject to special funding restrictions, regulatory requirements and eligibility standards and which the government may terminate at any time or determine not to extend after their scheduled expiration. During fiscal 2016 and fiscal 2015, we derived 28% and 37%, respectively, of our total revenue from contracts with the U.S. federal government and 72% and 63%, respectively, from contracts with foreign entities. We may not be successful in securing any additional contracts with the U.S. federal government in the future. Any such contracts are dependent on, among other things, appropriate funding by the U.S. Congress. If we are unable to replace these contracts, our business, financial condition and our results of operations could be adversely affected.

Government contracts are also subject to contractual and regulatory requirements that may increase our costs of doing business and could expose us to substantial contractual damages, civil fines and criminal penalties for noncompliance. These requirements include business ethics, equal employment opportunity, environmental, foreign purchasing, most-favored pricing and accounting provisions, among others. Payments that we receive under government contracts are subject to audit and potential refunds after the final contract payment is received.

If we are unable to obtain all necessary regulatory permits and approvals, we will not be able to implement our planned projects or business plan.

Offshore deployment of our PowerBuoy is heavily regulated. Each of our deployments is subject to multiple permitting and approval requirements. We are dependent on state, federal and regional government agencies for such permits and approvals. Due to the unique nature of in-ocean power generation and the associated environmental impact of PowerBuoy deployment, we expect our projects to receive close scrutiny by permitting agencies, approval authorities and the public, which could result in substantial delay in the permitting process. Successful challenges by any parties opposed to our deployments could result in increased costs, or in the denial of necessary permits and approvals. Governmental agencies can also condition permits in such a manner as to require additional expenditures or changes in the timing of expenditures associated with activities following deployment of our PowerBuoys.

If we are unable to obtain necessary permits and approvals in connection with any or all of our projects, those projects would not be implemented and our business, financial condition and results of operations would be adversely affected. Further, we cannot assure you that we have been or will be at all times in complete compliance with all such permits and approvals. If we violate or fail to comply with these permits and approvals, we could be fined or otherwise sanctioned by regulators.

We face risks relating to the referendum on the U.K.'s membership in the E.U.

The announcement of the U.K.'s advisory referendum vote to exit from the E.U. ("BREXIT") could cause disruptions to and create uncertainty surrounding our business, including affecting our relationships with existing and potential customers, suppliers and employees. The referendum is non-binding; however, if passed into law, negotiations would then commence to determine the terms of the U.K's future relationship with the E.U., including the terms of trade between the U.K. and the E.U. The effects of BREXIT will depend on any agreements the U.K. makes to retain access to E.U. markets either during a transitional period or more permanently. The measures could potentially disrupt some of our target markets and jurisdictions in which we operate, and adversely change tax benefits or liabilities in these or other jurisdictions. In addition, BREXIT could lead to legal uncertainty and potentially divergent national laws and regulations as the U.K. determines which E.U. laws to replace or replicate. In addition, the announcement of BREXIT has caused significant volatility in global stock markets and currency exchange rate fluctuations, including the strengthening of the U.S. dollar against foreign currencies. The announcement of BREXIT also may create global economic uncertainty, which may cause our customers and potential customers to monitor their costs and reduce their budgets for our products and services. Any of these effects of BREXIT, among others, could materially adversely affect our business, business opportunities, results of operations, financial condition and cash flows.

Business activities conducted by our third-party contractors and us involve the use of hazardous materials, which require compliance with environmental and occupational safety laws regulating the use of such materials. If we violate these laws, we could be subject to significant fines, liabilities or other adverse consequences.

Our manufacturing operations, particularly some of the activities undertaken by our third-party suppliers and manufacturers, involve the controlled use of hazardous materials. Accordingly, our third-party contractors and we are subject to foreign, federal, state and local laws governing the protection of the environment and human health and safety, including those relating to the use, handling and disposal of these hazardous materials. We cannot completely eliminate the risk of accidental contamination or injury from these hazardous materials. In the event of an accident or failure to comply with environmental or health and safety laws and regulations, we could be held liable for resulting damages, including damages to natural resources, fines and penalties, and any such liability could adversely affect our business, financial condition and results of operations.

Environmental laws and regulations are complex, change frequently and have tended to become more stringent over time. While we have budgeted for future capital and operating expenditures to maintain compliance, we cannot assure you that environmental laws and regulations will not change or become more stringent in the future. Therefore, we cannot assure you that our costs of complying with current and future environmental and health and safety laws, and any liabilities arising from past or future releases of, or exposure to, hazardous substances will not adversely affect our business, financial condition or results of operations.

In the event we are unable to satisfy regulatory requirements relating to internal control over financial reporting, or if our internal controls are not effective, our business and financial results may suffer.

Effective internal controls are necessary for us to provide reasonable assurance with respect to our financial reports and to effectively prevent fraud If we cannot provide reasonable assurance with respect to the integrity of our financial reports and effectively prevent fraud, our business and operating results could be harmed. Pursuant to the Sarbanes-Oxley Act of 2002, we are required to furnish a report by management on internal control over financial reporting, including management's assessment of the effectiveness of such control. Internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Therefore, even effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. In addition, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. If we fail to maintain the adequacy of our internal controls, including any failure to implement new or improved controls, or if we experience difficulties in their implementation, our business and operating results could be harmed, we could fail to meet our reporting obligations, and there could also be a material adverse effect on our stock price.

Risks Related to Litigation

We are the subject of pending and threatened securities and other litigation, which is costly and time-consuming to defend, and if decided against us, could require us to pay substantial judgments or settlements. We may be the subject of future securities or other litigation, which could adversely affect our company, our business and our liquidity.

We and our former Chief Executive Officer, Charles Dunleavy, are defendants in the Securities Class Action discussed in our Annual Report on Form 10-K for the year ended April 30, 2016, as amended, and our subsequent Quarterly Report on Form 10-Q for the quarter ended July 31, 2016. On May 5, 2016, the parties entered into the Stipulation in which they agreed to a settlement of the Securities Class Action, subject to Court approval after notice to class members. The Stipulation provides, among other things, for a settlement payment by or on behalf of us of $3,000,000 in cash, of which we will pay $500,000 (which was paid by us on July 31, 2016) and our insurer will pay $2,500,000, and the issuance by the Company of 380,000 shares of its Common Stock to the class members. In connection with the proposed settlement, the parties have agreed to execute mutually agreeable releases. On June 7, 2016, the Court entered an Order Granting Preliminary Approval of Settlement. The Court has scheduled a hearing for November 14, 2016 to determine, among other things, whether to grant final approval of the proposed settlement. The amounts agreed in the Stipulation agreement, including the amount to be contributed by our insurance carrier, have been reflected in our financial statements as of April 30, 2016 and July 31, 2016. The Stipulation is subject to approval by the Court following notice to all class members. We cannot assure you that the Court will approve the Stipulation or that this pending litigation will be settled on such terms or at all.

We are the subject of certain other pending and threatened litigation, some of which arises, in part, from the securities offering that we conducted in April 2014 and other activities, including several shareholder derivative lawsuits against certain directors and officers. This litigation is costly and time consuming to defend and may distract our management from the daily operations of our business. We may be the subject of additional future securities litigation, which could adversely affect our company, our business and our liquidity. Although we maintain directors' and officers' insurance coverage, we cannot assure you that this insurance coverage will be sufficient to cover the substantial fees of lawyers and other professionals advisors relating to these pending lawsuits or any future litigation, our obligations to indemnify our officers and directors who may become parties to such pending and future actions, or the amount of any judgments or settlements that we may be obligated to pay in connection with these lawsuits. In addition, these actions have caused our insurance premiums and retention amounts to increase, and we may be subject to additional increases in the future or be subjected to other changes in our insurance coverages. Further, given the volatility of the market price of our Common Stock, we may be subject to further class action securities and other litigation. Accordingly, we have incurred and may continue to incur substantial legal expenses, judgments and/or settlements relating to pending, threatened and future litigation and our management's time and attention may be diverted from the operation of our business, which could materially and adversely affect the Company.

We have a pending SEC investigation that has caused us to incur significant costs and expenses and has diverted our management time, and could have a material adverse effect on our business, financial condition, results of

operations, cash flow and our ability to raise capital in the future.

We have received two subpoenas from the SEC arising out of public disclosures related to a now-terminated agreement between Victorian Wave Partners Pty Ltd (“VWP”) and the Australian Renewable Energy Agency (“ARENA”), and related to our April 4, 2014 public offering. We have provided information to the SEC in response to that subpoena, and we continue to respond and cooperate with the SEC in this investigation. We have incurred and expect to continue to incur significant legal and other professional fees and other costs related to the SEC investigation. We are unable to predict what action, if any, might be taken by the SEC or its staff as a result of this investigation, the timing of any such actions, or what impact, if any, the cost of responding to the SEC’s investigation or its ultimate outcome might have on our financial position, results of operations or liquidity. We have not established any provision for losses relating to this matter. If the SEC were to conclude that enforcement action is appropriate, we could be required to pay civil penalties and fines, and the SEC could impose other sanctions against us or against our current and former officers and directors. In addition, our Board of Directors (the “Board”), management and employees may expend a substantial amount of time on the SEC investigation, diverting resources and attention that would otherwise be directed toward our operations and implementation of our business strategy, all of which could materially adversely affect our business, financial condition, results of operations or cash flows.

We are and may become the target of additional securities litigation, which is costly and time-consuming to defend.

In the past, companies that experience significant volatility in the market price of their publicly-traded securities have become subject to class action securities litigation. Our stock price has been volatile, and class action securities litigation and derivative lawsuits have been filed against us and it is possible that additional lawsuits could be brought against us in the future. The results of complex legal proceedings are difficult to predict. These lawsuits assert types of claims that, if resolved against us, could give rise to substantial damages, and an unfavorable outcome or settlement of these lawsuits, or any future lawsuits, could have a material adverse effect on our business, financial condition, results of operations and/or stock price. Even if these lawsuits, or any future lawsuits, are not resolved against us, the costs of defending such lawsuits may be material to our business and our operations. Moreover, these lawsuits may divert our management’s attention from the operation of our business.

Risks Related to our Financial Condition

Our auditors have raised substantial doubts as to our ability to continue as a going concern.

Our financial statements have been prepared assuming we will continue as a going concern. Due to the significant product development costs associated with our business and operations, we have experienced substantial and recurring losses from operations, which losses have caused an accumulated deficit of $181.7 million at July 31, 2016. At July 31, 2016, we had approximately $9.0 million in cash on hand. We generated revenues of $0.2 million and $0.1 million in the three months ended July 31, 2016 and 2015, respectively, and we generated revenues of only $0.7 million in fiscal 2016, and $4.1 million in fiscal 2015. Based on the Company’s cash and cash equivalents and marketable securities balances as of July 31, 2016, as well as the funds raised in public offerings completed in June and July of 2016, the Company believes that it will be able to finance its capital requirements and operations into at least the quarter ending April 30, 2017. We continue to experience operating losses and currently have only one primary revenue producing contract, which is an agreement with MES (the “MES Agreement”) to, among other things, lease and deploy our PB3 PowerBuoy off Kozushima Island, Japan and to provide certain engineering and other services. The total value of the lease and other services to be provided by us under the MES Agreement is $975,587. We currently expect the term of the lease to commence in March 2017, and the term of the MES Agreement to extend through August 2017. During the three months ended July 31, 2016, our net burn rate (cash used in operations less cash generated by operations) including product development spending was approximately $800,000 per month, excluding $500,000 cash paid in relation to the Securities Class Action settlement discussed above.

Our business is capital intensive and, to date, we have been funding our business principally through sales of our securities, and we expect to continue to fund our business with sales of our securities and, to a limited extent, with our revenues until, if ever, we generate sufficient cash flow to internally fund our business. This is a largely a result of the high product development costs associated with our product development. These factors, among others, raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. We anticipate that our operating expenses will be approximately $12 million in fiscal 2017 including product development spending of more than $5 million. However, we may choose to reduce our operating expenses through personnel reductions, and reductions in our research and development and other operating costs during fiscal year 2017, if we are not successful in our efforts to raise additional capital. We cannot assure you that we will be able to increase our revenues and cash flow to a level which would support our operations and provide sufficient funds to pay our obligations for the foreseeable future. Further, we cannot assure you that we will be able to secure additional financing or raise additional capital or, if we are successful in our efforts to raise additional capital, of the terms and conditions upon which any such financing would be extended. If we are unable to meet our obligations, we would be forced to cease operations, in which event investors would lose their entire investment in our company.

We may not be able to raise sufficient capital to continue to operate our business.

Historically, we have funded our business operations through sales of equity securities. We do not know whether we will be able to secure additional equity funding or, if secured, whether the terms will be favorable to us or our investors. Our ability to obtain additional funding will be subject to a number of factors, including market conditions, our operating performance, pending litigation and investor sentiment. These factors may make additional funding unavailable, or the timing, amount, terms and conditions of additional funding unattractive. If we issue additional equity securities to raise capital, our existing stockholders would experience dilution or may be subordinated to any rights, preferences or privileges granted to the new equity holders.

We have filed a shelf registration statement on Form S-3 with the Securities and Exchange Commission (the "SEC") registering the sale of up to $15,000,000 of debt, equity and other securities (the "Shelf Registration Statement"), which was declared effective on April 26, 2016. In June 2016, we completed an offering off of the Shelf Registration Statement of an aggregate of 417,000 shares of common stock together with warrants to purchase up to an aggregate of 145,952 shares of common stock. In July 2016, we completed a best efforts public offering off of the Shelf Registration Statement of 595,000 units, with each unit consisting of one share of common stock and 0.3 of a warrant to purchase one share of our common stock, for a total of 178,500 warrants.

Future sales under our current Shelf Registration Statement or other sales of equity or convertible securities could be dilutive to our stockholders. We cannot assure you that we will be able to issue any such securities or, if issued, what the terms of those securities would be. In particular, any new securities issued could have rights senior to those associated with our common stock and could contain covenants that would restrict our operations. Should the financing we require to sustain our working capital needs be unavailable or prohibitively expensive when we require it, our business, operating results, financial condition and prospects could be materially and adversely affected and we may be unable to continue our operations.

We have a history of operating losses and may not achieve or maintain profitability and positive cash flow.

We have incurred net losses since we began operations in 1994, including net losses of $3.8 million during the three months ended July 31, 2016 and $13.1 million in fiscal 2016. As of July 31, 2016, we had an accumulated deficit of $181.7 million. To date, our activities have consisted primarily of activities related to the development and testing of our technologies and our PowerBuoy. Thus, our losses to date have resulted primarily from costs incurred in our research and development programs and from our selling, general and administrative costs. As we continue to develop our proprietary technologies, we expect to continue to have a net use of cash from operating activities unless or until we achieve positive cash flow from the commercialization of our products and services.

We do not know whether we will be able to successfully commercialize our PowerBuoys, or whether we can achieve profitability. Even if we do achieve commercialization of our PowerBuoy and become profitable, we may not be able to achieve or, if achieved, sustain profitability on a quarterly or annual basis.

Our financial results may fluctuate from quarter to quarter, which may make it difficult to predict our future performance.

Our financial results may fluctuate as a result of a number of factors, many of which are outside of our control. For these reasons, comparing our financial results on a period-to-period basis may not be meaningful, and our past results should not be relied on as an indication of our future performance. Our future quarterly and annual expenses as a percentage of our revenues may be significantly different from those we have recorded in the past or which we expect for the future. Our financial results in some quarters may fall below expectations. Any of these events could cause our stock price to fall. Each of the risk factors listed in this “Risk Factors” section, including the following factors, may adversely affect our business, financial condition and results of operations:

delays in permitting or acquiring necessary regulatory consents;

- delays in the timing of contract awards and determinations of work scope;
- delays in funding for or deployment of autonomous buoys or multi-buoy arrays;
- changes in cost estimates relating to wave energy project completion, which under percentage-of-completion accounting principles could lead to significant fluctuations in revenue or to changes in the timing of our recognition of revenue from those projects;
- delays in meeting, or the failure to meet, specified contractual milestones or other performance criteria under project contracts or in completing project contracts that could delay or prevent the recognition of revenue that would otherwise be earned;
- decisions made by parties with whom we have commercial relationships not to proceed with anticipated projects;
- increases in the length of our sales cycle; and
- inherent uncertainties in our manufacturing processes.

Currency translation and transaction risk may adversely affect our business, financial condition and results of operations.

Our reporting currency is the U.S. dollar, and we conduct our business and incur costs in the local currency of most countries in which we operate. As a result, we are subject to currency translation risk. A large percentage of our revenues may be generated outside the United States and denominated in foreign currencies in the future. Changes in exchange rates between foreign currencies and the U.S. dollar could affect our revenues and cost of revenues, and could result in exchange losses. In addition, we incur currency transaction risk whenever one of our operating subsidiaries enters into either a purchase or sale transaction using a different currency from our reporting currency. We cannot accurately predict the impact of future exchange rate fluctuations on our results of operations. Currently, we do not engage in any exchange rate hedging activities and, as a result, any volatility in currency exchange rates may have an immediate adverse effect on our business, results of operations and financial condition.

Risks Relating to Our Common Stock

We may issue or sell shares of our common stock or securities convertible or exchangeable for our common stock in the future and this may depress our stock price.

In this offering, we are selling an additional 2,400,000 shares of our common stock, or 2,760,000 shares if the underwriters exercise their option to purchase additional shares of our common stock in full. As of October 13, 2016, there were 3,129,992 shares outstanding, excluding (i) options outstanding as of that date representing the right to purchase a total of 160,872 shares of common stock at a weighted average exercise price of approximately $23.78 per share, (ii) 380,000 shares of common stock that may be issued in the future pursuant to a settlement agreement of certain pending securities litigation discussed elsewhere in these Risk Factors, which is subject to court approval and other requirements, (iii) outstanding warrants to purchase up to 145,952 shares of our common stock that will first become exercisable beginning on December 8, 2016 at a price of $6.08, and (iv) outstanding warrants to purchase up to 178,500 shares of our common stock which are currently exercisable at a price of $9.36.

Our stockholders may experience substantial dilution in the value of their investment or their ownership interest as a result of this offering or if we issue additional shares of our capital stock in the future.

Our certificate of incorporation, as amended, currently authorizes us to issue up to 50,000,000 shares of our common stock and to issue and designate the rights of, without stockholder approval, up to 5,000,000 shares of preferred stock. We are offering 2,400,000 shares of our common stock in this offering, or 2,760,000 shares if the underwriters exercise their option to purchase additional shares of our common stock in full. In the future, in order to raise additional capital, we may offer additional shares of our common stock or other securities convertible into or exchangeable for our common stock at prices that may not be the same as the price per share paid by other investors, and dilution to our stockholders in the value of their investment and their ownership and voting interest in us could result. We may sell shares or other securities in any other offering at a price per share that is less than the price per share paid by existing investors, and investors purchasing shares or other securities in the future could have rights superior to existing stockholders. The price per share at which we sell additional shares of our common stock, or securities convertible or exchangeable into common stock, in future transactions may be higher or lower than the price per share paid by other investors.

In addition, we have a significant number of stock options and warrants outstanding. To the extent that outstanding stock options or warrants have been or may be exercised or other shares issued, investors purchasing our common stock in this offering may experience further dilution. In addition, we may choose to raise additional capital due to market conditions or strategic considerations even if we believe we have sufficient funds for our current or future operating plans. To the extent that additional capital is raised through the sale of equity or convertible debt securities, the issuance of these securities could result in further dilution to our shareholders or result in downward pressure on the price of our common stock.

Management will have broad discretion as to the use of the proceeds from this offering, and we may not use the proceeds effectively.

Our management will have broad discretion as to the application of the net proceeds from this offering, and could spend the proceeds in ways that do not necessarily improve our operating results or enhance the value of our common stock.

We may issue debt and equity securities or securities convertible into equity securities, any of which may be senior to our common stock as to distributions and in liquidation, which could negatively affect the value of our common stock.

In the future, we may attempt to increase our capital resources by entering into debt or debt-like financing that is unsecured or secured by some or all of our assets, or by issuing additional debt or equity securities, which could include issuances of secured or unsecured commercial paper, medium-term notes, senior notes, subordinated notes, guarantees, preferred stock, hybrid securities, or securities convertible into or exchangeable for equity securities, any of which may rank senior to our common stock. In the event of our liquidation, our lenders and holders of our debt and preferred securities would receive distributions of our available assets before distributions to the holders of our common stock. Because our decision to incur debt and issue securities in future offerings may be influenced by market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings or debt financings. Further, market conditions could require us to accept less favorable terms for the issuance of our securities in the future.

As a smaller reporting company, we are subject to scaled disclosure requirements that may make it more challenging for investors to analyze our results of operations and financial prospects.

Currently, we are a "smaller reporting company," meaning that our outstanding common stock held by non-affiliates had a market value of less than $75 million as of October 31, 2015. As a "smaller reporting company," we are able to provide simplified executive compensation disclosures in our filings; are exempt from the provisions of Section 404(b) of the Sarbanes-Oxley Act requiring that independent registered public accounting firms provide an attestation report on the effectiveness of internal control over financial reporting; and have certain other decreased disclosure obligations in our filings with the SEC, including being required to provide only two years of audited financial statements in annual reports. Consequently, it may be more challenging for investors to analyze our results of operations and financial prospects.

Furthermore, a material weakness in internal controls may remain undetected for a longer period because of our extended exemption from the auditor attestation requirements under Section 404(b) of the Sarbanes-Oxley Act.

The market price of our common stock may be volatile and could decline substantially.

Historically, the market price of our common stock has fluctuated significantly, and we expect that this will continue. Purchasers of our common stock could incur substantial losses relating to their investment in our stock as a result. For the twelve month period ended October 13, 2016, the 52-week high and low prices for our common stock were $15.65 and $0.95, respectively. Also, the stock market in general has recently experienced volatility that has often been unrelated or disproportionate to the operating performance of particular companies. These broad market fluctuations could result in fluctuations in the price of our common stock, which could cause purchasers of our common stock to incur substantial losses. The market price for our common stock may be influenced by many factors, including:

- developments in our business or with respect to our projects;
- the success of competitive products or technologies;
- regulatory developments in the United States and foreign countries;
- developments or disputes concerning patents or other proprietary rights;
- the recruitment or departure of key personnel;
- quarterly or annual variations in our financial results or those of companies that are perceived to be similar to us;
- market conditions in the conventional and renewable energy industries and issuance of new or changed securities analysts' reports or recommendations;
- the failure of securities analysts to cover our common stock or changes in financial estimates by analysts;
- the inability to meet the financial estimates of analysts who follow our common stock;
- investor perception of our company and of our targeted markets; and
- general economic, political and market conditions.

We do not anticipate paying dividends on our common stock in the near future.

We have not paid any dividends in the past and do not intend to pay cash dividends on our common stock in the foreseeable future. We currently intend to retain any earnings for the future operation and development of our business. We can provide no assurance that those restrictions will not prevent us from paying a dividend in future periods.

Provisions in our corporate charter documents and under Delaware law may delay or prevent attempts by our stockholders to change our management and hinder efforts to acquire a controlling interest in us.

As a result of our reincorporation in Delaware in April 2007, provisions of our certificate of incorporation and bylaws may discourage, delay or prevent a merger, acquisition or other change in control that stockholders may consider favorable, including transactions in which our stockholders might otherwise receive a premium for their shares. These provisions may also prevent or frustrate attempts by our stockholders to replace or remove our management. These provisions include:

- advance notice requirements for stockholder proposals and nominations;
- the inability of stockholders to act by written consent or to call special meetings; and
- the ability of our Board to designate the terms of and issue new series of preferred stock without stockholder approval, which could be used to institute a “poison pill” that would work to dilute the stock ownership of a potential hostile acquirer, effectively preventing acquisitions that have not been approved by the Board.

The affirmative vote of the holders of at least 75% of our shares of capital stock entitled to vote is necessary to amend or repeal the above provisions of our certificate of incorporation. In addition, absent the approval of the Board, our bylaws may only be amended or repealed by the affirmative vote of the holders of at least 75% of our shares of capital stock entitled to vote.

In addition, Section 203 of the Delaware General Corporation Law prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder, which is generally a person who together with its affiliates owns or within the last three years has owned 15% of our voting stock, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. Accordingly, Section 203 may discourage, delay or prevent a change in control of our company.

We do not currently have securities or industry analysts which publish research or reports about us, and as a result, our stock price and trading volume could be more volatile.

The trading market for our common stock can be influenced by the research and reports that industry or securities analysts publish about us, our industry and our markets. As no analyst currently covers us or publishes research or reports about us, the market for our common stock may continue to be limited and our stock price could be adversely affected. In addition, if and when we do have analysts covering us and one or more analysts ceases coverage of us or fails to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline. If one or more such analysts who elect to cover us adversely changes their recommendations regarding our common stock, our stock price could also decline.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

The information discussed in this prospectus, our filings with the SEC and our public releases include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), or in releases made by the SEC. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of us and our subsidiaries to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Statements that are not historical fact are forward-looking statements. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as the words "plan," "believe," "expect," "anticipate," "intend," "estimate," "project," "may," "will," "would," "should," "seeks," or "scheduled to," or other similar words, or the negative of these terms or other variations of these terms or comparable language, or by discussion of strategy or intentions. These cautionary statements are being made pursuant to the Securities Act, the Exchange Act and the PSLRA with the intention of obtaining the benefits of the "safe harbor" provisions of such laws.

The forward-looking statements contained in or incorporated by reference into this prospectus are largely based on our expectations, which reflect estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market conditions and other factors. Although we believe such estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control, including:

- our estimates regarding expenses, future revenues and capital requirements;
- the adequacy of our cash balances and our need for additional financings;
- our ability to develop and manufacture a commercially viable PowerBuoy product
- that we will be successful in our efforts to commercialize our PowerBuoy or the timetable upon which commercialization can be achieved, if at all;
- our ability to identify and penetrate markets for our PowerBuoys and our wave energy technology;
- our ability to implement our commercialization strategy as planned, or at all;
- our ability to maintain the listing of our common stock on the NASDAQ Capital Market;
- the reliability of our technology and our PowerBuoys;
- our ability to improve the power output, survivability and reliability of our PowerBuoys;
- the impact of pending and threatened litigation on our business, financial condition and liquidity;
- changes in current legislation, regulations and economic conditions that affect the demand for renewable energy;
- our ability to compete effectively in the renewable energy market;

our limited operating history and history of operating losses;

our sales and marketing capabilities and strategy in the United States and internationally; and

our ability to protect our intellectual property portfolio.

Many of these factors are beyond our ability to control or predict. These factors are not intended to represent a complete list of the general or specific factors that may affect us.

In addition, management's assumptions about future events may prove to be inaccurate. All readers are cautioned that the forward-looking statements contained in this prospectus and in the documents incorporated by reference into this prospectus are not guarantees of future performance, and we cannot assure any reader that such statements will be realized or that the forward-looking events and circumstances will occur. Actual results may differ materially from those anticipated or implied in the forward-looking statements due to factors described in "Risk Factors" included elsewhere in this prospectus and in the documents that we include in or incorporate by reference into this prospectus, including our Annual Report on Form 10-K for the fiscal year ended April 30, 2016, as amended, and our subsequent SEC filings. All forward-looking statements speak only as of the date they are made. We do not intend to update or revise any forward-looking statements as a result of new information, future events or otherwise, except as required by law. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

USE OF PROCEEDS

The estimated net proceeds to be received by us from this offering are expected to be approximately $6.0 million after deducting underwriting discounts and commissions and estimated offering expenses. We intend to use the net proceeds from this offering for working capital and general corporate purposes, which may include additional development, testing and demonstrations of our PowerBuoy system with the goal of furthering and accelerating our commercialization efforts and expanding our sales and marketing functions. The amounts and timing of these expenditures will depend on a number of factors, such as the timing, scope, progress and results of our research and development efforts, the timing and progress of any partnering efforts, and the regulatory and competitive environment. As of the date of this prospectus, we have not determined the amount of net proceeds to be used specifically for any particular purpose or the timing of any expenditures. Accordingly, management will retain broad discretion and flexibility in applying the net proceeds from the sale of the securities. Pending any use of the net proceeds, we intend to invest the net proceeds in repurchase contracts or deposit them in checking accounts at financial institutions.

CAPITALIZATION

The following table presents a summary of our cash and cash equivalents and capitalization as of July 31, 2016:

- on an actual basis; and
- on an as adjusted basis, giving further effect to the sale of 2,400,000 shares of common stock in this offering at a price of $2.75 per share, after deducting underwriting discounts and commissions and estimated offering expenses.

You should read the following table in conjunction with our historical financial statements and the related notes thereto incorporated by reference into this prospectus.

	July 31, 2016	
	Actual	**As Adjusted**
	(unaudited)	
Cash and Cash Equivalents	$9,024,512	$ 14,993,512
Debt		
Current portion of long-term debt and capital lease obligations	61,088	61,088
Long-term debt and capital lease obligations, less current portion	44,273	44,273
Stockholders' Equity		
Common Stock (par value $0.001 per share; 50,000,000 shares authorized); 3,551,850 shares issued and outstanding (actual) and 5,951,850 shares issued and outstanding (as adjusted)[1]	3,552	5,952
Treasury Stock, at cost (7,341 shares)	(141,887)	(141,887)
Additional Paid-in Capital	185,335,452	191,302,052
Accumulated Deficit	(181,711,458)	(181,711,458)
Accumulated Other Comprehensive Loss	(152,637)	(152,637)
Total Stockholders' Equity	3,333,022	9,302,022
Total Capitalization	$12,462,895	$ 24,400,895

(1) As of October 13, 2016, we had 3,129,992 shares of common stock issued and outstanding, which excludes (i) options outstanding as of that date representing the right to purchase a total of 160,872 shares of common stock at a weighted average exercise price of approximately $23.78 per share, (ii) 380,000 shares of common stock that may be issued in the future pursuant to a settlement agreement of certain pending securities litigation, which is subject to court approval and other requirements, (iii) outstanding warrants to purchase up to 145,952 shares of our common stock that will first become exercisable beginning on December 8, 2016 at a price of $6.08, and (iv) outstanding warrants to purchase up to 178,500 shares of our common stock which are currently exercisable at a price of $9.36.

DILUTION

If you invest in this offering, your ownership interest may be diluted to the extent of the difference between the public offering price per share and the as adjusted net tangible book value per share after giving effect to this offering. Our net tangible book value as of July 31, 2016, was approximately $3,333,022, or approximately $0.94 per share of common stock. Net tangible book value per share represents the amount of total tangible assets (total assets less intangible assets) less total liabilities, divided by the number of shares of our common stock outstanding as of July 31, 2016.

Dilution in net tangible book value per share represents the difference between the amount per share paid by purchasers in this offering and the net tangible book value per share of our common stock immediately after this offering. After giving effect to the sale of 2,400,000 shares of our common stock in this offering at the public offering price of $2.75 per share, and after deduction of commissions and estimated offering expenses payable by us, our as adjusted net tangible book value as of July 31, 2016 would have been approximately $9,302,022, or approximately $1.56 per share of common stock. This represents an immediate increase in net tangible book value of $5,969,000 per share of common stock to our existing stockholders and an immediate decrease in net tangible book value of $0.62 per share of common stock to investors in this offering. The actual amounts above are based on 3,551,850 shares outstanding as of July 31, 2016 and do not reflect the exercise of outstanding options, because the effect of such exercise would be anti-dilutive.

DIVIDEND POLICY AND COMMON STOCK PRICE RANGE

Dividend Policy

We have never declared or paid any cash dividends on our common stock, and we do not currently anticipate declaring or paying cash dividends on our common stock in the foreseeable future. We currently intend to retain all of our future earnings, if any, to finance the growth and development of our business. Any future determination relating to our dividend policy will be made at the discretion of our Board and will depend on a number of factors, including future earnings, capital requirements, financial conditions, future prospects, contractual restrictions and covenants and other factors that our Board may deem relevant.

Price Range of Our Common Stock

Our common stock is listed on the NASDAQ Capital Market under the symbol "OPTT." The following table sets forth, for the periods indicated, the range of high and low sales. The below prices retroactively apply our 1-for-10 reverse stock split that went into effect on October 27, 2015.

	Price Range	
	High	**Low**
Year Ending April 30, 2017		
First Quarter	$15.65	$1.37
Second Quarter (through October 13, 2016)	10.48	4.02
Year Ended April 30, 2016		
Fourth Quarter	2.86	1.25
Third Quarter	3.68	0.95
Second Quarter	5.61	2.31
First Quarter	8.50	4.90
Year Ended April 30, 2015		
Fourth Quarter	3.05	1.03
Third Quarter	1.54	0.91
Second Quarter	1.31	0.39
First Quarter	0.70	0.39

The reported last sales price for our common stock on the NASDAQ Capital Market on October 13, 2016 was $4.02 per share. As of October 13, 2016, there were 3,129,992 shares of common stock outstanding, and our outstanding shares of common stock were held by approximately 200 stockholder accounts of record.

BUSINESS

Overview

Nearly 70% of the earth's surface is covered by water, with over 40% of the world's population living within approximately 150 miles of a coast. Thousands of information gathering and/or power systems are deployed in the oceans today to increase understanding of weather, climate change, biological processes, and marine mammal patterns and to support exploration and operations for industries such as oil and gas. Most of these systems are powered by battery, solar, wind, fuel cell, or fossil fuel generators that are expensive to operate while also limited in their electric power delivery. These incumbent systems often require significant tradeoffs in sensor accuracy, data processing and communications bandwidth and frequency in order to operate with available power. More persistent power systems requiring less maintenance, like our systems, may have the ability to save costs over current operating systems. Just as importantly, increases in available power may allow for better sensors and shorter data sampling and communication intervals up to real-time which could as a result improve scientific and economic returns.

Founded in 1994 and headquartered in Pennington, New Jersey, we are the leader in ocean wave power. We are developing and seeking to commercialize our proprietary systems that generate electricity by harnessing the renewable energy of ocean waves. Our PowerBuoys® use proprietary technologies that convert the mechanical energy created by the heaving motion of ocean waves into electricity. We currently have designed and continue to develop our PowerBuoy product line which is based on modular, ocean-going buoys, which we have been periodically ocean testing since 1997.

We have designed our autonomous PowerBuoy to generate power for use in remote locations, independent of an existing power grid. Our current PowerBuoy product, the PB3, incorporates a unique power take-off ("PTO") and onboard system for energy storage and management, and is significantly smaller than our previous iteration utility-scale PowerBuoy. The PowerBuoy provides up to 3 kilowatts (kW) of peak power and 300 watts of continuous average power, which is deployment site dependent whereby average power can increase substantially in higher energy sites. Our standard ESS has an energy capacity of 44 kilowatt hours (kWh), scalable up to 150 kWh to meet specific application requirements. We are continuing to develop and test our PowerBuoys, including incremental scale up in power production. We believe there is a substantial addressable market for the current capabilities of our PB3 model, which we believe could be utilized in a variety of applications.

Our PB3 PowerBuoy design leverages portions of earlier features that we do not believe require further validation prior to implementation in our current products. Currently, our product development and engineering efforts are focusing primarily on developing technologies that will increase the energy output and reliability of our product through design scalability to meet and to maintain quality and speed time to our targeted markets. Our marketing and development efforts are targeting applications that require reliable, persistent, and sustainable power sources operating independently of the utility grid, either by supplying electric power to payloads that are integrated directly in our PowerBuoy or located in its vicinity, including on the seabed.

Based on our market research and available public data, management believes that there is the potential for us to pursue business opportunities in multiple markets that would have a direct need for our PowerBuoys including oil and gas, ocean observing, defense and security, communications, and offshore wind. Depending on power needs, sensor types and other considerations, we believe our PowerBuoy could have the ability to satisfy several application requirements within these markets. We believe that the PB3 generates sufficient persistent power to meet the application needs of many of the potential customers within our target markets. We are continuing our development efforts to increase the energy output of the PowerBuoy to generate more power required for other applications within these markets.

Since fiscal 2002, government agencies have accounted for a significant portion of our revenues. These revenues were largely for the support of our development efforts relating to our technology and development of our PowerBuoys. Our goal is that an increased portion of our revenues be from the sale or lease of our products and sales of services, as compared to revenue from grants to support our business operations. As we continue to develop and commercialize our products, we expect to have a net loss of cash from operating activities unless and until we achieve positive cash flow from the commercialization of our products and services. During fiscal 2015 and 2016, we continued work on projects with the DOE and MES, with whom we signed our first commercial leasing agreement in May 2016, and we continued our efforts to increase the reliability and power output of our PowerBuoys.

Market Opportunities

We are targeting our sales and marketing efforts in the following six markets, which we believe present market opportunities for our Company as we seek to commercialize our products and services.

Oil and Gas

We believe the oil and gas industry is undergoing a significant transformation. In light of industry consolidation due to relatively low oil prices, the industry continues to invest in new technologies which enable cost savings as well as the digitization of operations. We believe that minor improvements in oil field management can equate to significant additional revenues or cost savings for the operator and are driving the industry to search for new and enabling technologies. We believe that the addition of increased offshore power sources could enable activities like powering certain seafloor processes and/or augmenting associated power systems. We also believe that cost savings, the potential for increased revenues, and risk management are key drivers for adopting our PowerBuoy technology by the oil and gas industry. We also believe that applications such as charging stations for autonomous underwater vehicles, equipment monitoring, communications, reservoir management, weather forecasting, ocean current predictions, and seismic mapping are all significant customer market opportunities for our products.

The industry encompasses more than 10,000 sites, including exploration, production, reservoir management, and sites pending decommissioning. Multiple third party data sources were utilized for this analysis, including the U.S. Bureau of Safety and Environmental Enforcement and industry organizations and publications.

Ocean Observing

Ocean observing provides information for the entire ocean enterprise, which supports ocean measurement, observation and forecasting, and is an important provider of information to maritime commerce and the entire “blue economy” – a new term of art. Maritime commerce and the scientific community depend on information about areas such as weather, climate change, ocean seismometry, meteorology, and biological processes in order to inform operations and development and often require a power and communications solution in remote offshore locations.

According to NOAA's 2016 Ocean Enterprise report, the total U.S. available market over the five years beginning 2017 for ocean based systems infrastructure is $2.0 billion. Annual 2014 revenues for this sector were projected to be $287 million.

Security and Defense

In 2011, we deployed a prototype autonomous PowerBuoy off the coast of New Jersey, which we designed and manufactured for the U.S. Navy for coastal security and maritime surveillance (described more fully below under "Customers – Historical Projects – U.S. Navy"). Our PowerBuoy provided persistent power to an integrated radar system for nearly three months, and the system successfully extended the U.S. Navy's surveillance range by a significant amount. Two years later, we redeployed the system, powering both radar and sonar. We believe there is the potential for the U.S. Navy to seek to incorporate this type of surveillance capability in major ports throughout the United States.

We believe that a PowerBuoy can be used to provide power and communications for multiple applications, based on our current design which allows for multiple payloads to be integrated with or supported by the PowerBuoy. This may be an attractive feature for defense and security, as their systems can hide in plain sight or be easily integrated into other PowerBuoy applications. Example applications for domestic and international defense departments and defense contractors include forward deployed energy and communications outposts, above and below sea surface, early detection and warning systems, remote sensing stations, high frequency radar, sonar, electro-optical and infrared sensors for maritime security, network communications systems, and unmanned underwater vehicle docking stations.

According to a 2014 Frost and Sullivan report, market expenditures for global security reached $29 billion in 2012 and are projected to reach $56.5 billion in 2022. The report notes that maritime security expenditures were approximately 45% of the market.

Other Markets

We believe that opportunities also exist in markets such as communications and offshore wind.

With regard to communications, the addition of nearshore and offshore cellular and WiFi platforms with persistent power could decrease communications costs for the marine and airline industries. As an example, according to a 2015 Frost & Sullivan Oil & Gas Satellite Communications market report, the estimated 2020 annual spend on satellite communications in this market projected at $459 million.

We also believe that opportunities exist in the offshore wind market. There are approximately 9 GW of offshore wind installed worldwide as of the first quarter of 2015 according to an NREL 2014 - 2015 Offshore Wind Technologies Market report. This cumulative capacity is projected to increase to nearly 45 GW of installed capacity for projects with an announced COD through 2020. The NREL report projected a cumulative pipeline of nearly 250 GW for all projects, including those in the planning or early stages. For offshore wind applications, the PowerBuoy could be equipped with a Light Detection and Ranging (“LiDAR”) system to provide wind data for application in this market, after validation of the integrated system. Currently two methods of data collection are used for offshore wind: (1) meteorological masts, which are a significant cost to install on the ocean floor and can take more than 12 months for permitting and construction; and (2) floating, which uses LiDAR and which is gaining acceptance in the industry. Current power and communications platforms for floating LiDAR exist but may not be adequate for continuous data collection. We believe that our PowerBuoy solution may be able to decrease life cycle costs compared to these incumbent solutions. Global wind farm development market data suggest that hundreds of offshore wind sites are in the initial planning stages or beyond, with more being added each year.

Product and Technologies

The following is a summary of the development and history of our current PowerBuoy product and our technologies.

Wave Energy

The energy contained in ocean waves is a form of renewable energy that can be harnessed to generate electricity. Ocean waves are created when wind moves across the ocean surface. The interaction between the wind and the ocean surface causes energy to be exchanged. At first, small waves occur on the ocean surface. As this process continues, the waves become larger and the distance between the top of the waves becomes longer. Wave size, and the amount of kinetic wave energy, depends on wind speed, the duration the wind blows across the waves and the distance covered. The vertical motion of the waves moves the float component of our PowerBuoy, creating mechanical energy which our proprietary technologies convert into usable electricity.

We believe that there are the following potential benefits to using wave energy for electricity generation, compared to existing incumbent solutions.

Scalability within a small site area. Due to the dense energy in ocean waves, we believe that multiple PowerBuoys may be aggregated in an array that would occupy a reasonably small area to supply electricity to larger payloads. We believe the aggregation of a larger number of appropriately sized PowerBuoys could offer end users a variety of advantages in availability, reliability and scalability. To date, we have not deployed an array of PowerBuoys to test and validate our hypothesis, and we cannot assure that a PowerBuoy array would generate the energy required to meet the needs of prospective customers.

Predictability. The generation of power from wave energy can be forecasted several days in advance. Wave energy can be calculated with a high degree of accuracy based on satellite images and meteorological data, even when the wave is hundreds of miles away and days from reaching a PowerBuoy. Therefore, we believe end-users relying on PowerBuoys for power may be able to plan their logistics, payload scheduling and other operational activities based on such data and proactively, although we have not tested this theory.

Constant source of energy. The annual flow of waves at certain specific sites can be relatively constant and defined with relatively high accuracy. Based on our studies and analyses of various sites of interest, we believe that, at some point in the future, we will be able to deploy our PowerBuoys in locations where the waves could produce usable electricity for the majority of all hours during a year.

Methods for generating electricity from wave energy can be divided into two general categories: onshore systems and offshore systems. Our PowerBuoys are the offshore type. Offshore systems can be further divided into those that provide power to the electric grid and autonomous systems, which provide power to applications that are not grid-connected. Many offshore systems, including our PowerBuoy, utilize a floatation device to harness wave energy. The heaving or pitching of the floatation device due to the force of the waves creates mechanical energy, which is converted into electricity by various technologies. Onshore and near shore systems are often located on a shore cliff or a breakwater, or a short distance at sea from the shore line, and typically must concentrate the wave energy before using it to drive an electrical generator. Although maintenance costs of onshore systems may be less than those associated with offshore systems, we believe there are a variety of disadvantages to the former. As waves approach the shore, their energy decreases, therefore, onshore and near shore wave power stations are not capable of exploiting the same amount of energy produced by waves in deeper water. In addition, suitable sites for onshore and near shore systems are limited and potential environmental and aesthetic issues may impede development of these systems due to wave power station size and proximity of communities.

Our principal product is our autonomous PowerBuoy, which is designed to generate power for use independent of the power grid in remote offshore locations. It consists of a main hull structure surrounded by a floating buoy-like device. The hull is loosely moored to the seabed so that floating buoy can freely move up and down in response to the rising and falling of the waves. The PTO device that includes an electrical generator, a power electronics system, our control system, and our ESS are sealed within the hull. As ocean waves pass the PowerBuoy, the mechanical stroke action created by the waves is converted into rotational mechanical energy by the PTO, which in turn, drives the electrical generator. The power electronics system then conditions the electrical output which is collected within an ESS. The operation of the PowerBuoy is controlled by our customized, proprietary control system.

The control system uses sensors and an onboard computer to continuously monitor the PowerBuoy subsystems as well as the characteristics of the waves which interact with the PowerBuoy. The control system collects data from the sensors and the payloads, and uses proprietary algorithms to electronically adjust the performance of the PowerBuoy. We believe that this ability to optimize and manage the electric power output of the PowerBuoy is a significant advantage of our technology.

In the event of large storm waves, the control system automatically locks the PowerBuoy and electricity generation is suspended. However, the load center (either the on-board payload or that in the vicinity of the PowerBuoy) may continue to receive power from the on-board ESS. When wave heights return to normal operating conditions, the control system automatically unlocks the PowerBuoy and electricity generation and ESS replenishment recommence. This safety feature helps to prevent the PowerBuoy from being damaged by storm wave impacts.

In March 2016, we announced a rebranding of our PowerBuoy systems as part of our commercialization efforts and to closely align our PowerBuoy products with the perceived best practices of analogous industries based on power generation and on-board energy storage capabilities. Under our new naming conventions, our current PowerBuoy is referred to as the “PB3,” corresponding to “PowerBuoy with a peak power rating of three kilowatts.” This naming convention is based upon the ideal yet achievable ocean conditions that would result in a net AC peak power delivered by the PB3 PowerBuoy to a payload over a 20 minute period after converting the incoming wave energy into useful AC electricity. References on our website, and in our SEC filings to the “APB350” refers to earlier prototype PowerBuoys containing earlier generation PTOs and other earlier technologies.

The PB3 has undergone a design iteration from our immediate prior design focusing on improving its reliability and survivability in the anticipated operating ocean environment, and will continue to undergo further enhancements through customary product life cycle management. The PB3-A1 was an initial prototype that has now undergone in-ocean and accelerated life testing, and we believe that the PB3 will achieve a maturity level for use by early adopters in fiscal 2017, but we are in the early stages of seeking to commercialize our product and we cannot assure you that we will be successful in our efforts to do so. We believe that the PB3 will generate and store sufficient power to address some application requirements in our target markets. Our product development and engineering efforts are focused, in part, on increasing the energy output and efficiency of our PowerBuoys and, if we are able to do so, we believe the PowerBuoy would be useful for additional applications where cost savings and additional power are required by our potential customers. We have only begun to explore opportunities in these target markets, and we have not yet developed any integrated solutions and product offerings in these potential markets. We believe that by increasing the energy output of our PowerBuoys we may be able to address larger segments of our target markets. By improving our design and manufacturing, we also seek to reduce the cost of our PowerBuoys through further design iterations and manufacturing ramp-up. In so doing, we seek to improve customer value, displace more incumbent solutions, and become a viable power source for additional applications in our target market segments.

Research and Development

Our research and development team has a broad range of experience in mechanical engineering, electrical engineering, hydrodynamics and systems engineering. We have engaged in extensive research and development efforts to develop the PowerBuoy, improve PowerBuoy efficiency, reliability and power output, and to improve manufacturability while reducing cost and complexity. Our research and development efforts have been focused recently on optimizing the size of our PowerBuoys in order to achieve the most competitive overall cost (both operating and capital expenditures) in our target markets. Such efforts included reducing overall product size and weight by considering the use of materials other than steel for the external structure of our PowerBuoys. Other recent efforts included the development of scalable, higher efficiency, lower cost, higher reliability and less customized PTO systems, and the use of higher energy density and lower weight energy storage technologies. We continue to seek to increase the capabilities of our PowerBuoy systems by designing flexible interfaces and rendering them sensor and payload agnostic.

Other areas of research and development focus have included the development and implementation of accelerated testing regimens and techniques known as accelerated life testing. Such methods accelerate failures in a laboratory environment, as compared to more lengthy and expensive full scale ocean deployments during normal use conditions. This testing allows us to quantify the life characteristics of critical components and subsystems which would normally require several years of operation in ocean conditions to achieve similar levels of wear and tear. Accelerated life testing is used successfully in other industries such as automotive and aerospace, and is a critical enabler for rapid product and technology development and maturation. We believe that the combination of laboratory and ocean test regimens coupled with carefully planned PowerBuoy ocean tests will help us to improve our effectiveness in commercializing our products.

It is our intent to fund the majority of our research and development expenses over the next several years with sources of external funding, including cost sharing obligations under customer contracts. However, we cannot assure you that we will be successful in our efforts to secure additional contracts. If we are unable to obtain external funding, we may curtail our research and development expenses or reduce the scope of our operations as necessary to lower our operating costs.

Deployments

We continue to receive important feedback from in-ocean deployments of our PowerBuoys, as is customary in the marine industry for new vessels and products prior to final acceptance by their customers. If we are able to increase PowerBuoy production, we anticipate that the need for in-ocean trials of our mature products will diminish. Deployment sites are selected based on minimum ocean depth, appropriate wave activity for power generation requirements of associated deployment payloads, and proximity to end-user operations. The PB3 can be transported over land to the deployment port using a standard 40 foot "low-boy" trailer. Once at port, the PB3 can be lifted into the water or onboard a vessel using a readily available crane of appropriate capacity. The PB3 may then be towed to site using a standard vessel (if the location is within an appropriate distance from the port), or the PB3 may be carried aboard a vessel to its offshore location, and craned into the water at site. The PB3 is then attached to the mooring system, which is installed during a separate operation, after which a brief commissioning process places the PB3 into operation. Recent deployments include the PB3-A1 in August and October of 2015, and again in June 2016. In July 2016, we deployed our first commercial PB3 PowerBuoy, approximately four miles off of the coast of New Jersey. The Company currently anticipates that this deployment will be the final validation of the PB3 prior to the anticipated March 2017 six-month lease of the PB3 PowerBuoy under a previously announced customer agreement.

Product Insurance. We currently have a property loss and liability insurance policy underwritten by Lloyd's Underwriters that covers the deployment and storage of our PowerBuoys.

Site Approval. In the U.S., federal agencies regulate the siting of long-term renewable energy projects and related-uses located on the outer continental shelf ("OCS"), which is generally more than three miles offshore. OCS projects longer than one-year in duration are regulated by the U.S. Bureau of Ocean Energy Management ("BOEM"). For projects located within three miles of the U.S. shore regardless of duration, the adjacent state would be responsible for issuing a lease and other required authorizations for the location of the project. In either case, an assessment of the potential environmental impact of the project would be conducted in addition to other requirements. Generally, the same process applies to foreign sites where site approval is contingent on meeting both national and local regulatory and environmental requirements. In connection with issuing permits or leases enabling project use, the respective government agency often requires site restoration or other activities at the conclusion of the permit or lease period.

Environmental Approval and Compliance. We are subject to various foreign, federal, state and local environmental protection and health and safety laws and regulations governing, among other things: the generation, storage, handling, use and transportation of hazardous materials; the emission and discharge of hazardous materials into the ground, air or water; and the health and safety of our employees. In addition, in the U.S., the construction and operation of PowerBuoys offshore would require permits and approvals from the U.S. Coast Guard, the U.S. Army Corps of Engineers and other governmental authorities. These required permits and approvals evaluate, among other things, whether a project is in the public interest and ensure that the project would not create a hazard to navigation. Other foreign and international laws may require similar approvals. We provide you with additional information under “Regulation” below.

Customers

Current Customers

The table below shows the percentage of our revenue we derived from significant customers for the periods indicated:

	2016	2015	2014
E.U. (WavePort project)	58 %	23 %	15 %
U.S. Department of Energy	28 %	37 %	34 %
Mitsui Engineering & Shipbuilding	14 %	40	

Ernest C. Hill Age 68	Director	Class Three Director since 1994. Term expires at the Annual Meeting held in 2010 .	Consultant	1	None
Interested Director:					
Russell Cleveland[2] Age 70	Chairman of the Board, President, Chief Executive Officer, and Director	Class Three Director since 1994. Term expires at the Annual Meeting held in 2010 .	President & Chief Executive Officer of RENN Group	5	BPO Management Services, Inc., CaminoSoft Corp., Cover-All Technologies, Inc., Integrated Security Systems, Inc., Access Plans USA, Inc.

(1) The address of all such persons is c/o RENN Capital Group, Inc., 8080 N. Central Expressway, Suite 210, LB-59, Dallas, TX 75206.
(2) Mr. Cleveland is also President and CEO of RENN Capital Group, Inc. See "information About the Fund's Officers and the Investment Adviser."
(3) The term "Fund Complex" means all funds which share a common investment adviser.

Committees and Meetings

The Board of Directors held twenty-two (22) meetings or executed consent actions in lieu of meetings during 2008, and each director attended or executed at least seventy-five per cent (75%) of these meetings and consent actions.

The Audit Committee

During 2008, the Audit Committee consisted of Ernest C. Hill, Chairman, Peter Collins, Charles C. Pierce, Jr. and J. Philip McCormick. The Audit Committee held five (5) meetings in 2008. The Audit Committee is comprised entirely of independent directors, and is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. The Audit Committee's primary duties and responsibilities are to:

- appoint and approve the compensation of the Fund's independent auditors, including those to be retained for the purpose of preparing or issuing an audit report or performing other audit review or attestation services for the Fund;

- review the scope of the audit services of the Fund's independent auditors, and the annual results of their audits;

- monitor the independence and performance of the Fund's independent auditors;

- generally oversee the accounting and financial reporting processes of the Fund and the audits of its financial statements;

- review the reports and recommendations of the Fund's independent auditors;

- provide an avenue of communication among the independent auditors, management and the Board of Directors; and

- address any matters between the Fund and its independent auditors regarding financial reporting.

The Fund's independent auditors must report directly to the Audit Committee.

The Board of Directors has determined that J. Philip McCormick satisfies the standard for "audit committee financial expert" within the meaning of the rules of the SEC. The SEC rules provide that audit committee financial experts do not have any additional duties, obligations or liabilities and are not considered experts under the U.S. Securities Act of 1933.

The Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee was created in January 2004 and is responsible for nominating individuals to serve as directors. The Nominating and Corporate Governance Committee is composed entirely of independent Fund directors**.** Its members are Chairman Charles C. Pierce, Jr., Ernest C. Hill, and Peter Collins.

The Committee considers and recommends nominees for election as directors of the Fund. Stockholders wishing to recommend qualified candidates for consideration by the Fund may do so by writing to the Secretary of the Fund at the address shown in the Notice providing the candidate's name, biographical data and qualifications. In its assessment of each potential candidate, the Committee reviews the nominee's judgment, experience, independence, financial literacy, knowledge of emerging growth companies, understanding of the Fund and its investment objectives, and such other factors as the Committee may determine. The Committee also takes into account the ability of a director to devote the time and effort necessary to fulfill his or her responsibilities. At the direction of the Board of Directors, the Committee also considers various corporate governance policies and procedures.

Officers

Russell Cleveland, age 70, has served as Chairman of the Board, President, Chief Executive Officer, and a Class Three director of the Fund since 1994. He has also served as the President, Chief Executive Officer, sole Director, and the majority stockholder of RENN Group since 1994. He is a Chartered Financial Analyst with more than 35 years experience as a specialist in investments for smaller capitalization companies. A graduate of the Wharton School of Business, Mr. Cleveland has served as President of the Dallas Association of Investment Analysts. Mr. Cleveland also serves on the Boards of Directors of Renaissance US Growth Investment Trust PLC, BPO Management Services, Inc., CaminoSoft Corp., Cover-All Technologies, Inc., Integrated Security Systems, Inc., and Access Plans USA, Inc.

Barbe Butschek, age 54, has served as the Secretary and Treasurer of the Fund since 1994. She currently serves as Senior Vice-President, Secretary and Treasurer of RENN Group and has served with RENN Group with responsibilities for financial reporting and various other duties since 1977 and has been the minority shareholder of RENN Group since 1991.

Robert C. Pearson, age 73, has served as Vice President of the Fund since April 1997. He joined RENN Group in April 1997 and is Senior Vice-President - Investments. Mr. Pearson brought more than thirty years of experience to RENN Group's corporate finance function. From May 1994 to May 1997, Mr. Pearson was an independent financial management consultant. From May 1990 to May 1994, he served as Chief Financial Officer and Executive Vice-President of Thomas Group, Inc., a management consulting firm, where he was instrumental in moving a small privately held company from a start-up to a public company with more than $40 million in revenues. Prior to 1990, Mr. Pearson was responsible for all administrative activities for the Superconducting Super Collider Laboratory. In addition, from 1960 to 1985, Mr. Pearson served in a variety of positions at Texas Instruments in financial planning and analysis, holding such positions as Vice-President - Controller and Vice-President - Finance. Mr. Pearson holds a BS in Business from the University of Maryland and was a W.A. Paton Scholar with an MBA from the University of Michigan. He is a director of *e*Original, Inc., CaminoSoft Corp., and Vertical Branding.

Scott E. Douglass**,** age 50, has served as a Vice President of the Fund since November 2004. He has worked for three sell-side firms in the roles of institutional sales and investment banking. Prior to that he was a commercial loan officer for the First National Bank of Boston and Fleet Financial Group which are now part of Bank of America. He holds a Masters Degree in Business Administration from the Olin Graduate School of Business at Babson College.

Z. Eric Stephens, age 40, has served as a Vice President of RENN Group since January 2006 and a Vice President of the Fund since August 2006. His responsibilities with RENN Group include due diligence, portfolio monitoring and portfolio selection. Previously, Mr. Stephens was a director with CBIZ Valuation Group, a national valuation consulting firm. While with CBIZ, he valued public and private companies, performed purchase price allocations and goodwill impairment tests, wrote fairness opinions and solvency opinions and acted as an expert witness. Prior to working for CBIZ, Mr. Stephens was a staff accountant with the U.S. Securities and Exchange Commission. While with the SEC, he conducted on-site examinations of investment companies and investment advisers. Mr. Stephens has a BA in economics and finance from Southwestern Oklahoma State University and an MBA from Texas A&M University and is a Chartered Financial Analyst.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Fund's officers and directors and persons who own more than 10% of a registered class of the Fund's equity securities to file reports of ownership and changes in ownership with the SEC. Officers, directors, and greater-than-10% beneficial owners are required by SEC regulations to furnish the Fund with copies of all Section 16(a) forms they file. The Fund believes that during the fiscal year ended December 31, 2008, all Section 16(a) filings relating to the Fund's Common Stock applicable to its officers, directors, and greater-than-10% beneficial owners were timely filed.

Item 11. Executive Compensation.

The Fund has no employees, and therefore does not compensate any employees. Officers of the Fund receive no compensation from the Fund. The Fund has never issued options or warrants to officers or directors of the Fund. The Fund does not have any stock option plan or similar plan, retirement or pension plan, or any other form of compensatory plan for employees. As a result, the Fund does not have a compensation committee. Instead, the Fund has contracted with RENN Group pursuant to the Advisory Agreement to provide all management and operating activities.

DIRECTOR COMPENSATION

Directors who are not employees of either the Fund or RENN Group receive a monthly fee of $2,000 ($3,000 per month for the Chairman of the Audit Committee), plus $750 and out-of-pocket expenses for each quarterly valuation meeting attended. The Fund does not pay any fees to, or reimburse expenses of, its directors who are considered “interested persons” of the Fund. The aggregate compensation for the period from January 1 to December 31, 2008, that the Fund paid each director, and the aggregate compensation paid to each director for the most recently completed fiscal year by other funds to which RENN Group provided investment advisory services is set forth below:

Name	Fees Earned or Paid in Cash	Stock Awards	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation	Total
Russell Cleveland (1)	$ --	$ --	$ --	$ --	$ --	$ --	$ --
Peter Collins	$ 27,000	$ --	$ --	$ --	$ --	$ --	$ 27,000
Ernest C. Hill	$ 39,000	$ --	$ --	$ --	$ --	$ --	$ 39,000
Charles C. Pierce, Jr.	$ 27,000	$ --	$ --	$ --	$ --	$ --	$ 27,000
J. Philip McCormick	$ 26,250	$ --	$ --	$ --	$ --	$ --	$ 26,250

(1) Mr. Cleveland is President and Chief Executive Officer of RENN Group and a more than 5% beneficial owner of the Fund.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

The Fund has no equity compensation plans. The following table sets forth certain information known to the Fund with respect to beneficial ownership of the Fund's Common Stock as of December 31, 2008: (i) for all persons who are beneficial owners of more than 5% of the outstanding shares of the Fund's Common Stock; (ii) each director and nominee for director of the Fund; and (iii) all executive officers and directors of the Fund as a group:

Name of Beneficial Owner	Number of Shares Beneficially Owned or Directly or Indirectly	Percent of Class
Russell Cleveland, Chairman, President, Chief Executive Officer, and Director (1)	415,484 (2)	9.31%
Peter Collins, Director	2, 502 (3)	0.05%
Charles C. Pierce, Jr., Director	2,299	0.05%
Ernest C. Hill, Director	--	0.00%
J. Philip McCormick, Director	3,500	0.08%
	423,785	9.43%
other officers	11,861	0.27%
All directors and officers of the Fund as a group (9 persons)	435,646	9.70%

(1) "Interested person" as defined by the 1940 Act.
(2) Consists of 36,216 shares owned by the Cleveland Family Limited Partnership and 335,468 shares owned by RENN Investment Limited Partnership and 43,800 shares owned by RENN Capital Group, Inc.
(3) Includes 130 shares owned by Hilary Collins, Mr. Collin's spouse
*as of December 31, 2008

Item 13. Certain Relationships and Related Transactions and Director Independence.

In 2008, the Fund incurred a management fee to RENN Group of $455,005 of which $374,033 was paid in 2008. There was no incentive fee incurred for 2008. The Fund also received directors' fees from portfolio companies with respect to Mr. Cleveland's and Mr. Pearson's services as directors. Russell Cleveland and Barbe Butschek own 80% and 20%, respectively, of the Common Stock of RENN Group. The sole director of RENN Group is Russell Cleveland.

Item 14. Principal Accountant Fees and Services.

The following table presents fees paid by the Fund for professional services rendered by KBA Group LLP and accounting consultants for the fiscal years ended December 31, 2008 and 2007.

Fee Category	Fiscal 2008 Fees	Fiscal 2007 Fees
Audit Fee	$ 136,850	$ 148,575
Audit-Related Fees	$ -	$ -
Tax Fees	$ -	$ -
All Other Fees	$ -	$ -
Total Fees	$ 136,850	$ 148,575

Audit Fees were for professional services rendered for the audit of the Fund's annual financial statements and review of the Fund's quarterly financial statements. No non-audit fees were paid to the independent audit firm of KBA Group LLP.

No Other Fees were paid by the Fund to KBA Group LLP for the fiscal years ended December 31, 2008 or 2007.

Part IV

Item 15. Exhibits, Financial Statement Schedules.

DOCUMENTS FILED AS PART OF THIS FORM 10K

Financial Statements:

The financial statements filed as part of this report are listed in “Index to Financial Statements” on page F-1 hereof.

Financial Schedules:

There are no schedules presented since none are applicable.

EXHIBITS

3.1	Restated Articles of Incorporation[1]
3.2	Bylaws[2]
10.1	Dividend Reinvestment Plan[3]
10.2	Amendment No. 1 to Dividend Reinvestment Plan[4]
10.3	Amended Investment Advisory Agreement[5]
10.5	Custodial Agreement with The Frost National Bank[6]
14	Code of Ethics[7]
31.1	Certification of the principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

1 Incorporated by reference from Form N-2 as filed with the Securities and Exchange Commission February 25, 1994 (Registration No. 33-75758).

2 Incorporated by reference from Form N-2 as filed with the Securities and Exchange Commission February 25, 1994 (Registration No. 33-75758).

3 Incorporated by reference from Form N-2 as filed with the Securities and Exchange Commission February 25, 1994 (Registration No. 33-75758).

4 Incorporated by reference from Form N-2 as filed with the Securities and Exchange Commission February 25, 1994 (Registration No. 33-75758).

5 Incorporated by reference from Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission (File No. 033-75758).

6 Incorporated by reference from Form 10-K for the year ended December 31, 2000 as filed with the Securities and Exchange Commission (File No. 001-11701).

7 Incorporated by reference from Form 8-K as filed with the Securities and Exchange Commission (File No. 001-11701).

Signatures

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: March 18, 2009

Renaissance Capital Growth & Income Fund III, Inc.
(Registrant)

/s/ Russell Cleveland
By: Russell Cleveland, Chairman and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Fund in the capacities and on the date indicated Signatures.

Signature	Capacity in Which Signed	Date
/s/ Russell Cleveland Russell Cleveland	Chairman, President and Director	March 18, 2009
/s/ Barbe Butschek Barbe Butschek	Secretary and Treasurer	March 18, 2009
/s/ Ernest C. Hill Ernest C. Hill	Director	March 18, 2009
/s/ Peter Collins Peter Collins	Director	March 18, 2009
/s/ J. Philip McCormick J. Philip McCormick	Director	March 18, 2009
/s/ Charles C. Pierce, Jr. Charles C. Pierce, Jr.	Director	March 18, 2009

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stockholders and Board of Directors

Renaissance Capital Growth & Income Fund III, Inc.

We have audited the accompanying statements of assets and liabilities of Renaissance Capital Growth & Income Fund III, Inc. (the "Fund") including the schedules of investments as of December 31, 2008 and 2007 and the related statements of operations, changes in net assets and cash flows for the years ended December 31, 2008, 2007 and 2006 and financial highlights for the years ended December 31, 2008 and 2007. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. The Fund is not required to have nor were we engaged to perform, audits of their internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund'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 financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Renaissance Capital Growth & Income Fund III, Inc. as of December 31, 2008 and 2007 and the results of its operations and its cash flows for the years ended December 31, 2008, 2007 and 2006 and the financial highlights for the years ended December 31, 2008 and 2007 in conformity with accounting principles generally accepted in the United States of America.

/s/ KBA GROUP LLP
KBA Group LLP

Dallas, TX

March 18, 2009

Renaissance Capital Growth & Income Fund III, Inc.

Statements of Assets and Liabilities

December 31, 2008 and 2007

	2008	2007
ASSETS		
Cash and cash equivalents	$ 2,558,630	$ 3,679,949
Investments at fair value, cost of $41,524,234 and $43,820,011 at December 31, 2008 and 2007, respectively	15,931,925	36,251,126
Interest and dividends receivable	91,428	141,402
Prepaid and other assets	37,178	50,663
	$ 18,619,161	$ 40,123,140
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	$ 105,273	$ 57,726
Dividends payable	-	446,397
Accounts payable - affiliate	86,872	374,734
Taxes payable on behalf of stockholders	-	1,485,135
	192,145	2,363,992
Commitments and contingencies		
Net assets:		
Common stock, $1 par value; 20,000,000 shares authorized ; 4,673,867 shares issued; 4,463,967 shares outstanding	4,673,867	4,673,867
Additional paid-in-capital	26,617,105	27,925,813
Treasury stock at cost, 209,900 shares	(1,734,967)	(1,734,967)
Net realized gain on investments retained	14,463,320	14,463,320
Net unrealized depreciation of investments	(25,592,309)	(7,568,885)
Net assets, equivalent to $4.13 and $8.46 per share at December 31, 2008 and 2007, respectively	18,427,016	37,759,148
	$ 18,619,161	$ 40,123,140

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments

December 31, 2008 and 2007

	2008				
	Interest Rate	Maturity Date	Fair Value	Cost	% of Investment Assets
Eligible Portfolio Investments - Convertible Debentures and Promissory Notes					
CaminoSoft Corp. -					
Promissory note (2)	7 %	4/30/2009	$ 250,000	$ 250,000	1.57 %
Integrated Security Systems, Inc. -					
Convertible Promissory note (2)	6	9/30/2009	400,000	400,000	2.51
Convertible Promissory note (2)	8	9/30/2009	750,000	750,000	4.71
Promissory note (2)	7	9/30/2009	200,000	200,000	1.26
Promissory note (2)	8	9/30/2009	1,200,000	1,200,000	7.52
iLinc Communications, Inc. -					
Convertible debenture	12	3/29/2012	500,000	500,000	3.14
PetroHunter Energy Corp -					
Convertible debenture	8..5	11/5/2012	1,000,000	1,000,000	6.27
Pipeline Data, Inc. -					
Convertible debenture	8	6/29/2010	569,000	569,000	3.57
			$ 4,869,000	$ 4,869,000	30.55 %

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

	2008			
	Shares	Cost	Fair Value	% of Investment Assets
Eligible Portfolio Investments - Common Stock, Preferred Stock, and Miscellaneous Securities				
AuraSound, Inc.				
Common stock	1,000,000	$ 1,000,000	$ 20,000	0 .13%
BPO Management Services, Inc.				
Series F, preferred (2)	1,685,886	2,000,000	270,111	1 .69
Business Process Outsourcing Ltd. -				
Common stock (1)	18,349	20,000	79,268	0 .50
	3,813,321	5,295,521	38,050	0 .24
CaminoSoft Corp. -				
Common stock (2)				
eOriginal, Inc. -				
Series A, preferred stock (2)	10,680	4,692,207	40,904	0 .26
Series B, preferred stock (2)	25,646	620,329	98,224	0 .26
Series C, preferred stock (2)	51,249	1,059,734	196,284	1 .23
Series D, preferred stock (2)	36,711	500,000	140,603	0 .88
Global Axcess Corporation -				
Common stock	953,333	1,261,667	123,933	0 .78
i2 Telecom -				
Common stock	4,165,316	711,200	208,266	1 .31
Integrated Security Systems, Inc. -				
Common stock (2)	39,626,430	6,325,113	789,309	4 .95
Series D, preferred stock (2)	7,500	150,000	3,750	0 .02
Hemobiotech, Inc. -				
Common stock	1,200,000	1,284,117	876,000	5 .50

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

	2008			
	Shares	Cost	Fair Value	% of Investment Assets
Eligible Portfolio Investments - Common Stock, Preferred Stock, and Miscellaneous Securities, continued				
Murdoch Security & Investigations, Inc.- Common stock (1)	2,612,250	1,250,000	1,306,250	8.20
Narrowstep, Inc - Common stock	4,000,000	1,000,000	28,000	0.18
Riptide Worldwide, Inc. (Shea Development Corp). - Common stock	941,962	754,387	9,419	0.06
Symbollon Pharmaceuticals, Inc. - Common stock	607,143	500,000	4,250	0.03
Vertical Branding, Inc.- Common stock (2)	1,686,725	1,008,628	235,789	1.48
Miscellaneous Securities (3)		8,877	-	-
		$ 29,441,780	$ 4,468,410	28.06 %

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

	2008				
	Interest Rate	Maturity Date	Cost	Fair Value	% of Investment Assets
Other Portfolio Investments - Convertible Debentures and Promissory Notes					
Dynamic Green Energy Limited. - Convertible Promissory note (1)	7%	6/10/2011	$ 1,000,000	$ 1,000,000	6.27%
			$ 1,000,000	$ 1,000,000	6.27%

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

	2008			
	Shares	Cost	Fair Value	% of Investment Assets
Other Portfolio Investments - Common Stock, Preferred Stock, and Miscellaneous Securities				
Access Plans (Precis) - Common stock (2)	890,500	$ 2,139,777	$ 204,815	1.29%
A-Power Energy Generation Systems, Ltd. . - Common stock	48,000	409,256	206,400	1.30
Asian Financial, Inc. - Common stock (1)	130,209	500,000	500,000	3.14
Bovie Medical Corporation - Common stock	500,000	907,845	3,120,000	19.58
COGO Group, Inc. (Comtech Group, Inc). - Common stock	200,000	836,019	972,000	6.10
HLS Systems International, Ltd. - Common stock	58,500	498,557	163,800	1.03
Points International, Ltd. - Common stock	900,000	492,000	355,500	2.23
Silverleaf Resorts, Inc. - Common stock	100,000	430,000	72,000	0.45
Miscellaneous Securities	-	-	-	-
		6,213,454	5,594,515	35.12%
		$ 41,524,235	$ 15,931,925	100.00%

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

Allocation of Investments -
Restricted Shares, Unrestricted Shares,
Miscellaneous Securities, and Cash and
Cash Equivalents

	2008		
	Cost	Fair Value	% of Investement Assets
Private Securities (1)	$ 2,770,000	$ 2,885,518	18.11%
Restricted Securities (2)	$ 26,591,309	$ 4,817,839	30.24%
Unrestricted Securities	$ 12,154,048	$ 8,228,568	51.65%
Miscellaneous Securities (3)	$ 8,877	$ -	0.00%
	$ 41,524,234	$ 15,931,925	100.00%

(1) Securities in a privately owned company.
(2) Restricted securities due to the Fund’s having a director on issuer’s board or held less than 6 months.
(3) Other securities such as warrants and options.

See accompanying notes

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Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

	2007				
	Interest Rate	Maturity Date	Cost	Fair Value	% of Investment Assets
Eligible Portfolio Investments - Convertible Debentures and Promissory Notes					
CaminoSoft Corp. -					
Promissory note (2)	7 %	1/19/2008	$ 250,000	$ 250,000	0.69%
Integrated Security Systems, Inc. -					
Convertible Promissory note (2)	6	9/30/2008	400,000	400,000	1.10
Promissory note (2)	8	9/30/2008	525,000	525,000	1.45
Promissory note (2)	7	9/30/2008	200,000	200,000	0.55
Promissory note (2)	8	9/30/2008	175,000	175,000	0.48
Promissory note (2)	8	9/30/2008	450,000	450,000	1.24
Convertible promissory note (2)	8	12/14/2008	500,000	500,000	1.38
Promissory note (2)	8	12/12/2008	300,000	300,000	0.83
iLinc Communications, Inc. -					
Convertible debenture	12	3/29/2012	500,000	500,000	1.38
PetroHunter Energy Corp -					
Convertible debenture (2)	8.5	11/5/2012	1,000,000	1,466,667	4.05
Pipeline Data, Inc. -					
Convertible debenture	8	6/29/2010	500,000	500,000	0.37
Simtek Corporation -					
Convertible debenture (2)	7.5	6/28/2009	$ 700,000	$ 738,182	2.04
			$ 5,500,000	$ 6,004,849	16.57%

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

	2007					
	Shares		Cost		Fair Value	% of Investment Assets
Eligible Portfolio Investments - Common Stock, Preferred Stock, and Miscellaneous Securities						
Advance Nanotech, Inc. -						
Common stock	5,796	$	11,199	$	1,652	0.00%
AuraSound, Inc.						
Common stock	1,000,000		1,000,000		1,100,000	3.03
BPO Management Services, Inc.						
Series D, preferred (2)	104,167		1,000,000		716,667	1.98
Series D2, preferred (2)	52,084		500,000		358,333	0.99
CaminoSoft Corp. -						
Common stock (2)	3,539,414		5,275,000		283,153	0.78
eOriginal, Inc. -						
Series A, preferred stock (1)	10,680		4,692,207		145,462	0.40
Series B, preferred stock (1)	25,646		620,329		349,299	0.96
Series C, preferred stock (1)	51,249		1,059,734		698,011	1.93
Series D, preferred stock (1)	36,711		500,000		500,004	1.38
Gaming & Entertainment Group, Inc. -						
Common stock	112,500		50,625		788	0.00
Gasco Energy, Inc. -						
Common stock	775,586		465,352		1,543,416	4.26
Global Axcess Corporation -						
Common stock	953,333		1,261,667		324,133	0.89
i2 Telecom -						
Common stock	237,510		36,200		17,814	0.05
Common stock (2)	3,927,806		675,000		294,585	0.81

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

	2007			
	Shares	Cost	Fair Value	% of Investment Assets
Eligible Portfolio Investments -				
Common Stock, Preferred Stock,				
and Miscellaneous Securities, continued				
Integrated Security Systems, Inc.				
Common stock (2)	30,733,532	5,661,058	2,766,018	7.63
Common stock (2)	2,175,559	400,734	195,800	0.54
Series D, preferred stock (2)	7,500	150,000	16,875	0.05
Hemobiotech, Inc. -				
Common stock	1,200,000	1,284,117	1,680,000	4.63
Murdoch Security & Investigations, Inc.-				
Common stock (1)	2,000,000	1,000,000	1,000,000	2.76
Narrowstep, Inc -				
Common stock (2)	4,000,000	1,000,000	440,000	1.21
Nutradyne Group, Inc. -				
Common stock	13,917	12,500	21,571	0.06
Shea Development Corp. -				
Common stock (2)	1,838,396	1,093,332	643,439	1.78
Simtek Corp. -				
Common stock (2)	640,763	1,799,294	1,486,570	4.10
Common stock (2)	90,909	200,000	210,909	0.58
Symbollon Pharmaceuticals, Inc. -				
Common stock	607,143	500,000	391,607	1.08
Vertical Branding, Inc.-				
Common stock (2)	1,666,667	1,000,000	666,667	1.84
Miscellaneous Securities (3)		-	187,727	0.52
		$ 31,248,348	$ 16,040,500	44.24%

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

	2007			
	Shares	Cost	Fair Value	% of Investment Assets
Other Portfolio Investments - Common Stock, Preferred Stock, and Miscellaneous Securities				
Access Plans (Precis) - Common stock (2)	890,500	$ 2,139,777	$ 952,835	2.63%
AdStar, Inc. - Common stock	253,500	330,718	96,330	0.27
Asian Financial, Inc. - Common stock (1)	130,209	500,000	500,000	1.38
Bovie Medical Corporation - Common stock	500,000	907,844	3,185,000	8.79
Chardan South China Acquisition Corp- Common stock	48,000	409,256	640,800	1.77
Comtech Group, Inc. - Common stock	200,000	836,019	3,222,000	8.89
HLS Systems International, Ltd. - Common stock	58,500	498,557	521,820	1.44
iLinc Communications, Inc. - Common stock	23,266	13,908	12,564	0.03
Medical Action Industries, Inc. - Common stock	30,150	237,209	628,628	1.73

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Schedules of Investments (continued)

December 31, 2008 and 2007

	2007			
	Shares	Cost	Fair Value	% of Investment Assets
Other Portfolio Investments - Common Stock, Preferred Stock, and Miscellaneous Securities				
Points International, Ltd. - Common stock	900,000	492,000	3,735,000	0.10
Silverleaf Resorts, Inc. - Common stock	100,000	430,000	416,000	0.01
US Home Systems, Inc. - Common stock	55,000	276,375	294,800	0.01
Miscellaneous Securities		-	-	0.00
		7,071,663	14,205,777	39.19%
		$ 43,820,011	$ 36,251,126	100.00%

Allocation of Investments - Restricted Shares, Unrestricted Shares, and Other Securities			
Private Securities (1)	$ 8,372,270	$ 3,192,776	8.81%
Restricted Securities (2)	$ 25,394,195	$ 14,036,700	38.73%
Unrestricted Securities	$ 10,053,546	$ 18,833,923	51.94%
Miscellaneous Securities (3)	$ -	$ 187,727	0.52%
	$ 43,820,011	$ 36,251,126	100.00%

(1) Securities in a privately owned company.
(2) Restricted securities due to the Fund's having a director on issuer's board or held less than 1 year.
(3) Other securities such as warrants and options.

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Statements of Operations

December 31, 2008, 2007 and 2006

	2008	2007	2006
Investment income:			
Interest income	$ 454,420	$ 345,510	$ 340,145
Dividend income	33,193	432,478	584,139
Other income	87,730	48,601	27,684
	575,343	826,589	951,968
Expenses:			
General and administrative	440,671	432,563	335,641
Incentive fee to affiliate	-	-	3,157,367
Interest expense	40,841	-	60,188
Legal and professional fees	409,836	354,127	651,701
Management fee to affiliate	455,005	792,545	935,776
	1,346,353	1,579,235	5,140,673
Net investment loss	(771,010)	(752,646)	(4,188,705)
Realized and unrealized gain (loss) on investments:			
Net unrealized depreciation of investments	(18,023,424)	(12,797,981)	(13,339,923)
Net realized gain on investments	801,494	4,873,865	19,795,521
Income tax expense paid on behalf of stockholders	-	(1,485,135)	(6,302,806)
Net gain (loss) on investments	(17,221,930)	(9,409,251)	152,792
Net loss	$ (17,992,940)	$ (10,161,897)	$ (4,035,913)
Net loss per share	$ (4.03)	$ (2.28)	$ (0.90)
Weighted average shares outstanding	4,463,967	4,463,967	4,463,967

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Statements of Changes in Net Assets

Years Ended December 31, 2008 , 2007 , and 2006

	2008	2007	2006
From operations:			
Net investment loss	$ (771,010)	$ (752,646)	$ (4,188,705)
Net realized gain on investments	801,494	4,873,865	19,795,521
Income tax expense paid on behalf of stockholders	--	(1,485,135)	(6,302,806)
Net unrealized (depreciation) of investments	(18,023,424)	(12,797,981)	(13,339,923)
Net loss	(17,992,940)	(10,161,897)	(4,035,913)
From distributions to stockholders:			
Cash dividends declared from realized gains	(1,339,192)	(446,397)	(1,785,588)
Total decrease in net assets	(19,332,132)	(10,608,294)	(5,821,501)
Net assets:			
Beginning of period	37,759,148	48,367,442	54,188,943
End of period	$ 18,427,016	$ 37,759,148	$ 48,367,442

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Statements of Cash Flows

Years Ended December 31, 2008 , 2007 , and 2006

	2008	2007	2006
Cash flows from operating activities:			
Net loss	$ (17,992,940)	$ (10,161,897)	$ (4,035,913)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Net decrease in unrealized depreciation of investments	18,023,424	12,797,981	13,339,923
Net realized gain on investments	(801,494)	(4,873,865)	(19,795,521)
(Increase) decrease in interest and dividend receivables	49,974	4,744	(97,920)
(Increase) decrease in prepaid and other assets	13,485	(24,897)	75,832
Increase (decrease) in accounts payable	47, 547	(111,119)	82,063
Increase in due to broker	-	-	(2,075,975)
(Decrease) increase in accounts payable-affiliate	(287,862)	(3,435,728)	1,759,473
Increase (decrease) in taxes payable on behalf of stockholders	(1,485,135)	(4,817,671)	6,302,806
Purchase of investments	(2,141,220)	(9,326,046)	(4,116,806)
Proceeds from sale of investments	5,238,491	8,792,947	20,932,760
Net cash provided by (used in) operating activities	664,270	(11,155,551)	12,370,722
Cash flows from financing activities:			
Cash dividends	(1,785,589)	-	(5,931,274)
Net cash used in financing activities	(1,785,589)	-	(5,931,274)
Net increase (decrease) in cash and cash equivalents	(1,121,319)	(11,155,551)	6,439,448
Cash and cash equivalents at beginning of the period	3,679,949	14,835,500	8,396,052
Cash and cash equivalents at end of period	$ 2,558,630	$ 3,679,949	$ 14,835,500
Supplemental disclosure of cash flow information:			
Cash paid during the period for interest	$ 40,841	$ -	$ 60,188
Taxes paid on behalf of stockholders/excise taxes	$ 1,485,135	$ 6,302,806	$ 12,378
Supplemental disclosure of non-cash financing transaction:			
Cash dividends declared from realized gains but not yet paid	$ -	$ 446,397	$ -

See accompanying notes

Renaissance Capital Growth & Income Fund III, Inc.

Notes to Financial Statements

Years Ended December 31, 2008 , 2007 , and 2006

Note 1 - Organization and Business Purpose

Renaissance Capital Growth & Income Fund III, Inc., (the "Fund" or the "Registrant") is a non-diversified, closed-end fund that has elected to be treated as a business development company (a "BDC") under the Investment Company Act of 1940, as amended (the "1940 Act"). The Fund, a Texas corporation, was organized and commenced operations in 1994.

The investment objective of the Fund is to provide its stockholders long-term capital appreciation by investing primarily in privately placed convertible securities and equity securities of emerging growth companies.

RENN Capital Group, Inc. ("RENN Group" or the "Investment Adviser"), a Texas corporation, serves as the Investment Adviser to the Fund. In this capacity, RENN Group is primarily responsible for the selection, evaluation, structure, valuation, and administration of the Fund's investment portfolio, subject to the supervision of the Board of Directors. RENN Group is a registered investment adviser under the Investment Advisers Act of 1940, as amended (the "Advisers Act").

Note 2 - Summary of Significant Accounting Policies

Valuation of Investments

Portfolio investments are stated at quoted market or fair value as determined by the Investment Adviser (Note 6).

Other

The Fund follows industry practice and records security transactions on the trade date. Dividend income is recorded on the record date. Interest income is recorded as earned on the accrual basis.

Cash and Cash Equivalents

The Fund considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. As of December 31, 2008 and 2007, cash and cash equivalents are at risk to the extent that they exceed Federal Deposit Insurance Corporation insured amounts. To minimize this risk, the Fund places its cash and cash equivalents with major U.S. financial institutions.

Income Taxes

The Fund has elected the special income tax treatment available to “regulated investment companies” (“RIC”) under Subchapter M of the Internal Revenue Code (“IRC”) which allows the Fund to be relieved of federal income tax on that part of its net investment income and realized capital gains that it pays out to its stockholders. Such requirements include, but are not limited to certain qualifying income tests, asset diversification tests and distribution of substantially all of the Fund’s taxable investment income to its stockholders. It is the intent of management to comply with all IRC requirements as they pertain to a RIC and to distribute all of the Fund’s taxable investment income and realized long-term capital gains within the defined period under the IRC to qualify as a RIC. Failure to qualify as a RIC would subject the Fund to federal income tax as if the Fund were an ordinary corporation which could result in a substantial reduction in the Fund’s net assets as well as the amount of cash available for distribution to stockholders. Continued qualification as a RIC requires management to satisfy certain investment diversification requirements in future years. There can be no assurance that the Fund will qualify as a RIC in subsequent years.

Renaissance Capital Growth & Income Fund III, Inc.

Notes to Financial Statements (continued)

Years Ended December 31, 2008, 2007, and 2006

Federal income taxes payable on behalf of stockholders on realized gains that the Fund elects to retain are accrued and reflected as tax expense paid on behalf of stockholders on the last day of the tax year in which such gains are realized.

In January 2007 the Fund adopted the Financial Accounting Standards Board Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes* - An Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and requires companies to determine whether it is "more likely than not" that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. It also provides guidance on the recognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. The Fund did not recognize any adjustments to the Fund's financial statements as a result of the implementation of FIN 48.

Net Loss Per Share

Net loss per share is based on the weighted average number of shares outstanding of 4,463,967 during 2008, 2007, and 2006.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts and disclosures in the financial statements. Actual results could differ from these estimates.

Note 3 -Due to/from Broker

The Fund conducts business with various brokers for its investment activities. The clearing and depository operations for the investment activities are performed pursuant to agreements with these brokers. "Due to broker" represents unsettled purchase transactions and "due from broker" represents unsettled sales transactions. The Fund is subject to credit risk to the extent the brokers are unable to deliver cash balances or securities, or clear security transactions on the Fund's behalf. The Investment Adviser actively monitors the Fund's exposure to these brokers and believes the likelihood of loss under those circumstances is remote. At December 31, 2008 and 2007, there were no "due to broker" or "due from broker" balances.

Note 4 - Management Fees and Incentive Fees and Reimbursement

The Investment Adviser for the Fund is registered as an investment adviser under the Investment Advisers Act of 1940. Pursuant to an Investment Advisory Agreement (the "Agreement"), the Investment Adviser performs certain services, including certain management, investment advisory and administrative services necessary for the operation of the Fund. In addition, under the Agreement, the Investment Adviser is reimbursed by the Fund for certain directly allocable administrative expenses. A summary of fees and reimbursements paid by the Fund under either the Agreement or the prospectus is as follows:

The Investment Adviser receives a management fee equal to a quarterly rate of 0.4375% of the Fund's net assets, as determined at the end of such quarter, each payment to be due as of the last day of the calendar quarter. The Fund incurred $455,005, $792,545, and $935,776 in 2008, 2007, and 2006, respectively, for such management fees.

Renaissance Capital Growth & Income Fund III, Inc.

Notes to Financial Statements (continued)

Years Ended December 31, 2008, 2007, and 2006

The Investment Adviser receives an incentive fee in an amount equal to 20% of the Fund's cumulative realized capital gains in excess of cumulative realized capital losses of the Fund after allowance for any unrealized capital depreciation on the portfolio investments of the Fund at the end of the year being calculated, less cumulative incentive fees previously accrued. Unrealized capital depreciation equals net unrealized capital losses on each class of security without netting net unrealized capital gains on other classes of securities. The incentive fee is calculated, accrued, and paid on an annual basis.The Fund incurred, $0, $0, and $3,157,367 during the years ended 2008, 2007, and 2006, respectively, for such incentive fees.

The Investment Adviser was reimbursed by the Fund for directly allocable administrative expenses paid by the Investment Adviser on behalf of the Fund. Such reimbursements were $73,654, $230,797, and $386,809 in 2008, 2007, and 2006 respectively.

As of December 31, 2008 and 2007, the Fund had an accounts payable of $86,872, and $374,734, respectively, for the amount due for the fees and expense reimbursements disclosed above.

Note 5 - Eligible Portfolio Companies and Investments

Eligible Portfolio Companies

The Fund invests primarily in convertible securities and equity investments of companies that qualify as Eligible Portfolio Companies as defined in Section 2(a)(46) of the 1940 Act or in securities that otherwise qualify for investment as permitted in Section 55(a)(1) through (7) of the 1940 Act. Under the provisions of the 1940 Act at least 70% of the Fund's assets, as defined under Section 55 of the 1940 Act, must be invested in securities listed in Paragraphs 55(a)(1) through (6) of the 1940 Act ("Eligible Portfolio Investments"). In the event the Fund has less than 70% of its assets invested in Eligible Portfolio Investments, then the Fund will be prohibited from making non-eligible investments until such time as the percentage of Eligible Portfolio Investments again exceeds the 70% threshold. The Fund was in compliance with these provisions at December 31, 2008 and 2007.

Investments

Investments are carried in the statements of assets and liabilities as of December 31, 2008 and 2007, at fair value, as determined in good faith by the Investment Adviser, subject to the approval of the Fund's Board of Directors. The convertible debt securities held by the Fund generally have maturities between five and seven years and are convertible (at the discretion of the Fund) into the common stock of the issuer at a set conversion price. The common stock underlying these securities is generally unregistered and thinly to moderately traded. Generally, the Fund negotiates registration rights at the time of purchase and the portfolio companies are required to register the shares within a designated period and the cost of registration is borne by the portfolio company. Interest on the convertible securities is generally payable monthly. The convertible debt securities generally contain embedded call options giving the issuer the right to call the underlying issue. In these instances, the Fund has the right of redemption or conversion. The embedded call option will generally not vest until certain conditions are achieved by the issuer. Such conditions may require that minimum thresholds be met relating to underlying market prices, liquidity, and other factors.

Note 6 - Valuation of Investments

Effective January 1, 2008, the Fund adopted FAS 157, *Fair Value Measurements* (“FAS 157”), which establishes a framework for measuring fair value and applies to existing accounting pronouncements that require or permit fair value measurements. A fair value hierarchy is established within FAS 157 that prioritizes the sources (“inputs”) used to measure fair value into three broad levels: inputs based on quoted market prices in active markets (Level 1 inputs); observable inputs based on corroboration with available market data (Level 2 inputs);

Renaissance Capital Growth & Income Fund III, Inc.

Notes to Financial Statements (continued)

Years Ended December 31, 2008, 2007, and 2006

and unobservable inputs based on uncorroborated market data or a reporting entity's own assumptions (Level 3 inputs). The adoption of FAS 157 has not had a significant impact on the Fund's financial statements and has not resulted in any significant changes in the valuation of investments. The Fund's valuation policies are as follows:

- On a weekly basis, RENN Group prepares a valuation to determine fair value of the investments of the Fund. The Board of Directors of the Fund approves the valuation on a quarterly basis. Interim board involvement may occur if material issues arise before quarter end. The valuation principles are described below.

- Unrestricted common stock of companies listed on an exchange, NASDAQ or in the over-the-counter market is valued at the closing price on the date of valuation.

- Restricted common stock of companies listed on an exchange, NASDAQ or in the over-the-counter market is valued based on the quoted price for an otherwise identical unrestricted security of the same issuer that trades in a public market, adjusted to reflect the effect of significant restrictions.

- The unlisted preferred stock of companies with common stock listed on an exchange, NASDAQ or in the over-the-counter market is valued at the closing price of the common stock into which the preferred stock is convertible on the date of valuation.

- Debt securities are valued at fair value. The Fund considers, among other things, whether a debt issuer is in default or bankruptcy. It also considers the underlying collateral. Fair value is generally determined to be the greater of the face value of the debt or the market value of the underlying common stock into which the instrument may be converted.

- The unlisted in-the-money warrants or options of companies with the underlying common stock listed on an exchange, NASDAQ or in the over-the-counter market are valued at fair value (the positive difference between the closing price of the underlying common stock and the strike price of the warrant or option). An out-of-the money warrant or option has no value; thus, we assign no value to it.

- Investments in privately held entities are valued at fair value. If there is no independent and objective pricing authority (i.e. a public market) for such investments, fair value is based on the latest sale of equity securities to independent third parties. If a private entity does not have an independent value established over an extended period of time, then the Investment Adviser will determine fair value on the basis of appraisal procedures established in good faith and approved by the Board of Directors.

The following table shows a summary of investments measured at fair value on a recurring basis classified under the appropriate level of fair value hierarchy as of December 31, 2008:

Description	December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments	$15,931,925	$7,394,428	$8,537,497	$ -
Cash equivalents	$ 2,558,630	$ -	$ -	$ -

Renaissance Capital Growth & Income Fund III, Inc.

Notes to Financial Statements (continued)

Years Ended December 31, 2008, 2007, and 2006

As of December 31, 2008 and December 31, 2007, the net unrealized depreciation associated with investments held by the Fund was $25,592, 309 and $7,568,885, respectively. As of December 31, 2008 and December 31, 2007, the Fund had gross unrealized gains of $2,463,654 and $10,846,388, respectively, and gross unrealized losses of $28,055,963 and $18,415,273, respectively.

Note 7 - Income Taxes

During December 2007, and March, June, and September 2008, the Board of Directors declared cash distributions of $0.10 per share, $446,397, which were designated as distributions of realized capital gains and return of capital in accordance with the IRC, which assured that any Federal income tax on such realized capital gains, if any, is paid by the Fund's stockholders. These distributions were paid to the stockholders during January, March, July, and October 2008, respectively. During 2008 management followed a policy of distributing all of the Fund's taxable investment income and realized capital gains within the defined period under the IRC to ensure that any Federal income tax on such income, if any, is paid by the Fund's stockholders. Accordingly, no income tax expense was reported by the Fund for the year ended December 31, 2008.

During December, 2007, the Board of Directors, in accordance with rules under subchapter M of the IRC, declared a designated undistributed capital gain dividend ("Deemed Distribution") for 2007 on net taxable long-term capital gains of $4,243,244 that remained after the December 2007 cash dividend noted above. The Fund recorded a liability of $1,485,135 (which was paid during the first month of 2008) for taxes payable on behalf of its stockholders as of December 31, 2007. This amount was also recorded as income tax expense paid on behalf of stockholders in the statement of operations for the year ended December 31, 2007. Stockholders of record at December 31, 2007 received a tax credit of $0.33 per share. The balance of $2,758,108 was retained by the Fund.

During December 2006, the Board of Directors, in accordance with rules under subchapter M of the IRC, declared a Deemed Distribution for 2006 on net taxable long-term capital gains of $18,008,018. During the year-ended December 31, 2006, the Fund also distributed $0.40 per share in cash distributions which were designated as net long-term realized capital gains. The Fund recorded a liability of $6,302,806 (which was paid during the first quarter of 2007) for taxes payable on behalf of its stockholders as of December 31, 2006. This amount was also recorded as income tax expense paid on behalf of stockholders in the statements of operations for 2006. Stockholders of record at December 31, 2006, received a tax credit of $1.41 per share. The balance of $11,705,212 was retained by the Fund.

Note 8 - Commitments and Contingencies

As disclosed in Note 4, the Fund is obligated to pay to the Investment Adviser an incentive fee equal to 20% of the Fund's cumulative realized capital gains in excess of cumulative realized capital losses of the Fund after allowance for any capital depreciation on the portfolio investments of the Fund. As incentive fees on capital gains are not due to the Investment Adviser until the capital gains are realized, any obligations for incentive fees based on unrealized capital gains are not reflected in the accompanying financial statements, as there is no assurance that the unrealized gains as of the end of any period will ultimately become realized. Had an incentive fee been accrued as a liability based on all unrealized capital gains, net assets of the Fund would have been reduced by $0 and $2,058,485 as of December 31, 2008 and 2007, respectively.

Renaissance Capital Growth & Income Fund III, Inc.

Notes to Financial Statements (continued)

Years Ended December 31, 2008, 2007, and 2006

Note 9 - Financial Highlights

Selected per share data and ratios for each share of common stock outstanding throughout the years ended December 31, 2008 and 2007 are as follows:

	2008	2007
Net asset value, beginning of period	$ 8.46	$ 10.84
Net investment loss	(0.17)	(0.17)
Net realized and unrealized gain (loss) on investments	(3.86)	(2.11)
Total return from investment operations	(4.03)	(2.28)
Distributions:	(0.30)	(0.10)
Net asset value, end of period	$ 4.13	$ 8.46
Per share market value, end of period	$ 2.92	$ 6.15
Portfolio turnover rate	8.19%	21.11%
Annual return (a)	(52.52)%	(41.43)%
Ratio to average net assets (b):		
Net investment loss	(2.75)%	(1.65)%
Expenses, including incentive fees	4.79%	3.46%
Expenses, excluding incentive fee	4.79%	3.46%

(a) Annual return was calculated by comparing the common stock price on the first day of the period to the common stock price on the last day of the period, in accordance with American Institute of Certified Public Accountants guidelines.

(b) Average net assets have been computed based on quarterly valuations.

Renaissance Capital Growth & Income Fund III, Inc.

Notes to Financial Statements (continued)

Years Ended December 31, 2008, 2007, and 2006

Note 10 - Selected Quarterly Data

	2008			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net investment loss	($ 277,138)	($ 230,402)	($ 91,006)	($ 172,464)
Net unrealized appreciation (depreciation) on investments	(4,915,956)	(4,063,158)	(5,756,759)	(3,287,551)
Net realized gain (loss) on investments	1,287,083	(15,501)	(188,802)	(281,287)
Net income (loss)	($3,906,011)	($4,309,061)	($6,036,567)	($3,741,302)
Net income (loss) per share	($ 0.88)	($ 0.97)	($ 1.35)	($ 0.83)
Weighted average shares outstanding	4,463,967	4,463,967	4,463,967	4,463,967

	2007			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net investment loss	($ 115,003)	($ 322,584)	($ 161,653)	($ 153,406)
Net unrealized appreciation (depreciation) on investments	472,619	(1,703,609)	(6,259,982)	(5,307,009)
Net realized gain (loss) on investments	-	2,033,769	2,386,440	453,656
Income tax expense paid on behalf of stockholders	-	-	-	(1,485,135)
Net income (loss)	$ 357,616	$ 7,576	($4,035,195)	($6,491,894)
Net income (loss) per share	$ 0.08	$ 0.00	($ 0.90)	($ 1.46)
Weighted average shares outstanding	4,463,967	4,463,967	4,463,967	4,463,967