



QUARTERLY REPORT

PERIOD ENDED JUNE 30, 2010

**601 NE 26TH COURT
POMPANO BEACH, FL 33064
TEL: 954-943-8721
FAX: 954-788-6565**

WWW.CYCLONEPOWER.COM

Item 1 Exact name of the issuer and address of its principal executive offices.

Cyclone Power Technologies, Inc.

Formerly: Coastal Technologies, Inc. until 7-07

601 NE 26th Court
Pompano Beach, FL 33064
Tel: 954-943-8721
Fax: 954-788-6565
www.cyclonepower.com

Investor Relations:
Christopher Nelson
General Counsel
chris@cyclonepower.com

Item 2 Shares Outstanding.

COMMON STOCK

	Q2 2010	FYE 2009	FYE 2008
Shares Authorized	300,000,000*	1,000,000,000	1,000,000,000
Shares Outstanding	109,518,962	103,699,113	83,016,048
Freely Tradable	44,440,334	37,352,203	30,653,471
Beneficial Shareholders	2,965	2,582	2,031
Total Shareholders of Record	3,331	2,950	2,505

* Authorized shares reduced from 1,000,000,000 to 300,000,000 per shareholder consent as of April 29, 2010

SERIES A CONVERTIBLE PREFERRED STOCK

	Q2 2010	FYE 2009	FYE 2008
Shares Authorized	750,000	550,000	500,000
Shares Outstanding	644,153	540,000	500,000
Freely Tradable	0	0	0
Beneficial Shareholders	49	25	22
Total Shareholders of Record	49	25	22

SERIES B PREFERRED STOCK

	Q2 2010	FYE 2009	FYE 2008
Shares Authorized	1,000	1,000	1,000
Shares Outstanding	1,000	1,000	1,000
Freely Tradable	0	0	0
Beneficial Shareholders	2	2	2
Total Shareholders of Record	2	2	2

Warrants and Stock Options. The Company has issued the following common stock warrants:

<u>Shares Exercisable</u>	<u>Exercise Price</u>	<u>Vesting</u>	<u>Termination</u>
8,000,000	\$.25	Oct 1, 2010 ⁽¹⁾	Oct 1, 2011 ⁽¹⁾
2,190,379 ⁽²⁾	\$.19	Oct 1, 2010 ⁽³⁾	Oct 1, 2012 ⁽³⁾

(1) Estimated date of Vesting and Termination based the Company's License Agreement with Renovalia Energy, SA.

(2) Estimated number of shares based on 2% of the total current outstanding shares of common stock as of 6/30/10.

(3) Estimated date of Vesting and Termination based the Company's License Agreement with Phoenix Power Systems

The Company has issued the following stock options to management and other service providers:

<u>Shares Exercisable</u>	<u>Avg. Exercise Price</u>	<u>Vesting</u>	<u>Avg. Termination</u>
1,000,000	\$.325	Vested	July 1, 2018
450,000	\$.15	April 1, 2011	April 1, 2021

Item 3 Interim Financial Statements.

Interim Financial Statements for the period ended June 30, 2010 have been attached to the end of this Quarterly Report and are ordered as follows:

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Item 4 Management's Discussion and Analysis or Plan or Operation

The Company started to generate revenue from its operations in 2008; however, it has not had material or consistent revenue in each of the last two fiscal years. In order for the Company to maintain and expand its operations through the next 12 months, it must:

1. Continue to raise through capital infusions, either by means of equity or debt offerings, a minimum of \$1 million and up to \$5 million; or
2. Continue to secure license and development agreements that provide up-front fees or guaranteed royalties, which is in the normal course of the Company's business.

The Company is currently raising working capital to fund its operations via private placements of common and preferred stock, and has ongoing and pending contracts that are expected to generate operating cash. Currently, management believes that the Company has cash reserves and cash commitments to sustain operations through 2010. There is no guarantee, however, that the Company will be able to generate enough revenue and/or raise capital to support its operations, and if such funds cannot be raised or otherwise generated, the Company may be forced to reduce staff, minimize its research and development activities, or in a worst case scenario, shut-down operations. At this time, management is cautiously optimistic that they can improve operations and raise the appropriate funds to grow their underlying business.

Private Placements. In the six months ended June 30, 2010, the Company sold 1,750,882 shares of restricted common stock and 81,700 shares of Series A Convertible Preferred Stock in private placements under Regulation D and Regulation S of the Securities Act of 1933, as amended, for a total of \$552,977, which is being used for general administrative, research and development, and marketing activities. The issuance of shares of Series A Convertible Preferred Stock does not increase the number of shares of common stock into which all shares of Series A Stock are convertible, and therefore, is not additionally dilutive to the common stock shareholders.

Stock for Services. Despite its limited cash resources, the Company is able to retain engineering, consulting, legal and accounting personnel partially through the issuance of restricted common stock. In the six months ended June 30, 2010, the Company issued 4,068,947 shares of restricted common stock, 2,500 shares of Series A Convertible Preferred Stock and 450,000 restricted common stock options in lieu of \$351,517 in cash compensation. Management believes that the agreement of these individuals to forego some or all of their agreed upon cash compensation for shares of restricted common stock demonstrates a strong dedication and long-term commitment to the Company, its technology and its future prospects.

Effective April 15, 2010, the Company retained Bruce Schames as its Chief Financial Officer at an annualized salary of \$72,000, of which \$12,000 (17%) is payable in restricted common stock and an additional portion is to be deferred until the Company can pay his full salary. Mr. Schames also receives 150,000 common stock options per quarter. The agreement is terminable upon 60 days notice by either party.

Research & Development. As a research and development company, a material portion of all funds raised or generated through operations are placed back into the R&D activities of the Company. The Company's R&D expenditures were \$423,576 for the first half of 2010. This is down compared to the first half of 2009 partially due to the Company redirecting resources from R&D to inventory, reflecting engines commissioned by several customers that are nearing their completion and delivery dates. The Company also spent \$61,358 on U.S. and international patent filings during the first six months of 2010.

Commitments for Capital Expenditures. In the first half of 2010, the Company acquired \$28,131 of property and equipment (fixed assets). Should additional funding be secured, some proceeds will be used to purchase capital equipment used for development and testing of its technology. Additionally, should adequate funding be secured, the Company expects to increase the number of skilled employees on payroll, including the recruitment of high level executive management and additional engineers and mechanical staff. Such new hires will considerably increase the Company's monthly operational expenses.

Results of Operations

Three Months Ended June 30, 2010 compared to Three Months Ended June 30, 2009

Revenues. There were no revenues for the three months ended June 30, 2010 as compared to \$50,000 for previous year period, a decrease of \$50,000 or 100%. This decrease was primarily due to the timing of engine shipments in July 2010 after final testing and the end of the quarter. Other revenue in 2009 was derived from consulting and design services.

Gross Profit. There was no gross profit for the three months ended June 30, 2010, as compared to \$22,787 for the previous year period. For the three months ended June 30, 2010 and 2009, the gross profit margin was 0% and 46% of sales, respectively.

Operating Expenses. Total operating expenses incurred for the three months ended June 30, 2010 were \$722,099 as compared to \$746,785 for previous year period, a decrease of \$24,686 or 3%. This decrease is primarily due to lower R&D costs of \$31,323 (8%), reflective of the assignment of production resources to deliverable inventory (a balance sheet item), and lower expenses for R&D services paid with common stock.

Other Income and Expenses. In the three months ended June 30, 2010, the Company recognized \$29,998 of gain by selling a 5% equity share in its consolidated subsidiary, Cyclone-WHE LLC, to a minority investor. The consideration paid for this equity was accounted for as a reduction of debt. Also, the Company provided for a loss of \$159,050 in converting a \$15,950 loan into issuances of 2.5 million shares of restricted common stock that occurred in the third quarter.

Net Income and Earnings per Share. The net loss for the three months ended June 30, 2010 was \$861,671 as compared to a net loss of \$724,397 for the previous year period, a higher loss of \$137,274 (19%). Net loss per weighted average share was (\$0.01) for both quarters.

Six Months Ended June 30, 2010 compared to Six Months Ended June 30, 2009

Revenues. Revenues for the six months ended June 30, 2010 were \$104,900 as compared to \$94,938 for the previous year period, an increase of \$9,962 (10%), primarily due to the delivery in 2010 of the Company's biomass-to-power beta system to Robotic Technology Inc., under a DARPA sponsored research contract.

Gross Profit. Gross profit for the six months ended June 30, 2010 was \$53,103 versus \$49,596 for the previous year period. For the six months ended June 30, 2010 and 2009, gross profit margins were 51% and 52% of sales, respectively.

Operating Expenses. Total operating expenses incurred for the six months ended June 30, 2010 were \$1,156,936 as compared to \$1,164,209 for the previous year period, a decrease of \$7,273 (0.6%). This decrease is primarily due to lower R&D costs of \$142,767 (25%), reflective of the assignment of production resources to deliverable inventory (a balance sheet item), and lower expenses for R&D services paid with common stock. This is largely offset by expanded activities and higher professional expenses in recognition of the Company filing audited financial statements with its 2009 Annual Report, ongoing financial reporting and additional marketing expenses.

Other Income and Expenses. In the six months ended June 30, 2010, the Company recognized \$29,998 of gain by selling for a corresponding reduction of debt a 5% equity share in its consolidated subsidiary Cyclone-WHE LLC to a minority investor. Also, the Company provided for a loss of \$159,050 in converting a \$15,950 loan into issuances of 2.5 million shares of restricted common stock that occurred in the third quarter.

Net Income and Earnings per Share. The net loss for the six months ended June 30, 2010 was \$1,255,572 as compared to a net loss of \$1,127,345 for the previous year period, a higher loss of \$128,227 or 11%. Net loss per weighted average share was (\$0.01) for both quarters.

Liquidity and Capital Resources

At June 30, 2010, net working capital was negative (\$2,039,230) as compared with (\$1,886,841) at December 31, 2009, a decline of (\$152,389) or 8%. Funds for the six months ended June 30, 2010 were used by the net loss of \$1,255,572, an increase in inventory of \$101,397, an increase in fixed assets of \$28,131, and \$61,358 expended for patents.

Funds were provided by the sale of 1,750,885 shares of common stock for \$145,377, 81,700 shares of Series A Convertible Preferred Stock for \$407,600, an increase in related party loans of \$85,732, net higher related party payables of \$167,846 (primarily deferred and accrued officers' salary), \$125,000 of higher deferred revenue and deposits, and a non-cash loss provision for \$159,050 on future debt conversion to common stock. Additionally, to conserve cash, the Company issued for services 4,068,947 shares of restricted common stock, 2,500 shares of Series A Preferred Stock, and 450,000 restricted common stock options valued at \$351,517.

If the Company needs to obtain capital, no assurance can be given that it will be able to obtain this capital on acceptable terms, if at all. In such an event, this may have a materially adverse effect on the Company's business, operating results and financial condition. If the need arises, the Company may attempt to obtain funding or pay expenses through the continued sale or issuance of restricted stock. The Company may also use various types of short term funding, related party advances and expenses payment deferrals and external loans. Management is cautiously optimistic that it will be able to generate the funding required to continue and expand its operations over the long term.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements at this time.

Item 5 Legal Proceedings.

The Company is not engaged in any legal proceedings, or threatened proceedings, at this time.

Item 6 Defaults Upon Senior Securities.

The Company has no defaults upon senior securities.

Item 7 Other Information.

(a) For the three month period ended June 30, 2010, the Company issued shares of its Common Stock and Series A Convertible Preferred Stock in private offerings, for services rendered, and in conversion of notes and corporate debt, as follows:

# of Shares	Amount Paid	Nature of Offering	Trading Status/Restrictions
699,747	\$55,455	Common Stock - Services Rendered*	Restricted as per Rule 144
446,977	\$30,708	Common Stock - Regulation D/506	Restricted as per Rule 144
2,500,000	\$12,500	Common Stock – Note Conversion	Restricted as per Rule 144
73,700	\$368,500	Preferred A Stock – Regulation D 506	Restricted as per Rule 144
22,453	\$99,980	Preferred A Stock – Debt Conversion	Restricted as per Rule 144

* Services include accounting, marketing and engineering performed by nine different individuals, including one Director of the Company.

Item 8 Exhibits.

- Employment Agreement with CFO, Bruce Schames, dated June 1, 2010 (effective April 15, 2010), as described in “Item 4: Management’s Discussion and Analysis or Plan or Operation”

Item 9 Issuer's Certifications

I, Harry Schoell, CEO of Cyclone Power Technologies, Inc., certify that:

1. I have reviewed the Quarterly Report for the period ended June 30, 2010, of Cyclone Power Technologies, Inc.
2. Based upon my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report; and
3. Based upon my knowledge, the financial statements and other financial information included or incorporated by reference in this Quarterly Report fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this Quarterly Report.

August 12, 2010



Harry Schoell
CEO & Chairman

I, Frankie Fruge, COO and Controller of Cyclone Power Technologies, Inc., certify that:

1. I have reviewed the Quarterly Report for the period ended June 30, 2010, of Cyclone Power Technologies, Inc.
2. Based upon my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report; and
3. Based upon my knowledge, the financial statements and other financial information included or incorporated by reference in this Quarterly Report fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this Quarterly Report.

August 12, 2010



Frankie Fruge
COO & Controller

CYCLONE POWER TECHNOLOGIES, INC.
(f/k/a Coastal Technologies, Inc.)
FINANCIAL STATEMENTS
JUNE 30, 2010

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CYCLONE POWER TECHNOLOGIES, INC.
(f/k/a Coastal Technologies, Inc.)
CONSOLIDATED BALANCE SHEET
JUNE 30, 2010
(UNAUDITED)

ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	\$ 102,590
Inventory	242,238
Other current assets	1,128
Total current assets	345,956
PROPERTY AND EQUIPMENT	
Furniture, fixtures, and equipment-net	136,375
Less: Accumulated depreciation	(42,388)
Net property and equipment	93,987
OTHER ASSETS	
Patents, trademarks and copyrights	466,578
Less: Accumulated amortization	(65,310)
Net patents, trademarks and copyrights	401,268
Other assets	7,780
Total other assets	409,048
Total Assets	\$ 848,991
LIABILITIES AND STOCKHOLDERS' DEFICIT	
CURRENT LIABILITIES	
Notes and other loans payable	\$ 15,950
Notes and other loans payable-related parties	653,632
Capitalized leases-current portion	7,363
Accounts payable and accrued expenses	184,027
Accounts payable and accrued expenses-related parties	806,703
Deferred revenue	595,000
Accrued contract loss provision	5,036
License deposit	117,475
Total current liabilities	2,385,186
NON CURRENT LIABILITIES	
Capitalized lease obligations-net of current portion	7,285
Total non-current liabilities	7,285
Total Liabilities	2,392,471
MINORITY EQUITY IN CONSOLIDATED SUBSIDIARY	30,005
STOCKHOLDERS' DEFICIT	
Series A convertible preferred stock, \$.0001 par value, 750,000 shares authorized, 644,153 shares issued and outstanding at June 30, 2010	64
Series B preferred stock, \$.0001 par value, 1,000 shares authorized, 1,000 shares issued and outstanding.	-
Common stock, \$.0001 par value, 300,000,000 shares authorized; 109,518,962, shares issued and outstanding at June 30, 2010	10,951
Additional paid-in capital	7,600,900
Prepaid expenses via equity contribution	(27,500)
Preferred stock A subscription receivable	(18,000)
Accumulated deficit	(9,139,900)
Total stockholders' deficit	(1,573,485)
Total Liabilities and Stockholders' Deficit	\$ 848,991

The accompanying notes are an integral part of the financial statements

CYCLONE POWER TECHNOLOGIES, INC.
(f/k/a Coastal Technologies, Inc.)
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED JUNE 30, 2010 AND 2009
(UNAUDITED)

	<u>2010</u>	<u>2009</u>
REVENUES	\$ -	\$ 50,000
COST OF GOODS SOLD	-	27,213
Gross Profit	<u>-</u>	<u>22,787</u>
OPERATING EXPENSES		
Advertising and promotion	14,153	18,711
General and administrative	428,793	397,470
Research and development	279,153	330,604
Total operating expenses	<u>722,099</u>	<u>746,785</u>
Operating loss	<u>(722,099)</u>	<u>(723,998)</u>
OTHER INCOME (EXPENSE)		
Other income (expense)	(129,052)	10,387
Interest (expense)	<u>(10,520)</u>	<u>(10,786)</u>
Total other (expense)	<u>(139,572)</u>	<u>(399)</u>
Loss before income taxes	(861,671)	(724,397)
Income taxes	<u>-</u>	<u>-</u>
Net loss	<u>\$ (861,671)</u>	<u>\$ (724,397)</u>
Net loss per common share, basic	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
Weighted average number of common shares outstanding	<u>109,132,070</u>	<u>89,413,839</u>

CYCLONE POWER TECHNOLOGIES, INC.
(f/k/a Coastal Technologies, Inc.)
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009
(UNAUDITED)

	<u>2010</u>	<u>2009</u>
REVENUES	\$ 104,900	\$ 94,938
COST OF GOODS SOLD	51,797	45,342
Gross Profit	<u>53,103</u>	<u>49,596</u>
OPERATING EXPENSES		
Advertising and promotion	26,374	30,785
General and administrative	706,986	567,081
Research and development	423,576	566,343
Total operating expenses	<u>1,156,936</u>	<u>1,164,209</u>
Operating loss	<u>(1,103,833)</u>	<u>(1,114,613)</u>
OTHER INCOME (EXPENSE)		
Other income (expense)	(129,052)	10,387
Interest (expense)	<u>(22,687)</u>	<u>(23,119)</u>
Total other (expense)	<u>(151,739)</u>	<u>(12,732)</u>
Loss before income taxes	(1,255,572)	(1,127,345)
Income taxes	<u>-</u>	<u>-</u>
Net loss	<u>\$ (1,255,572)</u>	<u>\$ (1,127,345)</u>
Net loss per common share, basic	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
Weighted average number of common shares outstanding	<u>108,506,707</u>	<u>87,037,627</u>

The accompanying notes are an integral part of the financial statements

CYCLONE POWER TECHNOLOGIES, INC.
(f/k/a Coastal Technologies, Inc.)
STATEMENTS OF STOCKHOLDERS' DEFICIT
FOR THE YEAR ENDED DECEMBER 31, 2009 AND SIX MONTHS ENDED JUNE 30, 2010
(UNAUDITED)

	Preferred Stock A		Preferred Stock B		Common Stock		Additional Paid In Capital	Preferred Stock A Subscription Receivable	Prepaid Expenses Via Subsidiary Equity Contribution	Accumulated (Deficit)	Total Stockholders (Deficit)
	Shares	Value	Shares	Value	Shares	Value					
Balance, December 31, 2008	500,000	\$ 50	1,000	\$ -	83,016,048	\$ 8,302	\$ 4,468,122	\$ -	\$ -	\$ (5,359,227)	\$ (882,753)
Issuance of restricted shares for services					7,422,900	742	892,943				893,685
Sale of common stock					8,247,597	824	1,006,427				1,007,251
Issuance of restricted shares for debt conversion					4,000,000	400	19,600				20,000
Issuance of preferred stock A for notes receivables	15,000	1					21,195	(18,000)			3,196
Issuance of preferred stock A for debt conversion	25,000	3					29,997				30,000
Issuance of common stock pursuant to reverse merger adjustment					1,012,588	101	(101)				0
Net loss year ended December 31, 2009									0	(2,525,101)	(2,525,101)
Balance, December 31, 2009	540,000	\$ 54	1,000	\$ -	103,699,133	\$ 10,369	\$ 6,438,183	\$ (18,000)	\$ -	\$ (7,884,328)	\$ (1,453,722)
Issuance of restricted common shares and options for services					4,068,947	407	338,610				339,017
Issuance of Restricted Preferred Stock A for services	2,500						12,500				12,500
Sale of common stock					1,750,882	175	145,202				145,377
Sale of preferred stock A	81,700	9					407,591				407,600
Issuance of preferred stock A for debt conversion	13,153	1					65,764				65,765
Prepaid expenses via subsidiary equity contribution									(30,000)		(30,000)
Amortization of prepaid expense									2,500		2,500
Provision for loss on conversion of debt into common stock							159,050				159,050
Issuance of preferred stock A for liability conversion	6,800	0					34,000				34,000
Net loss six months ended June 30, 2010										(1,255,572)	(1,255,572)
Balance, June 30, 2010	644,153	\$ 64	1,000	\$ -	109,518,962	\$ 10,951	\$ 7,600,900	\$ (18,000)	\$ (27,500)	\$ (9,139,900)	\$ (1,573,485)

The accompanying notes are an integral part of the financial statements

CYCLONE POWER TECHNOLOGIES, INC.
(f/k/a Coastal Technologies, Inc.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009
(UNAUDITED)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (1,255,572)	\$ (1,127,345)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation & amortization	26,858	16,959
Issuance of restricted common stock and options for services	339,017	301,153
Issuance of restricted preferred stock for services	12,500	
Write-off of abandoned patent	-	24,715
Foregiveness of debt income	-	10,387
Provision for loss on debt conversion	159,050	
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	-	34,000
(Increase) decrease in inventory	(101,397)	3,939
(Increase) decrease in other assets	5,500	(2,803)
Increase in deferred revenue and deposits	125,000	163,489
Increase (decrease) in accounts payable and accrued expenses	50,497	(36,745)
Increase in accounts payable and accrued expenses-related parties	167,846	-
Net cash used by operating activities	(470,701)	(612,251)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for patents, trademarks and copyrights	(61,358)	(106,538)
Expenditures for fixed assets	(28,131)	(27,960)
Net cash used by investing activities	(89,489)	(134,498)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase (decrease) in loans-net	765	(39,585)
Payment of capitalized leases	(5,252)	-
Proceeds from sale of common stock	145,377	750,406
Proceeds from sale of preferred stock	407,600	-
Increase (decrease) in related party notes and loans payable	85,732	246,236
Net cash provided by financing activities	634,222	957,057
Net increase (decrease) in cash and cash equivalents	74,032	210,308
Cash and cash equivalents, beginning of period	28,558	1,366
Cash and cash equivalents, end of period	\$ 102,590	\$ 211,674
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Payment of interest in cash	\$ 1,686	\$ 224
NON CASH INVESTING AND FINANCING ACTIVITIES:		
Expenses paid with 4,068,947 and 1,707,737 shares of restricted common stock	\$ 325,766	\$ 301,153
Expenses paid with 450,000 restricted common stock options	13,251	-
Expenses paid with 2,500 shares of preferred stock A	12,500	-
Sale of 1,750,882 and 5,964,968 shares of common stock	145,377	750,406
Sale of 92,700 shares of series A preferred stock	462,600	-
Conversion of debt by issuing 2,000,000 shares of common stock	-	10,000
Conversion of debt & liabilities by issuing 19,953 shares of preferred stock A	99,765	-
Conversion of debt by selling 5% or consolidated subsidiary equity	30,000	-

The accompanying notes are an integral part of the financial statements

CYCLONE POWER TECHNOLOGIES, INC.
(f/k/a Coastal Technologies, Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

NOTE 1 – ORGANIZATIONAL AND SIGNIFICANT ACCOUNTING POLICIES

A. ORGANIZATION AND OPERATIONS

Cyclone Power Technologies, Inc. (the “Company”) is the successor entity to the business of Cyclone Technologies LLLP (the “LLL”), a limited liability limited partnership formed in Florida in June 2004. The LLLP was the developer and patent holder of the Cyclone Engine Technology.

Prior to July 2, 2007, the predecessor to the Company was a California corporation named Coastal Technologies, Inc. (the “Pink Sheet Company”) which was engaged in the business of medical software development, and was listed in the Pink Sheets Electronic Market Place. In June 2007, in connection with its reverse merger into the Pink Sheet Company, the Company re-domiciled to the state of Florida and changed its name to Cyclone Power Technologies, Inc.

Commencing in the second quarter of 2010, the Company has started operations in a 90% owned consolidated subsidiary (Cyclone-WHE LLC) to license and market waste heat recovery systems for all engine models.

The Company is primarily a research and development company whose main purpose is to develop, commercialize and market licenses for its Cyclone Engine Technology.

B. ACCOUNTING STANDARDS CODIFICATION

The Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC) 105-10 in June 2009, to be effective September 15, 2009. This establishes the ASC codification as the single source of authoritative nongovernmental Generally Accepted Accounting Principles (GAAP). All existing accounting standards are superseded as described in *FASB Accounting Standards Codification* (SFAS) No. 168, aside from those issued by the SEC. All other accounting literature not included in the Codification is non-authoritative. Adoption of this Codification as of September 30, 2009, which is reflected in our disclosures and references to accounting standards, had no change to our financial position or results of operations.

C. SUBSEQUENT EVENTS POLICY

In May 2009, the FASB issued SFAS No. 165, (ASC 855) *Subsequent Events* (ACS 855) which offers assistance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ACS 855 does not result in material changes in the subsequent events that an entity reports. This guidance requires disclosure of the date through which events subsequent to the Balance Sheet date have been evaluated and whether that date represents the date the financial statements were issued or were available to be issued. ASC 855 is effective for interim and annual periods ending after June 15, 2009. We evaluated events occurring between the end of our fiscal quarter ending June 30, 2010 and August 13, 2010 when the financial statements were available to be issued.

D. PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Cyclone Power Technologies and its 90% owned subsidiary (Cyclone-WHE LLC). All material inter-company transactions and balances have been eliminated in the consolidated financial statements. The accompanying unaudited consolidated financial

statements have been prepared in accordance with generally accepted accounting principles for interim financial information. As such not all of the information and footnotes required by generally accepted accounting principles for complete financial statements have been presented.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

E. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, cash in banks and any highly liquid investments with maturity of three months or less at the time of purchase. The Company maintains cash and cash equivalent balances at several financial institutions, which are insured by the Federal Deposit Insurance Corporation up to \$250,000.

F. COMPUTATION OF LOSS PER SHARE

Net loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share is not presented as the potential conversion of the preferred stock and exercise of outstanding stock options and warrants could have an anti-dilutive effect. As of June 30, 2010, this potential increase amounted to approximately 202.8 million shares on a fully diluted basis.

G. INCOME TAXES

Income taxes are accounted for under the asset and liability method as stipulated by Accounting Standards Codification (“ASC”) 740 formerly Statement of Financial Accounting Standards (“SFAS”) No. 109, “*Accounting for Income Taxes*”. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under ASC 740, the effect on deferred tax assets and liabilities or a change in tax rate is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced to estimated amounts to be realized by the use of a valuation allowance. A valuation allowance is applied when in management’s view it is more likely than not (50%) that such deferred tax will not be utilized.

Effective January 1, 2009, the Company adopted certain provisions under ASC Topic 740, Income Taxes, (“ASC 740”), which provide interpretative guidance for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Effective with the Company’s adoption of these provisions, interest related to the unrecognized tax benefits is recognized in the financial statements as a component of income taxes. The Adoption of ASC 740 did not have an impact on the Company’s financial position and results of operations.

In the unlikely event that an uncertain tax position exists in which the Company could incur income taxes, the Company would evaluate whether there is a probability that the uncertain tax position taken would be sustained upon examination by the taxing authorities. Reserves for uncertain tax positions would be recorded if the Company determined it is probable that a position would not be sustained upon examination or if payment would have to be made to a taxing authority and the amount is reasonably estimated. As of December 31, 2009, the Company does not believe it has any uncertain tax positions that would result in the Company having a liability to the taxing authorities. The Company’s tax returns are subject to examination by the federal and state tax authorities for the years ended 2006 through 2009.

H. REVENUE RECOGNITION

The Company's revenue recognition policies are in compliance with Staff Accounting Bulletin ("SAB") 104, included in the Codification as ASC 605, *Revenue Recognition*. Sales revenue is recognized at the date of shipment of prototypes, engine designs, research reports or other deliverables to customers when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of the Company exist and collectability is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as deferred revenue, which as of June 30, 2010 was \$595,000. The Company does not allow its customers to return prototype products. It is the Company's intention, when it has royalty revenue from its contracts, to book royalty revenue in the quarter received. The Company does not have any royalty revenue to date.

I. FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC 820 Fair Value "Measurements and Disclosures" requires disclosures of information about the fair value of certain financial instruments for which it is practicable to estimate the value. For purpose of this disclosure, the fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. The carrying amounts reported in the balance sheet for cash, accounts receivable, inventory, accounts payable and accrued expenses, and loans payable approximate their fair market value based on the short-term maturity of these instruments.

J. RESEARCH AND DEVELOPMENT

Research and development activities for product development are expensed as incurred. Costs for the six months ended June 30, 2010 and 2009 were \$423,576 and \$566,343, respectively.

K. STOCK BASED COMPENSATION

The Company applies the fair value method of ASC 718, Share Based Payment, formerly Statement of Financial Accounting Standards ("SFAS") No. 123R "*Accounting for Stock Based Compensation*", in accounting for its stock based compensation. This standard states that compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. As the Company does not have sufficient, reliable and readily determinable values relating to its common stock, the Company has used the stock value pursuant to its most recent sale of restricted stock sold to unaffiliated third-parties in the U.S. for purposes of valuing stock based compensation.

L. COMMON STOCK PURCHASE WARRANTS

The Company accounts for common stock purchase warrants at fair value in accordance with ASC 815-40 *Derivatives and Hedging*, formerly Emerging Issues Task Force Issue ("EITF") No. 00-19, "*Accounting for Derivative Financial Instruments Indexed to and Practically Settled in a Company's Own Stock*". The Black-Scholes option pricing valuation method is used to determine fair value of these warrants consistent with ASC 718, *Share Based Payment*, formerly Statement of Financial Accounting Standards ("SFAS") No. 123 R "*Accounting for Stock Based Compensation*." Use of this method requires that the Company make assumptions regarding stock volatility, dividend yields, expected term of the warrants and risk-free interest rates.

The Company accounts for transactions in which services are received in exchange for equity instruments based on the fair value of such services received from non-employees, in accordance with ASC 505-50 *Equity Based payments to Non-employees*, formerly EITF No. 96-18, *Accounting for Equity Instruments that are Issued to other than Employees for Acquiring, or in Conjunction with Selling Goods or Services*.

M. PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost. Depreciation is computed on the straight-line method, based on the estimated useful lives of the assets of generally three or seven years. Expenditures for maintenance and repairs are charged to operations as incurred.

N. IMPAIRMENT OF LONG LIVED ASSETS

The Company continually evaluates the carrying value of intangible assets and other long lived assets to determine whether there are any impairment losses. If indicators of impairment are present and future cash flows are not expected to be sufficient to recover the assets' carrying amount, an impairment loss would be charged to expense in the period identified.

O. RECLASSIFICATIONS

Certain prior years' comparative figures have been reclassified to conform to the financial statement presentation adopted for this year.

P. INTERIM ACCOUNTING AND SAS 100 REVIEW

The results of operations for the six months ended June 30, 2010 are not necessarily indicative of the results for the full fiscal year ending December 31, 2010. These financial statements should be read in conjunction with the financial statements and footnotes for the year ended December 31, 2009.

The company is not required to have quarterly financial statements reviewed as defined by SAS 100 since it is a "pink sheet" filer. These financial statements have not been reviewed, but an applicable review will be performed with the anticipated filing of an S-1 registration statement with the Securities and Exchange Commission.

Q. CURRENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standard Board (FASB) in October 2009 issued Account Standards Update (ASU) 2009-13 Revenue Recognition (Topic 605). This update provides guidance for revenue recognition consideration in multiple-deliverable contractual arrangements. The update requires that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis. This update will be effective after June 15, 2010, and early adoption is permitted. The Company has implemented this update effective for the years beginning January 1, 2010. The disclosure requirements for this update are:

- a. Multiple deliverable arrangements: the Company has contracts that provide for a working prototype or plans/schematics of the prototype engine (initial deliverable) and will record royalty fees after the customer constructs and puts the engine into operation or manufacturing, depending on the terms of the agreement.
- b. The initial deliverables are usually within a year of signing of the contract and upon the complete customer payment of the initial license/development fees.
- c. Revenue is based on the initial license/development fees charged for the deliverable, and then royalty income is recognized thereafter, through the life of the contract.

The implementation of this topic did not have any material effect on the financial statements and did not change any pattern and timing of revenue recognition.

In January 2010 FASB issued ASU “Equity” (Topic 505), accounting for distributions to shareholders with components of stock and cash. This amendment affects entities that declare dividends to shareholders that may be paid in cash or shares at the election of the shareholders with a potential limitation in the total amount of cash that all shareholders can elect to receive in the aggregate. The Company is evaluating the effect of this update.

NOTE 2 - GOING CONCERN

As shown in the accompanying financial statements, the Company incurred substantial net losses for the six months ending June 30, 2010 of \$1,255,572 and \$2,525,101 for the year ended December 31, 2009. Cumulative losses since inception are \$9,139,900. The Company has a working capital deficit at June 30, 2010 of \$2,039,230. There is no guarantee whether the Company will be able to generate enough revenue and/or raise capital to support its operations. This raises substantial doubt about the Company’s ability to continue as a going concern. Management states that they are confident that they can improve operations and raise the appropriate funds to grow their underlying business. The financial statements do not include any adjustments that might result from the outcome of these uncertainties. The Company is currently raising working capital to fund its operations pursuant to private placements of Series A Convertible Preferred Stock, common stock and advances from and deferred payments to related parties. The Company has raised \$ 552,977 from the sale of 81,700 shares of Series A Convertible Preferred Stock and 1,750,882 shares of common stock for the six months ending June 30, 2010.

NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivable consist of amounts due pursuant to licenses and development agreements, research and development prototype and analysis charges.

NOTE 4 – INEVTRY

Inventory is recorded at the lower of cost or market.

NOTE 5 – PROPERTY AND EQUIPMENT

Property and equipment at June 30, 2010 consists of the following:

	<u>2010</u>
Display Equipment for Trade Shows	\$9,648
Leasehold Improvements	46,332
Equipment and Computers	<u>80,395</u>
Total	136,375
Less: Accumulated Depreciation	<u>42,388</u>
Net Property and Equipment	<u>\$93,987</u>

Depreciation expense for the six months ended June 30, 2010 and 2009 were \$12,274 and \$6,459, respectively.

NOTE 6 – PATENTS AND TRADEMARKS AND COPYRIGHTS

The Cyclone Engine is currently protected under U.S. Patent # 7,080,512, its steam generator component is protected under U.S. Patent # 7,407,382, and the Company received notifications of U.S. patent allowance for the engine's valve/timing mechanisms in February 2010 and for its reversing and timing control mechanism in April 2010. Additionally, the Company has filed patent applications in the U.S. on five other major components of the engine, as well as the Waste Heat Engine. The Company also has received patents in seven countries plus the European Economic Union, which covers approximately 40 countries (which would require the Company perfecting the EEU patent in some or all of these countries), and patents pending in five more countries for the Cyclone Engine; and has patent applications pending in all these foreign jurisdictions for two of its major engine components. The Company plans to continue to pursue patent protection in the U.S. and internationally for its intellectual property.

The Company has filed trademark applications in the U.S. for Cyclone Power Technologies, Cyclone Power, WHE, WHE Generation, and Generation WHE.

Patents, trademarks and copyrights consist of legal fees paid to file and perfect these claims. For the six months ended June 30, 2010, \$61,358 was capitalized. Patents, trademarks and copyrights are amortized over the life of the intellectual property which is estimated at 15 years. Amortization for the six months ended June 30, 2010 and 2009 was \$14,682 and \$10,500, respectively.

NOTE 7 – NOTES AND OTHER LOANS PAYABLE

A summary of non related party notes and other loans payable as of June 30, 2010 is as follows:

6% uncollateralized convertible note payable on demand for original principal amount of \$62,275.	\$ 15,950
Total current non-related party notes and loans payable	<u>\$ 15,950</u>

In the second quarter of 2010, the Company provided for a loss of \$159,050 in converting this \$15,950 loan into future issuances of 2.5 million shares of restricted common stock.

A summary of related party notes and other loans payable as of June 30, 2010 is as follows:

6% demand loans to Company owned by shareholder, collateralized by lien on Company's patent application for its waste heat engine, balance includes principal and unpaid interest. For the six months ending June 30, 2010 the capitalized unpaid interest is \$1,444.	\$ 7,727
6% demand loans per Operations Agreement with Schoell Marine Inc., a company owned by Cyclone's CEO and controlling shareholder, collateralized by lien on Cyclone's patent for heat regenerative engine, balance includes principal and unpaid	544,975

interest. For the six months ending June 31, 2010 the capitalized unpaid interest is \$ 16,324.

6% promissory note from an officer shareholder, due January 21, 2011, unsecured and convertible into restricted common stock at \$.08 per share.	100,930
	<hr/>
Total current related party notes and loans payable	<u>\$ 653,632</u>

NOTE 8 – RELATED PARTY TRANSACTIONS

A. LEASE ON OFFICE/WAREHOUSE

The Company leases a 6,000 square foot warehouse and office facility located at 601 NE 26th Court in Pompano Beach, Florida. The lease, which is part of the Company's Operations Agreement with Schoell Marine, provides for the Company to pay rent equal to the monthly mortgage payment on the building plus property taxes, rent, utilities and sales tax due on rent. Occupancy costs for the six months ended June 30, 2010 and 2009 were \$43,482 and \$38,160, respectively. The Operations Agreement runs year-to-year, however, the lease portion of this agreement is month-to-month, but can only be cancelled on 180 days notice by Schoell Marine.

B. DEFERRED COMPENSATION

Included in related party payables is \$806,703 of accrued and deferred officers' salaries compensation which can be paid if funds are available. These are non-interest bearing and due on demand.

NOTE 9 – PREFERRED STOCK

The Series A Convertible Preferred Stock is currently convertible into an aggregate number of shares that equals 60% of the total issued and outstanding common shares of the Company (not including unexercised warrants and options), less 33 million shares. The Series A holders are the original equity holders of the LLLP plus approximately 14 additional investors who have purchased shares of Series A stock in the Company's current private offering. The conversion of the Series A shares will have the effect of diluting all other common stock shareholders. As of June 30, 2010, the Series A were convertible into approximately 81.8 million shares of common stock. The Series B Preferred Stock comprises majority voting shares and is held by senior management. Ownership of the Series B shares assures the holders thereof a 51% voting control over the common stock of the Company. The Series B shares are convertible on a one-for-one basis with the common stock in the instance the Company is merged or sold.

NOTE 10 – STOCK TRANSACTIONS

The Company relies on capital raised through loans, Regulation D private placements and Regulation S transactions (stock sold to foreign investors) to fund operations; however, since the beginning of 2009, the Company has commenced to generate revenue from license and development fees earned in connection with certain license agreements.

During the six months ended June 30, 2010, the Company issued 4,068,947 shares of restricted common stock for services valued at \$325,766 and 450,000 of common stock options valued at \$13,251. Also, 2,500 shares of Series A Convertible Preferred Stock were issued for serviced valued at \$12,500.

In March 2010, the Company commenced a private placement of up to 200,000 shares of its Series A Convertible Preferred Stock at a price of \$5.00 per share. Proceeds from this offering are being used for operations and working capital purposes. In contemplation of this offering, the Company also filed an amendment to its Articles of Incorporation to increase its authorized Series A Convertible Preferred Stock to 750,000 shares.

During the six months ended June 30, 2010, the Company sold 1,750,882 shares of restricted common stock for \$145,377 and 81,700 shares of Series A Convertible Preferred stock for \$407,600.

NOTE 11 – INCOME TAXES

A reconciliation of the differences between the effective income tax rate and the statutory federal tax rate for the six months ending June 30, 2010 is as follows:

Tax benefit at U.S. statutory rate	34%
State taxes, net of federal benefit	4
Change in valuation allowance	<u>(38)</u>
	=

As of December 31, 2009, the Company had a net operating loss carry forward for income tax reporting purposes of approximately \$6.2 million that may be offset against future taxable income through 2028. Current tax laws limit the amount of loss available to be offset against future taxable income when a substantial change in ownership occurs. Therefore, the amount available to offset future taxable income may be limited. No tax asset has been reported in the financial statements, because the Company believes there is a 50% or greater chance the carry-forwards will expire unused. Accordingly, the potential tax benefits of the loss carry forwards are offset by a valuation allowance of the same amount.

NOTE 12 – LEGAL MATTERS

The Company is not involved in any litigation at this time, and management knows of no legal proceedings against the Company, threatened, pending or otherwise.

NOTE 13 – STOCK OPTIONS AND WARRANTS

A. COMMON STOCK OPTIONS

In April 2010, the Company issued 450,000 common stock purchase options to corporate officers and consultants for services that had been previously provided. These options are valued at \$13,351 by the Black-Scholes option pricing model. A summary of the common stock options for the period from December 31, 2008 thru June 30, 2010 follows:

	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
<u>Common Stock Options</u>			
Balance, December 31, 2008	1,000,000	.325	9.5
Options issued	-	-	-
Options exercised	-	-	-
Options cancelled	-	-	-
	<hr/>	<hr/>	<hr/>
Balance, December 31, 2009	1,000,000	.325	8.5
Options issued	450,000	.150	2.0
Options exercised	-	-	-
Options cancelled	-	-	-
	<hr/>	<hr/>	<hr/>
Balance, June 30, 2010	<u>1,450,000</u>	<u>.27</u>	<u>6.5</u>

B. COMMON STOCK WARRANTS

As part of the license and royalty agreement with Renovalia Energy S.A. (“Renovalia”) of Madrid, Spain, for solar thermal engines, the Company issued to Renovalia stock purchase warrants for 8,000,000 shares of restricted common stock, exercisable at a strike price of \$.25 per share. These warrants vest upon the completion, delivery and testing of the first two Cyclone Solar I prototypes by Renovalia (projected for the second half of 2010) and terminate 12 months thereafter. The warrants are valued at approximately \$157,702 (by the Black Scholes valuation method) and are to be amortized in conjunction with revenue recognition from this contract, anticipated to commence in 2010.

As part of the Company’s license agreement with Phoenix Power Group LLC (“Phoenix”), the Company issued to Phoenix common stock purchase warrants at a price of \$.19 per share, equal to two (2%) percent of the total issued and outstanding common stock of the Company at the time of exercise. The warrants vest upon the delivery of the first two prototype Cyclone Mark V Engines to Phoenix and payment by Phoenix of the full \$400,000 license fee, and terminates 24 months thereafter. Delivery of the prototypes is estimated in the second half of 2010. The warrants are valued at approximately \$100,000 (by the Black Scholes valuation method) and are to be amortized in conjunction with revenue recognition from this contract, anticipated to commence in 2010.

A summary of outstanding warrants for the period from December 31, 2008 to June 30, 2010 follows:

	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
<u>Common Stock Warrants</u>			
Balance, December 31, 2008	250,000	\$.08	1
Warrants issued	10,073,983	\$2.38	*
Warrants exercised	250,000	\$.08	-
Warrants cancelled	-	-	-
	<hr/>	<hr/>	<hr/>
Balance, December 31, 2009	10,073,983	\$.238	*
Warrants issued	-	-	-
Warrants exercised	-	-	-
Warrants cancelled	-	-	-
	<hr/>	<hr/>	<hr/>
Balance, June 30, 2010	<u>10,073,983</u>	<u>\$.238</u>	<u>*</u>

*Vesting conditioned upon future events

NOTE 14 – CAPITALIZED LEASE OBLIGATIONS

In June 2009, the Company acquired \$27,401 of property and equipment via capitalized lease obligations at an average interest rate of 18.4%. The balance of leases payable at June 30, 2010 was \$14,648. Subsequent lease payments are:

2010	\$ 7,363
2011	4,748
2012	904
2013	1,095
2014	<u>538</u>
	<u>\$ 14,648</u>

NOTE 15 – COMMITMENTS AND CONTINGENCIES

The Company has employment agreements with Harry Schoell, CEO, at \$150,000 per year, and Frankie Fruge, COO, at \$120,000 per year (the “Executives”), that provide for a term of three (3) years from their Effective Date (July 2, 2007), with automatically renewing successive one year periods starting on the end of the second anniversary of the Effective Date. If either Executive is terminated “without cause” or pursuant to a “change in control” of the Company, as both defined in the respective agreements, the Executive shall be entitled to (i) any unpaid Base Salary accrued through the effective date of termination, (ii) the Executive’s Base Salary at the rate prevailing at such termination through 12 months from the date of termination or the end of his Term then in effect, whichever is longer, and (iii) any Performance Bonus that would otherwise be payable to the Executive were he not terminated, during the 12 months following his or her termination. No performance bonuses are currently owed under either of these agreements.

NOTE 16 – CONSOLIDATED SUBSIDIARY

Commencing in the second quarter of 2010, the Company has started operations in a 90% owned subsidiary (Cyclone-WHE LLC) to license and market waste heat recovery systems for all engine models. A 5% equity participation was sold to a minority investor for \$30,000, via the conversion of Cyclone note payable for a profit of \$29,998. An additional 5% was purchased directly from the subsidiary by a minority investor, for services valued at \$30,000 consisting of assistance in marketing, management and financing for projects to be carried out by Cyclone-WHE LLC. These services are being amortized over a 12 month period. Effective July 1, 2010, after the end of the quarter, the Company issued to the Managing Director of Cyclone-WHE 5% of the equity of the subsidiary company for services to be performed over the following 12 months.