TELKONET INC
Form 10-Q/A
March 03, 2008

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A
(Amendment No.1)

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

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the transition period from _____ to _____.

For the period ended March 31, 2007

Commission file number 001-31972

TELKONET, INC.
(Exact name of Issuer as specified in its charter)

Utah	87-0627421
(State of Incorporation)	(IRS Employer Identification No.)

20374 Seneca Meadows Parkway, Germantown, MD 20876
(Address of Principal Executive Offices)

(240) 912-1800
Issuer's Telephone Number

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

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

Large Accelerated Filer [ ] Accelerated Filer [X] Non-Accelerated Filer [ ]

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Exchange Act. [ ]
Yes [X] No

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 66,738,486 shares of Common Stock ($.001 par value) as of May 1, 2007.

TELKONET, INC.

FORM 10-Q for the Quarter Ended March 31, 2007

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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (the "Amendment") amends our annual report on Form 10-Q for the fiscal quarter ended March 31, 2007 as filed with the Securities and Exchange Commission on May 10, 2007 (the "Original Report"). The Company is filing this Amendment in response to comments received from the SEC. This Amendment corrects errors and provides additional disclosure information in Item 1 of Part I, Note B Acquisition of Subsidiary, Note D Intangible Assets and Goodwill, Note E Senior Convertible Notes Payable, and Note F Stock Options and Warrants, in the notes to the unaudited financial statements for the period-ended March 31, 2007, Item 2 of Part I, and Item 6 of Part II as permitted by the rules and regulations of the SEC. The amendment did not have any material impact on our financial results.

For convenience and ease of reference, we are filing the annual report in its entirety with the applicable changes. Except for the amendments named above and the updated certifications, this Amendment continues to speak as of the date of our Original Report, and we have not updated the disclosures contained herein to reflect any events that have occurred thereafter. For a discussion of events and developments thereafter, please see our reports filed with the Securities and Exchange Commission since May 9, 2007.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

TELKONET, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) March 31, 2007	December 31, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,187,024	$ 1,644,037
Accounts Receivable: net of allowance for doubtful accounts of $207,000 and $60,000 at March 31, 2007 and December 31, 2006.	1,384,299	295,116
Income tax receivable	291,000	291,000
Note receivable	37,562	-
Inventory	2,530,623	1,306,593
Prepaid expenses and deposits	473,291	229,333
Total current assets	6,903,799	3,766,079
Property and Equipment:		
Furniture and equipment, at cost	1,384,538	1,370,780
Less: accumulated depreciation	599,497	577,759
Total property and equipment, net	785,041	793,021
Equipment under Operating Leases:		
Capitalized equipment, at cost	4,218,582	4,026,255
Less: accumulated depreciation	738,660	568,721
Total equipment under operating leases, net	3,479,922	3,457,534
Other Assets:		
Long-term investments	193,847	193,847
Intangible assets, net of accumulated amortization of $367,656and $282,325 at March 31, 2007 and December 31, 2006, respectively	4,096,271	2,181,602
Note receivable	17,974	-
Goodwill	17,775,662	1,977,768
Deposits and other	157,802	146,665
Total other assets	22,241,556	4,499,882
TOTAL ASSETS	$ 33,410,318	$ 12,516,516
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and accrued liabilities	$ 3,908,835	$ 2,859,863
Note payable - officer	80,444	80,444
Income tax refund due to officer	291,000	291,000

Deferred revenue		207,397		160,125
Note payable under subsidiary acquisition		-		900,000
Customer deposits and other		70,439		5,281
Total current liabilities		4,558,115		4,296,713
Long Term Liabilities:				
Deferred revenue		29,473		42,019
Deferred lease liability & Other		52,727		42,561
Total long term liabilities		82,200		84,580
Commitments and Contingencies		-		-
Minority Interest		-		-
Stockholders' Equity :				
Preferred stock, par value $.001 per share;				
15,000,000 shares authorized;				
none issued and outstanding at March 31, 2007 and				
December 31, 2006		-		-
Common stock, par value $.001 per share;				
100,000,000 shares authorized;				
66,710,183 and 56,992,301 shares issued and				
outstanding at March 31, 2007				
and December 31, 2006, respectively		66,710		56,992
Additional paid-in-capital		104,529,437		78,502,900
Accumulated deficit		(75,826,144)		(70,424,669)
Stockholders' equity		28,770,003		8,135,223
TOTAL LIABILITIES AND STOCKHOLDERS'				
EQUITY	$	33,410,318	$	12,516,516

See accompanying footnotes to the unaudited condensed consolidated financial information

TELKONET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For The Three Months Ended March 31,	
	2007	2006
Revenues, net:		
Product	$ 637,856	$ 1,549,975
Rental	608,413	393,937
Total Revenue	1,246,269	1,943,912
Cost of Sales:		
Product	429,468	983,651
Rental	886,993	311,919
Total Cost of Sales	1,316,461	1,295,570
Gross Profit	(70,192)	648,342
Costs and Expenses:		
Research and Development	474,603	432,569
Selling, General and Administrative	4,260,111	3,092,043
Non-Employee Stock Options and Warrants	-	277,344
Employee Stock Based Compensation	354,186	376,281
Depreciation and Amortization	151,147	119,227
Total Operating Expense	5,240,047	4,297,464
Loss from Operations	(5,310,239)	(3,649,122)
Other Income (Expenses):		
Interest Income	42,347	102,684
Interest Expense	(133,584)	(720,253)
Total Other Income (Expenses)	(91,237)	(617,569)
Loss Before Provision for Income Taxes	(5,401,476)	(4,266,691)
Provision for Income Taxes		-
Loss Before Minority Interest	(5,401,476)	(4,266,691)
Minority Interest	-	19,569
Net Loss	$ (5,401,476)	$ (4,247,122)
Loss per common share (basic and assuming dilution)	$ (0.09)	$ (0.09)
Weighted average common shares outstanding	58,606,420	46,187,202

See accompanying footnotes to the unaudited condensed consolidated financial information

TELKONET, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(UNAUDITED)
FOR THE THREE MONTHS ENDED MARCH 31, 2007

	Preferred Shares	Preferred Stock Amount	Common Shares	Common Stock Amount	Additional Paid in Capital	Accumulated Deficit	Total
Balance at January 1, 2007	-	-	56,992,301	$ 56,992	$ 78,502,900	$ (70,424,669)	$ 8,135,223
Shares issued for employee stock options exercised at $1.00 per share	-	-	31,000	31	30,969	-	31,000
Issuance of shares for purchase of subsidiary	-	-	2,227,273	2,227	5,997,773	-	6,000,000
Issuance of shares for purchase of subsidiary	-	-	3,459,609	3,460	9,752,637	-	9,756,097
Shares issued in connection with a private placement, net of costs	-	-	4,000,000	4,000	9,606,000	-	9,610,000
Warrants issued in exchange for interest expenses	-	-	-	-	131,009	-	131,009
Stock-based compensation expense related to employee stock options	-	-	-	-	354,186	-	354,186
Stock options granted to directors in exchange for accrued service fees	-	-	-	-	153,963	-	153,963
Net Loss	-	-				(5,401,476)	(5,401,476)
Balance at March 31, 2007	-	$ -	66,710,183	$ 66,710	$ 104,529,437	$ (75,826,144)	$ 28,770,003

See accompanying footnotes to the unaudited condensed consolidated financial information

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TELKONET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For The Three Months Ended March 31,	
	2007	2006
Cash Flows from Operating Activities:		
Net loss from operating activities	$ (5,401,476)	$ (4,247,122)
Adjustments to reconcile net loss from operations to cash used in operating activities		-
Minority interest	-	(19,569)
Amortization of financing costs		100,225
Write-off of fixed assets in conjunction with loss on sublease	64,608	-
Value of additional warrants issued for senior convertible debenture	131,009	-
Amortization of debt discount - beneficial conversion feature of convertible debentures	-	121,586
Amortization of debt discount - value of warrants attached to convertible debentures	-	239,943
Stock options and warrants issued in exchange for services rendered	508,149	653,625
Common stock issued in exchange for services rendered	-	81,271
Depreciation, including depreciation of equipment under operating leases	321,146	215,537
Increase / decrease in:		
Accounts receivable	42,132	(320,083)
Inventory	(130,631)	157,727
Prepaid expenses and deposits	(286,327)	2,220
Customer deposits and other current liability	9,683	(66,996)
Accounts payable and accrued expenses	(33,447)	(155,536)
Deferred revenue	(37,848)	97,963
Deferred lease liability	-	245
Net Cash (Used in) Operating Activities	(4,813,002)	(3,138,964)
Cash Flows from Investing Activities:		
Costs of equipment under operating leases	(276,292)	(316,716)
Proceeds from sale of equipment under operating lease	-	340,130
Payment of note payable under subsidiary acquisition	(900,000)	(1,017,822)
Net cash acquired from MST	-	59,384
Investment in subsidiaries	(2,875,000)	-
Investment in affiliate	-	(44)
Purchase of property and equipment, net	(34,760)	(134,704)
Net Cash (Used in) Investing Activities	(4,086,052)	(1,069,772)
Cash Flows from Financing Activities:		
Repayment of convertible debentures	-	(1,250,000)
Proceeds from sale of common stock, net of costs	9,610,000	-
Proceeds from exercise of stock options and warrants	31,000	974,503
Repayment of subsidiary loans	(198,959)	(409,675)
Net Cash Provided by (Used in) Financing Activities	9,442,041	(685,172)

Net Increase (Decrease) in Cash and Cash Equivalents		542,987		(4,893,908)
Cash and cash equivalents at the beginning of the period		1,644,037		8,422,079
Cash and cash equivalents at the end of the period	$	2,187,024	$	3,528,171

See accompanying footnotes to the unaudited condensed consolidated financial information

TELKONET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For The Three Months Ended March 31,	
	2007	2006
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for interest	$ -	$ 622,530
Income taxes paid	-	-
Non-cash transactions:		
Note payable under subsidiary acquisition	-	900,000
Issuance of shares for purchase of subsidiary	15,756,097	1,800,000
Employee stock-based compensation	508,149	376,281
Warrants issued in exchange for interest expense	131,009	-
Issuance of stock options and warrants in exchange for services rendered	-	277,344
Allowance for Doubtful Accounts – acquired subsidiaries	137,000	-
Common stock issued for services rendered	-	81,271
Acquisition of subsidiary (Note B):		
Assets acquired	$ 4,386,762	$ 4,120,600
Goodwill (including purchase price contingency)	15,797,894	6,477,767
Minority Interest	-	(19,569)
Liabilities assumed	(1,303,559)	(1,460,976)
Common stock issued	(15,756,097)	(1,800,000)
Notes payable issued	-	(900,000)
Purchase price contingency	-	(5,400,000)
Direct acquisition costs	(250,000)	(117,822)
Cash paid for acquisition	$ (2,875,000)	$ (900,000)

See accompanying footnotes to the unaudited condensed consolidated financial information

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007
(UNAUDITED)

NOTE A - SUMMARY OF ACCOUNTING POLICIES

General

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Accordingly, the results from operations for the three-month period ended March 31, 2007, are not necessarily indicative of the results that may be expected for the year ended December 31, 2007. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated December 31, 2006 financial statements and footnotes thereto included in the Company's Form 10-K for the year ended December 31, 2006.

Basis of Presentation

Telkonet, Inc. (the "Company"), formerly Comstock Coal Company, Inc., was formed on November 3, 1999 under the laws of the state of Utah. The Company was a “development stage enterprise” (as defined by Statement of Financial Accounting Standards No. 7) until December 31, 2003. The Company is engaged in the business of developing, producing and marketing proprietary equipment enabling the transmission of voice and data over electric utility lines.

In January 2006, following the acquisition of Microwave Satellite Technologies (MST) (Note B), the Company began offering complete sales, installation, and service of VSAT and business television networks, and became a full-service national Internet Service Provider (ISP). The MST solution offers a complete “Quad-play” solution to subscribers of HDTV, VoIP telephony, NuVision Broadband Internet access and wireless fidelity (“Wi-Fi”) access, to commercial multi-dwelling units and hotels.

In March 2007, the Company acquired substantially all of the assets of Smart Systems International (SSI), a leading provider of energy management products and solutions to customers in the United States and Canada.

In March 2007, the Company acquired 100% of the outstanding membership units of Ethostream, LLC, a network solutions integration company that offers installation, sales and service to the hospitality industry. The Ethostream, LLC acquisition will enable Telkonet to provide installation and support for PLC products and third party applications to customers across North America.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Telkonet Communications, Inc. and Ethostream, LLC and 90% owned subsidiary Microwave Satellite Technologies (MST). Significant intercompany transactions have been eliminated in consolidation.

Investments in entities over which the Company has significant influence, typically those entities that are 20 to 50 percent owned by the Company, are accounted for using the equity method of accounting, whereby the investment is carried at cost of acquisition, plus the Company’s equity in undistributed earnings or losses since acquisition.

Reclassification

Certain reclassifications have been made to conform prior periods' data to the current presentation. These reclassifications had no effect on reported losses.

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007
(UNAUDITED)

NOTE A - SUMMARY OF ACCOUNTING POLICIES (continued)

Use of Estimates

The preparation of consolidated 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 reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

Concentrations of Credit Risk

Financial instruments and related items, which potentially subject the Company to concentrations of credit risk, consist primarily of cash and cash equivalents. The Company places its cash and temporary cash investments with credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit. The Company periodically reviews its trade receivables in determining its allowance for doubtful accounts. The allowance for doubtful accounts was $207,000 and $60,000 at March 31, 2007 and December 31, 2006, respectively.

Revenue Recognition

For revenue from product sales, the Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition (“SAB104”), which superceded Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements (“SAB101”). SAB 101 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) are based on management’s judgments regarding the fixed nature of the selling prices of the products delivered and the collectibility of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related sales are recorded. The Company defers any revenue for which the product has not been delivered or is subject to refund until such time that the Company and the customer jointly determine that the product has been delivered or no refund will be required. SAB 104 incorporates Emerging Issues Task Force 00-21 (“EITF 00-21”), Multiple-Deliverable Revenue Arrangements. EITF 00-21 addresses accounting for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets.

For equipment under lease, revenue is recognized over the lease term for operating lease and rental contracts. All of the Company’s leases are accounted for as operating leases. At the inception of the lease, no lease revenue is recognized and the leased equipment and installation costs are capitalized and appear on the balance sheet as “Equipment Under Operating Leases.” The capitalized cost of this equipment is depreciated from two to three years, on a straight-line basis down to the Company’s original estimate of the projected value of the equipment at the end of the scheduled lease term. Monthly lease payments are recognized as rental income. For sales-type leases, we record the discounted present values of minimum rental payments under sales-type leases as sales.

MST accounts for the revenue, costs and expense related to residential cable services as the related services are performed in accordance with SFAS No. 51, Financial Reporting by Cable Television Companies. Installation revenue for residential cable services is recognized to the extent of direct selling costs incurred. Direct selling costs have

exceeded installation revenue in all reported periods. Generally, credit risk is managed by disconnecting services to customers who are delinquent.

Management identifies a delinquent customer based upon the delinquent payments status of an outstanding invoice, generally greater than 30 days past the due date. The delinquent account designation does not trigger an accounting transaction until such time the account is deemed uncollectible. The allowance for doubtful accounts is determined by examining the reserve history and any outstanding invoices that are over 30 days past due as of the end of the reporting period. Accounts are deemed uncollectible on a case-by-case basis, at management’s discretion based upon an examination of the communication with the delinquent customer and payment history. Typically, accounts are only escalated to “uncollectible” status after multiple attempts have been made to communicate with the customer.

Liquidity

As shown in the accompanying consolidated financial statements, the Company incurred net loss from continuing operating of $5,401,476 and $4,247,122 for the three months ended March 31, 2007 and 2006, respectively. Net loss from continuing operations included $131,009 and $461,754 of non-cash expense in connection with the convertible debentures and $508,149 and $653,625 of non-cash compensation to employees and non-employees in connection with stock options granted and vested for the three months ended March 31, 2007 and 2006, respectively. The Company's current assets, on a consolidated basis, exceeded its current liabilities by $2,345,684 as of March 31, 2007.

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007
(UNAUDITED)

NOTE A - SUMMARY OF ACCOUNTING POLICIES (continued)

Guarantees and Product Warranties

FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), requires that upon issuance of a guarantee, the guarantor must disclose and recognize a liability for the fair value of the obligation it assumes under that guarantee.

The Company's guarantees were issued subject to the recognition and disclosure requirements of FIN 45 as of March 31, 2007 and December 31, 2006. The Company records a liability for potential warranty claims. The amount of the liability is based on the trend in the historical ratio of claims to sales, the historical length of time between the sale and resulting warranty claim, new product introductions and other factors. The products sold are generally covered by a warranty for a period of one year. In the event the Company determines that its current or future product repair and replacement costs exceed its estimates, an adjustment to these reserves would be charged to earnings in the period such determination is made. During the three months ended March 31, 2007 and the year ended December 31, 2006, the Company experienced approximately three percent of units returned under its product warranty policy. As of March 31, 2007 and December 31, 2006, the Company recorded warranty liabilities in the amount of $57,120 and $47,300, respectively, using this experience factor.

New Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS 159 permits entities to choose to measure many financial instruments, and certain other items, at fair value. SFAS 159 applies to reporting periods beginning after November 15, 2007. The adoption of SFAS 159 is not expected to have a material impact on the Company's financial condition or results of operations.

NOTE B - ACQUISITION OF SUBSIDIARIES

Acquisition of Microwave Satellite Technologies, Inc.

On January 31, 2006, the Company acquired a 90% interest in Microwave Satellite Technologies, Inc. ("MST") from Frank Matarazzo, the sole stockholder of MST, in exchange for $1.8 million in cash and 1.6 million unregistered shares of the Company's common stock for an aggregate purchase price of $9,000,000. The purchase price of $9,000,000 was increased by $117,822 for direct costs related to the acquisition. These direct costs included legal, accounting and other professional fees. The cash portion of the purchase price was paid in two installments, $900,000 at closing and $900,000 in February 2007. The stock portion is payable from shares held in escrow, 400,000 shares at closing and the remaining 1,200,000 "purchase price contingency" shares issued based on the achievement of 3,300 "Triple Play" subscribers over a three year period. In the year ended December 31, 2006, the Company issued 200,000 shares of the purchase price contingency valued at $900,000 as an adjustment to Goodwill.

The purchase price contingency shares are price protected for the benefit of the former owner of MST. In the event the Company's common stock price is below $4.50 per share upon issuance of the shares from escrow, a pro rata adjustment in the number of shares will be required to support the aggregate consideration of $5.4 million. The price protection provision provides a cash benefit to the former owner of MST if the as-defined market price of the Company's common stock is less than $4.50 per share at the time of issuance from the escrow. The issuance of

additional shares or distribution of other consideration upon resolution of the contingency based on the Company's common stock prices will not affect the cost of the acquisition. When the contingency is resolved or settled, and additional consideration is distributable, the Company will record the current fair value of the additional consideration and the amount previously recorded for the common stock issued will be simultaneously reduced to the lower current value of the Company's common stock.

TELKONET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007
(UNAUDITED)

NOTE B - ACQUISITION OF SUBSIDIARIES (continued)

MST is a communications technology company that offers complete sales, installation, and service of Very Small Aperture Terminal (VSAT) and business television networks, and is a full-service national Internet Service Provider (ISP). Management believes that the MST acquisition will enable Telkonet to provide a complete “Quad-play” solution to subscribers of HDTV, VoIP telephony, NuVision Broadband Internet access and wireless fidelity (“Wi-Fi”) access, to commercial multi-dwelling units and hotels.

The acquisition of MST was accounted for using the purchase method in accordance with SFAS 141, “Business Combinations.” The value of the Company’s common stock issued as a part of the acquisition was determined based on the average price of the Company's common stock for several days before and after the acquisition of MST. The results of operations for MST have been included in the Consolidated Statements of Operations since the date of acquisition. The components of the purchase price were as follows:

	As Reported	Including Purchase Price Contingency (*)
Common stock	$ 2,700,000	$ 7,200,000
Cash (including note payable)	1,800,000	1,800,000
Direct acquisition costs	117,822	117,822
Purchase price	4,617,822	9,117,822
Minority interest	19,569	19,569
Total	$ 4,637,391	$ 9,137,391

In accordance with Financial Accounting Standard (SFAS) No. 141, Business Combinations, the total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The fair value of the assets acquired was based on management’s best estimates. The purchase price was allocated to the fair value of assets acquired and liabilities assumed as follows:

	As Reported	Including Purchase Price Contingency (*)
Cash and other current assets	$ 346,548	$ 346,548
Equipment and other assets	1,310,125	1,310,125
Subscriber lists	2,463,927	2,463,927
Goodwill and other intangible assets	1,977,767	6,477,767
Subtotal	6,098,367	10,598,367
Current liabilities	1,460,976	1,460,976
Total	$ 4,637,391	$ 9,137,391

(*) At the date of the acquisition, the effect of the “purchase price contingency” shares valued at approximately $5.4 million had not been recorded in accordance with FAS 141. In the second quarter of 2006, the Company issued 200,000 shares of the purchase price contingency valued at $900,000 as an adjustment to Goodwill. The remaining shares, when issued, will reflect an adjustment to Goodwill and Other Intangibles.

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007
(UNAUDITED)

NOTE B - ACQUISITION OF SUBSIDIARIES (continued)

Goodwill and other intangible assets represent the excess of the purchase price over the fair value of the net tangible assets acquired. The Company used a discounted cash flow model to determine the value of the intangible assets and to allocate the excess purchase price to the intangible assets and goodwill as appropriate. In this model, expected cash flows from subscribers were discounted to their present value at a rate of return of 20% (incorporating the risk-free rate, expected inflation, and related business risks) over a period of eight years. Expected costs such as income taxes and cost of sales were deducted from expected revenues to arrive at after tax cash flows. In accordance with SFAS 142, goodwill is not amortized and will be tested for impairment at least annually. The subscriber list was independently valued at $2,463,927 with an estimated useful life of eight years. This intangible was amortized using that life, and amortization from the date of the acquisition through March 31, 2007, was taken as a charge against income in the consolidated statement of operations. In accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the intangible asset subject to amortization was reviewed periodically for impairment. Goodwill of $1,977,768, excluding the remaining purchase price contingency, represented the excess of the purchase price over the fair value of the net tangible and intangible assets acquired.

At December 31, 2006, the Company performed an impairment test on the goodwill and intangibles acquired, it was determined that there were no changes in the carrying value of goodwill and intangibles acquired.

Acquisition of Smart Systems International, Inc.

On March 9, 2007, the Company acquired substantially all of the assets of Smart Systems International (SSI), a leading provider of energy management products and solutions to customers in the United States and Canada for cash and Company common stock having an aggregate value of $6,875,000. The purchase price was comprised of $875,000 in cash and 2,227,273 shares of the Company’s common stock. The Company is obligated to register the stock portion of the purchase price on or before May 15, 2007 and 1,090,909 shares are being held in an escrow account for a period of one year following the closing from which certain potential indemnification obligations under the purchase agreement may be satisfied. The aggregate number of shares held in escrow is subject to adjustment upward or downward depending upon the trading price of the Company’s common stock during the one year period following the closing date.

The acquisition of SSI was accounted for using the purchase method in accordance with SFAS 141, “Business Combinations.” The value of the Company’s common stock issued as a part of the acquisition was determined based on the most recent price of the Company's common stock on the day immediately preceding the acquisition date. The results of operations for SSI have been included in the Consolidated Statements of Operations since the date of acquisition. The components of the purchase price were as follows:

	As Reported
Common stock	$ 6,000,000
Cash	875,000
Direct acquisition costs	100,000
Total Purchase Price	$ 6,975,000

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NOTE B - ACQUISITION OF SUBSIDIARIES (continued)

In accordance with Financial Accounting Standard (SFAS) No. 141, Business Combinations, the total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The fair value of the assets acquired was based on management's best estimates. The purchase price was allocated to the fair value of assets acquired and liabilities assumed as follows:.

Current assets	$ 1,229,867
Property, plant and equipment	36,020
Other assets	8,237
Goodwill	6,258,660
Total assets acquired	7,532,784
Accounts payable and accrued liabilities	(557,784)
Total liabilities assumed	(557,784)
Net assets acquired	$ 6,975,000

Due to its recent date of acquisition, the purchase price allocation to Goodwill is based upon preliminary data that is subject to adjustment and could change significantly. In accordance with SFAS 142, goodwill is not amortized and will be tested for impairment at least annually.

Acquisition of Ethostream LLC

On March 15, 2007, the Company acquired 100% of the outstanding membership units of Ethostream, LLC, a network solutions integration company that offers installation, sales and service to the hospitality industry. The Ethostream acquisition will enable Telkonet to provide installation and support for PLC products and third party applications to customers across North America. The purchase price of $11,756,097 was comprised of $2.0 million in cash and 3,459,609 shares of the Company's common stock. The entire stock portion of the purchase price is being held in escrow to satisfy certain potential indemnification obligations of the sellers under the purchase agreement. The shares held in escrow are distributable over the three years following the closing. If during the twelve months following the Closing, the Common Stock has a volume-weighted average trading price of at least $4.50, as reported on the American Stock Exchange, for twenty (20) consecutive trading days, the aggregate number of shares of Common Stock issuable to the sellers shall be adjusted such that the number of shares of Common Stock issuable as the stock consideration shall be determined assuming a per share price equal to $4.50.

The acquisition of Ethostream was accounted for using the purchase method in accordance with SFAS 141, "Business Combinations." The value of the Company's common stock issued as a part of the acquisition was determined based on the most recent price of the Company's common stock prior to the acquisition date. The results of operations for Ethostream have been included in the Consolidated Statements of Operations since the date of acquisition. The components of the purchase price were as follows:

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NOTE B - ACQUISITION OF SUBSIDIARIES (continued)

	As Reported
Common stock	$ 9,756,097
Cash	2,000,000
Direct acquisition costs	150,000
Total Purchase Price	$ 11,906,097

In accordance with Financial Accounting Standard (SFAS) No. 141, Business Combinations, the total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The fair value of the assets acquired was based on management's best estimates. The purchase price was allocated to the fair value of assets acquired and liabilities assumed as follows:

Current assets	$ 1,029,615
Property, plant and equipment	51,724
Other assets	31,299
Subscriber lists	2,000,000
Goodwill	9,539,234
Total assets acquired	12,651,872
Accounts payable and accrued liabilities	(745,775)
Total liabilities assumed	(745,775)
Net assets acquired	$ 11,906,097

Goodwill and other intangible assets represent the excess of the purchase price over the fair value of the net tangible assets acquired. Due to its recent date of acquisition, the purchase price allocation to Intangibles and Goodwill is based upon preliminary data that is subject to adjustment and could change significantly pending the completion of management's valuation to accurately evaluate this allocation. In accordance with SFAS 142, goodwill is not amortized and will be tested for impairment at least annually. The subscriber list was preliminarily valued and could also change significantly pending the completion of an independent appraisal at $2,000,000 with an estimated useful life of ten years.

The following unaudited condensed combined pro forma results of operations reflect the pro forma combination of the Telkonet, MST, SSI and Ethostream, LLC businesses as if the combination had occurred at the beginning of the periods presented compared with the actual results of operations of Telkonet for the same period. The unaudited pro forma condensed combined results of operations do not purport to represent what the companies' combined results of operations would have been if such transaction had occurred at the beginning of the periods presented, and are not necessarily indicative of Telkonet's future results.

	Three Months Ended March 31,	
	Proforma 2007	Proforma 2006
Product revenue	$ 1,386,652	$ 2,407,050
Recurring revenue	1,180,909	813,605
	2,567,561	3,220,655

Net (loss)	$ (5,668,394)	$ (4,627,504)
Basic (loss) per share	$ (.08)	$ (.08)
Diluted (loss) per share	$ (.08)	$ (.07)

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NOTE C - INVENTORIES

Inventories are stated at the lower of cost or market determined by the first-in, first-out (FIFO) method. Inventories primarily consist of Gateways, eXtenders, Couplers and iBridges, which are the significant components of the Telkonet solution. Additionally, inventories include raw materials and finished goods of Smart Systems International and finished goods of Ethostream, LLC as of the acquisition date March 9, 2007 and March 15, 2007, respectively. Components of inventories as of March 31, 2007 and December 31, 2006 are as follows:

	March 31, 2007	December 31, 2006
Raw Materials	$ 1,301,618	$ 516,604
Finished Goods	1,229,005	789,989
	$ 2,530,623	$ 1,306,593

NOTE D - INTANGIBLE ASSETS AND GOODWILL

As a result of MST acquisition at January 31, 2006 and the Ethostream acquisition on March 15, 2007, the Company had intangibles totaling $4,463,927 at March 31, 2007 (Note B).

In accordance with SFAS 142, Goodwill and Other Intangible Assets (SFAF No. 142), an impairment test will be performed on these assets at least annually. The consolidated statement of operations for the three months ended March 31, 2007 includes only charges for amortization of these intangibles.

We used a discounted cash flow model to determine the value of the intangible assets and to allocate the excess purchase price to the intangible assets and goodwill as appropriate. In this model, expected cash flows from subscribers were discounted to their present value at a rate of return of 20% (incorporating the risk-free rate, expected inflation, and related business risks) over a determined length of life year. Expected costs such as income taxes and cost of sales were deducted from expected revenues to arrive at after tax cash flows.

We have applied the same discounted cash flow methodology to the assessment of value of the intangible assets of Ethostream, LLC, during the acquisition completed on March 15, 2007, for purposes of determining the purchase price.

The MST subscriber list was determined to have an eight-year life. This intangible was amortized using that life, and amortization from the date of the acquisition through March 31, 2007, was taken as a charge against income in the consolidated statement of operations. MST's goodwill of $1,977,767, excluding the purchase price contingency, represented the excess of the purchase price over the fair value of the net tangible and intangible assets acquired.

The acquisition of Ethostream resulted from preliminary estimates by management and is subject to adjustment upon the completion of management’s valuation of Ethostream’s subscriber lists as intangible assets. The Ethostream subscriber list was estimated to have a ten-year life. This intangible was amortized using that life, and amortization from the date of the acquisition through March 31, 2007, was taken as a charge against income in the consolidated statement of operations. Ethostream's goodwill of $9,539,234 represented the excess of the purchase price over the fair value of the net tangible and intangible assets acquired.

Total identifiable intangible assets acquired and their carrying value at December 31, 2006 are:

	Gross Carrying Amount	Accumulated Amortization	Net	Residual Value	Weighted Average Amortization Period (Years)
Amortized Identifiable tangible Assets:					
Subscriber lists	$ 2,463,927	$ (282,325)	$ 2,181,602	$ -	8.0
Total Amortized Identifiable Intangible Assets	2,463,927	(282,325)	2,181,602	$ -	
Unamortized Identifiable Intangible Assets:	None				
Total	$ 2,463,927	$ (282,325)	$ 2,181,602	$ -	

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NOTE D - INTANGIBLE ASSETS AND GOODWILL (continued)

Total identifiable intangible assets acquired and their carrying value at March 31, 2007 are:

	Gross Carrying Amount	Accumulated Amortization	Net	Residual Value	Weighted Average Amortization Period (Years)
Amortized Identifiable tangible Assets:					
Subscriber lists - MST	$ 2,463,927	$ (359,323)	$ 2,104,604	$ -	8.0
Subscriber lists - Ethostream	2,000,000	(8,333)	1,991,667	-	10.0
Total Amortized Identifiable Intangible Assets	4,463,927	(367,656)	4,096,271	-	
Unamortized Identifiable Intangible Assets:	None				
Total	$ 4,463,927	$ (367,656)	$ 4,096,271	$ -	

Total amortization expense charged to operations for the three months ended March 31, 2007 was $85,331. Estimated amortization expense as of March 31, 2007 is as follows:

2007	$ 380,993
2008	507,991
2009	507,991
2010	507,991
2011	507,991
2012 and after	1,683,314
Total	$ 4,096,271

The Company does not amortize goodwill. As a result of the acquisitions of MST, Ethostream and SSI, the Company recorded goodwill in the aggregate amount of $17,775,662 as of March 31, 2007. There were no changes in the carrying amount of goodwill for the three months ended March 31, 2007.

Considerable management judgment is necessary to estimate fair value. We enlisted the assistance of an independent valuation consultant to determine the values of our intangible assets and goodwill as of the date of acquisition. Based on various market factors and projections used by management, actual results could vary significantly from managements' estimates.

NOTE E - SENIOR CONVERTIBLE NOTES PAYABLE

During the year ended December 31, 2005, the Company issued convertible senior notes (the "Convertible Senior Notes") having an aggregate principal value of $20 million to sophisticated investors in exchange for $20,000,000, exclusive of $1,219,410 in placement costs and fees. The Convertible Senior Notes accrue interest at 7.25% per annum and call for monthly principal installments beginning March 1, 2006. The maturity date is 3 years from the date of issuance of the notes. At any time or times, the Noteholders shall be entitled to convert any portion of the outstanding and unpaid note amount into fully paid and nonassessable shares of the Company’s common Shares at $5

per share. At any time at the option of the Company, the principal payments may be paid either in cash or in common stock at the lower of $5 or 92.5% of the average recent market price. At any time after six months should the stock trade at or above $8.75 for 20 of 30 consecutive trading days, the Company can cause a mandatory redemption and conversion to shares at $5 per share. At any time, the Company can pre-pay the notes with cash or common stock. Should the Company pre-pay the Notes other than by mandatory conversion, the Company must issue additional warrants to the Noteholders covering 65% of the amount pre-paid at a strike price of $5 per share. In addition to standard financial covenants, the Company has agreed to maintain a letter of credit in favor of the Noteholders equal to $10 million. Once the principal amount of the note declines below $15 million, the balance is reduced by $.50 for every $1 amortized. In accordance with Emerging Issues Task Force Issue 98-5, Accounting for Convertible Securities with a Beneficial Conversion Features or Contingently Adjustable Conversion Ratios ("EITF 98-5"), the Company recognized an imbedded beneficial conversion feature present in the notes. The Company allocated a portion of the proceeds equal to the intrinsic value of that feature to additional paid in capital. The Company recognized and measured an aggregate of $1,479,300 of the proceeds, which is equal to the intrinsic value of the imbedded beneficial conversion feature, to additional paid in capital and a discount against the Notes issued during the year ended December 31, 2005. The debt discount attributed to the beneficial conversion feature is amortized over the Notes maturity period (three years) as interest expense.

TELKONET, INC.
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NOTE E - SENIOR CONVERTIBLE NOTES PAYABLE (Continued)

In connection with the placement of the Notes in October 2005, the Company has also agreed to issue to the Noteholders one million warrants to purchase company common stock exercisable for five years at $5 per share. The Company recognized the value attributable to the warrants in the amount of $2,919,300 to a derivative liability due to the possibility of the Company having to make a cash settlement, including penalties, in the event the Company failed to register the shares underlying the warrants under the Securities Act of 1933, as amended, within 90 days after the closing of the transaction. The Company accounted for this warrant derivative in accordance with EITF 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock. The warrants were included as a liability and valued at fair market value until the Company met the criteria under EITF 00-19 for permanent equity. A registration statement covering shares issuable to the Noteholders upon conversion, amortization and/or redemption of the Convertible Senior Notes and upon exercise of the warrants was filed with the Securities and Exchange Commission on Form S-3 on November 23, 2005 and was declared effective on December 13, 2005. The warrant derivative liability was valued at the issuance date of the Notes in the amount of $2,919,300 and then revalued at $2,910,700 on December 13, 2005 upon effectiveness of the Form S-3. The Company charged $8,600 to Other Income and the derivative warrant liability was reclassified to additional paid in capital at December 13, 2005. The Company valued the warrants in accordance with EITF 00-27 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 4.00%, a dividend yield of 0%, and volatility of 76%. The $2,919,300 of debt discount attributed to the value of the warrants issued is amortized over the Notes maturity period (three years) as interest expense.

For the period end March 31, 2006, the Company paid principal of $1,250,000 and interest of $358,724 in cash. The Company amortized the debt discount to the beneficial conversion feature and value of the attached warrants, and recorded non-cash interest expense in the amount of $239,943 and $121,586, respectively.

The Company has warrants due the Noteholders as a result of the anti-dilution impact from a $10,000,000 private placement in February 2007 (Note I). The Company has accounted for the additional 76,230 warrants issued, valued at $131,009, as interest expense during the period ended March 31, 2007. The Company valued the warrants using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 4.75%, a dividend yield of 0%, and volatility of 70%.

Early Extinguishment of Debt

On August 14, 2006, the Company executed separate settlement agreements with the lenders of its Convertible Senior Notes. Pursuant to the settlement agreements the Company paid to the lenders on August 15, 2006 in the aggregate $9,910,392 plus accrued but unpaid interest of $23,951 and certain premiums specified in the Notes in satisfaction of the amounts then outstanding under the Notes. Of the amount to be paid to the lenders under the Notes, $6,500,000 was paid in cash through a drawdown on a letter of credit previously pledged as collateral for the Company’s obligations under the Notes. The remaining note balance of $1,428,314 and a Redemption Premium of $1,982,078, calculated as 25% of remaining principal, was paid to the lenders in shares of Company’s common stock valued at the lower of $5.00 per share and 92.5% of the arithmetic average of the weighted average price of the Company’s common stock on the American stock exchange for the twenty trading days beginning on August 16, 2006. The Company also issued 862,452 warrants to purchase shares of the Company’s common stock at the exercise price of $2.58 per share (92.5% of the average trading price as described above) and a contractual term of 5 years. The warrants were issued fully exercisable, and, upon exercise, the warrants will be exchanged for shares of the Company’s common stock. The

Company valued the warrants at $1,014,934 using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk free interest rate of 5.00%, a dividend yield of 0%, and volatility of 65%. The Company has accounted for the Redemption Premium and the additional warrants issued as non-cash early extinguishment of debt expense during the year ended December 31, 2006. Registration statements covering the shares underlying the warrants, were filed with the Securities and Exchange Commission on Form S-3 on September 29, 2006 and October 13, 2006 and were declared effective on October 16, 2006 and October 24, 2006, respectively. As of December 31, 2006, the Company included the warrant derivatives as equity since the criteria under EITF 00-19 for permanent equity was achieved in a nominal period of time subsequent to year end. The achievement of permanent equity had been realized on October 16, 2006 and October 24, 2006 upon the declared effectiveness of the Form S-3. Upon the declared effectiveness of the Form S-3, the registration rights agreement requirements had been satisfied and achieved; therefore the warrants were accounted for as equity. The registrations rights agreement required liquidated damages in the event of failure to achieve the registration with the SEC.

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As a result of the execution of the settlement agreements and the payments required thereby, the Company fully believes it repaid and satisfied all of its obligations under the Notes. The Company also agreed to pay the expenses of the lenders incurred in connection with the negotiation and execution of the settlement agreements. The settlement agreements were negotiated following the allegation by one of the lenders that the Company's failure to meet the minimum revenue test for the period ending June 30, 2006 as specified on the Notes constituted an event of default under the Notes, which allegation the Company disputed.

The Settlement Agreement provides that the number of shares issued to the Noteholders shall be adjusted based upon the arithmetic average of the weighted average price of the Company's common stock on the American Stock Exchange for the twenty trading days immediately following the settlement date. The Company has concluded that, based upon the weighted average of the Company's common stock between August 16, 2006 and September 13, 2006, the Company is entitled to a refund from the two Noteholders. One of the Noteholders has informed the Company that it does not believe such a refund is required. As a result, the Company has declined to deliver to the Noteholders certain stock purchase warrants issued to them pursuant to the Settlement Agreement pending resolution of this disagreement. The Noteholder has alleged that the Company has failed to satisfy its obligations under the Settlement Agreement by failing to deliver the warrants. In addition, the Noteholder maintains that the Company has breached certain provisions of the Registration Rights Agreement and, as a result of such breach, such Noteholder claims that it is entitled to receive liquidated damages from the Company.

NOTE F - STOCK OPTIONS AND WARRANTS

Employee Stock Options

The following table summarizes the changes in options outstanding and the related prices for the shares of the Company's common stock issued to employees of the Company under a non-qualified employee stock option plan.

	Options Outstanding			Options Exercisable	
Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 1.00 - $1.99	4,166,929	5.71	$ 1.00	4,166,929	$ 1.00
$ 2.00 - $2.99	2,130,000	8.10	$ 2.57	1,022,750	$ 2.46
$ 3.00 - $3.99	2,558,000	8.40	$ 3.21	907,500	$ 3.34
$ 4.00 - $4.99	160,000	8.38	$ 4.44	54,250	$ 4.44
$ 5.00 - $5.99	160,000	8.14	$ 5.28	58,250	$ 5.25
	9,174,929	7.11	$ 2.12	6,209,679	$ 1.65

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NOTE F - STOCK OPTIONS AND WARRANTS (continued)

Transactions involving stock options issued to employees are summarized as follows:

	Number of Shares	Weighted Average Price Per Share
Outstanding at January 1, 2005	9,614,767	$ 1.61
Granted	1,325,000	3.97
Exercised	(415,989)	1.18
Cancelled or expired	(372,700)	3.74
Outstanding at December 31, 2005	10,151,078	$ 1.85
Granted	1,125,000	3.01
Exercised	(2,051,399)	1.30
Cancelled or expired	(703,750)	2.67
Outstanding at December 31, 2006	8,520,929	$ 2.06
Granted	705,000	2.76
Exercised (Note I)	(31,000)	1.00
Cancelled or expired	(20,000)	3.26
Outstanding at March 31, 2007	9,174,929	$ 2.12

The weighted-average fair value of stock options granted to employees during the period ended March 31, 2007 and 2006 and the weighted-average significant assumptions used to determine those fair values, using a Black-Scholes option pricing model are as follows:

	2007	2006
Significant assumptions (weighted-average):		
Risk-free interest rate at grant date	4.75%	5.0%
Expected stock price volatility	70%	65%
Expected dividend payout	-	-
Expected option life-years	5.0.	5.0

The expected life of awards granted represents the period of time that they are expected to be outstanding. We determine the expected life based on historical experience with similar awards, giving consideration to the contractual terms, vesting schedules, exercise patterns and pre-vesting and post-vesting forfeitures. We estimate the volatility of our common stock based on the calculated historical volatility of our own common stock using the trailing 12 months of share price data prior to the date of the award. We base the risk-free interest rate used in the Black-Scholes-Merton option valuation model on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term equal to the expected life of the award. We have not paid any cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. Consequently, we use an expected dividend yield of zero in the Black-Scholes-Merton option valuation model. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation for those awards that are expected to vest. In accordance with SFAS No. 123R, we adjust share-based compensation for changes to the estimate of expected equity award forfeitures based on actual forfeiture experience.

The total intrinsic value of the options exercised for the period ended March 31, 2007 and 2006, respectively, is $52,390 and $952,438, respectively. Total stock-based compensation expense recognized in the consolidated statement of earnings for the three months ended March 31, 2007 and 2006 was $354,186 and $376,281, respectively, net of tax effect. Additionally, the aggregate intrinsic value of options outstanding and unvested as of March 31, 2007 is $0.

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NOTE F - STOCK OPTIONS AND WARRANTS (Continued)

Non-Employee Stock Options

The following table summarizes the changes in options outstanding and the related prices for the shares of the Company's common stock issued to the Company consultants. These options were granted in lieu of cash compensation for services performed.

Options Outstanding				Options Exercisable	
Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighed Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 1.00	1,815,937	5.09	$ 1.00	1,815,937	$ 1.00

Transactions involving options issued to non-employees are summarized as follows:

	Number of Shares	Weighted Average Price Per Share
Outstanding at January 1, 2005	1,999,169	$ 1.07
Granted	15,000	3.45
Exercised	(172,395)	2.07
Canceled or expired	-	-
Outstanding at December 31, 2005	1,841,774	$ 1.00
Granted	-	-
Exercised	(25,837)	1.00
Canceled or expired	-	-
Outstanding at December 31, 2006	1,815,937	$ 1.00
Granted	-	-
Exercised	-	-
Canceled or expired	-	-
Outstanding at March 31, 2007	1,815,937	$ 1.00

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NOTE F - STOCK OPTIONS AND WARRANTS (Continued)

Warrants

The following table summarizes the changes in warrants outstanding and the related prices for the shares of the Company's common stock issued to non-employees of the Company. These warrants were granted in lieu of cash compensation for services performed or financing expenses in connection with placement of convertible debentures.

Warrants Outstanding				Warrants Exercisable	
Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighed Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 2.59	862,452	4.37	$ 2.59	862,452	$ 2.59
$ 4.17	4,236,739	4.69	$ 4.17	4,236,739	$ 4.17
$ 4.70	2,211,628	3.96	$ 4.70	2,211,628	$ 4.70
	7,310,819	4.43	$ 4.14	7,310,819	$ 4.14

Transactions involving warrants are summarized as follows:

	Number of Shares	Weighted Average Price Per Share
Outstanding at January 1, 2005	575,900	$ 1.12
Granted	1,040,000	4.85
Exercised	(371,900)	1.00
Canceled or expired	(14,000)	1.00
Outstanding at December 31, 2005	1,230,000	$ 4.31
Granted	3,657,850	4.03
Exercised	(47,750)	1.15
Canceled or expired	(282,250)	2.64
Outstanding at December 31, 2006	4,557,850	$ 4.20
Granted	2,752,969	4.18
Exercised	-	-
Canceled or expired	-	-
Outstanding at March 31, 2007	7,310,819	$ 4.14

The Company has warrants due the Noteholders as a result of the anti-dilution impact from a $10,000,000 private placement in February 2007 (Note I). The Company has accounted for the additional 76,230 warrants issued, valued at $131,009, as interest expense during the period ended March 31, 2007. The Company valued the warrants using the Black-Scholes pricing model and the following assumptions: contractual terms of 5 years, an average risk-free interest rate of 4.75%, a dividend yield of 0%, and volatility of 70%.

The anti-dilution impact of the private placements from August 2006 and February 2007 to the existing Noteholders, obligated the Company to re-price all of the affected purchase warrants outstanding from a price per share of $5.00, to $4.87 as of December 31, 2006 and $4.70 as of March 31, 2007, respectively.

In addition, the Company issued 2,600,000 warrants to investors and 76,739 warrants to its placement agent in connection with the private placement in February 2007 (Note I). The warrants issued to the placement agent were valued at $139,112 using the Black-Scholes pricing model and the following assumptions: contractual term of 5 years, an average risk-free interest rate of 4.75 a dividend yield of 0% and volatility of 70%.

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NOTE G - BUSINESS SEGMENTS

The Company's reportable operating segments are strategic businesses differentiated by the nature of their products, activities and customers and are described as follows:

Telkonet (TKO) is engaged in the business of developing products for use in the powerline communications (PLC) industry. PLC products use existing electrical wiring in commercial buildings and residences to carry high speed data communications signals, including the internet.

Microwave Satellite Technologies (MST) (Note B), offers complete sales, installation, and service of VSAT and business television networks, and became a full-service national Internet Service Provider (ISP). The MST solution offers a complete “Quad-play” solution to subscribers of HDTV, VoIP telephony, NuVision Broadband Internet access and wireless fidelity (“Wi-Fi”) access, to commercial multi-dwelling units and hotels.

The measurement of losses and assets of the reportable segments is based on the same accounting principles applied in the consolidated financial statements.

Financial data relating to reportable operating segments is as follows:

	Three Months ended March 31,	
	2007	2006
	(In thousands of U.S. $)	
Revenues:		
Telkonet	$ 759	$ 1,636
MST	487	308
Total revenue	$ 1,246	$ 1,944

	Three Months ended March 31,	
	2007	2006
	(In thousands of U.S. $)	
Gross Profit		
Telkonet	$ 233	$ 679
MST	(303)	(31)
Total gross profit	$ (70)	$ 648
Loss from Operations:		
Telkonet	$ (4,147)	$ (3,280)
MST	(1,163)	(369)
Total operating loss	$ (5,310)	$ (3,649)

TELKONET, INC.
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NOTE G - BUSINESS SEGMENTS (Continued)

	March 31, 2007	December 31 2006
	(In thousands of U.S. $)	
Assets		
Telkonet	$ 24,210	$ 4,137
MST	9,200	8,379
Total assets	$ 33,410	$ 12,516

NOTE H - MINORITY INTEREST IN SUBSIDIARY

Minority interest in results of operations of consolidated subsidiaries represents the minority shareholders' share of the income or loss of the consolidated subsidiary MST. The minority interest in the consolidated balance sheet reflects the original investment by these minority shareholder in the consolidated subsidiaries, along with their proportional share of the earnings or losses of the subsidiaries.

On January 31, 2006, the Company acquired a 90% interest in Microwave Satellite Technologies, Inc. (“MST”) from Frank Matarazzo, the sole stockholder of MST in exchange for $1.8 million in cash and 1.6 million unregistered shares of the Company’s common stock for an aggregate purchase price of $9,000,000 (See Note B). This transaction resulted in a minority interest of $19,569, which reflects the original investment by the minority shareholders of MST. For the period ended March 31, 2007, the minority shareholder's share of the loss of MST was limited to $19,569. The minority interest in MST is a deficit and, in accordance with Accounting Research Bulletin No. 51, subsidiary losses should not be charged against the minority interest to the extent of reducing it to a negative amount. As such, any losses will be charged against the Company's operations, as majority owner. However, if future earnings do materialize, the majority owner should be credited to the extent of such losses previously absorbed in the amount of $457,318.

NOTE I - CAPITAL STOCK

The Company has authorized 15,000,000 shares of preferred stock, par value $.001 per share. As of March 31, 2007 and December 31, 2006, the Company had no preferred stock issued and outstanding. The Company has authorized 100,000,000 shares of common stock, par value $.001 per share. As of March 31, 2007 and December 31, 2006, the Company had 66,710,183 and 56,992,301 shares of common stock issued and outstanding, respectively.

During the period ended March 31, 2007, the Company issued an aggregate of 31,000 shares of common stock for an aggregate purchase price of $31,000 to certain employees upon exercise of employee stock options at approximately $1.00 per share. (Note F).

On March 9, 2007, the Company entered into an Asset Purchase Agreement (“Agreement”) with Smart Systems International, a privately held company. Pursuant to the Agreement, the Company issued 2,227,273 shares of Common Stock at approximately $2.69 per share (Note B).

On March 15, 2007, the Company entered into a Purchase Agreement (“Agreement”) with Ethostream,LLC , a privately held company. Pursuant to the Agreement, the Company issued 3,459,609 shares of Common Stock at approximately

$2.82 per share (Note B).

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NOTE J - COMMITMENTS AND CONTINGENCIES

During the period ended March 31, 2007, the company issued 4,000,000 shares of Common Stock valued at $2.50 per share for an aggregate purchase price of $10,000,000. Total costs and fees include $390,000 of cash and 76,759 warrants paid to the placement agent. The company also has issued to this investor warrants to purchase 2.6 million shares of its common stock at an exercise price of $4.17 per share. A registration statement covering the shares underlying the warrants, was filed with the Securities and Exchange Commission on Form S-3 on March 5, 2007 and was declared effective on March 20, 2007. In accordance with EITF 00-19-02, “Accounting for Registration Payment Arrangements”, at the time of the issuance of the equity for registration the Company deemed it probable that a registration of shares would be deemed effective therefore a loss contingency would not be necessary and the equity was recorded at fair value on the date of issuance.

Employment and Consulting Agreements

The Company has employment agreements with certain of its key employees which include non-disclosure and confidentiality provisions for protection of the Company’s proprietary information.

The Company has consulting agreements with outside contractors to provide marketing and financial advisory services. The Agreements are generally for a term of 12 months from inception and renewable automatically from year to year unless either the Company or Consultant terminates such engagement by written notice.

The Company entered into an exclusive financial advisor and consulting agreement in January 2007. The agreement provides a minimum consideration fee, not less than $250,000, in the event of an equity or financing transaction where the advisor is engaged. The agreement may be terminated with sixty days notification by either party.

Litigation

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, the Company believes that the final disposition of such matters should not have a material adverse effect on its financial position, results of operations or liquidity.

Senior Convertible Noteholder Claim

The August 14, 2006 Settlement Agreement with the Senior Convertible Debenture Noteholders provided that the number of shares issued to the Noteholders shall be adjusted based upon the arithmetic average of the weighted average price of the Company’s common stock on the American Stock Exchange for the twenty trading days immediately following the settlement date (Note E). The Company has concluded that, based upon the weighted average of the Company's common stock between August 16, 2006 and September 13, 2006, the Company is entitled to a refund from the two Noteholders. One of the Noteholders has informed the Company that it does not believe such a refund is required. As a result, the Company has declined to deliver to the Noteholders certain stock purchase warrants issued to them pursuant to the Settlement Agreement pending resolution of this disagreement. The Noteholder has alleged that the Company has failed to satisfy its obligations under the Settlement Agreement by failing to deliver the warrants. In addition, the Noteholder maintains that the Company has breached certain provisions of the Registration Rights Agreement and, as a result of such breach, such Noteholder claims that it is entitled to receive liquidated damages from the Company.

However, in the Company’s opinion, the ultimate disposition of these matters will not have a material adverse effect on the Company’s results of operations or financial position.

TELKONET, INC.

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NOTE J - COMMITMENTS AND CONTINGENCIES (continued)

Purchase Price Contingency

In conjunction with the acquisition of MST on January 31, 2006, the purchase price contingency shares are price protected for the benefit of the former owner of MST (Note B). In the event the Company's common stock price is below $4.50 per share upon issuance of the shares from escrow, a pro rata adjustment in the number of shares will be required to support the aggregate consideration of $5.4 million. The price protection provision provides a cash benefit to the former owner of MST if the as-defined market price of the Company's common stock is less than $4.50 per share at the time of issuance from the escrow. The issuance of additional shares or distribution of other consideration upon resolution of the contingency based on the Company's common stock prices will not affect the cost of the acquisition. When the contingency is resolved or settled, and additional consideration is distributable, the Company will record the current fair value of the additional consideration and the amount previously recorded for the common stock issued will be simultaneously reduced to the lower current value of the Company's common stock.

On March 9, 2007, the Company acquired substantially all of the assets of Smart Systems International (SSI), a leading provider of energy management products and solutions to customers in the United States and Canada for cash and Company common stock having an aggregate value of $6,875,000. The purchase price was comprised of $875,000 in cash and 2,227,273 shares of the Company's common stock. The Company is obligated to register the stock portion of the purchase price on or before May 15, 2007 and 1,090,909 shares are being held in an escrow account for a period of one year following the closing from which certain potential indemnification obligations under the purchase agreement may be satisfied. The aggregate number of shares held in escrow is subject to adjustment upward or downward depending upon the trading price of the Company's common stock during the one year period following the closing date.

On March 15, 2007, the Company acquired 100% of the outstanding membership units of Ethostream, LLC, a network solutions integration company that offers installation, sales and service to the hospitality industry. The Ethostream acquisition will enable Telkonet to provide installation and support for PLC products and third party applications to customers across North America. The purchase price of $11,756,097 was comprised of $2.0 million in cash and 3,459,609 shares of the Company's common stock. The entire stock portion of the purchase price is being held in escrow to satisfy certain potential indemnification obligations of the sellers under the purchase agreement. The shares held in escrow are distributable over the three years following the closing. The aggregate number of shares issuable to the sellers is subject to downward adjustment in the event the Company's common stock trades at or above a price of $4.50 per share for twenty consecutive trading days during the one year period following the closing.

NOTE K - NOTE RECEIVABLE

In conjunction with the acquisition of Ethostream on March 15, 2007, the Company maintains a net investment in certain sales-type lease notes receivable as of March 31, 2007 consisting of the following:

Total Minimum Lease Payments to be Received	$	60,668
Less: Unearned Interest Income		(5,132)
Net Investment in Sales-Type Lease Notes Receivable		55,536
Less: Current Maturities		(37,562)
Non-Current Portion	$	17,974

Aggregate future minimum lease payments to be received under the above leases are as follows as of March 31, 2007:

2007	$ 40,383
2008	11,690
2009	7,703
2010	912
	$ 60,688

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NOTE L - EMPLOYEE BENEFIT PLAN

The Company maintains a Profit Sharing and Retirement Savings Plan for qualified employees of its subsidiary MST as of the acquisition on January 31, 2006. Telkonet's expense for these benefits was $3,063 for the period ending March 31, 2007.

NOTE M - BUSINESS CONCENTRATION

There were no major customers with revenues representing more than 10% of total revenues for the period ending March 31, 2007. Revenue from one major customers approximated $683,451or 35% of sales for three-month period ended March 31, 2006.

Purchases from three (3) major suppliers approximated $51,862 or 17% of purchases and $48,496 or 33% of purchases for the period ended March 31, 2007 and 2006, respectively. Total accounts payable of approximately $2,495 or 0.4% of total accounts payable was due to these three suppliers as of March 31, 2007 and approximately $19,255 or 5% of total accounts payable was due to these three suppliers as of March 31, 2006.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Business

Telkonet, Inc., formed in 1999, develops and markets technology for the transmission of high-speed voice, video and data communications over the existing electrical wiring within a building. Telkonet has made definitive inroads into the Powerline communication (PLC) market and established the "leading" position for in-building commercial communication solutions.

The Company's offices are located at 20374 Seneca Meadows Parkway, Germantown, Maryland 20876. The reports that the Company files pursuant to the Securities Exchange Act of 1934 can be found at the Company's web site at www.telkonet.com.

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the accompanying financial statements and related notes thereto for the three-months ended March 31, 2007 and 2006, as well as the Company's consolidated financial statements and related notes thereto and management's discussion and analysis of financial condition and results of operations in the Company's Form 10-K for the year ended December 31, 2006 filed on March 16, 2007.

The Company reports financial results for the following operating business segments:

Telkonet Segment ("Telkonet")

Through the revolutionary Telkonet iWire System™, Telkonet utilizes proven PLC technology to deliver commercial high-speed Broadband access from an IP "platform" that is easy to deploy, reliable and cost-effective by leveraging a building's existing electrical infrastructure. The building's existing electrical wiring becomes the backbone of the local area network, which converts virtually every electrical outlet into a high-speed data port, without the costly installation of additional wiring or major disruption of business activity. The segment's net sales for the three months

ended March 31, 2007 were $759,363, representing 61% of the Company's consolidated net sales.

On March 9, 2007, the Company acquired substantially all of the assets of Smart Systems International (SSI), a leading provider of energy management products and solutions to customers in the United States and Canada for cash and Company common stock having an aggregate value of $6,875,000. The purchase price was comprised of $875,000 in cash and 2,227,273 shares of the Company's common stock. The Company is obligated to register the stock portion of the purchase price on or before May 15, 2007 and 1,090,909 shares are being held in an escrow account for a period of one year following the closing from which certain potential indemnification obligations under the purchase agreement may be satisfied. The aggregate number of shares held in escrow is subject to adjustment upward or downward depending upon the trading price of the Company's common stock during the one year period following the closing date.

On March 15, 2007, the Company acquired 100% of the outstanding membership units of Ethostream, LLC, a network solutions integration company that offers installation, sales and service to the hospitality industry. The Ethostream, LLC acquisition will enable Telkonet to provide installation and support for PLC products and third party applications to customers across North America. The purchase price of $11,756,097 was comprised of $2.0 million in cash and 3,459,609 shares of the Company's common stock. The entire stock portion of the purchase price is being held in escrow to satisfy certain potential indemnification obligations of the sellers under the purchase agreement. The shares held in escrow are distributable over the three years following the closing. If during the twelve months following the Closing, the Common Stock has a volume-weighted average trading price of at least $4.50, as reported on the American Stock Exchange, for twenty (20) consecutive trading days, the aggregate number of shares of Common Stock issuable to the sellers shall be adjusted such that the number of shares of Common Stock issuable as the stock consideration shall be determined assuming a per share price equal to $4.50.

As a result of Telkonet's acquisition of Smart Systems International and EthoStream, the Company can now provide hospitality owners with a greater return on investment on technology investments. Hotel owners can leverage the Telkonet iWire System™ platform to support wired and wireless Internet access and, in the future, to support a networked energy management system. With the synergy of Ethostream, LLC's centralized remote monitoring and management platform extending over HSIA, digital video surveillance and energy management, hospitality owners will have a complete technology offering based on Telkonet's core PLC system as the infrastructure backbone, demonstrating true technology convergence.

MST Segment ("MST")

MST is a communications service provider offering quadruple-play ("Quad-Play") services to multi-tenant unit and multi-dwelling unit ("MDU") residential, hospitality and commercial properties. These Quad-Play services include video, voice, high-speed internet and wireless fidelity ("Wi-Fi") access. In addition, MST currently offers or plans to offer a variety of next-generation telecommunications solutions and services, including satellite installation, video conferencing, surveillance/security and energy management, and other complementary professional services. The segments' net sales for the three months ended March 31, 2007 were $486,906, representing 39% of the Company's consolidated net sales.

Forward Looking Statements

This report may contain "forward-looking statements," which represent the Company's expectations or beliefs, including, but not limited to, statements concerning industry performance and the Company's results, operations, performance, financial condition, plans, growth and strategies, which include, without limitation, statements preceded or followed by or that include the words "may," "will," "expect," "anticipate," "intend," "could," "estimate," or "continue" or the negative variations thereof or comparable terminology. Any statements contained in this report or the information incorporated by reference that are not statements of historical fact may be deemed to be forward-looking statements within the meaning of Section 27(A) of the Securities Act of 1933 and Section 21(F) of the Securities Exchange Act of 1934. For such statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. These statements by their nature involve substantial risks and uncertainties, some of which are beyond the Company's control, and actual results may differ materially depending on a variety of important factors, including those risk factors discussed under "Trends, Risks and Uncertainties", many of which are also beyond the Company's control. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this report. The Company does not undertake any obligation to update or release any revisions to these forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events, except to the extent such updates and/or revisions are required by applicable law.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. On an ongoing basis, we evaluate significant estimates used in preparing our financial statements including those related to revenue recognition, guarantees and product warranties, stock based compensation and business combinations. We base our estimates on historical experience, underlying run rates and various other assumptions that we believe to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results could differ from these estimates. The following are critical judgments, assumptions, and estimates used in the preparation of the consolidated financial statements.

Revenue Recognition

For revenue from product sales, the Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition ("SAB104"), which superceded Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements ("SAB101"). SAB 101 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) are based on management's judgments regarding the fixed nature of the selling prices of the products delivered and the collectibility of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related sales are recorded. The Company defers any revenue for which the product has not been delivered or is subject to refund until such time that the Company and the customer jointly determine that the product has been delivered or no refund will be required. SAB 104 incorporates Emerging Issues Task Force 00-21 ("EITF 00-21"), Multiple-Deliverable Revenue Arrangements. EITF 00-21 addresses accounting for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets.

For equipment under lease, revenue is recognized over the lease term for operating lease and rental contracts. All of the Company's leases are accounted for as operating leases. At the inception of the lease, no lease revenue is recognized and the leased equipment and installation costs are capitalized and appear on the balance sheet as "Equipment Under Operating Leases." The capitalized cost of this equipment is depreciated from two to three years, on a straight-line basis down to the Company's original estimate of the projected value of the equipment at the end of the scheduled lease term. Monthly lease payments are recognized as rental income. For sales-type leases, we record the discounted present values of minimum rental payments under sales-type leases as sales.

MST accounts for the revenue, costs and expense related to residential cable services as the related services are performed in accordance with SFAS No. 51, Financial Reporting by Cable Television Companies. Installation revenue for residential cable services is recognized to the extent of direct selling costs incurred. Direct selling costs have exceeded installation revenue in all reported periods. Generally, credit risk is managed by disconnecting services to customers who are delinquent.

Management identifies a delinquent customer based upon the delinquent payments status of an outstanding invoice, generally greater than 30 days past the due date. The delinquent account designation does not trigger an accounting transaction until such time the account is deemed uncollectible. The allowance for doubtful accounts is determined by examining the reserve history and any outstanding invoices that are over 30 days past due as of the end of the reporting period. Accounts are deemed uncollectible on a case-by-case basis, at management's discretion based upon an examination of the communication with the delinquent customer and payment history. Typically, accounts are only escalated to "uncollectible" status after multiple attempts have been made to communicate with the customer.

The primary increase in the valuation of the allowance for doubtful accounts for the period ending March 31, 2007 was due to the inclusion of the SSI and Ethostream, LLC opening balances upon acquisitions of March 9, 2007 and March 15, 2007, respectively. The gross value of the additional allowance amounted to $137,000 of the $147,000 increase for the period ending March 31, 2007.

Guarantees and Product Warranties

FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), requires that upon issuance of a guarantee, the guarantor must disclose and recognize a liability for the fair value of the obligation it assumes under that guarantee.

The Company's guarantees were issued subject to the recognition and disclosure requirements of FIN 45 as of March 31, 2007 and December 31, 2006. The Company records a liability for potential warranty claims. The amount of the liability is based on the trend in the historical ratio of claims to sales, the historical length of time between the sale and resulting warranty claim, new product introductions and other factors. The products sold are generally covered by a warranty for a period of one year. In the event the Company determines that its current or future product repair and replacement costs exceed its estimates, an adjustment to these reserves would be charged to earnings in the period such determination is made. During the three months ended March 31, 2007 and the year ended December 31, 2006, the Company experienced approximately three percent of units returned under its product warranty policy. As of March 31, 2007 and December 31, 2006, the Company recorded warranty liabilities in the amount of $50,790 and $31,200, respectively, using this experience factor.

New Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS 159 permits entities to choose to measure many financial instruments, and certain other items, at fair value. SFAS 159 applies to reporting periods beginning after November 15, 2007. The adoption of SFAS 159 is not expected to have a material impact on the Company's financial condition or results of operations.

Revenues

The Company's revenue consists of product sales and a recurring (lease) model in the commercial, government and international markets of the Telkonet Segment including a partial month activity for SSI and Ethostream, LLC from the date of acquisition through March 31, 2007. Additionally, the MST Segment consists of three months of revenue in 2007 and two months of revenue from date of acquisition, January 31, 2006 through March 31, 2006 providing certain Quad-Play services. The table below outlines product versus recurring (lease) revenues for comparable periods:

	Three months Ended					
	March 31, 2007		March 31, 2006		Variance	
Product	$ 637,856	51%	$ 1,549,975	80%	$ (912,119)	-59%
Recurring (lease)	608,413	49%	393,937	20%	214,476	54%
Total	$ 1,246,269	100%	$ 1,943,912	100%	$ (697,643)	-36%

Product revenue

Product revenue in the Telkonet Segment decreased by approximately $832,000 for the three months ended March 31, 2007 compared to the prior year. The decrease is attributable the sale of certain rental contract agreements to HLC in the prior year of approximately $683,000 as well as unanticipated delays in certain Hospitality and Government direct installation initiatives in the three months ended March 31, 2007. The Telkonet Segment product revenue principally arises from the sale of the Telkonet iWire SystemTM to commercial resellers as well as directly to customers. The Telkonet iWire System™ utilizes a building's electrical wires as the backbone for a local area network, converting electrical outlets into data ports. The Telkonet iWire SystemTM consists of the Telkonet Gateway, the Telkonet Extender, the patented Telkonet Coupler, and the Telkonet iBridge. Telkonet's customers to date have been principally located in the Commercial (Hospitality and Multi-Dwelling) and International markets. Additionally, the acquisitions of SSI and Ethostream in March 2007 provides the Telkonet Segement multiple solutions of wired and wireless Internet access and energy management and from date of acquisition through March 31, 2007 amounted to approximately $150,000 of combined product revenue.

The MST Segment product revenue consists of equipment and installations and ancillary services provided to customers.

In the three months ended March 31, 2006, the Company consummated a non-recourse sale of certain rental contract agreements and the related capitalized equipment which were accounted for as operating leases with Hospitality Leasing Corporation. The remaining rental income payments of the contracts were valued at approximately $1,168,000 including the customer support component of approximately $357,000 which the Company will retain and continue to receive monthly customer support payments over the remaining average unexpired lease term of 37 months. In the period ending March 31, 2006, the Company recognized revenue of approximately $683,000 for the sale, calculated based on the present value of total unpaid rental payments, and expensed the associated capitalized equipment cost, net of depreciation, of approximately $340,000 and expensed associated taxes of approximately $64,000.

Recurring (lease) Revenue

The recurring revenue for the MST segment subscriber base amounted to approximately $427,000 and $168,000 for the three and two months ended March 31, 2007 and 2006, respectively. The MST Segment subscriber portfolio includes approximately 20 MDU properties with bulk service agreements and/or access licenses to service the individual subscribers in metropolitan New York. The Telkonet Segment recurring (lease) revenue decreased by

approximately $45,000 in the three months ended March 31, 2007 compared to the prior year primarily due to the sale of rental contracts to Hospitality Leasing Corporation (HLC) in 2006. As a result of the acquisition of Ethostream, the Telkonet Segment supports approximately 150,000 HSIA rooms and anticipates continued leadership in the HSIA industry.

Cost of Sales

	Three months Ended					
	March 31, 2007		March 31, 2006		Variance	
Product	$ 429,468	67%	$ 983,651	63%	$ (554,183)	-56%
Recurring (lease)	886,993	146%	311,919	79%	575,074	184%
Total	$ 1,316,461	106%	$ 1,295,570	67%	$ 20,891	2%

Product Costs

The Telkonet Segment product cost for the Telkonet iWire SystemTM product suite primarily includes equipment costs and installation labor. During the three months ended March 31, 2007, product costs decreased by approximately $422,000 for the Telkonet Segment, including the non-recourse sale of rental contract agreements in the period ended March 31, 2006 which amounted to approximately $347,000 of previously capitalized costs.

The MST segment product costs primarily consist of equipment and installation labor for installation and ancillary services provided to customers.

Recurring (lease) Costs

MST segment recurring costs primarily represent customer support, programming and amortization of the capitalized costs to support the subscriber revenue. Although MST's programming fees are a significant portion of the cost, MST continues to pursue competitive agreements and volume discounts in conjunction with the anticipated growth of the subscriber base. The customer support costs for the three months ended March 31, 2007 include build-out of the support services necessary to develop and support the build-out of the “Quad-Play” subscriber base in metropolitan New York. The capitalized costs are amortized over the lease term and include equipment and installation labor. The Telkonet Segment recurring costs decreased for the three months ended March 31, 2007 compared to the prior year period due to the sale of certain rental contracts.

Gross Profit

	Three months Ended					
	March 31, 2007		March 31, 2006		Variance	
Product	$ 208,388	33%	$ 566,324	37%	$ (357,936)	-63%
Recurring (lease)	(278,580)	-46%	82,018	21%	(360,598)	-440%
Total	$ (70,192)	-6%	$ 648,342	33%	$ (718,534)	-111

Product Gross Profit

The gross profit for the three months ended March 31, 2007 decreased compared to the prior year period which is attributable to the decrease in product revenue compared to the prior year as well as the gross profit attributable to the sale of the HLC contracts in the prior year.

Recurring (lease) Gross Profit

Telkonet Segment gross profit associated with recurring (lease) revenue decreased as a result of the sale of rental contracts to HLC resulting in a decrease in recurring (lease) revenue which offset by increased customer support services. As MST develops the infrastructure and continues to build-out the “Quad-Play” subscriber base, the gross margins decreased approximately $324,000 for the three months ended March 31, 2007 compared to the prior year, primarily due to programming costs and the support infrastructure.

Operating Expenses

	Three months Ended			
	March 31, 2007	March 31, 2006	Variance	
Total	$ 5,240,047	$ 4,297,464	$ 942,583	22%

Overall expenses increased for the three months ended March 31, 2007 over the comparable period in 2006 by $942,583 or 22%. The principal reasons for this increase were operating costs related to the build-out of the “Quad Play” subscriber infrastructure through the MST segment. Additionally, the Telkonet operating expenses increased for the three months ended March 31, 2007 compared to the prior year due to administrative costs, a loss on the sub-lease of the Crystal City, VA office space and an increase in sales and marketing expenses for the period ending March 31, 2007.

Product Research and Development

	Three months Ended March 31, 2007	March 31, 2006	Variance	
Total	$ 474,603	$ 432,569	$ 42,034	10%

Telkonet's research and development costs related to both present and future products are expensed in the period incurred. Total expenses for the three months ended March 31, 2007 increased over the comparable prior year by $42,034 or 10%. This increase was primarily related to costs associated the development of the next generation product suite and the integration of new applications to the Telkonet iWire System.

Selling, General and Administrative

	Three months Ended March 31, 2007	March 31, 2006	Variance	
Total	$ 4,260,111	$ 3,092,043	$ 1,168,068	38%

Selling, general and administrative expenses increased for the three months ended March 31, 2007 over the comparable prior year by $1,168,068 or 38%. The increase is attributed to approximately $607,000 increase in payroll costs including a $150,000 executive bonus paid in March 2007 and an additional increase of $200,000 related to the addition of sales, support and administrative personnel. MST accounted for the remaining increase of $250,000 for additional personnel compared to the prior year period. MST also increased their advertising costs by approximately $85,000 over the prior year period. In February 2007, Telkonet executed a sublease agreement on the Crystal City, Virginia office, resulting in a one-time expense of $167,000 in March 2007, for the incremental monthly amounts owed by Telkonet during the remaining term of the original lease agreement. Approximately $380,000 was incurred for additional professional fees, with $85,000 in compliance services related to the Sarbanes Oxley process, $75,000 in legal fees related to the private placement in February 2007, the two acquisitions and the review of our annual report in March 2007, and a total of $75,000 of fees paid to the American Stock Exchange during the period ended March 31, 2007. Administrative costs for the acquired businesses of SSI and Ethostream, LLC in March 2007 accounted for $69,000 and $93,000, respectively. For the three months ended March 31, 2007 and 2006, the expense incurred for non-employee stock options vested in the period was $0 and $277,000.

Backlog

In conjunction with the acquisition of Ethostream, LLC on March 15, 2007, the Telkonet Segment maintains contracts and monthly services for more than 1900 hotels which are expected to generate approximately $2,400,000 annual recurring support and internet advertising revenue. Additionally, Telkonet has been contracted to deploy the Telkonet iWire SystemTM at 50 properties for a major resort company which deployment represents revenue of approximately $1,100,000 over a 3 year term.

In conjunction with the acquisition of Smart Systems International on March 9, 2007, Telkonet assumed certain purchase orders relating to a major utilities energy management initiative provided through the two selected providers. The current order backlog amounts to approximately $500,000 and the estimated remaining program value amounts to $3,000,000 for products and services to be provided through 2008.

The MST subscriber portfolio includes approximately 20 MDU properties with bulk service agreements and/or access licenses to service the individual subscribers in metropolitan New York. The remaining terms of the access agreements provide MST access rights from 7 to 15 years with the final agreement expiring in 2016 and the revenues

to be recognized under non-cancelable bulk agreements provide a minimum of $1,800,000 in revenue through 2013.

Liquidity and Capital Resources

Working Capital

Our working capital increased by $2,876,315 during the three months ended March 31, 2007 from a working capital deficit of $(530,631) at December 31, 2006 to a working capital of $2,345,684 at March 31, 2007. The increase in working capital for the three-months ended March 31, 2007, is due to a combination of factors, of which the significant factors are set out below:

- Cash had an increase from working capital by $542,987 for the period ended March 31, 2007. The most significant uses and proceeds of cash are as follows:
    - Approximately $4,800,000 of cash consumed directly in operating activities
    - A cash payment of $900,000 representing the second installment of the cash portion of the purchase price for the acquisition of MST
    - The cash payment in the acquisition of Ethostream amounted to approximately $2,000,000, and as part of the acquisition the debt payoff amounted to approximately $200,000—see discussion of acquisition below;
    - The cash payments in the acquisition of SSI amounted to approximately $875,000—see discussion of acquisition below;
    - A private placement from the sale of 4,000,000 shares of common stock at $2.50 per share provided proceeds of $9,610,000.

Of the total $6,903,799 current assets as of March 31, 2007, cash represented $2,187,024. Of the total $3,766,079 current assets as of December 31, 2006, cash represented $1,644,037.

Convertible Senior Notes

In October 2005, the Company completed an offering of convertible senior notes (the “Notes”) in the aggregate principal amount of $20 million. The capital raised in the Note offering was used for general working capital purposes. The Notes bore interest at a rate of 7.25%, payable in cash, and called for monthly principal installments beginning March 1, 2006. The maturity date was 3 years from the date of issuance of the Notes. The Noteholders were entitled, at any time, to convert any portion of the outstanding and unpaid Conversion Amount into shares of Company common stock. At the option of the Company, the principal payments could be paid either in cash or in common stock. Upon conversion into common stock, the value of the stock was determined by the lower of $5 or 92.5% of the average recent market price. The Company also issued one million warrants to the Noteholders exercisable for five years at $5 per share. At any time after six months, should the stock trade at or above $8.75 for 20 of 30 consecutive trading days, the Company could cause a mandatory redemption and conversion to shares at $5 per share. At any time, the Company was entitled to pre-pay the notes with cash or common stock. If the Company elected to use common stock to pre-pay the Notes, the price of the common stock would be deemed to be the lower of $5 or 92.5% of the average recent market price. If the Company prepaid the Notes other than by mandatory conversion, the Company was obligated to issue additional warrants to the Noteholders covering 65% of the amount pre-paid at a strike price of $5 per share. In addition to standard financial covenants, the Company agreed to maintain a letter of credit in favor of the Noteholders equal to $10 million. Once the principal amount outstanding on the notes declined below $15 million, the balance on the letter of credit was reduced by $.50 for every $1 amortized.

These notes were repaid on August 14, 2006 as discussed in greater detail below under “Early Extinguishment of Debt.”

Principal Payments of Debt

For the period end March 31, 2006, the Company paid principal of $1,250,000 and interest of $358,724 in cash. The Company amortized the debt discount to the beneficial conversion feature and value of the attached warrants, and recorded non-cash interest expense in the amount of $239,943 and $121,586, respectively.

Early Extinguishment of Debt

On August 14, 2006, the Company executed separate settlement agreements with the lenders of its Convertible Senior Notes. Pursuant to the settlement agreements the Company paid to the lenders in the aggregate $9,910,392 plus accrued but unpaid interest of $23,951 and certain premiums specified in the Notes in satisfaction of the amounts then outstanding under the Notes. Of the amount to be paid to the lenders under the Notes, $6,500,000 was paid in cash through a drawdown on a letter of credit previously pledged as collateral for the Company's obligations under the Notes. The remaining note balance of $1,428,314 and a Redemption Premium of $1,982,078, calculated as 25% of remaining principal, was paid to the lenders in shares of Company's common stock valued at the lower of $5.00 per share and 92.5% of the arithmetic average of the weighted average price of the Company's common stock on the American Stock Exchange for the twenty trading days beginning on August 16, 2006. The Company also issued 862,452 warrants to purchase shares of the Company's common stock at the exercise price of the lower of $2.58 per share and 92.5% of the average trading price as described above. The Company has accounted for the Redemption Premium and the additional warrants issued as non-cash early extinguishment of debt expense during the year ended December 31, 2006.

As a result of the execution of the settlement agreements and the payments required thereby, the Company fully repaid and believes it satisfied all of its obligations under the Notes. The Company also agreed to pay the expenses of the lenders incurred in connection with the negotiation and execution of the settlement agreements. The settlement agreements were negotiated following the allegation by one of the lenders that the Company's failure to meet the minimum revenue test for the period ending June 30, 2006 as specified on the Notes may have constituted an event of default under the Notes, which allegation the Company disputed.

In conjunction with the settlement agreement, the Company recorded $4,626,679 of loss from early extinguishment of debt, which consists of $1,982,078 redemption premium paid with the Company's common stock, $1,014,934 of additional warrants issued to the lenders, write-off of the remaining unamortized debt discount attributed to the beneficial conversion feature and the value of the attached warrants in the amount of $430,040 and $845,143, respectively, and write-off the remaining unamortized financing costs of $354,484.

The settlement agreements provide that the number of shares issued to the noteholders shall be adjusted based upon the arithmetic average of the weighted average price of the Company's common stock on the American Stock Exchange for the twenty trading days immediately following the settlement date. The Company has concluded that, based upon the weighted average of the Company's common stock between August 16, 2006 and September 13, 2006, the Company is entitled to a refund from the two noteholders. One of the noteholders has informed the Company that it does not believe such a refund is required. As a result, the Company has declined to deliver to the noteholders certain stock purchase warrants issued to them pursuant to the settlement agreements pending resolution of this disagreement. One of the noteholders has alleged that the Company has failed to satisfy its obligations under the settlement agreement by failing to deliver the warrants. In addition, the noteholder maintains that the Company has breached certain provisions of the registration rights agreement and, as a result of such breach, such noteholder claims that it is entitled to receive liquidated damages from the Company. As of May 1, 2007, no legal claim has been filed by the noteholder.

Acquisition of Microwave Satellite Technologies, Inc.

On January 31, 2006, the Company acquired a 90% interest in MST from Frank Matarazzo, the sole stockholder of MST in exchange for $1.8 million in cash and 1.6 million unregistered shares of the Company's common stock for an aggregate purchase price of $9,000,000. The cash portion of the purchase price was paid in two installments, $900,000 at closing and $900,000 in February 2007. The stock portion is payable from shares which will be held in escrow, 400,000 shares of which were paid at closing and the remaining 1,200,000 shares of which shall be issued based on the achievement of 3,300 "Triple Play" subscribers over a three year period. In the period ended December 31, 2006, the

Company issued 200,000 shares of the purchase price contingency valued at $900,000 as an adjustment to goodwill. In the event the Company's common stock price is below $4.50 per share upon issuance of the shares from escrow, a pro rata adjustment in the number of shares will be required to support the aggregate consideration of $5.4 million. As of March 31, 2007, the Company's common stock price was below $4.50. To the extent that the market price of Company's common stock is below $4.50 per share upon issuance of the shares from escrow, the number of shares issuable on conversion is ratably increased, which could result in further dilution of the Company's stockholders.

Acquisition of Smart Systems International (SSI)

On March 9, 2007, the Company acquired substantially all of the assets of Smart Systems International (SSI), a leading provider of energy management products and solutions to customers in the United States and Canada for cash and Company common stock having an aggregate value of $6,875,000. The purchase price was comprised of $875,000 in cash and 2,227,273 shares of the Company's common stock. The Company is obligated to register the stock portion of the purchase price on or before May 15, 2007 and 1,090,909 shares are being held in an escrow account for a period of one year following the closing from which certain potential indemnification obligations under the purchase agreement may be satisfied. The aggregate number of shares held in escrow is subject to adjustment upward or downward depending upon the trading price of the Company's common stock during the one year period following the closing date.

Acquisition of Ethostream, LLC

On March 15, 2007, the Company acquired 100% of the outstanding membership units of Ethostream, LLC, a network solutions integration company that offers installation, sales and service to the hospitality industry. The purchase price of $11,756,097 was comprised of $2.0 million in cash and 3,459,609 shares of the Company's common stock. The entire stock portion of the purchase price is being held in escrow to satisfy certain potential indemnification obligations of the sellers under the purchase agreement. The shares held in escrow are distributable over the three years following the closing. The aggregate number of shares issuable to the sellers is subject to downward adjustment in the event the Company's common stock trades at or above a price of $4.50 per share for twenty consecutive trading days during the one year period following the closing.

Proceeds from the issuance of common stock

During the three months ended March 31, 2007, the Company received $31,000 from the exercise of employee stock options.

During the three months ended March 31, 2007, the Company issued 4,000,000 shares of Common Stock valued at $2.50 per share for an aggregate purchase price of $9,610,000, net of placement fees. The Company also issued to this investor warrants to purchase 2.6 million shares of its common stock at an exercise price of $4.17 per share in this private placement transaction.

Cashflow analysis

Cash utilized in operating activities was $4,813,002 during the three months ended March 31, 2007 compared to $3,138,964 the previous comparable period. The primary use of cash during the three months ended March 31, 2007 was for operating activities.

The Company utilized cash for investing activities of $4,086,052 and $1,069,772 during the three months ended March 31, 2007 and 2006, respectively. These expenditures were primarily the result of the payment of cash portion of the MST purchase price payable in February 2007 and the acquisition of SSI and Ethostream in March 2007 of $875,000 and $2,000,000, respectively. Additionally, cost of equipment under operating leases amounted to $276,292 and $316,716 for the three months ended March 31, 2007 and 2006, respectively, offset by proceeds from sale of certain equipment under operating lease of $340,130 for the three months ended March 31, 2006. Furthermore, purchases of property and equipment amounted to $34,760 and $134,704 for the three months ended March 31, 2007 and 2006, respectively.

The Company was provided and utilized cash in financing activities of $9,442,041 and $685,172 during the three months ended March 31, 2007 and 2006, respectively. The financing activities represent proceeds from the sale of 4.0 million shares of common stock at $2.50 per share for an aggregate purchase price of $9,610,000, net of placement fees, during the three months ended March 31, 2007. Additionally, the financing activities represent proceeds from the exercise of stock options and warrants of $31,000 and $974,530 during the three months ended March 31, 2007 and 2006, respectively. In 2006, the proceeds of the financing activities were offset by repayment of senior convertible debt principal of $1,250,000 and repayment of debt of $409,675 and, in 2007, repayment of the subsidiary debt of $198,959.

The Company believes it has sufficient access to capital to meet its working capital requirements through the remainder of 2007 in available cash and in cash generated from operations. Additional financing may be required in order to meet growth opportunities in financing and/or investing activities. If additional capital is required and the Company is not successful in generating sufficient liquidity from operations or in raising sufficient capital resources on terms acceptable to the Company, this could have a material adverse effect on the Company's business, results of

operations, liquidity and financial condition.

If additional capital is required and the Company is not successful in generating sufficient liquidity from operations or in raising sufficient capital resources on terms acceptable to the Company, this could have a material adverse effect on the Company's business, results of operations, liquidity and financial condition.

Inflation

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could adversely affect our business, financial condition and results of operations.

Off Balance Sheet Arrangements

None.

Acquisition or Disposition of Property and Equipment

During the three months ended March 31, 2007, fixed assets and costs under operating leases increased $311,052 primarily for additions to the MST Segment equipment purchases for the MST "Quad-Play" build-out. The remainder related to computer equipment and peripherals used in day-to-day operations. The Company anticipates significant expenditures in the MST Segment to continue the build-out the head-end equipment, IPTV and other related projects. The Telkonet segment does not anticipate the sale or purchase of any significant property, plant or equipment during the next twelve months, other than the purchase of computer equipment and peripherals to be used in the Company's day-to-day operations.

In April 2005, the Company entered into a three-year lease agreement for 6,742 square feet of commercial office space in Crystal City, Virginia. Pursuant to this lease, the Company agreed to assume a portion of the build-out cost for this facility. In February 2007, the Company agreed to sub-lease the Crystal City, Virginia office through the remaining term of the contract resulting in a loss of approximately $192,000.

MST presently leases 12,600 square feet of commercial office space in Hawthorne, New Jersey for its office and warehouse spaces. This lease will expire in April 2010.

Following the acquisitions of Smart Systems International and Ethostream, the Company assumed leases on 9,000 square feet of office space in Las Vegas, NV for the Smart Systems International office and warehouse space on a month to month basis and 4,100 square feet of office space in Milwaukee, WI for Ethostream. The Ethostream lease expires in May 2011.

Number of Employees

As of May 1, 2007, the Company had 182 full time employees.

Disclosure of Contractual Obligations

		Payment Due by Period			
Contractual obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt Obligations	-	-	-	-	-
Capital Lease Obligations	$ 17,921	6,078	11,843	-	-
Operating Lease Obligations	$ 1,758,147	493,068	693,551	296,306	275,222
Purchase Obligations					-
Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet Under GAAP					-
Total	$ 1,776,068	499,146	705,394	296,306	275,222

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Short Term Investments

We held no marketable securities as of March 31, 2007. Our excess cash is held in money market accounts in a bank and brokerage firms both of which are nationally ranked top tier firms with an average return of approximately 400 basis points. Due to the conservative nature of our investment portfolio, an increase or decrease of 100 basis points in interest rates would not have a material effect on our results of operations or the fair value of our portfolio.

Investments in Privately Held Companies

We have invested in privately held companies, which are in the startup or development stages. These investments are inherently risky because the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize. As a result, we could lose our entire initial investment in these companies. In addition, we could also be required to hold our investment indefinitely, since there is presently no public market in the securities of these companies and none is expected to develop. These investments are carried at cost, which as of May 1, 2007 was $131,044 and $8,000 in BPL Global and Amperion, respectively, and at March 31, 2007, are recorded in other assets in the Consolidated Balance Sheets.

Item 4. Controls and Procedures.

As of March 31, 2007, the Company performed an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Vice President Finance (Principal Accounting Officer), of the effectiveness of the design and operation of its disclosure controls and procedures as defined in Rules 13a - 15(e) or 15d - 15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based upon that evaluation, the Chief Executive Officer and Vice President Finance concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information required to be included in the Company's periodic filings with the U.S. Securities and Exchange Commission. During the three months ended March 31, 2007, there was no change in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

The Company's results of operations, financial condition and cash flows can be adversely affected by various risks. These risks include, but are not limited to, the principal factors listed below and the other matters set forth in this quarterly report on Form 10-Q. You should carefully consider all of these risks.

The Company has a history of operating losses and an accumulated deficit and expects to continue to incur losses for the foreseeable future.

Since inception through March 31, 2007, the Company has incurred cumulative losses of $75,826,144 and has never generated enough funds through operations to support its business. Additional capital may be required in order to provide working capital requirements for the next twelve months.

If the Company's common stock ceases trading on the American Stock Exchange, an investment in the Company's common stock could become significantly less liquid.

On April 17, 2007, the Company received notification from the American Stock Exchange (AMEX) that, as of such date, the Company was not in compliance with Sections 120 and 121(A) of the AMEX Company Guide, which compliance is required for the continued listing of the Company's common stock on the AMEX. Although on May 1, 2007 the Company submitted a Plan of Compliance in response to AMEX's correspondence and the Company believes this Plan of Compliance adequately addresses all of the concerns raised by AMEX, if the Plan of Compliance is rejected, AMEX could take steps to delist the Company's common stock from the exchange. If the Company's common stock ceases to trade on the AMEX, the trading market for the Company's common stock could be negatively impacted. Generally speaking, securities that are not traded on a national securities exchange tend to be less liquid and trade with larger spreads between the bid and ask price than securities traded on exchanges or automated quotation systems. As a result, holders of our common stock may have some difficulty selling their shares in the open market if the Company is unable to maintain its listing on the AMEX.

Any acquisitions we make could result in difficulties in successfully managing our business and consequently harm our financial condition.

We may seek to expand by acquiring competing businesses in our current or other geographic markets, including as a means to acquire spectrum. We cannot accurately predict the timing, size and success of our acquisition efforts and the associated capital commitments that might be required. We expect to face competition for acquisition candidates, which may limit the number of acquisition opportunities available to us and may lead to higher acquisition prices. There can be no assurance that we will be able to identify, acquire or profitably manage additional businesses or successfully integrate acquired businesses, if any, without substantial costs, delays or other operational or financial difficulties. In addition, acquisitions involve a number of other risks, including:

- failure of the acquired businesses to achieve expected results;
- diversion of management's attention and resources to acquisitions;
- failure to retain key customers or personnel of the acquired businesses;
- disappointing quality or functionality of acquired equipment and people: and
- risks associated with unanticipated events, liabilities or contingencies.

Client dissatisfaction or performance problems at a single acquired business could negatively affect our reputation. The inability to acquire businesses on reasonable terms or successfully integrate and manage acquired companies, or the occurrence of performance problems at acquired companies, could result in dilution, unfavorable accounting treatment or one-time charges and difficulties in successfully managing our business.

A significant portion of our total assets consists of goodwill, which is subject to a periodic impairment analysis and a significant impairment determination in any future period could have an adverse effect on our results of operations even without a significant loss of revenue or increase in cash expenses attributable to such period.

We have goodwill totaling approximately $17.8 million at March 31, 2007 resulting from recent and past acquisitions. We evaluate this goodwill for impairment based on the fair value of the operating business units to which this goodwill relates at least once a year. This estimated fair value could change if we are unable to achieve operating results at the levels that have been forecasted, the market valuation of those business units decreases based on transactions involving similar companies, or there is a permanent, negative change in the market demand for the services offered by the business units. These changes could result in an impairment of the existing goodwill balance that could require a material non-cash charge to our results of operations.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

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

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit Number	Description Of Document
2.1	

	MST Stock Purchase Agreement and Amendment (incorporated by reference to our 8-K filed on February 2, 2006)
2.2	Asset Purchase Agreement by and between Telkonet, Inc. and Smart Systems International, dated as of February 23, 2007 (incorporated by reference to our Form 8-K filed on March 2, 2007)
2.3	Unit Purchase Agreement by and among Telkonet, Inc., Ethostream, LLC and the members of Ethostream, LLC dated as of March 15, 2007 (incorporated by reference to our Form 8-K filed on March 16, 2007)
3.1	Articles of Incorporation of the Registrant (incorporated by reference to our Form 8-K (No. 000-27305), filed on August 30, 2000 and our Form S-8 (No. 333-47986), filed on October 16, 2000)
3.2	Bylaws of the Registrant (incorporated by reference to our Registration Statement on Form S-1 (No. 333-108307), filed on August 28, 2003)

4.1	Form of Series A Convertible Debenture (incorporated by reference to our Form 10-KSB (No. 000-27305), filed on March 31, 2003)
4.2	Form of Series A Non-Detachable Warrant (incorporated by reference to our Form 10- KSB (No. 000-27305), filed on March 31, 2003)
4.3	Form of Series B Convertible Debenture (incorporated by reference to our Form 10-KSB (No. 000-27305), filed on March 31, 2003)
4.4	Form of Series B Non-Detachable Warrant (incorporated by reference to our Form 10-KSB (No. 000-27305), filed on March 31, 2003)
4.5	Form of Senior Note (incorporated by reference to our Registration Statement on Form S-1 (No. 333-108307), filed on August 28, 2003)
4.6	Form of Non-Detachable Senior Note Warrant (incorporated by reference to our Registration Statement on Form S-1 (No. 333-108307), filed on August 28, 2003)
4.7	Senior Convertible Note by Telkonet, Inc. in favor of Portside Growth & Opportunity Fund (incorporated by reference to our Form 8-K (No. 001-31972), filed on October 31, 2005)
4.8	Senior Convertible Note by Telkonet, Inc. in favor of Kings Road Investments Ltd. (incorporated by reference to our Form 8-K (No. 001-31972), filed on October 31, 2005)
4.11	Warrant to Purchase Common Stock by Telkonet, Inc. in favor of Portside Growth & Opportunity Fund (incorporated by reference to our Form 8-K (No. 001-31972), filed on October 31, 2005)
4.12	Warrant to Purchase Common Stock by Telkonet, Inc. in favor of Kings Road Investments Ltd. (incorporated by reference to our Form 8-K (No. 001-31972), filed on October 31, 2005)
4.13	Form of Warrant to Purchase Common Stock (incorporated by reference to our Current Report on Form 8-K (No. 001-31972), filed on September 6, 2006)
4.14	Form of Accelerated Payment Option Warrant to Purchase Common Stock (incorporated by reference to our Registration Statement on Form S-3 (No. 333-137703), filed on September 29, 2006.
4.15	Form of Warrant to Purchase Common Stock (incorporated by reference to our Current Report on Form 8-K filed on February 5, 2007)
10.1	Amended and Restated Telkonet, Inc. Incentive Stock Option Plan (incorporated by reference to our Registration Statement on Form S-8 (No. 333-412), filed on April 17, 2002)
10.2	Employment Agreement by and between Telkonet, Inc. and Stephen L. Sadle, dated as of January 18, 2003 (incorporated by reference to our Registration Statement on Form S-1 (No. 333-108307), filed on August 28, 2003
10.3	Employment Agreement by and between Telkonet, Inc. and Robert P. Crabb, dated as of January 18, 2003 (incorporated by reference to our Registration Statement on Form S-1 (No. 333-108307), filed on August 28, 2003)
10.4	Employment Agreement by and between Telkonet, Inc. and Ronald W. Pickett, dated as of January 30, 2003 (incorporated by reference to our Registration Statement on Form S-1 (No. 333-108307), filed on August 28, 2003)
10.5	Registration Rights Agreement by and among Telkonet, Inc., Kings Road Investments Ltd. and Portside Growth & Opportunity Fund, dated October 27, 2005 (incorporated by reference to our Form 8-K (No. 001-31972), filed on October 31, 2005)
10.6	Employment Agreement by and between Telkonet, Inc. and Frank T. Matarazzo, dated as of February 1, 2006 (incorporated by reference to our Form 10-K (No. 001-31972), filed March 16, 2006)

10.7	Settlement Agreement by and among Telkonet, Inc. and Kings Road Investments Ltd., dated as of August 14, 2006 (incorporated by reference to our Form 8-K (No. 001-31972), filed on August 16, 2006)
10.8	Settlement Agreement by and among Telkonet, Inc. and Portside Growth & Opportunity Fund, dated as of August 14, 2006 (incorporated by reference to our Form 8-K (No. 001-31972), filed on August 16, 2006)
10.9	Securities Purchase Agreement, dated August 31, 2006, by and among Telkonet, Inc., Enable Growth Partners LP, Enable Opportunity Partners LP and Pierce Diversified Strategy Master Fund LLC, Ena (incorporated by reference to our Form 8-K (No. 001-31972), filed on September 6, 2006)
10.10	Registration Rights Agreement, dated August 31, 2006, by and among Telkonet, Inc., Enable Growth Partners LP, Enable Opportunity Partners LP and Pierce Diversified Strategy Master Fund LLC, Ena (incorporated by reference to our Form 8-K (No. 001-31972), filed on September 6, 2006)
10.11	Securities Purchase Agreement, dated February 1, 2007, by and among Telkonet, Inc., Enable Growth Partners LP, Enable Opportunity Partners LP, Pierce Diversified Strategy Master Fund LLC, Ena, Hudson Bay Fund LP and Hudson Bay Overseas Fund, Ltd. (incorporated by reference to our Current Report on Form 8-K filed on February 5, 2007)
10.12	Registration Rights Agreement, dated February 1, 2007, by and among Telkonet, Inc., Enable Growth Partners LP, Enable Opportunity Partners LP and Pierce Diversified Strategy Master Fund LLC, Ena, Hudson Bay Fund LP and Hudson Bay Overseas Fund, Ltd. (incorporated by reference to our Current Report on Form 8-K filed on February 5, 2007)
10.13	Employment Agreement by and between Telkonet, Inc. and William Dukes, dated as of March 9, 2007(incorporated by reference to our Form 10-K (No. 001-31972), filed March 16, 2007)

10.14	Employment Agreement by and between Telkonet, Inc. and Robert Zirpoli, dated as of March 9, 2007(incorporated by reference to our Form 10-K (No. 001-31972), filed March 16, 2007)
10.15	Employment Agreement by and between Telkonet, Inc. and Jason Tienor, dated as of March 15, 2007(incorporated by reference to our Form 10-K (No. 001-31972), filed March 16, 2007)
10.16	Employment Agreement by and between Telkonet, Inc. and Jeff Sobieski, dated as of March 15, 2007(incorporated by reference to our Form 10-K (No. 001-31972), filed March 16, 2007)
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Ronald W. Pickett
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Richard J. Leimbach
32.1	Certification of Ronald W. Pickett pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Richard J. Leimbach pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	Telkonet, Inc. Registrant	
Date: March 3, 2008	By:	/s/ Jason Tienor Jason Tienor Chief Executive Officer